Board of Airline Representatives of Australia

Submission to the Productivity Commission's inquiry into price regulation of airport services

June 2006

Key Messages

1. The Board of Airline Representatives of Australia (BARA) represents most of the international airline carriers using Australian airports. BARA's comments in this submission are limited to airports' pricing arrangements for international air services.

2. BARA understands the key objectives of the current airports' pricing regime are to promote direct commercial negotiations between airlines and airport operators and to deter unjustified increases in aeronautical charges.

3. There are fundamental weaknesses in the current 'light handed' prices monitoring regime that limit its effectiveness in deterring abuses of market power. They include:
   - the 'scope' of the aeronautical till for price monitoring purposes does not cover all core aeronautical services and facilities;
   - substantial disagreement over the valuation of aeronautical assets at most airports, with some airport operators considering that they are entitled to continuously increase aeronautical charges based on periodic asset revaluations; and
   - a lack of a formal mechanism for dealing with material abuses of market power by airport operators.

4. In addition to these issues, some airport operators more recently have demonstrated a reluctance to deliver the same level of financial transparency as occurred at the time of the removal of direct price controls.

5. Sydney Airport Corporation Limited (SACL) has recently notified airlines of further increases in international aeronautical charges to apply from 1 July 2006. BARA has advised SACL and BARA member airlines that the increases are unjustified and inconsistent with the Review Principles.

6. On the basis of the evidence available, BARA considers there is a clear case for re-imposing price controls on the provision of international air services at Sydney Airport. A failure to properly deal with the abuse of market power by SACL will undermine the credibility of the current regime.

7. For other major international Phase I and II airports, BARA holds the strong view that, at a minimum, an effective form of prices monitoring should continue to apply. Recommended improvements to the existing regime are:
   - clarification of the scope of aeronautical services, underlying asset valuations and future revaluations;
   - development of guidelines for service level monitoring and commitments to be incorporated into all aeronautical service agreements;
   - introduction of a formal mechanism for registering material abuses of market power by airport operators with the Department of Transport and Regional Services (DOTARS);
   - introduction of a formal response mechanism from DOTARS or the relevant Minister as to whether a public inquiry into the pricing practices of an airport operator is justified; and
   - provision for the ability to 'claw back' the over-recoveries when setting future aeronautical charges where an airport operator has been found to have abused its market power.

1. Introduction

The Board of Airline Representatives of Australia (BARA) represents most of the international airline carriers using Australian airports. BARA members provide over 95% of international passenger flights to and from Australia. Most BARA members operating scheduled passenger services also engage in large scale international freight operations. BARA also represents three international freight-only carriers operating in and out of Australia. A list of current BARA members is attached as Appendix 1.

In their capacity as international carriers operating regular public transport services, BARA members use services provided by eight airports in Australia: Adelaide, Brisbane, Cairns, Darwin, Gold Coast, Melbourne, Perth and Sydney. Some BARA members use services provided by other airports in Australia to provide domestic and regional services. BARA's comments in this submission are limited to airports' pricing arrangements for international air services.

In considering pricing arrangements for privatised airports, a number of fundamental economic circumstances need to be highlighted. These include:

- International airports have significant market power. International airlines operating to and from Australia face no alternatives but to use the major international airports in the cities their customers seek to visit.
- Entry of a competing provider of airport services is unlikely in Australia's capital cities and major regional cities. The large economies of scale of providing airport services combined with the significant sunk costs of investing in airport infrastructure make new entry unlikely.
- Many of the services provided by airports in Australia are essential inputs into the provision of passenger and freight air services. Without many of the services provided by airports, airlines would be unable to provide services to consumers. Service quality, therefore, is an important factor in the airlines' commercial relationship with airport operators.
- The countervailing power of airlines is limited. As there is no substitute airport in the capital cities or the major regional cities in Australia, if individual airlines do not purchase aeronautical services from the airport they will not fly to the city. The loss to the airline of not serving a major city is likely to be significant.

The above fundamental economic circumstances existed when the Commonwealth Government removed caps on airports' aeronautical charges and implemented a light-handed regulatory approach. However, despite the market strength of airports, the Productivity Commission (PC) considered there was merit in more direct 'commercial' negotiations between airports and airlines. That is, airports and airlines should negotiate and agree on matters including capacity, service quality, investment requirements and prices necessary to support agreed investments. BARA considers that, in most instances following the removal of the CPI-X price cap, there were meaningful negotiations with airport operators over the provision and pricing of aeronautical services and facilities for the following five years.

BARA does not believe that the Government intended light-handed regulation to deliver to airport operators excessive returns on the actual investments they have undertaken. Rather, airport operators should be required to earn profits by growing demand and running their businesses efficiently. That is why the Government specified that the Australian Competition

and Consumer Commission (ACCC) should monitor the behaviour of the privatised airport operators.

A key principle underpinning the light handed regulatory regime is:

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

This submission, therefore, considers the extent to which the regime has achieved its intended goals of promoting meaningful negotiations on an ongoing basis and minimizing the incentive and ability of airport operators to abuse their market power. The key issues discussed are:

(a) the appropriate definition of aeronautical assets, ie what services aeronautical charges should cover,

(b) the appropriate valuation of aeronautical assets for pricing purposes,

(c) issues associated with future revaluation of aeronautical assets,

(d) the appropriate structure of aeronautical charges,

(e) transparency in airports' pricing arrangements, and

(f) non-price terms and conditions.

Based on evidence provided by participants to the review, the PC will need to form a view on whether direct price controls should be imposed on some or all price monitored airports. BARA holds the strong view that, at a minimum, an effective form of prices monitoring should continue to apply. On this basis, BARA provides suggested ways to improve the current light handed regulatory regime so as to better promote its intended objectives.

2. Scope of Aeronautical Services

Currently, there are differences in the scope and definition of aeronautical services associated with the regulations to the Airports Act 1996 and the Directions for the prices monitoring regime (Direction 24). BARA believes that one consistent set of aeronautical definitions needs to be created within the regulations. The Direction can then refer directly to the regulation. The current definition of aeronautical services in the regulations does not encompass two services provided to airlines that are indispensable for the purposes of operating regular passenger transport (RPT) services. Those services are:

(a) aircraft refueling (BARA has particular issues with the treatment of fuel throughput levies (FTLs)), and

(b) check-in counter facilities.

The justification for the inclusion of each of these services is discussed briefly below.

2.1 Fuel throughput levies

The operators of Brisbane and Perth airports impose a FTL on aviation fuel suppliers located at the airports. Ultimately, FTLs on oil companies are passed on to airlines. Consequently, while airport operators may claim that the issue of FTLs should be restricted to negotiations between themselves and the oil companies, the final effect of the levies is to increase the cost of operations to airlines.

BARA holds the strong view that revenues collected by airport operators for provision of aircraft refueling services should be incorporated in the aeronautical charging regime envisaged by the Government's airports' pricing policy. With the adoption of a "dual till" pricing arrangement under the airports' pricing policy, the FTL represents a monopoly rent stream to the airport operator. A BARA position paper on the application of a FTL at Brisbane Airport sets out the reasons in support of BARA's arguments. The position paper is attached as Appendix 2.

2.2 Check-in counter licence fees

At the time of airport privatisation check-in counter charges by airport operators were the subject of separate lease/licence agreements with airlines and, therefore, were excluded from the definition of aeronautical services. However, airlines maintain that the provision of check-in facilities by airport operators should be classified as an aeronautical service. The provision of check-in facilities is not a non-aeronautical "commercial" or "retail" function that airlines may access off airport.

Presently, the check-in facilities comprise counters and terminal space. In the future the facilities also are likely to include common user self service stations within the terminal building. Aviation security requirements presently - and almost certainly will in the future - preclude off airport check-in by airlines or third parties. The most likely scenario, therefore, is that airport operators will continue to be monopoly providers of check-in facilities.

BARA is concerned that there is a lack of transparency regarding costs of providing check-in facilities by airport operators relative to the revenues earned from airlines via check-in counter charges. BARA recognises that the bid for the airport at the time of sale would have included consideration of the prices contained in the existing check-in counter licences. Agreement over future charges has been reached with some airport operators. However, some operators have refused to provide airlines with sufficient information for airlines to make a judgement about the rate of return on the investments made to facilitate the service delivery. Airlines have a reasonable basis to suspect that some airport operators earn a return on check-in counter investments that is well in excess of that necessary to justify the initial purchase of the assets and the continued provision of the service. The inclusion of check-in facilities within the definition of aeronautical services would ensure that the provision and pricing of this monopoly service is consistent with other aeronautical services and facilities.

3. Aeronautical Asset Valuation

A key requirement of any future regulatory regime is the ability to identify and deter unjustified increases in aeronautical charges. BARA considers that this can only be done with reference to an agreed set of aeronautical asset valuations. Without agreement over how aeronautical assets

are valued, it is not possible to determine if an airport is setting charges consistent with the Review Principles.

BARA considers that aeronautical assets should be valued in a manner consistent with maintaining the airport operators' commercial interests in the delivery of aeronautical services and facilities. With pricing on a dual-till basis, this suggests a value equal to the amount actually invested by airport operators in obtaining the lease over the aeronautical assets at the time of sale. This valuation would then be updated for depreciation, investment and disposal of assets.

The privatisation of Phase I and II airports did not explicitly involve a valuation of aeronautical assets at the time of sale. Nor did airport operators disclose the value as part of the overall bid for the airport. The absence of an agreed and published set of aeronautical asset valuations is a major weakness of the current regime.

Nevertheless, BARA considers that an understanding of the privatisation process and aeronautical charges post the removal of the CPI-X price cap provides a basis for determining aeronautical asset values.

Once a set of aeronautical asset values is established there is no need to revalue such assets in the future. Rather, such values should simply be 'rolled forward'. That is, they should be updated for depreciation, investment and disposal of assets. This approach is consistent with airport operators being able to earn commercial returns on their aeronautical investments.

3.1 Privatisation of Phase I and II airports

Phase I and II airport operators purchased an expected aeronautical revenue stream based on a CPI-X price cap applied to the 'network, single till', prices associated with the former Federal Airports Corporation (FAC). Phase I and II airport operators argued to the PC in 2002 that such prices were 'unsustainably low' or did not reflect the 'value of the assets' utilised by the airlines. These are two separate arguments. The former largely relates to the issue of funding future investment. The latter is a serious problem as it relates to price increases associated with the existing asset base.

The difference between the network, singe till charge and a dual till charge is likely to have differed significantly between airports. In particular, while the aeronautical services at major airports were subsidised from non-aeronautical revenues, the 'network' component meant that major airports also subsidised smaller airports. Smaller airports and/or those airports with relatively newer assets are likely to have been the largest beneficiaries of the pricing policies of the former FAC. That is, the difference between a dual till price and the starting point prices at the time of sale were likely to have been the greatest at smaller airports and/or those with newer assets.

BARA reiterates that it was, in fact, the intention of the Government to share the benefits of privatisation between the Government, airlines and passengers. Specifying a CPI-X price cap on single till starting point prices was one way of ensuring that the airlines and passengers benefited from the privatisation process.

The 'low' aeronautical prices associated with Phase I and II airports that operators took on at the time of sale were, of course, simply reflected in the bid prices to the Government. What this did,

therefore, was drive a wedge between the implicit sale value of the aeronautical assets and a valuation based on their replacement cost.

It is this increase in aeronautical asset valuations, which the airport operators never actually paid for, that is generating an increasing divide between the airlines and most airport operators over what constitutes fair and reasonable aeronautical charges. BARA notes that some price increases have been consistent with funding future investment in aeronautical assets. This is a separate issue to price increases purely associated with perceived increases in existing asset values.

With the removal of direct price controls, some Phase I and II airport operators now consider that they are 'entitled' to charge prices based on revalued assets, along the lines implemented by the ACCC for Sydney Airport. BARA notes that, in undertaking these revaluations there has been no 'optimisation' of the asset base as applied by the ACCC. Basing charges on revalued assets, usually depreciated replacement cost (DRC), suddenly 'justifies' price increases of at least 50% with little, if any, investment in aeronautical infrastructure.

Some airport operators now even appear to go so far as to suggest that this is what they had assumed all along when they made their bids to the Government in the mid 1990s. BARA finds the proposition that airport operators assumed price increases of 30% to 117% after the first 5 years difficult to accept for obvious reasons. Adelaide Airport's expectation of CPI-1% going forward supports this position (see Appendix 3, p 3).

Even after achieving price and aeronautical revenue increases far beyond their expectation at the time of sale, some airport operators continue to claim that aeronautical charges are still 'inefficiently low'. As noted by the PC, some airport operators consider that aeronautical charges should be raised further to reflect perceived increases in land values in surrounding areas. Indeed, some airport operators consider that periodic revaluations are justified in setting future charges.

3.2 Arguments of some airport operators

Key themes used by some airport operators to justify increasing aeronautical charges are notions of economic inefficiency and the distribution of rent. Apparently, aeronautical charges **not** based on revalued assets encourage 'over-usage', unnecessarily bring forward aeronautical investments and encourage excessive non-aeronautical developments. It is also claimed that increases in charges simply end up as higher superannuation returns to hard working Australians. These arguments are discussed in more detail in the advocacy paper prepared by Access Economics for the Privatised Airports Group of the Australian Airports Association.[1]

BARA offers the following comments on these claims.

Airport operators usually spend most of their time arguing that aeronautical charges are a very small proportion of ticket prices and that they do not influence demand in any meaningful way. Indeed, in presenting demand forecasts to BARA, no airport operator has claimed that their charges will have any impact on forecast traffic levels. There is a clear inconsistency with this position and arguments over the valuation of aeronautical assets, including land. On one hand, the airlines are told that aeronautical charges do not influence demand. On the other hand,

[1] Access Economics, The Value of Airport Land – Report by Access Economics Pty Limited for the Privatised Airports Group of the Australian Airports Association, 31 October 2005.

perceived 'under pricing' of aeronautical assets significantly influences demand and, hence, future investment decisions.

The valuation of aeronautical land as an input into the price negotiations is not influencing the overall use of airport land in any meaningful way. The allocation of land between aeronautical and non-aeronautical activities post privatisation does not support the claims of some airport operators. The values contained in the airports' financial accounts lodged with the ACCC indicate that, in many cases, the share of aeronautical land has actually increased. The reality is that airport operators have a legal requirement to facilitate aeronautical activities – an obligation accepted by them with the other opportunities and requirements associated with the airport lease. Airport operators are able to reallocate land to non-aeronautical activities consistent with meeting their obligations under the lease. Revaluing the land under runways, taxiways and other core aeronautical infrastructure for pricing purposes has no effect on the use of such land.

BARA also considers that the purpose of privatising key infrastructure assets in the Australian economy is not simply to bolster the returns of superannuation companies. If this is a policy objective of the Government, then it should provide direct assistance. Such an approach is more transparent and effective than allowing unjustified increases in aeronautical charges at the expense of the travelling public.

BARA, therefore, rejects the notion that increases in aeronautical charges should be allowed through the revaluation of aeronautical assets. Rather, airport operators should be required to earn profits by growing demand and running their businesses efficiently. Some airport operators have accepted this approach to their business. Others, unfortunately, seem obsessed simply with maximising the short run cash returns from the assets. This does not lead to meaningful negotiations over forecast demand, capacity, service standards, investment and prices. Rather, the airport operator wants to engage in theoretical debates about economic efficiency, generating endless reports from economic consultants. BARA doubts this is what the PC intended to occur under light handed economic regulation.

3.3 How should the aeronautical assets of Phase I and II airports be valued?

The valuation of aeronautical assets, indeed any assets, could be undertaken through various approaches. They include:

(a) a cost based analysis, such as ODRC or DRC,

(b) the purchase price of the asset if it has traded in the market place, or

(c) a revenue based analysis, where asset values are a function of the prices and revenues established following the removal of direct price controls.

BARA considers that, given the nature of the privatisation process, the valuation of aeronautical assets of Phase I and II airports logically should be undertaken with reference to the prices currently charged. It seems reasonable to BARA to accept the premise that current aeronautical charges are more than sufficient to provide an adequate return for existing levels of capacity and service quality. Therefore, with the exceptions of Perth and Sydney airports (see below), asset values should be established with reference to the prices and forecast revenues associated with the commercial agreements between the airports and airlines after the removal of direct price controls. In addition, any revenues from fuel throughput levies (FTLs) and the revenues and costs from check-in counter licence fees should be included as returns against these valuations.

With the move to light handed regulation, Phase I and II airport operators were afforded considerable pricing flexibility. As noted earlier, they also enjoy considerable market power. One can, therefore, reasonably assume that the price increases obtained by airport operators after the removal of direct price controls were **at least** sufficient to sustain their commercial interests in the assets. That is, the prices generated returns at least equal to the airport operator's cost of capital on the implicit value of the aeronautical assets.

Given the strong growth in traffic volumes over the last few years, it is likely that current aeronautical revenues far exceed the airport operators' expectations at the time of sale. This has important implications for assessing the currently measured financial performance of airport operators. That is, the claimed 'low' returns at some airports are, in fact, merely a function of over valued assets. They are not a function of inefficiently low charges.

BARA offers the following comments on the aeronautical asset valuations and charges of the main Phase I and II international airports. Comment about Cairns Airport is also provided as it is instructive in assessing the attitudes of some Phase I and II airport operators.

Melbourne Airport: Aeronautical asset values were agreed as part of the price negotiations that underpin the current charges. These values were accepted, along with the lowest increase in charges, largest capital spend and a first attempt at a service level agreement. BARA, therefore, has no issue with how Melbourne Airport has stated its aeronautical asset valuations for price monitoring purposes. Importantly, Melbourne Airport has not revalued its aeronautical assets from those lodged with the ACCC in its first set of financial accounts.

Brisbane Airport: After various discussions, Brisbane Airport offered a set of prices to airlines they considered sufficient to meet their commercial objectives. These are the prices currently being paid by the airlines. Claims by Brisbane Airport that its returns are 'low' are easily explained. The airport's aeronautical assets are over valued. They should be written down to reflect current charges, which are more than sufficient to sustain its commercial interests. Brisbane Airport also imposes a FTL. The revenues from the FTL, as well as the revenues and costs from check-in counter licence fees, should be included as returns against the aeronautical asset valuation based on current aeronautical charges.

Perth Airport: BARA believes that Perth Airport abused its market power in setting charges after the removal of direct price controls. Little meaningful negotiation occurred with airlines. A set of prices was simply imposed and the concerns of airlines dismissed. A key point of contention was the revaluation of aeronautical assets, including land. BARA has advised Perth Airport that it does not accept its revaluation of aeronautical land for pricing purposes. The asset values need to be written down to correct this abuse of market power. Going forward, new prices need to be negotiated with the airlines recognising the over-charging implicit in prices imposed after the removal of direct price controls. Perth Airport also imposes a FTL. The revenues from the FTL, as well as the revenues and costs from check-in counter licence fees, should be included as returns against the agreed aeronautical asset valuation.

Further, Perth Airport has failed to abide by all of the terms of the aeronautical services agreement that it established with airlines following the expiry of the CPI-X regulatory regime. Perth Airport has ignored the requirement to consult with airlines about adjustment to aeronautical prices in response to greater than (or less than) expected growth of passenger numbers.

Adelaide Airport: After various discussions, Adelaide Airport accepted a set of aeronautical charges offered by the airlines. The increase in charges far exceeds those Adelaide Airport considered likely prior to the removal of direct price controls. Aeronautical asset values (excluding the new MUIT) should be based on the current charges.

Cairns Airport: After considerable consultation over traffic volumes, capital expenditure and service quality, a set of prices for five years were agreed between Cairns Airport and the airlines. The overall agreement also includes service level standards and commitments to consultation. The case of Cairns Airport further demonstrates that, if they choose to, airport operators can enter into meaningful negotiations with airlines and reach agreement over service capacity, quality and price.

By linking aeronautical asset valuations to current charges – with downward adjustments where necessary – the issue of aeronautical asset valuation can be resolved. This will remove a major impediment to meaningful negotiations between airlines and Phase I and II airport operators.

BARA acknowledges that this approach does not result in a 'mechanical' or necessarily entirely transparent way of determining aeronautical asset values. Instead, airport operators and airlines would need to negotiate acceptable asset valuations as part of the pricing process for new agreements. However, such an approach seems reasonably consistent with the PC's desire for commercially negotiated outcomes. That said, BARA considers that this approach would only be likely to work when combined with BARA's suggested improvements to the light handed regulatory regime (see section 8 of this submission).

Cost based approaches

Alternatively, aeronautical prices could be related back to the valuation of the aeronautical asset base at the time of airports' privatisation – that is, the 'starting point' aeronautical asset base. In this case, new capital expenditure would be added to the starting point asset base to determine depreciation (the return of capital) and the return on capital. It is BARA's contention that, under this approach, the asset values contained in the first set of airports' financial accounts lodged with the ACCC would represent a reasonable allocation of the purchase price of the airport lease between aeronautical, non-aeronautical and the lease premium.

It is possible that some airport operators may claim that the values in the first set of accounts lodged with the ACCC do not reflect the 'true' value of the aeronautical side of the business. In that case BARA can only speculate about what the values lodged with the ACCC were supposed to represent.

As an alternative to the asset values lodged with the ACCC, some airport operators could be expected to argue that the aeronautical asset values should be established through a cost based assessment, such as ODRC or DRC. Such values, updated for depreciation and investment are unlikely to differ significantly from the revalued assets currently contained in the 2004-05 regulatory accounts.

The use of ODRC or DRC would imply a further round of significant price increases at most Phase I and II airports. As noted earlier, BARA considers that the current prices are at least sufficient to sustain the commercial interests of airport operators. Further price increases for existing services will not generate any improvement in economic efficiency. Instead, the result would be simply a greater transfer of rent from airlines and the traveling public to airports. BARA does not consider this outcome to be consistent with the Government's Review Principles or the intended outcomes of the removal of direct price controls.

3.4 Sydney Airport – a special case

The ACCC valued the aeronautical assets and aeronautical land at Sydney Airport as part of its May 2001 pricing decision. Perhaps even more importantly, Sydney Airport Corporation Limited (SACL) was required to disclose to the investment community the assumptions it made as part of its bid. For example, in the Macquarie Airports Prospectus, it states that:

- *"Land value maintained using the ACCC's preferred methodology of indexed historic cost."*
- *"…whilst the Productivity Commission strongly backed the opportunity cost approach, the adoption of land value based on indexed historic cost is unlikely to be challenged and is consistent with the ACCC's May 2001 Decision."*

and,

- *"…Southern Cross Holdings has proposed a policy of 'shadow regulation' and consultation with its airline partners. That is, forecast aeronautical charges have been estimated as if Sydney Airport was still being regulated."*

Further, when Virgin Blue sought to have SACL declared under Part IIIA of the Trade Practices Act in 2002, SACL quickly pointed out that declaration was not warranted because SACL had accepted the ACCC's May 2001 pricing decision:

> *"Although having a difference of opinion on a number of aspects of the ACCC pricing decision, SACL accept[s] the judgement of the ACCC, even though this delivered charges lower than had been proposed. Evidence of this is SACL's pricing behaviour since deregulation on 1 July 2002, with SACL not having made any substantive increases in charges."*

However, SACL's stance on its acceptance of the ACCC's valuation of aeronautical assets has changed. Like some Phase I and II airport operators, SACL appears to have focussed its attention on creating wealth through aeronautical asset revaluations.

Based on the public statements of SACL soon after privatisation, the appropriate aeronautical asset valuations are those determined by the ACCC. The current owners adopted these valuations in forming their bid for the airport. To allow revaluations simply transfers rent to the owners with no improvement in economic efficiency. It would also send the wrong signal to airlines and the broader community about the intent and objectives of privatising Australia's largest airport.

4. Revaluation of Aeronautical Assets

It is established regulatory precedent that, once a starting asset value is determined, that value is then 'locked in' for pricing purposes and only updated for actual investment, depreciation and disposal of assets. This approach was endorsed by the ACCC in respect of Airservices Australia as follows:

> *'The ACCC notes Airservices' agreement to the approach suggested by participants in the ISC [Industry Steering Committee] that no further asset valuations will be undertaken that would adjust prices within the pricing period or at the beginning of the next cycle.*

> *Further to this, Airservices has agreed in principle to track the value of its asset base accounting for its actual capital spend, depreciation and asset disposals.*
>
> *The ACCC endorses this approach and considers that the value of Airservices' asset base can now be used as a reference point for future notifications, taking into account new, efficient investment.'* [2]

BARA endorses the approach advocated by the ACCC. Airport operators should not be permitted to increase aeronautical charges for existing assets and investments through continual revaluations.

There is an inherent conflict in the argument of some airport operators that they should be allowed to earn a reasonable return on their actual investments and that they are entitled to continual increases in prices and returns associated with periodic revaluations. Economic regulators have overcome this problem by locking in the starting point asset base value. The same sensible approach should be applied to aeronautical assets.

5. Structure of Airports' Pricing

5.1 Passenger based charges

Most airports now set aeronautical charges on a per passenger basis, rather than on the basis of aircraft weight. All international airports express aeronautical charges for international airlines on a per passenger basis.

The switch to passenger based charges occurred following the ACCC Decision in May 2001 in relation to aeronautical charges at Sydney Airport. International airlines considered a SACL proposal to restructure aeronautical charges and accepted that passenger based charges represented a more efficient charging regime.

Since 2001, BARA has not altered its view that passenger based charges are a more efficient pricing structure for international airline operations. The costs of providing international terminal services and most security services are more closely aligned to passenger numbers than other common airport charge metrics, such as aircraft weight.

BARA understands the concerns of some airlines that passenger based charges do not reflect the cost of providing airfield services. BARA considers that this question can only be addressed by a detailed analysis of the cost drivers associated with providing different airfield services, including runways, taxiways and parking aprons for different types of aircraft. On this basis one could then compare the cost of the service to the revenues obtained under various charging structures. BARA notes, however, that in some cases aeronautical land represents a substantial amount of the overall airfield asset base for pricing purposes. It is difficult to find a meaningful cost driver, by aircraft type, in the case of aeronautical land.

[2] ACCC, Preliminary View – Airservices Australia, November 2004, p. 43.

5.2 Aviation rescue and fire fighting services

BARA draws to the attention of the PC the recent decision of the ACCC in respect of charges for aviation rescue and fire fighting (ARFF) services. BARA is concerned that, if at some time direct price controls are implemented at any Australian airport, international airlines will be required to fund the activities of domestic airlines. That is, airport pricing will be used to promote regional development objectives by effectively taxing international operations to subsidise airline operations to regional locations.

In December 2005 the ACCC released its Final Decision on pricing arrangements for ARFF services provided by Airservices Australia at various Australian airports. The ACCC Final Decision, in rejecting location specific pricing (LSP) and returning ARFF charges to a network basis. This decision, in effect, taxes the operations of international airlines by tens of millions of dollars each year to subsidise airline operations to regional locations.

The decision by the ACCC sets crucial and disturbing precedents for pricing at individual airports. BARA maintains that the key assumptions relied upon by the ACCC in its ARFF Final Decision should be evaluated in the context of the review of airports' pricing for aeronautical services.

Prior to July 1997, charges for ARFF services were set on a network basis. A key aviation policy reform was, in fact, the move to LSP for ARFF and terminal navigation (TN) services. Before making the move to LSP, the Government first sought independent advice on the issue for pricing of ARFF and TN services.

In 1992, the former Industry Commission undertook a public inquiry into Intrastate Aviation in Australia. A key issue addressed by the Industry Commission was the charging of ARFF and TN services by the provider at the time, the Civil Aviation Authority (CAA).

In considering network pricing for ARFF services and the cross-subsidies it generates, the Industry Commission stated that:

> *"…cross-subsidisation distorts production and consumption patterns and can impose considerable costs on the community. These shortcomings have been recognised by governments throughout Australia, especially over the last two or three years. During this period, government have, to varying degrees, committed themselves to eliminating, or at least reducing, cross-subsidisation which has been identified in a wide range of publicly owned business enterprises."*

and:

> *"…network pricing as practiced by the CAA can encourage the over-use of facilities which are under-priced and the under-utilisation of those which are over-priced. This can affect patterns of demand and, as noted previously, can result in inappropriate investment decisions in costly aviation infrastructure."*

and:

> *"To encourage a more efficient pattern of use of CAA facilities and services, the Commission recommends that, where practicable, CAA charges be modified so as to better reflect the differences that exist in services provided and the cost of their supply at different locations."*

So, according the Industry Commission, network-based charges for ARRF services impose a considerable burden on the community, including inappropriate investment in expensive aviation infrastructure at regional airports. Yet, in its Final Decision, the ACCC is adamant that network based charges for ARFF services were more efficient all along:

> *"…the ACCC remains of the view that the common category 6 element of Airservices' preferred charging methodology better promotes allocative efficiency than Airservices' existing location specific pricing structure."*

The ACCC's clear position is that the Government actually wasted its time and damaged the efficiency of the Australian economy by implementing LSP for ARFF services. Consequently, the ACCC has effectively over-turned one of the key principles underpinning the reform of Australian airports and Airservices. That is, prices should be set to fully recover the cost of providing individual services at individual locations. BARA is concerned about the ability of the ACCC to overturn aviation policy reforms without regard to the process and investigations that led to the reforms being implemented. Of course, it is unarguably the case that, should the Government deem it appropriate to apply a subsidy to regional aviation services, the subsidy should be direct and transparent.

The end result of the ACCC's Final Decision is that charges for ARFF services significantly under-recover the incremental labour and capital costs at regional locations. This under-recovery is funded by over-charging for the provision of ARFF services at major airports.

Airservices and the ACCC have decided that prices charged at regional locations for ARFF services need only to recover the short-run marginal cost (SRMC) of the service. Because most costs are fixed and do not vary by the landing of individual aircraft, the SRMC is close to zero. Based on this logic, virtually all the costs of providing ARFF services at regional locations are allocated to major airports on a 'capacity to pay' basis, crudely approximated by the landed tonnage of aircraft at each airport. Airservices even goes so far as to claim that there are, in fact, no cross-subsidies associated with its ARFF pricing structure because charges only need to recover SRMC. This appears to suggest that any charge levied for the provision of ARFF services at regional locations would reduce allocative efficiency.

BARA is concerned that the ACCC's logic could be applied to the pricing of individual aeronautical services at airports. In particular, under the SRMC approach to setting prices, the international airlines could be expected to pay for the majority of the fixed costs associated with providing domestic terminal operations at major airports. Indeed, under the logic adopted by the ACCC the international airlines could be expected to fund the majority of all fixed costs at regional airports. This would suggest that the current LSP approach to pricing for aeronautical services and facilities at Australian airports, including runways, taxiways and navigation aids, is actually inefficient and should be replaced by some form of network-based charging regime.

BARA notes that a key pricing principle to be inserted in Part IIIA of the Trade Practices Act – as endorsed by the Council of Australian Governments – is that prices should:

> *"be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services."*

In this regard, it is noteworthy that the Australian Competition Tribunal recently recommended that the domestic airfield activities at Sydney Airport be subject to declaration. One of the key justifications put forward by the Tribunal was that SACL did not structure its airfield charges

based on a consideration of the underlying cost drivers. The Tribunal noted that this approach to price setting also tended to favour some airlines over others. However, the ACCC has clearly supported prices not being based on incremental cost and favouring some airlines over others – namely, domestic airlines operating to regional locations over international airlines.

With the ACCC now departing from the sound approach of recovering at least the incremental cost of providing ARFF services at different locations, there are now conflicting positions between the ACCC and the Tribunal as to what constitutes fair pricing for aeronautical services or an abuse of market power.

BARA, therefore, maintains that the light handed regulatory arrangement in place for airports should specifically acknowledge that prices for individual aeronautical services at Australian airports should be based on the incremental cost of provision, rather than SRMC. This will provide some necessary guidance about the pricing of individual services at Australian airports should any such airports be subject to direct price controls.

6. Transparency in Airports Pricing

In 2002 the ACCC produced a Guideline on airports' reporting requirements under the light handed regulatory regime. BARA endorsed the Guideline and the information requirements specified by the ACCC. In particular, BARA supported the ACCC's proposals regarding the following airports' reporting requirements:

- the level of detail required for collection - it is important that the information supplied by airport operators is sufficient to allow an accurate independent assessment of the effects of deregulation of airports' prices,
- details of the basis of allocating costs between aeronautical, aeronautical-related and other non-aeronautical services - there should be opportunity to comment on cost allocation methodologies adopted by airport operators and seek changes if appropriate,
- details of material changes in asset valuation methodologies – as noted previously it is important that acceptable asset valuation methodologies be adopted by airport operators as consideration of returns on aeronautical assets is a crucial part of the price monitoring arrangement in place, and
- calculation of the airports' weighted average costs of capital - this information is necessary to assess the reasonableness of returns achieved by airport operators.

The above information set represents the minimum requirement that should apply for airport operators in order to permit public scrutiny of the outcomes of light handed regulation of monopoly service providers. However, for the purposes of detailed commercial negations, airlines require access to far more detailed financial information. In general terms, airlines were satisfied with the amount of financial data provided by most airport operators as part of the negotiations that took place after the removal of price controls. However, more recently some airport operators have demonstrated a reluctance to deliver the same level of financial transparency.

This is a particular problem in the case of Sydney Airport. It is also a problem in the case of Perth Airport. Recently, Brisbane Airport also appears to be following the trend of disclosing

less and less meaningful information on which to base negotiations. BARA has no issue with the level of transparency currently provided by Melbourne Airport.

The lack of transparency over pricing is becoming of increasing concern to BARA. BARA suspects that some airport operators are forming a view that they are no longer required to justify increases in aeronautical charges to airlines. This might be because the same approach used to justify the price increases associated with the removal of direct price controls no longer supports continued increases in charges. Consequently, airport operators may be striving to find new ways of increasing charges not justified by cost.

6.1 Sydney Airport's failure to support price demands

BARA has been involved in lengthy negotiations with SACL for the establishment of a longer term commercial agreement for aeronautical services and facilities. The agreement proposed by BARA identified, amongst other things, a fixed price path for aeronautical services over the term of the agreement.

BARA expected the longer term commercial agreement with SACL to replace the current Conditions of Use imposed by SACL in January 2004 and the existing aeronautical charges applying at Sydney Airport, which were implemented in accordance with the May 2001 Decision of the ACCC in relation to the SACL Aeronautical Pricing Proposal. It should be noted that the ACCC Decision adopted a building block model for price determination. The term of the ACCC Decision was five years. Consequently, the pricing framework of the ACCC Decision has now lapsed.

BARA entered into negotiations with SACL for a longer term commercial agreement with the aim of establishing an aeronautical price path to apply from the end (or thereabouts) of the term of the ACCC Decision. BARA expected the price path to be negotiated with SACL to be consistent with:

- the valuation of aeronautical assets, including land, undertaken by the ACCC prior to sale, updated for investment, depreciation and disposal of assets;
- agreed forecast operating and capital expenditure;
- ACCC determined rates of return; and
- forecast passenger numbers.

BARA believes that the Government, PC and ACCC, under the light handed regulatory regime for airports' pricing, also would expect new aeronautical charges at Sydney Airport to be consistent with the above parameters.

However, in BARA's opinion, the pricing proposal put forward by SACL in the negotiations does not reflect this approach to determining aeronautical charges. In summary, SACL's proposal locks in prices applying under the ACCC Decision for the next five years and increases those base prices to recover the costs of future capital expenditures. BARA believes this approach generates excessive returns on existing assets. This is because SACL's price offer fails to take account of the influence of significant growth in passenger numbers since 2001 in reducing unit per passenger charges for existing aeronautical services. SACL's price offer also is based upon a rate of return in excess of that determined for the airport operator by the ACCC.

SACL took a unilateral decision to increase its rate of return above that assessed as reasonable by the ACCC.

SACL's proposal also fails to commit SACL to accepting the ACCC's asset valuations into the future. Rather, SACL has agreed only to set aside asset valuation issues for the time being and has reserved the right to determine prices based on revaluations of its assets at some time in the future. SACL has adopted this position despite its clear acceptance of the ACCC's asset valuations in the Macquarie Airports Prospectus.

BARA and airline representatives devoted considerable time to reviewing the pricing information provided by SACL. The analysis undertaken by BARA and airline representatives indicated that the current base aeronautical charge over-compensates SACL for its capital and operating costs and for its reasonable rate of return. It is estimated that this over-compensation is at least $1.00 per arriving and departing passenger and may be as high as $2.20.

However, BARA is unable to accurately quantify the extent of over-compensation to SACL because SACL has not justified the prices sought by providing fully transparent cost information. SACL has recently notified airlines that it intends to increase aeronautical charges as from 1 July 2006. In the absence of the necessary supporting information, BARA cannot determine the efficient overall price that should apply at Sydney Airport. Consequently, BARA has formed the view that there is no justification for SACL to increase aeronautical charges as proposed in the recent notification. To the best of BARA's knowledge, the current aeronautical charge already over-compensates SACL for its aeronautical costs by a greater amount than the proposed price increase.

SACL's behaviour, especially its disregard of the Review Principles, provides an important 'test case' for the current light handed regime. In BARA's opinion, SACL has materially abused its market power by imposing further increases in international aeronautical charges. BARA understood the current regime to be one where material abuses of market power would lead to at least a formal price inquiry under Part 7A of the Trade Practices Act 1974 or, more directly, the reimposition of direct price controls.

BARA is concerned that there is no meaningful threat of re-regulation. A failure to properly deal with the abuse of market power by SACL will undermine the credibility of the current regime.

6.2 Perth Airport's failure to consult

Perth Airport established an aeronautical services agreement with airlines following the expiry of the CPI-X regulatory regime. The agreement imposed a set of aeronautical prices that were unacceptable to airlines because they were based upon written up asset values put in place some four years after the sale of the airport. Perth Airport also required the agreement to contain a clause designed to limit the airport operator's exposure to risk.

Clause 4.8 of the Perth Airport aeronautical services agreement states in part:

> *"If actual passenger numbers for a financial year differ by plus or minus 10% from the updated forecasts shown in Attachment 2, then WAC will consult with the airlines on variations to pricing for those passenger numbers outside the 10% range."*

Perth Airport, in insisting on the inclusion of the above provision, was concerned that it should be able to increase aeronautical charges in the event that passenger numbers should decline sharply. Perth Airport at least accepted that the clause also could provide the same arrangement for price adjustment in the event that passenger numbers exceeded forecast levels by the same margin. BARA understands that, in the financial year 2004-05, actual passenger numbers exceeded the base forecasts by 10%. It is also understood that anticipated passenger numbers for 2005-06 also exceed the base forecasts by 10%.

However, Perth Airport has ignored the requirement to consult with airlines on the matter of a price adjustment. Rather, the airport operator has taken the unilateral decision to increase both the landing and terminal components of the aeronautical price for 2004-05 and to increase the terminal component and maintain the airfield landing component of the aeronautical price for 2005-06. The terminal charge component of the aeronautical price for 2005-06 has been adjusted upwards by CPI. It appears that Perth Airport is being over-compensated for aeronautical costs when compared with the provisions of the aeronautical services agreement with airlines. Certainly, the greater than expected passenger growth affects the unit passenger charge for both the airfield landing component and the terminal component. However, Perth Airport has not provided airlines with the necessary information to enable an informed assessment of a revised charge to take account of that passenger growth.

The failure of Perth Airport to consult with airlines and abide by the terms of its aeronautical services agreement demonstrates the relatively weak negotiating position of airlines. BARA understands that, due to issues of stamp duty, Perth Airport was not prepared to enter into signed or binding agreements with airlines. Instead, the airlines were expected to take Perth Airport on good faith that it would abide by the terms of the agreement. However, once those terms proved inconvenient, Perth Airport has decided to ignore its obligations. Perth Airport also has not provided the necessary transparency in relation to all the parameters that influence the efficient price level for aeronautical services and facilities.

7. Non-Price Terms and Conditions

The ACCC has responsibility for monitoring quality of service at designated core airports. In performing this role the ACCC needs to establish appropriate indicators of service quality.

BARA maintains that the primary functions of an airport operator are to facilitate the efficient movement of aircraft to and from the airport and to facilitate the efficient movement of passengers and their baggage through the airport terminals and onto the aircraft. Other commercial activities pursued by airport operators are secondary to these aeronautical functions.

It is also necessary to consider the relationship between the prices and quality of airport services within the framework developed for their monitoring. Aeronautical services need to be cost effective as well as of acceptable standard.

Broad airport service/infrastructure indicators are specified in Part 8 of the Airports Act 1996 and the Airport Regulations 1997. However, BARA maintains there is a case for adding to, improving, revising and reorienting the existing quality of service indicators.

An important aeronautical service/infrastructure facility not included in the existing list of indicators is the baggage handling system (BHS). Yet the reliability of the BHS is an important

factor in airlines being able to meet scheduling requirements and delivering to passengers an overall quality aeronautical product. There have been occasions where BHS failures at airports have been a particular concern to airlines.

Terminal signage is another aeronautical service/infrastructure facility not included in the existing list of indicators. The existing indicators include flight information display and signs, but not directional signage within the terminal. The need for easily located and clearly readable terminal directional signage is particularly important. Airport terminals are becoming increasingly cluttered with retail concessions and airport operators deliberately design terminals to force passengers to progress through retail outlets on the way to departure gates.

Another aeronautical service/infrastructure facility omitted from the existing indicators is staff car parking. The existing indicators address passenger car parking facilities only. However, in BARA's view a separate category for staff car parking facilities is required. The provision of staff car parking within reasonable proximity to terminals and at a reasonable cost has been and continues to be a contentious issue between airlines and some airport operators. The safety and security of airline personnel must be taken into account.

A number of the existing quality of service indicators would benefit from some revision and reorientation of the indicator being monitored.

In the case of aerobridges, the number of aerobridges and the percentage of passengers using aerobridges for boarding do not address the complete service function. The number and type of aerobridges available must be appropriate for the aircraft fleet using the airport.

BARA maintains that a persistent failure on the part of an airport operator to provide aerobridge facilities for certain classes of aircraft during certain times of the day represents a failure to meet service obligations. Such failure should not be seen as being mitigated even though the number of airline operators or the percentage of passengers affected may be minor. The quality of aeronautical services delivered by airport operators should be assessed against standards for all airlines and their passengers separately.

Similarly, the types of indicators specified in the existing check-in category do not address the complete service function. It is invariably the case that airport operators retain the right to unilaterally allocate check-in desks to airlines, based upon the assessment of the airport operator of airlines' seasonal schedules. There is the potential for the airport's counter allocation arrangements to cause disruptions to airline operations.

Airlines expect airport operators to engage in bona fide consultations and negotiations on operational terms and conditions, licences for the use of airport facilities, aeronautical strategic development and capacity expansions and the commercial terms and conditions attaching to each of these matters. BARA recognises that it is difficult to effectively ‘monitor’ these non-price outcomes. Nevertheless, the current and suggested future reviews of airport pricing arrangements offer at least some opportunity for airlines to comment on the quality of negotiations with individual airport operators. Material breaches of the Review Principles should include consideration of the information provided by airport operators and their willingness to engage in bona fide consultations.

BARA maintains that airport operators should provide airlines with a commitment to the ongoing delivery of quality of service. This is especially so, given that airport operators are monopoly service providers which are subject to only price and quality of service monitoring. BARA

recognises that, in the first instance, it might be necessary to understand (monitor) performance outcomes, including the reasons for system non-performance. From this base service level commitments, including commercial consequences, can be developed.

Yet most airport operators provide services on the basis that they do not promise any specific level or quality of service. Three exceptions are the operators of Melbourne, Cairns and, to a lesser extent, Brisbane. These airports have committed in general terms in contractual arrangements with airlines to maintain aeronautical service levels and service quality at least at present standards. Airlines have not reached agreement with other airport operators on commercial terms that include commitments to service delivery and quality.

The priorities set by some airport operators in recent new developments illustrate the potential for airport operators to give primary concern to profit maximisation rather than the efficiency of the aviation transport system. For example, the redevelopment/expansions of the international terminal at Sydney Airport, under both the Sydney 2000 and STAR projects, arguably placed a higher priority on increasing retail shopping space at the expense of optimum expansion and, hence, efficiency of aeronautical services.

BARA maintains that SACL's behaviour in the commercial negotiations with airlines highlights the need for the Government's airports' pricing policy specifically to address the matter of non-price terms and conditions associated with airports' pricing behaviour. Whilst other airport operators have given undertakings in relation to service levels, the SACL draft commercial agreement provided to airlines during the negotiation process did not address any such commitments. BARA has delivered a number of "model" service level requirements to SACL for consideration, but has yet to receive any comment.

The service level commitments given by other airport operators vary in their usefulness. Some airport operators provide for measurable performance parameters while others merely provide a statement of intent. BARA believes that all aeronautical services agreements between airlines and airport operators need to be strengthened in terms of service level commitments by airport operators. It is BARA's view that the Government's airports' pricing policy should address this matter by providing specific guidelines for service level commitments to be incorporated in all aeronautical services agreements. BARA's 'model' aeronautical services agreement, including service level requirements, developed by airlines is attached as Appendix 4.

8. A Future Prices Monitoring Regime

BARA has never considered that non-aeronautical revenues constrain/influence the pricing practices of Australian airports in any meaningful manner. Airport operators probably think the same. However, for the purposes of this inquiry it is likely that non-aeronautical revenues will be presented by some airport operators as a significant discipline.

The reality is that aeronautical pricing is only disciplined by market mechanisms if an airport operator is genuinely concerned that it could lose a significant number of flights as a result of excessive price levels. This could occur due to the effect of prices on the overall profitability of the airline on certain routes or from competition at the margin from other airports. Such situations are rare and do not represent any effective form of discipline over an airport operator's general approach to setting aeronautical prices.

The current regime lacks a credible threat of re-regulation for some airport operators. The pricing practices of SACL, in particular, demonstrate this fact. There is a clear need for the Government to intervene and curb the continual abuse of market power by SACL.

8.1 Reliance solely on Part IIIA?

BARA does not consider that Part IIIA of the Trade Practices Act 1974 adequately addresses the intent of the Government in moving to a light handed economic regulatory regime for Australian airports. Part IIIA is fundamentally about competition and not primarily the abuse of market power. One must prove both a market power and a competition issue under Part IIIA.

As noted earlier, BARA does not believe that the Government intended light handed regulation to deliver to airport operators excessive returns on the actual investments they have undertaken. This is highlighted in the speech by the Hon. Warren Truss MP to the Australian Airports Association 24th National Convention and Industry Exhibition:

> *"One particular issue that the Productivity Commission [will be] asked to review is the issue of aeronautical asset valuations (particularly leased land) and whether seeking to increase aeronautical prices on the basis of revalued aeronautical assets could lead to windfall gains for the airport operators at the expense of the traveling public.*
>
> *"The Government is not prepared to support such windfall gains from frequent asset revaluations at our leased airports."*

The Government has, therefore, clearly specified that the regime should be able to deal directly with abuses of market power. It need not necessarily have implications for competition in downstream markets. Part IIIA, therefore, does not align with the Government's stated objectives on airport pricing. Instead, a more robust and credible approach to price monitoring and re-regulation is required to promote the Government's stated objectives.

8.2 An improved prices monitoring regime

A better constructed and well understood prices monitoring regime might provide a worthwhile constraint on aeronautical charges. A key element of any regime is a willingness of Government to intervene and re-impose price controls if an airport operator abuses its market power.

BARA maintains the view that airport operators should earn profits through growing demand and managing their businesses efficiently. Unfortunately, the current view of some airport operators is that they should simply be able to boost profits through imposing charges far beyond what they expected when they obtained their lease over the airport. With a focus on rent transfer, true negotiations over capacity, service standards and prices necessary to fund future investment are a secondary consideration of the airport operator. The only guaranteed winners from such processes are the economic consultants hired to try to justify ever increasing aeronautical prices on existing assets. BARA doubts this was the intended outcome of removing direct price controls.

At present, the prices monitoring regime provides no effective discipline on such attitudes and behaviour. There is simply insufficient clarity over both what constitutes unacceptable pricing practices and how such pricing will be dealt with. For those airport operators focused on

maximising the short-term cash flows from the business, the current regime is fertile ground for regulatory gaming and rent seeking.

BARA considers that the challenge for the PC is to find the appropriate balance within a prices monitoring regime. BARA recommends the following elements need to supplement the Review Principles for there to be some creditability to a prices monitoring regime:

- clarification of the scope of aeronautical services, underlying aeronautical asset valuations and future revaluations;
- development of guidelines for service level monitoring and commitments to be incorporated into all aeronautical service agreements;
- establishment of a formal mechanism for registering material abuses of market power by airport operators with the Department of Transport and Regional Services (DOTARS);
- establishment of a formal response mechanism from DOTARS or the relevant Minister as to whether a public inquiry into the pricing practices of an airport operator is justified; and
- providing for the ability to 'claw back' the over recoveries when setting future aeronautical charges if an airport operator has been found to have abused its market power.

Prices monitoring should be reviewed in another five years. Such relatively new approaches to economic regulation need to be reviewed at suitable intervals to assess outcomes and the appropriateness of existing arrangements.

BARA does not consider that the proposed approach will have any adverse consequences on investment in aeronautical infrastructure. The Review Principles clearly allow all capital investment to be priced on a dual-till basis. In BARA's experience, every airport operator has been prepared to invest in aeronautical infrastructure at the rates of return previously determined by the ACCC. While some airport operators are likely to make ambit claims about low returns, the reality is that they are well compensated for their investments under the current and proposed arrangements.

The purpose of the prices monitoring regime is more about capping the unjustified rent transfers to airport operators associated with existing assets. Ambit claims by airport operators extend not only to rates of return but also assumptions over the basis on which airport charges could be set in purchasing the airport lease. This capping has no adverse consequences for economic efficiency. Rather, it supports sound public policy and the objectives of privatisation.

Appendix 1

List of BARA Members

Aeroflot Russian International Airlines
Aerolineas Argentinas
Air Caledonie International
Air Canada
Air France
Air India
Air Mauritius
Air New Zealand
Air Pacific Limited
Air Vanuatu
Asiana Airlines
Asian Express Airlines
Austrian Airlines
British Airways
Cathay Pacific Airways Limited
China Southern Airlines
Emirates
EVA Airways Corporation
FedEx Corporation
Garuda Indonesian Airways
Gulf Air
Japan Airlines
Korean Air
Malaysian Airline System
Martinair Holland
Olympic Airways
Philippine Airlines
Qantas Airways Limited
Royal Brunei
Scandinavian Airlines System
Singapore Airlines
South African Airways
Swissair
Thai Airways International
Turkish Airlines Inc
United Airlines
Vietnam Airlines
Virgin Blue Airlines

Appendix 4

Key elements of an Aeronautical Services Agreement

Grant of licence and term

- A non-exclusive licence to use the Airport and utilise ("Permitted Use") Aeronautical Services and Facilities
- Prior to the expiry of the agreement the parties will meet and negotiate in good faith a new agreement. If agreement is not reached at the expiry date, [AIRPORT] will not unreasonably restrict the Operator's ability to undertake the Permitted Use, including imposing unreasonable charges.
- Failing agreement at the expiry date the parties will seek Expert Determination of the terms and provisions of a new agreement.

Services provided by [AIRPORT] and service level specifications

- The services provided by [AIRPORT] and service level agreement (SLA) should be specified in separate schedules.
- The services provided by [AIRPORT] will allow airlines to undertake the Permitted Use.
- [AIRPORT] will also provide the necessary security arrangements to meet the security measures as mandated from relevant Authorities.
- The generic service level standards that should apply to all Services and Facilities include:
    - Fit for purpose;
    - With all due care and skill;
    - In a clean, safe and efficient manner,
    - In accordance with applicable laws and regulations;
    - At sufficient capacity to accommodate all passengers arriving and departing the airport.
- [AIRPORT] will ensure that passengers have unencumbered access to relevant airport Services and Facilities.

Safety

- [AIRPORT] is responsible for the safe operation of the Airport's Services and Facilities.

Operator's obligations

- The Operator must comply with requirements contained in:
    - the Airports Act;

  - the Air Navigation Act;
  - the Civil Aviation Act;
  - the Aviation Transport Security Act 2004
  - associated regulations and directions;
- Operations Procedures Manual (this Manual needs to be reviewed and agreed).
- All security, environmental and occupational health and safety requirements of relevant Authorities.

[AIRPORT]'s obligations

- [AIRPORT] must comply with requirements contained in:
  - the Airports Act;
  - the Air Navigation Act;
  - the Civil Aviation Act;
  - the Aviation Transport Security Act 2004
  - associated regulations and directions;
- Operations Procedures Manual (this Manual needs to be reviewed and agreed).
- All security, environmental and occupational health and safety requirements of relevant Authorities.
- Service standards identified in relevant Australian or international building or airport codes. The minimum code will be IATA code C specified in the Airport Planning Guide.

Day to day operation of the airport

- [AIRPORT] will manage the airport consistent with the good order and management of an airport generally.
- [AIRPORT] will treat airlines consistently and equitably. No less favourable terms will apply between airlines.
- Unless required for emergency safety or security, [AIRPORT] will not implement any operational change without first:
  - Providing written notice at least 30 days before the proposed change; and
  - Allow 21 days for a written response for the Operator; and
  - Take into account the submission from the Operator and the AOC before introducing the change; and
  - After the first 3 steps, [AIRPORT] will not implement the change until 14 days after written notification to the Operator and AOC.

Consultation over capital works

- [AIRPORT] will provide the Operator with reasonable notice but in any case not less than 90 days notice of any capital works that could be reasonably be expected to materially affect the Operator or the ability to undertake the Permitted Use;

- [AIRPORT] will use its best endeavours to agree any operational changes with airlines.

- After service of the written notice [AIRPORT] must consult with the Operator over the works. [AIRPORT] must distribute minutes of the meeting to the Operator.

- [AIRPORT] must not undertake any works if there is a change in the approach to the works that may impact the Operator's ability to undertake the permitted use without first complying again with the first two principles.

- [AIRPORT] must use reasonable endeavours to minimise any impact on the Operator in undertaking capital works. [AIRPORT] will commit to completing works as soon as possible.

Consultation generally

- [AIRPORT] and the Operator will meet quarterly to consult in relation to the development and operation of the airport.

- [AIRPORT] will provide on an annual basis a statement containing:
    - actual and forecast traffic volumes (10 years);
    - actual and forecast capital expenditure;
    - actual and forecast operating expenses;
    - information relating to performance against the SLA;
    - [AIRPORT]'s accounts as required by the Airport's Regulations.

- Confidentiality provisions will apply as appropriate.

Fees and Charges

- [AIRPORT] should levy 'Usage Fees' and 'Recovery Charges'. The basis for calculating these fees should be in a separate schedule.

- Where fees and charges become overdue, [AIRPORT] will first provide notice and time to remedy before imposing an interest penalty.

No other charges

- [AIRPORT] will not impose any new or additional charges for use of the Services and Facilities. FTLs will be specifically included in this provision.

Provision of Passenger information and payment of charges

- The Operator must provide [AIRPORT] in an agreed format with the necessary activity data to calculate Usage fees and Recovery Charges 5 business days after the month in which the activity occurred.

- Confidentiality provisions will apply as appropriate.

- [AIRPORT] must use reasonable endeavours to generate an invoice within 3 business days after receiving the activity data.

- Payment will be due on the last business day of the month.

Audit of activity data

- [AIRPORT] at its own cost will be entitled to have an independent audit of the activity data;

- If the Audit finds that for the period of review the data is within 1% accuracy [AIRPORT] shall pay the Operator all reasonable costs in supplying the information, including internal administrative costs

- The Operator shall not be required to keep records of the activity data for more than 3 years.

Indemnities

- Each party (including employees, agents, contractors, etc) will not be held liable for loss or damage to property owned by the other party or injury or death to any person unless it arises from a negligent act or omission or wilful misconduct or default.

- Each party will indemnify the other party (including employees, agents, contractors, etc) from claims for loss or damage to property or injury or death to any person unless it arises from a negligent act or omission or wilful misconduct or default.

- Passengers are to be specifically excluded from these provisions.

Dispute resolution

- The agreement will specify an agreed dispute resolution process.

- In the event of CEOs being unable to resolve a dispute, the matter will be given to an independent expert to determine.

- The decision of the independent expert will be final and binding.

Variation of the Agreement

- The Agreement can only be varied by the agreement of both parties.

Termination

- [AIRPORT] may terminate the agreement if after providing 60 days notice to the Operator of:
    - Unpaid charges for up to 30 days and the unpaid amount is not in dispute;
    - The Operator ceases to conduct the Permitted Use at the Airport;
    - Has omitted or failed to perform an essential term and the agreed process of rectification through this agreement has been performed.

Force Majeure

- The force majeure provision will be limited to suspension of requirements to perform obligations because of a force majeure event.
- There must be a clear and unambiguous definition of a force majeure event.

- The list of Services and facilities may be varied only by agreement in writing signed by both parties.
- Aircraft movement services and facilities includes access to and use of:
    - the runways, taxiways, and common use aprons;
    - the airfield in general and in particular the airfield grounds and roads;
    - airside and airfield lighting;
    - airside safety;
    - nose-in guidance;
    - visual navigation aids;
    - aircraft parking facilities;
    - areas for the staging of ground handling vehicles and equipment for aircraft operations;
    - areas for access to parked aircraft for the purpose of cleaning, catering, refuelling, maintenance, loading and unloading baggage and freight, and performing other related ground handling services; and
    - areas for the parking and storage of ground handling equipment may be subject to separate licence.
- These services and facilities will be provided in a safe and efficient manner and will meet the standards set by Relevant Authorities, both airside and landside.
- Passenger services and facilities includes access to and use of:
    - visual navigation aids and nose-in guidance systems;
    - the inwards and outwards baggage system including baggage make-up areas and reclaim facilities and hold and cabin luggage screening equipment;
    - toilets for passengers and staff (in common use with others);
    - directional signage;
    - flight information display systems;
    - facilities to allow passengers to board aircraft including, but not limited to aerobridges and boarding gate desks;
    - facilities in which passengers may wait prior to boarding aircraft but excluding commercially important persons lounges;

- emergency and public address systems;
- public areas in terminals including public amenities, lifts, escalators and moving walkways (if any);
- immigration and customs service areas;
- check-in desks; and
- forward airline support area services.

- These services and facilities will be provided in a safe and efficient manner and will meet the standards set by Relevant Authorities.
- [AIRPORT] will provide terminal safety and security services, including but not restricted to the screening of passengers and their accompanied baggage, in accordance with the standards set by any Relevant Authorities.
- [AIRPORT] will provide and manage in a safe, prudent and efficient way the necessary infrastructure to enable airline employees, customers and suppliers to access aircraft, facilities and other premises at the Airport.

Schedule B: Service Level Agreement

- [AIRPORT] will provide Services and Facilities of a certain quality and standard.
- The service levels specified below will be used as a tool to ensure that services are consistently provided in a timely manner and at an agreed level of service quality.
- Reports should be made available on a regular basis (normally monthly) to the relevant AOC and records to be available for audit/inspection.

Facility or Service: Runways

Service Level

The runway system will be available 100% of occasions with the exception of the specific exclusions listed below

Compensation/Rebate

A rebate of 20% of the Domestic Landing Charge and International Terminal Charge will be given for each flight arrival and each flight departure after the period of the complete fix has expired until the complete fix has been substantially made.

Measurement

[AIRPORT] will:

- Ensure that records are kept of the availability of the runway system
- Provide a monthly report of runway system availability

Exclusions

- Agreed planned maintenance
- Force Majure
- The closure of a runway was caused by an Airline

Initial response, contingency plan and complete fix

[AIRPORT] will respond to any availability issue with the runways with 2 minutes of the reported failure. A contingency plan will be put in place within 30 minutes with a complete fix of 24 hours.

Facility or Service: Inbound Baggage System

Service Level

Baggage reclaim carousels will be available for 100% of occasions with the exception of the specific exclusions listed below

Compensation/Rebate

A rebate of 20% of the International Terminal Charge will be given for each flight arrival after the period of the complete fix has expired until the complete fix has been substantially made.

Measurement

[AIRPORT] will:

- Ensure that records are kept of the availability of the baggage reclaim carousels
- Provide a monthly report of inbound baggage reclaim carousel availability

Exclusions

- Agreed planned maintenance
- Force Majure
- The breakdown was caused by an Airline or handling agent.

Initial response, contingency plan and complete fix

[AIRPORT] will respond to any breakdown in the Inbound baggage System with 2 minutes of the reported failure. A contingency plan will be put in place within 30 minutes with a complete fix of 24 hours.

Facility or Service: Aerobridges

Service Level

The aerobridges will be available for 90% of occasions with the exception of the specific exclusions listed below

Compensation/Rebate

A rebate of 20% of the International Terminal Charge will be given for each flight arrival and each flight departure after the period of the complete fix has expired until the complete fix has been substantially made.

Measurement

[AIRPORT] will:

- Ensure that records are kept of the availability of the aerobridges
- Provide a monthly report of aerobridge availability

Exclusions

- Agreed planned maintenance
- Force Majure
- The breakdown was caused by an Airline

Initial response, contingency plan and complete fix

[AIRPORT] will respond to any breakdown in an aerobridge with 20 minutes of the reported failure. A contingency plan will be put in place within 30 minutes with a complete fix of 24 hours.

Schedule C: Pricing Policy

Usage Charges

- List Usage Charges Payable
- Annual indexation (CPI-X) of Domestic and International PSC or other agreed price path.

Unplanned capital expenditure

- Unplanned capital expenditure is a result of:

- Changes in regulatory standards relating to safety, the security, the environment or other issues.
- Changes in service expectations

- Unplanned capital expenditure does not include:

- Replace or refurbish assets;
- Maintain service quality standards
- Works [AIRPORT] should have reasonably known.

- Usage Charges only need increase if the actual plus recent forecast of capital expenditure exceeds the total planned capital expenditure contained in Schedule D.

- The cost of the project will be actual costs;
- WACC parameters consistent with the pricing of Usage Charges

Recovery Charges

- [AIRPORT] must not charge more than the reasonable costs incurred in providing Government mandated security services.

- Every six months [AIRPORT] will provide the airlines with a statement showing:

- Costs and revenues for the proceeding six months;
- Forecast costs and revenues for the next six months;
- Forecast prices for the next six months.

Schedule D: Indicative Capital Program

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