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ECONOMIC REGULATION OF AIRPORTS

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COMMISSIONER LINDWALL: There's a little bit of an introductory spiel that we need to go through so I'll welcome you all here. So good morning, welcome to the public hearings for the Productivity Commission inquiry into the economic regulation of airports. I am Paul Lindwall and Presiding Commissioner of the inquiry with Stephen King here is my fellow Commissioner. I would like to say that we're on the lands of the Wurundjeri people of the Kulin Nation.

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10 The inquiry started with a reference from the Australian Government in June 2018. The purpose of the inquiry is to investigate whether the economic regulation of airport services promotes the efficient operation of airports and related industries. We released an issues paper in July 2018 and have talked to a range of organisations, individuals and others with an interest in the economic regulation of airports.

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20 This has included representatives from the Australian State and Territory Governments, local councils, airports, airlines, industry representative bodies, academics, researchers and other individuals with an interest in the issues. We held public hearings focused on competition in the jet fuel market in Sydney and Melbourne in late November 2018 and following the release of our draft report in February 2019, we, the Commissioners, called for further submissions and is undertaking consultations along with these public hearings. We received 88 submissions prior to the release of our draft report and about 30 since then and I think they're still arriving of course.

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30 We're grateful to all of the organisations and individuals who have taken the time to prepare submissions and to appear at these hearings. This is the third public hearing for the inquiry this year. Following this hearing, another day of hearing will be held tomorrow here in Melbourne. We'll be then working towards completing a final report having considered all the evidence presented at the hearings, in submissions, and through meetings, and other work that we undertake and the report will be submitted to the Australian Government in June 2019. Participants and those who have registered their interest in the inquiry will be advised of the final reports release by the government which may be up to 25 parliamentary sitting days after completion.

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40 The purpose of these hearings is to provide an opportunity for interested parties to provide comments and feedback on the draft report, or what other people say. We like to conduct all hearings in a reasonably informal manner but I remind participants that a full transcript is being taken. For this reason comments cannot be taken from the floor but you will have the

opportunity at the end of the day if you wish to come up here and have another say or rebut or concur with someone else's presentation.

5 Participants are not required to take an oath but are required under the Productivity Commission Act to be truthful in their remarks and they're welcome to comment on issues raised in other submissions or anything else they wish to that's relevant to the inquiry. Transcripts will be made available on our website after they've been processed and submissions, of course, are also on our website. For any media representatives attending
10 today, we have some general rules. Please see one of our staff for a handout which explains those rules.

To comply with the requirements of the Commonwealth Occupational Health and Safety legislation, you are advised that in the unlikely event of
15 an emergency requiring the evacuation of this building, you will listen for instructions over the P.A. Follow the exit signs to the nearest stairwell and lifts are not to be used. Please follow the instructions of floor wardens at all times. If you believe you are unable to walk down the stairs, it's important that you advise the wardens who will make alternative
20 arrangements for you.

Participants are invited to make some opening remarks, preferably not much more than five minutes. Keeping them brief will allow an opportunity for us to have a conversation about these submissions and
25 your points. So now I'd like to welcome Melbourne Airport. Would you like to introduce yourselves for the record and make your statements.

MR STRAMBI: Good morning.

30 **COMMISSIONER LINDWALL:** Good morning.

MR STRAMBI: Thank you, Mr Lindwall and Mr King for having us here today. We're both very pleased to be here. My name is Lyell Strambi. I am the chief executive officer and managing director of the
35 Australia Pacific Airports Corporation, the parent company that owns and operates Melbourne Airport under licence from the Commonwealth government. With me today is Lorie Argus. She's our chief of parking and ground access.

40 I'd like to start today really by thanking the Commissioners and their staff for the terrific work and time that's been spent on this inquiry, all of the effort that's actually gone into it. The inquiry itself does form a really important part of the regulatory environment in which we operate within. An engagement on substantive issues has been of high quality. This time
45 round your job has been made harder by the bluster and noise that has

accompanied this review. But your job clearly is to look through the noise and assess the facts. And the facts show that the existing light-handed regulatory framework should be preserved.

5 When you look back at what's actually been achieved under the system of regulation, the facts show that it's delivered strong outcomes for passengers through more competition resulting in greater choice and cheaper fares; it's delivered for airlines through the delivery of capacity and improved facilities that allow them to reduce costs in their businesses; 10 and for airports through sustainable returns for our investors. And then finally, and probably importantly, for the Australian community through the economic development and employment that aviation (indistinct) actually generates.

15 In 1997 when Melbourne Airport was first privatised, there were some 14,000,000 passengers travelling through the airport in any one year. Only one in seven of those flew on an international service directly out of Melbourne. Of course many more were flying internationally, they just didn't have the option of flying internationally directly out of Melbourne. 20 Usually they flew somewhere else to join an international flight.

Today the overall number has grown to over 37,000,000 passengers and in fact we're getting very close to 38,000,000 passengers. But importantly with 11,000,000 international passengers now flying out of Melbourne 25 and that's almost one in three; so from one in seven to one in three. And while it took around 37 years to reach the first 5,000,000 international passengers, it's only taken another ten years now to achieve the second 5,000,000 passengers so not hitting in excess of 10,000,000 annually.

30 This enormous growth that we've seen has been delivered largely through incremental investments to get more efficient utilisation of existing assets. Like many airports that were privatised in the late nineties, we were lucky to acquire an asset that actually had some headroom in it. We've grown our capacity at the airport by augmenting the existing infrastructure by 35 extracting greater efficiencies through better planning and innovation. By being able to grow into this legacy infrastructure, it's had many benefits and it certainly allowed expenses to be kept low. And another benefit was that the base infrastructure costs were booked in 1960's values when that airport was developed, on what were empty paddocks, and construction 40 was relatively simple and cheap at the time.

But the scale of that incremental investment since, required just to really grow this asset in line with the market, should not be underestimated, it certainly is significant. The book value of the aeronautical assets has 45 increased since privatisation from some \$460m to \$2b today. That's under

5 a world where we've been efficiently using the assets available. As we have demonstrated, passenger growth has been strong and investment in infrastructure has managed to keep with that demand. This investment has helped to create an environment in which strong competition has seen international airfares decrease over the long run and that is why the facts show these outcomes of Melbourne Airport and probably similar to other major airports, underlying the effect of this current regulatory regime.

10 This regime has evolved and matured in the 15 years since it was first introduced. As well, agreements have become far more sophisticated and the best elements of deals struck in various places have been shared and incorporated in future or in current deals that are being done. I think our recent ASA is a really good example of this because it contains a number of new features that have been introduced to improve the consultation process and share more risks, as examples. Talking of the risk sharing, our last agreement includes service failure rebates and also annual price resets on capital expenditure.

20 Now, these additions were added to address the issues that were raised during the consultative process and actually, in a lot of cases, actually to the benefit of all parties including the airlines. The risks of the proposed mandatory negotiate-arbitrate framework would significantly outweigh any potential benefits. Such a framework would almost inevitably change behaviour and it does have the potential to be gamed resulting in very poor outcomes. Given the complexity that's inherent in aeronautical agreements, just think about it: it often involves multiple parties and we're not just talking here about airports and airlines but even within the airline community. Very different parties with very different motives and very different goals.

30 And then you think about the variables which you have to deal with, which are many complex and often interrelated. A great example of that is the interrelationship between passenger volume variables, capital spend and operating expenditure and you can (indistinct) more passengers should drive more capital expenditure. Capital expenditure often can be to reduce operating expenditure so you're trying to solve a very, very, complex and multidimensional puzzle with multi-partners. Given the complexity that's inherent in those aeronautical agreements, it is still preferable to take the necessary time to reach a good outcome. I know some have argued that a negotiate-arbitrate process would be quicker and I think that's something we agree with, but quick is not necessarily good or better. So our preference is to have a process that actually works and delivers the right outcome even if that takes a little bit longer, the stakes are so high.

45

Again just reflecting on a negotiate-arbitrate framework, such a regulatory approach would really only serve to distract from the progress being made within the existing framework and put future investment at risk without any tangible benefits for passengers or the community. There's been some comments on parking and ground access and we can say really clearly that the price of parking at Melbourne reflects the need to effectively manage congestion. It also reflects the convenience of amenities provided and competition from other services provided either near or even at the airport.

Our parking business is subject to strong competition from at least 15 different off-airport car parks. Certainly from other modes of transport, such as taxis, buses or rideshare and even from our own products of free pick up and drop off. We are definitely seeing disruption of this space at the moment. Last year total car parking transactions declined despite an additional 1,600,000 passengers flying through the airport. This, I think, highlights changes in customer's preferences. Passenger demand, particularly being strong for rideshare at the moment. This alternative mode of access is one that we've actually taken submitting of steps to facilitate.

Investment in new facilities has included for rideshare, the indicated of dedicated holding areas and pick up zones. We have also invested in a taxi management system to streamline taxi pick-ups. We've upgraded facilities for car rental operators. We've also invested in the free options and in some cases actually sacrificing parking revenues and car parking space to provide these facilities for free. That's been driven really to reduce congestion and to provide passengers with choice and better and safe access to and from the airport. And also at the airport we've been a very strong advocate for rail. A project which will introduce even greater competition but more importantly choice between modes and enhanced passenger experience and frankly meet an expectation on major airports such as ours.

So while I respect the Commission has reserved its judgment on ground access at Melbourne, we have certainly provided significant evidence that through pricing and consultation with a myriad of operators, we are prioritising the passenger with a clear focus on congestion management choice and safety in what is, and obviously, a very constrained environment in which we actually operate the front of our terminals.

Now, we agree with the intent of all of the Commission's draft findings or recommendations however we do propose an alternative approach to providing additional financial monetary information and that is to use the existing ministerial instructions that already exist rather than promoting a change in regulation.

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We think this just provides a simple lower cost approach and it's already been used in monitoring of aeronautical and car parking prices. Other than this one change we have no other concerns with any of the recommendations in the draft report and we've set out the detail behind this position in our response to that draft report. So now looking forward, Melbourne like most airports faces a very significant growth challenge. Our projections are that our passengers forecast almost double to around 67,000,000 over the next 20 years.

We're approaching, and I guess a compounding factor is, we're approaching the practical capacity of some of that legacy infrastructure that we were so lucky to have. At the same time we also have a need to now replace ageing, hopefully not an emergency, ageing 50 year assets with new for old. Often with upgrades they have to now meet modern environment construction and safety standards and by the way we have to do this in a live operating environment, it's a challenge. So in order to meet growing demand we are going to require a step change in infrastructure investment. The most obvious example at Melbourne is our third runway and in that particular case we can't add incremental runway capacity, we had to build a whole new runway that almost doubles capacity of the airport the day it opens.

Airlines who are not seeking to grow potentially won't like this. But it's important that all stakeholders in our sectors, be airports, the airlines, the government, the regulators, really need to approach this next phase of development with a clear understanding of these challenges. The existing light-handed regulatory environment has delivered to the Australian community since 2002 gives us the best chance of success. This major investment in long life infrastructure requires a stable, predictable, regulatory environment. Unnecessary regulatory change creates risk for investors. It increases funding costs and it compromises the delivery of economic infrastructure at the time it's needed.

We must remember that the ultimate beneficiary, our first and last priority, must be the passenger. We succeed commercially by providing an airport where more airlines can fly more people to more destinations. Regulatory stability is critical to facilitate the necessary investment to continue to make this happen over the next decade and beyond. Thank you.

COMMISSIONER LINDWALL: Can I just ask you about countervailing power. Now, some of (indistinct) have said that the airlines have no countervailing power against the airports and Qantas the other day gave an example of Newcastle where (indistinct) because of the pilot shortages, withdrew services from Newcastle and immediately was

replaced by Virgin Airlines so is that an example that you would agree is an example of not having countervailing power?

5 **MR STRAMBI:** I really can't talk to the Newcastle example but I can - - -

COMMISSIONER LINDWALL: Hypothetically if one airline withdraws services, another one would come in with similar service.

10 **MR STRAMBI:** Yes, I don't believe that is always the case. I've heard people say, "Of course we can't stop flights to Melbourne, therefore we have no power". Well, to be honest having been in this industry for decades and actually being on the other side of the fence for decades, you know, on the airline side of the equation, airlines will make lots of choices
15 around fringe services, for example, it might be just marginal. You know, clearly with an airport like Melbourne, a major airline will have to have Melbourne in its itinerary. But does it have to really do those fringe services and they could be used tactically to exercise some power but I think there's a lot of other ways in which that power is actually
20 exercised. It doesn't just have to be (indistinct) services.

COMMISSIONER LINDWALL: And presumably if Melbourne's growing and other airports are growing, an airline has the choice about where to place any additional growth that he might see too.

25 **MR STRAMBI:** Yes, it's really interesting. You compete very hard for traffic, particularly international traffic, and it's often not against the obvious. You know, people say, "Oh you're competing in Sydney for traffic to Australia"; well, when they're determined to come to Australia
30 that may be the case although there are other good airports in Australia (indistinct) destinations of Australia but I can't tell you how many times I'm out on the road talking to airlines and governments and you're competing against Paris, you're competing against New York, you're competing against a lot of destinations and airlines - the great thing about
35 running an airline is you have an asset that you can move around to where the market actually is. We don't have that luxury as an airport.

COMMISSIONER KING: Sorry, just to follow-up on one of the things you just said. So you said there are other ways that countervailing power or power by the airlines can be exercised other than withdrawal of service.
40 I think I may have your words quite correct. Do you mind just expanding on that, so you said that they could withdraw "fringe" services, what other sources of market power, bargaining power, could they have?

MR STRAMBI: Yes, whether it meets your definition exactly. The negotiations are extraordinarily complex. There are all sorts of different perspectives that could be brought to bear. So an airline that has a substantial sizeable operation in your airport could continue to grow by juggling its aircraft around between different service and could continue to grow by upsizing aircraft. It has a lot of different ways of growing. That's real power when it comes to the table when you're talking about growing the airport facilities for the benefit of the entire community.

And so people could come at this with very different motives and very different positions around that to say, "We can continue to grow. We don't need that growth asset. We can grow within (indistinct) that we have" and in fact sometimes that might be an advantageous way of keeping competition out so there's a real mixed bag of market power out there in terms of not just - it's not a discussion, I think, solely between airlines and the airports, it's also between airlines themselves so it's very complex.

COMMISSIONER KING: The negotiate-arbitrate framework was introduced from the east coast gas market about 18 months ago and since then agreements have been concluded and they have been not having to go to arbitration so does that suggest that perhaps you're overstating the concerns about negotiate-arbitrate?

MR STRAMBI: Let me address this in two different ways. Look, I'm not a gas regulation expert, I know little about it. But from what I've learnt and read it's actually quite a different problem. It's very different in the context of there is no inability to deny access at an airport whereas in the gas pipeline - - -

COMMISSIONER KING: Do you mean no "ability" to deny access at an airport"?

MR STRAMBI: Yes, yes.

COMMISSIONER KING: I thought you said "inability" to deny access at an airport.

MR STRAMBI: So I might have used a double negative, sorry. Thank you for the correction. No, but there is no ability to deny access, we have to allow access and I'm not sure that is the case in the gas pipeline case. I think it's also a different problem which is actually trying to be solved, they don't believe it's a capacity conversation. So our problem is far more complex than that. But maybe let me answer it a different way and come

at this from a negotiate-arbitrate perspective. I know we talk a lot about the costs and the time of these arbitration techniques as being a big barrier, but I actually (indistinct) it as I think the biggest problem is the risk of regulatory failure. That's the real concern here.

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So if I think about the way the system works today, is the parties will sit around the table and actually start from quite wide positions, very different perspectives. You may start with your version of the building block models but it actually starts from quite different positions. What you've got though is very well informed and very smart people in the room then and the task is to how do you move those positions together so that you can meet in the middle and often at the very end you've still got a gap and that's where you start to move away from the building block model and you get to a situation of actually making trade-offs to say, "What's important to you but maybe less important to me that I'm prepared to trade" versus "What's important to me and less important for you that you might be prepared to trade" and you get to that final conclusion. But it's two parties working on actually getting to the right answer.

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The great concern for me around negotiate-arbitrate is it's a different game completely. To stare into that and say okay, knowing that you're going to potentially go to arbitration and a very low effort to get to arbitration, who is going to move towards the middle to only then be arbitrated between that position and follow a resting point. And in fact your resources, those great resources, that great knowledge, the people with skin in the game will get very, very, focused on actually their starting position and arguing for their position in arbitration rather than actually being at the (indistinct) of the problem so now all of a sudden the adjudicator is lumped with making all of those trade-offs, all of those concessions, because the parties actually are starting with, "How do I maximise my position going into arbitration?" not, "How do I solve this problem?" and that becomes (indistinct) and I can give you an example. I did witness this a little bit in the UK when I worked there and I was on the other side of the fence of the airlines.

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It ultimately doesn't work for all of the parties unless - it's very hard to work for all the parties. What happened there was, they actually did have some very good techniques around consultation in the early part of the process so through the (indistinct) the players. But you knew that you were always going to end up in front of a regulator in that case, at the tail end of it, so you never gave away too much, you never really sought the balance - you actually just worked up to make sure your position was one you could defend in that regulatory test at the final end of the game and it does influence behaviours. So I stare into this and say, "Why are some people proponents for this?" and I'm not sure I can figure that out.

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5 My suspicion is that some parties, some clever parties, stare into this and
say, "In that world...", if you use the term "gaming" involved and how to
play it, some people might believe that they can play it better than others
and therefore win in that process and it's the only reason I can understand
why it would be desirable because the risk of regulatory failure is huge.
And by "regulatory failure" it means just a wrong decision when you're
trying to decide volumes, capital, operating expenses, and, you know, in a
messily complex world and I'm not sure how it works when you've got
10 other parties who are not in agreement that it's part of a network problem
that you're actually trying to solve.

15 **COMMISSIONER KING:** Sorry, just to clarify something that you
said. You used the word "gaming", what do you mean by "gaming"?

20 **MR STRAMBI:** Yes, well think about - I probably should use a different
term because actually "gaming" implies something negative. Businesses
and teams and management are paid to optimise an outcome, right, so if
your lens is, "How do I optimise the outcome?", I will make arguments to
optimise the outcome. And if that's what this process is all about, making
strong arguments to optimise your outcome, that's all you'll be focused on.
You won't turn those energies into, "How do we optimise a compromise
that actually works for everybody" and from what I've seen already
through this process, it's really interesting.

25 I don't see too many occasions where, you know, we work really hard and
it takes a long time to get the parties to this final point of actually
resolution and it does feel like at the moment nobody walks away - you
don't walk away in a scene where everybody walks away happy. What it
30 tends to be is everybody walks away a little unhappy and probably that's
the best result that you can hope for because it's this massive balance in
compromise you actually have to achieve. Everybody, you know, kind of
walks away thinking, "I didn't quite get all I want" and that's probably the
right outcome actually.

35 **COMMISSIONER KING:** But you've said the current system works
and gets compromised on an outcome, the case before the Western
Australian Supreme Court between Perth and Qantas tends to suggest the
opposite. That's a situation where the parties have ended up before a
40 judge trying to work out differences and indeed to act as an arbiter on
what Qantas should be paying to Perth. So doesn't that run counter?

45 **MR STRAMBI:** No, no, it's a good question, Commissioner, but I think
there's an obvious answer to it which is: firstly, there has to be a pathway
as a last course of action and there are already in the current environment.

5 You can take court action, you can declare - you can seek declaration, you
can take those paths. I think the fundamental difference here between
even that action, I can't speak for Perth and I wouldn't dare to and I think a
good question to ask them, however putting myself into that place, you
say what you don't want is a system that makes that your first port of call
not your last port of call. Because, as I say, going to that there is a real
risk of regulatory error and I think all parties are staring into that now as
to what that error might be. And then you must think through, "And what
10 happens if this action becomes not just a once-off event but actually a
regular event?" and that's the danger here because you'll get learned
(indistinct) behaviour as a result of that.

15 So for example, let's say the arbitration has done something very simple
and it doesn't go the airport's way and actually let's say it gets a piece of
asset that it has to deliver at a poor return. You can live with that, right.
In the overall context it's not the be all and end all. The problem is
though, when you go for the next round of a conversation around
something, that is going to change your thinking going in there and it's
also - if you think about it as a management team going to their board
20 saying, "Well, we didn't get a great return on that and in fact we are
actually now (indistinct)", whatever the outcome that you might not like,
whatever it is.

25 You then say to the board, "But we're going to go forward with another
thing", well then clearly they're going to say, "Well, is that really, really,
worthwhile taking that risk?" and this is the danger is that this (indistinct)
but I think that fundamental difference is you have got the mechanisms
today. They're there but they're rarely, rarely, used. I would say they're
only used in an extreme situation when everything else fails and that's
30 right because it's not the best process at the end of the day, much better if
the smart parties in the room were actually reaching that combined
outcome and conclusion.

35 **COMMISSIONER LINDWALL:** When you have negotiate-arbitrate
and you compare it with a status quo, would you posit, speculate here
I guess, would you lead to less investment and more congestion or more
investment and less congestion to compared to the status quo? Is it
possible it can see more investments than you would have currently
planned?

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MR STRAMBI: More?

COMMISSIONER LINDWALL: Yes.

MR STRAMBI: It's an interesting - the thing is any of these variables can go in its direction but let's - and it is nothing more than hypothetical. A regulator might be inclined on the basis - I'm not sure who they're decided for so I'm just going put that caveat out there because who's
5 bringing the arbitration and what's the nature of the arbitration that it actually represents? Because it might be one topic for the one airline but it actually might have community interest. Let's go to the extreme and say they're there for the community interest, then it might actually lead to - and who's the expert in the room? How does the arbiter decide what is the
10 right level of capacity to introduce given the passenger volume coming out to the airport but it's complex, it's really complex. Because every airport in every case is going to be different, every asset's going to be different.

15 This ten per cent growth rate doesn't mean a ten per cent growth in gates. Maybe in one airport, yes, maybe in another airport, no, because of a whole lot of different factors in here: the aircraft size, how you utilise (indistinct) all sorts of things. So we're going to ask an arbiter to decide that or adjudicate it to decide it. I think that's why regulation in this space
20 wasn't the best answer in the first place because you've got people making decisions that probably lead to, "Well, what's in the national interest", "Well, let's have a Taj Mahal" because that will present our nation better to the world, is that the right thing to have? But it could go the other way so I'm not - this is the danger, I think it could go anyway, maybe not the
25 right way, it may result in regulatory failure - - -

COMMISSIONER LINDWALL: (Indistinct) negotiate-arbitrate (indistinct)?

30 **COMMISSIONER KING:** (Indistinct) land side?

COMMISSIONER LINDWALL: Yes, go onto land side, yes.

COMMISSIONER KING: So just some of the issues with regards to
35 land side access. You said that it's driven by the need to effectively manage congestion. One of the things that stands out when you look at car parking prices, which are obviously a large media issue, when we do our comparison to other venues it seems, for example, the short term less than say three hours seems comparable with other venues but the at
40 terminal car parks, those day long charges so if you park there all day or park there for a couple of days at terminal on the drive up rates, they do seem to be out of line with what you'll get at other venues or equivalent, you know, places where you would have scarce parking so can you explain why they seem to be out of line or you may say they're not out of
45 line, but - - -

MS ARGUS: Yes, sure. We've done a fair amount of consumer research that says that that is the right price but taking your point, I think what we have to balance is occupancy and congestion. So you can imagine a world
5 where if we've got 23,000 car park bays and equally our competitors together have the same amount, if you had a price that was too competitive then you could imagine a world where you've got a queue of congestion and not enough car park bays to offer to that convenience traveller. The real challenge for us is to make sure that when you're a
10 drive up customer and you want to go to that convenience car park, there is an expectation that you have occupancy there for that customer driving up.

So we really balance the utilisation and the congestion as well as the right
15 price but when you compare - well, you can't really compare it to I've seen in the report around hospitals or even an entertainment location, because we work on a 24 hour basis so one day parking is in fact two days of parking because a one day price at \$51 means that if you come in at 9 am in that morning, you have that car park until 9 am the next morning and
20 that really means that the really early morning peak of meeters and greeters may miss out on that car parking bay.

So I think in the report, the Rod Laver example for me is an interesting
25 one because their one day parking is cheaper than their event parking but they're driven by a consumer result which is you're going there for an event so you will be there for three hours and you will pay your \$30. They may have a one day price that's more effective than that but there's no events there so therefore you might not be going there. And equally when you compare hospitals, I think it's about what drives that market so
30 their three hour price is very similar to their one day price which says to me they're maximising their market which is likely to be the three hour market. So I think it's quite difficult to compare.

COMMISSIONER KING: But I think in the opening comments it was
35 stated that the utilisation of car parks have gone down in the last 12 months. Doesn't that just indicate directly that your prices are too high?

MS ARGUS: Well, I think that we compete. So we compete with the
40 free public pick up and drop off as an example so you may choose to have a loved one drop you off and pick you up instead of park, you may choose a rideshare option, you may choose a bus option. So I think that our decline in parking performance is genuinely competition particularly when you look at we've reduced our prices by up to 20 per cent over the last 18 months particularly in that market because we heard from that consumer
45 that they thought that price was not competitive enough. But ultimately

there is multiple choices for one day parking including the long term car park which, yes it has been named "long term car park" but you can park there for \$25 for a day and still walk with close proximity to the terminal.

5 **COMMISSIONER KING:** So you've argued it's competition and part of
the competition is I think, again, in the opening comments it was
mentioned there was at least 15 off-airport car parks that are competitive
but you control a critical part of their price which is the price to pick up
and drop off passengers using their shuttle buses at the terminal. The off-
10 airport car park operators that raised concerns with us about the land side
access at Melbourne Airport, that the prices have gone up despite the fact
that the facilities haven't improved and surely there's, you know, just an
obvious competition problem when you control a direct cost of your
competitors, those same competitors who say are keeping you honest in
15 your car park.

MS ARGUS: I think if you look at our car parking, I think it's important
not to lose sight of the fact that we're only 13 per cent of the mode for
people's choice to get to that location and we compete with off-airport just
20 like we compete with our own car parking but I do think it is a different
product as well. So there is a convenience location car park as well as off-
airport decisions but if you look at the access fee, we attribute that equally
so - and including it's quite a small proportion of what your off-airport
would be charging, but we have communicated and consulted with all of
25 the bus industries.

I mean, there's over 300 companies that we work with at the airport, to
say, "Well, this is the cost of our capital and this is the cost of maintaining
those lanes, ensuring that they've got the security for congestion to keep
30 flow moving, ensuring public don't go into those areas", we've built up
and shown to that community, "Here is our proposal for what we're paying
in capital and operating costs which works into an access model for that
fee" and that's similar for all of those buses. So arguably it's not just for
the buses that we compete with, it's for all of the buses in that location that
35 would pay that access fee.

MR STRAMBI: It's a cheap shot too to say that we've not invested and
you'll be charging for things. You know, we've created a multi-modal
transport hub at terminal four which the ground floor is allocated to that
40 mode of transport largely. So that's not free, that's a big investment and
it's an investment in a competitor's product. But that's not what's driving
us, what's driving us is actually access to the airport because throughput at
the airport is really important. There's no point having an airport that can
grow to 60-70,000,000 passengers in the next 20 years if nobody can get
45 there; that's the bigger drive actually and also the criticism we get for

congestion is the forecourt, means we do have to make lots of investments and lots of tweaking.

5 Now, for example, at the moment we've just invested in millions of dollars' worth of dynamic signage to try and optimise the use of that particular space. Now, if we were minded to boost the car park, we'd spend that \$6m or more on the car park not on that forecourt, we'd make it even more congested. Our actions show that we're actually trying to deliver a better product for all of the different segments because it's
10 actually important for the overall working of the airport. There's no point optimising a car park business if your airport fails and that's the thing that really drives us and I think that's why we're very much in line with the traveller interest here. You know, our business is really linked to the success and the volume of travellers coming through here and nothing we should do should constrain that. So if you're not behaving well in the car parking space, (indistinct) so if you're not behaving in the (indistinct) access space to (indistinct) your car park up, then you're potentially
15 risking airport throughput and that's silly economically.

20 **COMMISSIONER LINDWALL:** Can I move onto quality of service and that was an example of it but obviously you have a lot of range of customers from passengers to retail clients, airlines and so forth; what type of measures do you have to try and give yourself an incentive to improve the quality over time and meet your customer expectations better
25 in contracts, for example?

MS ARGUS: So on the land access side, I think there's - we use the same quality measures that we use for aeronautical which Lyell can touch on through the aeronautical agreements but equally we do the same land side
30 so we have regular quality and mystery shoppers, we look at the cleanliness of it, is it intuitive to get through the experience, in particular to Lyell's point on congestion, we measure everything from throughput to access to cleanliness to safety and security and those are measured on a regular basis as well as net promoter score for our direct customer
35 relationship with our parking and then there's the aeronautical agreements.

MR STRAMBI: And talking more broadly about quality across the airport, I mean, this is a conundrum which is also part of that commercial consultation we actually have with our partners at the airport. And again
40 it's complex because it's different people at the table here but let's talk about the airline piece of it. It's an important part of the conversation and you are dealing with partners who might have very different views on what quality actually is and this is one of the dilemmas you have here. One of the challenges we have as the airport is we are often the last person
45 to blame when things go wrong.

I had a problem with Melbourne Airport. I didn't have a problem with an airline at the airport, I had a problem with Melbourne Airport. So you've got this incredible balancing that you're trying to do which is you have to facilitate your customers and I understand this very well, you know, given again my history, that we'd have to enable them to be able to differentiate their product and find a sweet spot in the market that works for them so we have to be able to give that flexibility and at the same time there are others who are saying, "We want absolutely the lowest possible cost here, hang the quality" because you'll get blamed for it, Melbourne Airport.

And we have a live example of that at the moment. You know, we don't always get it right but please - you know, I think the system works very well but we don't always get it right and we're always looking for ways to improve that. When we were designing terminal four, and I would argue as a low fares terminal experience, it is a great experience but it was designed with travelators to take people out to the more distant gates. A certain airline, remember these are our customers who I'm talking about here, certainly one felt that that was not needed. You know, it didn't match their business model because customers want the lowest price and we listened to them and we took those travelators out but not only that, we also took the structure out of the building to produce the lowest cost building and now we, Melbourne Airport, get the complaint that says, "It's a long walk down to those gates" and I think we got it wrong. I actually think we got it wrong in that particular case.

And so there's always this trade-off. You do have to listen to your customer, there's no doubt about that because at the end of the day their business model is reliant on being able to square the circle in terms of incomes and expenditures. But the challenging bit is this: what is the baseline? What is the right baseline and that's a role that we have to play, I think, as an airport. This is not about gold plating. This is about where that right lower level actually is and the thing that does motivate us enormously is the pressure that we get, the brand damage that happens to us when we don't get that right.

COMMISSIONER KING: Can I say it is a long way.

MR STRAMBI: And the facts are that for those particular customers, if you actually measure the distance of what they were travelling previously, it's the same distance but it doesn't matter, it's a long corridor and it feels long and these are - no, I'm not arguing your point. I said at the start we got it wrong, right, we should have put a travelator in.

COMMISSIONER KING: Nothing's ever (indistinct), yes.

MR STRAMBI: But again though, that discussion, that debate, Your Honour, it might have actually brought us to a slightly different answer so, let's be smart. Now, what we're doing halfway down the way to actually
5 make it a relief for passengers on the way, you can find different answers here but gee, you're going to have a world where an adjudicator's trying to decide these things, I just struggle to see how it's going to work.

COMMISSIONER LINDWALL: As long as you don't put in an extra
10 type of diagram that makes it look like they're forever walking. Could I ask about, because we're running out of time, jet fuel. You've announced or you've moved towards more of an open access for the jet fuel JUHI at Melbourne Airport. How has that gone and has it been manifested with new interest in trying to enter the JUHI?

MR STRAMBI: So again just to be clear here, our role in the provision
15 of aviation fuel was actually a relatively small one. We lease the land on which those facilities are built. We don't own them, we don't control and we don't operate them but we had a problem. We had a problem where
20 there was a constraint of supply in fuel at Melbourne Airport and there were very difficult access provisions, or very little opportunity for new access to those facilities. So in renewing those land leases, we argued for and got better contractual arrangements around those things. So, for
25 example, open access: other companies can actually now come and apply to use that facility which is great; another company can come along and bolt a new pipe into that facility which is great. So we kind of created that framework.

I think at the moment there are other problems we were trying to solve in
30 terms of storage on site and reliability and throughput challenges and I think they're now coming to fruition and looking really good but I think on that access piece, the real question there is, I think it's a bit too early to call, the challenge I think in that JUHI space is there are a number of
35 players in that market but they are really different competitors - I'm trying to think of the right word, they're not on an even playing field even with the existing operators because unless you can give access to the pipes that feed that facility, you're bringing your fuel by road, of course your costs are higher than a pipeline cost, you know, so even that's not great. We'd love to see that improved but we'd also like to see the opportunity if
40 someone's interested.

Now, we've had a number of people express interest. At this stage, as
I said, it's too early to call whether those changes there will work because
45 this is a much bigger problem when you're trying to address the fuel market because it's not just the access at the airport, it's all the other pieces

upstream that you've got to get right as well and we can influence but our role is quite small as I say.

5 **COMMISSIONER LINDWALL:** Do you have any final questions?
Well, I think given the time, Lyell, we might have to end it there. Thank you.

MR STRAMBI: Thank you.

10 **MS ARGUS:** Thank you.

COMMISSIONER LINDWALL: Now, I'm trying to fix this up because we're getting that echo in here. It might be the microphone.

15 **MR STRAMBI:** It might have been me moving that microphone forward.

MS ARGUS: No, I don't think so.

20 **COMMISSIONER LINDWALL:** Now, we'll call on A4ANZ, we've got Graeme and an Alison. So welcome and if you could just introduce yourselves and perhaps give a statement.

25 **PROF SAMUEL:** I'm Graeme Samuel, Chairman of Airlines for Australia and New Zealand.

30 **DR ROBERTS:** Alison Roberts, CEO of Airlines for Australia and New Zealand although we might variously be known as "bluster and noise", I'm not sure to use Lyell's point, who's bluster and who's noise but we can work that out at the end. Thank you very much, Commissioners, for the opportunity to present. I do want to open by saying that the tone of the responses from A4ANZ to this draft report is not one that we'd hoped to adopt when we commence the process. We'd hope for a constructive process, a debate of ideas and key policy questions.

35
40 Some other stakeholders have approached us, you know, from other airport users to politicians, regulatory, legal and economic experts, have expressed to us a view that any further engagement in this process seemed futile and many were completely discouraged from responding to the report or attending hearings. And I think it has to be said that this is an extremely damaging outcome from a public policy perspective and we're quite sure not one that you would have intended. Obviously we are engaged and as you've seen we've decided to provide a strong response and this is in the interests of continuing our contribution to the

formulation of evidence informed policy. We don't pretend to speak for all but offer our comments today for your consideration.

5 When making any decision but particularly when considering big policy questions, there's a tendency towards what's called "status quo bias". As the name suggests this phenomenon is where decision makers stick with or defend what is known. Once made policies frequently persist and are often viewed as a success by evaluators even if they were measured through say as a cost benefit test that was applied to a new policy, they
10 would have little chance of passing.

There's also another type of bias known as confirmation bias and that is those who hold a particular position seek out and give greater credibility to those who support or share the same views. Now, advocacy groups
15 have been known to do this from time to time and we'll cop that but the PC is not an advocacy group. Our assessment is that this draft report, the commentary that's followed, some of the nature of the questions at the public hearings thus far are indicative of both sorts of bias. Now, why we're talking about this? Because these biases have the effect of
20 diminishing independent thought, proper appraisal of evidence and the search for truth. In other words, their presence makes it hard for the Commission to do its job given that your duty is to "*use the best available evidence and the most rigorous analytical techniques to reach its conclusion*", that's from your report.

25 But most importantly the reason we're talking about this is, as you've heard loud and clear, many of us, both within and outside the sector, were genuinely perplexed by this report and by your comments. We sought to understand how the PC could have arrived at these conclusions? What was
30 influencing the processes in thinking? We don't accept it was laziness, as I think someone suggested on Tuesday, and we know it's not a lack of intellectual ability. We wanted to give words to an explanation for the collective scratching of heads and the general "what-the" that followed the report's release.

35 Many other submissions coming from a range of interest groups all shared the same theme and we've seen it now coming up on the PC website. It's perhaps best summed up by a quote from one of them. It said, "*We were hoping for an in depth analytical forensic assessment of the practices adopted by these airports and their customers based on actual experience and with real data*". That is not what collectively we got and it should
40 give the Commission cause to reflect, as Qantas said on Tuesday, that the only people congratulating you on the quality of the draft report are the airports. So we offer this as a genuine reflection of what we think has
45 happened and we share it so that Commissioners and the staff might

reflect on this perspective in the hope that these biases will have no place in the formation of the final report.

5 We think also that this failure of process comes from the Commission's explicit decision to adopt what you've terms a "philosophical perspective" in undertaking this review. We would ask, "Is that the role of the Productivity Commission?" Sure, as Commissioner King highlighted on Tuesday, there are philosophical differences between regulators on whether a sector should be regulated only if market power is shown to be
10 exercised or the alternate view, whether they should be regulated simply because they have market power to protect society from its potential abuse. But an independent body like the PC should not be taking a philosophical position. Surely if the Commission accepts that there are different positions out there, different positions put by different regulators,
15 it's in your court to weigh up the relative merits of both otherwise it leaves the Commission vulnerable to the very types of bias I've just outlined.

We believe that this has led the Commission to firstly, seek out and treat more favourably any submissions and expert views that are sympathetic to
20 this perspective and to not undertake an economic analysis of the current regime. The draft report doesn't consider the costs of administering the current regime or assess a cost benefit ratio. There's no gap analysis, no comparison of the existing regime to others and there's very little reference to other reviews that have taken a look at this kind of thing. We
25 also think it's led the Commission to ignore other reviews and assessments dating back to the Hilmer review in 1993 which all reached the conclusion that: yes, regulation is necessary for monopoly assets. It would seem that at some point, Commissioner King, you also shared this view in that piece that you authored for the Conversation in 2014 which was titled, "A
30 privatised monopoly is still a monopoly, and consumers pay the price", you said:

If competition is not possible then the privatised business needs to be regulated so that it cannot exploit its market power

35 We also believe it's led the Commission to describe the prospect of airport regulation in the absence of more evidence of market power exercise as unfair. Naturally, the airports agree. The Sydney Airport CEO on Tuesday argued that any change to the regime was unnecessary as
40 "airlines can more than stand up for themselves in negotiations" and this is a similar sentiment we heard this morning from Melbourne Airport and by Canberra Airport on Monday. That may be a genuine perception of the airports but let's not forget that those comments are made from the position of privilege, that being a monopolist affords them. It's been said
45 that to those in a position of privilege, equality can feel like oppression. Is

that why the airports are describing the proposal for negotiate-arbitrate as unnecessary and unfair? Because it seems, and we've heard from them, they seem blind to the fact that when they turn up to a negotiating table, the bargaining power is significantly uneven. No one can argue that the bargaining power of a monopolist is not greater than their opponent who's operating in a competitive market.

If the conditions and charges are as reasonable as the airports describe, what are they so afraid of? Perhaps the Commissioners might consider putting that question to the AAA and other airports yet to present. It's rather extreme, and certainly to consumers, to hear proposals for access to dispute resolution mechanisms through arbitration only in the case of intractable disputes remember, described as "unfair" or judging the airports as "Guilty until proven innocent" but it's of even more concern to us that these are words used by Commissioners. No one is being punished here. This is not a case of saying everyone's guilty. As Commissioner Lindwall has said, the gas pipelines have had just one case referred for arbitration in 20 months. Have the 50 plus monopoly gas pipeline operators all been treated unfairly because users have access to arbitration if negotiations don't work out?

I can tell you that the Australian Energy Regulator doesn't think so, the ACCC doesn't think so, Dr Michael Vertigan didn't think so when he recommended the framework designed after extensive consultation and review of alternatives. All of the State and Territory governments didn't think so when COAG adopted the framework. The Federal Minister at the time, now our treasurer, didn't think so when he announced the framework. And finally, the Australian Energy Market Commission didn't think so when it conducted a 273 page review of the scheme nearly a year into its operation. But the PC disagree. Just why, has not been made clear to us. Where is the review of different regulatory options like the one Dr Vertigan undertook over a similar timeframe to this inquiry or the one that the Energy Market Commission undertook last year?

Their terms of reference, if you have a look, were very similar to the PC's. They had to take into account the exercise of market power and long term interests of consumers and like the PC they were expected by government to provide independent assessment informed by best available evidence. But a quick at the consultation questions they asked shows what at different conversation we might all be having today if a similarly rigorous approach had been taken here.

To be crystal clear, nobody, not the ACCC, not A4ANZ, has suggested that we simply parachute the gas pipeline framework into the airport sector. Nor the UK model, which is quite different where you've got the

5 arbitrator sitting in the room, we recognise the obvious differences in the
markets. It's called a "sector specific scheme" for a reason. But here's
where we've got to get real: are the objections to a negotiate-arbitrate
regime for airports based on reality? When airport representatives were
asked about this in Sydney on Tuesday and again today, they cite gaming,
inexpert arbitrators, competition, multiple airlines, as reasons it would be
no good. But no one's actually backed that up with actual evidence or
even reference to situations from other sectors where this has occurred.
Just that we should avoid it "just in case".

10 Surely these claims are worthy of further scrutiny and surely it's worth
looking at the Vertigan review which considered questions about gaming
and investment incentives. These were raised in that review. They
undertook a significant consultation on this. In response, investment
analysts found that the framework did not fundamentally alter investment
cases. The review also identified that gaming could be an issue where
there was information asymmetry but this was addressed through the
guidelines which specifically talk about how to address that information
asymmetry. There was and is nothing to stop the PC from seeking these
same inputs in your review given that those same concerns are again being
raised but without substance. And if the PC objects to looking at other
sectors, perhaps it might be useful to look back at the Australian
Competition Tribunal's final ruling when Sydney Airport's air-side
services were declared in 2005. So this is an airport-specific example.

25 Refusing to recognise these spurious arguments about the risks presented
by arbitration and in response to Greg Houston's submission on behalf of
Sydney Airport, Justice Goldberg said:

30 *We consider Mr Houston's analysis to be of little probative
value. It is speculative and based on a number of assumptions
that will not necessarily be valid at any given point of time.
Much would depend upon the nature of the dispute and the
extent to which there had been negotiations to resolve the
dispute. Any estimate of such costs, particularly where
arbitration is not inevitable, is speculative in the extreme. It
should also be remembered that the legislation anticipates a
speedy and cost efficient arbitration.*

40 So given that this inquiry is not yet completed and we're still discussing a
draft with requests for more evidence but much of the evidence having
been ignored, it is deeply concerning that in a speech last week to
Infrastructure Partnerships Australia, Commission Lindwall made the
rather conclusive statement that a negotiate-arbitrate regime for airports
would, and I quote:

Profoundly change the way in which contracts are negotiated between airports and airlines, disrupt investment and harm the community

5

It does make us wonder if Commissioners are really open to listening in these hearings. Even the CEO of Melbourne Airport said this morning that these concerns were nothing more than hypothetical. It will be up to the government to determine if the PC has fulfilled its obligations in undertaking this review so far. We clearly do not believe it has but this information is all out there and there is still time before the final report is due. I'll hand over to Graeme now.

PROF SAMUEL: I want to get to the heart of the issue and that is the choices available to the Commission to resolve what is clearly a difference of option between the airports and/or their users or their customers. And the choice is this: we already have a monitoring regime. As Commissioner King and I will both agree on this issue, the monitoring regime is virtually useless. Commissioner King and I attended a meeting of regulators within the ACCC several years ago and a presentation was made by an economist and the last slide was the most telling one when it said:

Monitoring is a heavy handed regulatory process that has no other purpose than to serve the political process or the political purpose and objective, of being seen to be doing something

And that was the view that was put and was accepted by every regulator within the ACCC at the time because that's what monitoring does. Monitoring just simply looks at what has happened in the past, provides information. One airport, traditionally it's always been Sydney airport, has objected to some of the monitoring reports, unless it's a good one, but ultimately what happens is that within 24 hours it's vanished into the ether and no one takes any notice of it. So monitoring is a basically useless practice and we know it, and Commissioner King and I know it and we've agreed on that in the past.

And so what we have is a monitoring regime. What's the other choice? It's negotiate-arbitrate. Negotiate-arbitrate is not in fact a regulatory process. It's a normal commercial process. In fact we have already, in relation to airports and airlines and other users, a negotiate-arbitrate process, it's already there. It's called the courts. And Perth Airport, in its action against Qantas Airlines group, has already got - has already started to exercise the negotiate-arbitrate process in respect of the arrangements, the agreements between Perth Airport and Qantas, and the judge there has

been asked to opine on the reasonable prices that should be charged to the Qantas Airline group from July 2018 in respect of airport services. That's in the statement of claim. That's the negotiate-arbitrate processes there at the moment. I'll call that the "litigation process".

5

Now, it's very interesting. On Tuesday when the questions were being asked of Sydney Airport - and I have to say that I was very, very, disappointed in the process that occurred Tuesday because the questions that were asked were questions that led the person being asked to give a standard stock answer of a vested interest and I'm sitting there thinking, "Now, the next question is surely going to be...", and it never happened. And Commissioner King and I are well used to this process because both of us have sat on two inquiries, groceries and petrol, and we knew that we were being giving a stock standard vested interest answer.

15

The next thing you do is start an inquisition. You'd actually start delving deeper and asking deeper questions and so when, for example, the Sydney Airport CEO, Geoff Culbert, said that he didn't like negotiate-arbitrate because arbitration was subject to gaming. I'm waiting for the next question which thankfully, and I do thank Commissioner King that he asked Lyell Strambi the next question, "What do you mean by gaming?" and although the answer from Lyell Strambi was not terribly satisfactory in informing on that, there was no answer from Geoff Culbert because he wasn't even asked what he meant by "gaming".

25

COMMISSIONER LINDWALL: Correction, we did ask about gaming. I think you'll find it if you check the transcript.

30

PROF SAMUEL: No, in fact what you asked was about gaming in negotiations and he never even suggested that there was gaming negotiations.

35

COMMISSIONER LINDWALL: Let's not argue. The transcript will determine who's correct.

40

PROF SAMUEL: Yes. Anyway, and there were a whole series of questions that were asked. There was a standard answer that was given and then there was no further interrogation so what are we looking at here? We already have negotiate-arbitrate. We have a litigation process that's there by a judge who would not, I think, claim to be an expert in aviation or an expert in airports or the various intricate or complex issues that Lyell Strambi has talked of this morning, he would not claim to be an expert in setting regulatory prices but he's been asked to do all of that as part of the litigation process. What are your other choices? Well, there are two. One is to say that what we ought to do is to give any party the

45

5 chance to be able to refer an intractable dispute, such as appears to have occurred in Perth, to a commercial arbitration. Now, that's one choice that's open, you've rejected it. But then what you've said is, "Well, there is another choice" and the other choice is to go through Part IIIA declaration process.

10 **COMMISSIONER LINDWALL:** Excuse me, Graeme. You've used 15 minutes so far and I did say at the beginning there'd be about five minutes, so (indistinct).

15 **COMMISSIONER KING:** Well, it just means that you can't ask as many questions.

20 **PROF SAMUEL:** Yes, you'll have plenty of time for questions. I think the fact that we actually represent airlines that use about 80 per cent of the capacity of the airports means that we've got a bit to say and we're quite happy to take the questions. But let me just simply say this: so the issue of commercial arbitration is one choice you've rejected, you've said use Part IIIA. We've already provided advice from Michael O'Bryan QC, now a justice of the Federal Court, and recommendations from the National Competition Council which say Part IIIA is no longer available in these circumstances following the amendments made to Part IIIA in November 2017.

25 However, it's very interesting. You recommend that Part IIIA ought to be a process that's exercised. Where does Part IIIA lead you? Actually to an negotiate-arbitrate outcome except the ACCC becomes the arbitrator. Now, both the ACCC and A4ANZ and other parties have said, "We want to go with negotiate-arbitrate but we don't think it needs to be done by the ACCC. It can be done by a proper expert commercial arbitrator who's got expertise in the area, he's selected for that reason. Set process timelines, which are very, very clear.

35 Timelines that say that the arbitration should be completed in the following process that can enable the arbitration to be completed, the only one occurred with the gas framework in four months, not four years, as may well occur with a litigation process. And has guidelines or directions as to the matters to be taken into account including enhancing competition, taking account of the interests of consumers, and importantly as occurs in every arbitration, taking account of prospective CapEx investment, the sort of things frankly that Lyell might have well found had operated to his benefit if there'd been a debate between airlines and airports about whether there should have been travelators put in to cover the 500 metres between terminal buildings -with terminal four.

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5 So we say take your choice. Your choice is there at the moment which is litigation arbitration, time consuming, costly, unproductive, can take many, many years and clearly has the hangover of great uncertainty until the outcome is determined not by the single judge and not by the appeal judge or judges but ultimately potentially by the High Court of Australia after up to six years as we experienced in the Sydney Airport access position; that's one choice. Another choice is Part IIIA and if you want to go Part IIIA then again expect a similar sort of process that occurred with Sydney Airport and Virgin back in the early part of the naughties which went on for six years and the then chair of Sydney Airport said, "Frankly, I could run this on for 12 years if I wanted to". Now, in the end they gave up and ultimately an agreement was reached, as Commissioner King knows because he was involved in it, on literally the eve of the ACCC about to present an arbitrated outcome in respect of the landing charges applicable to Qantas and to Virgin at Sydney Airport.

20 So there was very good evidence of where the negotiate-arbitrate process led to an agreement that ultimately was reached between the parties. It was the threat of the arbitrator that caused the difficulty. So what we say is, "Okay, Part IIIA, you say we should do that" rather than go through a 6-12 year process of trying to figure out whether Part IIIA still applies contrary to the advice that's been given by Michael O'Bryan, now Justice Michael O'Bryan, and the NCC, deemed declaration, if you like, deemed declaration in respect of airports and say, "Okay, we'll deem the declaration, then the negotiate-arbitrate process under the Competition and Consumer Act will apply.

30 But the much simpler process would be simply to say: where an intractable dispute exists between an airport and the users of the airport service, that dispute can be referred by any part to commercial arbitration subject to the following directions as to the matters to be taken into account and subject of course ultimately to the process of guidelines and directions that were set by the arbitrator.

35 **COMMISSIONER LINDWALL:** Well, I don't think - yes, the echo. Someone might have dialled in. I don't think we're going to respond to every one of those examples of verballing and also they've a lot of assertions there, but we do have a number of questions that I think we need to ask. In particular, I mean the status quo bias that Alison mentioned - I mean, the way the PC always thinks about this is this is where we are, we only move somewhere else if there's a net benefit to do so to the community and we take it very seriously on that. I think we need to talk about specifically what you mean by negotiate-arbitrate in a "practical" sense because airports are quite different to many other forms of business like gas pipelines, there are many users.

For example, A4ANZ has spoken a lot about car parking and yet I can't see that a car park user would resort to negotiate-arbitrate so (indistinct) does it rely on airlines to look after the interests of car park users? I mean, how exactly would negotiate-arbitrate be implemented and don't try and pretend that it's costless. Everything that is introduced, it's mandatory so it's like it's a new regulation, it has benefits and costs. We need to ascertain whether the benefits are more than the costs, it's as simple as that.

10

DR ROBERTS: I mean, just on that issue of costs and your opening comment about taking seriously you know that there's going to be a net benefit, it also ought to surely be compared when you're talking about a "net" benefit to the costs of the existing system and what's going on currently and I guess - - -

15

COMMISSIONER LINDWALL: We are where we are. Everything's from - no, nothing can start from - that's what net benefits - it's always from where you are, you can't go back to 100 years ago.

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DR ROBERTS: Sure but the question is whether it's fit for purpose in a current environment and I guess if you have a look at these other reviews and the way they've looked at things, they've also weighed up the benefits and risks and downfalls of existing regimes and that was simply my point, just to clarify.

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PROF SAMUEL: Negotiate-arbitrate, you pick the one area where negotiate-arbitrate can't operate and that is car parking and car parking ultimately, if there is a continued view amongst consumers and amongst parliamentarians that car parking charges are too high, we can get to a debate about that but I won't because it's not an airline issue. Then, yes frankly that may have to be the subject of regulation and Parliament will do that if that's what (indistinct). It's been always the hot issue as far as consumers are concerned. Negotiate-arbitrate works, and you know it because I've described Perth is a very good example but I won't get into too much of it because obviously it's subject to litigation at the moment. The parties negotiate, they negotiate until they get to a position of an intractable dispute.

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At the present time the only way that a dispute like that can be referred to arbitration is by the agreement of both parties and Sydney Airport talked about mediation, mediation is a different thing, Mediation, we all know that, you know, where parties are brought in to see if we can't get some agreement, but in the end they said it's not binding. Of course it's not because mediation or conciliation is where you try to get the parties to

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agree and it fails. What happens after that? Well, then you've got a problem. You've got an intractable dispute. What does the Competition and Consumer Act say in the event of a, for example, a declaration where any one party notifies the ACCC that there is a dispute, an intractable
5 dispute, then the ACCC can be called in to actually arbitrate and the ACCC then steps in and starts through an arbitration process.

How can it be gamed? Well, the best ways of gaming is what invariably happens, and will happen in negotiations as well, is that one party puts in
10 a bid or an offer like that, another party puts in an offer like that, then the arbitrator's got to sit there and say, "Well, I better start from the beginning and see if I can't work out what is the appropriate process". The process that's been adopted in Canada and the United States and has rarely been done in Australia is what's known as last offer or final offer arbitration
15 which is where the arbitrator says, "I'm not going to put up with gaming. I'm saying to the two parties give us your final offer, give me your final offer, and I will look at those and I will take one or other offer".

Now, of course what that does is it forces the parties to come to what they
20 would perceive to be a reasonable position and then the arbitrator will make a choice of one or other. Of course what that invariably does is it says to the parties, "You better reach an agreement because you're going to come so close together in terms of a reasonable outcome in terms of your final offer" but gaming won't be part of the process. Now, what of
25 course it also does is it makes it much easier for the arbitrator to reach a final decision. The arbitrator should be able to do two things: (indistinct) set process guidelines. You have 30 days to put in your final offer. I have 60 days to look at those final offers and reach a determination. If I request material from you it should be provided in 30 days and then I will reach
30 my decision within four months. That's the timeline factor. No judge will do that, not with the process of appeals et cetera.

And then the other thing is that the guidelines that are set for the
35 arbitrator, the directions that are given to the arbitrator, say, "You must take into account enhancing competition. You must take into account future investments", that's a standard process for arbitration anyway, "You must take into account the interests of consumers. You must take into account a whole range of different factors and they're all put there". Now,
40 that's all part of the process. It's part of the process that doubtless will occur in Perth versus Qantas Airline Group but that will be a long, tedious, complex, costly, litigation process to ultimately get the material before the courts for a single judge who would, I suggest, claim no specific expertise in this area to try and reach a decision as to what are reasonable prices for the charging of aeronautical services by Perth
45 Airport to Qantas Airline Group.

5 **COMMISSIONER LINDWALL:** Would you agree that in much of this time, airlines and airports have similar objectives and similar ways of thinking of things? There's a lot of common interest but they diverge in a couple of areas. One being an airport will have an incentive to try and grow its capacity to bring in new airlines. Incumbent airlines will try and resist that. If you take that, you might say that there would be an incentive by airlines, incumbent airlines, to try and restrict a new investment at an airport and therefore they would go to negotiate-arbitrate and use that to reduce that level of investment. Now, Frontier Economics did a study of Heathrow which found that when there is congestion, the rents from which went to airlines through higher fares. You've claimed, which we might be persuaded, we're open on this, that negotiate-arbitrate would lead to lower fares. Could it not lead to higher congestion and higher fares?

15 **PROF SAMUEL:** (Indistinct) not the arbitrator is required to take all those issues into account in determining what's appropriate. I refer to the matter that Lyell Strambi raised before. Now, maybe an arbitrator may have looked at all that and said, "I hear the airline's view. I hear the airport's view", actually Lyell Strambi said himself, "We made a mistake" about travelators. In the interests of consumers which I'm bound to take into account, I'm saying to you that a 500 metre walk is too long and put in a travelator. The travelator and the CapEx investment ought to be made or alternatively if it's a third runway or whatever it might be, they're the sort of factors they'll take into account yet arbitrators are skilled at looking at all these factors and taking all of them into account and it may well be that there will be circumstances where the views expressed by airlines in their own interests, are not necessarily of the view that ultimately is determined by the arbitrator.

20 **COMMISSIONER LINDWALL:** Sorry can I get you to clarify it please.

25 **COMMISSIONER KING:** Because you have said, as I understand it, that A4ANZ supports final offer arbitration. The sort of decision you've just come up with where, for example, the airport says, "No travelators" and the airline says, "No travelators", the arbitrator under final offer arbitration cannot say there will be travelators so I'm now - - -

30 **PROF SAMUEL:** No sorry, Commissioner. No, what I was suggesting was that the airport says, "We really did need there to be travelators", the airline is saying - - -

35 **COMMISSIONER KING:** No, no, but take the example because we had a live example where the airline and the airport both put the positions

and you've said the arbitrator has to act in the consumer interest, I'm not sure how that gets put to the arbitrator unless there is consumer representatives but let's not go down that path yet, and in final offer you can't have three things unless there's another consumer group coming up with another offer, I don't understand how the final offer arbitration, they could come up with a solution that isn't part of either offer?

PROF SAMUEL: Look, you're absolutely right. One would expect though in those circumstances, and I don't want to presume what Mr Strambi would have done in those circumstances, but one would expect that he would say, "Look, I sincerely believe travelators are necessary". The airlines say, "We don't think they are". The final offers have travelators and no travelators and ultimately the arbitrator reached a conclusion but let me emphasise this: final offer is but one of the processes of arbitration that we've suggested. It's not the only one. There are a whole range of different ways.

The ACCC has the discretion at the moment, for example, in arbitration to set whatever guidelines it wants, whether it wants final offer, it might say, "We want final offer but in doing so we reserve the right to deal with the interests of consumers" or "We reserve the right to deal with the issue of competition that would take us outside what the two final offers have provided". That's the beauty of arbitration, is that you've actually got that flexibility for the arbitrator to be able to do that and the guidelines or the directions that can be given to the arbitrator can say, "You can conduct your arbitration whichever way you want but above all you must account of enhancing competition, the interests of consumers, and taking into account the issue of capital investment. That's the arbitrator's determination.

DR ROBERTS: And the gas code and the accompanying guidelines do deal with that issue so they talk about the use of different types of arbitration based on the complexities and the multiple factors that are involved so they do - - -

COMMISSIONER LINDWALL: But isn't that the nature of commercial agreements as they stand, that the two parties put their position and they reach an agreement, they have reached agreements, and you haven't shown a problem yet that requires a solution.

PROF SAMUEL: Well, hold on when you say we - - -

DR ROBERTS: I think we have shown a problem.

COMMISSIONER LINDWALL: No, you made a number of assertions.

5 **PROF SAMUEL:** No, no, there's not an assertion. Perth Airport is one where an agreement hasn't been reached.

COMMISSIONER LINDWALL: Correct, yes.

10 **PROF SAMUEL:** I don't quite - you might well ask Mr Strambi whether have been reached in respect to Melbourne Airport and, you know, the services agreements there so don't assume and don't make an assertion that agreements have been reached (indistinct) as Sydney Airport said that the last set of agreements were made in 2015, I suggest you might well want to ask Perth Airport, and I have no knowledge now about what the
15 position - - -

COMMISSIONER LINDWALL: I understand there have been three agreements that have been concluded since our draft report has been released.

20 **PROF SAMUEL:** I don't know.

DR ROBERTS: That's (indistinct). But I mean, the other thing is to say we're just asserting it, you have numerous submissions including
25 confidential ones because of the nature of what was involved, that point to the challenges and the problems in the negotiation process and the protracted nature.

COMMISSIONER LINDWALL: Correct, (indistinct) protracted.

30 **DR ROBERTS:** And the things that are included in there so we see lots of inclusions of non-aeronautical things in aeronautical charges. Just last night I had emailed to me an example from one of our member airlines of one particular airport, of a range being given for a capital project ranging
35 from \$83m to \$127m, 'details will be provided after you sign'. That's while this Productivity Commission process is going on so if you're asking us for evidence of a problem, I think we have more than provided that and if you look through all of the submissions, including the confidential ones, there are - - -

40 **COMMISSIONER LINDWALL:** But it has to be more than evidence of a problem. There has to be evidence that the problem is so great that the net cost or the net benefit of going to a new system like negotiate-arbitrate would outweigh that.

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DR ROBERTS: But has that been measured?

5 **COMMISSIONER KING:** Yes, has that been measured because in a sense that's what I would like to spend the remaining time on which is exploring negotiate-arbitrate in trying to understand the benefits and the costs a bit better and because there's no point quite frankly, in the Productivity Commission putting a theoretical principle to the government and saying, "Let's go down negotiate-arbitrate" unless we have worked out those costs and benefits and that is the exercise we're engaged in.

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DR ROBERTS: Understood and that's what the Vertigan review did.

15 **COMMISSIONER KING:** And to do that you have to work on the practical aspects. So, for example, I understand one of the submissions that has come in post-draft has suggested that there should be a regulatory return on capital that is set for any arbitration. Is that the position of A4ANZ that there should in a sense be some - maybe the ACCC, maybe another body, but they say a fair rate of return or reasonable rate of return on airports if X per cent.

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PROF SAMUEL: I have to say I am sympathetic with the view that you expressed on Tuesday that this is not a thing that the government needs to get intimately or intricately involved in. If the ACCC is the arbitrator, it ultimately sets the WACC, it sets the rate of return. If there's a commercial arbitrator, the commercial arbitrator would do that according to the relevant circumstances at the time which will take into account the risks, you know, associated for example with investment, factors such as that but you will know the issues in setting the rates of return. Look, from my own part I think if you've got a commercial arbitrator, then what it does is it puts it into the hands of the parties and the commercial arbitrator to resolve the intractable dispute.

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COMMISSIONER KING: Can I just then follow-up on that. Let's say there's an investment that is being considered in the arbitration, a new investment, but that investment will involve common use of facilities. So there's the airport, the airline, that are having the dispute but there is also another airline out there. Should that airline, that other airline which will be affected by the investment, should they automatically be included in the arbitration or should they not be included?

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PROF SAMUEL: Well, they won't necessarily be included in the arbitration but the arbitrator I think would clearly take it upon himself or herself to actually enquire of the other airline whether they have views to express as equally they'll take into account the views of consumers. They'll take the views of potential new entrants into the market. That's the

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5 issue of competition, that's the issue of taking into account consumers. In terms of investment there may well be that the arbitrator says, 'I want not just the view of the airport as to costs of the investment, I want the view of others. I want to understand what the real efficient cost of the investment might be'.

10 There'll be other issues such as, "When do the users of the capital investment start to get an economic return?" and that will also be taken into account as part of the process. So effectively you will have multiple airlines - I mean, they've got to be at the table whether officially at the table or whether the arbiter says, "We need the input of multiple airlines to be able to make a sensible decision".

15 **DR ROBERTS:** Yes. In order for them to take account of the, you know, the competitive outcomes, yes.

20 **COMMISSIONER KING:** Other parties that may be affected by investment decisions so, for example, if it's a terminal decision, there's the airlines, there's the retailers that operate in the common user facility. Those retailers, are they also at the bargaining table?

25 **PROF SAMUEL:** Well, frankly the retailers as a collective group if they were to get together collectively, might well have another issue on arbitration in terms of their rentals and the like. But again, they would be part - you see, we're giving you the detail of arbitration. Arbitration - - -

COMMISSIONER KING: I'm trying to work out if it will work, that's the - - -

30 **PROF SAMUEL:** Yes, yes, well but - - -

DR ROBERTS: But isn't it the same processes under Part IIIA? I mean, if you were take this to its natural conclusion, wouldn't it be the same process that an arbitrator who was making an arbitration under Part IIIA, say it was - - -

COMMISSIONER LINDWALL: You've have to meet a hurdle first.

40 **DR ROBERTS:** Yes, yes.

COMMISSIONER LINDWALL: Which the NCC has given the submission to us they were being reasonable in the circumstance.

45 **DR ROBERTS:** Yes, okay, just assuming though because you're asking - - -

PROF SAMUEL: No, that's the declaration, that's the declaration.

DR ROBERTS: Yes.

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PROF SAMUEL: We're not talking about a declaration at the moment, that's the Part IIIA declaration issue which the NCC has got jurisdiction over. Let's jump over that - - -

10 **COMMISSIONER KING:** Yes, let's say it's been declared and - - -

DR ROBERTS: Yes because you're asking about the arbitration process that - - -

15 **COMMISSIONER KING:** Yes and the answer from the arbitration perspective is that the declaration is for particular services and there are very strict rules about investment, particularly on the basis that, and there is an assumption in Part IIIA, that - well, they're a statement in Part IIIA, that an existing user cannot be required to pay the cost of any investments
20 required by another party. So I think there is a legitimate argument that you're putting up there, is whether Part IIIA is appropriate for common user facilities and I think that's an interesting point. But if you're putting up as an alternative negotiate-arbitrate and you're saying that Part IIIA doesn't work for common user terminals nor does negotiate-arbitrate so
25 you may have a great argument against Part IIIA but I can't see how you've (indistinct) but negotiate-arbitrate (indistinct).

PROF SAMUEL: No but forgive me, forgive me. The choice is
30 litigation arbitration, all right. There are no rules. That's Perth Airport. The second one is commercial arbitration where you can set the rules, they have to be taken into account. The third is Part IIIA which we've said frankly on all the legal advice we've got, it doesn't apply anymore. It's no longer available because you can't get declaration. If you had declaration
35 then you are bound by the Part IIIA requirements in respect of negotiate-arbitrate by the ACCC.

COMMISSIONER KING: But I want to discuss your proposal though rather than the alternatives.

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PROF SAMUEL: All right, our proposal is to say litigation is there, right. Any person exercising normal common sense would say that's not the most efficient means. Part IIIA we put aside because we don't think it's available in fact our advice is it's not. So we look at commercial
45 arbitration, then you're asking, "How do you structure a commercial

arbitration?", right, and what we've said is, "Well, the beauty of commercial arbitration is you've got total flexibility as to what you can build into it or not and then it's a question of how much, if you like, how much envelope providing - envelope edging you want to provide to the commercial arbitration and that involves, you know, and we've suggested two or three issues.

It involves setting criteria that say you must look at competition, you must take account of the interests of the consumers, you must take account of investment that is required to satisfy the issues of competition and consumers. And then it must take account of other affected third parties. There are all those factors you take into account but that doesn't make the arbitration any more costly or complex. What it really says is, "That's the way you make the arbitration work to (indistinct)".

COMMISSIONER KING: Can I come back. Again, I still can't see exactly how we have (indistinct) and all the other airlines involved in the negotiation if they're affected? Maybe that can be overcome. Can I come back to say an investment example. So let's say that there's a dispute about an investment. The airport says they need a hurdle rate of return - let's say it's 15 per cent, let's say it's quite a high rate, they think that's necessary for the risk. The arbiter says that this investment needs to go ahead and the rate of return will be ten per cent. So you would then see that the airport would have to make that investment, they would be forced to make that investment to meet the arbiter's decision?

PROF SAMUEL: Well, what we've got is we'll have, you know, two proposals put in; one by the airport and one by the airline. It may well be that the result of the arbitration, as Mr Strambi has indicated, is that the Airport Board says, "Well, look we're not going proceed with that investment", right, so be it. Then it will be a matter of the parties sitting down and saying, "Well, hold on. You said you were going to proceed with the investment, you wanted a 15 per cent rate of return, the arbitrator has said 10 per cent. Well, that's clearly not going to work. Well, we better start sitting you down and seeing, you know, what we can deal with in terms of rates of return and the need for the investment. The airlines might well say the investment is not going to occur. The airport might say it's not going to occur or alternatively they might say, "Well, we better have a look at this in another way to see whether we can make - - -

COMMISSIONER KING: So the arbiter's decision isn't binding. It may lead simply to further negotiations.

PROF SAMUEL: No, the arbitrator's decision as to prices will be binding but the arbitrator can't be in a position where it says, "I require you to make an investment".

5 **DR ROBERTS:** I mean, that's not the case in any arbitrations

COMMISSIONER KING: So let's say that the arbiter has made a decision about an investment, the airport is going ahead with that investment, it's on particular passenger forecasts. Those forecasts are not
10 met, those forecasts have been put forward by the airline possibly in good faith, who bears the risk of the passengers? At the moment it would be the airport but given that the airline has put forward those forecasts, should it be the airline that bears the risk?

15 **PROF SAMUEL:** Well, that's - - -

DR ROBERTS: Is that assumption actually correct though that they bear all the risk in the agreements, I don't know.

20 **PROF SAMUEL:** As I understand it that's the case for most of the agreements, yes, I can't be sure but it's in all of the agreements, so that's my understanding.

COMMISSIONER KING: Sorry, who bears the risk?

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DR ROBERTS: That the airport bears all the risk.

PROF SAMUEL: Yes but that's part of a process, isn't it, at the moment. It (indistinct).

30

COMMISSIONER KING: No but again I'm just trying to understand, under your solution the arbiter has certain information provided to be (indistinct) and to give the example, you know that in, for example, electricity transmission investments where the regulator says there are
35 certain demand forecasts that underpin an investment. If those demand forecasts are later shown to be incorrect then the regulated asset can say, "Well, we didn't make as much money. We need to make it up next period". Your arbiter is in a similar position where the arbitration is based on passenger forecasts provided by the airlines because they're the ones
40 with the information, if they are not proven to be correct who bears the risk? (Indistinct) say, "Well, you didn't make the expected return. The arbiter said 10 per cent and you only made 8 so therefore we must be allowed to make 12 next time and the arbiter says, "Yes, that's fine".

DR ROBERTS: To be clear, this solution as you're calling it, our solution, is also something that's been proposed by the ACCC. We haven't just plucked it out of thin air. It also exists as a solution in the gas code but part of the solution is actually that these types of schemes
5 discourage the seeking of the arbitration and that has been borne out since the gas code came in. It also has been borne out in other sectors that use these types of schemes, is that it actually drives parties to reach agreements but I'll park that, I just - - -

10 **COMMISSIONER KING:** As agreed under Part IIIA with Tiger and Melbourne Airport but - - -

DR ROBERTS: Well, Tiger withdrew that application but anyway - - -

15 **COMMISSIONER KING:** Yes, after they reached an agreement but can - sorry, can I just have an answer to that question.

PROF SAMUEL: Because what you've got this is, and forgive me but the airlines don't on their own make assessments of passenger growth or
20 whatever it might be, airports will make their own assessments of those and there may well be some debate or dispute about that because that will impact on the timing, for example, of building a new terminal facility, the timing of building new runways and the like, but let's assume that the airports and the airlines reach a decision where they don't agree on
25 passenger growth and the airport then says, "All right, here's the deal. We'll build this runway or we'll build this terminal facility based on your projections but in the event that your projections prove to be wrong, there's going to be an adjustment".

30 An arbitrator will look at that surely and say, "Well, that's the way it ought to be" or in the alternative, and you talked about the electricity transmission light, alternatively what then happens is in the second five year agreement, or whatever it might be because most of these agreements are five year agreements, the arbitrator says, "The airport actually had a
35 lower rate of return than what was appropriate" and arbitrated upon in the first five years, that's got to be made up on the second five years. That's all part of the arbitration process.

40 **COMMISSIONER KING:** So an arbitrator now can make binding decisions on a future arbitrator?

PROF SAMUEL: No, no, I didn't say that. I said what the arbitrator did - - -

COMMISSIONER KING: No, because if it goes back in five years to a different arbitrator - - -

5 **PROF SAMUEL:** Yes and the different arbitrator will then have one of the factors to be put to them will be that the airport will say, "We were last time arbitrated, determined by arbitration, a 10 per cent rate of return". It turned out that it was 8 per cent only because the airlines projection of passenger growth wasn't met, right, and that wasn't adjusted through the period of the five years of that first agreement and therefore, and this is
10 the proposition that would be put by the airport, "Mr Arbitrator, we want you to take that into account in this second five years".

DR ROBERTS: It would be part of their justification for the pricing.

15 **COMMISSIONER KING:** Can I do one more, or?

COMMISSIONER LINDWALL: One more, yes.

20 **COMMISSIONER KING:** All right. And again, so you've got the risk in the second arbitration feeding into the rate of return in the first which is interesting. But an airport wants to make an investment. Currently there are no disputes and the airport wants to go ahead and make that investment but it knows it's doing it again. Let's say it's a - I can't remember what I used before whether it was a 15 per cent hurdle rate, it
25 believes that that will be a relevant investment but it (indistinct) the services involved in that investment may be subject to future arbitration so a risk to the airport in currently, you know, building those facilities is that the prices that will lead to a rate of return, an appropriate rate of return, in its view are subject to potential future arbitration.

30 How does the airport then take that risk? Does that mean that the risk that the airport needs to take into account is such that the hurdle rate has to go up to 20 per cent or can the airport, in a sense, approach an arbiter and say, "Well, look these are the prices we need for this long term 30 year
35 investment", or whatever it is, "So can we have those built in today?" So is there, in a sense, a forced upfront arbitration negotiation process before - because to reduce the risk of future arbitration, just again, how does that work? And again I'll run the gas pipeline or the transmission network approach, what happens there is the people doing the investment go and
40 see the regulator and say, "Please approve this investment" and say that it's an appropriate investment and therefore we'll get the appropriate rate of return before we do it and that's the standard approach that occurs by default in these situations. So I assume that's not what you want so how would it actually work?

45

PROF SAMUEL: Well, I'm a bit bemused you asked that question because you've conducted a few arbitrations back at the ACCC yourself so you know how these things work.

5 **COMMISSIONER KING:** I think there's only ever been one Part IIIA application.

PROF SAMUEL: I'm not talking about just Part IIIA applications and the like, all of which have got long life in terms of the investment itself.
10 So there have been a number of arbitrations that you've been involved in as I have and of course these are all factors - you know, the fact that these agreements are five year agreements doesn't mean that what is done is that rates of return are set only on a five year basis lifetime of the investment if the investment has got a 30 year lifetime of (indistinct) and
15 so they are the matters that were taken into account by you and by me and others in terms of the ACCC telecommunications. The one arbitration we actually never finally reached which was the Virgin Sydney Airport, (indistinct) Sydney Airport arbitration because they reached an agreement on the 11th hour but they're all the factors that are taken into account by a
20 commercial arbitrator. There's nothing magic in it. It's nothing terribly impossible. It's the sort of thing the ACCC has been doing for years.

COMMISSIONER LINDWALL: It's very easy to say something is simple but I think we've decided at this stage that we need to move on to
25 another group but there is a complex situation. Airports are quite different to moving gas molecules. If you want to give some more thought and perhaps give us another submission about the practicalities of negotiate-arbitrate I think we'd welcome that.

30 **COMMISSIONER KING:** And I must say I'm impressed, Graeme, that at your time as chair of the ACCC, you thought telecommunication regulation was simple.

PROF SAMUEL: But I did think that telecommunications arbitration in
35 the end resulted in what we - - -

COMMISSIONER KING: Thank you, Graeme and Alison.

40 **DR ROBERTS:** Thank you.

COMMISSIONER LINDWALL: Thank you.

DR ROBERTS: Thank you, Paul.
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COMMISSIONER LINDWALL: Thank you, Graeme.

PROF SAMUEL: Righto.

5 **COMMISSIONER LINDWALL:** I'd now like to welcome the AAA and then we'll have - and sorry for being a bit late but we might have to eat into our morning tea to some extent, we'll see how we go. I'm sure people are not too keen to have the instant coffee of PC.

10 **COMMISSIONER KING:** Which is why we want the 15 minutes to duck downstairs and get the decent stuff.

COMMISSIONER LINDWALL: Well, if you could just introduce yourselves and give a statement. Trying to keep it within five or so
15 minutes would be preferable.

MR THOMPSON: Equal time would be reasonable wouldn't it, Commissioner?

20 **COMMISSIONER LINDWALL:** Yes, it's up to you.

COMMISSIONER KING: It just means there's less questions and we can't get through all the issues (indistinct) so it's in - - -

25 **COMMISSIONER LINDWALL:** It's in your hands how much you would like for issues to be explored.

MR THOMPSON: Fantastic. So, thank you. Guy Thompson, Chairman of the Australian Airports Association and I have with me Dr Warren
30 Mundy who is the Chief Economist for the Australian Airports Association. Conscious of time and certainly pleased to leave sufficient time for questions, I'm quite comfortable to ensure the Commissioners have what they need. But some very basic facts around the AAA. Founded in 1982 as the voice for Australian airports. We currently
35 represent in excess of 340 airports around Australia and some 160 members that are in the corporate space that provide services to the aviation airport sector.

We are pleased to be here to answer questions and provide further
40 information for the Commission in its inquiry. We acknowledge and are pleased with the findings that the monitored airports, the Commission found in the draft report that the monitored airports have not abused their market power to the detriment of the community and strongly support the recommendation for continuation of the existing regulatory regime for
45 those monitored airports. The Commission is correct in its assessment

that with the exception of the four largest airports in the country, airports do not possess significant market power to warrant any form of regulation.

5 We do, however, recognise concerns raised during the inquiry and remain
keen to work with airlines, the Department and all the other stakeholders
to find pragmatic and cost effective ways to improve outcomes for the
industry as a whole. We're also very pleased that the Commission has
recognised the very difficult financial position that regional airports find
10 themselves in. We find that the funding gap for essential infrastructure in
that space in 2016 figures was in the region of \$170m combined across the
country and that is just stuff to ensure the airports can continue to operate
and service their communities.

15 We think that the solution to the funding gap and we have been
advocating the government, in fact both sides of politics, around the need
for some form of funding but we recognise and in fact agree with the
Commissioner's observations that any funding provided in that space in a
grant sense ought have a robust business case that demonstrates the
20 benefits and the costs associated with the spending of any money in the
public purse. So I think that's all I will say. I will hand over to Dr Mundy
who I know has got a few things he would like to outline and then we're
happy to take your questions, Commissioners.

DR MUNDY: I say this not to seek to curry favour but as somebody who
25 has been an active participant in the proceedings of this Commission
since June 2001 when Commissioner Byron conducted the Prices
Surveillance Act inquiry and having served six years as a member of the
Commission I have to say that, in the broad, the conduct we've seen from
the domestic airlines in questioning the integrity, the motivation, and the
30 competence of the Commission is in my experience unprecedented and it
is unfortunate, I think, that this has occurred and people have tried to,
I think, politicise the proceedings in the Commission in a way that we
didn't even see when tariff reform was a live issue. So I just make those
observations to start.

35 I think it's also quite peculiar the claims that are being made, that the
Commission has ignored the evidence of experts put to it. It seems to me,
particularly in relation to the analysis of Frontier Economics, the
Commission has given it some extensive consideration and quite frankly
40 has found it wanting. Now, I don't want to go through the Frontier
Economics analysis because we are pretty comfortable with the
Commission's analysis and it looks pretty much like what we thought of it.
But it's equally fair to say that significant expert evidence from competent
international experts has been put to the Commission by ourselves.

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Greg Houston, as you know, was one of the leading expert economic evidence providers in this country and indeed it's the fact that Greg provided advice to Qantas in its submission to this Commission in 2006. Mike Tretheway who is the principal economist of InterVISTAS is actually cited in the most recent submission from A4ANZ for his 2007 work about elasticities work he did for IATA and indeed Mike has provided advice on competition pricing matters to the majority of A4ANZ's members at various points in the past and it's interesting to note Michael, who has helped us form our views about the appropriateness of final offer arbitration, probably has conducted more final offer arbitrations in Canada than any other person. So we come to this and the last point I would make is now legal advice, I have read at length the legal advice that has been provided by A4ANZ. We have provided legal advice from Simon Uthmeyer who acts for the ACCC in the Port of Newcastle arbitration and who acted for the National Competition Council when the Virgin Blue declaration was before both the tribunal and the Federal Court.

So we come to this matter with experts, everyone's got them. The question for the Commission is to examine that evidence and weigh it up. So we think the Commission has looked at the evidence, formed its own view, and applied, and I think this is an important issue, has applied the test that the government has determined certainly in relation to returns. It is patently clear that the pricing principles lead the Commission when assessing whether excess returns have been earned in the aeronautical business to look at pre-tax returns on tangible assets having applied the line in the sand methodology determined by Treasurer Costello at 2007. That's the test. Now, we provided evidence by HoustonKemp to that effect. The Commission, whilst not having determined what a reasonable return is, has formed the view that the returns are not excessive.

This furphy of we now must create a single till analysis, a debate which has been had in this country for a very long time and in fact was rejected on recommendation of the Prices Surveillance Authority when it reviewed the pricing of the FAC chaired then by Professor Fels has been a set piece and the Commission in 2002 made very clear that the sovereign risk issues of arbitrarily switching the character of the till. So the Commission has got that right. It has undertaken assessment, it's landed on the facts.

We note that that assessment on the basis of the test as set out in the pricing principles, is not challenged by the material that has been put by others to the Commission. Others say that there is an alternative test but our members having seen the test set down by the Commonwealth, have complied with it and it would simply be a great regulatory error to now say, "Regulation is required to be single till returns rather than dual till

returns are excessive". It's up to the Commission to form the view that the single till is a better way to think about these things and make that recommendation to Government but it is not right to ex post change the nature of the test.

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I'd like now probably to move on to the interesting question of negotiate-arbitrate. And again the outrage that has come in this matter, I find really quite surprising. The Commission has looked at an industry specific arbitration framework for airports on no less than five occasions before. Each of the previous airport's reviews considered this matter and so did both the reviews of the National Access Regime and therefore that the Commission might not fall now in a different place should not be surprising and the arguments that have been put really are not that different but I just think I want to - there are just some issues that have sort of come to my mind during the course of today which I'd just like to explore. It seems to be that the proposition is that any airport user can seek to have its dispute arbitrated. When you're driving to Melbourne Airport, on the right-hand side there's a Mercedes Benz dealership. Arguably this is an airport user.

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Now, this airport user could locate their Mercedes Benz dealership in Essendon say. They might even be able to find a bit of land about 400/500 metres back along the road that isn't on airport land. So what we're going to have, it seems to be proposed, is that this Mercedes Benz dealer will go and work out what the property market is in the general vicinity of north west Melbourne and all the sites will essentially be the same except one. That's the one where I can go and get my dispute arbitrated by the ACCC over what my rent should be. I think when you start to unbundle this, at least the scope of persons who arbitration should be available to needs some serious consideration.

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I am interested also in how an arbitrator is going to ascertain abuse of consumers. To the best of my knowledge there is no consumer group that the Commission could currently turn to about uses for Melbourne Airport. I think the Commission should validate that itself. The regulation in the energy sector has been problematic in trying to find a way that consumers can be given a voice in decisions around the setting of tariffs, both transmission and distribution. Progress has been made but it's been a long time coming and it's going to be a struggle to work that out.

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The other thing that is beginning to quite concern me is the ability of the arbitrator to intervene in what might be planning and design decisions which as a matter of law are rightly the purview of the Minister who was administering the Airports Act and that would need to be carefully considered. I think what also needs to be considered is that airports have a

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range of statutory duties which they must undertake and these duties from time to time bring them into conflict with airlines and other persons and that can range from safety issues, it can be issues about security of persons who may or may not be permitted at the airport, a whole range of matters.
5 Under the propositions that are being advanced it seems that all of those matters may be subject to dispute and in some final determination.

The last point I'd like to make is that I think there is a very, and I think you were getting to this Commissioners, is what happens to the other
10 parties who have an interest in investment and how that's resolved? And it seems to me that inevitably they must have the same rights in that arbitration as the disputing parties because if an outcome were to be such that the return on an investment were to be so low that it prohibited the meeting of other contractual obligations, this is going to become a very,
15 very, messy circumstance. I just make one other observation about the - as you were trying to get at, Commissioner King, the issue about over and under recoveries of returns. As you'd know the transmission code in fact doesn't work every five years. It tops you up and makes you whole every year.

20 The problem is with the thing of course, as you would know with transmission, is that the customers are there and they're pretty stable, we know where they are. But in an airport - I'm thinking particularly and let me give you a real life example of this: Mr Strambi's airport built a small
25 terminal to facilitate the entry of Impulse and an airline called Virgin Blue in about 2001. Melbourne Airport reached a price with Impulse Airlines uncontracted and proceeded on that basis to build that terminal to facilitate the entry of those two carriers. There was a dispute around the price of that terminal brought by then Virgin Blue and the price that Virgin Blue
30 was allowed access for was significantly lower and it subsequently transpired that Impulse Airlines exited the industry and Melbourne Airport experienced a significant reduction in its revenue for that terminal. It couldn't turn to Virgin Blue to make it whole.

35 You could perhaps consider it a more obscene example of what happened with the collapse of Ansett. And the fact that this sort of situation will exist is exactly the circumstance that Qantas has objected to pre financing of the new runway in Brisbane. Why should we pay for things that we mightn't ever use? What if - and international carriers may not be there.
40 So how this is made whole is very difficult. The simply reality is, is that airports bear volume risk. In the vast bulk of the agreements that have been written by Australian airports with airlines since the first one was written by Mr Strambi's company in 2002, have left the airports fully exposed to volume risks. That's the reason why, when you compare their

returns to say electricity transmission businesses. They are higher. So I think we'll just leave it at that.

5 **COMMISSIONER LINDWALL:** Can we start with the case before the Western Australian Supreme Court over Perth airport and comments you've heard earlier from A4ANZ that this showed that negotiate-arbitrate might have been a better solution rather than going to a Supreme Court for what looks like a negotiate-arbitrate in some form anyway.

10 **DR MUNDY:** Commissioners, I have to be careful about what I say - - -

COMMISSIONER LINDWALL: I understand that.

15 **DR MUNDY:** - - - about the litigation of Perth airport because I advise Perth Airport. But I make the more general observation. In the 20 years since privatisation, airport investors have been able to reach agreements with the airlines and others to underpin the investment in this industry that has enabled airlines to grow their businesses and has enabled airports to grow their businesses, that has facilitated the reduction in prices for
20 international carriage, arguably for domestic carriage depends on the time period.

But that has happened without this framework, other than the more distant framework of Part IIIA that is currently proposed. The fact that there is a
25 legal dispute is not – one dispute in 17 years is, in our view, not evidence that the system needs replacing, it's evidence that the rest of it has worked. And the vast bulk of disputes that arise, and certainly the vast bulk of agreements that exist between airports and airlines, have extensive dispute resolution procedures written into them anyway.

30 So the only issue that is really at large here are disputes about the formation of contracts because once a contract's formed – they're all modern commercial contracts, they all control dispute resolutions, and one would have thought that if there was a serious dispute within a contract, that is
35 absolutely a matter that should be resolved in a court under the normal contract law, not having some regulator who – I'm one of them in Queensland – may not be expert in resolving a question about contracts.

40 So all we're talking about here is the formation of contracts and as we increasingly get off a fixed term basis, all airlines have the same contracts, contracts are growing in length. The common length of contract now is probably longer than five years, these things start to overlap. So not everyone's forming contracts at the same time, so there's going to be this interaction of contracted rights, people who want to enter and the whole

thing is going to be not amenable to the sort of, you know, final (indistinct) arbitration system that is proposed.

5 I think there's two questions here. Question 1 that needs to be answered is, does there need to be an arbitration framework, and if so, how is it accessed? We say there's the courts. We say there's Part IIIA. We don't agree that access to Part IIIA is more difficult than it was when the tribunal declared Sydney airport. We say it is less difficult, and then there are other arrangements if the parties can agree to them, that you can have the matter commercial arbitrated under the relevant statute that exists in that state. So that's - - -

15 **COMMISSIONER LINDWALL:** Do you want to talk more about negotiate-arbitrate or do you want to - - -

COMMISSIONER KING: I want to move on to the commercial negotiation, the proposal that - - -

20 **COMMISSIONER LINDWALL:** All right. Let's move on.

COMMISSIONER KING: One role of these hearings are to explore the alternative ways that have been put forward by participants. One that has been put forward by the AAA together with BARA and Sydney airport is that the airports and airline stakeholders should work together to develop contracting and negotiating principles, at that point, it seems to me that seems innocuous. However, it's also proposed the Commonwealth government should work with those airports and airline stakeholders to develop these contracting and negotiating principles. Please tell me why is the government suddenly in here?

30 **DR MUNDY:** Well, I have to say this, with respect, Commissioner. I've worked with the Department of Infrastructure in the aviation sector for 20 years. I find them helpful. I find them thoughtful and they are able to sort their way through things. It may well be, it may well be that in the fullness of time the chief-executive officer of the AAA and the executive-director of BARA and some other people, can sit in a room and resolve these issues and maybe the Commonwealth doesn't need to be there. Maybe the industries can just sort them out.

40 But sometimes the presence of an interested but, if you like, interested but stakeless person in a room, can just help it through. It is nothing more than that. This is not a proposal for a memorandum of understanding. It is not a proposal for some sort of binding guideline. It is a proposal simply to move things forward and it is certainly not a cynical response as was described in Sydney on Tuesday. Our response is a recognition of

legitimate concerns raised by a major user group about matters that they wanted clarified and we thought those issues are important and they are fair enough.

5 What we didn't agree with BARA on was their mechanism for solving the problem. So what we're trying to do is – with respect, I think you are reading too much into this. Now, maybe I should have expressed it better.

10 **COMMISSIONER KING:** I may be reading too much into this but there is a long history in Australia of groups getting together under various guises, often before the current competition laws were put in place, and working against the public interest by doing such things as coming up with template contracts, particular pricing schemes and so on. I worry that this starts looking like a collusive device.

15 **DR MUNDY:** As you are well aware, the board of airline representatives is authorised by the ACCC to collectively bargain on behalf of its members. Our industry has consistently supported that because it brings benefits to our members and it brings members to the travelling public. This is really
20 just us saying "Let's sit down and talk about these things". BARA has in the past expressed concerns, for example that there are a range of boilerplate clauses in these agreements and I'll just – I have an agreement between a major international carrier and a major airport in front of me. I won't disclose who they are and I don't intend to table the document. It is not
25 necessary.

And these deal with such complex and competition imperative matters such as the service of notices. Dispute resolution clauses. The treatment of stamp duties. The application of the new tax system legislation in relation
30 to goods and services tax. And what happens from time to time is that the drafting of these things moves on, and it is quite annoying, I understand, for international carriers to have to confront this plethora of clauses which are pretty unimportant, but they all do the same thing, and it is my experience that the time – these sorts of matters take up quite a substantial amount of
35 time for their commercial worth and they cause a lot more grief on top of that.

40 So all we're saying, all we're saying is "Let's just have an understanding about where the drafting of these clauses are". This doesn't go to quality of service provision. It doesn't go to price. It doesn't go to rights of access. It's just a simple proposition to try and facilitate the bargaining and contracting processes. It is nothing more than that.

45 **COMMISSIONER KING:** I just want to make sure I understand the proposal because you keep mentioning BARA, and you've said that they are

authorised by the ACCC to act as a bargaining group which I don't know off the top of my head but I'll take that as being fact.

5 **DR MUNDY:** I think you might have authorised them once Commissioner.

COMMISSIONER KING: Possibly. Would you - - -

DR MUNDY: Maybe twice.

10 **COMMISSIONER KING:** I am not sure if I was the Commissioner. It depends if they came up twice in five years. Would you see this really being BARA and the airports or do you see BARA and Qantas and Virgin Australia as being all part of this group to be work out - - -

15 **DR MUNDY:** It would be all of them. Of course, BARA and Virgin are – Qantas and Virgin are members of BARA.

20 **COMMISSIONER KING:** I understand that, but would they have separate seats and would it be limited to international or go to domestic as well?

DR MUNDY: All the boilerplate clauses, the application of the Goods and Services Tax, all those things are the same for all of them. So yes.

25 **COMMISSIONER KING:** Okay. So how would – and again, I'm pressing you on this but again, we can't put what sounds like good ideas to the government unless we have explored "Are they workable and what are the costs and benefits" as being - - -

30 **DR MUNDY:** Obviously a new approach by the Commission but - - -

COMMISSIONER KING: Perhaps in your time.

DR MUNDY: And before.

35 **COMMISSIONER KING:** Sorry, now, I've completely lost my question after that.

DR MUNDY: I understand, it happens.

40 **COMMISSIONER KING:** No, I have completely lost my - - -

COMMISSIONER LINDWALL: Can we move on to a different topic?

45 **COMMISSIONER KING:** Please move on to a completely different - - -

DR MUNDY: Send me an email and we'll put the response on the record.

COMMISSIONER KING: Let's talk about the regional airports now.
5 Now, in a number of testimonies, say from Rex for example, they talk about
the concerns where the government gives a grant to an airport of an amount
of money for a new bit of infrastructure and then the airport or the council,
if you like, adds that value into the asset base and then depreciates it and
charges for that in landing fees, something which it actually receives as a
10 grant.

Would you agree that anything that's received as a grant from government
shouldn't be depreciated by local councils?

MR THOMPSON: So I think again that there are, in a general sense, the
15 funding of the asset comes via a variety of means. Often grants, and in fact
in most cases, grants are either multiple contributions or (indistinct)
contribution state, local government and Federal. I would say at the outset
that the issue in a general sense around Australia is a small one because
20 there just isn't enough grants available to fund regional infrastructure at
airports.

So I think working your way down a decision around how funding is
25 allocated, in most regional airports settings, the replacement of the assets
and the ongoing upkeep of the assets is where the cost of depreciation is
spent. It's lovely to get a grant, and in a lot of local government scenarios
not particularly airports, but in fact airports in a very general sense
regionally are under the ALOP and were given to local councils with an
amount of money and very aged assets and serviced a very different fleet
30 and a very different Australian network a very long time ago, and now don't
work properly anymore.

So the concept of being able to upgrade your assets and seek funding that
35 sees other than the local communities funding them, because our data
identifies that something like 45 per cent of the regional airports operate at
a loss. They can't cover the cost of operating facilities, let alone replacing
and upgrading the facilities, and the rules are the same. So the rule book
that comes from CASA about operating your airport says you'll have a
certain standard and if you don't, you can't fly planes there because it is
40 deemed not safe.

The cost of doing those works in regional areas is more difficult and harder
often, and the costs are higher. Grant funding is often the only path to
45 getting that solution. Now, at a fundamental level, how you then deal with
grant funding going into ongoing charging, I think, depends on the source,

5 the nature and the volume of the grant funding. I said earlier, we've said we think there is work to be done in that space. I don't reconcile from that. I think there is work to be done in that space. You can put an argument that if you've got some of the money gifted to you in a grant, why are you charging for it?

10 Well, the equal and other end of that argument is, "The money we are charging for is to enable us to have sufficient funds to operate it and then replace and maintain it as it goes". So it continues to serve the purpose. Often grants come with that as a requirement. You need to be able to maintain the asset to a certain standard.

COMMISSIONER LINDWALL: Of course.

15 **MR THOMPSON:** So I don't think there is one answer, but I don't think you can say you should never be allowed to put grant funding in your costs, and I don't think you can say you should automatically be able to put whatever funding you've got in.

20 **COMMISSIONER KING:** Would you see a benefit in having a coherent Federal, state organisation, if you like, or fund or something, which, as you say, cost benefit analysis for the regional airports? They come up with proposals. They work together. They finance them. Provide guidance on how it should be spent and then how it should be accounted for and so on, over time, including for the maintenance and operations of it?

25 **MR THOMPSON:** So I think the short answer to that is yes. The devil is then always in the detail of how do you make that work efficiently and effectively and not add a layer of operating costs and administrative stuff and reporting.

COMMISSIONER KING: Yes.

35 **MR THOMPSON:** But I think generally and under the guise of beggars really can't be choosers, to be perfectly honest whatever guidance came with an additional amount of money that came from Federal, state and allowed local governments to continue to fund their necessary infrastructure, would be welcomed. Not quite sure it gets to handcuffs in gaol and reporting every 15 minutes, we would hope not. But at this point of time, we nearly take anything, almost any set of guidance, because at the moment there is a void. There is not enough money there.

40 So it is hard for me to say would you not accept guidelines if money came with it? The answer is absolutely so and in fact, I think it is necessary with an industry this diverse and wide to actually have a pretty solid test. Can

you come up with a standards one that applies across the country? I think that would be a hard task, but I don't think that should stop you having a go at it.

5 **DR MUNDY:** Sorry, can I just answer? There's two issues here. There's one about appropriate funding mechanisms for regional airports and I think we all agree that Commonwealth money should be prudently spent. The question is, what are the relevant issues in the benefits test? I just make that observation.

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But the question you originally asked, Commissioner Lindwall was how should that relate to the setting of local prices? There is a body of regulatory precedent across particularly the state jurisdictional regulators about the treatment of gifted assets, and this sort of waddles and quacks a bit like that. But I'd make this observation. A council owned airport, the equity in that airport is owned by the ratepayers, whatever the equity is in them. It should be remunerated on a competitive neutrality basis on the same basis as the equity provided by someone like Cbus. Competitive neutrality tells us that the source of the equity should make no difference.

20

It is not clear to me, so therefore if council says "We need to spend \$15m on upgrading our terminal", let's just say that's a reasonable decision, council should be able to earn a normal return on that \$15m because otherwise it is in breach of its competitive neutrality obligations, I would say. So then the question comes along that says "Well, what if the Commonwealth gives the council that money for that purpose to be equity within that business?" It is not clear to me what the issue is here.

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The other point I make is that the funding of the infrastructure – and this is the position of the Commission as you'll recall, you and I sat on the public infrastructure inquiry – is that the source of the financing should not be the consideration. So the absurd observation to make in relation to your question is that if the proposition is that an airport funded by Commonwealth grants should not be able to earn a return on the assets that the grants support, would suggest to me that the Commonwealth should not charge for the use of Badgerys Creek when it opens.

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COMMISSIONER KING: Can I just follow up on regional airports? I don't know if you were present for the testimony of Rex in Sydney?

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DR MUNDY: No, we are aware of it.

COMMISSIONER KING: Okay. Rex – and I am going to paraphrase their position as I understand it, so please take it on that basis.

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DR MUNDY: Yes.

5 **COMMISSIONER KING:** I won't try and – and if Rex believes that I haven't got it right I would hope they tell me, but my understanding is that Rex felt that our draft recommendations, I think they're 10.6 and 10.7, provide a framework for a longer term solution of what they see as pricing issues at regional airports, but, and we had a short discussion about whether some pricing decisions at regional airports related to market power or incompetence.

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20 Regardless, and understanding the pressures that sometimes exist from local councils through their regional airports, the changes in state depreciation rules may feed through to local airports on islands, those sort of issues, Rex, in my opinion, had the view that whilst there may be a long-term solution, that still leaves them very exposed in the short term to situations where there may be completely uneconomic rises in price from their perspective. That leads to a lot of dispute and a lot of argy bargy is the term we use, very unproductive argy bargy on both sides, and you will be aware in certain situations there's been threats and actual situations where services have been withdrawn.

25 How do you see from the airports' perspective, and regional airports' perspective, how can that be addressed in the shorter term? Is there a - well, I'll put it in two bits. Is there a problem? You may not think there's a problem, but if there is a problem, how can that be addressed in the short term?

DR MUNDY: Can I just make first observations?

30 **COMMISSIONER LINDWALL:** Please.

35 **DR MUNDY:** It is generally promulgated guidance by most states that the trading activities of councils, and I've used the word trading very loosely, should achieve lower bound pricing. They don't earn a return on the capital but they should at least try to cover their depreciation. That to me, I think, is a non-contestable proposition if you understand how competitive neutrality has developed for councils in this regard.

40 The bulk of small regional airports don't cover their depreciation. It seems to me in some of these disputes, in particular King Island to look at, what King Island has I won't say has been told, but what they're trying to achieve is lower bound pricing based on some understanding of local government financing principles that prevail in Tasmania.

COMMISSIONER LINDWALL: That's what they told us when we spoke to them, yes.

5 **DR MUNDY:** Yes. So that, and for example, a lot of businesses in country Queensland, that is a direction, so this proposition about lower bound pricing is common as mud. The problem is, as Guy alluded to earlier, these businesses don't have enough cash, and in particularly in a small community like King Island, if the airport needs cash, council can only get it from two places, or three. It gets it from a government, it gets
10 it from the ratepayers, or it gets it by not doing something else, and the problem I see in this part of the issue in this, and particularly the proposition that a regulator should deal with this is that that regulator runs the risk of effectively suborning the fiscal decisions of elected councils because their resourcing is so - this commission has looked at the
15 economic viability of local government in the past and I don't imagine it's changed. So I think there is a real fiscal problem. To be frank, most councils set their aerodrome fees on the same way they set the dog catching fees. They just index it to CPI every year.

20 **COMMISSIONER LINDWALL:** Yes. Could I - sorry, go on. We're running out of time because we've got another person coming on teleconference so I've got one more question because you did say in your submission that you think there should be fewer of the PC reviewed durations or gaps should be logged, though. Is there anything - I mean,
25 does the reduce the credibility of it?

DR MUNDY: Your five yearly review is effectively a six-yearly review if you think about where the start and end dates are. Discussion has occurred in the past of a longer period. We, unlike Qantas, don't think
30 reviews should be abolished, and nor do we think that this matter should be put in the hands of Parliament. That, I don't think, would serve anyone's interest. My proposition was more that, what is the magic about five years. It was me more - we were more seeking an explanation of what's the reasoning rather than it should be 10. It's not a big issue of
35 dispute.

COMMISSIONER LINDWALL: That's all right. We'd better finish it there, so thank you very much, Guy and Warren.

40 **DR MUNDY:** Thank you.

MR THOMPSON: Thank you.

45 **COMMISSIONER LINDWALL:** Then have a quick cup of tea and then we'll continue, I think.

Our practical experience is that underlying market demand, will and does grow above airline capacity if we do not promote that airline capacity growth. This is particularly the case internationally where nearly 40 per cent of our customers looking to travel between South Australia and destinations overseas have to fly via another Australian airport first. When we negotiate with airlines, our objective entering these negotiations is to provide as much and as many operational options and flexibility as we can to ensure that we have a level playing field that can promote to all of our customers, while at the same time attempting tailoring bespoke arrangements for each of our unique airline customer needs.

In practice, during negotiations, we find ourselves constantly having to compromise on our objectives or otherwise unable to achieve them. This is because of the need to agree capital and capacity plans with airlines and there is the tension between what might serve the market as a whole and what might serve the individual commercial interests of each airline, and where the interests of encumbrance and competitors looking to grow do diverge.

As evidence of that, we have been unable to achieve our goals and that we have had payment withheld for a number of years as a result of these sorts of disagreements around where capital should be deployed and what our view of where it can be most effectively be deployed to benefit as many airlines as possible in order to continue to grow capacity.

In an international context we are competing with airports around Australia and Asia, if not globally. Every scheduling season we have potential airline customers tell us what they think that they could profitably grow from Adelaide, but they subsequently choose other destinations because they can make more money. For example, in the past years various airlines have stated that Adelaide Airport has come second or third behind destinations such as London, Madrid, Venice, Paris and other locations, Japanese, Chinese and South Korean cities in Asia, a number of North American cities in addition to all four major Australian airports and the major New Zealand airports.

I want to turn quickly to the topic of commercial agreements and consultation. Over time both consultation processes and commercial agreements have become more and more sophisticated. Increasingly our experience is that the commercial agreements reflect the deep mutual understanding of our airlines' needs and our investment requirements and service level expectations. Our approach is always to ensure that we engage in extensive consultation with airlines and other key stakeholders as early as possible in the process to ensure transparency and efficient

outcomes. This approach generally does result in sensible commercial outcomes for all parties including (indistinct).

5 For example, it's typical for our airline agreements to include service level agreements which includes targets and financial penalties, infrastructure plans which include capital expenditure envelopes, directional plans including specified projects, and consultation process for updating the plans, elements of operational plans such as gate allocations and commercial agreements in relation to some of the aviation related
10 services, and finally, an airport pricing including overall price path and incentive structures to encourage volume growth and efficiency improvements.

15 We take risk in relation to all of those areas, including risks related to traffic, aeronautical yield, expenses, capital expenditure and service level of commitments. It shouldn't come as any surprise that those agreements do take a long time to conclude and that they require the dedication of significant resources and that the negotiations are tough and challenging. This is the case and it should be the case as the stakes are high and the
20 outcomes of those negotiations impact our community as much as they do the airport and the airline involved.

Briefly turning to negotiate arbitration model, our view remains that due to the complexity of these contract commercial agreements and
25 consultation, and the strong interdependencies between the contracts with different airlines and other customers we simply do not understand how a negotiate-arbitrate model is practical and will advance the discussions in any meaningful way. We think it would create high risks for all parties and the broader community, and it's an unduly blunt instrument and we
30 think it undermines the benefit of bespoke commercial agreements that have been progressively evolving.

In relation to any competitive clause removal, we consider that the
35 Productivity Commission's draft recommendations to remove anti-competitive clauses in commercial aeronautical agreement may help. We say this because it's just not appropriate for the business and contractual terms of one customer to be brought into the room when considering the terms of an agreement with another customer.

40 Our view around landside access is that it is critically important to us that landside access is never, and should never be, a reason not to fly. We have, and we continue to work closely with our South Australian government to ensure that both off-airport and on-airport road infrastructure networks are development to meet the demands of both
45 passengers and freight. An integral part of our upcoming master plan

process is to agree a set of infrastructure principles with our state government.

5 By way of supporting travellers, Adelaide Airport doesn't charge access fees to public buses or shuttle buses used by off airport competitors, and we also look to ensure that the facilities for all of our public and private buses, our car parking, our taxis, and ride share operations are all broadly equivalent in terms of their convenience.

10 Our car-parking prices are set by competition from alternatives. In addition to off-airport carparks, public buses, taxis, drop off, pick up and ride share, we also have many passengers using informal, free onsite parking. In fact, I see every day people walking past our office to and from the terminal, using the informal free parking in areas around the
15 airport. So the economics of car parking can be – is more challenging than it might appear, and this is due to the need to provide capacity for the peak hour, and the relatively high cost of providing multistorey car parking spaces in premium locations.

20 So in terms of introductory remarks, commissioners, that's all I wanted to say upfront. We thank you for the opportunity, and I trust that those remarks have added to our original submission in terms of market power, commercial agreements, consultation, the negotiate/arbitrate model, any competitive clauses and landside access. Happy to hand back now and
25 take questions.

COMMISSIONER LINDWALL: Thank you very much, Mark. Could I ask about your terminal expansion plans? The Australian Airports Investors Group made a submission saying that Adelaide Airport
30 significantly descoped its plans because of - a major airline didn't agree to the plans. How has that affected your operations and costs, do you think, going forward, and your customers? How does it affect your customers?

MR YOUNG: It's true that we had a number of years of negotiation with
35 all of our airlines, domestic and international around a terminal expansion that we thought may provide in the longer term a more efficient facility over the long term. However, we accept the fact that dealing with our domestic airlines, that ultimately they had a different view about where our traffic would grow, how our traffic would grow from a domestic and
40 international point of view, and ultimately we have to accept that. They're our major customer, and they are the counterparty to any successful airport fee negotiation.

45 However, we have the need and we have progressed with a project that is designed around improving, substantially improving, our quality and

offering our customer experience service to our international airlines, and that's the project that we're getting on with.

5 **COMMISSIONER LINDWALL:** Okay. So does that not suggest that airline had a significant amount of countervailing power, because if you were able to build it as you originally planned and charged, they would have been forced to accept it, but clearly you've backed off that.

10 **MR YOUNG:** I'm not sure about the ability to force them – you know, charge and force them to pay. That's certainly not – in my experience, in 15 years of negotiating airline agreements, starting with the original terminal that's here now. I think we'd accept that we had a very robust interaction with our airlines and that the risks of not doing the expansion that we believe was the expansion required at that time, or could have
15 been a longer run, more efficient expansion, may still materialise depending on where the growth – where the view about growth might come from.

I think the best that can be said is we had a – we agreed to disagree. We
20 moved forward. We need to take control of our business. We cannot be kept in the spotlight where we are constrained in being able to improve our facilities and provide the best facilities that we can to the South Australian public, but also enable as many other airlines to get in and out of Adelaide as efficiently as possible. We had to move on the
25 international side of things. That's what we've done; it is what it is.

COMMISSIONER KING: Okay, now - - -

30 **COMMISSIONER LINDWALL:** Yes. Sorry, go on.

COMMISSIONER KING: Sorry, just to clarify some points there. You said it was a robust interaction, but am I right in just characterising it, there were differences of opinions between yourselves and the domestic airlines about future passenger growth, and that was really the source of
35 what you called a robust interaction, so it was really about forecast.

Did it go beyond that, or was it simply that the airport decided, well, we'll go with the airline's forecast and move ahead? What other action – why the term "robust", I guess is what I'm getting at.
40

MR YOUNG: Because of the fact that so many other factors also came into that consideration, i.e., where the terminal should expand, how it should expand, where the aprons should expand, how they should expand. One airline's view about where aprons should expand and why they should
45 expand that way versus the other end, another part of the terminal that in

our view may have suited a broader range of airlines. So there are - a number of considerations came into play. Then we also, we didn't even get to the point of having pricing discussions because we could not get to the point of agreeing the style and the scope and the timing of the expansion.

That said, the expansion that we are undertaking will be an extremely good expansion, and it will benefit all of the international airlines that operate here out of Adelaide. Some point down the track when we have to expand domestically, then we'll have to cross that bridge in terms of, where is the best place to expand the terminal or the aprons to accommodate what then hopefully may be an agreed position around where domestic growth is coming from.

COMMISSIONER KING: So again, just to clarify, did the airlines have a uniform position – the domestic airlines have a uniform position with a different view to Adelaide Airport, or did the domestic airlines themselves have differing opinions, for example, you mentioned where the aprons need to be expanded. Was it a case of – yes, please.

MR YOUNG: Pretty much had a standard view about traffic growth, but different views about how and where the terminal and the apron facilities should expand according to their own particular style of operation.

COMMISSIONER KING: So did it just all get too hard for the airport? That's sort of what I'm hearing.

MR YOUNG: No, not too hard. I mean we had a – we settled on a list of matters that we agreed to disagree on, and as a business, we had some other large issues that we had to resolve in terms of our international business, and we've moved on with that.

COMMISSIONER LINDWALL: Okay. You know that both BARA and the AAA have proposed effectively boilerplate contractual terms for airports and airlines to negotiate on. Do you think that would help your negotiation processes? Do you agree with that in principle?

MR COX: Yes. We've seen those proposals and spoken a lot with BARA about that, and actually the way that the AAA this morning characterised their desire to see those rolled out more is also what we've heard, in that when you're dealing with international counterparties that need approvals through multiple jurisdictions, I mean for us as an example, we're a very, very small part of their overall network, and even that would be the case in other ports around Australia.

They're looking at ways to simplify those negotiations from their perspective, rather than having to have bespoke negotiations with each individual airport around international terms of access. They are looking to sort of simplify it, and now we're open to entertaining that debate and don't necessarily have a firm view either way on that, and that's something that we hadn't had to go down the path of in the past, but we're open to that discussion with BARA invigilating that discussion, I guess.

COMMISSIONER LINDWALL: That was Brenton speaking, I assume.

MR COX: Yes, correct.

COMMISSIONER LINDWALL: Okay. Now Adelaide Airport also suggests that the development of service quality indicators for ACCC monitoring should be agreed between airlines and monitored airports, with the ACCC to build on the work if necessary. Do you think that this should be coordinated between airports, so that each airport has the same set of indicators?

MR COX: Well we think that given the pretty bespoke or unique nature of each airline - airport and airlines relationship according to the, you know, the city that it serves, that service level standards and the monitoring of those should be something that the airports and the airlines operating to those airports should be agreeing and monitoring.

COMMISSIONER LINDWALL: Yes.

MR COX: It is also probably worth an opening comment in the sense that most of the time, airports and airlines already have service qualities that they are monitoring together, they're actually is a starting point and a useful constructive base and that would feel like the most appropriate place to start as opposed to a clean slate from an external party. That's just at a practical perspective but in many respects, it's not really our position to be judging on all of that. As an example, we have really quite bespoke existing arrangements in place and we sort of think that if we were being subject to additional service quality monitoring, you'd want to make sure that they were useful and that all the parties involved at least at the starting point, thought they were useful. There's nothing stopping layering on additional service quality levels above that, that are already being used but just as a starting point, that was just a practical matter we thought would be sensible.

COMMISSIONER LINDWALL: Fair enough. Could I now move on to jet fuel, unless you've got some other issues, Stephen. We will talk

about jet fuel. You know that Melbourne Airport has moved to more of an open access scheme. Darwin is also buying back its joint facilities. Has Adelaide Airport considered changes to the current lease arrangements for the joint operated storage facility to improve competition of fuel supply to your airports?

MR YOUNG: Yeah, it is definitely a live subject and people often comment that if you strip away service quality, all you really need at an airport is a runway and jet fuel and at the moment, we're often in the situation where jet fuel access is held, controlled I guess, by a relatively concentrated group of people and that for competitors to access supply to an airport, they have to run through those competitors, so we sort of look at that and see the moves around the country and there is a sense that the previous system doesn't quite work and we are definitely interested and looking at opening up the access that we have at our airport. We are possibly in a slightly different situation to others in that we have no pipeline access but through our aeronautical agreements, the airport owns the (indistinct) so for us here, it's really the storage tanks that we're talking about that are held, what's really fuel companies. So there's a, I think, an acknowledgement that something does need to change there.

COMMISSIONER KING: Do you have enough supply certainty if you have expansions over time, to be confident that you won't have any outages or shortfalls?

MR YOUNG: No, that's part of the issue is that we only have two relatively small tanks. It's effectively (indistinct) only really a day-and-a-half of backup and then especially if there's supply issues down through the course and everything's coming by truck, they're really isn't much - we're definitely also in need of additional storage - at the moment it hasn't been coming because of some debates on tenure. So it's an area we need to improve on.

COMMISSIONER KING: Just to follow up on that, have you explored - given the need for additional storage, have you explored the possibility of bringing in a new fuel supplier to provide that storage?

MR YOUNG: We have - I mean the debate is a reasonable one here in that at the moment, because we're looking to explore different models, we haven't provided the existing fuel company incumbents with tenure and they, quite reasonably, desire tenure to invest in additional storage. So our focus at the moment has been to resolve that issue and what we're possibly looking at is, in collaboration with our airline customers, is taking responsibility for building that storage ourselves or through an expert. We have looked at alternatives for that.

COMMISSIONER KING: Okay. I have got one more question and that's about your submission, describing the effects of Sydney Airport's regulatory constraints on Adelaide. How often did delays affect Adelaide Airport due to constraints at Sydney and how long do these delays typically last?

MR YOUNG: It's - I mean there's the old saying, "If Sydney sneezes the network catches the cold" and it really is relatively ad hoc and it's difficult to say how regular it might occur. It could be for all sorts of reasons that are occurring over in Sydney but when it does occur - and what typically happens is that our aircraft are pushing back on time but then having to sit and idle on the tarmac and that creates I guess at times, additional demand for apron and also taxiway space. It is very difficult to be specific about it and also very difficult to plan for it. What we were - when (indistinct words) I think and certainly others have, is that often it's a notion of that 80 movement cap is pretty blunt and it might be better done around scheduled movements, as opposed to flown movements and I mean even just had an example of last week and I was coming into Sydney from the US and on an A380 and we had this issue of where there were disruptions and the movement cap meant that the aircraft was kept in the sky and was circling over the Pacific for an additional half an hour. I was just thinking of 480 people wasting half an hour of time and all the jet fuel burning and it just seemed that that could be - and to really no benefit other than a blunt instrument - and it wasn't protecting people from noise because that aircraft eventually landed and it was just through that blunt instrument that you would have this huge cost.

In another context, if you could save that amount of time for that number of people on a regular basis, if that was a road, you'd be investing tens of millions of dollars but in this situation, by the stroke of pen and no obvious externalities - as in external parties suffering - you could relieve that congestion pretty quickly. So it just seemed like an opportunity to make some improvements and for us, it could reduce our need to invest in peak apron capacity to deal with where aircraft are being held on the ground in Adelaide because there's a disruption so no slots available in Sydney.

COMMISSIONER KING: Thank you, that's good, Stephen. So just one last area for me. You mentioned you don't charge for either public buses or the off airport car park drop-off buses, did I get that right?

MR YOUNG: Yes, that's correct.

COMMISSIONER KING: I was wondering why you don't, everyone else - well most other large airports do and it's been put us they can get a return on capital. It has also been involved in setting up those slots, it's also been put to us that it's necessary for congestion management. Why don't you guys?
5

MR YOUNG: Well I think there's two considerations there. One is the congestion management and the other is the capital. A lot of our facilities are there and in place and for as long as it can be the case and we don't see the significant congestion issues or people taking advantage of the fact that there is no way for us to control the congestion like through pricing, we'll just keep doing what we're doing. But you know, there will come a time I would think, where continuing to be able to provide premium locations that are competing with all other sorts of ground transport just won't be able to be the case unless it is somehow priced and controlled through - controlling congestion that way. For us, it is as much about ensuring the efficient throughput of vehicles and people as much as anything. I'm not saying that we won't, at some point in the future, introduce some sort of access charge and that obviously will be designed around cost of capital - but presently, our system isn't clogging up to the extent where we think that that's necessary at the moment.
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COMMISSIONER KING: But yes, I'm slightly confused, presumably there is investment in those locations, pick-up and drop-off locations, so there is capital. Currently in a sense you've made a commercial decision not to get a return on that capital. Why? You know, you could charge a price there and get a return on that capital. It is obviously not going to affect congestion. So congestion is off to one side here. Why have you decided not to get a return on that particular set of capital that you're investing?
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MR YOUNG: We look at our ground transport assets and the capital invested in that really as a holistic system, and there are, you know, there are areas where we are not getting an adequate return on our capital. Those areas tend to relate to the public transport and those types of areas. There are some things that we accept that being an airport you're required to do, and one of them is to provide as much alternative in terms of ground transport as you possibly can. So the entire system we look at. We are earning a return but in some areas of that investment, it is significantly less than what you might regard as being a full commercial return.
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COMMISSIONER LINDWALL: Okay. Well, I think will do us very nicely. Thank you very much Mark and Brenton for speaking with us today.

45 **COMMISSIONER KING:** Thank you.

MR YOUNG: Thank you.

5 **COMMISSIONER LINDWALL:** Now, we move onto BARA. Is Barry around? Penny? If you could introduce yourselves and then give a statement as you see fit.

10 **MR ABRAMS:** We will. Okay. I am Barry Abrams, the executive director of the Board of Airline Representatives of Australia.

MS SWAIN: I am Penny Swain. I am a commercial lawyer who works with BARA and I would just make the observation that I'm not a competition lawyer, so my specialisation is infrastructure services agreements.

15 **COMMISSIONER LINDWALL:** Fair enough.

MR ABRAMS: That's what we do. Thank you. We will keep our opening remarks to about seven minutes, five to seven minutes. The Board of
20 Airline Representatives of Australia does appreciate the opportunity to provide further comment on the Commission's draft report on the economic regulation of airports.

25 International airlines would like to convey three key messages in response to the Commission's draft report. First, international airlines were surprised that the Commission has downplayed their genuine and legitimate concerns over the provision of pricing of airport services. It isn't clear to us what evidence the Commission would need to see to take these concerns more seriously.

30 Second, international airlines do see a large gap between the performance outcomes deemed acceptable by the Commission in its draft report, and what they consider to be a reasonable standard for the prices charged. Airlines do remain concerned over problems in airport services that are
35 reducing the efficiency of their operations.

40 Third, BARA working through multiple, unbalanced ambit claim airport service agreements is just simply wasting member resources. It need not be overly challenging or complicated to establish some appropriate accountabilities. What it actually takes is a willingness of an airport operator to accept that it must deliver its services to an appropriate standard for the prices charged.

45 In its submission to the draft report, BARA has presented empirical evidence covering on-time performance and baggage for international

5 flights. International airlines do see plenty of room for improvement in airport services in supporting better outcomes for passengers and airlines, ones which could deliver an estimated 270 million in operating efficiencies over the next five years. So in a sense what we've just sought to do in our follow-up submission is just sort of re-package and re-present the first information to sort of say this is the magnitude of what we think we are dealing with here.

10 For us, we also believe such outcomes really do highlight the different incentive structures for the airport operators which we think goes to the heart of the differences in the service ratings the Commission has seen between international passengers and international airlines.

15 As we see it, the airport operators already have a commercial incentive to provide a quality of terminal services to international passengers that fits with maximising their discretionary retail spend in the terminal. As it's profit maximising to do so, airport operators are far more prepared to set benchmarks for international terminal services, and as long as those retail activities don't interfere with efficient airline operations, BARA has no issue with such incentives.

20 International airlines however, don't see the same positive incentives for airport operators in providing the core services needed to support efficient aircraft operations. These services include airfields, baggage systems, boarding areas, contact gates and airside bussing. It is here airlines report to BARA and the ACCC poor and highly unacceptable outcomes. It is also here where the performance benchmarks accepted by the airport operators in their airport services agreements, are weakest or often just simply non-existent.

30 These airport services underpin efficient aircraft operations and therefore we believe need to be evaluated on a stand-alone basis. We don't consider it is appropriate to effectively balance off deficiencies in these services against the quality of other services say going within the terminal, in reaching an overall performance assessment.

40 We would also say that the airport services agreements which are individual contracts between each international airline and the airport operator are also unfortunately proving ineffective in resolving problems in common use services that affect many airlines. This reflects, we think, the reality for an individual international airline operating to Australia in taking the commercial risk in speaking out and taking an airport operator to task over common use services.

5 The Commission's draft conclusion is that the available evidence does not suggest the airport operators have systematically exercised their market power to the detriment of the community. It is also stated that overall the quality of service meets users' expectations. BARA disagrees with those conclusions unfortunately given its objective of supporting safe and efficient international aviation. International airlines would rate airport services below a reasonable standard in many areas. Identified problems include airside bussing services that regularly fail airline on time performance and aircraft turnaround targets. I could talk airside bussing for 10 a long time.

15 Poorly performing baggage systems causing excessive rates of mishandled bags and we've presented further empirical evidence on that. The extensive foreign object debris around Sydney airport's international terminal which is impacting on the efficiency of aircraft operations, increasing airline costs and causing damage to their aircraft. Check-in facilities not balanced to airline demands causing congestion in some areas while other areas remain unused, and I would just note as BARA has always done in what its put in its airline views, what is published and is put to the Commission, when 20 we've seen good outcomes and good efforts, we have always sought to recognise that.

25 BARA does note the Commission's draft report draws attention to the potential limitations and biases associated with airline surveys about airport services. International airlines have interpreted that, given it downplayed problems in airport services drawn from the BARA member survey, the Commission has discounted their evidence on the basis they might be seeking to gain the regulatory system.

30 International airlines which to make it clear they flatly reject any suggestion of regulatory gaining, rather they are doing their best to show where the regulatory regime is not delivering as intended. BARA does conclude that the airport's monitoring regime is currently not capable of supporting the delivery of airport services to a reasonable standard consistent with those 35 prices being charged for those services. We don't see that revamping the monitoring report is going to improve matters because it is not going to change the underlying commercial accountabilities between the parties and the form of the agreement itself.

40 Unfortunately therefore, international airlines do not see a practical way left to address the problems they experience in airport services under the Commission's draft findings and recommendations. BARA has clearly articulated the commercial benchmarks that could deliver a reasonable standard of airport services for the prices paid and we detailed them in some 45 detail in our first submission. They are based on principles for

infrastructure services in both Australia and overseas drawing on people who have extensive experience in infrastructure service agreements and we've also sought to include a lot of information from the airport's council international themselves as a reasonable benchmark we should be working to.

We do consider that greater regulatory support in some form is required if the airport services agreements which ultimately underpin the delivery of the services and the pricing of outcomes are to be brought up to what we consider to be a reasonable standard. While the Commission has deemed regulatory options put forward by airlines as unwarranted, which is the negotiate-arbitrate model, I probably don't want to go into so much, it is still open to the Commission to propose reforms that would address the problems in airport services which BARA considers would better support safe and efficient international aviation in Australia.

COMMISSIONER KING: Now, just to be clear BARA represents international airlines, some of which you would get new members at various times obviously, a carrier that's not in Australia now wants to come , they'd probably join BARA, is that basically right.

MR ABRAMS: Yes, we are a voluntary organisation. What I would often say about a new carrier is when they come they may form a view that look, you know, being part of the club might be a bit of a disadvantage and I'd like to go around and negotiate my own things and good on them, God bless them, they go and do what they need to do. Often once they get established, they see benefits in BARA which are much broader than just the negotiations of the agreement. So we provide details and updates as to where the industry is heading. Where these airports are going, security services. We have a pretty broad remit of activities that we get involved in and so it's for a range of reasons that an airline will see some value in BARA.

COMMISSIONER KING: If I recollect, Sydney mentioned that – well, it has described to us that it is a very peaky operation and that a number of international carriers arrive pretty much at the same time. So the facilities are heavily, heavily used, baggage and so forth, for a very concentrated period. Then there's a long period where they're not much used at all. Is there anything that can be done in terms of timing to alleviate that, rather than new investments, because that comes at a cost obviously?

MR ABRAMS: It certainly does. I think when we look at this very critically in every case, we are trying to look at what are the sorts of incremental costs of expansion at these airports. I think, in coming at it from a couple of angles, one of the frustrations we find is it always just

5 seems to be a big capital solution usually to a problem, rather than the airport operator going back and saying, "Okay, we seem to have some congestion and some issues here, how might we look at some of the scheduling? How might we look at towing? How might we look at coordination issues?", which is more OpEx type based. You need to have a very deep understanding of airfield operations to make that happen.

10 We are certainly supportive of any efforts by an airport operator that may induce a carrier to say they want to move out of that peak time, move more into the shoulder. But from BARA's perspective our job is to provide effectively a collective overarching view of the sorts of service outcomes and sorts of, what we might see as reasonably acceptable pricing outcomes, and then some of this then. And the role of the airport operator is then to take this on board and say, "Okay, based on everything I've seen here across
15 all of these airlines, this is what I think will work".

COMMISSIONER KING: Well, obviously the airports have said that they are trying to meet your services better over time and you are saying they are not.
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MR ABRAMS: Yes.

COMMISSIONER KING: Within the – I know what you have said about the monitoring regime, but if you were to continue the monitoring regime which is what we did recommend in our draft report, we might – and we did say that it needed to split out so more there's data and maybe change the quality of service indicators to some extent – can you think of good ways that that could be achieved that maybe would give an added incentive to airports to better meet the needs and requirements of the airlines?
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MR ABRAMS: Here's probably a good example. And as we put in our second submission, we showed mishandled bag rates by airport. So in December 2018 for Sydney airport, so for directly checked-in bags by passengers in the international terminal, the rate of mishandled bags was almost six per 1,000. To put that into context, now, the system we have doesn't cover all flights, but I just extrapolated that over all flights, we were looking at nearly 6,000 mishandled bags through that system. Now, that's a lot of passengers who didn't get their bag.
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40 The international airlines it probably has cost them about \$1.8m reconnecting those bags to their passengers. For Sydney airport, it has meant precisely zero in terms of the revenues it receives from airlines for the provision of those poor baggage services in December 2018. So I certainly appreciate that providing more data and information can be useful, but from an airlines perspective, as I think Penny would agree, what
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airlines are after is the direct contractual ability to go and sort these problems out.

5 **COMMISSIONER KING:** So you'd like to have an incentive in the contract - - -

10 **MR ABRAMS:** In the contract itself, yes. So what we would like to see is – and I suppose if I just come back to – and I've got to do this off my phone, just because it is from our first submission – what we made it clear was, we wanted some overarching principles that said airlines should be able to operate reasonably efficiently and not experience persistent significant delays as a result of unavailable or substandard airport services. And that airport operators should facilitate the safe and efficient journey of passengers through the airport.

15 So we would like those as overarching principles. We would then believe the airport operators actually have to have some financial skin in the game in meeting those objectives as we've agreed to measure them. At the moment unfortunately as we, I suppose, try to write a fair bit on these rebate schemes, they are not genuine financial incentives that hit the bottom lines of airports.

20 Now, what we've been able to do is at least try to get the airport to take some interest when these things go wrong, but until they actually have a bit of meaning and we've put in – written extensively in airline views around how you would look at caps and limitations and let's get – you know, we're not saying, "Well, we didn't get this service, therefore we're never paying anything". It has been around, how do you actually create some genuine commercial incentives to deliver better outcomes, rather than me having to wait for a monitoring report to then go wave it at the airport operator and say "Get on with it".

25 **COMMISSIONER KING:** Monetary can be good for, you know, an average but for a particular day, if I was Sydney airport or something and they say "And I can handle three, seven A380s or whatever per hour" or whatever they handle, and suddenly because of weather events we get an extra one coming in, that would cause congestion, so how would you design incentives that – it's not really in the control of Sydney airport in that sense. Some of it is in their control and some of it is not.

30 **MS SWAIN:** All right. I would make the comment that it is unusual, in my view, to see a regime where a party negotiates around a rebate for services, effectively availability and performance, and there's a pool, let's say a pool just for argument sake, \$100 and that gets added to the cost of the model and you're effectively paid in advance on the assumption that

there is going to be breaches and that you're going to get the money back through the pool. That, to me, is a strange way of doing it, and it completely isolates the service provider from risk.

5 The rebates are quite modest and they are for very, very specific scenarios. The practical examples of people who have actually been to get money out of the system, as I understand it, it's a surprisingly low number, and also there is the individual airlines' reluctance to even push for that anyway. But there is no exposure to risk for providing poor service in a situation where
10 you've got a sole remedy of a very small rebate. If there was ongoing, really poor quality performance, the suggestion, I'm sure from the airline would be "Well, that was your sole remedy. What are you going to do about it?"

15 I mean, that's the issue that the arrangement that has been put in place in a lot of these places, as has just been said, was simply to try and get management attention because just having no communication for them to even discuss these sorts of things makes it very difficult to get practical solutions which is what we have really focus on here.

20 And if you don't have any vehicle to discuss, even paying a couple of thousand dollars, people just aren't interested.

MR ABRAMS: And sorry, just touching on your point about how would you come up with these - - -

25 **COMMISSIONER KING:** Well, yes, the risk sharing - - -

MR ABRAMS: Yes, the risk sharing, okay. What you sort of start with, a good way to do it is, you sit down and you work through some scenarios.
30 So rather than first of all, trying to bash it out legally, you actually sit down and say, okay, what was the situation, and obviously we have many, many practical situations.

35 You can then into the agreement effectively just write the carve-out clauses. So the carve-out clauses can be, you know, we have to agree that we're all going to apply some common sense here. So if an airline lodges and the airport operator comes back and says, "Well sorry, it was actually pouring down rain and the weather conditions were terrible," and you know, "we changed the runway modes," then that's the answer. We also
40 have force majeure clauses and definitions, and they come in. Now just to be clear, we don't accept that the airport operator's own contractor's actions represent force majeure, so that's some of the things that have been pushed onto us that we think is highly unacceptable.

5 But we do believe that with a bit of goodwill, it's actually pretty straightforward to sit down and work these things out, especially if you do it in – as we said, you're talking limited amounts, you're talking a cap. So ultimately, the airport's genuine financial accountability is limited to a cap. So you might say, "Maybe this might won't quite work in this situation or that situation." You just handle it at a high level. Let it run for an agreement, and then look to build on it and improve on it from there.

10 **COMMISSIONER KING:** Can I just follow up, so I guess my starting point is that these are issues of commercial negotiation. If for some reason they're not in the contracts working effectively from BARA's perspective, and maybe it's a matter of having the payments for failure to meet service larger, maybe making it easier to get those payments, maybe
15 making it clearer when force majeure – I understand all of that.

I guess my question then is, you know, you've suggested the overarching principles, but is there any further role for government in here, or is it really that you want the commercial agreement facilitated in a better way?
20 And if so, what do you see as being that better way?

MR ABRAMS: Very good question, and I appreciate it's difficult to answer fully. What I would say is at the moment, we were a bit taken
25 aback to see comments in the draft report that said in terms of the commercial negotiations and outcomes, there was little cause for concern. Because we actually see many of the agreements to be, to be honest, rather basic and a bit backwards in terms of how we would view them against some reasonable standards.

30 There could be a lot of ways to go about this. What we're after, and I suppose what we did in our submission, was to say, there's the high level principle. Here is where we would see sensible service level arrangements existing. We would be more than happy to talk to the AAA and others
35 around those high level principles. Our view is that though what we do within the aeronautical principles as one option, we make it very clear for each airport operator, these are important issues to be negotiated.

40 So you can no longer go to BARA and the airlines and say, "Sorry, if you want a rebate for equipment failures, you will need to prepay." There is some understanding that there will be some genuine financial skin in the game; that we will see some positive obligations to deliver the service. Perhaps we can even look at things like, you know, we will not see clauses that allow the airport operator to amend any clause at its own
45 convenience."

5 So as we would see it, we need to find a way of saying, one of the commercially sensible, good things that should be in agreement that clearly will align with dealing with the problems that we've raised, and somehow – so that could be, for argument's sake, given the commission has, I understand, reviewed the agreements from the airports – could that then not be part of the process and say, "Here are the things that we would expect to see in those agreements."

10 **COMMISSIONER LINDWALL:** Yes.

MR ABRAMS: Yes.

COMMISSIONER LINDWALL: So can I follow up though.

15 **MR ABRAMS:** Yes.

COMMISSIONER LINDWALL: Because BARA has also, together with AAA, have suggested a forum, for want of a better word, with government involvement to deal with what was put boilerplate contract issues.

MR ABRAMS: Yes.

25 **COMMISSIONER LINDWALL:** Do you see this as being part of that forum, or this as being separate to that forum?

MR ABRAMS: I think perhaps best just to talk to what BARA put forward first.

30 **COMMISSIONER LINDWALL:** Yes, please.

MR ABRAMS: Okay, which was a combination of, let's get the high level commercials right, because that's what's going to align you. We then had within every agreement this mundane, boring, but I suppose important from an infrastructure perspective, set of clauses around indemnities and insurance arrangements and the GST. And what we'd like to do is reach some sort of agreement or expectations about what they can just be. So as we would see it at the moment, it is a bit silly for Penny and I to be spending our time debating or commercially negotiating with an airport operator as to whether or not the international airlines should be indemnifying them for acts of their own negligence.

45 And we just sort of go, well this is just a stupid waste of everybody's time, but we do it all the time. So what we would like to see is some basis of people saying, you know, and we've developed many of these clauses

5 already, that we then just shoot off to each airport operator and say, "Here is a standard set of clauses that have been deemed acceptable to the international airlines, because they've signed up to them. Please have a look at them, and if you think they're okay, just put them in." Don't give them, say for argument's sake, to your external lawyer to say, "How do I rework every clause to make in unfavourable for airlines?" These are the sorts of practical problems we're trying to get over so that we actually focus on the things that matter, rather than just this legal minefield we get into.

10

COMMISSIONER KING: Okay. So I understand that part of the complex.

MR ABRAMS: Yes.

15

COMMISSIONER KING: I'm trying to see then, is there any connection, is there any way for what you're solving in terms of the boilerplate clauses can also become a productive way of getting discussion going on the services and getting appropriate service levels and appropriate compensations or (indistinct).

20

MR ABRAMS: Yes, punishments, yes.

COMMISSIONER KING: Incentives, that's the word I'm after. Incentives in all those service levels.

25

MR ABRAMS: Yes. I think it comes down to a level of detail. So when it comes to boilerplate clauses and indemnities and the like, you can say – you can actually write the clause as we do and say, "There it is."

30

COMMISSIONER KING: You can't do that to services (indistinct).

MR ABRAMS: No, no, no. That's where you're just trying to agree that there will be general principles, because what BARA may want to negotiate with each airport might be quite different. There are no bussing services at Perth Airport. See, Kevin, I said I'd get Perth Airport in again. And so we wouldn't need or want to see any service type things around airside bussing. Airside bussing services are big and we think poorly performing services at major airports, so that's one where we'd like to see a lot of attention and detail. But we're trying to start from an understanding that the airport operator, he is going to be monitoring, measuring these things, and there are going to be some commercial consequences for what happens.

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COMMISSIONER KING: So that (indistinct) could, in your opinion, be – set those basic principles at least?

5 **MR ABRAMS:** Yes, yes. And then it's up to the parties to then go and negotiate.

COMMISSIONER KING: Yes.

10 **MR ABRAMS:** And then there needs to be, as we tried to put in our submission, and I get it that the AAA and that said, "Oh, is BARA looking for de facto type regulation here?" What we're trying to say is, if we've agreed that they are the things that matter and drive good outcomes, we should expect to see them in the agreement. It's then not good enough for an airport operator to say, "Well you know, the board and investors have
15 thought about that, and we don't really want to go play ball on this," because that's what we see today.

COMMISSIONER KING: Are you concerned under – if there was a negotiate arbitrate framework, that it could be used by some domestic
20 competitors to reduce investment and harm international airlines?

MR ABRAMS: That's a nice question to ask, given I have domestic carriers as BARA, though we only represent the international clause, obviously.
25

COMMISSIONER KING: (Indistinct words.)

MR ABRAMS: Yes, thank you. I think what I would say to that is in BARA's experience for the provision of international services, we have
30 not experienced situations where we consider the ability to provide services to international airlines has been unfairly or impinged by what the domestics are seeking to achieve. Now these are obviously common use assets. As I would see it, every airport operator, as they keep saying, has an incentive to grow its international operations. In most cases, those
35 services are separate to the domestic services anyway.

So we normally have our own domestic terminal, and then even where we find that terminal is integrated, like Mark Young was talking about with Adelaide. If they can't reach agreement with the domestics when we sort
40 something out for the internationals. So I do struggle to see how it would happen in a practical sense. I mean one of the things that BARA does is, you know, we receive an offer from the airport operator. We then go to members to get, you know, sort of some high level feedback as to whether or not we think it's hitting the mark, and that's what we provide forward.
45 So as part of that, and then obviously if BARA was part of that at all, all

the experts sought any input from the international airlines, that's how we'd provide it in terms of the services we needed.

5 **COMMISSIONER LINDWALL:** But in case of say Perth Airport where there are effectively two domestic terminals; one occupied by our major Australian domestic carrier and the other one by all the other international carriers, one could argue that the former has a competitive advantage over the others.

10 **MR ABRAMS:** I think what I would say is that there's a lot of swings and roundabouts when it comes to airport capacity.

COMMISSIONER LINDWALL: It'd be (indistinct)

15 **MR ABRAMS:** Yes, I think that these things can, perhaps, be a little bit overstated.

COMMISSIONER LINDWALL: Yes.

20 **MR ABRAMS:** At the end of the day, no one ever said life always had to be fair and reasonable and an equal playing field for everybody in life and I think the Commission actually makes those sorts of types of statements in its report, which says, "Well, we don't expect all the parties at the table to have the same bargaining power." So the fact that there
25 may be some differences in the services that you get and the efficiency of that, well, so what. That's life.

COMMISSIONER LINDWALL: Given the time, Barry, I think we better talk a bit about jet fuel which has always been a concern, now, after
30 all of BARA.

MR ABRAMS: Yes, sure.

35 **COMMISSIONER LINDWALL:** We've identified a number of options in our draft report. I don't know what you think of them (indistinct) mentioning what (indistinct) for example, one was that the Minister for Infrastructure apply to the NCC for a declaration for jet fuel infrastructure sort of services. There was another option too, like under
40 Part 7A and so on.

MR ABRAMS: Yes, I think as a general position from BARA is what we'd, in the first instance, would like to see is each of these infrastructure providers, you know, voluntarily just create a sensible and workable set of access arrangements that they could share with stakeholders for comment
45 and, you know, that could be looked at and deemed reasonable.

5 It was, then, I think, though BARA would support that if that doesn't prove to be the case, then, there is, then, a justification for some form of regulatory intervention as you've said there that, then, in effect, makes it happen in practise.

10 We see obviously Western Sydney Airport as a great opportunity. I think our only comment there was to say, "Don't call it JUHI," because we wouldn't expect it would be JUHI-type arrangements.

COMMISSIONER LINDWALL: Yes.

15 **MR ABRAMS:** And we also see a lot of advantage in the quality forum on the basis that – sorry, not the quality forum; the sort of coordination-type forum because we do need a way for the parties, for all the stakeholders to get their head around and understanding the type of arrangements going on there.

20 And I suppose if we're talking fuel, we've obviously provided our evidence and understanding of Sydney Airport's fuel throughput levy. We obviously don't see this as justified. I suppose this is my perspective; I wasn't particularly convinced by their arguments, but that's obviously something for the Commission to decide.

25 **COMMISSIONER KING:** I'm just wondering, is it worth them walking this through analysis or are we a bit out of time.

30 **COMMISSIONER LINDWALL:** We're a bit out of time. But if it's quick maybe or - - -

35 **COMMISSIONER KING:** Well, I'll ask them some slightly different questions because maybe that's one best done through correspondence. BARA obviously went for declaration of the Sydney JUHI; was unsuccessful. The reason put forward by the NCC related to the fact they simply, you know, because the way the legislation's worded, they couldn't be convinced that there was a problem that increased access would have a (indistinct) of benefit to competition in a market, other than the market for the service. Part of that just seemed to be that they just couldn't get the information from yourselves or from the - - -

40 **MR ABRAMS:** Yes, for BARA and it's the same for the Commission's inquiry as well, at the end of the day, we are down here in Australia and we have many international airlines who operate one or two flights a day and there's about 40 of them. So unfortunately you run into a problem
45 that, in the big scheme of things, getting a large number of international

airlines, the people here in Australia, to be able to convince their head offices to devote the resources to pull this information together to bring forward is unfortunately quite difficult.

5 What we have sought to do is through (indistinct) this time bring more information to the table and they've done that. So hopefully we find that to be satisfactory. But, yes, it is very difficult and I think it just reflects a practical reality of, you know, we are here in Australia, we're not a Singapore in terms of fuel consumption and in terms of these sorts of things. If we were, I'm sure there'd be a lot more stuff put forward.

10 I think importantly, though, that doesn't change the relative benefits that we could achieve here in Australia by getting reform that drove some outcomes where we had some competition on its merits.

15 **COMMISSIONER KING:** So one of our options we've put forward is either an ACCC Part 7A price inquiry or more formal monitoring and potentially with ACCC involvement, given the difficulties of getting that cost-base or the cost, the prices, the profits, all of that information which I've just mentioned, would those sort of things be beneficial so that, perhaps, the next time BARA or an airline goes to the NCC, the information's there.

20 **MR ABRAMS:** Certainly. More information has to be better and the more that we can shine a light on what is going on here. I suppose the way that we'd sort of come at it is try to give information on the number of bids as much as possible, so that we could get an understanding that, by and large, when an international airline turns up, what sort of competitive tension can it actually expect in its tenders.

25 Obviously, say through the coordination forum that's talked about, if there was a lot more information shared, and lodged and, then stored, then, that would provide everyone with a lot more information and understanding around the quality of the infrastructure, its capacity to actually facilitate entrance and the like. I mean I'm not surprised that somewhere like Melbourne at the moment, you can create some open access regimes and outcomes on the facilities there, but they're ultra-constrained at the moment in terms of, you know, you being a new competitor being able to come in and actually supply fuel into those facilities; all sorts of coordination issues and the like, I would understand.

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45 You know, Melbourne JUHI can probably talk more about that than I ever could. But certainly you want a situation where the parties are comfortable that there's enough capacity there with some sensible access arrangements that would be broadly consistent with generating good

outcomes. And that's always going to be a level of judgment call, but to do that we do need a fair amount of information.

5 **COMMISSIONER LINDWALL:** Well, Barry and Penny, I think we'll have to call it quits here. So thank you very much for coming.

MR ABRAMS: It's our pleasure.

10 **COMMISSIONER LINDWALL:** Thanks, Penny.

MS SWAIN: Thank you.

15 **COMMISSIONER LINDWALL:** So I might, now, invite Perth Airport if they're able to come forward. Usual thing, if you could introduce yourselves and then give a statement that you (indistinct) and apologies for eating into your lunch time.

MR PEREIRA: No pun intended.

20 **COMMISSIONER LINDWALL:** Yes, and no pun intended. Okay, so it's Brian Pereira and Kevin Brown, CEO of Perth Airport.

25 **MR BROWN:** Thank you, Commissioners. Perth Airport as a lessee operator of Perth Airport, welcomes the opportunity to appear before the Commission and to respond to questions that the Commission may have about Perth Airport-related matters arising out of our submission or about the Commission's draft report and to the economic regulation of airports.

30 Perth Airport has welcomed the Commission's inquiry into economic regulation of airports and through the course of the inquiry has provided extensive and transparent data and information, which illustrates that.

35 If I, first of all, just touch on investment and service levels. Under the light-handed regulation regime Perth Airport has made considerable aeronautical capital expenditure to address significant capacity constraints and service efficiencies which became particularly apparent at the commencement of the mining construction boom in 2009 and 2010.

40 Now, this investment has seen Perth Airport move from being one of the lowest rated airports on its Airport Service Quality Benchmark Panel through the earlier part of this data, to having, now, the highest overall quality of service rating in the past two ACCC monitoring reports.

Now, as noted by the ACCC and its latest monitoring report, from an airline perspective, Perth Airport has significantly improved its performance over the past three years and was the only airport to receive a good rating from the airlines in 2017-18. Further investment to
5 accommodate future growth and to provide the requisite capacity and level of service required by airline partners as planned. Information on these proposed investments has been provided to the Commission already.

I'll just touch in relation to the agreements with our airline partners —
10 seven year price and service agreements with airlines operating at Perth Airport expired on 1 July, 2018. Perth Airport has since concluded new agreements with 23 of the 24 airline partners operating out of Perth Airport.

15 In 2017 and 18, Perth Airport's approach to negotiations for new agreements with their airlines partners was to conduct an open and transparent process where high quality, comprehensive and non-sensitive information was provided to all airlines, and indeed, any interested party through Perth Airport's publicly accessible website.

20 Contrary to the claims of one participant to this Inquiry, Perth Airport does use a building block methodology to assist in formulating agreements with the airlines, and does not make take-it or leave-it offers. Even a cursory examination of our publicly accessible website, the time
25 taken to negotiate agreements and the content of those agreements will show the allegations of take-it or leave-it behaviour to be demonstrably false.

30 In fact, as part of our extensive negotiations over almost 18 months with that airline, we made several offers for longer term agreements, all of which involved prices lower than what was being paid under the previous contracts. The last of these offers was made before Christmas, and we are yet to receive a formal response to it. Despite offers of lower prices, that
35 airline continues to underpay by up to 40 per cent.

40 As the Commission may be aware, legal proceedings are currently on foot in the WA Supreme Court, and it would be inappropriate for us to comment any further on the legal process, however, we do not want to have those comments made to the Commission earlier this week, to be unchallenged.

45 Both previous and current agreements with all airlines include risk-sharing mechanisms, incentives for passenger growth, and rebates recognising differential service offerings at Perth Airport. In collaboration with our international airline partners, Perth Airport is committed to exploring

further the ability to link the risk-sharing arrangements to delivery of agreed service outcomes within the new agreements.

5 These, by necessity, see outcomes diverge from pure building block outcomes. This, and other evidence provided to the Commission, demonstrates our commitment to engaging in genuine, bona fide negotiations with all our airline partners on a bilateral basis. We endeavour to understand what is important and valuable to each of our airline partners, and work with them to find a win-win outcome.

10 In relation to the issues of market power: information Perth Airport has provided on Perth Airport's quality of service rankings, operating costs, capital efficiency, aeronautical prices and profitability has demonstrated that Perth Airport has not wielded market power through withholding
15 supply, nor allowed quality to deteriorate, nor operating inefficiently, nor earning excess returns or imposing unreasonable prices and conditions.

In relation to ground transportation and carparking: Perth Airport has provided information which demonstrates that it participates in a
20 competitive market for land transport services to Perth Airport. We have provided considerable evidence that consumers can choose between numerous land transport alternatives, and they exercise that choice.

25 Successive ACCC monitoring reports show that Perth Airport's carparking prices are the lowest of the monitored airports. There is no evidence from a decade and a half of monitoring to suggest that Perth Airport has engaged in any inappropriate conduct in relation to the pricing of its carpark products or the manner in which it has interacted with its competitors. There is considerable evidence to the contrary.

30 Perth Airport has not sought to restrict access to infrastructure in the vicinity of Perth Airport terminals, nor has it applied unreasonable price on non-price conditions of access. In contrast, Perth Airport has invested significantly to create fit-for-purpose, secure, and convenient parking
35 facilities for the travelling public, and prices charged reflect the appropriate rate of return required to underpin the investment.

In light of the above, we now turn to the Commission's draft report. Perth
40 Airport believes the draft report provides a considered position, based on thorough analysis and observable outcomes in the industry, and is not swayed by unsupported rhetoric. We note that the report's overall conclusions are in line with the submission of independent organisations and persons with expertise in the area of economic regulation, such as the National Competition Council, Mr David Starkey, former adviser on
45 economic regulation to the United Kingdom Civil Aviation Authority, and

Dr Harry Bush, former board member for economic regulation at the UK Civil Aviation Authority.

5 Perth Airport supports - with a few qualifications which are outlined in our submission in response to the draft report - the report's overall conclusions and recommendations, which effectively support the ongoing regime of light-handed regulation. Perth Airport believes the continuation of the light-handed regulation regime is critical to the ongoing support of investment in Australian aviation infrastructure, as outlined in the
10 submission from groups such as the Australian Airport Investors Group, Infrastructure Partnerships Australia, and IFM Investors.

Detailed responses to each of the Commission's requests for further information are included in our public responses to the draft report. In
15 addition, we will provide time-series data on utilisation rates of all at-terminal domestic carparks, which we are confident will rule out the exercise of market power in carparking at Perth Airport.

20 So, thank you, Commissioners. We're happy to answer any questions you may have of Perth Airport.

COMMISSIONER LINDWALL: Thank you very much for speaking with us today. Now, could I ask, given we just had BARA before, saying that there are some quality indicators that could be in contract with the
25 international airlines, and they were talking about baggage handling and so on; is there anything you'd like to say about how you'd get the right incentives in place to service any international and domestic airlines, for that matter, in those type of products?

30 **MR BROWN:** No. With my engineering background, I love dashboards and looking at the trending of data, and we've been working very closely and extensively with Barry in BARA on this. Quite happy. Perth Airport; has some skin in the game already within the current agreements. I think there is a lot more scope to enhance a number of additional measures, and
35 we've been doing a lot of work with our airline partners and BARA to actually scope-up what some of those measures would be.

40 For me, from the earlier questions, there are some common measures such as first-bag, last-bag, the availability of key plant and of equipment on the airport. But I think, let's look at this in a broader sense: an airport is made up of many different parties, whether it's the airline, the handling agents, the airport itself, but the border agencies as well; for us, one of the key issues we have is with the processing time for Border Force on arrival.

5 So, I think having a holistic set of measures, and there's some of them - as Mark mentioned earlier - that may be more specific to the airport; there will be a core set, but there may be some specific to the airport. But we're certainly not shy of those measures, we're not shy of having skin in the game, and I'm certainly not shy of publishing them.

10 We have demonstrated throughout our pricing agreements over the last two years, an open and transparent publicly accessible website of the key data, and happy to do that on the basis of the operating performance of the airport.

15 **COMMISSIONER LINDWALL:** Now, I know you can't comment on the Supreme Court action, but A4ANZ earlier testified and said that - and I might be not exactly saying exactly what they're saying - but it possibly was that what you're achieving there is effectively what negotiate/arbitrate would be, but at a much higher cost. And wouldn't you be better to have negotiate/arbitrate as a policy and then you would be avoiding going to expensive Supreme Court actions?

20 **MR BROWN:** Well, I think from some of the discussion today, and leading up to today, it's obvious there's some ideas but they're not well-formed in terms of what that arbitration/negotiation model may actually look like.

25 My view is there's an already existing, well-defined regime in place, and that's exactly what we're following through at the courts in Western Australia. Why are we inefficiently talking about developing new regimes when there's existing regimes already in place? And that the courts, yes, offer an alternative independent umpire, and that is available to resolve
30 disputes.

I think it's fair to say with the modern day case management techniques in place the courts, and I certainly consider the courts are actually faster, more cost effective in bringing that certainty to a conclusion, and they can
35 certainly be well informed by expert witnesses to make sure that the full facts are in consideration in the determination of the outcome. So there's already well defined processes in place. That's what we're going through, and we know locally there are some significant cases through that arbitration model that have taken many years and considerable amount of
40 money and are no closer to resolution. So I believe there's already models in place and it's normal for business parties who cannot agree on certain terms to use the courts to determine that and they have well developed models to resolve.

COMMISSIONER LINDWALL: It does strike me, and maybe it's me, but it does strike me that a WA Supreme Court judge no matter how expert he or she is in matters of law, they aren't arbitrators, they're not airline or airport experts. Wouldn't it be better to have a system where
5 you could go to an expert arbitrator with a background in airports and airlines who would be able to make these decisions rather than having to go through a very formalistic legal process with formal claims, formal issues of standing and so on. It does strike me, but I can see very few reasons why you wouldn't want the arbitrator type approach rather than a
10 court approach.

MR PEREIRA: Yes. So if I can just answer that. So I think firstly I think the most cost effective and efficient way of actually reaching agreement is to negotiate. So I think that outcome for us, despite the fact
15 that we're in the courts, that option is still open and we're continuing to reach out to Qantas to try and reach an agreement. The legal case that's before us is about a historical view, it's about what services have been provided and what prices should have been paid in the absence of an agreement. So it's not really about arbitrating what a going forward view
20 of rates should be.

We still think negotiating should be the outcome, and then I think listening into the conversation earlier about a negotiate-arbitrate model - the negotiations are quite multi-dimensional and actually cover lots of
25 different parties, as we heard earlier, and actually having an outcome on a very specific matter through a negotiate-arbitrate outcome could actually lead to some perverse outcomes for other users of common use assets at the airport, and I think some of the examples that we heard earlier are testament to the fact that it's very unwieldy, not very practical in terms of
30 application.

COMMISSIONER KING: Probably if I go - sorry, I am just thinking of my question, I don't want to take it too far down the legal side, so I probably can't ask that. Sorry, Paul.
35

COMMISSIONER LINDWALL: Well, I mean obviously the court case is about a particular issue rather than a generalised one. The fact is at the moment you have two international terminals, (indistinct), as I mentioned earlier. Presumably that has an extra cost. Is there an extra cost to the
40 taxpayer from this because the Border Force has to be in both places?

MR BROWN: Yes, Commissioner, there's a significant subsidy. I know Qantas often refers to a number of \$25m. That's a very defined part of the project, of the build. There are additional costs on the project in addition
45 to that, but as I am sure you can imagine duplicating facilities of Border

Force agents, quarantine agents and Federal Police agents when there's already capacity in an existing facility and having to duplicate that, and doing that on a 24 hour basis, you know, it's maybe six to ten officers on duty at one time, but you need four or five times that to actually maintain that around the clock.

So, yes, a very considerable subsidy involved in duplicating facilities. It's extremely inefficient, and in addition to that you end up then having to duplicate security facilities, that you do not get the economies of scale, and the customers in the international terminal (T1), then having to pay a greater proportion of the costs of providing that security facility that's not being maximised in its utilisation for other flights who get a very significant subsidy.

COMMISSIONER LINDWALL: Do you have an estimate of that subsidy?

MR BROWN: I do.

COMMISSIONER LINDWALL: Are you able to share with us.

MR BROWN: I can't but it's a significant number; many, many, many millions of dollars.

COMMISSIONER LINDWALL: The monitoring report did say that Perth Airport costs per passenger are higher than other monitored airports. Could you describe why that might be the case?

MR BROWN: I will pass to Brian in a second, but that high level perspective there, Commissioner, you understand we had significant investment to do with the mining construction boom. Since then (indistinct) a million less passengers are passing through the airport. So, yes, when you look at the cost per passenger it does look disproportionately high. That has not been passed through to the airline partners during that deal. The forecasts and the development costs at the time were locked in. A million passengers have come off. That is a cost our shareholders have absorbed in the process. But as you will see, and it's been mentioned in the ACCC reports, those costs have actually continued to reduce over the last few years, Brian - - -

MR PEREIRA: That's right. So just to add to what Kevin just said the previous seven year agreements which started in 2011, obviously based on - informed by a building block model - had a trajectory of costs and a passenger forecast that underpinned that price.

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COMMISSIONER LINDWALL: During the peak of the mining boom.

5 **MR PEREIRA:** During the peak of - well, yes. I guess the cost base that was locked in there was what actually informed the price. So to the extent that Perth Airport incurred costs beyond that embedded costs in those agreements at the expense of the airport. So they were not passed on to the airline partners.

10 Then to add to Kevin's other point we have lost almost a million passengers since that mining construction boom. Again that's a passenger risk element that Perth Airport takes. Linking up into new agreements that we have just started from 1 July, and again 23 of our airline partners have got agreements, we have incorporated into those agreements efficiency dividends where we're actually locking in a CPI minus efficiency dividend to those prices to actually hold ourselves accountable to delivering more efficiencies of a time, because we do recognise, and certainly in the last two years we actually have taken costs out of the business, and we're not finished yet.

20 **COMMISSIONER LINDWALL:** What's the size of the efficiency dividend?

MR PEREIRA: We can't share that with you.

25 **MR BROWN:** I think is it fair to add, Brian, that the cost efficiencies that we have been working on are being passed through in terms of our most recent pricing. Our pricing has reduced significantly.

30 **MR PEREIRA:** Yes. So I think that's the other point. So every airline that has entered into agreement with us is now paying less than what they were previously paying under the previous agreements, anything between 11 per cent and 25 per cent less.

35 **MR BROWN:** I think, Commissioner, when you put that in the context our on-time performance is strong, our customer service ratings are strong from both our airline partners and the passengers and our costs are reducing. I think that's a good demonstration of running the business effectively and efficiently.

40 **COMMISSIONER LINDWALL:** Obviously mining booms are very difficult to predict. Governments were unable to, Reserve Bank unable to - in fact there was a long series of predictions that it would continue, mining investment (indistinct) for a lot longer than it did. Some people even said the terms of trade had become perpetually higher. Did that factor into your anticipation of the growth into your terminals and other

45

activities, and perhaps you overestimated the growth that might have - obviously it's a million less now. Were you affected - I guess my question is going back in the other direction where there was a period before the mining boom when you were caught effectively by surprise with the growth of the passenger numbers because of the mining boom. Did that change your attitudes and you tended to overestimate a path of the mining boom? Is that a bit confusing what I just said?

COMMISSIONER KING: Did you make a mistake? I think that's what - - -

MR BROWN: I think if we look back at the terminals that were built, the terminal 2, the fly-in fly-out terminal, that was probably getting closer to its capacity during the boom, and it's a terminal that we're seeing a growth coming back again. So, no, I don't believe we made mistakes. We are facilitating the economic development of the state and it's important as the key infrastructure asset that we're able to do that, that the state is able to fully realise its economic worth. I think where we - and it's one of the reasons, and it's been in our master plan for some time, and that's why we are progressing bringing all our terminals together centrally is we really want to work with our partners, including Qantas, and we've had these discussions. We want to see common departure lounges. We actually want to see with domestic and international terminals are effectively one and the same as the terminals I was used to operating in the UK where you have no more deficient swing gate capability then that gate can be used for either or, because there are peaks in domestic and international at different parts of the day.

Your terminal doesn't have to be so big, you don't need as many gates, you don't need as much apron to park the aircraft. Then you don't need as much taxi way infrastructure to connect to the runway. So, the whole philosophy of bringing our facilities together to make it easier for the passengers to transfer from one terminal to another and to do it more cost effectively and withdraw those – remove those subsidies at the border agencies, make the security at its optimum operational level and not duplicating, that's where the cost base can continue to reduce.

That's why we're confident that we will be able to continue to go over that cost base by bringing the airport operations together. And that will negate the need to build the standalone individual terminal. So with that existing infrastructure, enjoin that with what we're proposing allows us not to have to build this large infrastructure. But we're working closely with the government and our airline partners to make sure we can actually get that true common departure lounge capability which will be of significant benefit across the whole aviation sector in Australia.

COMMISSIONER KING: So, the situation that you've gone through at Perth Airport, it's unfortunate from Perth Airport's perspective, but it is an interesting situation where you've had a significant drop in passenger numbers, and it was presumably unexpected. How did you see the airlines responding over time, so particular major domestic airlines. Did you see them relatively quickly reorganising their schedules, reorganising their fleet, perhaps not upgrading the fleet as they had intended to do for at least one of the carriers, how quickly did that occur or has that been a very slow process over a number of years, I mean, just from the airports perspective, what sort of flexibility did you see that the airlines perhaps had to – you can't get rid of your – well, maybe I would get rid of a terminal. Your capital source, how quickly could they adjust their capital?

MR BROWN: Well, within the same day. I mean, you just canceled the flight. You don't fly anymore as we heard earlier on today. I can't role up the runway and the terminals and move them to the east coast of Australia. The airlines, when I was working on the east coast of Australia, we saw flights coming out of there, coming here, they move with the market. As in, there's aircraft now coming back from the east coast to the west coast, because there is – there's an uplift in terms of that mining traffic again, it's starting to come back again. So the aircraft can be moved immediately.

The airlines have that maximum flexibility, we don't have that in our business. And that's where we take the risk on the passenger numbers. We're talking about seven year deals and working off forecast and they are challenged by our airlines partners. So, they're with us in looking at those numbers and then determining what's the capital spend in the infrastructure to support that growth. So, we're all putting our heads together and that's part of the negotiation process to understand what may be around the corner. But none of us have a crystal ball. But certainly the airlines have moved aircraft and east. They can also down gauge aircraft to go to smaller aircraft and they can reduce the frequency and we've seen all of that happen.

And I think we're starting to see some of that come back again. And just going back to Barry's point earlier, I mean, if you look at our cost base with that million passengers who are projected to be there, if you actually put that million passengers back in there, our operating costs are very similar and equivalent across the average of the other airports. But we can't rely on what it may be, that's why we continue to look to cut our costs accordingly and what we can do through the lean practitioners and our team, our continuous improvement ethos to improve what we do at the airport in terms of our cost base.

5 But it's not just about cutting costs, it's the efficiency in the productivity and how can we serve our airlines customers better and make sure that the bags are delivered on time. The aircraft to depart on time, the customers do get a good experience, that the airport is clean, working, friendly, safe and secure. Those fundamentals can never be lost and that's certainly something very close to our team and I think the findings from the ACCC report and the independent customer satisfaction survey suggest that we do focus on those. And that's why for us working with Barry and BARA in developing these service standards is not an alien concept, we very much welcome
10 Barry and his team on that, and I think together we'll actually develop a much superior outcome.

COMMISSIONER KING: I was going to go to land side - - -

15 **COMMISSIONER LINDWALL:** You go on to land side, yes.

COMMISSIONER KING: All right. How do – so the airport has charges, for example, for taxi pickups, for ride sharing pick-ups. Actually, do you have charges for off airport carpark buses picking up – so you don't have the charges there?
20

MR BROWN: No.

COMMISSIONER KING: All right. I'll put to you the same way that I put to Adelaide Airport, why not?
25

MR BROWN: Well there's a number of reasons – there's the key – well, there's the two key ones, public transport and its evolving in Perth, it's not quite where it should be but there is an inefficient – you know, there's an efficiency of people coming on the bus or coming on the train and the train will be connecting into Perth's central precinct by 2020, which will be very much welcome. Otherwise you have to keep lengthening your forecourt. It becomes very inefficient and what you do when you lengthen your forecourt, you make people walk further away, you're actually giving them
30 an inferior service. I don't want to annoy my passengers and my customers, I actually want them to have a good experience. If they're in a good frame of mind, they will come and enjoy the experience, they might actually come sooner and they might actually spend more in the retail establishments.
35

40 So, there's a commercial perspective, you want to get your customers in and out of your facility smoothly. You don't want to congest them. And we certainly do not want to damage the fundamentals of our business which is the on-time departure of our airline partners' aircraft because passengers are not turning up or they're congested and can't get into the terminal
45 through check-in, through security, embarkation control and on the aircraft.

5 So, we're looking at this more holistically. So, it's more efficient to get people in and out, the airport operates more smoothly. And we are very much unique as an airport, we don't charge the off airport carpark operators, but we've actually got an off airport carpark operator who actually operates on airport. They're actually located within our carpark in both precincts. So, we're not shy of the competition and I think if you want to try and fight the shared economy that's evolving in our planet then I think you're on a hiding to nothing. So, you know, we're one of the first airports that encourages Uber and Ola to operate through the airport along with the taxis.

15 Yes, that does take business out of our carparks but that's part of the value in choice that our customers expect whether they want to use a free drop off and pick up or they want to use the bus or use the train. Or come on their bike on the bike paths, however it might be, we want to make sure we offer the full value in choice. And we're not scared of the competition that that brings with all these different mediums, the off airport or the on airport competition. That's healthy practice and we welcome that. Keeps us on our toes in terms of us commercially being focused on our pricing structure and our service standard. So, I don't think it does any harm.

20 **COMMISSIONER KING:** Yes, but following on that logic, you do charge the taxis and the ride share operators a pick up charge. Why do you charge them, on your logic, you should be saying well they don't get charged either?

25 **MR BROWN:** Yes, well you understand taxis typically would take one person away at a time. There's multiple taxis, we have holding areas for taxis, because there's literally hundreds of them. We then actually have to build the forecourt with dedicated lanes just for the taxis. The space one bus takes up, that takes 60, 70 people away, versus taking 60 to 70 cars in space, it actually takes up a lot of valuable space at the front of the airport.

30 But what we are very much focused on is that competitive neutrality in terms of what we charge all our Uber and taxis, it's all the same pricing, \$3 per pick up, there's no cost for drop off. But they just take up a lot more space. As time goes on, we probably actually have to consider a multiple story car parks and actually having multiple layered forecourts to actually make sure that you're getting people with what they want as getting close to that front door and into your terminal. You can't keep extending forecourts. One of our longest forecourts in Perth Airport is in Terminal 2, the fly in, fly out terminal, its 220 metres long. It's one of the most congested because of its very peakiness of people dropping off and picking up. So, we're looking at different methodologies and controls to try and actually encourage people to use it for what it's made to be. It's not a

carpark, it's there for the efficient movement in and out of vehicles of the forecourt. And that's why we offer an hours free parking in our long term carpark.

5 If you turn up too early, you can use our app and monitor where the aircraft is and park for free and then drive around when the person's ready to pick up. If you're closer in, you can have ten minutes free in the short term car park just behind the forecourt, if you want a bit more time to pick up. So, there's all of these different mediums coming together but its value and
10 choice for our customers and – because not a lot of customers – you cannot provide a one-size fits all service for your customers. You have to provide the service to the full range of our customers and the 14 million passengers that use our airport each and every year.

15 **COMMISSIONER KING:** I think your submission, one of your submissions, you stated that – and I don't know which one unfortunately. I know it's on p.3 of one of them. In your submission you stated that for land side access operators, this is a quote,

20 *PAPL does not therefore negotiate applicable access charges with any individual operators within any given mode.*

So, does that mean once you've got those access charges, you simply provide them to service providers, you know, as a take it or leave it offer,
25 this is the charge, you pay it if you want to - - -

MR BROWN: I'm sure you can understand there's thousands of taxi drivers in and around each city and I think - - -

30 **COMMISSIONER KING:** But they're not the only providers - - -

MR BROWN: yes, there are of course many car hire operators. But the dispatch operators that the taxi operators work to, we work with them in terms of what options or service provisions there should be or what's
35 working or what's not working and well and what the charge may be. But if you look at our taxi access charge, I think in the last 17 years, I think when it was first installed and it's only been changed once since then. So, it's not something that has changed on a regular basis. We're actually investing, I think it's \$12m to provide a system for the whole airport that
40 actually negates the need, that's more of a tolling system rather than the gold coins, and actually to speed up the movements of taxis and actually predict where the taxis are needed because they're tracked on site to make sure we get the right number of taxis in the right terminal at the right time.

And that they're feeding through from the rank to be where the passenger meets them at the time that they need them. So we are investing in these systems to actually make a smoother operation and make it more efficient for the taxi operators and they can remotely determine if there's actually a
5 need for them to come to the airport because the demand is about to spike or if it's a quiet period and there's no demand in which case they can go and make money somewhere else. So, it is adding value to the operators but we work through the dispatch companies to have those discussions.

10 **COMMISSIONER KING:** Okay. So that's going forward but the \$3 that you've got in place. I assume there's no great science behind that. It's a coin based system, as I understand it, for the airport so it's presumably – it's got to be \$2, \$3 or it's got to be a multiple of gold coins going in there. Is that all the science that's behind it?

15 **MR BROWN:** Yes. It's a bit clunky and obviously it doesn't speed up the departure because someone getting the coins out and pushing them into the hopper this new system will eradicate that.

20 **COMMISSIONER KING:** Will that mean a significant increase in charges?---No.

COMMISSIONER LINDWALL: Will it lead to any increase?

25 **MR PEREIRA:** We're still modelling that but we're not expecting that to change radically.

COMMISSIONER LINDWALL: On jet fuel.

30 **MR BROWN:** Yes

COMMISSIONER LINDWALL: Could you describe what you think of what's happened in Melbourne, for example, the open access system, how
35 are you happy about the security of supply in Perth and would you consider moving to more of an open access regime there?

MR BROWN: Most definitely and this is one of the key projects that BARA is driving and I think it's fair to say we very much share various
40 principles on the fuel supply at the airport.

MR PEREIRA: So we are in the middle of negotiations. The current ground lease ends in three years' time. So all the discussions are around the key objectives that we're trying to achieve and one of them is security of
45 supply and one of them is open access. So the key objective for us is to work with the JUHI operators on a new open access model. And so far the

negotiations have been moving towards that and we're looking towards the Melbourne model as perhaps one model that could work but we're looking to get more transparency on that one to make sure that - - -

5 **COMMISSIONER KING:** Would you consider the Darwin model, for want of a better term where you actually own the infrastructure?

MR PEREIRA: No, we don't see that as our primary role to own that infrastructure. If we can facilitate the objectives of open access without
10 actually owning the structure then that would be preferable.

COMMISSIONER KING: Okay, that's fair enough yes.

COMMISSIONER LINDWALL: Qantas in its submissions spoke about
15 security costs and it said that it could – that many of the airports provide the same level of security at a much lower price. That's what they've said, what do you – you don't agree, obviously otherwise you'd get Qantas to provide the security.

20 **MR PEREIRA:** Yes, we recently took over Terminal 4 as part of the detailed transition piece and I can confirm that the security cost that we have applied going forward since transition is actually slightly lower than what Qantas are paying.

25 **MR BROWN:** And I think a fact of the contribution to that is the economy of scale of right of operating the security across the terminal, you need less management supervision. Whereas if you have a distinct company then it's got its own supervisions. So, we're extremely proud of our security standards which are important but the cost is important as well. But that is
30 discussed and it's a straight pass through cost. And there's an annual wash up that returns any overrecovery, obviously more passengers come through and that's helping dilute the overhead, then that money is returned back to airline partners.

35 **MR PEREIRA:** And to that end, the transition involved taking over the existing same operator which is different to the operator at the rest of the airport. So for us, we believe that actually there's opportunities to further drive those costs down again once we get economies of scale, by providing a single operator cost on all the terminals.

40 **COMMISSIONER LINDWALL:** Do you have any more questions – you don't have any plans for a major new runway or something (indistinct)?

MR BROWN: We do. We have a parallel runway – we are - - -
45

COMMISSIONER LINDWALL: So it's in your master plan?

5 **MR BROWN:** It is. It's being designed at the moment. We estimate it will be probably be required sometime between 2023 and 2028, that will depend on the passenger forecast. Currently, our movements are 132,000 a year. During the mining construction boom, we were up to 152,000 movements a year. Modelling the aircraft movements of the resource sector on its demands, actually , a new parallel runway will be required to serve 10 140,000 plus movements per annum. We actually need to have the parallel runway to maintain the on time departure, and that's why we go back to the last mining construction boom and some of the congestion existed because it was over that threshold and we cannot allow that to happen again. So, that's why the design is in development at the moment and they're working with the airline partners to make sure that that's an efficient design.

15 **MR PEREIRA:** So, typically planning and environmental approvals and the like take several years.

20 **MR BROWN:** Of course.

MR PEREIRA: And I think during the mining boom, airlines were crying out for that second runway. So what we're doing is actually doing all the work now to make sure that project is effectively shovel-ready and the boom if and when it returns, will be ready.

25 **MR BROWN:** Well, that's a cost that we are bearing to develop that to have it ready. It's not an insignificant cost in terms of the design and development of the runway. It's possibly in the order of \$50m to actually get it shelf-ready. So that's a cost we're wearing to make sure that we're 30 able to make sure that our customers, our airline customers, are actually able to operate the business affectively as the passenger numbers increase.

35 **COMMISSIONER KING:** Now Sydney regulatory restrictions, I have asked this to other airports too, what type of (indistinct) on Perth and restrictions to Sydney's airspace?

40 **MR BROWN:** Well, I think we've heard earlier on, when there's a sneeze the others catch the cold because the aircraft are obviously coming across the country and there's a lot of flight movements into Sydney - - -

COMMISSIONER KING: But you've got the issue that you're further away, therefore there's less time that you have to be – the weather changes more rapidly - - -

5 **MR BROWN:** And we do see that if aircraft don't get away in time or if there's weather issues or if there's any mechanical issues with aircraft unable to leave on time, and that can result in flight cancellations and they actually can't depart, they then have to cancel the flight and people get stood down and moved for the following day. So, yes, weather conditions have quite an impact on the network as well. Sydney is certainly prone to some significant storm weather.

10 **COMMISSIONER KING:** But you don't have the same issue as Adelaide with the extra tarmacs and the planes kept idling for long periods of time, half an hour or whatever they said.

15 **MR BROWN:** Well, potentially passengers can sit on the tarmac to be delayed because Air Services Australia will hold the aircraft and there's no point putting the aircraft into the air until they know that there's a slot to land at the other end. It's not good for the environment but equally the passengers get frustrated sitting on the ground for long periods of time and they just want to make their way on their journey.

20 **COMMISSIONER KING:** (Indistinct) final question in which case I think we've finished, thank you.

MR BROWN: Thank you.

25 **COMMISSIONER KING:** Thank you very much.

MR BROWN: Thank you.

30 **MR PEREIRA:** Thank you Commissioner.

COMMISSIONER KING: Thank you. It's time for lunch now. So we're due to resume at quarter past two with Cbus. So let's go and have a bite to eat.

35 **LUNCHEON ADJOURNMENT** [1.08 pm]

40 **RESUMED** [1.48 pm]

45 **COMMISSIONER LINDWALL:** Well, welcome back, everyone. I'd like to introduce and welcome Cbus, and if you've introduced yourselves, give a statement that you see fit.

MS CALLEBAUT: Diana Callebaut, head of infrastructure at Cbus.

MR BRACKS: Okay. And Steve Bracks, the chair at Cbus; I've been the chair for the last 10 years. And obviously an asset owner, and it's that perspective I guess, I'm presenting here today. So, would you like me to proceed?

COMMISSIONER LINDWALL: Please, yes.

MR BRACKS: Well, first of all, could I thank the Commission for the opportunity to appear on behalf of Cbus Super. We are an industry superannuation fund; we represent about 750,000 members, about 150,000 employers. We have about \$50 billion in funds under management; we're not the largest fund, but we're in the top quartile of the large funds in Australia.

At any one time, we would invest in the (indistinct), in property and infrastructure, probably about 25 per cent of that \$50 billion; about half of that in infrastructure, about 12 and a half per cent. Or in our terms, something like about \$6.2 billion we'd allocate to infrastructure, both in Australia and internationally, either directly or through other managers that we employ to undertake that.

At the moment, superannuation funds hold about 47 per cent of the equity in Australian privatised airports, so we're a significant player. We have, as Cbus, invested \$5.5 billion, so we've got some capacity for further investment at the moment in global infrastructure assets, of which 22 per cent is committed to Australian airports; so a significant exposure. We're invested in all four airports currently monitored by the ACCC, as well as holding stakes in Adelaide, Launceston, Darwin, Alice Springs, Tennant Creek and Parafield.

As a not-for-profit member fund, we're certainly proud to be investing in Australian infrastructure assets that drive economic growth such as airports.

And whilst, as I mentioned at the start, I appear on behalf of Cbus, I can say with some certainty that other superannuation funds are equally as proud of the investment in our airports across the country.

Cbus has been investing in Australian airports since 1997, with look-through ownership of over 5 per cent, and 10 per cent in Melbourne, Launceston and Perth Airports, respectively. Over the years, a key pillar of the investment theses for Cbus investment in Australian airports has been the predictability of returns, which has been supported by the consistent application of the current light-handed regulatory approach. It

is the consistency of process, as well as the predictability of outcomes that cannot be underestimated.

5 We are privileged to have the opportunity to invest in a range of
infrastructure assets in different sectors and different geographies,
however, as a result we are required to prioritise the allocation of capital,
to maximise return for our members. From a portfolio perspective, a key
pillar of the investment theses for the infrastructure asset class is
10 predictability of returns; a reduction in that predictability for a certain
sector therefore reduces the likelihood we will allocate capital to that
sector in the future. And we have options, clearly, in investing in other
infrastructure in other areas.

15 The benefits of a stable Australian airport regulatory framework are
unambiguous: Over \$15 billion has been invested in airport infrastructure
since 2002, including \$10 billion in aeronautical assets. There is an even
greater task ahead, with an estimated \$20 billion of infrastructure
investment required over the next 20 years. We are keen, Cbus is keen, to
20 support new runways being built in Melbourne and Perth, and the
realisation of a range of other opportunities at regional airports.

25 The investments that make up this \$20 billion in spending are vital to
ensure both safety and amenity for domestic and international passengers
alike; they are also investments that help foster competition in our skies,
benefit passengers directly by lower airfares, and improve the
competitiveness of our economy overall.

30 To ensure the continued availability of capital, and the benefits to the
consumer and the economy overall that flow from this capital investment,
it is critical that the current light-handed regulatory framework - which
has been implemented so effectively over the last 15 years - is continued.

35 We've had some experience of more heavy-handed regulatory regimes in
the energy and water sectors in Australia and the UK; we held some water
assets in Thames Water - which we thankfully sold - those regimes
involving explicitly setting out the allowed financial return for each
business. This has presented a number of challenges for investors in these
sub-sectors, including investment stress and significant caution regarding
40 investment of future capital.

45 More broadly, the increase in regulation and uncertainty has increased
volatility and sector-specific sovereign risk, with no change to return to
offset that risk. And that is something that we would cost and identify,
and we would expect compensatory increased returns if that was to be the
case, which this asset class wouldn't give.

5 Since the Commission recommended the removal of price controls in 2002, the problems that bedevil these industries, from both the perspective of investors and consumers, have been avoided in the Australian airport sector, and the benefits to the community are plain to see.

10 Cbus admits that regulatory stability is a key - if not the key - driver of new infrastructure investment, and in providing further capital to existing investments. We understand the complexity of balancing different stakeholder objectives. We are a responsible investor and we acknowledge the importance of having a social licence to operate, from the communities we interact with. We expect that the businesses we invest in - if they do possess an element of market power - will not use it to the detriment of the community and we're pleased that the draft report
15 finds this in relation to the monitored airports.

20 We believe evidence supports the view that the current light-handed regulatory regime has successfully balanced airport, airline, community and other stakeholder objectives. It has enabled the owners of Australian airports such as our members, to generate sufficient returns to promote required investment, while not earning excessive profits, and this investment has contributed to the growth of the Australian state economies. The current light-handed regulatory approach has encouraged the negotiations that generate commercial outcomes and the innovation
25 that comes with competitive markets, to benefit communities.

30 The light-handed regulatory approach should be maintained, in our view. And I'll stress again, that we do have options. If you look at the competing infrastructure investments that we undertake: ports; we own I think most of the ports in Australia, the Port of Brisbane, Botany, Port Kembla. Roads, the toll roads. These are predictable, certain, long-concession deeds.

35 There is less certainty and more volatility in airport ownership, and therefore, ensuring that we have the proper regulatory regime is going to be very important for our future investment in those. Otherwise, you know, clearly, that future capital requirement will not be able to be met for reinvestment and/or, we will look at looking at new investments in other areas.

40
45 **COMMISSIONER LINDWALL:** Okay, thanks very much. Could I start by asking about, if you could compare and contrast the ownership of a listed company like Sydney versus the other airports? And you're a passive investor, is that right, or - - -

MR BRACKS: Yes.

5 **COMMISSIONER LINDWALL:** You do have this social licence to operate. Obviously, you expect of your investors, investments, but how do you manifest that and compare it and contrast the listed company versus the unlisted ones?

10 **MR BRACKS:** Yes. We largely invest through a vehicle, through IFM Services, which we're a shareholder in; one of the largest shareholders in it. And they bulk-up, if you like, the investments from several super funds: Australian Super, Hesta, Hostplus, Cbus. And they invest on our behalf, with our agreement and support, into these assets.

15 As a result, IFM Investors are able to nominate for the board; for example, I think there's one or two, I can't remember now. We also have another vehicle, Morrisons UTA, in which we have a significant investment through that infrastructure manager, in Perth Airport; I think something in Melbourne as well, from there as well, but certainly in Perth.

20 So we do it through those investment vehicles, and we have a stakeholder as a result of that, in the management of those airport facilities. So, that would be different to a listed company. Well, we're a shareholder in that as well, by the way.

25 **COMMISSIONER LINDWALL:** Yes.

30 **MR BRACKS:** I think superannuation funds, more broadly, have about 20 to 25 per cent of the Australian listed market at the moment. And with the funds under management growing and tripling in the next 10 to 15 years, we'll probably have about 30 to 40 per cent of the Australian listed market. So, we do have holdings there as well, but that's a much more passive investment from that point of view.

35 **COMMISSIONER LINDWALL:** You've implied before, or you said this before, but just to be clear: if the airports - as some participants have said - have been exercising their market power and earning excessive profits, would the claim be that you're happy about that because you're earning a lot of money for your superannuants and therefore, you can sit back with a lazy investment that's earning you a good return?

40 **MR BRACKS:** No, that's not true. I mean, we're not talking about excessive profits; we're talking about profits which are meeting a threshold which is required for that risk profile of that investment as a return to our members. And it's not excessive from that point of view; it is reasonable and adequate.

45

5 But, it's on the edge, you know, it's very likely that if there was significant change that it might push it back over the edge and that we wouldn't be an investor. So it's not unreasonable; it's not dissimilar to the return of any infrastructure asset we hold.

COMMISSIONER LINDWALL: Do you want to add to that, Diana?

10 **MS CALLEBAUT:** Yes. I mean, we are a strong supporter of the current regulatory framework, and obviously there is always the credible threat of it becoming heavy-handed regulation. So it is not in our interest to actually earn excessive profit.

15 **MR BRACKS:** Because it could be manifested and - - -

MS CALLEBAUT: Because it would manifest and change the regime, and that presents increased risk for us and would be more challenging for us to invest more capital. So that's sort of just my additional - - -

20 **MR BRACKS:** I suppose the other thing is that we're long-term investors so we're not after – we're not listed, we don't have to mark-to-market regularly. And so as long-term investors we're looking for long-term sustainable returns. So that really obviates the need for any excessive profits - - -

25 **MS CALLEBAUT:** I would probably just add to that a structural comment, which I think is relevant. Is that as Steve previously indicated, we are invested through our two fund managers, both are open-ended funds. There's no exit. So often when there's an exit there is more pressure to increase profitability, but we are long-term investors, as Steve said, and we intend to remain invested, subject to the appropriate risk return profile of the investments.

30 **COMMISSIONER KING:** So, Steve, you did mention a threshold level of return that you would be looking for in an airport, are you able to say what that threshold is?

35 **MR BRACKS:** I think I was told not to. But it's probably not a great surprise that for the risk profile of infrastructure investments with the CPI plus 5 per cent type range, I think would be the – and that's commensurate with the sort of risk of that asset class.

40 **MS CALLEBAUT:** But it would also be fair to say the return is contingent on the maturity of the airport and obviously how long you've held it and the

size. There's a number of factors, and as Steve said, we've got exposure to multiple airports, so they're actually different.

5 **COMMISSIONER KING:** Yes. And you did mention I think the volatility of airport ownership compared to say long-term or long concession toll roads, for example.

MR BRACKS: Yes.

10 **COMMISSIONER KING:** So would you expect a higher return or a higher threshold return for airports and for, say, long concession toll roads?

15 **MR BRACKS:** Yes, you would. Because clearly the revenue is different to a long concession deed, which is predictable rate of return each year for the next 25 years. It requires the economic activity of the airport, you know, landing fees, retail, car parking, all the rest of it, and that's really market driven. If it's market driven it's going to be less certain and less predictable. So yes, we would require a higher rate of returns as well.

20 For example, we know in purchasing a concession deed on a port that that port will largely operate in conjunction with the state gross product of the state in which it operates. It's largely sort of almost equivalent, whereas airports are not.

25 **MS CALLEBAUT:** There's a larger discretionary spend component in airports than there is....

30 **COMMISSIONER KING:** Just to follow up on that, does – because think of toll roads and ports, does the location of airports in that production chain of passenger transport, the fact that they are reliant on the airlines, unlike a toll road, it's directly – it's dealing with the end users. Does that change the way that you think about the risk of airports?

35 **MR BRACKS:** Well, yes.

40 **MS CALLEBAUT:** Yes, well location is obviously important, whether it's a toll road or an airport, and there's an illiquidity element to that the more remote it is. But, broadly, if you were looking in the same jurisdiction and you kept everything neutral, a toll road receives a lower return threshold than an airport.

COMMISSIONER KING: Okay.

45 **COMMISSIONER LINDWALL:** Obviously we've observed this inquiry and there's been a lot of, how would you say it, argy-bargy, for want of a

5 better term, over the negotiate-arbitrate model and increasing regulation from its current level. Why do you think this has been manifested, obviously some participants think that or claim that the returns are excessive and a new model is needed to bring them down, you don't concur with that. Apart from what we've spoken about the implications of such a change in regulation, but why do you think it's being brought out in such a way now?

10 MR BRACKS: I'm surprised it is being, in a sense, because if you look at the last 15 years, there's really only been one case which has been brought before the courts for consideration, and that's in Perth, is my understanding. Otherwise, the market has operated, as it should. That is contractual agreements, commercial negotiations have been the key issues which have dominated, and we would see that as a material matter that was a move
15 away from those matters of commercial arrangements and contract arrangements to an arbitrated system.

20 We would see that as a trigger to effectively say that there is heavy-handed regulation and probably therefore we have to account for that risk. And we would. I know in the work that Diana does, she would come back with a different return rate and risk profile that we would have to give to that asset class if that was the case, which would require a premium, a greater return.

25 **COMMISSIONER LINDWALL:** Presumably because there is a threat of regulation under the current system, which of course is – consists of annual monitoring and the five-yearly Productivity Commission review, that itself has a little bit of a risk element to it.

30 **MR BRACKS:** It has some, but it's predictable.

COMMISSIONER LINDWALL: Predictable, yes.

35 **MR BRACKS:** I think that's the key issue. And it's been accounted for. To interrupt that, to change that, I think would be a material matter which would have significant impact on investors. That is, would we look at re-investing \$20 billion into the future? Well, yes, we might if you gave us a higher return and compensation for that.

40 **COMMISSIONER LINDWALL:** Yes, of course.

MR BRACKS: Basically. Because in the end, you know, we're serving our members and the best interests of members, and making sure we maximise the benefits for them in retirement is the key. So we want to make sure that we account for that.

45

COMMISSIONER LINDWALL: How would you compare your investments in Australian airports compared to overseas airports and the regulatory structure, say, of those airports?

5 **MR BRACKS:** Similar.

MS CALLEBAUT: Yes, so they're obviously different structures. I think the critical aspect of it is that when you invest you invest along the assumption of the regulatory regime in place and how that's going to play out going forward. So it's all about being able to price in at that point of acquisition, what you expect going forward.

COMMISSIONER LINDWALL: And the reliability.

15 **MS CALLEBAUT:** Correct, and the reliability of that. So the challenge is once you're invested when there is a change, because that changes the risk profile once you're actually already invested. If it's already set at the beginning, it's a different evaluation.

20 **COMMISSIONER LINDWALL:** You took that into account.

MS CALLEBAUT: Correct, correct.

25 **MR BRACKS:** And we had the situation, not an airport, with – before your time – THAMES Water, which we were an investor in, and the regulation changed, heavy-handed Government regulation came in, we divested that asset, we didn't re-invest in it. That's an example, I guess, to a large extent.

30 **COMMISSIONER LINDWALL:** So are you able to expand on that? So was it – I mean, if it's a one shot change to a heavy-handed regulation - - -

35 **MR BRACKS:** It was price – controlled price regulation which the regulator was enforcing, which wasn't enforced previously, and that caused us to look at redeeming that asset, which it took us a couple of years, not easy to redeem an asset, but we did, and we redeemed it.

40 **MS CALLEBAUT:** But just building on that, it's also a signal about the certainty going forward, and so in the case of UK Water, there has been increasingly adverse regulatory determinations across time and we have actually other exposures there through funds, and it is – as often is the case, it's only in retrospect we can look back and say that divestment decision was the right decision, because subsequently on these other assets we've had come under a lot of stress.

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5 **COMMISSIONER LINDWALL:** Could you think about or postulate some – we’ve obviously outlined some changes to the current framework in our report, but I don’t know if you want to comment on particular recommendations. But if you were to improve the current regulation of airports, where would you be looking?

10 **MR BRACKS:** I think we’re happy with the direction that the Productivity Commission’s going in, so we’re happy and satisfied that what has been proposed in draft form today is where we would see significant benefit going forward.

COMMISSIONER LINDWALL: But you see an important role for five-yearly or so reviews?

15 **MR BRACKS:** Totally, yes. No question, yes. Public transparency and monitoring is very, very important and we would support that.

20 **COMMISSIONER KING:** One of the proposals that has been put up is a negotiate-arbitrate type approach put on the airports and the airlines, which I suspect their opponents would say that is an alternative light-handed approach to regulation, I don't think they'd characterise it as heavy-handed but they're obviously for themselves. What would be Cbus's, would Cbus think that is a useful way forward, would Cbus have concerns about that as a way forward?

25 **MR BRACKS:** Arbitration?

COMMISSIONER KING: A negotiate-arbitrate regime being - - -

30 **MR BRACKS:** We'd have concerns about it.

COMMISSIONER KING: Why?

35 **MR BRACKS:** The lack of predictability on outcome I think, in relation to the original undertakings that you had when you reinvested in the asset in the first place, which might disrupt therefore the effective return that we envisage. Without compensation - if there was compensation, if that was applied to investments (indistinct) okay, we could have a look at that.

40 **COMMISSIONER KING:** But the point is, it's an increase in risk and you want an increase in returns, not just - - -

45 **MR BRACKS:** And we're obliged if there is an increase in risk to identify it, cost that and it will be a factor in our thinking in the future.

COMMISSIONER KING: I think we have probably exhausted everything we could ask here - there's lots of other subjects but in terms of airports, anyway.

5 **MR BRACKS:** Right thank you.

COMMISSIONER KING: Thank you very much.

10 **COMMISSIONER LINDWALL:** So now Frontier Economics, if they are here? Hello, I'm Paul Lindwall, good to see you. Again, if you wouldn't mind introducing yourselves and give us statement as you see fit?

15 **DR WILLIAMS:** I am Philip Williams, I work at Frontier Economics.

MS WILSON: Anna Wilson, also Frontier Economics.

MR DAVIS: And Warwick Davis, also from Frontier.

20 **DR WILLIAMS:** I thought I would open by talking a little bit about a couple of lessons for this inquiry, generated by the literature on multisided platforms. An airport is a multisided platform, like a shopping mall. Airports offer aeronautical services to airlines, pipeline services to suppliers of fuel, car hire concessions to car hire operators, retail
25 concessions to retailers and on occasion, car part concessions to car park operators.

An airport does not necessarily determine the pricing and marketing of the services of the users of the platform. In the case of most Australian
30 airports, the important exception to this is the operation of car parks. In Australia, airports tend to be vertically integrated into the operation of car parks, rather than offering these services as part of a multisided platform. There are a number of contributors to the literature on multisided
35 platforms who observe that platforms sometimes choose whether or not to vertically integrate into one or other of their sides. There are positive network externalities among the various services produced by airports, however, like newspapers, these network externalities work predominantly in one direction. The greater the take-up of aeronautical services, the greater is the demand for the various non-aeronautical
40 services.

Some multisided platforms tend to tip to monopoly; airports tend to tip to monopoly principally because of interconnectivity. Each airline wishes to land and take off from the airport used for other routes, so that passengers and freight can interconnect or particularly passengers. Only in large
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cities do we observe multi-homing by airlines. In a multisided platform controlled by a monopoly supplier, the platform owner is in a position to seize all the gains from interactions among the participants on the platform. That is a quote without acknowledgment.

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My first proposition is this - or the first question I wish to address is this. Has the existing regime been effective in deterring potential abusers of market power by airport operators? The Commission has been asked to consider whether the existing regime is effective in appropriately deterring potential abusers of market power by airport operators. How should one assess the market power of an airport? The tendency to tip to monopoly does not necessarily mean that each airport has substantial market power. The ability of a monopoly to generate monopoly profits will depend on the demand for the various services that it produces. Indeed, even a single producer monopoly may have little market power if demand for its services is relatively low compared with the fixed costs it needs to recover.

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When analysing the market power of a multisided platform, one should not treat each side as a separate market; one must acknowledge the externalities that exist between the various sides of the platform. Prices on one side of the platform need not reflect the cost of serving that side.

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The operator of a platform will balance the participants on the many sides of the platform. For this reason, one cannot assess the monopoly power of an airport by comparing the price of one of its products with its long run average costs. In particular, if the externalities flow overwhelmingly in one direction, the price of the originator of the external benefit may be close to, or even below, marginal cost.

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Examples of such strong one-way flows are from newspaper readers to advertisers or from airlines to purchasers of non-aeronautical services. This means that any attempt to assess the market power of an airport by examining its profit on aeronautical activities, is likely to seriously underestimate its degree of market power.

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The extent to which a monopoly airport is able to exercise market power is its ability to generate profit over the sum of its operations. In many cases, this is often difficult to assess, for two reasons. In the first place, one generally lacks cash flow data for a period sufficiently long to enable inferences to be drawn. Secondly, even if one has cash flow data for a long period, one generally lacks evaluation of the airport at the beginning and end of the run of cash flow data.

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As we point out in our report assessing the profits of Australian airports, these problems are of little consequence in the particular case of the four Australian airports which report data to the ACCC.

5 Because of the theory of multisided platforms and because of the
availability of a long run of cash flow data for the four reporting airports,
the best way to assess the extent to which they are able to exercise market
power is to use the available cash flow data over the sum of their
10 operations. To assess the market power of an airport by looking at the
prices or profits it generates from one particular source of revenue is to
violate the lessons economists have learnt from the literature on
multisided platforms.

15 The second question I'll address is whether the monitoring regime
conducted by the ACCC has been effective. The Commission has been
asked to consider the effectiveness of the monitoring regime conducted by
the ACCC, including the methodology used and the adequacy of the
information collected. In my opinion, the monitoring regime conducted
20 by the ACCC produces a misleading picture. The principal reason for this
is that it reports on one particular side of a multisided platform. The data
contained in the most recent ACCC monitoring report illustrates the
problem.

25 The ACCC monitors only aeronautical services, however in the case of
Sydney Airport, non-aeronautical services generate 45 per cent of revenue
but are allocated only 25 per cent of its costs. This results in a set of non-
aeronautical activities which generate 45 per cent of the revenue being
attributed with generating 60 per cent of EBITA. The ACCC's monitoring
30 gives a distorted picture because it reports only one side of a multisided
platform. That is all I wish to say by way of opening.

MS WILSON: I think we're happy to take questions.

35 **COMMISSIONER LINDWALL:** Okay.

MS WILSON: I mean, you guys would be aware that we've obviously
been involved in supporting A4ANZ on this.

40 **COMMISSIONER LINDWALL:** Yes, yes.

MS WILSON: But also, AFIA and Qantas.

45 **COMMISSIONER LINDWALL:** In the terms of a multisided platform,
where do you draw the line? So for example, an airport could own all the
land that it currently occupies, plus it could own a lot of other operations

well away from an airport; should that be included in the multisided platform?

5 **DR WILLIAMS:** No, one has to look at, in fact, whether this is a major problem or a small problem. If one actually looks at the cash flows at the airports, these amounts of money are trivial; in the cases of the Australian airports, the amount of revenue that they generate from things that are not related to the flying of passengers or freight is really trivial. But that could be removed, yes.

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COMMISSIONER LINDWALL: So business parks, for example?

DR WILLIAMS: Yes, if they run a business park or something like that.

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MS WILSON: Well, I think we'd add to that though, some caution in the sense that I think where we probably differ in some of what the Productivity Commission has said in the draft report; is that a lot of these non-aeronautical services, in a sense, are linked to the aeronautical services. Take, for example, a business park: most of the businesses that you would anticipate to be in a business park next to an airport would, in fact, be related to freight activities, logistics. I mean, that's a logical spot for them to house either their sort of back-office operations or any other aspect of that.

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I think it's really (indistinct) that that's their preferred location, and therefore in some respects you have to ask whether that is passenger or freight-related, and therefore potentially within what you could argue is a reasonable till for an airport.

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COMMISSIONER LINDWALL: Or freight, yes.

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MS WILSON: Yes. I mean, sort of our preferred approach more generally is that you would adopt a sort of hybrid till which takes anything out that is clearly unrelated; and when I say clearly unrelated, say, you know, a wave park or a - - -

COMMISSIONER LINDWALL: DFO.

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MS WILSON: A DFO. But as Philip mentioned, these things are trivial, particularly in the context of looking backwards. If you're looking at existing data for the past 20 years, this is not a thing that affects the outcome of the analysis.

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COMMISSIONER KING: Can I come back to your two-sided market, or your two-sided platforms approach, or multisided platforms approach?

So as I understand, you're saying that it's really the aero that drives the demand for things like carparking and - - -

5 **DR WILLIAMS:** Principally. There may be some other flows back the other way, but it seems to me that it's largely one directional, yes.

10 **COMMISSIONER KING:** Yes, and that's why you need to look over the entire platform for profits, to look at market power. But that same theory would say that if the aeronautical is creating the positive externalities, then you would expect aeronautical to be relatively under-priced, compared to the others. And to use your own example, consumers don't pay for the newspaper, and the newspapers make their money from the advertising.

15 Now, obviously the airlines pay something for the aeronautical, but on your analysis, the airlines are paying less for their aeronautical charges than if these other parts of the market – car parking and so on - weren't there.

20 **DR WILLIAMS:** No, not if they weren't there, but rather, if you say to allocate costs according to revenue, airlines would definitely be paying less than would a lot of the other non-aeronautical activities.

25 **COMMISSIONER KING:** Indeed, airlines may be paying below cost.

30 **DR WILLIAMS:** Well, that depends. I mean, I don't need to tell you, but what is meant by "cost" of aeronautical, or "cost" of non-aeronautical is not clearly defined at all. But if we were to think of some other way; I mean, costs are sometimes allocated by revenue. If you think of it that way of allocating costs, well then definitely, aeronautical would be paying less, as I pointed out with respect to the example of Sydney.

35 **MR DAVIS:** I think the point is, like, a monopoly platform will have the same price structure as a competitive-priced platform, it's just that all the monopoly prices will be higher.

MS WILSON: Yes. The question at hand is whether - - -

40 **COMMISSIONER KING:** Sorry, hang on, let's just explore that for a moment. So a monopoly newspaper that was not receiving advertising would not be distributing free to its customers, it would be charging those customers; I'm sure you agree with that.

45 **MR DAVIS:** As in price structure though. I'm saying if you're not competing, you know, paid for newspapers or something, they've got the

same basic structure but the monopolist will have higher prices on both sides.

5 **COMMISSIONER KING:** But the simple facts of two-sided markets, where you have the direction moving from aero providing the positive externality to other services, the simple fact, as a matter of economics, is that aeronautical may be receiving prices, the charges for aeronautical may be below - they could be below operating costs.

10 **MR DAVIS:** They could be, in theory.

COMMISSIONER KING: In theory; I'm not saying they are.

15 **MS WILSON:** I mean, that's not the question at hand, at the end of the day; the question is whether that monopoly platform should, in fact, have prices that are lower overall, with the same price structure, not whether their price structure would change.

20 **COMMISSIONER LINDWALL:** Well, it could mean that the non-aeronautical prices should be lower and the aeronautical higher, but the overall level could be lower.

MS WILSON: But why would the price structure change?

25 **DR WILLIAMS:** What I was trying to tell you earlier had nothing to do with what ought to happen; rather, what I was saying: accept that in assessing market power, one ought, in the case of a multisided platform, to assess the cash flows over the whole range of the platform. Now, it's another question altogether what would be the optimal regulatory or legal
30 set of arrangements to solve a problem if we found that there was significant exercise of market power by this monopoly platform. So, I think we have to keep these issues separate.

35 **COMMISSIONER KING:** Well, happy to keep them separate, but the pricing. As you said, prices will change in their balance because of the positive externalities - - -

DR WILLIAMS: Indeed.

40 **COMMISSIONER KING:** - - - in the favour - compared to a monopolist where these externalities didn't exist - in the favour of the airlines and against car parking, retail, and whatever else.

DR WILLIAMS: I'm sorry. There was some confusion about what the comparator was. Of course, if there were no externalities, well then what you say is right: that both prices would be higher; that's the corner sort of - - -

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COMMISSIONER KING: So to put it simply, the airlines gain a benefit from expensive carparks.

DR WILLIAMS: No. They gain a benefit from - - -

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COMMISSIONER KING: (Indistinct) for once.

DR WILLIAMS: No, no. Most of the - - -

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COMMISSIONER KING: Well, except that (indistinct) - - -

DR WILLIAMS: - - - externalities - - -

MS WILSON: Services, yes.

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DR WILLIAMS: Most of the externality is in one direction, and I agree with the proposition that that means that the prices of aeronautical services will be relatively low, compared with the prices of other services. And that will be true whether there is say, overall revenue capped regulation or there's no revenue regulation. I agree with those - - -

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COMMISSIONER KING: And if the externalities didn't exist, aeronautical prices would be higher and car parking prices would be lower for that monopolist.

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DR WILLIAMS: Other things being equal, yes.

MS WILSON: Yes.

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DR WILLIAMS: That's all I'm getting at.

COMMISSIONER KING: But I just wanted to verify - - -

COMMISSIONER LINDWALL: It's a matter of what we compare with what, yes?

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MS WILSON: Yes.

COMMISSIONER LINDWALL: So Philip, would you also be suggesting that the monitoring regime which you say is inadequate

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because it excludes a lot of other services could be improved by adding these other aspects of an airport to that regime?

5 **DR WILLIAMS:** Indeed. It would give a much more truthful picture of the market power of airports.

MR DAVIS: Well, just to add to that. I mean, I think, you know, obviously the key difference between the work that we've done on profitability and the work that you've done on profitability, you know, we
10 get results that are much higher returns and that simply comes - and we've both used, presumably, the same data: it's out of the ACCC monitoring.

The point is, with our data, we've used the revenue and costs on the non-aeronautical side as well. So in a sense, all we're saying is, that's what's
15 explaining that difference. So you know - - -

COMMISSIONER KING: Fully understand that.

MR DAVIS: - - - if you're coming up with returns that are you know, 10
20 per cent on aeronautical and we're coming up with returns that are 20 per cent and it's non-aeronautical - or sorry, it's the total airport - the differences, obviously, are non-aeronautical. My point is, the monitoring regime already picks up some of this.

COMMISSIONER KING: Yes, true, true. Okay, so let's take perhaps, a
25 non-platform approach about it. Let's imagine you had aeronautical was highly competitive and carparking was being abused ruthlessly by the monopoly, but there weren't any externalities going on in here, that could also explain why we would get a 10 per cent; let's say that's a market rate
30 of return on aeronautical.

You get a 20 per cent overall because they're making it okay, and it's a 50 per cent return on carparking. That would be an equivalent explanation.

35 **MR DAVIS:** So in the - - -

COMMISSIONER KING: (Indistinct).

MR DAVIS: - - - (indistinct) yes. Yes.
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COMMISSIONER KING: All right, one at a time.

DR WILLIAMS: I just want to be clear: are you saying that there are no
45 complementarities on demand or supply, in costs or revenue, between - - -

COMMISSIONER KING: I'm just asking an alternative way of understanding the differences of works presented. Yes, to make life very simple, let's imagine there were no externalities here, there aren't any
5 complementarities, but you have no market power in aeronautical and you have a very significant amount of market power in car parking; that would also explain the difference in numbers.

In other words, one does not have to go to multisided markets to try and
10 explain the difference in numbers between Frontier numbers and the PC numbers.

DR WILLIAMS: Well, one does, I think. I don't know what Warwick's answer to the question is, but one does. And for this reason: that what
15 your question presupposes is that you can, in fact, separate-out, in a proper way, the costs of doing one function compared with the other.

COMMISSIONER KING: Well, what I'm trying to point out is that different degrees in competition on different sides of the market can
20 explain the difference in your numbers and the PC's numbers. And in fact, if you got rid of the market altogether, it could be a complete explanation without having to go to complementarity.

So the claim that you've had is that you need to think about this in terms
25 of overall market because it's a platform.

DR WILLIAMS: Yes.

COMMISSIONER KING: But actually, if you had different levels of competition on different sides of the platform, that would also explain the
30 difference in your numbers, to our numbers.

MS WILSON: I mean, it would. But if we extended that from the sort of hypothetical question to saying, well, where is the actual difference, it
35 would actually imply that you have no competition in the car parking side because there's high profits in that area, which is sort of contrary to what a lot of the PC report describes, in that there's a presumption of competition in some of those other services that an airport provides.

And, that you would have to have lots of competition on the aeronautical
40 side, which is actually quite hard to describe why that would be, in the context of an airport.

COMMISSIONER KING: But it would be consistent, for example, if
45 there was significant bargaining power or countervailing power from the

airlines, so that the airports, whilst being in a situation of market power, were unable to exploit that market power on the aeronautical side because of that bargaining power. So, that would be consistent with the two sets of numbers.

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DR WILLIAMS: Yes, it would be.

MS WILSON: Yes, it would. It wouldn't hamper the answer; assessing it on a whole of airport basis would still get you the right answer.

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COMMISSIONER LINDWALL: But the question that, say, A4ANZ said, is that we should have a negotiate/arbitrate framework because of the profitability numbers that you've postulated. Surely, you could take from what Stephen has just said that if the aeronautical prices are actually lower than they would be because of the nature of the market, and the car parking, et cetera, should be lower because they're too high, then you should regulate the car parking directly and not have negotiate/arbitrate for the aeronautical services, which are actually under-priced, if anything.

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DR WILLIAMS: No, because the question presupposes that you can assess the profitability of the airport independently of the profitability of the other sources of revenue from the platform.

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COMMISSIONER LINDWALL: Well, I hear that.

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DR WILLIAMS: Yes.

COMMISSIONER LINDWALL: But once you've assessed that, then you have to decide what type of regulatory structure is most efficient for that, and you might have different structures for different parts of the airport.

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DR WILLIAMS: Indeed, but I think they're two quite separate issues if we come to regulation: one is what would be an optimal arrangement of the structure of prices? Another is what would be an optimal level of these prices? So it seems that any consideration of what would be an optimal regulatory or legal structure should think of these questions quite separately.

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So, it would be possible - and this may not be at all what A4ANZ is advocating, so please don't attribute the views to A4ANZ - but it would be possible, for example, to have an aggregate revenue cap on what the airports are allowed to get, and let them decide how they structure their prices.

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5 **COMMISSIONER KING:** Can I come back? Because negotiate/arbitrate has been put to us as being a preferable approach. One of the questions we raised earlier on today actually related to the sort of externalities you were talking about, although looking at externalities between airlines in things like common user facilities. But a similar situation would hold in the externalities you're talking about, between carparks, retail, aeronautical and non-aeronautical.

10 Let's imagine that one of the domestic airlines brought a dispute before the arbitrator, with a particular airport; that arbitrator would need to think about the consequences of any price decision that arbitrator made, not just on the other aeronautical services, but also the consequences on the non-aeronautical services as well.

15 **DR WILLIAMS:** But this is presupposing that the arbitrator's job is to resolve disputes about prices for particular services. Now, I'm not sure that that is the optimal solution, I have to say.

20 **COMMISSIONER KING:** I'm not sure it's even feasible, if it's a two-sided market.

25 **DR WILLIAMS:** Exactly. That's why, in my opinion, it would be much more sensible for the arbitrator to decide, or somebody to decide, on an aggregate revenue cap, rather than to decide anything about a particular price or the structure of particular prices.

COMMISSIONER KING: So an aggregate revenue cap would require that there's a regulated rate of return - - -

30 **DR WILLIAMS:** Yes.

COMMISSIONER KING: - - - in there, so the airport would face a regulated rate of return under that sort of approach?

35 **DR WILLIAMS:** Well, if there were disputes, and undoubtedly there are likely to be disputes. So probably, it would have to face a regulated rate of return.

40 **COMMISSIONER KING:** So, we know from regulation in other areas that that can cause issues for airports where they may make investments and then seek to get a return on those investments from their customers; they then go to arbitration and the arbiter may say, "Well, that wasn't appropriate investment, or that was too big," or whatever.

Under a revenue cap, would you see the arbiter having that role in, you know, ex-post, saying, "No, that was gold-plating. You were just trying to push up your asset base so that I'd set a higher price." I mean, would that be a role for the arbiter?

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DR WILLIAMS: I think it would, yes.

COMMISSIONER KING: Okay. So in that situation again, we know from other areas of regulation that that risk on infrastructure means that usually, the infrastructure companies go and seek ex-ante approval for their investments. So, would you see ex-ante approval for investments as probably being a relevant part of the sort of method you're approaching?

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DR WILLIAMS: Yes. Well, I should say, this is not something that we've written on.

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COMMISSIONER KING: No, no, that's fine. I'm just - - -

DR WILLIAMS: But just talking off the top of my head - - -

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COMMISSIONER KING: - - - exploring (indistinct) yes.

DR WILLIAMS: - - - yes, I think so, yes.

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COMMISSIONER KING: Okay.

DR WILLIAMS: Just as it does in other regulatory models, yes.

MS WILSON: In a sense, I think Phil is pointing out the fact that you can give an arbiter a broader role than just determining on the specific matters at hand. But there's nothing stopping a negotiate/arbitrate process including that within it; I mean, there are plenty of negotiate/arbitrate arrangements that include an overlay. I mean, in a sense, Part IIIA does that as well: you come with a particular access dispute. But the ACCC can determine on far and wide matters. There's no reason any negotiate/arbitrate regime can't incorporate some aspect of you know - - -

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COMMISSIONER KING: And the sort of things that Philip's been talking about?

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MS WILSON: Yes, the sort of things that Philip's been talking about. I think you're presupposing a lot, that investment disputes will happen and they'll happen frequently.

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DR WILLIAMS: Well, that might happen - - -

MS WILSON: Which is not necessarily - - -

5 **COMMISSIONER KING:** It need not be frequent, but if I'm going to sink a couple of hundred million dollars into an airport infrastructure, I might like to know that the arbitrator isn't going to come along later on and say, "Well, sorry, that wasn't appropriate investment. You can't get a return on it."

10 **MS WILSON:** No, indeed. But I think there's an aspect to which you can overstate the significance of the problem, which is that by and large, if you're talking about specific investments at specific airports where airlines might not be that interested in making certain investments, it's going to be on certain aspects, not on the investment itself, because - - -

15 **COMMISSIONER KING:** Such as terminals?

DR WILLIAMS: Or the runways. I mean, there's - - -

20 **MS WILSON:** No, I would argue it might be on the design of the terminal, as opposed to whether or not to have the terminal.

DR WILLIAMS: Well, I'm not so sure about that.

25 **MS WILSON:** Because in a sense, airlines have an interest in having facilities for their passengers, in much the same way as the airport.

COMMISSIONER LINDWALL: Surely, you can use long-term contracts?

30 **MS WILSON:** Yes, I mean, that's what long-term contracts are here for.

COMMISSIONER KING: Were you here when Adelaide Airport was discussing its issues with terminal investment?

35 **MS WILSON:** No, no, but you could - - -

COMMISSIONER KING: Well, I'll let you read the transcript. But I think, if you had been here, I would've asked you questions.

40 **COMMISSIONER LINDWALL:** Well, I mean, they're the same type of issues. I mean, I would've heard it a number of times through this inquiry of hold-ups on runways and other major bits of infrastructure.

5 I mean, Frontier in the UK did a study for Heathrow which said that the congestion at Heathrow produced rents - they went to airlines. So one could understand that airlines might rationally try to reduce - especially incumbent airlines - reduce investment to encourage the congestion, because they're going to earn rent themselves.

DR WILLIAMS: Airlines?

10 **COMMISSIONER LINDWALL:** Airlines, yes.

MS WILSON: Just to be - - -

15 **DR WILLIAMS:** It's not clear to me why an airline would benefit from congestion at the airport.

COMMISSIONER LINDWALL: Well, that Frontier study in the UK showed that congestion - - -

20 **MS WILSON:** They - - -

COMMISSIONER KING: I can give you a simple example: consider Sydney; Sydney has slots. Let's imagine there's an investment that would increase the capacity and increase the number of slots at Sydney Airport, and that those slots would be allocated to new entrants, as occurred post-Ansett collapse. I assume you would agree that incumbent airlines would prefer not to have more competition and would like that investment not to go ahead.

30 **DR WILLIAMS:** I understand. I think it would – I think it is important that any arbitrator or regulator have some overriding public interest concern. I definitely agree with that, and I can understand that it may be in the interests of the airlines or indeed the interests of the airports to act and perhaps even jointly contrary to the public interest. So I accept that, I agree with that.

35 **COMMISSIONER KING:** I'm just a bit wary of time because we had half hour slots this afternoon. Can I just understand because pass through was a key element of your work and the degree of pass through to the customers. There are, of course, too, you know, if you like, text book approaches to thinking about prices and pass through. On one side you have a single price setting, airport setting, landing charges to a single price setting airline, and then you get pass through according to the elasticity of demand and the percentage of the input and so on. So the sort of analysis that appears that Frontier undertook.

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Alternatively, you have a downstream firm that is able to engage in price discrimination. Let's for the sake of argument assume it's (indistinct) if not perfect price discrimination, in which case you would get a very different answer in terms of pass through of any increase in an upstream uniform price. In fact, in that situation there would be some change at the margin, but basically no change and no pass through of that cost for any passengers who continue to fly after that change had been made. I was wondering why you choose the first approach where you're essentially taking little, if any, price discrimination, rather than the second approach which assumes significant price discrimination by airlines, given that what appears to occur in practice is significant price discrimination by airlines.

MS WILSON: I can answer that question. I think I'd probably start by saying in some respects that analysis and evaluation of regulatory remedies has been a bit misunderstood and misrepresented, in the context that most of that report was actually about talking about whether you could get reforms that were cost effective, i.e. not looking at broader connectivity benefits. If you could in some way short circuit extensive and extended time unlimited negotiation processes, what would be the avoided cost of that and therefore would the reform be beneficial on a purely cost basis. So that was the main part and first part of the report.

COMMISSIONER LINDWALL: On the assumption that the outcome was identical in the short-circuited negotiation versus the traditional one?

MS WILSON: Indeed, - - -

COMMISSIONER LINDWALL: Which I don't think is a reasonable assumption.

MS WILSON: Well, you could say it could either way, but it was – but for the purposes of highlighting the fact that the current negotiation process is not costless. So then the second part was on, are there broader benefits that have thus far been largely ignored primarily I presume because they are complicated to assess which, as it turns out they are complicated, and they do require a lot of assumptions and they do introduce an element of uncertainty when you do it. So we presented that work quite separately to say, "Here are some benefits that come out as quite significant" you know, "up to – we're a bit uncertain about them, but they certainly – there are some wider benefits that probably need to be considered".

So on those wider benefits, what we were focused on was showing whether there would be connectivity impacts. In other words, would more routes be offered than are currently offered by virtue of a presumed fall in aeronautical charges, and I should say, we presumed all of the airports'

charges would drop by a percentage, we didn't, sort of, take the non-aero profits and jam into aeronautical, that's not what we did. We reduced all of them evenly, and said, "Would that lead to more connectivity", and that was our focus.

5

So, sort of, in the context of that, thinking about cost pass through is actually a little bit of a distraction, because from an airline's perspective you can either have a reduction in aeronautical charges, that is cost, that is passed through to consumers that will result in lower airfares, that would lead to greater demand and therefore routes that were more or less marginal before, would then tip over into being routes that become profitable and therefore get offered. So that's one approach, assuming 100 per cent costs pass through which is what we did because it was largely a slim (indistinct) process in order to make the estimation.

15

The other is if they're not passed through what happens to them? In a sense it still makes from the airlines' perspective, it still makes those routes more profitable because it reduces their costs on those routes, which makes more routes tip into being less marginal or profitable, and so you get the same connectivity impacts essentially under either assumption. So the reason we adopted 100 per cent cost pass through, not identical but similar, was actually to – in order to actually make the estimation process.

20

COMMISSIONER LINDWALL: So did you – given that you made what seems to be a fairly important assumption but 100 per cent pass through.

25

MS WILSON: Yes.

COMMISSIONER LINDWALL: Did you do the analysis, an alternative of say perfect price discrimination and zero pass through to the customer so that we can see what the importance of price discrimination actually is to the modelling? And I don't want to try and guess whether it pushes one way or the other. It's just I would have thought it's important.

35

DR WILLIAMS: It is pretty easy to see, isn't it? If you think of say third-degree price discrimination, the answer is going to be about 50 per cent pass through. If you raise marginal costs for all the different services that you're providing – I know it depends on the slopes of the demand curve, but roughly you'll get about 50 per cent.

40

COMMISSIONER LINDWALL: Sorry, but to come back to Anna's bit about connectivity, so let's say what we're really worried about is what new services are going to be offered.

45

DR WILLIAMS: Sure.

MS WILSON: Yes.

5 **COMMISSIONER LINDWALL:** That's not a pass through question, but
the result will presumably still depend on what pass through has been
assumed. It is purely – and you know, I'm not putting an argument that the
airlines price discriminate or don't price discriminate. I don't think that's
10 relevant, but I do think it is relevant just to make – it is a sensible test of
your modelling if I can put it that way.

MS WILSON: You can put it that way. I mean, we were essentially time
limited by your processes so no, is the short answer, but - - -

15 **COMMISSIONER LINDWALL:** We're time limited by the
Government.

MS WILSON: Exactly. I mean, we were – our purpose was largely to say,
"Were there benefits, could they be sizeable?" And I think the answer is
20 yes, there are benefits and yes, they could be sizeable. But again, I come
back to the fact that the costs, the reduced costs would have been passed
through to an airline. They would definitely have gone through. So even
if you took a 50 per cent pass through, you're still not accounting for those
reductions in cost that an airline now has on some of its routes, which may
25 lead it to increase its service frequency or increase the number of routes it
offers. So by default through either route, you get a connectivity effect.

COMMISSIONER LINDWALL: Except if it also led to less investment
and more congestion and higher fares.

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MS WILSON: Again.

COMMISSIONER LINDWALL: We should touch on countervailing
power - - -

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COMMISSIONER KING: Yes, so just touch on countervailing -
because it comes out of – you've done a report for Qantas and in there you
have said, "We have indicated that assessment of countervailing power
requires a case by a case assessment of each airline's position at each airport.
40 Undertaking such an assessment would be difficult". So that's on p. 21 of
Appendix 1. Should we read that as basically saying look, it just isn't
practical to assess whether airlines have countervailing power in Australian
airports. We're just trying to understand what sentence means.

MS WILSON: I think it would be probably be more or less saying to determine that there is countervailing power at Australian airports as a generality would be challenging in the sense that you would actually need to assess it more rigorously at each airport.

5

COMMISSIONER LINDWALL: So if a PC had looked at, for example, Melbourne airport and looked at countervailing power and looked at Sydney power and countervailing power and looked at Adelaide airport – hang on I'll do more than one – Perth, and so on, if that's how the PC had done its analysis, then that would meet your requirements?

10

MS WILSON: Well, I guess that would be more rigorous, yes.

MR DAVIS: Well, I think perhaps what grated in our view in the report was just there was, you know, a selection of examples that seemed to have fairly limited, let's say broad applicability by picking on fairly small airports and you know, not major airlines. That was, in some sense – you know what I'm referring to.

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COMMISSIONER LINDWALL: Yes, of course. Presume Rex and King Island.

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MR DAVIS: That just didn't seem to be, you know, able to extrapolate that - - -

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COMMISSIONER LINDWALL: I don't think we were trying to extrapolate that. I mean, for example, the newspaper said today that, if I'm not mistaken, that Qantas is withdrawing its planned route from Perth to Paris until Perth settles the dispute with Qantas. One could argue that's an exercise of countervailing power surely.

30

MS WILSON: One could also argue that the price has now go to the point where it makes that (indistinct).

COMMISSIONER LINDWALL: Well, has Perth reduced its prices as a result of that?

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MS WILSON: That's the question.

MR DAVIS: Isn't that the question?

40

COMMISSIONER LINDWALL: It said it had. So anyway, - - -

MR DAVIS: I mean, that's the evidentiary point.

45

COMMISSIONER LINDWALL: Of course. Thank you very much for coming to see us. Unfortunately we have run out of time. We've got to go and speak to Smithson and planning.

5 **MR DAVIS:** Thank you very much.

COMMISSIONER LINDWALL: So if I could invite Neil Smithson. He's on, that's right, the video. Good afternoon Neil, how are you.

10 **MR SMITHSON:** I'm very well.

COMMISSIONER LINDWALL: Would you like to give an introduction and a bit of a speech, or discussion?

15 **MR SMITHSON:** Yes, by all means. I'm assuming that Kenneth Baxter and Stephen King are both there with you?

COMMISSIONER LINDWALL: Stephen's here, yes. Stephen and Paul.

20

MR SMITHSON: Stephen and Paul, no worries, not Kenneth. Okay, my submission, and thank you for the opportunity to provide one, is probably a little bit different to most other people's. I'll just confirm, there's the actual covering submission which was published on the website, and then there were several attachments. One was a federal cabinet briefing statement, the other was a state cabinet briefing statement, and there were also two letters supporting, or otherwise (indistinct) from Dr Martin Parkinson and also Dr Peter Shergold, as former Secretaries of the Department of Prime Minister and Cabinet.

30

COMMISSIONER LINDWALL: Yes, I think we did receive (indistinct). We have received them, yes.

MR SMITHSON: Okay, that's fine.

35

COMMISSIONER LINDWALL: I think - no, go on.

MR SMITHSON: Basically, Smithson planning's core business is strategic regional development. Over my 35 year career, I've had a bit of a relationship with airports, and consequently, when I relocated from the eastern states back to Western Australia in 1997, I wrote a strategic regional plan for Albany and the Great Southern region - one of the core components thereof, was the establishment of a Albany Port Corporation. So, it wasn't just about airports. It was looking after the airports, and it was also looking after a ring road which was proposed to be a toll route.

45

So that goes back to 1997, hence the two letters from the two DPM&C secretaries over that last 22 years.

5 The Commonwealth has consistently maintained the position that the things that we were trying to address were really the area of responsibility of state and regional governance and not the Commonwealth government. Yet here we are, today, 22 years on, and the Commonwealth has certainly embraced the Anzac Centenary commemorations, which were a huge success, but also in the next ten years, we'll have to negotiate the
10 bicentennial celebrations for Western Australia, in which Albany, Fremantle, and Perth all play a significant part.

That was the - the gist of the 30 year plan, if you like, that it is actually a plan for strategic regional development in Australia, and not just Albany
15 and the Great Southern, and consequently the relationship between public-private sector partnerships and airports, and a range of other facilities, intermix between local and regional and state and federal politics, and it all starts to get extremely interesting.

20 Anyway, along the way, my company was acting on behalf of a couple of international hospitality and tourism groups, and consequently, when I put together the plan for an Albany International Airport, embracing direct flights overseas, and tourism opportunities, one of the groups I briefed to along the way was the West Australian Airport Corporation, now Perth
25 Airport.

At that time, I was of the opinion that their core business was investment in aviation in Western Australia, particularly through Perth Airport. But there was really no reason why they shouldn't also take an interest in every
30 other strategic, regional airport in Western Australia.

One of the key factors there was, you'll be aware, all airports have to have an alternate destination. When I wrote the plan, Perth's alternate destinations were Learmonth and Adelaide, which is an awful long way to
35 travel if you have to divert an aircraft. Several years ago, the State Minister for Transport, then, basically selected Kalgoorlie as the new alternate destination, but that could have easilt have been Albany or Geraldton, as two airports closer to Perth.

40 That's history now, and basically the two hotel groups I was representing, Taj and Versace, they wanted to establish five star hotels and they had direct aspirations for airport links, from Albany, straight into Asia, hobbing through Singapore, Jakarta, Bangkok and Kuala Lumpur, but ultimately through to India and China, and using airlines associated there
45 with - we found out we had a lot of commercial interest. There was

another individual who was looking after Accor Asia Pacific, in terms of their hotel group, which was related to their proposal for the Albany waterfront development (and LandCorp). But we'd had discussions with Air New Zealand and Qantas, and all the rest.

5

What transpired over 22 years is just a huge melee of public policy, particularly on regional airport development, and it's regrettable, depressing, unfortunate - whatever you want to call it, but it hasn't actually happened, and when you look at airports as trade portals, there is both inherent risk, and reward to having one major airport, being Perth Airport, servicing all of Western Australia. There have been numerous calls by regional airports to provide international access, particularly those in the north of the state, and what you can see is the interplay between state and federal politics, and we've got a lot of things coming into that equation.

10

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Relative to Albany, we started off with a regional service airline, Skywest, and they eventually threw in the towel, and the State sought to procure another service provider for RPT travel between Albany and Perth, and as it turned out, also Esperance and Perth. Basically Virgin won that contract, and it was conditional on being a sole operator. Qantas would have liked the contract as well, but their offer was also conditional on being a sole operator, and as things transpired, even with the benefit of the hugely successful Anzac Centenary official launch in Albany, we still don't have five star hotels in Albany, and we still don't have, what I would call a quality airline. They've actually gone backwards.

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We now have the service provider Rex, and you know, good for them. They're - they're building their business, and traveling into Western Australia, one would argue with support from various groups, politically. But, you know, the service is what the service is. From my own perspective, I think strategic regional development is so important to the future of regional airport, and seaport for that matter, and what I did was provide a particular interesting alternative way to think about the future of development opportunities, and then to follow the whole evolution of the strategy. So, we're just sitting back and watching it. Quite literally today for example, the Prime Minister, Scott Morrison has made an announcement regarding infrastructure development, and one of those announcements pertained to the funding for the \$172m Albany Ring Road, albeit not a toll route.

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Future funding and construction of the ARR is conditional on Infrastructure Australia approval, but we shall see what we actually get from the elected Government - and we'll also see where that goes in the future.

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Relative to other things that I've included in my submission, you can see the RPT aviation criteria in the various different categories and the international aviation specifications of how far different planes can go. You'll notice that some planes are moving in and out of favour, as a function of age, profitability and route application, and of course the airport has to basically be able to cater in terms of what they provide in the airside, and also the landside facilities to match up with what their customers are looking for.

I could say that there are other entities, all along the way, that are looking at the growth and development of Australia's cities, and you guys are focusing on four particular ones, with the major airports in Australia, which is fair enough. But, there are a lot of other strategic, regional airports capable of much greater things, if they had what I call a fair and open playing field, both in your regulatory system, and also the state that they're applicable to. Basically, in the briefing notes, particularly in the federal cabinet briefing notes, you can see there the pictures of the airports opposed. They were opposed over the last 22 years, those names have changed.

Basically, we've gone through seven Prime Ministers now, and five Premiers, and I can assure you I kept them all briefed all the way along. So, it's like talking to a brick wall, is the way to put it, both in Perth and also in Canberra. The tyranny of regional politics and multiple political jurisdictions, so getting things done in regional centres and opening up all of Australia for opportunity was quite challenging in a regulatory condition.

Coming back to the scope that you guys are working on, your key point, does this new airport regulation benefit the community and remain fit for purpose – I'd argue, yes. I think that is the overall situation. With four big airports that are not systematically exercising their market power, I disagree with that statement. I can't say I completely agree with other ones, but for a short while, I managed Mildura's airport and was aware of our relationship, then, in Sydney and Melbourne and Adelaide. Mildura is an interesting location, but Perth has definitely acted in its own self-interest which is, you know, fair enough. It's an international airport, now, a big corporation but that comes back to whether you see the bigger picture or whether you won't put forward the bigger picture.

There's no reason for airports to be complacent; 100 per cent agree with that statement, particularly on the future of fuel supply. I think that's a major factor in terms of aircraft movements, particularly with our extensive network in Western Australia, FIFO destinations and carrying mandatory fuel loads and getting fuel to the remote location. It's not

going to be the easier or cheaper and, especially for more remote locations but, of course, it's a highly sensitive aspect and whenever you have a failure in your aircraft, well, people look for the reasons why and fuel contamination is not an uncommon cause.

5

It is perceived and commonplace to resent the cost of car parking. But, you know, it's a monopoly situation and if you were going out to the airport, there's only a couple of ways of getting there and different airports are being addressed. You know, you've got trains coming to Tullamarine, you got trains going to Perth, you got the western airport in Sydney with trains going there. The biggest improvement, you've got a different government moved (indistinct) on the nation.

10

I don't have enough information in relation to the kind of planes operating in relation to jet fuel supply. I think a lot of people are very nervous about the future of jet fuel supply. In the context of Western Australia, the state government and Colin Barnett – four years ago I think it was – renegotiated the contract for the BP refinery and at that point in time a big picture decision had to be made whether or not that refinery would remain in place or close and they elected to give BP another 50 year term, I think. So it's there for a while, as long as they get the raw materials for it, will they be able to manufacture jet fuel and then they had to basically distribute the fuels around the State by land transport.

20

In relation to government funding for infrastructure and regional airport; yes, by all means, but going back to the Albany ring road there were a lot of discussions and I know it got first proposed in 2007. They've called in Infrastructure Australia and they've tried to generate the business case for the \$172 million road, but at the end of the day, the prime minister unilaterally made the decision yesterday without promising the business case and so – yep, that's going to get funded. So historically sometimes (indistinct) straight over the top. And as far as the things that I wanted to say, that'll pretty much do it I reckon. We can have a discussion.

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COMMISSIONER LINDWALL: Well, thank you, Neil. Can I ask about Albany Airport which I am looking at the map of it at the moment? The runway is 1.8 kilometres long and 30 metres wide for runway 3214. I would've thought if it needed to be an international, it'd be about 2.4 kilometres long. Is the council proposing to extend the runway?

40

MR SMITHSON: The area is part of the problem. First of all, you could ask whether the City of Albany actually has some of these – like, is there a licensed aerodrome manager on staff. But anyway, the City of Albany as I understand it, they're not proposing to do anything for the airport. It

hasn't done since the day my proposal was submitted for the Albany International Airport in 1997.

5 Relative to the picture you're looking at, the black tarmac with the original runway which is 1800 metres long, they did a little bit of recent work and realistically you can't extend the current runway out past 2,100 metres.

10 **COMMISSIONER LINDWALL:** Yes.

MR SMITHSON: Which is why I designed a parallel runway and the parallel runway over there is to full international standards; 3 kilometres.

15 **COMMISSIONER LINDWALL:** I see (indistinct)

MR SMITHSON: Now, that can be done. What you can't pick up from that aerial photo is the topography and quite literally the land drops off at both ends with the existing black runway. I might add that the brown runway, the cross runway has now been sealed and so that is – both
20 runways are currently sealed. But neither is long enough for international traffic.

COMMISSIONER LINDWALL: Of course not, no.

25 **MR SMITHSON:** The whole intention was to basically build a whole new international airport in Albany, and part of the argument there is that just like – you can fly into Cairns, you can travel down all through Queensland and fly out to Brisbane or from Sydney I can fly out of Melbourne, but invariably it's better to have an entry port and an egress
30 port relative to international tourism and for Western Australia, you know, I can argue that the south west is the most interesting part and the most attractive part and the most entertaining part and be able to fly in and out.

35 In the earlier submission I made to the inquiry in relation to Antarctic Territories, and I don't think there's any doubt that Albany's very well place in the future for actual travel to Antarctic Territory both for tourism and scientific and/or geological exploration .

40 **COMMISSIONER LINDWALL:** Well, thank you very much, Neil. Did you have any questions, Stephen?

45 **COMMISSIONER KING:** Yes, I guess just, Neil, I mean a parallel runway; that's going to be pretty expensive. You had the original investors; so the hotel investors and you had airlines interested. I mean, you know, well, how much were they willing to I guess put up front to be

able to do that big investment that you needed, to be able to get this vision going?

5 **MR SMITHSON:** Put it this way, okay? I costed the entire exercise to seaport relocation and airport expansion at about \$3 billion. At that point in time, and every financial adviser I've spoken to since, has said that if that product, being the Albany International Airport, the ring road and control route and also the seaport relocation and upgrade was offered to the market place, it would be oversubscribed. I would see that airlines and
10 hotels and various other people send stakeholders, along with anybody in the community that wants to buy a share in the investment but most interest would be generated by superannuation and infrastructure funds. I never saw a problem in terms of raising the finances to deliver the outcome.

15

COMMISSIONER KING: Yes.

MR SMITHSON: The problem – and I had this response, again, in 2014 when I briefed both the Chinese and the Japanese consulates in Perth and
20 for that matter, going back to 2009, when I'd briefed the diplomatic missions in Canberra every one of them said basically, "This is fabulous. What's the problem?" and I said, "It's just culture." And realistically it's about regional city development and government wants to grow that part of Albany. However, there's an awful lot of people in Albany who like
25 Albany just the way it is right now and they don't want to see it grow. It's also the politics of Perth relative to Western Australia and that's both apparent in the airport as well as the seaport and you can see the discussions that are currently taking place in terms of relocation of Fremantle seaport down to Kwinana and also the discussions that have
30 been place for Perth Airport in terms of the parallel runway. That's been an extraordinarily large decision commercially with the board and Western Australia Airports Corporation to (indistinct) going little bits and pieces along the way and I wish we would go into a discussion just where we form a frontier. You know, Qantas will negotiate as well as
35 (indistinct) Perth Airport an introduction of air travel between Perth and Paris.

40 So, you know, why not, but you know, anything's possible if you want to make it happen and, yes, that plan is a very doable plan. After recent discussions I've had with other groups in politics as it were is that this plan's for Albany, but also the port relocation plans for Fremantle, and airport and Perth's (indistinct) region, you know, they represent the two largest urban redevelopment projects in Western Australia and the planning industry and the redevelopment of vacant industrial land goes a

long way to helping to fund that exercise and of course they'll create taxing opportunity in their own right.

5 **COMMISSIONER LINDWALL:** Well, Neil, thank you very much for talking with us today. I think Albany is a lovely part of the country and hope to visit you sometime.

MR SMITHSON: No worries.

10 **COMMISSIONER LINDWALL:** So appreciate you having a chat and giving us your ideas and good luck with the project in the future. I think that having sensible infrastructure policy is something that the PC has always proposed.

15 **MR SMITHSON:** Thank you very much, Paul, thank you for your time.

COMMISSIONER LINDWALL: Bye. Could I suggest a five minute break and then we will have Qantas - Qantas Jetstar actually.

20

SHORT ADJOURNMENT [3.10 pm]

25

RESUMED [3.12 pm]

30 **MR DAL PRA:** We'll kick off. So good afternoon Commissioners Lindwall and King. My name is Mark Dal Pra and I'm the chief financial officer for Jetstar, and I'm joined here today by my colleagues Alan McIntyre, who's the executive manager of commercial planning for Jetstar, Carly Povey, who's the head of commercial operations improvement, but importantly for today she's our lead negotiator with airports and has been doing that for the last three and a half years. Also
35 joined by Nick Brodribb who is the head of legal, and Moksha Watts, head of sustainability and industry affairs in support of legal and policy matters that might be common to Jetstar and Qantas.

40 **COMMISSIONER LINDWALL:** Before you go on when you speak separately given there's five of you could you just say your name for the record so it doesn't get confused.

MR DAL PRA: That's loud enough, close enough to the microphone.

45 **COMMISSIONER LINDWALL:** Purely for the transcript.

MR DAL PRA: Okay, thank you. So I'd like to make an opening statement and begin with a background on Jetstar. So Jetstar has revolutionised air travel in Australia since we launched in 2004. Since we launched we've built up our Australian domestic operations to carry 14 million passengers a year. Over that same period the total domestic market has grown by 24 million passengers, which means we contributed to 60 per cent of the growth in domestic air travel.

We have grown in demand in existing markets and stimulated travel to new destinations. Places like Gold Coast, Ballina, Launceston, Newcastle, Ayers Rock and the Whitsundays have seen phenomenal growth since Jetstar arrived on the scene. This growth in travel would not have occurred but for Jetstar's competitive pricing structure. This has led to air travel becoming more affordable and accessible for price sensitive Australians.

As a low cost carrier the very nature of Jetstar's business model is reliant on maintaining reasonable fixed and variable costs so that travellers can fly from Sydney to Melbourne for as low as \$45, from Sydney to Ballina for \$56, and Brisbane to Sydney for \$79.

The Commissioner's report is deeply disappointing for LCCs or low cost carriers like Jetstar whose business model is highly reliant on airports setting fair and reasonable prices through transparent negotiations. Excessive airport costs can significantly constrain Jetstar's ability to offer lowest possible fares to passengers. Jetstar is looking at its airport charges increasing by an alarming 7 per cent, including CPI, between this year and next, while our other costs will likely grow by less than 2 per cent, and it's worth saying that has also been experienced over the last few years.

After fuel, which is a cost we obviously can't control, except by trying to find efficiencies to reduce fuel burn, airport charges are our next biggest cost, and they are growing quickly. It's neither sustainable nor fair for low cost carriers or our passengers to continue to absorb these excessive monopoly charges.

Sydney Airport on Tuesday stated that an airfare from Sydney to Singapore is now more affordable than ever, and that it can be as cheap as \$350 on a low cost carrier. That is true, and low fares are not only available during periodic sale events. If you feel like it you can fly up to Sydney for \$68 one way with us this weekend, and that's actually cheaper than parking your car at either of those airports.

Jetstar continues to work hard to deliver affordable travel for Australians by keeping a laser focus on all aspects of our cost base. However, it's

wrong and deliberately misleading for airports to claim that they have in any way contributed to these low fares. In reality they've done the opposite.

5 Over the last 12 months almost two-thirds of Jetstar's airfares sold for less than \$100. Australian monopoly airports have done nothing but increase the cost of delivering those fares. Australian monopoly airports earned 25 per cent more revenue per passenger in real terms than a decade ago. Australian monopoly airport margins are more than double that of their
10 international peers.

Efforts by the Commission to dismiss concerns about monopoly prices as a fight for revenue share are also misguided. More competitive airport charges have facilitated lower fares and passenger growth, which has
15 positive flow-on effects to aviation jobs and also to tourism economies. As an example of this in 2015 Jetstar and Ayers Rock Airport negotiated a new more competitive pricing strategy. This contributed to a 150 per cent increase in Jetstar passenger numbers to the airport in the space of a year, and we continue to add capacity. Over the last three and a half years
20 we've grown about 20 per cent more capacity into Ayers Rock.

We would also caution the Commission from suggesting that this is an example of the flexibility of low cost carriers to switch airports. In the case of Ayers Rock we knew there was latent travel demand, but more
25 competitive pricing was needed to unlock it. But that's not the case with the vast majority of our network. Australia is the most urbanised continent in the world with a population concentrated in a handful of cities. In the four years prior to September 2018 Jetstar changed at most about 2 per cent of its capacity in association with new routes and route
30 exits in any given year, even in the face of increasing airport charges and monopolistic airport behaviour.

Claims that low cost carriers can credibly withdraw or threaten to withdraw services from airports as some sort of negotiation tactic are also
35 wrong. You only have to look at the work Frontier Economics have done on the myth of countervailing power. One of the scenarios they considered was the impact of Qantas threatening to withdraw a Newcastle Brisbane service. They found that Qantas stood to lose up to eight times more than Newcastle Airport if it carried out that threat. That's what they
40 call cutting off your nose to spite your face.

We would also like to address the frankly false claims made to the Commission this week by Canberra Airport. Yes, Jetstar was in discussions with Canberra Airport to commence a Melbourne Canberra
45 service. The reason Jetstar has not been able to start a service to Canberra

is because the airport is simply too expensive. Canberra's prices can be nearly three times the prices of other monopoly airports across the domestic network. The short term incentives they offered would have meant that Canberra Airport was only twice as expensive in the first year rising back up to three-fold by the third year. The economics simply did not work for us, especially when you consider that two-thirds of our fares as I said before sell for less than \$100.

Claims by the Commission that airports like Canberra Airport do not exercise market power because of the presence of modal substitution are also erroneous. We gave it a red hot go. We actually started a coach there with Murray's Coaches about two years ago, and we only managed to sell 2.3 seats a month between Canberra and Sydney on those coaches. I'd now like to hand over to Nick Brodrribb to speak briefly about arbitration.

MR BRODRIBB: Thanks, Mark. Nick Brodrribb, I'm head of Legal across Qantas and Jetstar. The importance of arbitration for airport negotiations is driven by a simple fact: the airports are a monopoly and the airport owners, not surprisingly, expect to get a monopoly return from their assets. The airlines want to see fair and reasonable price but those two things are fundamentally opposed. There is usually a gap between that cannot be breached. The key reason for driving to arbitration as a final outcome where negotiations fail, is that both parties now know where the negotiation is going to (indistinct). And both players are now driving towards an outcome that can be understood because it's what's fair and reasonable as set out in the arbitration methodology.

Without that as the end point, neither party is going to be able to concede their position because they are fundamentally different and the monopoly return is fundamentally different to a fair and reasonable price. Now, if you look at the reasons that have put up, over many years, as to why arbitration is such a terrible idea and if you look at them with some degree of analysis, you see that they really are hollow. The first one is this concept of the floodgates. The floodgates will be opened and every man and his dog is going to run an arbitration case. Well, it's in no commercial party's interests to give up their rights to negotiate to an independent third party. That doesn't serve anyone's purpose.

But secondly, the largest and most valuable airport in Australia was open to free arbitration for everybody for five years and not a single case was decided by arbitration. So the floodgates were wide open and not a drop came through. The concept of delay, to be honest I find extraordinary. I have been negotiating airport agreements since 1998 and the amount of time that has been spent in negotiations is unbelievable. The idea that somehow going to an arbitration model would create delay is a nonsense

because the delay is already there. I think made the Perth that it would be "too complex", that an arbitration wouldn't be able to fathom the complexity of the decision which suggests to me that fair and reasonable can't be ascertained, it's an ascertainable concept. But that to me seems to be like a bit of a nonsense particularly when Perth Airport has sought that the Supreme Court determine what a fair and reasonable price is.

And then in terms of efficiency, as the Commissioner's rightly pointed out this morning, how efficient is it to go to the Supreme Court that deals with rape, murder, kidnap and ask it to determine a specific a specialist economic decision when you have a pre-existing regime that allows that to occur, albeit very difficult to access. So given that all those reasons for objecting to arbitration seem hollow and without basis or evidence, the question that is left is, "Well, then why is this dogged resistance to arbitration?" and the simple answer is: because arbitration will deliver a fair and reasonable outcome, and that's it. And if the Commissioner were to legislate such that access to arbitration that gave rise, obviously failed negotiations, but gave rise to a fair and reasonable outcome.

If that change were made and we're wrong, then you'll end up with some delays, which we've already got, and you'll end up with some complexity, which we've already got, and you might end up with the opening of floodgates, but the evidence strongly supports and suggests that's not the case, but ultimately you will end up with a fair and reasonable price and if we're right, which all of the historical evidence suggests, then it will be negotiated much more quickly because everyone's working towards the "same" outcome. Nothing will ever go to arbitration and you'll also end up with a fair and reasonable price. So our concern at Jetstar, and at Qantas indeed, is what is the fear of a fair and reasonable price? Why is the Commission, and certainly the airports, so terrified of a fair and reasonable price?

There's a couple of things I just want to touch on as well. Perth made some comments which I think the Commissioner repeated on the Frontier session which is that Qantas was somehow using countervailing power to threaten to withdraw from the Perth-Paris route. So I just want to point out, we don't operate Perth-Paris route. But Perth has been vocal in its criticism of the Perth-London route saying its loss-making and has been terrible for the airport and it's the protracted dispute about price that is preventing Qantas from being able to explore each of the routes because how can we operate a route when we don't even know what the airport charges are?

COMMISSIONER KING: But I thought the (indistinct) said that they were stopping discussions about all Perth-Paris, so.

MR BRODRIBB: Yes, as I said, how can we continue to negotiate a route with an airport that can't even tell us what the price is and make economic decisions about whether it's going to be economically viable, whether there'll be demand, whether it can operate; without that transparency it would seem like a foolish, highly imprudent decision for an airline to make particularly when the airport is taking it to the Supreme Court to try and determine what price it's going to charge.

And the second issue was that Perth made a comment that the security charges that it was now passing down to Qantas were actually acknowledging what Qantas had been incurring which is in fact correct. Qantas is paying about 5 per cent more than it was paying previously. But there's a dearth of information provided making it very difficult to understand how they cover the prices in the first place?

COMMISSIONER KING: Well, that's two different statements about the security costs so only could be (indistinct) I suppose, but is there anything else?

MR BRODRIBB: No, that's the end of it.

COMMISSIONER LINDWALL: Could I go back to Canberra since that (indistinct) statement first.

MR BRODRIBB: Yes.

COMMISSIONER LINDWALL: Canberra Airport has told us that, because of what we said in our report, there's an anti-competitive contract clause; they can't offer Jetstar a lower price which they otherwise want to do so Canberra Airport, and I'm just telling you what they told us, says that they would like to offer Jetstar a much lower price to allow you to fly into Canberra but they're unable to through their contractual condition.

MR BRODRIBB: We don't know what clauses Canberra's got in its contracts with other carriers. If it's got a provision that prevents it from offering Jetstar a lower price than it offers to one of its competitors, then the simple question would be, "Why doesn't it offer a competitor a lower price as well?"

COMMISSIONER LINDWALL: Well, I guess it wants to price discriminate, doesn't it.

COMMISSIONER KING: Just on that. Would Jetstar be in favour of a Productivity Commission recommendation that most favoured customer

clauses, to the degree that they exist in its services agreements, be removed from those air services agreements on the basis that they're anti-competitive?

5 **MR BRODRIBB:** Yes, so it's an interesting question. The ACCC's looked at the so-called provisions in relation to an airport back in 2002 and found that they weren't unreasonable, that they made no finding in relation to it and brought no proceedings in relation to it, so.

10 **COMMISSIONER LINDWALL:** There had been more recent cases, for example, the US in The Apple e-books case. The decision there was made that the most favoured customer clauses were from (indistinct) competitor.

15 **MR BRODRIBB:** Yes, in a completely different set of factual circumstances. So in relation to a scenario where you have an airline operating over a terminal that's being asked to effectively fund the majority of the costs if a different terminal, then it's reasonable you would say to that airline, "Well, I'm not going to charge you anti-competitive prices". So the operation of terms like this (indistinct) simply says to an
20 airport, "You can't competitively discriminate against this airline".

COMMISSIONER LINDWALL: "You can't offer terms and conditions to airline A given the clause is in airline B's contract, you cannot offer
25 terms and conditions to airline A preferable to those to B without also offering this to airline B" which for practical purposes it would mean airline A doesn't get offered the terms and conditions.

MR BRODRIBB: No, I don't agree with at all. The principle is that if
30 you want to offer lower fares to an airline, you ought to offer them to all airlines and if you want to offer them on a basis that they are available to anyone of those airlines, for example, if you start a new route you can have a cheaper price. When the incumbent carrier's already operating that route, only the new airline will get the benefit of that. That's not difficult
35 to operate.

COMMISSIONER KING: Your view would be then that somehow all airlines should be facing exactly the same sort of prices from the airport. One airline shouldn't be getting lower prices - I mean I'm just trying to
40 push where you're going because your position quite frankly surprises given that these clauses it's been put to us; these contract clauses work against Jetstar's interest so I'm really quite interested in understanding what you would want then in terms of the airports?

5 **MS WATTS:** I think, Commissioner, as we discussed Tuesday, we don't have as NCC said, we don't have any – an objection to the removal of these clauses as long as they're coupled with overall reform to how the system operates now. And we also face clauses where we are prevented from accessing declaration which we provided two examples of.

COMMISSIONER KING: Which we've also said are anticompetitive and should be removed - - -

10 **MS WATTS:** Absolutely. So for these clauses – the removal of these clauses is not – we don't object to them, we would much rather see a fairer negotiate arbitrate system which will take any incentive to have most of these clauses.

15 **COMMISSIONER LINDWALL:** Steve Bracks from Cbus appeared earlier. I don't know if you saw him and he said, that you did introduce negotiate, arbitrate they would basically sell off that asset unless the return went up significantly to cope with the additional risk. He also said that all of the things, the assets they invest in have to have a social licence to
20 operate and he would not accept or they would not accept excess profits because they would see that their long term investors that if you could take short term profits eventually there would be extra regulation and it would be counter-productive so they just want normal returns (indistinct) returns. That's what he clearly told us just an hour ago or so.

25 **MR BRODRIBB:** Sure. I can answer that in two very simple answers. The first one is, the airports bought – sorry, the airport companies bought the airports in CPI-X, they were regulated. So, they made the decision at that time to purchase the airports with their obligations to invest
30 infrastructure at that time. I can guarantee or I can't guarantee you but I think it is absolutely certain that if one of the airports sought to divest itself of its investment in the airport infrastructure in scenarios where it was guaranteed a fair and reasonable return, there would be a queue of investors, both domestic and foreign, who would take that up in a
35 heartbeat.

40 But the second question is, Steve Brack's comment, as you repeated it, suggests that the only way infrastructure in Australia can be supported by the private sector is if its allowed to gouge with monopoly returns and that - - -

COMMISSIONER LINDWALL: Well he doesn't say that he said it certainly isn't monopolies - - -

5 **MR BRODRIBB:** So, if that's right, if what he's saying is correct, then why would he would be fearful of going to an arbitrator that would give you a fair and reasonable price. If Steve's position is, he wants a fair and reasonable price, why would he be so fearful of an arbitrator that guarantees you a fair and reasonable price?

10 **COMMISSIONER LINDWALL:** Well, I didn't ask him that question but I don't know, how would - - -

MR BRODRIBB: I'm sorry it - - -

15 **COMMISSIONER KING:** Well, can I put back to you, do you believe that moving to a negotiate arbitrate model, would not lead to any change in risk from the airports perspective?

20 **MR BRODRIBB:** A change in risk?

MS WATTS: What sort of risk?

25 **COMMISSIONER KING:** The risk that they face from an investment perspective in the sense that they will clearly have less control over their future pricing strategies and so on - - -

MS WATTS: We would - - -

30 **MR BRODRIBB:** They'd be guaranteed a fair and reasonable return. Guaranteed a fair and reasonable return.

35 **COMMISSIONER LINDWALL:** They're guaranteed not that at all. They're guaranteed that an arbitrator will reach a decision, whether it's fair and reasonable that's – no one can guarantee that. What is fair and reasonable?

MR BRODRIBB: Okay, well if your argument is there's no such thing as fair and reasonable - - -

40 **COMMISSIONER LINDWALL:** Well, fair and reasonable will be in a purely competitive market, I suppose would be the competitive price - - -

COMMISSIONER KING: Or fair and reasonable will be whatever is written down in terms of the rules of the arbitrator to work out what is fair and reasonable, so I mean - - -

5 **MS WATTS:** But that sounds eminently sensible. Surely, that's something that can be written down in terms of the arbitration frameworks that allows the arbitrator to determine what might be – how to determine a fair and reasonable price. I mean - - -

10 **COMMISSIONER KING:** But the arbitrator would never know as much as you on one side and the airport on the other side, no matter how good the arbitrator is. They're not going to be in full possession of the knowledge that comes to commercial contracts that - - -

15 **MS WATTS:** But they will have – they will have power. I mean, this is where I suppose we're trying to say that there isn't a credible threat that airports face at the moment. So, the information, asymmetry that exists now, is what enables them to charge high prices, or there's a lack of transparency in how those prices are calculated. If that power imbalance
20 were to be corrected by having the threat of going to an arbitrator, we would submit that the negotiation process would be more disciplined as a result. I mean, it might be helpful if Carly Povey is able to elaborate some examples of the unreasonable infrastructure that we have been asked to pay for over the past few years.

25 **COMMISSIONER KING:** Just before we do that, just back on the fair and reasonable. So, you heard – well I'm not sure if you heard earlier today but earlier today but A4ANZ, said that you could include, for example, consumer interest in there and that would be part of a fair and
30 reasonable, I would've thought. So, let's say that an arbitrator said, "Well, yes Canberra", just to pick on them because you said they were charging three times what the other monopoly airports were charging.

35 So let's say Canberra was under this regime and the arbitrator said, "Well, yes we think Canberra Airports prices should be significantly dropped to all airlines, subject to those price drops being passed through to customers." Would Jetstar be happy with that sort of outcome, which is clearly fair and reasonable to the customers, gets to what you believe will
40 be closer to a fair and reasonable price, but also would require Jetstar not to see those as their own profit but to pass them through.

MR DAL PRA: I guess the starting point, with Canberra we don't operate there today, so it'll be hard to say - - -

45 **COMMISSIONER KING:** No - - -

5 **MR DAL PRA:** But in terms of answering that question, I mean, we are a low cost carrier. Our (indistinct) and our business model is about offering low fares to customers, so we have only grown those 15 million customers because we have continued to drop fares and find ways to make our business more efficient - - -

10 **COMMISSIONER KING:** That's not answering my question though, would you be happy to make a guarantee to an arbiter, that yes, we will accept the lower price on the condition that it is passed – try again, passed through in full to the final consumers. And being a low cost carrier - - -

15 **MR DAL PRA:** I'm not sure I'd know what that would mean in practice, because we're not operating it today and - - -

COMMISSIONER KING: It's across - - -

MS WATTS: Would that apply to all airlines, I mean it's a - - -

20 **COMMISSIONER KING:** It applies to all airlines – what I'm trying to get at is you said fair and reasonable - - -

MR DAL PRA: If you look at pricing - - -

25 **COMMISSIONER KING:** - - - and example, I'm just trying to work out will you abide by the arbiter's decision?

30 **MR DAL PRA:** It's very difficult to answer that specifically because pricing varies for a whole bunch of different reasons in different times of the year, different days of the week. Is it a daylight flight, there are many things that determine price of an airline. But if you look at the aggregate prices over time, we've seen prices drop since 2003, the year before we launched by 40 per cent. So, it is in our best interest to stimulate demand through low prices and that is how we operate.

35 **COMMISSIONER LINDWALL:** But going back to Stephen's point, if the reduction in price was \$5 per passenger, because it will be a fixed amount, that would in theory would mean you'd be cutting all your fares, no matter the higher price or the lower price by \$5 each, would you do that?
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MR DAL PRA: The difficulty is we are suggesting arbitration in a monopoly market. And you're now suggesting a cost pass through in a competitive market. So the prices in that market are set entirely by competitive forces. Because if - - -
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5 **COMMISSIONER KING:** And based on cost price presumably so as cost come down those prices will come down. I mean if you're competitive it should be a complete no brainer for you, you should say, "Yes, that will occur."

10 **MR DAL PRA:** Well it may or it may not. The pricing of an airline is incredibly complex because it's built not just – it's not built on inputs, it's built on what the market will bear.

15 **COMMISSIONER LINDWALL:** Okay, so can I come back then to a question that I put to A4ANZ, which is negotiate arbitrate, the consumer isn't directly there, you could try and set up some sort of consumer body as the AER has tried to do, I'm not sure how effective that is. But any arbitration that is going to provide a benefit not just for the airlines and potentially the airports, it could be of benefit to them, but for the consumers would have to have a requirement of pass through of some or all of a price drop to the customers and it appears that Jetstar would not consider that would be a reasonable or enforceable decision by the arbiter.

20 **MR DAL PRA:** No, I think your premise is flawed.

25 **MS WATTS:** I think you're misunderstanding us. What we're saying is that, if that is a model that the Commission would stomach and would be willing to recommend we would be very happy to look at it as soon as there were some practical details to consider it. But you're providing us with a hypothetical which is far divorced from how any airport negotiation has worked. So were we to have that model to consider, absolutely we'd consider it.

30 **MR BRODRIBB:** And very importantly, that arbitration model that exists now which is unfortunately defended by an almost impenetrable declaration, it has public interest tests in it, and it has public interest considerations in it, that the arbiter must take into account. So, it's already there, this is not new, I'm surprised Steve Brack's isn't aware of it - - -

40 **COMMISSIONER LINDWALL:** The NCC in its submission – the NCC in its submission to us didn't agree that it was impenetrable burden, by the way. It said that it considered the declaration test was quite appropriate and reasonable.

45 **MR BRODRIBB:** Well, I mean we probably (indistinct) that as - I mean, clearly any structure of (indistinct) discussing with A4ANZ, it's what we have to decide if we're to change from our draft recommendation is that where you've got the status quo, as we have with some modifications, we

5 have to be convinced that there's a net benefit to the community to choose something else. Now, the actual implementation of a negotiate-arbitrate, if that were to be the model, is critical to that because it's not very good to say it's an impractical thing. The Commission's been criticised in the past for proposing things that are not practical to recommend so you really have to know exactly how you would implement something like that and there are going to be costs and benefits, let's face it.

10 **COMMISSIONER KING:** And it is important to understand the standard economic approach to cost benefits says that shifting a dollar from airport shareholders to Qantas' shareholders is not a community benefit. At the end of the day it has to go back to the customers and I'm trying to work out how it gets there.

15 **MS WATTS:** Well, what we say - well, it's competition.

COMMISSIONER KING: If you're - - -

20 **MR BRODRIBB:** (Indistinct).

25 **MR McINTYRE:** If you're reducing the costs of the airport, that's exactly the opportunity, in this of Canberra which allow Jetstar to operate, would allow Jetstar to pass on the benefits to the customer and in the way that Jetstar managed to reduce fares to a customer by 40 per cent over the last ten years or whatever it is, so that is exactly the opportunity. We obviously had to price at a lower level because we are a low cost customer.

30 **COMMISSIONER KING:** Of course you do.

MR McINTYRE: So that is the opportunity, if Canberra were to do that, to bring lower fares to the customer.

35 **COMMISSIONER LINDWALL:** But that seems to be the argument that if Canberra were to reduce its price, then you would be to enter the market but that's not the same as passing on that to a customer. That just means that you're now operating where you weren't before.

40 **MS WATTS:** But doesn't that go to the - - -

45 **MR McINTYRE:** But if we were to enter the market, there would be a dilution anyway because we would be extra seats onto the market anyway but the more capacity into the market and we cannot, because we are a low-cost carrier, charge the same as other carriers anyway because of who we are. Therefore we, by entering the market, we would be de facto

passing on lower fares to the customer both through who we are and the fact that you would have more seats in the market.

5 Exactly. It's happened on all the other markets we've entered into and (indistinct) really.

MR McINTYRE: I mean, just by track record really. It's a fact of economics; you've got more supply. But the issue there is that there isn't the supply there because we can't afford it because it's a such large
10 proportion of that total airfare because we're a low-cost carrier.

COMMISSIONER KING: Just as a matter of interest; Tiger operates out of Canberra and have done so for a number of years. Any thoughts on why they can do it you can't?
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MR McINTYRE: Well, we talked about I don't know what incentives they've been offered.

COMMISSIONER KING: That's fine if you don't know.
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MR DAL PRA: Well, they've got (indistinct) clauses but they only operated for a while.

COMMISSIONER LINDWALL: But I mean, surely whatever the costs of Canberra Airport, theoretically Jetstar could operate and yet your price might just be a bit higher than it might be other airports?
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MR DAL PRA: Well, there's a point though, a price point, where people choose not to travel and that's the issue. We stimulate markets because
30 the price points are low and there would be people who would choose to take a holiday because they can now afford to take a family of four on holiday to the Gold Coast, or wherever it may be, because the price is low. And if the price was higher they might just say, "Look, I'm not going to do that. I'll drive down the road for holidays." So we do stimulate demand
35 through those low fares.

COMMISSIONER LINDWALL: I don't think there's no doubt about that, it's perfectly true. So, did you want to go - - -

40 **COMMISSIONER LINDWALL:** Do you have any more to say - - -

COMMISSIONER KING : Just understanding how Jetstar does it for commercial negotiation with airports; does Jetstar negotiate independently with airports? Does Qantas handle the group's negotiations? Do Qantas
45 and Jetstar as a group negotiate - just to understand what's happening here.

COMMISSIONER LINDWALL: Yes.

MR DAL PRA: I'll let Carly - - -

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MS POVEY: Hi there, Carly Povey. It really depends. It depends on factors, including whether there are commonalities in what we're negotiating again. So, for example, in Melbourne T4, we have our own terminal therefore that agreement sits separately to a common group agreement but we've actually found particularly in recent years is that as we've become an adult, not a starter airline shall we say, we have less significant growth opportunity particularly because of cost and we also have more commonality in the kind of discussions we're having with airports and over time we've actually started to negotiate as a group.

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To be frank, it would be totally unsustainable for us to manage the length of protracted negotiations if we didn't work that way. I'm a team of three. Jetstar alone flies to 39 ports. On average negotiations take four years which talk to the challenge that we have with the framework at the moment and from our perspective it's an efficient way of working. It actually allows the airport to have one conversation with one team about the same airport as opposed to two teams about the same discussions. Where there are services that differ by Qantas and Jetstar, then then become separate services. So, for example, Jetstar doesn't need a lounge, Qantas does. Those things do get separated but whether are commonalities, we take the most efficient course to what is a highly inefficient process, to be frank.

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COMMISSIONER LINDWALL: Well, they're complex negotiations I'll agree on that. What about the other types of differences between Jetstar and Qantas? I mean, I take it buses versus, you know, gates is not so important in some ports where there's sufficient gates and others it would be more important where there are insufficient gates. I mean, logically speaking the operating cost, I would imagine, of a bus is more than a gate because a gate, once it's invested, it's just there. If it's vacant, there's no operational - you don't have to get security people to take people around, and so on, on a bus.

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COMMISSIONER LINDWALL: Yes, yes.

5 **MS POVEY:** So where we do that, is one example, is dual door boarding so that would actually mean that for us a more efficient process is to have stairs which means we don't need as much airport infrastructure.

COMMISSIONER LINDWALL: Yes, but it's quicker.

10 **MS POVEY:** But it allows us to drive that very productivity that we need to drive costs down.

MR DAL PRA: So you save on the aerobridges.

15 **COMMISSIONER LINDWALL:** Yes.

MR DAL PRA: So you don't need to pass on that cost and you get better utilisation of your aircraft.

20 **COMMISSIONER LINDWALL:** Yes. Well, obviously negotiate-arbitrate talks about price but in terms of other things that airports provide to you as Jetstar, I mean in terms of the quality of the service and how innovative they are and how they respond to your needs. Can you talk to that perhaps, and what can be done to improve that?

25 **MS POVEY:** Yes, so look I've worked in similar roles in low-cost airlines for 17 years now. I've been in this role with Jetstar for three and a half years. In my whole time in this role I have never seen an airport proactively talk to me about their service levels. I would struggle to give you an example of where they've looked at innovative ways to increase
30 service levels; I would struggle to give you any evidence of them proactively showing me how they meet those services levels; and I would say that there's a significant need for us to think about how we drive more robust frameworks moving forward. Because from our perspective, if the two come together in the right way, it's actually about driving efficiencies.
35 But right now I would say there's a significant challenge there with how one gets clear line of sight, even with significant persuasion, to understand exactly what service levels have been met and - - -

40 **COMMISSIONER LINDWALL:** Because Melbourne Airport this morning, if I'm not mistaken, told us about the little bridge thing that you go out to the terminal.

MR DAL PRA: Yes, T4 Jetstar.

45 **MS POVEY:** Yes, yes.

COMMISSIONER LINDWALL: And how they now wished that they had built the walkway to, whatever they call them, - - -

5 **MR DAL PRA:** Travelators.

COMMISSIONER LINDWALL: Travelators, which they didn't have an agreement with Jetstar and so they didn't build it and now apparently passengers walk along a very long corridor, I've done it myself, it's a very
10 long corridor and people think that it's annoying and - - -

MS POVEY: Let me explain to you why we have that extra walk time. The reason why the terminal was designed the way it was, was to enable a first of a kind multi-lane taxiway that was critical for high utilisation of
15 aircrafts so it would allow Jetstar's aircraft and other aircrafts to push back onto the taxiway at the same time which actually means you can drive better efficiency of aircraft and one's not waiting effectively in a queue behind the other. That was the premise of us moving to T4; that was the premise of the design that included that long walkway. We've been in T4
20 nearly two and a half years. That multi-lane taxiway is still not in operation. So that's, from our perspective, a bigger issue.

COMMISSIONER LINDWALL: Okay, yes. Well, obviously. I mean, I can fully understand that you want to have the airport provide services,
25 baggage handling and so on, very efficiently and that's what they should do.

MS POVEY: Yes.

30 **COMMISSIONER KING:** Were you here when we were having the discussion with BARA about potentially having some sort of - sorry, let me step back. It's been put by BARA and I think the AAA and someone else, who I can't remember off the top of my head at this time of day, that
35 an approach that would be desirable for boilerplate parts of clauses is to have the airports, airlines and government representatives sit down together and try and work out sort of contract templates. We were discussing this morning about whether such an approach could be useful to start getting service standards and to get service standard measurement and appropriate penalties or incentives for not meeting them. I'm not sure
40 if any of you were present for that discussion so it's a bit unfair then to ask what you think of that type of approach but I'm going to ask it anyway. What do you think of that type of approach?

45 **MS POVEY:** Let me start with saying as the person who has the pleasure of many of these negotiations with airports, we'd welcome some

independent direction particularly on the inputs of frameworks such as the building block model and what is a fair and reasonable return? I've been in this role three and a half years and we've signed two airport contracts in three and a half years. I spend every day on airport negotiations. That's a sign of, for everybody, a rather inefficient and unproductive process so we'd welcome some independent direction. Whether that also leads to your point on important factors such as once you've reached agreement, how you then think about how you drive efficient service levels and how you enhance customer outcomes; absolutely, that would be something we'd welcome but the initial challenge we have is even getting to that stage.

We see significant issues with - you know, I think the only thing we do agree to agree on is that we're misaligned on our view as to what is fair and reasonable and so some direction that would allow us to get to the crux of the issue and actually start to talk about things, like service levels, would be welcomed from my perspective.

COMMISSIONER KING: Why do other airlines seemingly less problems? I mean, a lot of the airports have told us that they've settled, you know, 30-odd agreements with airlines and only one's outstanding.

MS POVEY: So the example, I think, was Perth which said that it had agreements with 23 or 24 airlines. They said that today. We're the only airline that operates in the terminal that's in dispute so there are now 23 airlines in the terminals that are not subject to negotiations. It's a bit of a fallacy for Perth to suggest that, it's a little cute.

COMMISSIONER KING: Well, the other airlines have terminal agreements because they don't have the Qantas terminal. I mean, it's not like the airlines that have reached agreements are operating out of some tin shed or something. They're - - -

MS POVEY: But they're not apples and apples is our point.

COMMISSIONER KING: No, there is a dispute between Qantas and Perth Airport which relates to the airport which relates to the terminals, and we understand that. I don't think it's quite fair to say that, "Well, you can ignore the fact they've reached agreements with all the other airlines, that they are irrelevant because they're operating out of a different terminal?"

MS POVEY: We would suggest, firstly, that that's where you're boilerplate terms may be worthy of investigation because in our experience where we hold out and have more - are able to drive any

additional efficiency in price or service, you know, we can't tell you if that is then passed on to the other airlines so effectively in those cases it's Qantas or Jetstar that end up doing that heavy lifting which others may benefit from. We don't have transparency around that.

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COMMISSIONER LINDWALL: But doesn't that mean that you have countervailing powers and still do the heavy lifting?

MS POVEY: It seems odd to - - -

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COMMISSIONER LINDWALL: I mean, it sounds like a countervailing power to me.

COMMISSIONER KING: She can bargain for a better result than everybody else so they free ride on (indistinct) and they say, "(Indistinct cost us?"

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MS POVEY: Well, I would submit that's not a great regulatory outcome either.

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COMMISSIONER KING: Quite possibly not the question that Paul asked is, "Doesn't that show that you have some degree of bargaining power that's more than the other airlines?"

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MS WATTS: Can I just - - -

MS POVEY: It's just that it takes us longer to negotiate because we'd be going more complex, that's all it suggests.

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MS WATTS: And just to talk to that as well I think, you know, if you look at the fact that our airport costs are rising more than 7 per cent actually before CPI every year. It takes on average more than four years to reach agreement. And even in airports where we have significant market share, we have been wholly ineffective quite frankly at reaching agreement. They don't suggest countervailing power to me. They actually suggested seriously challenging the process. We just do not feel that, you know, there is power to even do by, you know, putting together as a group. It's a wholly substantive process (indistinct).

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MS POVEY: And I think just to add to what you were discussing there around why other airlines may agree and Jetstar, in this example, may not. I can't talk to why they do agree but I can talk to why it takes so long for us to reach a negotiation and I'll give you some examples of the kind of challenges we have without some form of framework to find pathways through negotiation. We've seen examples where airports will try to pass

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5 on aeronautical costs or its aeronautical cost. They include everything from moving security facilities to enable retail growth when those security facilities don't need to move and \$6m being passed on to Jetstar. That same airport was proposing a design for a new terminal with a koala sanctuary in it and was adamant that it was not gold plating.

MS WATTS: And that it was aeronautical.

10 **MS POVEY:** Exactly. We've seen examples from airports where they have asked us to pay for CCTV for the security and car parks. We have seen multiple examples where they have asked us to pay double (indistinct) escalations. We have seen many examples where they have said that the whole reason that they are needing to invest in infrastructure is to drive aeronautical growth and to remove congestion in terminals.
15 They are proposing to pass through 90 per cent of costs to airlines and 74 per cent growth in retail is part of that. So we just see so many different examples, with more time that we could talk to in more detail, while we really struggle to even see transparency inputs, never mind get to the stage where we can agree a fair and reasonable outcome.

20 **COMMISSIONER LINDWALL:** Well what about on the other side. I've heard testimonies, say from Perth, that they upgraded their ILS to Cat 3 and Qantas and Jetstar don't want to pay for that and don't pay for it and yet still land planes during conditions that require Cat 3 ILS landing.

25 **MS POVEY:** No, no - - -

30 **COMMISSIONER LINDWALL:** That's what they did say to me. So I mean, you know, you're saying one thing and the other side says the other thing.

MS WATTS: Indicates a system that needs reform.

35 **COMMISSIONER LINDWALL:** Not necessarily, not necessarily. It might but it may not.

40 **COMMISSIONER KING:** Can I ask whether Jetstar or Qantas, or the group, whether you think there should be a single till approach or the current dual till approach or a hybrid till similar to a single till; but in other words, should pricing relating to aeronautical be based on the return and the operations so that the entire airport, including car parking and so, all should, for pricing for aeronautical, just be based on aeronautical?

45 **MS POVEY:** We believe that single and hybrid till methods are worthy of additional consideration. We've provided some analysis in our

submission on what would be the relevant merits of both of those systems. We don't have a definitive, a solution, to present to you but we do believe that they're worthy of further investigation by the Commission.

5 **COMMISSIONER KING:** Even though single till, by implication, means that yes, Qantas might be asked to or Jetstar might be asked through the aeronautical charges to pay for additions to car parks because that's where the airline has or the airport has determined that they will get the return rather than getting it on some other part of the single till. A
10 single till means you are operating overall and you take the money from where you can so exactly the situation you said was unfair, could be possible under a single till.

15 **MS POVEY:** Well, it currently occurs under the dual till so we've been asked to pay for koala sanctuaries et cetera under the current system. The issue we have now is that there is no transparency of what airports regard as aeronautical infrastructure, there's very little transparency. We're not able to tell if there's retail added into that aeronautical price now. We do absolutely acknowledge that there would be some risks around a pure
20 single till methodology, obviously that's why some jurisdictions have considered a hybrid till where you mitigate the risk to both airport and airline. Again, we would say that those are all worthy of consideration. Certainly, in our experience, there are a number of non-aeronautical assets or non-aeronautical services that reliant on passenger traffic which is why
25 it's worthy of further consideration.

30 **COMMISSIONER LINDWALL:** Jetstar and other low-cost carriers; are they disproportionately or equally affected by the 15 minute of 80 movements an hour rolling cap at Sydney airport?

35 **MS WATTS:** Yes, it's a regime that we're all affected by, yes.

40 **COMMISSIONER LINDWALL:** But do you think LCCs are more affected than full cost carriers?

45 **MR DAL PRA:** Alan, this would be more a one for you really?

50 **MR McINTYRE:** I'm trying to think whether we're disproportionate. In fact, I think we're probably - - -

55 **MS WATTS:** Not materially obviously.

60 **MR McINTYRE:** I think we're kind of all affected by this. Sorry, what's behind your question?

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COMMISSIONER LINDWALL: I don't know, you've got that very tight - - -

MR McINTYRE: I agree absolutely.

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COMMISSIONER LINDWALL: - - - margins, therefore fuel would be more important and timing - - -

MR McINTYRE: Congestion – I mean to go back to Carly's point, obviously anything that slows us down and doesn't allow us a 30 minute turn, but that's not specifically in relation to the rolling cap, it's a slightly different issue, so I think in terms of the - - -

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COMMISSIONER LINDWALL: I suppose on the other hand - - -

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MR McINTYRE: It's not regime, it's kind of affected together, I think.

COMMISSIONER LINDWALL: I suppose that's right and I mean, the person who pays the full price business class ticket on Qantas is going to be probably annoyed at being waiting five minutes more than someone who is paying \$58 - - -

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MR McINTYRE: I think everybody gets annoyed when - - -

MS WATTS: They definitely have loud voices

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MR McINTYRE: It doesn't work that because you paid more you shout less or more.

COMMISSIONER LINDWALL: That's probably true. Do you have any more questions or – any other final points you want to make? Anything else you'd like to say because – anything we have missed?

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MS WATTS: I think the only thing we would say is that our – just in terms of the price pass through question just as a concluding point. The record of – certainly Jetstar's record has been that wherever costs have lowered, those prices – those savings have been passed through to customers either through fare savings or through additional routes and additional seats, so that is certainly a track record that it has held for 14 years and the benefits that come through some of the reforms that A4ANZ and BARA have been advocating and (indistinct), we are absolutely confident they would have similar benefits for passengers. That's the record that Jetstar has stood on and it is certainly something - - -

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MR DAL PRA: I think it would be true of low cost carriers around the world.

MS WATTS: Absolutely.

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MR DAL PRA: We are part of that and that's how the business model works.

MS WATTS: Yes.

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MR DAL PRA: We stimulate demand, lower the costs, (indistinct) scales and you just continue to get that virtuous circle of reducing costs, passing it onto consumers, growing, it is a virtuous circle.

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COMMISSIONER LINDWALL: Look, I applaud Jetstar, done a fantastic job. I should ask you finally, how do you find access to foreign airports that Jetstar services?

MR McINTYRE: How do you mean, how do we find them?

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COMMISSIONER LINDWALL: I mean the cost, the access terms, the types of services you receive - - -

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MR McINTYRE: It varies a lot. I mean we are seeing some concerning indications. Price increasing which is affecting us not well. Certain parts of Asia at the moment, and it's having – it is not having a good effect because for the very reason, as we've said, we run – we stimulate demand and airport charges are a considerable part of our costs. I mean, it is 20, sometimes more percent, of our costs, of the airport costs and so it means

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COMMISSIONER LINDWALL: And they're actually rises in airport charges rather than exchange rate effects or anything - - -

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MR McINTYRE: Yes, rises in airport charges and material.

COMMISSIONER LINDWALL: All right. Well, I think - - -

MR McINTYRE: Thank you very much.

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MR DAL PRA: Thank.

COMMISSIONER LINDWALL: An opening statement would be fantastic. Could I just have five seconds?

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MR ZANARINI: For the purpose of the transcript ,, Matteo Zanarini, Area Manager south-west Pacific representing the International Air Transport Association based out of Sydney.

5 **MR RAFFO:** Good afternoon. My name is Cesar Raffo. I am head of Airport Charges in IATA.

MR ZANARINI: So first, IATA appreciates the opportunity given to participate at this hearing, as well as hopefully provide commentary and clarifications as required, for consideration with the inquiry on the Economic Regulation of Airports and its draft report.

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15 The International Airport Transport Association, IATA, is a trade association for the world airlines. We represent 290 airlines globally or 82 per cent of global air traffic. IATA member airlines include many that operate flights to Australia including Australian carriers Qantas and Virgin Australia. IATA supports many areas of aviation activity that helps formulate industry policy on critical aviation issues with the objective to drive safe secure and a sustainable environment for aviation to flourish.

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25 Our views for consideration in our submission are from an international perspective based on global best practises which are relevant and applicable also for Australia. In the draft report, whilst the PC rightly identifies that the monitored airports possess market power, IATA is surprised and concerned regarding the PC's draft conclusion that these airports have not systematically exercised market power and therefore the existing light-handed regulatory framework remains sufficient.

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35 Given that the purpose of this inquiry is to determine the effectiveness of the economic regulation of services provided by airport to airlines, passengers and the people and businesses that access the terminal precinct, our response respectfully encourages further assessment and for a balanced accord of the evidence presented by our members as well as A4ANZ and BARA.

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45 Overall, we consider this matter too important for airlines, passengers, third party operators and airports, as well as for jobs, tourism and economic development within Australia. Our latest response to the draft report does not present again the details already provided in previous submissions, as we rely on the public hearing and our submissions to encourage the Productivity Commission to revisit the areas of concern or explain why they are not being considered.

45 Rather we have focused on areas where there should be some revision to the assessment methodology in order for the PC to seriously consider the

5 need for an efficient and effective dispute resolution system as a meaningful and credible regulatory threat notably in the areas of additional scrutiny on the costs of the monitored airports, particularly capital expenditure efficiency and return on capital, and reassess its conclusion on airports exercising their market power.

10 A reassessment on whether scarcity rents exist based on the information provided in our submission, and also reconsider the much needed creation of guidelines on the minimum information to be provided at consultations. The PC is urged to investigate such implementations in other regions and to determine independent fact-based conclusions. Based on our experience across the globe, our view is that the progressive improvement would not be interventionist, nor lead to perverse incentives not to reach agreement during the consultations.

15 With me today, Cesar, has been, as he said, is responsible for airport charges and together with my colleagues, has been instrumental in formulating our submission. Our submission has three components; economic regulation of airports, Sydney regional access scheme and slots, and jet fuel supply. 20 Cesar is here to help answer all your queries and requests for clarification on the economic regulation of airports.

25 Unfortunately, we were not able to also bring our subject matter experts all the way from Geneva as Cesar has come all this way - - -

MR RAFFO: I drew the short straw.

MR ZANARINI: - - - and he is holding up very well, I might say.

30 **COMMISSIONER LINDWALL:** When did you arrive?

MR RAFFO: The day before yesterday. I did the last two nights have been

35 **COMMISSIONER LINDWALL:** So your brain is telling you it is two in the morning - - -

40 **MR RAFFO:** I know, it's like – I woke up at 3 am and then it was impossible to sleep and so my apologies - - -

MR ZANARINI: So in short, I give Cesar the onus of taking the lead from this time on, but unfortunately we won't be able to respond to any request for comments on our slots and jet fuel submission, but we, of course, welcome the PC to provide any questions that you require and we can take them off line through normal communication. So thank you very much. 45

COMMISSIONER LINDWALL: Well, maybe that's the best thing to do, we'll talk generally about things and we might send you separately some questions about fuel and slots. Yes, that might be the best way of handling it. Perhaps you could talk about – well, since IATA covers so many countries and so many airlines, different countries around the world and their regulatory approach in general, and how you compare Australia's regulatory approach to other countries of similar type of size.

COMMISSIONER KING: Yes, so comparison say to the constructive engagement approach of the UK and any others.

MR RAFFO: Yes. So in the world you have the full spectrum. Now, the question is where you believe Australia – where Australia should be in that spectrum, you know. So, to go to the worse, is like you can have countries especially, let's say not that well developed, although that's not necessarily the case, where you have from one day to the other a decree saying "charges are going up twenty dollars", whatever, and then you start shouting like what's going on, you know. And it becomes more political than anything else at that point in time.

On the other side of the spectrum you have much more, let's call it, well developed regulatory regimes, let's call it with a proper independent regulator which defines what's the best regulatory framework given their statutory duties. Now, I guess that you will probably – well, and then you have many different versions in the middle, so in Europe for instance, you have some of these regimes but you also have what is called the – well, all the airports in the European Union what you have is what is called the Airport Charges Directive, so for instance, which is, first of all, a law all countries has to comply with.

COMMISSIONER LINDWALL: Except for the UK, is that right?

MR RAFFO: Well, once it leaves. Yes. If it leaves. No, there is – no, so there is a clause in the directive if the airport is deemed to be in competition then there could be alternative arrangements. So that's what the, for instance, that what has been applied for instance in some of the UK airports, you know. And then what you have in there is the designation, the designation, again, but this is the UK, you know.

But in Europe all airports above 5 million, competition or not, the ACD applies. And again, which provides for the basic ICAO principles, transparency, consultation, discrimination et cetera. And also provides a process on how – although not in detail which is one of our issues, provides a process and also most importantly, an appeals process.

5 So if the airport makes a decision which the users are not – or believe is not
fair enough, they have the opportunity to go to a – what they call is an
independent supervisory authority, that is how it is called over there. Now,
10 what does the ISA do? It depends on the countries and the ISA for instance
some things that we are raising our hands and say well, it is not the best
thing because in some countries the ISAs do have the right powers to deal
with this type of issues. In some countries they don't. So which is why we
are asking, currently asking the Commission, in public and everything, to
15 have a review of the directive.

Let's say if the worse is on the left and the best is on the right, I would say
and then you have the ACD in the middle, although I have to admit I am
not involved in the negotiations here but we are in contact with our
15 stakeholders here and we have experience elsewhere in the world.
Australia's a little bit on the left because once again, you don't have at least,
this opportunity to access an arbitrator, an authority that can solve matters,
issues that happens between the users and the airport, especially when we
are speaking about airports with market power, you know. If they were in
20 competition well, that would be different, if they were.

But those that do have the power, is like not having a third party, then it just
opens up the opportunity for – well, what you call so elegantly, exercising
their market power, I would call it abuse, no. Maybe, I have expanded a lot
25 but there's a lot to speak about here, you know. So that – that's – I don't
know, it's no coincidence that our friends from some of the – let's call it
airport associations, in the world favour very much what is happening in
Australia as well. I wonder why, but yes, and I presume that is because you
– it is much the situation is less stringent on the airport providers.

30 **COMMISSIONER LINDWALL:** I mean, it is interesting, I met a little
while back the regulator for the Singapore airport because it has a very
interesting situation because they have Singapore Airlines, of course.

35 **MR RAFFO:** Yes, CAAS.

COMMISSIONER LINDWALL: The national carrier. They've got -
Singapore Airlines has no choice but to land at Singapore Airport, can't go
to Malaysia. And so that symbiotic relationship gives a lot of power to
40 Singapore Airport. So that would justify more regulation for - - -

MR RAFFO: And they are regulated by the CAAS.

45 **COMMISSIONER LINDWALL:** Sorry?

MR RAFFO: There is an authority - - -

COMMISSIONER LINDWALL: Yes - - -

5 **MR RAFFO:** Interestingly – sorry, going a little bit in Asia, in Malaysia, MAVCOM has been created and actually does, with the economic regulation of airports, and currently they are consulting on how they should be setting the charges, it is a quite interesting approach. So it is not just a European thing, the UK, it is happening and people are realising the
10 importance of having a reasonable level of charges.

COMMISSIONER KING: But when you look at Australia also, the other distinguishing feature is that individual airlines have contracts,
15 individualised contracts with the airport, contracts to New Zealand where each – there's a common contract for Auckland airport and all carriers, and some would say, I think that, that a number of participants have said that that's a great advantage because those contracts can be tailored to the desires of each party. Do you agree with that?
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MR RAFFO: It depends what are the differences in the sense if there are differences in the service levels maybe there could be some justification.

COMMISSIONER KING: That's a type of thing - - -

25 **MR RAFFO:** But then we'd have to quantify your differences. I think we have gotten to a stage about linking service and price and I think this is something that BARA has been mentioning all along, is like right now - - -

30 **COMMISSIONER KING:** Exactly.

MR RAFFO: We are paying something and we don't know what we are getting, so there needs to be a much better, how can I say this, relationship between all of these.

35 **COMMISSIONER KING:** So you were here, I think, for the earlier discussion with - - -

MR RAFFO: Yes.

40 **COMMISSIONER KING:** Where we discussed whether the sort of forum they had been thinking about for boilerplate type contracts could be extended to think about service levels and appropriate service levels and incentives
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So any thoughts on that?

MR RAFFO: Well, I can tell you how it works elsewhere.

5 **COMMISSIONER KING:** Well, it is.

MR RAFFO: And where it works properly the discussions are, I don't know how to call it, multilateral.

10 **COMMISSIONER KING:** It's multilateral between different (indistinct).

MR RAFFO: So it's the airline community.

15 **COMMISSIONER KING:** Yes that speaks with the airport.

MR RAFFO: Because something that you need to realise that happens very much, I think the airport negotiations is a divide and conquer thing, so it's quite important that the community is there - - -

20 **COMMISSIONER KING:** That occurs in Europe so you have the airlines that - - -

MR RAFFO: Well, you can't have everything. Sorry, the discussion in terms of service level?

25 **COMMISSIONER KING:** Yes.

30 **MR RAFFO:** Well I wouldn't say - I don't know, in every single airport, but in general it is at the community level. So for instance, I don't know in the case Heathrow, in the case of, if I'm not mistaken, in Manchester, an SLA is being discussed. In Dublin where you have regulated environment, you have KPIs for the airport which are then consulted with entire airline community. In Spain as well, same thing. You have service levels that are set in consultation with the airline community. I participate in those discussions.
35 And so on, you know, it's

COMMISSIONER KING: And the European Commission doesn't have any competition concerns about them, I mean, you know, having all the airlines altogether in one room of the airport?

40 **MR RAFFO:** Well, the thing is - I'm not a competition lawyer.

COMMISSIONER KING: No, and I understand.

45 **MR RAFFO:** But first of all my - first of all my personal think is, you're leading a monopoly. So it's a kind of monopoly and then - but having the clients separated, that doesn't sound right. Again, divide and conquer.

Secondly, this is - the type of discussions is not that, "Well, this is the price and if you don't accept it we don't fly" or anything, we don't enter into that. We discuss a level of charges based on, I would like to say, a reasonable discussion on the costs and the underlying costs of the charges and that's as far as it go. Now, depending on the regulatory regime, we as an association can appeal or individual airlines, again, it will vary depending on the country you're speaking about but it's not like - it's not seen that we - the words in Spanish are here but the - like, everyone going together against the airport, I think it's like that. It's - we need to try to level the playing field.

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COMMISSIONER KING: Is there enough flexibility though in that sort of system? So let's say I'm starting a new low-cost carrier, so to be able to get my foot in the door to set up my network, I need to get special deals essentially from some airports. If I just go and say, well, you know, "Stephen King Airlines is starting up" but I got the same deals that all the airports that everyone has got then, you know, essentially I'm starting behind the baseline. You know, I've got all the extra costs of the start-up, of advertising, building up a network, dealing with the fact that I have low passenger numbers. So can you do special deals in that European type framework?

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MR RAFFO: Well, rather than a special deal, what you have over there is what is called "incentives" which are published.

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COMMISSIONER KING: Yes.

MR RAFFO: Now, whether you are ready or not with incentives that's a separate thing but they are available and they are available to everyone so it's not, "I'm dealing with you and I'm giving you this" so it's - - -

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COMMISSIONER KING: But the incentives usually, unless it's different to other industries, but I guess, and I am guessing, they'd be that you get a lower charge the more volume you bring through an airport. So again they would operate against a new start-up who's starting from zero who would have to build up their volume at the airport so a new start-up could face higher charges not lower charges.

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MR RAFFO: Well, the thing is what the airports do is that they offer incentives to help the airlines to develop their route. It's like, you don't have 100 per cent capacity utilisation from the first date so that is a type of incentive.

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COMMISSIONER KING: So you can do that, okay. That's the bit I wasn't clear about.

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MR RAFFO: Yes, my apologies.

COMMISSIONER KING: No, no. Your English is a lot better than my Spanish.

5 **COMMISSIONER LINDWALL:** In your experience, Cesar, how would you describe Australian airports in general in terms of quality and price compared to say the United States, Europe, England, Asian - - -

10 **MR RAFFO:** I would need to defer to the airlines locally but again, as far as I understand, is the data on quality is not there so it's very difficult to compare. So it's only you have subjective surveys and to base your assessment on that is - no that's a no-go. No, you need to have quantitative data - how many minutes of queues on security or whatever, you know, and that is measured in the same way.

15 **COMMISSIONER LINDWALL:** Would IATA publish the types of standards that should be measured? Would we have guidance on this(indistinct)?

20 **MR RAFFO:** We do have guidance. This was included already in our first submission so you need to read it. We have a series of - well, first of all it's called a service level agreement, a paper.

COMMISSIONER LINDWALL: That's right.

25 **MR RAFFO:** And it does mention a number of indicators that could be used for measuring performance. Now, there needs to be a further discussion where in these particular circumstances those indicators, are they the appropriate ones or not, no?

30 **COMMISSIONER LINDWALL:** Yes.

MR RAFFO: That would be a starting point and it includes series of examples.

35 **COMMISSIONER LINDWALL:** And this is a type of thing that evolves over time I would imagine.

MR RAFFO: Absolutely.

40 **COMMISSIONER LINDWALL:** And do you collect the type of information from your member airlines, that 290, to say the types of things that value to them and perhaps help provide guidance to improve the standards over time? Because it's all very well having quality standards but as you know they're fixed in stone. You need to improve quality over time,
45 don't you, in a number of areas and expectations change too.

MR RAFFO: Well, yes and no. It depends on - because there's always a cost to it.

COMMISSIONER LINDWALL: Of course there is, yes.

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MR RAFFO: You know, it's like when I was dealing with ATC, air traffic control is like - yes, ideally you would see no delays, no, but there is a cost to it as well.

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COMMISSIONER LINDWALL: It's called gold plating.

MR RAFFO: Yes and so this is part of the conversation that you need to have at an airport level, you know, to see what are the requirements of the airlines behind there and then having a proper discussion on the cost related to it.

15

COMMISSIONER LINDWALL: Do you think there should be more transparency on pricing then?

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MR RAFFO: Yes, for the record.

COMMISSIONER LINDWALL: Well, I know you said that before, so.

MR RAFFO: Well, there needs to be transparency and I'm going to take advantage of something if I may please.

25

COMMISSIONER LINDWALL: Yes, certainly.

MR RAFFO: In a way I'm - and my apologies how this is going to come out, it's like you sort of dismiss in the draft report the idea that there needs to be some sort of minimum requirements when you have consultations. It's like oh, it's like giving the hand to the airlines. Actually, it's not, it's levelling the field and again, from what I was hearing in some of the examples is, "Look, I cannot receive one pager for, I don't know, \$100,000 investment and the same one pager for a \$200 million investment. So there needs to be some sort of minimum principles, what is what needs to be provided, the type of justification that needs to be provided and then get on with it and have the consultation. It's like, at least with a proper transparency, we don't stay in the first - let's call it the first fight, and say, "Well, I cannot even have an informed opinion because I don't have a transparency", you know. At least we have the transparency and then we can have the proper discussion. Now, we all can agree, we cannot agree that - well, you would always have two things but at least we're not fighting on whether you gave me two lines or three lines or one line, you know, if that makes sense, so having those on the cost side but on the investment side some processes, as you were saying, the constructive engagement process.

45

COMMISSIONER LINDWALL: Minimum information requirements.

5 **MR RAFFO:** Minimum information and if that could be actually through consultation, could be the ACCC, could be any other agency to have that discussion; what is the minimum necessary?

COMMISSIONER LINDWALL: So there's the monitoring information we get through the ACCC each year but - - -

10 **MR RAFFO:** But ex post.

COMMISSIONER LINDWALL: Exactly ex post. This is ex ante information

15 **MR RAFFO:** This is when you are having the discussion itself.

COMMISSIONER LINDWALL: That's right, yes.

20 **MR RAFFO:** So that you don't end up in a Turkey bazaar type of situation, you know.

COMMISSIONER LINDWALL: Yes.

25 **MR RAFFO:** No, it's like you have an appropriate level of costs and appropriate discussion and hopefully you reach some sort of agreement, you know, but if you can't because you don't think they are reasonable then you have an instance where you can escalate matters.

30 **COMMISSIONER LINDWALL:** The building block methodology used in Australia, was that traditionally used also?

MR RAFFO: That's ICAO. That's ICAO's policies, building blocks. That's the baseline for the calculation of charges. Key thing is not just using the building blocks, it is what goes into the building blocks.

35 **COMMISSIONER LINDWALL:** Of course.

40 **MR RAFFO:** If the operating costs are efficient, what are the depreciation accounting rules that you use, you know, if you're building a terminal or a runway that would last 50 years and you depreciate it on 15 then there's a problem. The WACC, obviously that's the typical discussion. The CapEx, is it the right scope, is it being delivered at the right time, at the right price, at the right cost. So it's all these things that are – ah, well, the discussion has already happened throughout the day, what do you do with the other part of
45 the airport, that's like, on the non-commercial side? It's how you set the charges; if you treat the airport as a single thing or as separate businesses. So

those are the key discussions. The building block is no problem, it's the other things, you know.

5 **COMMISSIONER KING:** And that's why discussion about the blocks correct?

MR RAFFO: Yes and having the right environment that will allow the right discussion about the blocks.

10 **COMMISSIONER KING:** So one of the things that has occurred in Australia because of issues of re-evaluation of assets, de facto - I think all the airports, or the monitored airports certainly, use a capital base in their building block calculations that actually took the value, I can't remember, a number of years, it might be ten years ago now, I'm not sure of the exact
15 year, and then added on actual costs after that, so.

MR RAFFO: The line in the sand.

20 **COMMISSIONER KING:** Yes, the line in the sand approach. Do you think that sort of regulatory guidance, if I can put it that way, for things like the building block model that the airports use is useful?

25 **MR RAFFO:** Well, it certainly could be useful but again - well, it's difficult to deal with the past because it's - but again you need to know what goes in it, and this is something that we highlighted in our submission as well because you were looking at the return on assets but without really making an assessment or whether the assets were efficient or not. Now, looking at the past again it's quite difficult and for looking forward then probably something
30 could be done, you know, so that only efficient assets or efficient costs are included.

35 **COMMISSIONER LINDWALL:** Yes, once you start going there, who chooses whether the assets are efficient or not, that would have to be done by an external party presumably?

MR RAFFO: If the negotiations fail probably you will need to go there into that direction. It depends on how the framework is set.

40 **COMMISSIONER LINDWALL:** And so is that done in any overseas countries because where it has occurred here in other industries, it's led to regulated businesses trying to seek ex-ante approval for assets so saying, "Well, we won't invest unless we know that the arbiter or the third party body is...", in this case it's a regulator usually, "Is not going to later on say 'No, no, we think that was excessive or inappropriate'" or whatever.
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MR RAFFO: Yes.

COMMISSIONER LINDWALL: So you end up with this unfortunate situation where every investment is second guessed by a regulator and, you know, so we're not far off from the regulator saying, "Well, this is what you can build and this is what you can't".

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MR RAFFO: But then what's the alternative? Let them build whatever they want at what cost. So it's - - -

COMMISSIONER LINDWALL: No, I'm asking has that been a result in the case of where - - -

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MR RAFFO: Yes, obviously, and I was surprised to hear some of these comments today. yes, you need to have this type of discussion in advance. You know, it's like on that particular item I would agree with the person of Cbus, it's making changes ex post is, it's - I will disagree with much of the other stuff like he said but

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COMMISSIONER KING: It's got to be ex-ante.

COMMISSIONER LINDWALL: It has to be ex-ante.

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MR RAFFO: Yes. Now, for example, the UKCA says, "Okay, I'm giving you ex-ante but I'm also doing a check ex post just to ensure that there's nothing - - -

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COMMISSIONER KING: Which is standard among regulated assets in electricity and gas and elsewhere here in Australia.

MR RAFFO: Yes, so it would have to be ex-ante. The question is how?

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COMMISSIONER KING: Devil is in the detail as it were.

COMMISSIONER KING: Now, it seems to me that there's going to be a fundamental change in the air market or the transport market over the next few years with the increased use of the long range white bodied aircrafts, you know, Qantas already is flying from Perth to London and I'm sure there'll be more of that. About 15 or 20 years ago, or more even, there were a lot of European carriers, Alitalia, Air France, Lufthansa and so on, coming to Australia. But now of course they tend to go to hubs, so we don't see much of that anymore. They go to Singapore, Dubai and so on.

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MR RAFFO: Yes.

COMMISSIONER LINDWALL: I guess I'm wondering if you think that we'll see a lot more different carriers coming to Australia that haven't been coming to Australia for many years because of a growth of long range transports?

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MR RAFFO: I cannot answer that. My apologies.

COMMISSIONER LINDWALL: Can I ask for speculation?

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COMMISSIONER KING: I'm just surprised (indistinct), do you ever fly Alitalia (indistinct), I'm just surprised you want them back.

COMMISSIONER LINDWALL: Alitalia, for the record - - -

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MR RAFFO: I'm Italian, (indistinct words).

MR ZANARINI: I would hate to tell you who I used to work for.

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COMMISSIONER LINDWALL: The very first 747 to land at Canberra Airport was in 1972 and was an Alitalia plane and it was diverted from Sydney Airport and at the time the runway was nowhere near long enough for a 747, but anyway, so yes I was just speculating that's all. I don't think I've got any more questions.

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COMMISSIONER KING: No, I'm fine.

COMMISSIONER LINDWALL: There's a lot of questions we've got on jet fuel and slots and so on but maybe more things that you'd like to talk to us about, you know, before we finish our conversation?

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MR RAFFO: Yes, well I'm just repeating what has already been said, you know, it's like we were a little bit surprised with the report especially with analysis. We thought it was, again apologies, a little bit light touch, in the sense that no, it's like, okay with the indicators that you saw, analysed, and then determined that the market power was not systematically exercised and therefore we - and again, especially in light of all what has been said in these hearings, I think there is merit in going back and have a further look at some of these things and further analyse them. Maybe there is - well, I mean in our view there is enough evidence to propose a change in the way the regulatory system works here.

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Now, I heard at the beginning of the day you were asking, "Okay, how exactly do you see this happening?" I'm not sure if we need to - well, I'm not sure if you need to say this at this point in time in the report. In my view the report needs to say, "Is there a problem? Yes or no," and if there is a problem then what can be solved. A4ANZ was mentioning, "Well, what are the options?", you know, it's like in a way, again from me looking at things from 41 thousand feet it's like saying, "it looks like these guys are trying to shoot down the final offer arbitration," or whatever, you know, but if, for instance, If you believe that there is a problem (we believe that there is a problem) and you think that something needs to be done. Maybe the next step will be to

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5 have some sort of follow-on consultation on, "Okay, we know that something needs to be done. Okay, let's discuss all the options, pros and cons in much more detail, let's all think here how this thing will work," and then get a solution out of it. You know, instead of in June saying, "this is the solution," if that makes sense.

COMMISSIONER LINDWALL: Yes, I understand that.

10 **MR RAFFO:** You know, it's - okay, I don't know if it's within your remit but it will be a recommendation to the government, for the government to then send it back to the PC, I don't know, but as a follow up, no?

15 **COMMISSIONER LINDWALL:** When we're convinced, and say this was a draft report, that there needs to be a change to something, we would usually investigate different alternatives and then we would try and judge ones against the other.

20 **COMMISSIONER KING:** Yes and I mean, I think what you're seeing is that some parties have put forward a particular solution and we're just trying to work out if it's practical so you are seeing one solution being debated more but, for example, Dr Williams mentioned an alternative which would be a sort of single till price capped which is more of a sort of approach that was used in other industries in the UK and it's certainly one I'm familiar with and there's a long history of that in other industries and it's got merits and it's got -
25 but, no one in a sense has put that up other than Dr Williams at the moment so we haven't been really trying to explore it in depth.

30 **MR RAFFO:** Well, probably I think it would be good to explore all options to show that you have been exhaustive in the different options, you know, and not just say, suggestion again, you know, "This is what we have received, this is what we have analysed" and then yes or no and then that's it. So maybe again, if you think there is a problem, maybe yourself come up with a solution, I don't know. But it's this analysis of different ways of solving a problem that will hopefully be competent. Thank you.

35 **COMMISSIONER KING:** Thank you.

40 **COMMISSIONER LINDWALL:** Thank you very much. Well, everyone, there's always an opportunity for anyone who wants to come and have a say and either rebut or agree to something that's been said through the day so does anyone want to take another opportunity? Please, Graeme.

PROF SAMUEL: Do I come up here?

45 **COMMISSIONER LINDWALL:** Yes and you better say your name again for the record.

PROF SAMUEL: Now, I promise you, Commissioners, this won't take longer than an hour and a half so - - -

PROF SAMUEL: We'll keep it short for you guys.

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PROF SAMUEL: I will be short, I promise. I just wanted to cover on a few things that have come up through the day and can I say to you that personally I found this a really constructive day. It's been very helpful indeed and I think you will detect an approach made for ANZ that is much closer to the approach of our Spanish friends, or Spanish friend from IATA, which is, We'll apologise for, you know, suggesting that things are a bad light, in terms of the investigations you've done or whatever it might be but we'll still be pretty firm as to the approach we're going to adopt. I just wanted to correct a couple of things for the record. First of all, arbitration is not just about price, it's about everything, it's about the whole thing including terms - because if you take the standard aeronautical service agreement, the ASA, it covers the whole process of the provision of aeronautical services and land side services as well and that's probably one of the reasons why Dr William's approach of a price cap is not going to work because - and I might say that's not an A4ANZ approach, it is framed this way too.

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COMMISSIONER LINDWALL: No, no, understand that. He said that.

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PROF SAMUEL: He said it, yes, but when you talk about a price cap, you talk about a price cap in return for something and that's very easy - well, I say easy to do when you're talking about, you know, pumping electricity down a transmission line or pumping gas down a gas pipeline, a lot harder to do when you're talking about all the various elements of the 70 page aeronautical services agreement so I respectfully put aside the concept of a price cap. So we are dealing with services as well. The problem that the airlines have, and as you are aware, most of the airlines that used to manage or own their own terminals are gradually transferring them to the airports.

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That's where service becomes a very relevant factor because, for example, at the Melbourne terminal Virgin manages its main terminal, I think it's terminal 3. Qantas at the moment manages its terminal 1. But the terminal is branded a Virgin terminal and if you, dare I say it, use the conveniences there, the toilets, and they're dirty, as they have been twice for me, then I think, "Well, I'll ring Virgin and find out what's going on," and they'd say, "It's not us, it's the Melbourne Airport" and they have no way of actually controlling that so elements that would be involved in the negotiations/arbitration will involve potentially penalties for a failure to meet the various service standards that are required if they can be negotiated. So that was item one.

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Item two, you did raise the issue of pass through - actually I've done two because there was the price cap issue. You did raise the issue of pass through and the response I think I'd have given is this: If the arbitrator cannot be

convinced that the normal process of competition such as, for example, exists between Jetstar and Tiger Air as two low-cost airlines, will result in the lowest possible airfares relative to costs and the like, then clear that the arbitrator's going to then, in the context of the public interest that he would have to apply or she would have to apply, will then say, "Well, maybe I want to have some form of pass through." But we shouldn't underestimate the very complex aspects of "passing through," if you like. It's quite complex indeed. It has, by the way, the aeronautical charge for the low-cost airlines can form a very significant part of the total airfare as you'd be aware.

The third thing I'd say is this, and it follows on from something that our friends from IATA commented upon just at the conclusion when they said, "If you were of a mind to even consider the issue of negotiate-arbitrate", and we've talked about all that this morning and following the discussion that Commissioner King and I had about the details of it, it seems to me, and what we will undertake (indistinct words) is give you a detailed submission on the way that the arbitration might be conducted with, you know, appropriate references particularly to the Vertigan analysis and the like. But if you're of a mind to be pursuing that, may I respectfully suggest that you follow-up the suggestion made by IATA which is that we get a round-table together and you actually say, "Well, what about this? What about "if the airline and the airports don't agree on a travelator?" but the arbitrator thinks the travelator ought to be there, how would you deal with it, right?

The reason I suggest that is this: that if we put something forward, we could put through a list of criteria that ought to be examined or ought to be part of the directions for an arbitrator, but if we put in too much then I can well hear Commissioner King say, "But hold on, the government's getting too involved". If we put in too little then you'll say, "Yes, but what about this? What about that?" and I think the way that you develop that is we'll give you a draft template, if you like, but we think there'd be a lot of benefit in having a round-table where we actually talk about, between us, the sort of things that you might say, "You've forgotten this" or "Why do you want that?" or whatever it might be and we'd be very happy to participate in that as I think IATA themselves has said is a sensible way of taking that forward otherwise they think we'll end up with a problem.

We do think that the three fundamental issues are public interest, competition and efficient investment. The efficient investment is a really interesting one and I know Commissioner King has actually discussed this a bit in terms of the ex-ante approval, if you like, of investment. I'm not sure that necessarily happens. What happens is two things: first of all in the negotiations a lot of the investment is agreed upon. There will tend to be three fundamental problems or disagreements. The first is: is the investment proposed efficient? That is, it is being done at an efficient cost? And so often the airlines will say to the airports, "Your cost is not efficient. We can do it more efficiently," and can demonstrate just that. That indicates to the airlines that what's

happening is that the airports have less concern about efficiency because they pass through the costs in terms of charges to their various users of services.

5 The second thing that happens is this: is that, you asked the issue about the most favoured party clause and things of that nature, and I can tell you exactly what occurs. With the exception of the major operator Qantas, and this is not a countervailing power issue but with the exception of that the rest are either much smaller players or they are, in the case of Virgin, the challenger and they can be - I don't want to put it in terms that this is what happens, but it is very easy to actually settle terms with a challenger that says, "You are very keen to have a lounge put in place. We'll pay for the lounge or we'll put it in place for you. We know you need it quickly because that's part of the challenge process to get in the domestic area," and then the challenger will say, "Well, that's fine but you can't do a deal that's better than the one you're offering us to any other party."

10 And essentially they hang up the cloak with coat tails of the larger player and the larger player says, "Well, look we can just sort of sit there and we can do one of three things. We can reach an agreement", which doesn't happen, "We get to an intractable no-deal," like a no-deal Brexit and then you know what happens there, and then thirdly they simply say, "We're not going to pay" and "What are you going to do about it?" because, you know - and the airport says, "Well, in the end we'll sue." And that's what's happening at Perth Airport.

15 And that's where we then get into this problem that we had that we discussed before which is litigation arbitration, and I think Commissioner King has actually said on a few occasions there in the questions he's asked, "Well, is that really sensible having an inexperienced judge do these sort of things with the various constraints of litigation" or you've got Part IIIA access declaration.

20 Yes, if you've got enough years to wait for that process of the NCC. I should just emphasise the NCC has no position of arbitration. It's only position, as we all know, is to determine whether or not there's a declaration so we go through an eight year process of court appeals to determine whether declaration occurs or the simplest and most efficient is say, "Why don't we just have a commercial arbitrator that can be called upon by any one of the parties experts subject to criteria, ones that mention competition, public interest, the efficient investment, and all the others that were put up to you and yes, that's the way that we see it going. So they're the primary things I just wanted to raise. It's just to deal with a couple of the corrections of, you know, some things that we heard just through the day.

25 **COMMISSIONER KING:** All right. On that Virgin toilet issue, did you say that was Melbourne?

PROF SAMUEL: No, one was Melbourne and one was Sydney and I lost two pairs of shoes as a result. I had to throw them out.

5 **COMMISSIONER KING:** I will say that because you've raised this before and maybe we're both elderly gentlemen - - -

PROF SAMUEL: I'm prepared to concede I am, but go on.

10 **COMMISSIONER KING:** I went into the Virgin toilets and found them comparable to the ones in the Qantas terminal.

PROF SAMUEL: Yes, yes. I can't think of any - are you talking about in Sydney or in Melbourne?

15 **COMMISSIONER KING:** No, Melbourne.

20 **PROF SAMUEL:** Melbourne, yes and that may well be the case but you could take that up - you see, Qantas then bears the responsibility for that until they handover the terminal to Melbourne Airport. Virgin bears the responsibility because their toilets are branded Virgin - they're actually branded male and female but they're actually there in the Virgin terminal.

COMMISSIONER KING: Yes, I didn't have to throw my shoes away.

25 **PROF SAMUEL:** Yes, I did.

COMMISSIONER LINDWALL: Well, it must be getting close to the end when we're talking about toilets.

30 **PROF SAMUEL:** But that is the - - -

COMMISSIONER LINDWALL: (Indistinct words) arbitration.

35 **PROF SAMUEL:** Yes. But it is the issue of quality and of course what we do find is that the areas where they get (indistinct), if you go into the Virgin terminal, the large retail area, superbly glossy and fresh and everything else. You go into the non (indistinct) areas, if you like, then you have a totally different standard.

40 **COMMISSIONER LINDWALL:** Well, thank you, Graeme. I should ask does anyone else want to come and have a chat?

MR LYON: I'm an observer, I'm not - - -

45 **COMMISSIONER KING:** No, that's fine. That's in fact what's meant to be for so.

COMMISSIONER LINDWALL: You'll just have to introduce yourself.

MR LYON: Yes, okay. Yes, I'd just make one point - I'm David Lyon from RMIT University. I'm in the School of Engineering. It hasn't been discussed
5 today but I'd just like you to take into account the fact that the competitive model for airports in Australia is changing over time. Just to talk about the two biggest cities, so Sydney and Melbourne, Sydney first. So when the Sydney Airport was leased by the Federal Government to Sydney Airport, they were given the first right to operate any other airport within 100
10 kilometres of that airport. The government then put the pressure on them for the West Sydney Airport to see whether they wanted to exercise that right, they chose not to do so.

In choosing not to do so the Federal Government and, I think, the New South
15 Wales Government, developing that airport which will then either be operated by the current owners or it will then be leased off to another airport party so therefore there will be competition in the Greater Sydney area within 2026 and that airport's already under construction or (indistinct). So there's going to be more competition there, so that's something. And in terms of
20 Melbourne, we have two airports that are operating internationally now already, so - - -

COMMISSIONER LINDWALL: And Avalon as well, yes.

MR LYON: Yes. So since December last year AirAsia moved their
25 operations from Melbourne to Avalon and Jetstar operate from there. Jetstar before were arguing about the pricing issues that they have but they actually - their operations from Avalon are subsidised by the airport, by discounting, and also by the Victorian Government. So I guess the only point I'd make is
30 in the life of the next - in a relatively short term, the two largest cities in Australia are going to have airports which then airlines could choose to operate out of.

So already Jetstar is operating from Sydney and Melbourne and could choose
35 to operate - the other major airlines could operate certain airports in Sydney. Some of my students, we did a project and we looked at the third runway for Melbourne and concluded that, you know - and Melbourne have actually delayed their third runway because it's a major infrastructure, and you can actually model it as if you're saying, "Well, a third runway for Melbourne has
40 already been built, it just happens to be at Avalon," and airlines need to make a choice as to whether they exercise where they want to operate from and they will have two independent airport companies that they can then negotiate with.

COMMISSIONER LINDWALL: And of course Brisbane's got the Gold
45 Coast and the Sunshine Coast.

MR LYON: Yes, that's - - -

COMMISSIONER LINDWALL: They're so different I suppose.

5 **MR LYON:** Yes, well I think that's owned by the same company.

COMMISSIONER LINDWALL: Yes, that's the trouble, yes.

10 **MR LYON:** So there's not the same competitive level. I think Coolangatta is - - -

COMMISSIONER KING: I'm pretty sure Brisbane Airport and - - -

15 **COMMISSIONER LINDWALL:** Brisbane and Gold Coast are not the same.

MR LYON: Sorry, yes. So just in terms of there being a more competitive airport market, I think that that is starting to occur.

20 **COMMISSIONER KING:** And we might start looking a bit more like Europe. Just on Avalon though, Avalon and competition from Avalon has been coming for an awfully long time.

25 **MR LYON:** Yes.

COMMISSIONER KING: Any thoughts on why it has been so unsuccessful in being a second airport in Melbourne?

30 **MR LYON:** The distance to Avalon is a problem. The CEO of Avalon Airport is advocating that there be another railway station just further past Lara so that you would actually go to - you would catch a train out to the station, which will be called Airport or Avalon, and then you would check-in at the airport - sorry, at the railway station. They have a master plan like all the other airports and they have the two runways. They've just invested a
35 large amount of money to attract AirAsia there and they've built the 5 thousand metre, so yes. As the growth of Melbourne is going to towards the west, you've also got perhaps tourism operators looking at the Great Ocean Road and other attractions and yes, so it will come into its own over time.

40 **COMMISSIONER LINDWALL:** All right. With the fights over the fast rail - fights, I shouldn't say that, the various - you can smell an election in the air when you suddenly have fast rail projects coming up. Have any of those actually - because I just haven't looked at the detail and it really is something I should have thought of, have any of those actually taken into account
45 Avalon?

MR LYON: Any of those?

COMMISSIONER KING: Taken into account Avalon Airport, so Geelong Airport, probably Sunshine would be next.

5 **MR LYON:** Well, the CEO of Avalon Airport is trying to do that because he could pull-off that rail link to his airport where as the rail link to Tullamarine Airport is way in the distance. It witness actually make a competitive advantage for Avalon over Tullamarine.

10 **COMMISSIONER LINDWALL:** Okay.

COMMISSIONER KING: Yes, okay.

15 **MR LYON:** Thank you very much.

COMMISSIONER LINDWALL: All right, thank you very much, David. Anyone else want to come and have a - - -

20 **MR RAFFO:** Just to follow-up on this.

COMMISSIONER LINDWALL: Yes, please.

COMMISSIONER KING: You'll have to do it up here for the microphone

25 **MR RAFFO:** All right, just a quick one and - - -

COMMISSIONER LINDWALL: You better say your name again, Cesar.

30 **MR RAFFO:** Cesar Raffo. I probably have to say this so that it doesn't stay unanswered. The existence of two airports doesn't mean that there is going to be a competition. We need to understand what are the market dynamics, that people travel from the airport that is closest to them and this type of things so again I would suggest extra care before jumping- making any conclusions.

35 **COMMISSIONER LINDWALL:** We mention this in our report, yes.

MR RAFFO: Okay, thank you.

40 **COMMISSIONER LINDWALL:** Thank you, Cesar. Anyone else? In which case I'll adjourn the hearing until tomorrow. What time do we start tomorrow? 9 am tomorrow. Thank you all for attending.

45 **MATTER ADJOURNED AT 4.57 pm
UNTIL FRIDAY 29 MARCH 2019**