

11 August 2006

Mr Gary Potts  
Presiding Commissioner  
Review of Price Regulation of Airport Services  
Productivity Commission  
PO Box 80  
BELCONNEN ACT 2616

Dear Mr Potts

Cairns Port Authority (CPA), a Queensland Government Business Enterprise (GBE), is the owner and operator of Cairns International Airport (CNS). Unlike other major airports in Australia we do not lease the airport from the Commonwealth but rather, the airport was transferred to CPA as part of the Commonwealth's Airport Local Ownership Program.

CPA also operates the port of Cairns. This is a diverse business with traditional port activities in general cargo, sugar and petroleum products. It is also the home of a major fishing fleet and HMAS Cairns – a major naval base. Increasingly, the port's focus has been on facilitating the operations of large and small vessels that provide a range of tourist and leisure experiences centred around the Great Barrier Reef. Cairns is also the home a range of maritime service providers such as boat building, repairs and providoring for cruise ships.

It should be noted that whilst the seaport and the airport are to some extent complimentary businesses, they are operated and accounted for as separate business units.

CNS is the sixth largest airport in Australia in terms of total passenger movements and the fifth largest in terms of international passenger movements. It is also home for a diverse range of general aviation operators that provide a range of vital community services (such as the Royal Flying Doctor Service) throughout Tropical North Queensland (TNQ) and the Torres Strait as well as support to the tourist industry based around Cairns.

As CNS was not part of the FAC, it has not been subject to the various price control and monitoring arrangements that followed privatisation. As CPA is a GBE there is provision with the Queensland Competition Act for a range of price control arrangements to be imposed at the discretion of the relevant Minister. This discretion has not been exercised to date and to the best of CPA's knowledge no approach has been made by airlines or any other person requesting the Minister to exercise this discretion.

We were quite surprised, and to some extent disappointed, by the suggestion of Virgin Blue in its submission to this inquiry that CNS should be subject to the same sorts of price controls as airports such as Sydney and Melbourne. This suggestion has not been made on the basis of an objective analysis such as that undertaken by the Commission in its 2002 report (see pages 141-143) or with any reference to the facts relating to current market conditions and CPA's recent conduct.

Whilst CNS is Australia's sixth largest airport it is better understood as Australia's largest regional airport. The size of CNS is a direct reflection of the attractiveness of TNQ as a tourist destination. The five airports that are larger than CNS all serve cities with populations in excess of 1 million people and some also serve large regional cities close by. By comparison, the catchment of Cairns is of a similar size to Townsville or Hobart but much smaller than Canberra, the Gold Coast or Newcastle. As such, the commercial viability of CNS is critically dependant upon the TNQ tourist industry and is without question subject to greater destination substitution than those airports that are larger than it and indeed many that are smaller than it such as Canberra or the Gold Coast.

As a smaller international airport, which almost exclusively relies on leisure traffic for international services, CNS finds itself competing with other destinations and larger gateway airports. These factors dictate that CPA adopts a highly consultative approach to the development of CNS and negotiation of charges, to ensure the airport is competitive.

The lower yielding nature of CNS's international services has made them more susceptible to one-off shocks to aviation and tourism and to adverse developments, impacting route economics, such as rising fuel costs.

CNS's exposure to international tourist markets has been born out by recent decisions taken by the Qantas Group as they seek to restructure their international operations by replacing Australian Airlines and Qantas services with services provided by Jetstar.

Qantas direct services to Cairns from Hong Kong, which have existed for over twelve years, have been discontinued from 1 July 2006 and it is clear that the planned international services by Jetstar are designed to improve lower yielding leisure dominated route performance, such as those to Cairns. Hence CPA is currently holding comprehensive negotiations with Jetstar, seeking to attract them to the proposition of establishing Cairns services. Jetstar's position in these negotiations highlights that the airline has many alternatives for its fleet and that the TNQ region needs to provide attractive charging and marketing investment proposals to secure Jetstar's international business.

The Australian Airports Association submission to this inquiry has drawn the Commission's attention to the impact that domestic low cost carriers (LCCs) are having on pricing outcomes at regional airports such as CNS. Jetstar and Virgin Blue both adopt a far more aggressive negotiating stance than has traditionally been the case and it is clear that aircraft allocation between routes, at least at the margin, are dependant on the level of prices and services provided at different locations. If nothing else, LCCs have opened up a range of new destination markets that directly compete with TNQ for domestic holiday makers.

During negotiation of agreements with the LCC's they have emphasised that they have a wide range of route options and that, in the context of the lower airfare environment, the relative cost to fly to destinations is an important factor in the airlines' determining which destinations will be serviced. It is important to note that each of the domestic airlines operating to CNS actively participated in the extensive consultation process leading to the agreements that are now in place and at no stage raised any concerns with CPA's approach. In fact, CPA received favourable feedback in relation to the extent of information made available to our airline customers.

Whilst not being subject to the Commonwealth's policy to date, CPA has conducted its business in a manner that ensures any scrutiny of our conduct and airport pricing approach would clearly demonstrate we are operating in a competitive environment and engaging with our airline customers in a fair and reasonable manner. In 2004 we embarked on a process to put in place five year commercial agreements with our airline customers. We fully disclosed our costs, capital expenditure expectations and traffic forecasts to airlines and modified them as a result of an extensive consultation. Indeed, we adjusted our proposed international prices to meet the request of international carriers using CNS.

We now have in place contractual arrangements with most of our airline customers. These arrangements require us to provide a more extensive range of information than other airports provide to the ACCC even though we have no statutory obligation to do so. We have specific obligations in relation to consultation, OH&S and workplace behaviour and binding dispute resolution. We also have in place an arrangement to make specific rebates to airlines in the event we do not meet certain performance obligations – this we believe is a first for Australian airports.

In its last report the Commission noted concerns from both Ansett and Board of Airline Representatives (BARA) that the conduct of CPA at that time could lead to conclusions of abuse of market power. Their concerns were primarily about consultation and the level of charges. On both these counts it is interesting to note the following comment in the Cairns Post on 22 July 2006

*BARA Executive Director of the board Warren Bennett said the CPA's approach to negotiations about charges was among the best in Australia.*

*"The prices that have been set are considered to be reasonable by airlines, taking into account the nature of the airport's business, the needs of its customers and the significant capital expenditure it has undertaken," Mr Bennett said.*

It is acknowledged that CNS's international prices are relatively high in comparison to other Australian airports. This is largely a reflection of scale and the peakiness of demand. This peakiness can be seen in the fact that CNS processes less than a quarter of the international passengers Melbourne does yet requires about half the international gates to manage its peak demand as compared to Melbourne.

That said, it is interesting to note from the data provided on Australian airport prices by Melbourne Airport on page 28 of its submission to the Commission that CNS's international prices are lower than those international airports that are smaller than it (Adelaide and Darwin). They are around the same level as Australia's largest international airport, Sydney. With airline agreement these prices will increase more rapidly than CPI over the next few years to enable CPA to finance the \$55 million being invested specifically in upgrading the international terminal, as well as providing a contribution by international airlines to a range of other airport infrastructure improvements.

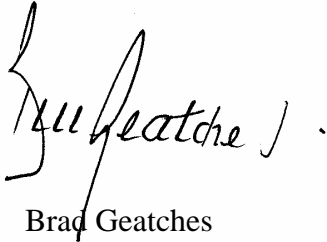
As far as domestic charges are concerned, the same page of Melbourne Airport's submission shows CNS to have among the lowest domestic charges in Australia along with Canberra (which has roughly the same number of domestic passengers) and Melbourne (which has more than five times the number of domestic passengers). It is also interesting to note the other airports in the sample, other than Darwin, all have significantly larger traffic bases than CNS.

Domestic charges are expected to grow at CPI. This is necessary to fund a circa \$140 million expansion and reconfiguration to common use of the domestic terminal.

In closing, the Commission concluded in its last review on airport price regulation there is no case for the imposition of any form of price control or monitoring on CNS; it was correct then and such a conclusion is correct now.

If you or your officers require any further information regarding developments at CNS, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Brad Geatches', with a stylized flourish at the end.

Brad Geatches  
**CHIEF EXECUTIVE OFFICER**

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