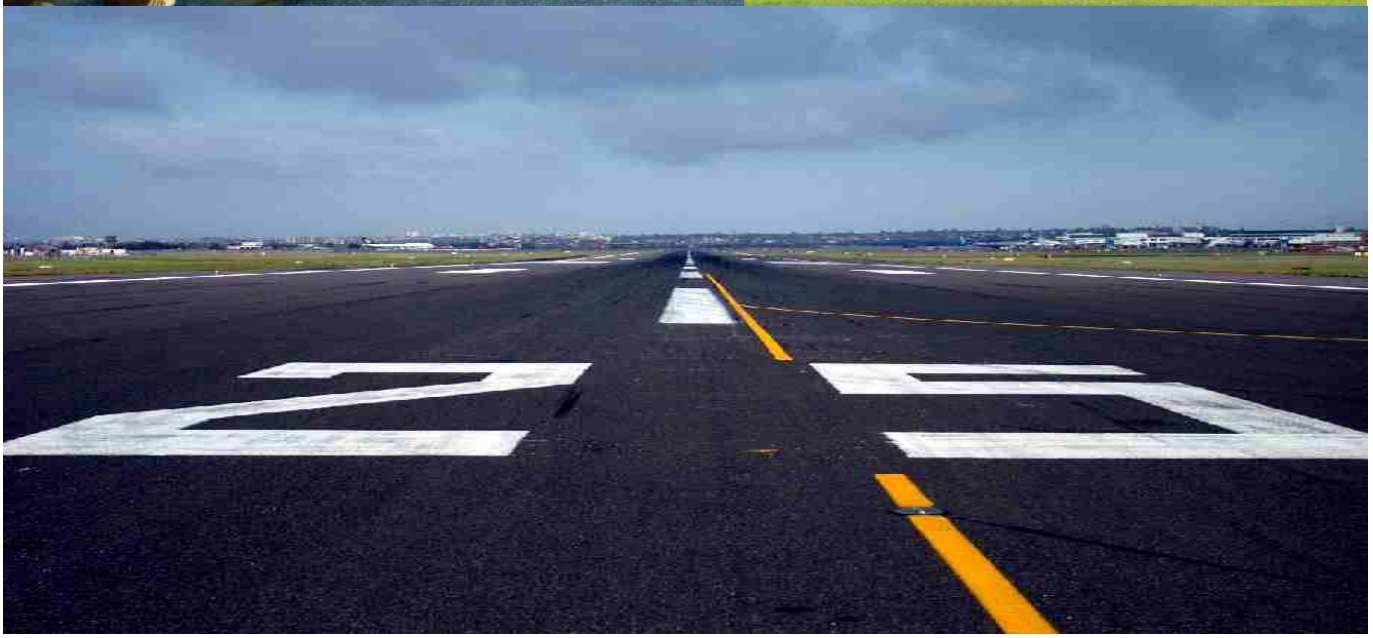

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Sydney Airport Corporation Limited

Submission to the Productivity Commission

Inquiry Into Price Regulation of Airport Services (2006)

21 July 2006

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Executive Summary

Sydney Airport Corporation Limited ("**SACL**") generally supports the draft findings and recommendations set out in the Commission's draft report.

In particular, SACL endorses the Commission's finding that a reversion to stricter price controls is not required, and welcomes the Commission's realistic recognition that some tensions are inevitable in developing workable commercial relationships, particularly at a major strategic airport such as Sydney.

SACL considers that the Commission's findings and draft recommendations would, if adopted in its final report, provide valuable guidance as to the expectations on both airports and airlines under the light-handed regime and should go a long way to facilitate more meaningful engagement between those parties.

SACL welcomes the Commission's recognition of the need for "give and take that characterises genuinely commercial negotiations" and that "such negotiations can reasonably give rise to a range of outcomes, rather than a single outcome based on previous regulatory precedent".

This recognition is especially important in an environment where, as the Commission correctly identifies, previous price regulation arrangements continue to exert considerable influence on expectations regarding future price outcomes.

To the extent that airlines have tended to consider that their interests may be best served by resisting the formation of commercially negotiated arrangements, SACL also considers the reaffirmation of the light-handed regime to be a positive development. While SACL had proposed that the incentives to conclude agreements would be best enhanced by the removal of the "probationary" nature of the regime and its adoption as a long-term policy, SACL considers that the five year review period should still assist in allowing the goals of the regime to be achieved.

SACL strongly supports the approach taken by the Commission that, wherever possible, the relationship between airport and airlines should be governed by direct commercial negotiation. SACL therefore welcomes the Commission's recognition of the danger of too ready a recourse to arbitration in order to reach a resolution of contentious issues, or indeed, simply to attempt to secure a "better" outcome than might otherwise be achieved through commercial negotiation.

The proposed "line in the sand" for asset values provides a pragmatic, although arbitrary, approach to facilitating commercial outcomes over the coming review period. Further clarity is required in relation to indexation of assets to provide a sustainable long term approach to monitoring. The approach to asset valuation should also be reassessed as part of the 2011 review.

The Australian Competition Tribunal ("**Tribunal**") and subsequent Federal Court decisions in relation to Part IIIA of the Trade Practices Act ("**TPA**") suggest that the national access regime provides significantly easier recourse to declaration and arbitration than was considered to be the case when the light-handed regime was introduced, effectively "lowering the bar" for declaration. The recent judicial interpretation of Part IIIA will result in uncertainty for infrastructure providers and will undermine the light-handed airports regulatory regime. The Government should consider amending Part IIIA to ensure it is operating as intended and to provide greater certainty as to its application.

1. Introduction

SACL is pleased to make this supplementary submission to the Productivity Commission following the release of its draft report on price regulation of airport services.

This submission responds to a number of issues raised in the Commission's draft report and also to certain issues raised in other submissions provided to the Commission as part of its inquiry.

SACL has not sought to respond to all issues raised in the Commission's draft report or in submissions by other parties, but has rather confined its comments to responding on the more important issues and providing further information which it believes may assist the Commission in the preparation of its final report.

The structure of this submission is as follows:

Section 2 Sets out SACL's comments in relation to the Commission's draft findings and recommendations on the valuation of land and other assets for the purpose of setting aeronautical prices;

Section 3 Sets out SACL's comments in relation to the Commission's draft findings on calls by certain industry participants for compulsory arbitration or dispute resolution procedures;

Section 4 Sets out SACL's comments on the relationship between Part IIIA of the Trade Practices Act and the light-handed regime. This is supported by further information provided in Attachment 1;

Section 5 Sets out SACL's comments in relation to the Commission's draft recommendations on price monitoring arrangements;

Section 6 Sets out SACL's comments in relation to the Commission's draft findings and recommendations on quality of service reporting; and

Section 7 Sets out SACL's response in relation to a number of specific factual issues raised in other submissions to the Commission. That response is supported by further information provided in Attachments 2-4.

2. Valuation of assets

Asset Values – the Commission's proposed "Line in the Sand" approach

In its draft report, the Commission observes that the issue of asset valuation has been a barrier to the further development of commercial outcomes between airports and their airline customers. Accordingly, the Commission has suggested that a degree of "pragmatism" is required to resolve the treatment of land and asset valuation under the light-handed regime, and that:

- "*previously 'booked' revaluations in the aeronautical asset base submitted by airports for price monitoring purposes should be allowed to stand, but that a line now be drawn in the sand*";

- "*any revaluations made after 30 June 2005 should be netted out of the asset base used to monitor rates of return*"; and

- "*unless agreed with customers, future asset revaluations should not provide a basis for higher charges*".

SACL recognises that the Commission's draft recommendation to "draw a line in the sand" based on the information provided to the ACCC in regulatory accounts for price monitoring covering the year ended 30 June 2005 has some advantages in terms of:

- providing an approach which can be applied in a fairly straightforward manner at a wide range of airports;

- recognising that the use of historic cost values or privatisation valuations would be likely to provide a poor basis for pricing, and impact unfairly on airports and their investors;

- adopting an approach which is likely to go at least some way towards an opportunity cost solution; and

- providing a compromise solution which meets some, but not all, of the objectives of the various airports, airlines and other parties involved.

However, while SACL acknowledges that the proposed solution is pragmatic and workable, it is in SACL's view clearly a "second best" one. In particular:

- it does not have strong economic foundations. While the Commission stated in its draft report that there may not be significant efficiency gains accruing from adoption of opportunity cost land values at this time, over the life of an airport lease of 99 years SACL would expect the efficiency issues arising from the proposed "line in the sand" approach to become increasingly significant;

- contrary to suggestions by certain parties, the valuation of land has important practical consequences for SACL and other airports, in particular in relation to the allocation of marginal land between aeronautical and non-aeronautical uses; and

- it is inequitable in its treatment of airports and their investors because, if the Commission's draft recommendation is adopted, the position of each airport will arbitrarily depend not on any point of economic principle, but rather on the

accounting treatments used in the price monitoring report provided by that airport to the ACCC for 2005 and the timing of any revaluations.

Implementing the "Line in the Sand" approach

SACL appreciates that the Commission's proposed approach is a pragmatic attempt to facilitate constructive commercial negotiations. It is important, however, not to lose sight of the longer term goal of efficient prices. There are a number of important practical considerations in adopting the proposed approach to asset valuation, notably:

1. *The time value of money must be taken into account, through adjustment for inflation, when recovering the cost of long-lived assets valued using historical cost accounting principles*

   Asset values contained in regulatory accounts cannot necessarily be translated directly into asset values for the purpose of monitoring returns because of the differences between the concepts and requirements of asset accounting and the economic principles underpinning infrastructure pricing.

   SACL's financial accounts record assets at their depreciated cost, and relevant accounting standards provide only for historical cost or market value treatment of assets and do not, for example, provide for indexation of the value of the assets.

   This is not suited to price setting and monitoring as infrastructure businesses such as airports involve significant "lumpy" investment in long-lived assets, with the return on the investment generated over a prolonged period. Accordingly, return on the asset must take into account the impact of inflation for the period over which the recovery is generated.

   For this reason, regulatory pricing generally adopts two basic formulations for calculating the value of assets and appropriate rates of return, applying a:

   - nominal rate (incorporating inflation) to the depreciated historic cost of assets; or
   - real rate of return (excluding inflation) to indexed assets.

   The first approach compensates the infrastructure owner for the impact of inflation through the use of a nominal WACC, while the underlying asset base depreciates over time. This is readily applied to the historical asset base held in an entity's financial accounts, although this approach alters the profile of returns over time by generating higher returns in earlier years.

   The second approach is the one adopted by the ACCC in its 2001 pricing decision for Sydney Airport, and the preferred formulation under its *Statement of Principles for Regulation of Electricity Transmission Revenues*. This approach involves the indexation of assets for inflation, while applying a real rate of return.

2. *The price monitoring regime should recognise the need to assess returns against an indexed asset base*

   If price monitoring is based on the written down historical asset base, over time, an increasing disparity would be expected to arise between this and the indexed asset base used for pricing purposes. Reported returns for monitoring purposes

based on a depreciating historical asset base would be expected to escalate, wrongly implying improper returns.

Accordingly, SACL recommends that the longer term implications of the "line in the sand" approach be considered further by the Commission before it finalises its report, so as to provide for indexation of the asset base for pricing purposes and recognition of this for price monitoring.

3. *Necessary adjustments should be able to be made for monitoring purposes to correct errors, inconsistencies or omissions in the 2005 ACCC accounts*.

   The proposed adoption of asset values as at 30 June 2005 is intended to overcome issues of asset revaluation, however, must make provision for the correction any errors that were contained in those accounts that were identified and adjusted in subsequent periods' accounts.

4. *The review of the light-handed regime in 2011 should reconsider the appropriateness of the "line in the sand" approach.*

   SACL continues to hold the view that opportunity cost represents the most appropriate basis for valuation of aeronautical land. Given that the Commission's proposed approach is acknowledged as an arbitrary one, and is intended to achieve commercial outcomes over the coming period of the light-handed regime, SACL considers it important that this issue is formally reconsidered as part of the 2011 review.

3. Dispute resolution

Introduction

A number of parties have submitted to the Commission that mandatory arbitration or some other form of third party dispute resolution is necessary to resolve disputes between airport operators and their airline customers. While expressing an inclination not to recommend an airport-specific regime at this stage, the Commission has sought further input in relation to potential dispute resolution procedures and, in particular, whether it would be possible to implement a regime which continues to provide strong incentives for negotiated outcomes.

Before commenting on those proposals, in the interest of clarity SACL notes that its current commercial agreements with airlines (the Conditions of Use) already contain a clear process for resolving disputes which may arise in relation to the parties' respective rights and obligations under those agreements. That process involves good faith negotiation followed, if necessary, by external mediation.

There is a range of dispute resolution methods that are frequently adopted to resolve disputes arising under commercial agreements, including good faith negotiations, internal escalation to senior management level, independent expert reports, external mediation, binding third party arbitration and, ultimately, commencement of legal proceedings. In SACL's view, the way that disputes arising under an agreement should be resolved is clearly a matter for commercial negotiation between the parties at the time the agreement is put in place.

However, the submissions to the Commission also raise the issue of dispute resolution in circumstances where airports and airlines are unable to achieve agreement. That is, binding dispute resolution that would give rise to new terms and conditions between the parties.

As set out in its initial submission, SACL does not believe that binding dispute resolution in this latter sense (beyond that available under Part IIIA) is either necessary or desirable under the current regulatory regime.

This is consistent with the views expressed by both the ACCC[1] and the NCC[2] in their respective submissions to the Commission.

The introduction of light-handed regulation in 2002 has led to a much greater level of commercial engagement with airlines over prices, terms of use, investment plans and service levels than occurred under the previous regime of formal price regulation. However, the industry is still transitioning from the previous price-regulated and government-owned environment into the commercial environment and, while much progress has been made, there is still some way to go before mature commercial relationships have been fully developed in all areas.

In reality, the vast majority of operational and other issues arising between airports and airlines are routinely addressed and resolved through commercial negotiation and agreement. Although negotiations between SACL and some of its airline customers have been difficult on a small number of issues, SACL considers that guidance provided by the Commission in its draft report on key points of contention (e.g. asset valuation, asset beta and sharing of productivity gains), together with a Government commitment to continuation of the light-handed regulatory regime, should assist airports and airlines to resolve those outstanding issues on a genuine commercial basis.

Given that negotiations on certain issues have been difficult and are ongoing, there may at first glance be some attraction to the idea of a "circuit breaker". However, as the Commission has recognised, there are very real difficulties in implementing any form of circuit breaker which would not fundamentally undermine the incentives for parties to negotiate genuine commercial outcomes. Put simply, there are substantial problems in designing a system which would not provide an incentive for parties who perceive that they may get a better outcome from third party dispute resolution (on one or more of the issues under negotiation) to simply "go through the motions" as a prelude to arbitration.

This is particularly the case in circumstances where, as the Commission has observed, not all parties may have fully accepted either the need for an element of "give and take" that properly and normally characterises genuinely commercial negotiations, or that such negotiations can reasonably give rise to a range of outcomes rather than a single answer based on previous regulatory precedent.

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1 ACCC *Supplementary Submission to the Productivity Commission's inquiry into price regulation of airport services*, August 2006, page 3.

2 NCC, *Price Regulation of Airport Services Submission to the Productivity Commission inquiry*, July 2006, pages 17-18

There is also an inherent risk that the creation of a mandatory circuit breaker would promote "regulatory" gaming and actively provide incentives for parties to entrench their respective positions in preparation for third party dispute resolution, rather than encouraging genuine concessions in an effort to reach a mutually satisfactory outcome. It is also likely that parties would be reluctant to offer concessions in relation to particular issues for fear that an external referee could settle the outstanding matters still in dispute without appropriate regard to the concessions already made in reaching that point in negotiations (and, in particular, the extent to which those concessions were dependent on a satisfactory overall position being reached).

Clearly, these would not be desirable outcomes from light-handed regulation. Moreover, mandatory arbitration of the type proposed in some submissions would be simply inconsistent with the very concept of light-handed regulation.

Proposals for a mandated dispute resolution mechanism

SACL believes that various proposals for binding dispute resolution put to the Commission would, in practice, operate as a substantial disincentive to commercial negotiation and impose an onerous regulatory framework relating to prices and other terms (despite those proposals sometimes being misrepresented as both "commercial" and consistent with the current light-handed regime).

For example, while SACL agrees with Qantas that negotiations under the light-handed model should be characterised by "constructive engagement" between airports and airlines, SACL views constructive engagement primarily as a process for good faith commercial negotiations between airport operators and airlines which needs to be distinguished from the "constructive engagement" model implemented in the United Kingdom under the regulatory price cap regime that applies at major airports. The manner in which Qantas proposes to incorporate the concept into a "negotiate-arbitrate" model would not involve adequate protections to ensure that recourse to third party dispute resolution was used only as a last resort and not as a "default option" with all its attendant costs and risks.

In addition, the proposal by Virgin Blue would involve a mechanism for the compulsory arbitration by the ACCC of all disputes relating to the provision of "aeronautical services" in circumstances where the definition of "aeronautical services" suggested by Virgin Blue encompasses a very expansive and *non-exhaustive* list of services, many of which cannot be justified on any market power grounds, and is effectively a thinly veiled attempt to reintroduce heavy handed price controls and a single till approach to airport pricing. Indeed, Virgin Blue itself describes this as involving the automatic declaration of aeronautical services at major airports[3].

Clearly, Virgin Blue's proposal is not consistent with light-handed regulation. If implemented, it would involve the introduction of regulatory arrangements that would be more heavy-handed and intrusive than:

- any previous regulatory regime applying at Australian airports;
- the former section 192 of the *Airports Act* 1996, which the Government repealed on the express basis that an airport-specific access regime was not desirable;

[3] Virgin Blue Supplementary Submission, page 6.

- Part IIIA or Part XIC of the TPA ; and

- the regulatory regimes that apply at many other major airports internationally.

SACL has similar concerns in relation to Qantas' alternatives to its "Core Principle" which would involve deemed declaration, mandatory access undertakings or mandatory access codes under Part IIIA of the TPA. SACL has considered whether, beyond the mechanisms proposed in other submissions, there exists any other form of dispute resolution which would be consistent with the goals of light-handed regulation and retain the incentives for commercial outcomes. However, in SACL's view, the key difficulty with implementing any form of mandatory, airport-specific "circuit breaker" is that it would inevitably promote regulatory gaming and deter genuine commercial negotiation.

While the appointment of a commercial arbitrator (i.e. rather than a traditional regulatory agency) may bring an improved commercial focus to the resolution of disputes, the identity of the "arbitral backstop" does not overcome SACL's fundamental concerns.

In its draft report, the Commission notes that "final offer" arbitration (also called "baseball arbitration") has been raised as a potentially appropriate form of dispute resolution[4]. However, in addition to the difficulties with this form of dispute resolution identified by the Commission, SACL believes that "final offer" arbitration is not well suited to the resolution of complex and interdependent commercial issues.

Put simply, "final offer" arbitration may offer certain advantages in relation to the resolution of disputes which involve a single issue and where the parties will not necessarily have any ongoing relationship (e.g. where the only issue is the quantum of damages payable to settle an insurance claim or the quantum of damages payable for a breach of contract). However, there are substantial difficulties in implementing any form of "final offer" arbitration in circumstances where the parties have an ongoing commercial relationship which involves continual negotiations and cooperation on a wide range of interrelated operational, commercial and strategic matters, each of which requires flexibility, trade-offs and an element of "give and take" that characterises genuinely commercial negotiations.

[Confidential section]

In SACL's view, it is simply not practical to resolve a dispute in relation to one aspect of the parties' ongoing commercial relationship by soliciting "final offers" which are inherently unable to reflect the complexity of the wider business arrangements between the parties. This difficulty is exacerbated in circumstances where there is more than one party to the dispute or where, given the multi-user nature of the facility, the outcome of the dispute may potentially affect a number of parties.

[4] Draft Report, page 116.

SACL believes that it is erroneous to suggest that greater commercial incentives or more efficient outcomes would result by imposing any of the suggested dispute resolution procedures and thereby implicitly reverting to a regulatory environment which would be far wider-reaching and more intrusive than that which existed prior to the introduction of the current regime.

This is not to deny that, in appropriate circumstances, it may well be beneficial for parties to agree on the appointment of a third party (i.e. an independent expert, a mediator or arbitrator) to facilitate or assist in the resolution of a particular dispute. However, as with other commercial terms and conditions, and given the wide range of issues under discussion by airports and their airline customers at any point in time, the adoption of appropriate dispute resolution mechanisms should be a matter for commercial negotiation and agreement between airport and airlines and not the inflexible regulatory imposition of a "one size fits all" approach to resolving commercial issues.

Finally, given the progress that should be able to be made with the additional clarity provided by the Commission in relation to some of the key points of contention between airports and airline customers, it is not clear that introducing best practice guidelines or mandatory information disclosure is required. In keeping with a light handed regulatory approach, it is desirable to allow a more mature commercial environment to develop, and additional regulatory requirements should only be considered if they are necessary, will produce more satisfactory commercial outcomes and the benefit outweighs the additional compliance costs they may impose.

In summary, SACL agrees with the Commission's draft finding that the "*most likely outcome of implementing the suggested arbitration mechanisms* [or, indeed, any additional form of mandated or airport-specific dispute resolution] *would be a return to heavy-handed determination with all of its attendant costs*". In SACL's experience, this would involve not only significant direct costs, but also very substantial indirect costs associated with regulatory gaming and regulatory error. It is for these reasons that SACL has a number of concerns in relation to the Federal Court's recent decision in relation to the operation of Part IIIA of the TPA (see section 4 and **Attachment 1** below).

As such, SACL does not consider that a binding dispute resolution mechanism is required as part of the light-handed regime, or that one can be developed that does not represent a return to intrusive regulation and impact on incentives to achieve commercial resolutions.

4. Relationship between Part IIIA and the Light-handed Regime

On 18 October 2006, the Federal Court dismissed SACL's application for judicial review of the decision by the Tribunal to declare the domestic airside service at Sydney Airport under Part IIIA of the TPA[5].

[5] *Sydney Airport Corporation Limited v Australian Competition Tribunal* [2006] FCAFC 146 ("**Decision**")

The Court agreed with SACL that the Tribunal had misconstrued the mandatory pre-condition to declaration contained in section 44H(4)(a) of the TPA, which requires "*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*". However, the Court adopted Virgin Blue's alternative construction of that section and concluded that, on that construction, section 44H(4)(a) must be satisfied in relation to the domestic airside service at Sydney Airport.

Further commentary in relation to the Court's decision is set out in **Attachment 1**.

In SACL's view, the Court's decision has resulted in recourse to declaration of essential infrastructure services under Part IIIA being significantly easier and therefore for users to invoke compulsory arbitration by the ACCC to determine the terms and conditions for supply of those services. This ready access to ACCC arbitration can now apparently be invoked in respect of nationally significant infrastructure that cannot be economically duplicated any time a user would prefer different terms of use, even in circumstances where the facility owner is not vertically integrated, already provides access to all users, and is already subject to substantial market and regulatory constraints.

SACL is concerned that the Court's decision will enable airlines to use, and continue to use, Part IIIA of the TPA not as a method of obtaining access (or increased access) to airport services – such access is already provided - but rather as a method of first resort to seek regulated pricing outcomes and regulated determination of airport operational and commercial issues.

The potential use of Part IIIA (or any other form of mandatory dispute resolution) as a method of seeking regulated outcomes in relation to any matter in respect of which airlines and airport providers have diverging views significantly lessens the incentives for airlines to pursue genuine commercial outcomes with airports and is likely to increase substantially the costs associated with regulatory gaming.

SACL also believes that this outcome is fundamentally in conflict with both the intention of Part IIIA generally and the Government's policy objectives in relation to light-handed regulation of airports in particular.

The Court's decision, and in particular the significantly expanded scope of the Minister's or Tribunal's discretion whether or not to declare a service, is also likely to create substantial regulatory uncertainty, and therefore disincentives for investment, for all major infrastructure providers in circumstances where the Commission has previously identified the potential for access regulation to deter investment in essential infrastructure as a "paramount concern" [6].

Given the likely impact of the Federal Court's decision on the willingness of infrastructure providers to continue to invest in all major infrastructure in Australia, there is a pressing need for the Government to consider amendment of Part IIIA to ensure it is operating as intended and to give proper effect to the policy of light-handed airport regulation. In particular, there is now a need to clarify the applicability of the access regime in circumstances where the facility owner is not vertically integrated and already provides access to all potential users.

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[6] Productivity Commission Inquiry Report, Review of the National Access regime, 28 September 2001, Page xii

5. Price monitoring arrangements

SACL supports the Commission's draft recommendation to provide consistency between the reporting and monitoring definitions under the Airports Act and the TPA. SACL also supports the abolition of the unnecessary "aeronautical related" classification of items for monitoring purposes. In addition, the draft recommendation for two-yearly reporting would desirably reduce the burden of regulatory compliance, while still providing sufficient information to facilitate a meaningful assessment of airport service quality and pricing behaviour.

SACL outlined its views regarding monitoring of check-in counters and fuel services in its initial submission to the Commission and in writing previously to DOTARS. While not endorsing the recommendation for inclusion of these items as 'aeronautical' services for monitoring purposes, SACL welcomes the Commission's recognition that, because check-in counter and aircraft fuel service revenues are essentially market-based, their inclusion within the definition of "aeronautical revenue" for monitoring purposes may legitimately show an increase in reported returns against assets without necessarily signalling concerns over airport performance under the light-handed regime or requiring offsetting decreases in other aeronautical charges.

Additional Reporting Items

The Commission's draft report makes specific recommendations regarding fuel services, check-in counters and freight and ground handling services, and it also notes somewhat less precisely, that "the services encompassed by the new price monitoring regime should be those specified in the current proposal by the Department of Transport and Regional Services to align the coverage of the two regulatory instruments giving effect to price monitoring."

However, the Commission does not appear to have considered each of the relevant services in detail. As a starting point, SACL submits that the categories of services to be monitored should only be extended where there is good reason to do so, particularly given the light handed nature of the regulatory regime and, in some instances, the Commission's assessment in 2002 of low to medium market power for these services.

SACL is strongly opposed to the inclusion of certain of the additional items proposed by the Department where there does not appear to have been rigorous analysis or compelling argument to support such inclusion.

Indeed, it is not even clear what the "telecommunications" item is intended to encompass.

In addition, SACL does not see that a case has been made to justify monitoring pricing of airline office accommodation. To the extent that airlines determine that they require an office presence on-airport, this is negotiated with SACL on terms that reflect the location of the facility and comparable rents in other equally high demand locations. If SACL were to offer rentals that were inappropriately high, then a rational airline would ensure that it took only the minimum office space required on-airport, with other staff located elsewhere where lower rents could be obtained. This would impact SACL's revenues through leaving office space vacant, driving down rents to levels where the amount of space that airlines are prepared to rent matches the office space available.

In its draft report, the Commission has suggested that the Government should consider the case for separate monitoring of car parking and other landside vehicle charges.

SACL notes the views of the ACCC, in its submission in response to the draft report, that a sufficient case has not been made on market power grounds for monitoring of landside access and car parking charges.

SACL believes that provision is subject to significant off-airport competition and that its charges are therefore appropriately market-based. Any price monitoring of car parking services, which should have regard to off-airport comparables such as CBD car parking rates.

6. Quality of service reporting

SACL welcomes the Commission's recognition, in its draft report, that the current ACCC quality of service monitoring regime could be significantly streamlined and improved by focussing reporting requirements on specific areas of interest to airport users, rather than the current mechanistic arrangements which yield few real insights into the practicalities or effectiveness of service delivery.

SACL also appreciates that one of the key purposes of enabling airlines and airports to provide commentary on quality of service issues is to try to provide some additional context around the financial reports submitted to the ACCC. However, SACL has real concerns about the alternative approach proposed in draft recommendation 5.3.

It is clear from the submissions provided to the Commission that there are a number of non-price issues in respect of which airports and their airline customers have different perspectives. As the Commission has indicated in its draft report, this is not of itself a cause for concern, but is rather to be expected given the scale and nature of the parties' respective business activities and what can be at stake for each party.

However, there is, in SACL's view, a very real risk that a quality of service monitoring regime which was informed predominantly by commentary received from individual parties would do little more than provide a new forum for those parties to reproduce (and potentially amplify) any differences in perception on particular issues. This would be of particular concern if it were proposed that the ACCC would make publicly available complaints or allegations about airport conduct which have not been investigated, much less substantiated.

This, in turn, raises the question of what role is anticipated for the ACCC under draft recommendation 5.3. Would the ACCC simply receive commentary from relevant parties and reproduce that commentary in its reports, or is it anticipated that the ACCC would have a more active role in investigating any complaints?

Given that the light handed regime has seen a much closer engagement between airports and airlines as to service quality, SACL is not convinced that there is a need for a more intrusive regime which would involve detailed factual inquiries by the ACCC or another third party into specific quality of service issues. In any event, procedural fairness would dictate that airports and airlines must be given a fair opportunity to respond to any allegations about their conduct before those allegations

were included in any report published by the ACCC. And, even then, SACL believes that there would be very limited value (and likely to be very few real insights) in any report which simply contained a list of unsubstantiated complaints by one party, together with the response provided by the other.

Any system which is based primarily on commentary received from individual parties will inevitably tend to focus on lower level operational issues which, although they can be frustrating, generally provide little or no information about either the existence or exercise of market power or appropriate domestic and international industry comparisons.

SACL also believes that it would not be appropriate (or helpful in the sense of identifying potential "exercises of market power") for government agencies to provide commentary to the ACCC about service delivery by airports to their customers and passengers. To the contrary, SACL considers that the monitoring regime would benefit from an increased focus on benchmarking the quality and timeliness of service delivery to passengers by those government agencies (particularly given the potential impact of their services on passengers' travel experiences and airline and airport operations).

In these circumstances, a desirable improvement on the current quality of service arrangements would be to dispense with ACCC reporting altogether and replace it with a requirement that major airports publish annually the results of a properly constructed ***and objective*** passenger satisfaction survey (e.g. information sourced from the internationally recognised ACI Airport Service Quality monitor or an approved ongoing passenger research program such as the Sydney Airport Passenger Satisfaction survey).

Passenger satisfaction is a key measure of an airport's quality of service and any material concerns in relation to an airport's service standards would be expected to be revealed through passengers' experiences, although noting that many aspects of service are the responsibility of third parties (such as airlines and government agencies).

The results of that objective feedback would provide substantial assistance to airports, airlines and other third party service providers in identifying the causes of any dissatisfaction (i.e. whether it is attributable to matters within the responsibility of the airport, airline or government agencies) and determining what steps can be taken to address them in a constructive manner that benefits passengers as the ultimate consumers of services at airports. The publication of results of passenger feedback and international benchmarking would also provide a strong incentive for airports to maintain and, where necessary, improve the quality of their service delivery.

In addition, properly constructed passenger surveys which draw on customer satisfaction data collated at other major international airports (such as the ACI quality of service monitor) would also provide a clearer basis for benchmarking the performance of Australian airports with that of other airports internationally.

7. Response to allegations about SACL's conduct

As is apparent from the submissions provided to the Commission, there have been a number of specific matters over the past few years in respect of which SACL and individual airline operators maintain different perspectives.

For the most part, SACL's perspective in relation to those matters is set out in its initial submission. However, there are a small number of additional matters raised in other submissions provided to the Commission to which SACL believes it is necessary to respond in order to provide SACL's perspective for the Commission. SACL's response to those specific matters is set out in **Attachment 2**.

Both Qantas and Virgin Blue have also suggested that their perspectives on those matters demonstrate the lack of any effective constraint on airport behaviour. Again, SACL's views in relation to the constraints on airports are set out in its initial submission. However, we have also set out in **Attachment 3** a number of additional observations about the material presented to the Commission on these issues in other submissions.

Attachment 4 provides further information concerning material presented to the Commission in the submission of the Deputy Premier and Minister for Transport for New South Wales, relating to taxi fees, car parking revenue and transport mode share.

8. Conclusion

SACL looks forward to explaining its views further, and responding to any questions the Commission may have, at the public hearing in Sydney on 30 October 2006.

Sydney Airport Corporation Limited
October 2006

Attachment 1

Declaration of the Airside Service at Sydney Airport

Introduction

On 18 October 2006, the Federal Court dismissed SACL's application for judicial review of the decision by the Tribunal to declare the domestic airside service at Sydney Airport under Part IIIA of the TPA.

In its initial submission to the Commission, SACL set out a number of concerns in relation to the Tribunal's decision, both concerning its interpretation of section 44H(4)(a) of the TPA and certain findings of fact.

The judicial review proceedings were limited to considering whether the Tribunal erred in law. Accordingly, SACL was not able to seek review of the Tribunal's findings of fact.

SACL argued to the Federal Court that, contrary to the approach adopted by the Tribunal, section 44H(4)(a) of the TPA requires the Minister (or Tribunal on appeal) to identify whether the supply of the airside service has, in fact, been denied or restricted. Once any denial or restriction of access is identified, the Minister (or Tribunal) can then compare the future state of affairs with the denial or restriction of access with the future state of affairs without that denial or restriction of access to determine whether or not access or increased access (i.e. the removal of any actual restriction on access) would promote competition in the downstream market.

In summary, SACL argued (not unreasonably in its view) that there must actually be an *access* issue or concern before the "access regime" under Part IIIA can be invoked.

The Court agreed with SACL that the Tribunal had misconstrued section 44H(4)(a) of the TPA by "*infusing an overly elaborate body of considerations into that criterion*". However, the Court disagreed with SACL's interpretation of that section. Specifically, the Court found that "*the terms of s 44H(4)(a) do not incorporate the requirement for comparison with what is factually the current position in any given circumstances*" and that section 44H(4)(a) does not "*limit the possibility of declaration except where it can be demonstrated as a fact that the service provider has in the past denied or restricted access to the service or the supply of the service*".

Instead, the Court adopted Virgin Blue's alternative submission that "*the relevant enquiry in section 44H(4)(a) is the comparison between access and no access and limited access and increased access*".

Accordingly, section 44H(4)(a) simply requires the decision-maker to undertake a hypothetical comparison of the state of competition in the dependent market with a right or ability to use the service and the state of competition in the dependent market without any right or ability to use the service. Put another way, section 44H(4)(a) merely requires the decision-maker to ask, in respect of the airside service, "do airlines need to use the airside service in order to compete in the airline market?".

Based on this construction, the Court found that there is little doubt that section 44H(4)(a) must be satisfied and therefore affirmed the Tribunal's decision (but not its reasons) to declare the airside service.

Consequences of the Court's decision

The Court's decision creates a very low bar for declaration of essential infrastructure services

SACL is currently considering its options in relation to the Federal Court's decision.

One of SACL's key legal concerns with the Court's decision is that it attributes a meaning to section 44H(4)(a) which is no different to the mandatory criteria contained in section 44H(4)(b) which requires the Minister (or Tribunal on appeal) to be satisfied that "*it would be uneconomical for anyone to develop another facility to provide the service*". That is, once section 44H(4)(b)[7] is satisfied (i.e. it is established that the infrastructure facility has natural monopoly characteristics), it is difficult to see how section 44H(4)(a) would not also be automatically satisfied[8].

This concern is borne out and highlighted by the 4 factors considered by the Court in concluding that section 44H(4)(a) must be satisfied in the case of the airside service at Sydney Airport. Specifically, the Court stated that:

> "*Virgin submitted that, on its alternative construction, which we favour, it is clear that s 44H(4)(a) would be satisfied. It is submitted that this conclusion could easily be reached because (as substantially found by the Tribunal) (a) Sydney Airport is a natural monopoly and SACL exerts monopoly power; (b) the Airside Service is a necessary input for effective competition in the dependent market; (c) neither Bankstown or Richmond Airport could provide the service; and (d) the parent company of SACL had the first right of refusal to build and operate and second major airport within 100 kilometres of the Sydney CBD. Further, there was no real debate among the experts before the Tribunal that, given the strategic nature of Sydney as Australia's largest city and a significant gateway to international air travel, access to Sydney Airport is essential to compete in the domestic air passenger market.*
>
> *In these circumstances, there appears little doubt that on Virgin's alternative argument s 44H(4) must have been satisfied here"*[9].

On this basis, once the logically prior condition is satisfied (i.e. it is established that the infrastructure facility has natural monopoly characteristics), it is apparently sufficient to also satisfy section 44H(4)(a) that:

- the natural monopoly facility is a natural monopoly and its owner or operator exerts monopoly power;

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7 The Tribunal has noted that this criterion "logically precedes" the promotion of competition criterion in section 44H(4)(a): *Services Sydney Pty Limited* [2005] ACompT 7 at [101].

8 For completeness, SACL also notes its concern that Court's interpretation of section 44H(4)(a) gives little or no meaning to expression "(or increased access)". Specifically, if section 44H(4)(a) does not require any consideration of the actual factual position, then the comparison of "limited access and increased access" adds nothing to the comparison between "access and no access" (Decision at para 81).

9 Decision, paras 91-92.

- the service provided by means of that natural monopoly facility is a necessary input for competition in the dependent market; and

- there are other facilities in the immediate area that compete with the natural monopoly facility to provide the service.

That this creates an extremely low bar for the satisfaction of section 44H(4)(a) is readily apparent.

In addition, once the "logically prior condition" is satisfied, and the service is not already the subject of an effective access regime, it is likely to be only in highly unusual circumstances that the Minister (or Tribunal) would not also be satisfied that:

- the facility is of national significance (i.e. there are few, if any, small natural monopolies); and

- access to the service can be provided without undue risk to human health and safety. This is particularly the case given the Tribunal's previous statement that safety, health and operational standards "are more appropriately addressed at the second stage of the access process, a negotiated or arbitrated agreement for access".[10]

In these circumstances, unless some greater meaning is given to section 44H(4)(f) – the public interest criterion – or a substantial part of the decision whether or not to declare depends on how the Minister or Tribunal exercises their discretion (which, in turn, raises other substantial concerns), the Court's decision establishes an extremely low bar for the declaration of essential infrastructure services and therefore for users to invoke compulsory arbitration by the ACCC to determine the terms and conditions for supply of those services.

In its draft report the Commission stated that:

> "*… in the Commission's view, it is not unreasonable to set a high bar for invoking compulsory arbitration of disputes over the terms and conditions of supply for essential infrastructure services. Experience in other sectors suggests that easy access to a sector-specific arbitration process can fundamentally undermine genuine negotiations, with parties who perceive they will get a better outcome from the designated arbiter simply going through the motions as a prelude to arbitration.*
>
> *Indeed, this is precisely why the Commission has considerable reservations about the introduction of an airport-specific arbitration regime. That is, it is not clear that it is possible to devise a mechanism that would retain strong incentives for all of the parties to negotiate outcomes, rather than viewing arbitration as the default option … Accordingly, the most likely outcome of implementing the suggested arbitration mechanisms would be a return to heavy-handed determination of charges and conditions, with all of its attendant costs*"[11].

SACL agrees entirely with these comments and further believes that, although Part IIIA of the TPA is not an industry-specific regime, the effect of the Court's decision is

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10 *Sydney International Airport* [2000] A CompT1, Para 146.

11 Productivity Commission Draft Report *Review of Price Regulation of Airports Services, September 2006, page* 112.

that Part IIIA now clearly raises each of the fundamental objections identified by the Commission in its draft report.

The Court's decision creates substantial uncertainty and disincentives for investment in essential infrastructure

In deciding not to remit the matter to the Tribunal, the Court stated that, although the Tribunal had "*infused an overly elaborate body of considerations*" into its consideration of section 44H(4)(a), "*the nature of those detailed considerations … are not such as to be irrelevant … to the enquiry as a whole as to whether to declare the service, even though they were irrelevant to a consideration of s 44H(4)(a)*"[12].

The Court further stated how the facility owner has behaved and the degree to which it can be said that monopolistic behaviour has or has not impeded the efficient operation of the market in question may be relevant to the question of whether or not the service should be declared:

> "*For instance, if it can be demonstrated that the service has been provided in a manner that can be described as fair, even-handed and in a way most likely to maximise vigorous competition in the downstream market, that may be a powerful and relevant consideration as to why no declaration should be made… The enquiry is simply not mandated by the pre-condition of satisfaction in s 44H(4)(a)*"[13].

It has long been accepted that the Minister and Tribunal each have a discretion (described in previous Tribunal decisions as a "residual discretion") beyond the mandatory criteria for declaration set out in sections 44H(4)(a)-(f). However, these 2 passages clearly imply that the scope of that discretion is extremely broad and, in fact, encompasses a potentially wide-ranging enquiry into the conduct of the infrastructure owner. The judgement also appears to suggest that the Minister or Tribunal may consider (as part of that discretion) whether or not the facility owner has acted to maximise competition in another market, even though there is no duty or obligation on infrastructure owners (or for that matter any other person) under the TPA or common law to base their business decisions on what would maximise vigorous competition in either the market in which they operate or a downstream market in which they do not operate.

In SACL's view, it is highly unsatisfactory that key decisions on whether or not significant infrastructure services should be declared would now appear to depend to such a significant extent on the discretion of the Minister or Tribunal to consider a wide range of unarticulated and undefined matters.

The consequences of uncertainty caused by regulatory discretion and the resulting disincentives for efficient investment in infrastructure facilities are well documented. More recently, these concerns have been identified by both the Productivity Commission in its 2001 Review of the National Access Regime and the Exports and Infrastructure Taskforce in its 2005 Report to the Prime Minister, with the Commission stating that "*the paramount concern is the potential for access regulation to deter investment in essential infrastructure*"[14].

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12 Decision, para 94.

13 Decision para 85.

14 Productivity Commission Inquiry Report, Review of the National Access regime, 28 September 2001, Page xii

SACL also believes that the regulatory uncertainty which inevitably flows from the Court's decision is inconsistent with one of the key objects of Part IIIA which was inserted into the TPA in October 2006 – namely, to:

> "*promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets*": section 44AA.

That uncertainty is also likely to promote regulatory gaming as parties will have little incentive not to appeal any decision of the Minister to the Tribunal if they believe that the Tribunal may exercise its discretion in a different way.

Conclusion

In SACL's view, there is a substantial risk that Part IIIA of the TPA, as now interpreted by the Court, will be used to undermine the success of the Government's light-handed regulatory regime. In particular, there is a risk, not only for airports but also all major infrastructure facilities in Australia, that the low bar for declaration will simply result in the introduction or re-introduction of heavy-handed regulation of charges and conditions, with all of its attendant costs.

Given the significant consequences of the Federal Court's decision for all major infrastructure providers in Australia, SACL believes that there is now a compelling case for further amendments to Part IIIA of the TPA to ensure that it is interpreted to give proper effect to the Government's general and airport-specific intentions. In particular, SACL believes that there is a clear need for further amendments to clarify the applicability of the access regime in circumstances where the facility owner is not vertically integrated, already provides access to all users, and is already subject to substantial market and regulatory constraints.

Attachment 2

Response to matters involving Sydney Airport raised in other submissions

In its submission, Qantas raises a number of specific experiences it has had in its dealings with Sydney Airport. In order to assist the Commission to make a properly balanced assessment of airport conduct under light-handed regulation, SACL has set out its perspective on those specific matters below.

(a) The introduction of new charges and "miscellaneous charge increases"

Qantas has provided the Commission with 3 specific "case studies" of SACL allegedly introducing new charges which are, in Qantas' view, "hidden" or "obscured" from ACCC prices monitoring, and a further case study of SACL introducing what Qantas terms a "miscellaneous price increase"[15].

SACL believes that none of those "case studies" provides the Commission with an accurate or complete picture (see below).

The introduction of ground handling charges

In its submission, Qantas refers to initial discussions with SACL about ground handling charges (which occurred more than two years ago) as an example of airport operators "hiding charges from price monitoring".

However, the key difficulty with this example is that SACL does not charge ground handling fees for use of the airside at Sydney Airport.

SACL has in the past considered whether it might be appropriate to introduce a charge for ground handlers who conduct substantial businesses using facilities provided by SACL. However, SACL has not implemented such a charge (payable by either airlines or ground handlers) and does not have plans to do so. To the contrary, in September 2005, as part of its commercial agreement negotiations, SACL indicated to Qantas, BARA and other airlines that it would commit to not introducing any ground handling fees for at least five years, and SACL has not proposed introduction of ground handling charges beyond that five year moratorium.

SACL does not therefore accept Qantas' suggestion that this corroborates its "direct experience" of airport operators "hiding" charges from price monitoring.

Imposition of charges for essential aircraft movement information

SACL has, for a number of years, provided information on aircraft movements to customers located outside its terminals via the Internet.

However, in March 2006, Airport Fuel Service requested SACL to provide a quote for the provision of that information via dedicated screens in their premises rather than via the Internet. SACL indicated that it could provide Flight Information Display System ("**FIDS**") information via data cable, although this enhanced service would involve additional costs in terms of hardware and technical support (e.g. maintenance, upgrades, and FIDS data entry).

[15] Qantas submission, pages 17 and 18.

Airport Fuel Services accepted the quote provided by SACL for this alternative method of providing the service, which was based on the costs incurred by SACL in providing the service.

SACL continues to provide flight information through its publicly accessible web-page free of charge. However, if individual customers request customised views of FIDS data or the provision of that information via another means, SACL is willing to provide cost-related quotes for the provision of those enhanced services (which can be accepted or rejected by the relevant customer).

Given that there are alternatives and that this enhanced service was specifically requested (and SACL's quote accepted) by Airport Fuel Services, this cannot be characterised as a misuse of market power, but rather as an example of SACL responding to a customer's request.

Imposition of airside driving fee

Under the *Airports (Control of On-Airport Activities) Regulations* 1997 (Cth) ("**Regulations**"), a person cannot operate a vehicle on the airside unless they have an Authority to Drive Airside ("**ADA**") and the vehicle has an Authority for Use Airside or is operated under escort.

Under the Regulations, ADAs for Sydney Airport can only be issued by SACL, or a person appointed by SACL as an "approved issuing authority", in accordance with the criteria set out in the Airside Vehicle Control Handbook. The Regulations also provide that SACL can revoke an authorisation to issue ADAs by providing 7 days notice. Any decision by SACL to revoke an authorisation is subject to review by the Administrative Appeals Tribunal ("**AAT**").

In addition to its responsibilities under the Regulations, SACL has clear safety obligations, under NSW occupational health and safety legislation, in respect of areas under its control.

Prior to 1 January 2005, Qantas held the status of an Approved Issuing Authority at Sydney Airport. However, SACL had substantial concerns in relation to the manner in which Qantas administered its duties in relation to the issuing of ADAs. Those concerns, which it raised with Qantas on a number of occasions, were confirmed by three independent audits conducted over a six year period.

Following a serious safety incident involving a Qantas-trained driver in August 2004[16], SACL decided to withdraw Approved Issuing Authority status from Qantas (and from Airservices Australia also) and centralise the administration, driver testing and issuing of ADAs through its own Airside Driving Centre. Qantas did not seek review of SACL's decision in the AAT.

SACL charges a fee of $70 per test for theoretical and practical driver competency testing, which was set based on the anticipated costs of operating the Airside Driving Centre and conducting the competency-based training.

SACL finds it difficult to accept Qantas' submission that it previously conducted the training and issued licences "at no cost". Training staff to an adequate standard and

[16] The safety incident involved a runway incursion by a Caterair vehicle and a very narrowly missed collision with a Garuda Airlines A330 on take-off.

testing their competence necessarily requires a commitment of facilities and staff time, whether or not this is explicitly recorded in Qantas' internal accounting systems.

Since implementing the enhanced competency testing requirements, SACL has observed tangible improvements in airside driving safety, with a reduction in the number of runway incursions attributable to vehicles.

Electricity network charges

In its submission, Qantas incorrectly asserts that SACL's on-airport electricity network tariff exceeds equivalent off-airport distribution network tariffs by over 100%. Qantas also misstates the cost-based approach adopted to electricity charging for airport users.

Significant users of power on Sydney Airport are levied a network electricity charge. This incorporates both the network charge levied on SACL by Energy Australia and a charge to recover the cost of the on-airport electricity infrastructure provided by Sydney Airport. Because of the magnitude of on-airport electricity consumption, SACL pays electricity network charges to Energy Australia that are calculated by Energy Australia using a Cost Reflective Network Pricing ("**CRNP**") methodology. Those charges are higher than Energy Australia's standard network tariff, and the charge per unit passed on to users reflects this. Accordingly, the comparison set out in Qantas' case study would only be partly valid if SACL were in fact charged Energy Australia's standard network tariff.

SACL does not have the ability to require Energy Australia to levy network charges based on a series of small users as suggested by Qantas. Energy Australia aggregates SACL's metered consumption which places it above the 10MW threshold and therefore attracts the higher CRNP tariff.[17]

The component relating to SACL's network infrastructure is cost-based and set using a regulatory style pricing approach.

SACL has discussed this issue with Qantas on a number of occasions and Qantas is well aware of Energy Australia's position. It is therefore disappointing that Qantas has sought to portray this issue in its submission as an example of SACL charging more than 100% above its costs.

(b) Non-price issues

The launch of Jetstar

In its submission, Qantas also provides the Commission with a "case study" in relation to the launch of Jetstar in May 2004 entitled "Making Life Difficult on the Launch of Jetstar"[18]. As set out in its initial submission[19], SACL strongly disagrees with the findings of the ACT in relation to that issue.

SACL also believes that it is incorrect to suggest that it has in any way "made life difficult" for Jetstar in launching new services or operating at the airport.

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17 [Confidential]

18 Qantas submission, page 20.

19 See Appendix A of SACL's initial submission.

[Confidential]

[Confidential]

[20] [Confidential section footnote]

As set out in its initial submission, SACL has offered service level commitments as part of the enhanced commercial agreements currently being negotiated with airlines and BARA. Those service level commitments were based on a framework proposed by BARA and discussed with Qantas. SACL understood, based on public comments by BARA in December 2005, that BARA considered the terms of the service level undertakings to be "nearly finalised".

However, since SACL's initial discussions with Qantas in relation to service level commitments, Qantas has requested far more expansive and wide-reaching commitments.

SACL is currently negotiating with Qantas in relation to its proposal and believes that this issue should be resolved through good faith negotiations by both parties. In this regard, SACL acknowledges that negotiations have not progressed as quickly as either it or Qantas would like. However, given that Qantas has (in SACL's view) maintained a fairly "wide" negotiating position in relation to a number of issues, it is neither fair nor reasonable to suggest that SACL is solely responsible for those delays.

(c) Statements by BARA in Submissions to the Commission

Existing commercial arrangements at Sydney Airport

BARA, in its 14 August 2006 supplementary submission to the Commission, rejects SACL's statement that it has binding contractual arrangements in place with its airline customers. BARA asserts that "*SACL has imposed upon airlines a Conditions of Use document which was never formally accepted by BARA or BARA's member airlines. SACL merely deems that airlines accept the Conditions of Use because they continue to operate to Sydney Airport*".

This misunderstands the contractual arrangements with airlines at Sydney Airport.

Approximately half of the BARA member airlines formally accepted a version of the Sydney Airport Conditions of Use that was expressly negotiated with BARA in 2001. In addition, a number of other carriers operate under signed versions of the Conditions of Use specifically negotiated between the airline and SACL. Further, the majority of other domestic, regional and international passenger carriers have subsequently formally acknowledged that they operate at Sydney Airport in accordance with the Conditions of Use.

If necessary, SACL would be pleased to provide this evidence to the Commission.

Treatment of Land Value in Privatisation Process

SACL is also concerned by the apparent misconception raised by BARA in its submission to the Commission that Sydney Airport should somehow be bound to the ACCC's view of land value because of statements contained in a public offer document. In turn, the Commission's draft report appears to place some weight on these statements.

BARA's submission appears to misrepresent the quotes from the prospectus document as a set of commitments made in the sale process by the Southern Cross Consortium regarding the basis on which aeronautical prices would be set. However, the prospectus quoted was not part of the privatisation documentation for Sydney Airport, but was instead a public offer document to issue financial instruments called "FLIERS" as part of the sell-down of equity subsequent to the privatisation.

The quotes contained in BARA's submisison have been drawn from an independent expert report appended to the prospectus, which was intended to evaluate the risks associated with the financial forecasts contained in the prospectus. In particular, the independent expert report noted that key assumptions underpinning financial forecasts provided in the prospectus included:

> "*land value maintained using the ACCC's preferred methodology of indexed historic cost*"
>
> and commented that:
>
> "*Whilst the Productivity Commission strongly backed the opportunity cost approach, the adoption of land value based on indexed historic cost is unlikely to be challenged and is consistent with the ACCC's May 2001 decision*".

In the context of the independent expert report, the notion of indexed historic cost being "unlikely to be challenged" clearly does not infer that the methodology was considered to be irrevokable or even appropriate but rather that, as an assumption underlying financial forecasts, the approach to land value was sufficiently conservative.

In addition, the prospectus (on a non-selective reading) also notes that the light-handed regulatory regime provides Sydney Airport with flexibility in setting aeronautical charges and the opportunity to further develop commercial relationships with airlines.

SACL firmly believes that the body of opinion available at the time of the introduction of the light-handed regime, along with the reference in the Review Principles to appropriately valued assets including land, strongly indicated that an opportunity cost approach to land value would be appropriate under the light-handed regime.

To the extent that asset values had been incorrectly set for the purposes of pricing, Sydney Airport sees no justification for the Commission's draft finding that

> "*…the argument that airport operators had reasonable expectations of being able to increase charges on the basis of asset revaluations seemingly has less force in relation to Sydney Airport than elsewhere*".

SACL also rejects any assertion that its willingness to provide aeronautical services on the basis of existing charges and engage in commercial negotiations with its airline customers should be viewed as its agreement with the ACCC's approach to land valuation.

BARA's Submission on the Draft Report

The submission provided by BARA in response to the Commission's draft report contains a range of unsubstantiated assertions and inaccuracies. SACL does not consider that it is fruitful to respond to all such statements in the BARA submission, however, does wish to provide its perspective on the following key matters:

- *SACL has already implemented price increases based on a method that contradicts the PC's statements over prices going forward (page 2)* – This statement is demonstrably untrue. SACL's current charges can be directly traced to the ACCC's 2001 pricing decision. The only variations in charges at Sydney Airport since privatisation have been to reflect new investment in capital works agreed with airlines, and to recover the cost of security measures to comply with Government requirements. The Domestic PSC introduced in 2003 was set based on the allowable revenue model established by the ACCC in 2001.

- *The building block model brings forward returns on assets because the average length of pricing agreements is less than the average life of the assets (page 6)* – This appears to demonstrate a fundamental misunderstanding of the basis of pricing under a regulatory model. The building block approach generally sets prices based on a five-year forecast of traffic and costs, but incorporates a return on assets and depreciation over the useful life of the assets. There is no relationship between the period over which prices are set and the period over which the investment in assets is recovered.

- *If SACL had really believed in the merits of its arguments on pricing and asset valuations it would have acted on them long ago (page 7)* – this is the classic 'catch 22' situation where a responsible approach to consultation and negotiations with airlines is taken to be a shortcoming in SACL's behaviour, while implementing variations may be characterised as a misuse of market power.

- *SACL overcharges airlines by creating two aeronautical tills (page 8 & 9)* – SACL has offered airlines a price path that includes all new aeronautical investment planned for a five year period, however, has not to date agreed a mechanism for this approach. As an alternative, SACL has approached commercial discussions in a manner with which airlines are considered to be more comfortable, focussing on charges for the existing asset base and separate recovery of the cost of individual investment projects once completed.

Attachment 3

Comments on the effectiveness of constraints on airport conduct

In their respective submissions, both Qantas and Virgin Blue suggest that, under the current light-handed regulatory regime, there is no effective constraint on airport conduct.

Qantas has presented a report prepared by NERA Economic Consulting ("**NERA**") which focuses on three constraints articulated by the Commission in its 2002 Report – namely, the inter-relationship between aeronautical and non-aeronautical revenue, countervailing power of airlines, and the scope for airports to price discriminate in the setting of aeronautical charges - and suggests that, as in its view none of those constraints is effective, the light-handed regime itself is flawed in its current form.

However, NERA's conclusion that SACL is unconstrained is not borne out by its pricing behaviour since the introduction of light-handed regulation -- in particular, its compliance with the Government's Review Principles and substantial under-recovery against the allowable revenue or five year pricing path approved by the ACCC in May 2001[21].

NERA concludes that the observed price changes at other airports since the removal of price cap regulation in 2001/2002 "*can only be explained by the ability of airports to act without constraint*"[22]. Similarly, Virgin Blue has sought to highlight price increases at airports following the introduction of light-handed regulation as evidence that airports are unconstrained and to demonstrate that there is no credible threat of re-regulation.

However, in contrast to these submissions, the Government has publicly stated that price increases were expected in line with the Review Principles. For example, the spokesman for the then Federal Transport Minister, John Anderson, in responding to the ACCC airport price monitoring and financial report for 2002-03, stated that:

> "*we were expecting to see price increases because they had been held artificially low over the last few years*".

The then Minister for Transport and Regional Services provided further indication that price increases at airports were an anticipated outcome of the light-handed regime in his speech to the Transport and Tourism Industry Summit in September 2003, where he noted that:

> *"So far, the major airports have responded to the new price monitoring system as expected".*

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21 In SACL's view, the report prepared by NERA also presents, in a number of respects, a different picture than the evidence provided by Mr Houston of NERA in the ACT proceedings. In particular, NERA's report does not undertake any substantive analysis of the threat of the government re-introducing direct prices controls, which was also a clear basis upon which the Commission made its recommendation and the Government adopted the light-handed regime; does not consider the *combined* impact of each of the constraints on airports (which was a key criticism made by Mr Houston against another expert economic witness in the ACT proceedings); and does not consider the substantial potential costs of imposing a negotiate/arbitrate model (which, again, formed a substantial part of the evidence provided to the ACT by Mr Houston).

22 Report prepared by NERA for Qantas, page 30.

In addition, consistent with SACL's submission, NERA's report also shows very modest increases in SACL's "annual aeronautical revenue per passenger" (approximately 3% per year since 1 July 2002), and increased efficiencies (based on "aeronautical operating expenses per passenger") of approximately 4% per year during that period[23]. These efficiency gains are entirely consistent with the light-handed regulatory regime and, indeed, constitute one of the Government's key objectives in privatising airports. NERA's report also shows very stable asset valuations at Sydney Airport since the introduction of light-handed regulation[24].

The measured increases in aeronautical revenue per passenger also overstate the change, as they include the impact of revenues from Terminal 2 (the former Ansett Terminal) which domestic and regional carriers began to use over the course of 2002-03. This represents SACL generating revenue from increased utilisation of the [newly acquired] common user terminal asset, rather than from increased charges for the same services and facilities.

In this regard, the adverse consequences modelled by the ACCC in 2001 in relation to airports operating in an unconstrained environment have not eventuated. In its October 2001 response to the Productivity Commission's draft report, the ACCC presented modelling which indicated that, in a genuinely unconstrained environment, Sydney Airport would maximise profits by setting charges at $120 per departing domestic passenger and $510 per departing international passenger[25]. The ACCC went on to state that it would not expect prices of this magnitude because of the threat of government intervention.

As set out in its initial submission, SACL has acted consistently with the Government's Review Principles and, during the period 2001/2002 to 2004/2005, substantially under-recovered against the allowable revenue approved by the ACCC in May 2001. These matters alone suggest that the continuing monitoring of airport behaviour and the threat of Government intervention combine to operate as a substantial constraint on airport behaviour in Australia.

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23 NERA Report, page 12.

24 NERA Report, page 14.

25 Submission to the Productivity Commission by the ACCC, October 2001, page 9.

Attachment 4

SACL's comments on the submission by the Deputy Premier and Minister for Transport of New South Wales

1. Taxi access fees

In his submission, the NSW Deputy Premier and Minister for Transport stated that:

> "*Taxi passengers now incur an airport access fee which, when proposed by the Sydney Airport Corporation, was to provide better access and facilities for taxi drivers and passengers. I am advised that this to all intents and purposes has not eventuated".*

The information provided to the Deputy Premier and Minister for Transport is not correct. Over the past two years, there have been significant improvements to all public transport facilities for taxis, buses and limousines at Sydney Airport. These improvements include major and minor capital works projects designed to improve public transport vehicle access, driver amenities and passenger facilitation at each of the three terminals.

Improvements to airport ground transport facilities and services include:

- the reconstruction of both Domestic Terminal taxi ranks to accommodate 10 passenger loading bays at each rank. This produced a 66% increase in the rank loading capacity, and relocated the T3 (Qantas Domestic Terminal) taxi rank to the kerb closest to the terminal doors for improved passenger accessibility;

- the introduction of an electronic taxi short fare return priority system at all three airport taxi ranks. This provides an accurate system to prevent short fare refusals by allowing drivers who return to the airport a short time after accepting a fare to go directly to the front of the queue. It has largely resolved the major customer service issue of short fare refusals;

- the construction of a prayer room facility for drivers in the domestic holding area. The area has been fitted with appropriate ablution requirements for Muslim drivers;

- the construction of a dedicated transport industry meeting room;

- construction of a new food and beverage outlet and adjacent covered seating area at the domestic holding area;

- construction of a taxi docket exchange office for drivers to complete their business needs while waiting at the airport;

- development of the new Unigas fuel station for taxis, providing the lowest cost gas for taxis in the region;

- new dedicated pre-booked taxi ranks at all three terminals;

- shaded passive recreation areas for drivers at both domestic and international holding areas;

- construction of a new larger domestic taxi holding area. Improved queue lane arrangements allow drivers to turn off their engines whilst waiting in the queues to visit the toilets or food outlet;

- construction of new toilet amenities at the domestic holding area, with more than double the previous number of amenities;

- duplication of the international taxi holding area toilets;

- improvements to terminal frontage streetscapes, including pavement resurfacing and extensive landscaping (International terminal);

- the provision of water coolers at both international and domestic taxi holding areas, with both drinking and bottle filling functions;

- modifications to the domestic kerbside private car pick-up areas to improve terminal access for public transport vehicles;

- the introduction of a new bus, coach and hire car holding area in the domestic precinct;

- working with the Transport Workers Union to deliver a Sydney Airport taxi driver training program; and

- working with the Taxi Council of NSW to provide peak period Multi Hire Coordinators at domestic taxi ranks. This initiative is designed to maximise passenger throughput at times of taxi short supply. (Trial operation currently in progress).

Other initiatives currently in progress include:

- the introduction of an e-tag access arrangement for taxis to each rank, improving capacity of the ranks and further reducing inappropriate driver behaviour;

- upgrading the international taxi rank to improve amenity and add 50% capacity through a peak period overflow passenger loading area; and

- installation of taxi passenger rights information signage.

In addition to improving existing access and facilities, the introduction of the taxi access fee also sought to partially recover sunk capital costs of SACL's ground access developments (including infrastructure used by taxis and passengers) and to partially recover the substantial operational costs of managing taxis at the airport. For example, SACL meets the full construction and maintenance costs of Airport Drive and Qantas Drive, as they are located on SACL land. These costs are not recovered from airport users through aeronautical charges.

These roads form an integral part of Sydney's arterial road system and the majority of traffic on the main roads around Sydney Airport is not generated by the airport. In this regard, peak period traffic consists mostly of urban commuters and commercial traffic in the overall mix is largely generated by surrounding industrial developments,

such as the Port Botany development. A recent survey found that Airport Drive carries around 56,000 vehicles each day[26], only approximately 45% of which is related to the airport.

2. Car parking pricing

The submission by the NSW Deputy Premier and Minister for Transport also suggested that commercial parking revenues may drive SACL strategy towards 95% car mode share.

This is not correct. A recent survey to establish the mode share of transport for passengers and visitors at Sydney Airport[27] showed that only 43% of trips were by private car. A further 32% of trips were by taxi and 25% used public transport and other means.

In addition, as required under the Commonwealth approval of the International Multi Storey Car Park developments, SACL is committed to developing its Airport Ground Travel Plan to identify and promote strategies to actively reduce the mode share of private car traffic to and from the airport.

[26] Based on traffic count data from 8 December 2005.

[27] Airport Ground Travel Plan Phase 7, based on a survey of 8 December 2005