Northern Territory
Airports

PRODUCTIVITY COMMISSION REVIEW OF AIRPORT SERVICES

SUBMISSION TO THE PRODUCTIVITY COMMISSION

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1 EXECUTIVE SUMMARY

Northern Territory Airports Pty Ltd, NTAPL, (Alice Springs Airport **[ASA]** and Darwin International Airport **[DIA]**) thanks the Productivity Commission for the opportunity to participate in the review of price regulation of airport services.

Following the terrorist attacks and the collapse of Ansett in September 2001, the Federal Government brought forward the implementation of the Productivity Commission's recommendations from their review of Price Regulation of Airport Services, completed in August 2001. The price cap at DIA was removed and it became subject to price monitoring of aeronautical and aeronautical related services, and ASA was no longer subject to price regulation or quality of service monitoring.

Whilst the nature of DIA's infrastructure and location may appear to have some monopolistic characteristics, due to its' reliance on the airlines actually featuring Darwin as a destination, its ability to operate as a monopolist is in reality non-existent.

NTAPL believes that DIA should be excluded from any future monitoring regime because DIA for the reasons set out below and in the ensuing paper, cannot behave like a monopoly.

NT Airports has consistently behaved in accordance with the Government's Review Principles during the prices monitoring period.

This places significant commercial constraints on NT Airports, and compels it to behave in a fair and reasonable manner in its commercial negotiations with airport users. DIA has developed a pricing model consistent with the ACCC SACL decision and used the outcomes to consult and negotiate user charges. These charges were set below the 'allowable' price so as to minimise shocks to users (see table 1), and allowed DIA to begin to make positive returns which in turn fuelled investment.

During the last 18 months this is also evidenced by the fact that long term pricing agreements have been achieved with all airlines bar one. Therefore, NT Airports believes that it should not be subject to any form of prices regulation in the future. The volume based regime adopted at NT Airports in respect of pricing on a per passenger basis aligns the interests of the airlines and airport operators and allocates the risk across the parties.

In its submission, BARA argues that the airlines do not have significant countervailing market power, and that they must travel to the airports that their customers request. DIA does not agree with BARA in relation to the circumstances associated with the market place for air services to Darwin – airlines can and do adjust their flight schedules, but do not automatically respond to customers requesting additional services.

DIA's first-hand experience has been that airlines have other route and destination options that are marginally more profitable to service than others, and they can and do withdraw services at very short notice with little or no consultation with the airport operator. It is in the airport operator's best interest to offer prices that are competitive and encourage additional airline services, not to discourage activity. Airlines clearly have substitutes in terms of alternate routes and destinations, whereas an airports infrastructure is essentially fixed, and in our experience the airlines as our customers have substantial countervailing market power.

DIA due to its heavy reliance on tourism as its main passenger base, also faces very real competition from other destinations in Western Australia and North East Queensland, specifically Broome and Cairns.

DIA, like other airports, offer commercial incentives to support new services and increased airline capacity and thus increase the number of passengers utilising our airport. Our incentive program is available to all domestic and international airlines on an equal basis. Thus, the airlines and airports have a common commercial objective of increasing passenger numbers.

NT Airports has not made a comparison to the other capital city airports as we do not believe we are comparable by virtue of our size, location and number of passengers. DIA is about the same size as Townsville and Avalon airports and considerably smaller than Hobart and the Gold Coast airports.

Key Point: For this reason we believe that Darwin International Airport should no longer be classified as a price monitored airport.

2 Background

Airports inherited on 10 June 1998, a pricing structure that was established as part of the FAC network NT pricing regime. The network price implied that certain airports were cross-subsidised and the prices charged at some of the smaller airports were insufficient to cover the costs of operating those airports or the investments required. As a result of this there was a disconnect in terms of user charges (and therefore revenue) and operating costs including a return on and of assets. NT Airports made a loss in its first six years of operation, and in the first three years this was an increasing loss. The introduction of more liberalised arrangements under the price monitoring regime has allowed a correction of the pricing structure to one which more closely aligns user charges to the true cost of service provision at NT Airports.

As part of the 2002 Report the Commission recommended that there be a review in 5 years to report on the effectiveness of the regime.

"*Specifically, the Commission is to:*

- *Report on whether airport operators have acted in a manner consistent with the Government's Review Principles (spelt out in the terms of Reference), and the effectiveness of the current form of price regulation of airport services having regard to the objectives of:*
    - *Promoting the economically efficient operation of airports*
    - *Minimising compliance costs for airport operators and the Government; and*
    - *Facilitating commercially negotiated outcomes in airport operations, benchmarking comparisons between airports and competition in the provision of services within airports (especially protecting small users and new entrants against discrimination);*
- *Review aeronautical asset revaluation practices and dispute resolution mechanisms at each of the price monitored airports and advise on improvements that would be consistent with the Governments' Review Principles;*
- *Identify relevant alternatives to the current arrangements and the extent to which these alternatives would better achieve the Governments' objectives in privatising the airports and moving to a light-handed pricing regulatory regime; and*
- *Analyse and, as far as practicable, quantify the benefits, costs and economic and distributional impacts of the current arrangements and alternatives to them."*

The Productivity Commission has identified a number of key issues which NTAPL will seek to address in its submission, including:

- Current regulatory format
- Pricing & Commercial Arrangements
- Investment (including security requirements)
- Competition & market power
- Quality of Service
- Classification of services
- Compliance Costs
- Dispute Resolution and;
- Future Regulatory Arrangements

Key Point: At the time of privatisation, Darwin International Airport inherited a network pricing model that did not take into account the value of infrastructure investment made or its prevailing operating cost structure.

3 Introduction

Air travel is essential to Australia's economic and social well being. For the purposes of this submission Northern Territory Airports comprises two key Airports – Darwin International Airport (DIA) and Alice Springs Airport (ASA). Both airports are key pieces of infrastructure vital to the economic and social development of the Northern Territory.

The Northern Territory is 1,346,200 square kilometres of vast open spaces. It is resource rich and has world famous natural attractions. It represents approximately one sixth of the Australian continent but has just under one percent of the Australian population, almost 200,000 people.

The Territory's population is concentrated in the urban centres. The population of Darwin is in the order of 100,000, accounting for approximately 53% of the total Territory population. Alice Springs accounts for approximately 14%.

Tourism is the second largest private industry sector value generator, after mining and oil and gas in the Territory economy and employs an estimated 20% of the Northern Territory workforce.

3.1 Darwin International Airport

Darwin, the seat of Government for the Northern Territory, whilst the closest Australian Capital City to the key South East Asian centres of commerce and trade including Singapore, Kuala Lumpur, Jakarta and Manila, competes for air services with Perth, Brisbane, Sydney, Adelaide, Melbourne and Cairns, and has fewer frequencies and capacities than some of the competing airports. DIA is the major international and domestic airport serving the air transport needs of Darwin and the Northern Territory. DIA is curfew free for 24 hours a day with excess capacity. Being curfew free allows airlines to schedule appropriate connecting services to other major centres that are subject to curfew. At present, four major international airlines operate through Darwin. They are Qantas Airways, Garuda Indonesia, Royal Brunei Airlines and Tiger Airways. Qantas Airways, Jetstar, Virgin Blue, Skywest, and Airnorth provide domestic and regional services and Vincent Air as a small Regular Passenger Transport (RPT) operator.

Twenty three general aviation (GA), two helicopter and one cargo operator have facilities on the airport. GA is important given the small widely scattered remote communities and lack of all weather roads on the mainland and numerous islands off the coast of Arnhem Land.

DIA is a joint user airport meaning that DIA shares areas with the Royal Australian Air Force (RAAF). The RAAF owns and occupies a major military base on one side of the airport. The RAAF also owns and maintains the joint user areas, which include the runways and taxiways. There is an allocation of responsibilities between DIA and the RAAF and a Joint User Deed for the application of costs (this is based upon the relative tonnages associated with the historic civilian and military aircraft movement numbers with DIA assuming the majority of airport maintenance and development costs). This arrangement is unique to Darwin and Townsville (an airport of equivalent size but outside the price and quality monitoring arrangements) airports.

DIA is located approximately 13 kilometres from Darwin's central business district. The site occupies an area of approximately 1,527 hectares of land including 311 hectares under the control of NT Airports, with approximately 168 hectares airside. DIA has a two runway system comprising the main 11/29 runway (3,354 metres in length) and the secondary 18/36 runway (1,524 metres). DIA's combined domestic and international terminal was commissioned in December 1991.

Darwin is strategically located to take advantage of the increase in trade with the countries of Asia. The Northern Territory Government, since the last PC review, has recently completed the deepening of the port and has seen the completion of the rail link to Alice Springs.

Darwin is the closest capital city in Australia to Asia and is the natural gateway to this region. Darwin is closer to Jakarta than to Brisbane and lays half-way between Manila and Melbourne. All the territorial lands of Indonesia, Malaysia, Papua New Guinea and the Philippines, as well as the island republic of Singapore, are located within a radius of 4,000 kilometres of Darwin. The combined population of these countries is approximately 330 million people.

3.2 Alice Springs Airport

Alice Springs Airport is essentially located in the centre of Australia. As a major tourist destination, the majority of passengers through the airport are visitors to the region. Alice Springs Airport is curfew free for 24 hours a day but current scheduled operations are predominantly between 0900 and 1700. Qantas Airways provides domestic services to all major centres and Aboriginal Air Services provides some limited local regional services.

Alice Springs and Central Australia are dependent on air transport, because of their remoteness. It is important that the potential of Alice Springs Airport is fully realised in order to satisfy the national and the Northern Territory community needs for safe, effective and efficient air transport services.

Alice Springs Airport is situated some 14 kilometres from the township of Alice Springs. It occupies a site of approximately 3,550 hectares. Of this area, about 750 hectares are used directly for aeronautical purposes. The Government acquired the excess land (in the late sixties/early seventies) to minimise visibility problems caused by dust pollution occurring as a result of unsuitable land uses. Alice Springs Airport has a two runway system comprising the main 12/30 runway (2,438 metres), and the secondary general aviation 17/35 runway (1,133 metres). The current terminal was commissioned in 1991.

Alice Springs Airport was until the 1980s, the only jet capable airport in Central Australia and it handles all forms of domestic and regional aviation services together with some military operations and occasional international charter flights. However it now faces increasing competition from Yulara (Ayers) Rock and its associated Connellan Airport and as a consequence is experiencing a steady decline in air traffic. This has been more evident since Virgin Blue withdrew its services leaving only one monopoly carrier, Qantas servicing both ASA and Ayers Rock.

Alice Springs plays an important role in the development of the economy of its surrounding region. Tourism has been the major source of activity in a number of sectors across the Northern Territory. The direct and indirect effects of tourism are responsible for employment for about 13 percent of the population of Alice Springs of about 30,000. The tourist expenditure in the Region accounts for about 40 percent of the total tourist expenditure in the Northern Territory.

Alice Springs is also serviced by a passenger train service (The Ghan) and strong coach links.

3.3 Ownership

Privatisation of Darwin International and Alice Springs Airports occurred 10 June 1998. The airports have therefore been under private ownership and management for approximately eight years. A purchase price of $110.2 million was paid for a 50 year lease of Alice Springs, Darwin International and Tennant Creek Airports with an option to extend that lease for a further 49 years.

Both DIA and ASA were previously managed by the Federal Airports Corporation (FAC) and formed part of the FAC network. This ownership structure existed from 1 April 1989 to 10 June 1998 and during that time a airport network pricing regime was in place. The basis for charging was *the FAC Act 1986* and specifically Section 56. The shareholders comprise of the following entities:

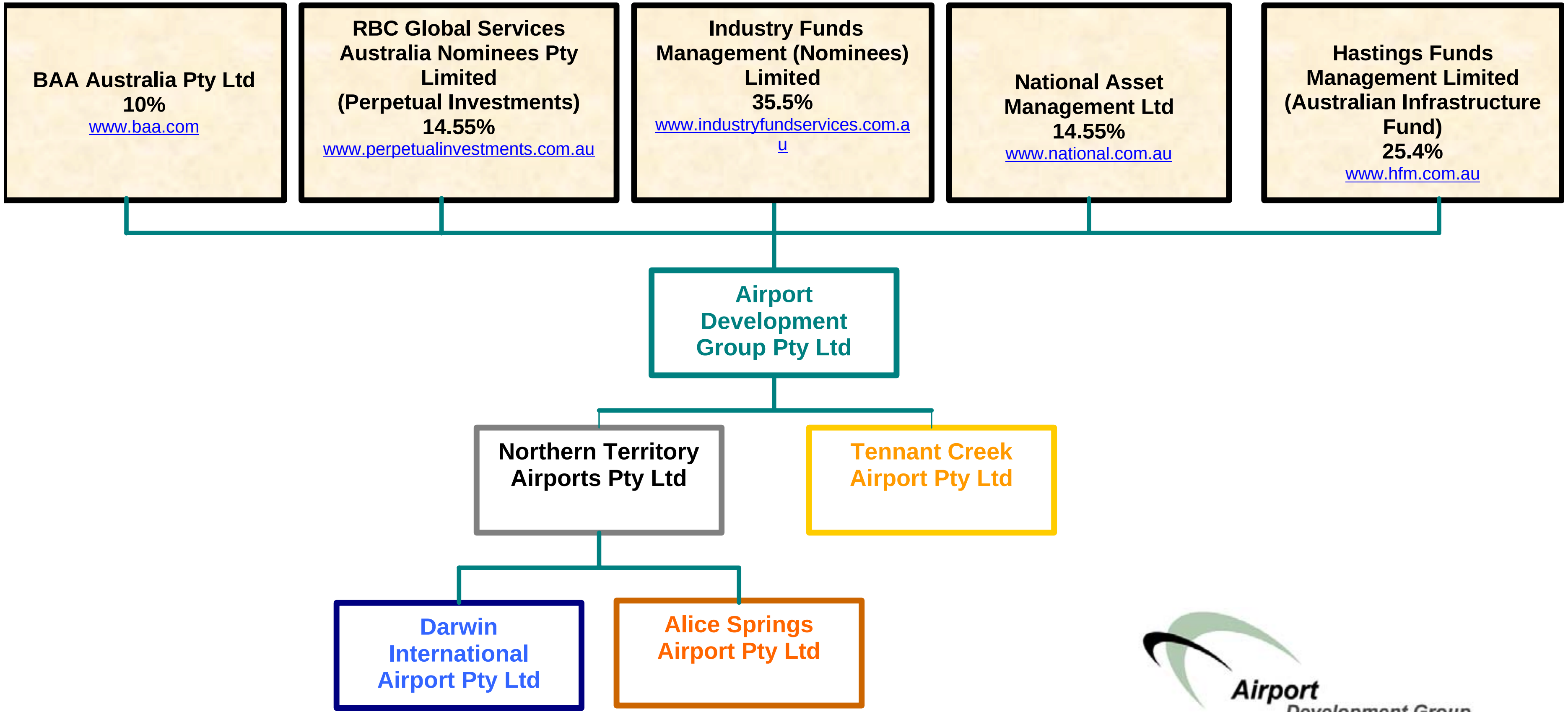
Industry Funds Management (IFM) is the wholly owned investment management subsidiary of Industry Fund Services (IFS). IFS was established in 1994 to provide cost effective, innovative and market leading products and services for industry superannuation funds and their members. IFS has recently announced its merger with Members Equity Bank. The merged group has some 5 million superannuation fund members Australia wide and around 450,000 sponsoring employers, with a combined asset base of $25 billion. As at 30 June 2006, IFM had over $10 billion in funds under management across its investment specialisations, including infrastructure, private equity, enhanced and indexed funds and private debt. An IFS owned entity also owns the units in the NAMPL Alternative Assets – Infrastructure (Airports) Trust, which is a shareholder in ADG.

Hastings Funds Management was established in 1994 and built on the support and foresight of the industry and public superannuation funds. Hastings Funds Management Limited (Hastings) plays a significant role in alternative asset funds management with approximately $3.6 billion in funds under management in infrastructure, private equity, timberland and high yield debt investments.

Perpetual Investments is one of Australia's most highly regarded investment managers offering a broad range of products for personal investment, superannuation and retirement in addition to managing corporate funds. Investors believe Perpetual Investments are responsive and reliable, trusting their experience to provide the benefits of perspective and vision. Perpetuals specialist infrastructure team has invested in ADG via Perpetuals Diversified Infrastructure Fund, which is a wholesale managed investment scheme, investing on behalf of Australian Superannuation Funds.

BAA is the world's leading airport company. Not only did it pioneer airport privatisation, retailing and security, it is widely recognised for its responsible and efficient airport operations. BAA's success in running airports has led to expertise in other airport-related activities – property, retail, rail, construction, international airports, fire service, cargo and safety and security.

The following illustration shows the company structure associated with Northern Territory Airports Pty Ltd (current as at 31 July 2006).



4 Current regulatory framework

Direction No.27 requires the ACCC to undertake prices monitoring of the prices, profits and returns from aeronautical and aeronautical services and facilities (as defined in Direction No.27).

The Australian Council for Infrastructure Development (AusCID) commissioned Access Economics to develop a scorecard with which to evaluate the design of economic regulation of Australia's key infrastructure sectors. The rating focused on four broad areas of good regulatory design:

1. Independence
2. Efficiency focused
3. Transparency, predictability and consistency
4. Accountability.

The results of this study show that most of Australia's infrastructure regulatory regimes are rated as being mediocre to good, compared with best practice principles. Whilst the regulation of airports scored good overall, and while this is in part due to the increased investment since the Productivity Commission recommended the removal of price controls on some and price monitoring of other Federally owned Leased airports, there are still areas for improvement in the design and implementation of the regulatory regime.

NT Airports has a number of concerns with the manner in which the ACCC has executed its prices monitoring function:

- The ACCC compares charges (and other measures such as costs and margins) across a number of years, which may give a misleading impression of the annual changes in aeronautical charges. It is clear that aeronautical charges under the price cap regime were too low, as evidenced by the negative returns on aeronautical assets reported by the ACCC in its annual regulatory reports.[1] For example, there was no recovery by the FAC in its pricing charges arrangements for the new terminal buildings that it had constructed at ASA and DIA in 1991. By comparing current charges to that period suggests that those historical prices were appropriate – they were not. NT Airports believes that comparisons should be limited to year-on-year comparisons otherwise they can create a bias when negotiating with airlines.
- The ACCC compares the relative proportions of aeronautical and non-aeronautical revenue. NT Airports believes this is outside the scope of the ACCC's mandate, which in Direction No.27 requires the ACCC to undertake prices monitoring of the prices, profits and returns from aeronautical and aeronautical services and facilities (as defined in Direction No.27).
- The ACCC reports on the revenue, operating expenses, margin and return on assets for DIA as a whole. This is clearly not required under Direction No.27, nor is it required for ACCC to carry out its prices monitoring functions. By reporting on the airport's performance as a whole effectively means that the ACCC is taking

[1] See, for example, Chart 3.4.5 (p.61) of the ACCC's 2003-04 report, *Price Monitoring and Financial Reporting – price monitored airports 2003-04* (February 2005),

a single-till approach to prices monitoring. This approach is inconsistent with Direction No.27 and the Government's Review Principles, which clearly stipulate a dual till approach to airport pricing. The ACCC also consistently reports late and does not encourage suggestions of ways to improve the reporting and communications process.

Key Point: Light handed regulation of airports has lead to a substantial increase in airport infrastructure investment and acknowledgement that this model has delivered good outcomes in comparison to other regulated infrastructure asset classes.

5 Pricing and Commercial Arrangements

NT Airports Pty Ltd is the holding company for Darwin International Airport and Alice Springs Airport. Under the current regime Darwin is currently price monitored and Alice Springs is not, and the main body of this report refers to Darwin. However, NT Airports does not treat DIA or ASA differently in respect of its approach to commercial arrangements and pricing, irrespective of the regime, and therefore for the purposes of this submission, ASA has been used as supporting evidence where appropriate.

5.1 Pricing

Following the terrorist attacks and the collapse of Ansett in September 2001, the price cap at DIA was removed and it became subject to price monitoring of aeronautical and aeronautical related services (see Direction No.26). At the same time, ASA was deregulated for pricing and quality of service. These arrangements were confirmed in the Government's response to the Productivity Commission's 2002 review of airport prices, which found that DIA had a moderate degree of market power.

5.1.1 Has the structure of airport charges changed?

Prior to the introduction of price monitoring, DIA operated within the regulated CPI-X pricing regime. Charges under this regime were Maximum Take Off Weight (MTOW) based and effectively represented a fixed price for the plane, (regardless of the number of passengers), and then an additional amount for rentals for, storage, GSE, check-in counters, departure lounge space, club lounges etc, and these rentals were previously classified as non-aero services. Whilst this provided a fixed revenue stream dependant on the number of flights it was not conducive to the introduction of new carriers, where the build up of passenger numbers was a key factor; or to the aiding of services by incumbent carriers with reduced load factors. Under this pricing regime the risk of cost recovery was borne by the airline if the plane had reduced load factors.

With the introduction of the price monitoring regime, DIA was able to introduce a simplified variable charging regime which amalgamated many of the rentals previously charged to airlines on fixed terms, as outlined in the paragraph above, and this has amalgamated into one charge both aero and non-aero charges.[2] Since December 2001, DIA and ASA have charged on a per passenger (Per Pax) basis as two separate components:

[2] The ACCC has failed to understand this when reporting figures from DIA

- A Passenger Facilitation Charge (PFC), covering all aspects of the terminal including aero bridges, storage space for airlines, check-in counters (in effect a Terminal Charge); and
- An Airport Services Charge (ASC), covering all airside infrastructures (in effect a Landing Charge).

NT Airports also charge on a Per Pax basis a Safety and Security Charge (SSC) on all departing passengers to recover the costs of mandated security measures and a return on the capital investment in equipment and infrastructure used to provide those services.

NT Airports reconcile SSC costs versus recoveries at least every six months and adjust the charge to take into account any under or over recoveries.

The revenue from the SSC and costs associated with these services are reported to the ACCC under the regulatory reporting regime.

We will continue to provide this information to airlines regardless of whether it remains a regulatory requirement.

With the introduction of the variable charging system there has been a shift in the risk borne as NT Airports is now sharing the load factor risk with the airline. This method of charging has proved to be especially effective when working with new airlines to encourage them to fly into NT Airports, and was particularly welcomed by Virgin Blue who commenced services on December 2001, and by subsequent airlines such as Tiger Airways who commenced services January 2005. It has also encouraged incumbent airlines such as Garuda Indonesia to maintain the route even though they have experienced a decline in passengers recently due to events in Bali.

All airlines have readily accepted the transition from MTOW to PER PAX based charges. Moving landing charges and terminal based costs from the expense line to the “airport taxes and charges” line allows the airlines to exclude this segment of revenue from the base for commission payments to travel agents and for the airlines to recover this cost from frequent flyers when utilising award tickets. We are also aware of one major airline that increased (and collected) its “taxes and charges” by our proposed increased rate to its passengers whilst refusing to accept and pay the increase to our airport.

The transition to passenger based charges was envisaged in NT Airports third submission to the Commission’s Review in 2002:

> *“In addition we will transition from a landing charge based upon a per landed tonne of Maximum Take Off Weight (MTOW) basis to a per passenger (PAX) basis. We have decided to do this after extensive consultation with all regional, domestic and international RPT airlines that operate into DIA. They all expressed a clear desire to have the charges levied on a Per Pax basis.”*

DIA offers a package of pricing and rebate incentives to all airlines (existing and new, domestic and international) to add capacity and new services.

These incentives have been embraced by Qantas, the previously operating Australian Airlines, Jetstar, Virgin Blue, Skywest and Tiger Airways and DIA has made over $480,000 in support payments to these airlines during the review period.[3]

5.1.2 Are the current structures of charges consistent with the efficient provision of airport services and the Government's Review Principles?

For airports that are not capacity constrained (as is the case for DIA), the Government Review Principle that is relevant for pricing purposes 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."*[4]

Following the changes to the pricing structure in 2001/02, DIA indicated to its airline customers that it would seek an independent review of those charges, the purpose being to justify the price increases associated with the introduction of the ASC and PFC.

KPMG was subsequently engaged to develop a 5-year pricing model based on accepted ACCC "building block" principles, using demand, asset base, capital expenditure and operating expenditure assumptions provided by DIA.

The initial analysis was conducted for the 5-year forecast period commencing 2002/03. The following table summarises the results for the first year of that modelling.

Table 1 Charge Comparison, 2002/03

Charge	Charging Basis	Actual Implemented Charges	Calculated Charges	Difference Actual vs Calculated
Airport Services Charge	Pax	$4.98	$5.41	-9%
Passenger Facilitation Charge	Pax	$2.50	$5.98	-140%
Non-RPT Airport Services Charge	MTOW	$14.00	$15.07	-8%

Source: NT Airports, KPMG 2003

Under the FAC there was no recovery by the FAC in its pricing charges arrangements for the new terminal buildings that it had constructed at ASA and DIA in 1991. As shown in the table the calculated charge for this was $5.98 at DIA. DIA believed, however, that our airline customers would struggle with a jump in the PFC from $0 to $5.98, and therefore a glide-path approach was adopted with an interim charge of $2.50 being introduced which included the cost of the following facilities:

(a) forward airline support area services; and

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[3] NT Airports, *Inquiry into Price Regulation of Airport Services – Third Submission to the Productivity Commission*, November 2001, p.12

[4] Productivity Commission (2006), *Price Regulation of Airport Services*, Issues Paper, p.4

(b) aerobridges and airside buses; and
(c) departure lounges and holding lounges (but excluding commercially important persons lounges); and
(d) immigration and customs service areas; and
(e) security systems and services (including closed circuit surveillance systems); and
(f) baggage make up, handling and reclaim; and
(g) public areas in terminals, public amenities, and public lifts, escalators and moving walkways; and
(h) flight information display systems.

KPMG estimated that, based on current charges and forecast demand, gross aeronautical revenue at DIA was expected to be about 30% less than the estimated allowable revenue based on the building blocks formula, and a lesser charge was implemented even though this was estimated to be the case to minimise shock to the airlines.

The price modelling undertaken by KPMG in 2003 is considered to be consistent with the above Review Principle, as it:

- Used a WACC consistent with the ACCC approved nominated new investment process and reflective of the regulatory and commercial risks faced by DIA;
- Was based on conservative asset values;
- Included forecasts of capital expenditure over the five year period of the analysis, and thus was based on the long run cost of service provision; and
- Was determined on a “dual till” basis.

Initial analysis has indicated that this has been borne out in practice.

DIA used these prices to consult with the airport users. The outputs and inputs to the model were shared, and DIA sought feedback and responded to the users questions. Due to uncertainty around volume forecasts however the agreed prices and agreed 5 year pricing path could not be implemented, but DIA consulted annually with airlines to arrive at an appropriate price using the same model. During the last half of 2004 and throughout 2005, however, DIA consulted with the airlines to implement a longer term pricing path. This was agreed to by the majority of airlines and implemented on 1 January 2006.

5.1.3 Have price monitored airports used market power to increase charges by more than could be justified?

As shown above, the aeronautical charges at DIA are consistent with the Government’s Review Principle for airports that are not capacity constrained. This clearly shows that prices have not increased by more than could be justified on the basis of costs, investment requirements and service quality enhancements. In fact, prices have been well below that required for long run cost recovery.

Further, the actual charges included in the Conditions of Use for DIA were determined through consultation with airport users, consistent with the Government’s Review Principles (see Section 5.2 below).

5.1.4 To what extent is the experience to date indicative of what may happen in the future?

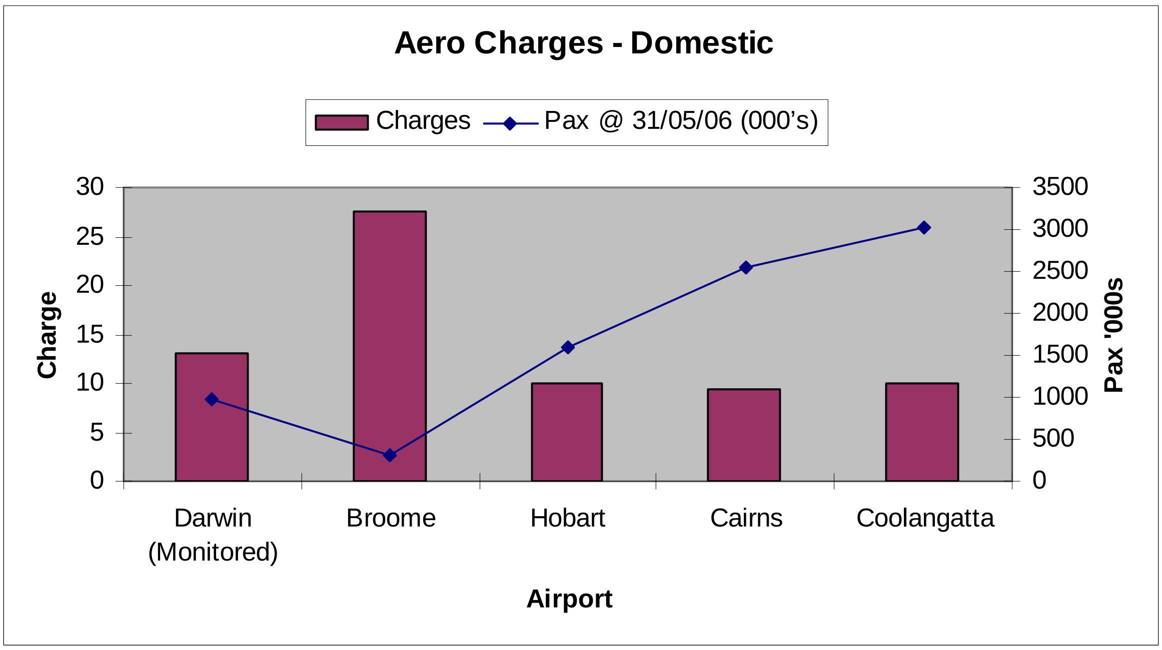
NT Airports has experienced a more positive attitude and input from the majority of airlines under this regime and intends to continue with the regime of consultation and co-operation into the future. This positive attitude has encouraged a regime of investment (approximately $80million to be spent over the next five years on both aero and non-aero). NT Airports prices did initially increase in since 2001- 02 to bring prices to a more efficient level. The introduction of Per Pax based charges vis-à-vis the old FAC MTOW based pricing regime has more closely aligned airline and airport risk in that we share volume or patronage risk. NT Airports is committed to the provision of quality service delivery and customer satisfaction, and the consultative nature of the negotiations with airlines has enabled NT Airports to commit to performance indicators as indicated in Section 8 (QSM).

5.1.5 Comparison of Airport Prices

NT Airports has not made a comparison to the other capital city airports as we do not believe we are comparable by virtue of our size, location and number of passengers. In fact, Melbourne Airport believes for these reasons that Darwin and Canberra should not be under the price and quality monitoring regime (Melbourne Airport Submission July 2006).

Figure 1 shows a comparison of DIA's aeronautical charges against other regional airports. These airports are unregulated and either State or privately owned. Whilst we have compared our pricing to similar size airports it should be noted that each airport is still very different in size, location, number of passengers and the point at which it is in its Capital Expenditure (CAPEX) development lifecycle. Other limiting factors are the market it serves from its population base.

Figure 1



Even though we have presented the above information for comparison purposes', DIA believes that comparing airport costs is somewhat meaningless because each airport has a different asset base and different operating expenses. However, some of our airline customers are keen to conduct these "benchmarking" exercises without any detailed analysis as to the underlying reasons for the different operating and investment costs.

5.1.6 How is airport land, most appropriately valued for charging, monitoring and longer term augmentation purposes?

DIA, as a Joint User Airport, does not own the runways and taxiways and of the 1527 hectares designated as airport land, only 311 are assigned to DIA (the rest is owned by the RAAF). The DIA land area is split as follows:

- 143 hectares Non Aeronautical
- 168 hectares Aeronautical

DIA believes that in order to continue to make an economic return, all assets, including land assets, need to be re-valued at appropriate intervals (5-10 years), for pricing purposes. Various arguments have shown that this complies with IFRS. Accounting Policy whether it be IFRS or AGAAP (the standard has not significantly changed) is not a pricing policy and should not therefore be introduced as a basis for one, it is used for financial reporting purposes to allow comparative Balance Sheets. Any commercial business is required to make a return on investment for its shareholders, and part of that investment analysis will be the alternate use for the invested funds. The generally accepted practice in many regulated industries is to value assets using a Depreciated Optimised Replacement Cost (DORC) valuation methodology. The DORC of an airport is the sum of the depreciated replacement cost of the aeronautical assets that would be used if the airport were notionally reconfigured so as to minimise the forward looking costs of service delivery.[5]

The ACCC provides two common alternative interpretations of the DORC value of an asset:

> *"… the valuation methodology that would be consistent with the price charged by an efficient new entrant into an industry, and so it is consistent with the price that would prevail in the industry in long run equilibrium.*
>
> *… the price that a firm with a certain service requirement would pay for existing assets in preference to replicating the assets."*[6]

The DORC methodology was that adopted by the ACCC in its revenue cap decisions for electricity and gas transmission businesses. Furthermore, it is commonly applied by jurisdictional regulators for regulated electricity and gas distribution businesses.

BARA (June 2006) argues that land should be valued at the amount actually invested by airport operators in obtaining the lease. This is effectively a historic cost, which has previously been dismissed as inappropriate by the Commission (PC Review 2002). It would also seem illogical to say that the value of an investment in 99 years retains the same value as the date of purchase. Would the same point hold true if the airports were on-sold?

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[5] Adapted from the definition provided by the ACCC in its *Draft Statement of Principles for the Regulation of Transmission Revenues* (27 May 1999).
[6] ACCC (1999), *Draft Statement of Principles for the Regulation of Transmission Revenues*, p.39

In its 2002 Review, the Commission concluded that, where charges are based on a production-cost basis (as is the case under a building block methodology), then the appropriate value for aeronautical land is opportunity cost, rather than an indexed historical cost. Specifically, the Commission noted that:

> *"For an airport with significant excess demand, the lower production-cost-based aeronautical prices resulting from using historical cost land values rather than opportunity cost would give particularly inappropriate price signals."*[7]

DIA agrees with this approach.

5.2 Commercial arrangements

Under the price cap regime, consultation between airlines and the airport was very poor. This has improved significantly with the introduction of price monitoring arrangements. During the 5 years of the price monitoring regime DIA has used prices calculated from a pricing model which utilised a WACC consistent with the ACCC approved nominated new investment process and reflective of the regulatory and commercial risks faced by DIA. to consult with the airport users. The outputs and inputs to the model were shared, and DIA sought feedback and responded to the users questions. Due to uncertainty around volume forecasts however the agreed prices and agreed 5 year pricing path could not be implemented, but DIA consulted annually with airlines to arrive at an appropriate price using the same model. In order to set our long-term pricing arrangements from 1 January 2006 to 30 June 2009, DIA consulted extensively with the airlines and reached commercial agreements with all bar one of the airlines, including those represented by BARA, operating RPT services through DIA and ASA. The consultative process commenced in August 2004 and took place over 18 months. Prior to consulting with the airlines NT Airports' Management and Board of Directors agreed the following:

- October 2004 framework distributed with confidentiality agreements
- Passenger forecasts distributed
- WACC paper prepared by KPMG
- Annual capital expenditure plans distributed, meeting with airlines February 2005
- Operating expenditure agreed with airlines using 2005 ACCC reported figures.
- Pricing model accepted December 2005
- Documentation production, commencing March 2006
- New Charges effective 1 July 2006, and agreed in advance for 3½ years, (Jan 06 to Jun 09). The term of 3½ years was finally agreed on rather than the initial 5 years due to the uncertainty surrounding capital expenditure and passenger forecasts beyond that timeframe.

This view is supported by BARA (June 2006) in its submission to the Commission where it states 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."*

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[7] Productivity Commission (2002), *Price Regulation of Airport Services*, Report No.19, p.256.

BARA has also endorsed our long term pricing arrangements to 30 June 2009.

The agreed prices provide transparency and certainty for airport users and DIA.

NT Airports is continuously reviewing and updating its Airports “Conditions of Use” (COU) that sets out the terms and conditions for all airlines using DIA and ASA. The first COU was published in December 2002. The most recent COU was updated on 1 July 2006, and includes the publishing of our aeronautical charges for the three years from I July 2006 through to 30 June 2009.

The COU (which along with our Annual Reports and other information for the wider public can be found on NT Airports’ website www.ntapl.com.au) covers all aspects of the airport’s operations and the terms and conditions associated with access to the following services:

- **Aircraft movement facilities and activities,** which means any of the following:
  - (a) airside grounds, runways, taxiways and aprons; and
  - (b) airfield lighting, airside roads and airside lighting; and
  - (c) airside safety; and
  - (d) nose-in guidance; and
  - (e) aircraft parking; and
  - (f) visual navigation aids; and
  - (g) aircraft refuelling services.
- **Passenger processing facilities and activities,** which means any of the following:
  - (a) forward airline support area services; and
  - (b) aerobridges and airside buses; and
  - (c) departure lounges and holding lounges (but excluding commercially important persons lounges); and
  - (d) immigration and customs service areas; and
  - (e) security systems and services (including closed circuit surveillance systems); and
  - (f) baggage make up, handling and reclaim; and
  - (g) public areas in terminals, public amenities, and public lifts, escalators and moving walkways; and
  - (h) flight information display systems.

5.2.1 Would there be value in general guidelines or a code of practice for commercial agreements?

DIA believes there would be value in further clarification of the pricing principles that should be applied during the negotiation process, particularly clarification of the definition of aeronautical and non-aeronautical assets, confirmation of the dual till approach and appropriate valuation methodologies for aeronautical assets.

However, DIA believes that these should be incorporated into guidelines, rather than an industry code of practice. Further, the guidelines should list high level principles, rather than specifics. The reasons for this are that each airport is unique, and the application of specific guidelines may not be appropriate for each airport. Further, the substance of the agreements should be an outcome of commercial negotiations between the airports and the airlines, consistent with the Government's Review Principles.

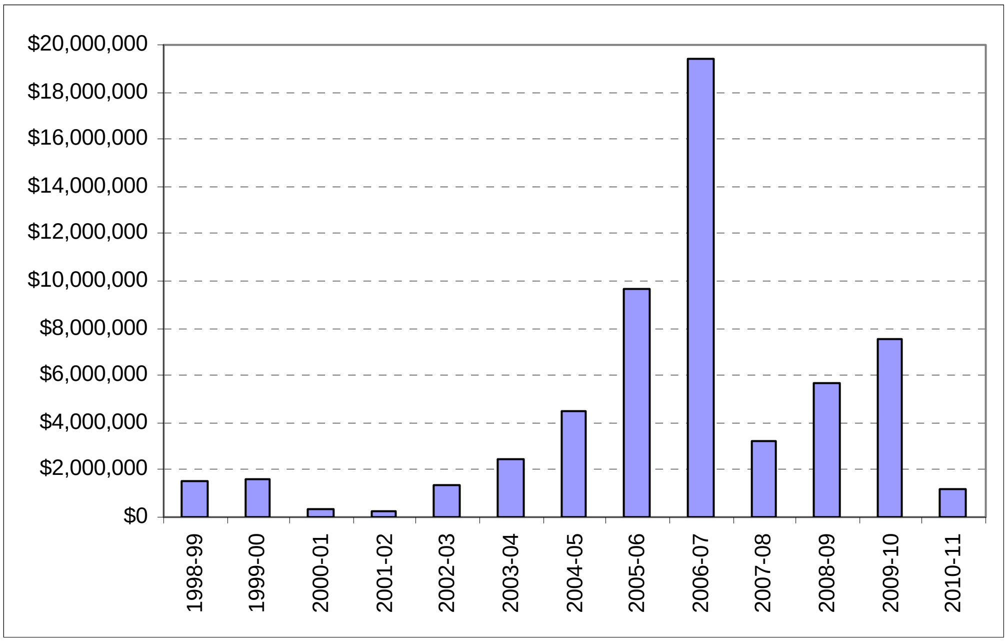
Key Point: DIA has after extensive consultation with its airlines customers, reached agreement on long term Per Pax based pricing that more equally shares risk and reward but still under recover against accepted allowable revenue pricing methodologies.

6 Investment at the airport

The necessary new investment process that applied during the price caps regime was used by the airlines to frustrate investment and compromise the potential entry of new airlines. The lack of certainty under that regime discouraged investment.

Following the removal of the price caps, DIA has negotiated with airlines to undertake significant development at the airport. However, due to the fact that DIA is a Joint User airport, certain capital projects are controlled by the RAAF, for example runway, taxiway and airport lighting upgrades. The Department of Defence control the timing and quantum of this capital expenditure whilst DIA bears the majority of the cost, and thus we have less control over our forward looking capital expenditure than other price monitored airports. The actual and forecast level of capital expenditure is presented in the following graph.

Figure 2. Aeronautical Capital Expenditure at DIA, 1998/99 – 2010/11



DIA undertook approximately $3.5 million of capital expenditure during the 3-year period that it was subject to a price cap, based on the definitions used by the ACCC. Since then, DIA has negotiated price increases with airport users to allow it to invest a further $18.2 million (from 20001/02 to 2005/06) in airport facilities and services. The forecast capital expenditure program is consistently higher than the actual capital expenditure achieved during the price cap regime. In the five years commencing 2006/07, DIA expects to invest a further $7.4 million per annum on aeronautical assets.

The evidence of the growing investment since 2001/02 is shown by the report rating received in a report issued by GHD rating infrastructure in the Northern Territory. DIA and ASA were rated A-, and were shown to be well maintained, with sufficient capacity for the projected passenger numbers.

Key Point: DIA has with airline support made valued investments in airport infrastructure that far exceed its original Schedule 11 Lease commitments to the Federal Government.

7 Competition and countervailing power

7.1 Countervailing Market Power

BARA argues that the airlines do not have significant countervailing market power, and that they must travel to the airports that their customers request. DIA does not agree with BARA in relation to the circumstances associated with the market place for air services to Darwin – airlines can and do adjust their flight schedules, but do not automatically respond to customers requesting additional services.

In the case of DIA, airlines have removed services that were presumably not profitable. For example, Virgin Blue ceased operating Sydney-Alice Springs and Sydney-Darwin direct flights in the second half of 2005 and Qantas stopped its Alice Springs – Broome flight in early 2006. Virgin Blue has not responded to request of NTAPL or the NT Government for a restoration of these services as customers and the market would want. Qantas removed 60% of its Singapore capacity out of Darwin in December 2001 and this represented 40% of capacity at that time.

An airline in a monopoly position can control capacity and demand to a destination through pricing. Airlines often hold sales to increase capacity on certain routes, targeting the recreational market in particular. Airlines that also have holiday companies or affiliation with holiday companies/hoteliers have significant influence over a destination by pricing packaged holidays competitively against other destinations.

It should be noted that one major domestic airline averages its airport charges across its destinations, and at present fuel taxes are higher than airport charges.

DIA operates in a highly competitive international market and is disadvantaged through its relatively small population base of 100,000. This population size does not warrant high (or perhaps even low) frequency operations by long haul wide body aircraft, which are operationally capable of “over flying” Darwin to their ultimate international destination. Darwin has seen a fall in its relative share of international passengers to Australia by 50% over the past six years, yet DIA cannot reduce its aeronautical asset base in response. Overseas passengers visiting Darwin are forced to fly into other major cities and connect back through to Darwin with additional time and cost imposts.

Asia and points beyond in Europe and the Middle East to Australia are well serviced with flights from Sydney, Melbourne, Brisbane and Perth. Apart from the lack of operational reasons to schedule a stop in Darwin, such a stop is considered unacceptable commercially with passengers originating east coast Australia expecting minimal stops between origin and destination.

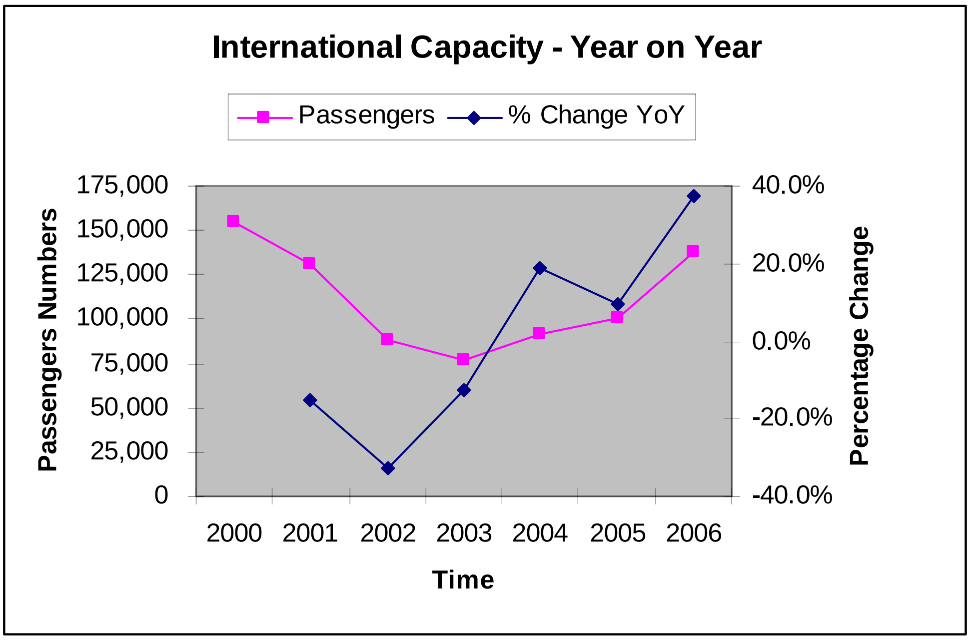
The following table reflects international seats provided into Darwin from 2000. There was a significant decline in seats after the withdrawal of Singapore Airlines and Malaysia Airlines (exercising their right to cease services into Darwin they considered unprofitable) and the collapse of Ansett Australia Airlines in September 2001 with the corresponding reduction in Qantas international capacity in December 2001.

Table 2 International Seats into Darwin, 2000 – 2006

	2000	2001	2002	2003	2004	2005	2006	2005/06 % Change
Total Seats	*154,468*	*130,721*	*87,997*	*77,074*	*91,627*	*100,440*	*138,004*	*37.4%*
% Change YoY		*-15.4%*	*-32.7%*	*-12.4%*	*18.9%*	*9.6%*	*37.4%*	
No of Airlines	*6*	*5*	*4*	*4*	*5*	*4*	*5*	
Monthly Average	*12,872*	*10,893*	*7,333*	*6,423*	*7,636*	*8,370*	*11,500*	*37.4%*
Weekly Average	*2,971*	*2,514*	*1,692*	*1,482*	*1,762*	*1,932*	*2,654*	*37.4%*

The above table shows that international capacity has almost returned to pre 9/11 levels (although still 10.7% down on 2000) due to the increase in Qantas capacity associated with the use of A330 aircraft on the Singapore service and the commencement of Tiger Airways Singapore services in December 2005. With the demise of Australian Airlines, Qantas has changed the aircraft operating to Singapore and has reduced capacity on an annualised basis by 7000 seats or 5% of total capacity.

Figure 3 – International Capacity Movement - DIA



Despite strenuous efforts, via constant lobbying by NT Airports and Tourism NT to entice Singapore Airlines and Malaysia Airlines to recommence services to Darwin (and other legacy airlines such as Emirates to commence), such airlines do not see the traditional ex-Europe market into Darwin as sufficient to justify such a service when they have other priorities for adding new services or increasing frequency to larger markets, especially India and China.

This is notwithstanding that NT Airports and Tourism NT can demonstrate that about 90,000 visitors from UK / Germany that before 9/11 entered or departed Australia via Darwin no longer do so because of lack of international airline capacity to and from Darwin, therefore the demand remains but the capacity does not.

In December 2005, Singapore based low cost carrier (LCC) Tiger Airways commenced 4 per week services Singapore-Darwin with a 180 seat A320 aircraft. Their low cost fares for example $435 Darwin Singapore return together with the new airline gateway to Europe largely accounts for the filling of the increase in international seats offered in 2006, as shown in Table 2.

Tiger Airways has demonstrated the price elasticity of demand possible on the Singapore-Darwin route, and that there are new inbound markets to Darwin from the nearby Asian region.

Competition from a LCC has expanded passenger numbers, refer Table 3.

Table 3. Passengers, DIA, 2001/02 – 2008/09

	2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**2005/06**
Domestic[1]	947,149	796,381	877,221	985,047	1,104,061	1,098,800
International[1]	433,389	290,826	209,147	197,114	279,788	333,800
Subtotal	***1,380,538***	***1,087,207***	***1,086,368***	***1,182,161***	***1,383,849***	***1,432,600***
% Change		***-21.2%***	***-0.1%***	***8.8%***	***17.1%***	***3.5%***

[1]Arriving and departing, Source NT Airports.

BARA suggests that the removal of services can cost the airline a significant sum of money. This is also true for the airport. For example, the Virgin Blue withdrawal of a single service - their Sydney Darwin service in 2005 represented a loss of $550,000 or 3.3% of DIA's annualised aeronautical revenue (not to mention the airport concession revenue that was also lost). This is a significant amount for a small regional airport like Darwin.

DIA, like other airports, offer commercial incentives to support new services and increased airline capacity and thus increase the number of passengers utilising our airport. Our incentive program is available to all domestic and international airlines on an equal basis. Thus, the airlines and airports have a common commercial objective of increasing passenger numbers.

Specifically, 38% of the landings (non-GA) at DIA occur between 11 PM and 2 AM. Thus, DIA has significant excess capacity that it is keen to develop, and it is our intention to stimulate growth through appropriate service and price provision.

DIA's experience has been that airlines have other routes and destinations to service and they can and do withdraw services at very short notice with little or no consultation with the airport operator. It is in the airport operator's best interest to be price competitive and encourage additional airline services; not to discourage activity. Airlines clearly have substitutes in terms of alternate routes and destinations and as our customers; the airlines have substantial countervailing market power.

Key Point: Since September 11, 2001 DIA has experienced the brunt of reduced airline competition in its domestic and international market segments and believes that the countervailing market power of its main airline customers has grown markedly during the review period.

7.2 Competition

NT Airports believe that DIA has sufficient competition from other airports to ensure that we price competitively. Of the Northern Territory visitor base, 73% are either on holiday or VFR (compared to other major capital city airports where the business traveller is a greater percentage and not as sensitive to price). Given this high proportion of visitors DIA has to compete with other holiday destinations such as Cairns and Broome.

Cairns is an international airport with approximately 1.3 million international passengers and 2.6 million domestic passengers. Cairns International Airport is effectively owned by the Queensland State Government and is not subject to regulation or subject to the *Airports Act*. This has enabled it to react to market conditions without being subject to a regulatory framework.

Broome International Airport is privately owned and similarly not subject to any regulation other than normal market forces. In fact Broome is currently advocating its potential as a further International Gateway to Asia, with the Western Australia Government providing a grant of approximately $400,000 to carry out a feasibility study. Should this feasibility prove successful Broome will seek to establish itself as a full-time international airport in direct competition with Darwin as a hub for services to Asia, from domestically and internationally bound airlines and competing airports.

Given the reliance DIA has on tourism as its main passenger base NT Airports believes that Darwin faces real competition from Broome from a destination perspective.

This is particularly so because Broome and Darwin are the only Australian cities within the range from Singapore, of a new generation narrow body aircraft (the A320 or the B737NG series). To minimise costs, LCCs such as Tiger Airways and Jetstar seek to operate on a round trip basis with one crew, thus limiting these aircraft to Broome and Darwin from Singapore – although the aircraft types will fly Perth-Singapore a crew change is required at Perth, and they would be subject to competition from wide-bodied aircraft.

Key Point: Darwin faces significant competition from the non regulated Broome and Cairns International Airports for future international traffic into Northern Australia.

8 Quality of services

The objectives of the Quality of Service Measurement (QSM) are to:

- ***"****Assist in the assessment of an airport operator's conduct in a prices monitoring environment (in light of the independent review which will be undertaken at the end of the five years of the monitoring arrangement); and*
- *Improve the transparency of airport performance in order to:*

- *Discourage airport operators from providing unsatisfactory standards for services which are associated with significant market power;*
- *Provide information to users of airport facilities including passengers and the aviation industry, as a basis for improved consultation and negotiation on pricing and investment proposals;*
- *Highlight changes in service quality over time;*
- *Facilitate inter-airport comparisons and benchmarking and;*
- *Assist the Government in addressing other public interest matters.*"

NT Airports believes that quality of service is part of doing business. In today's environment of triple bottom line reporting the community and customers are as important as the stakeholders. Whilst we agree with the principle of QSM, the measurements and a uniform approach may not be appropriate for all airports.

NT Airports operates common user terminals, and passengers flying Qantas out of DIA and ASA depart/arrive from/to an area that is part of the QSM and arrive/depart to/from a Qantas terminal. Many of the QSM measurements set by the ACCC are not applicable to Darwin and therefore the data becomes somewhat meaningless for comparative purposes.

For example DIA did not rate well in the 2004-05, ACCC Quality of Monitoring Report, particularly in the Availability and Standard of Facilities segments by ACS by the 2 out of 8 RPT airlines that responded. However, the poor rating for baggage facilities standards and availability failed to record that we had commenced installing in line CBS facilities inside the working baggage hall.

Similarly in 2003-04 we rated excellent with ACS for departures immigration availability after new outwards immigration counters were installed and in 2004-05 with no change to the facilities, our rating slipped to satisfactory.

As part of its conditions of use, NT Airports have developed a set of performance indicators and we believe it is these indicators which should be used in consultation with the airlines' during the price negotiations to assess quality of service. In order to provide world class facilities and services, NT Airports will take all reasonable steps to apply the following performance principles to guide our activities and development of our airports. We will:

(a) "*maintain and operate secure, safe and efficient Airports and will, within a reasonable time after a request from you to do so, provide satisfactory evidence of certification of all reasonable or necessary maintenance and safety checks and inspections;*

(b) *provide a comfortable and friendly environment to the travelling public;*

(c) *to the extent that it is our responsibility, keep all Facilities and Services in good repair and condition and effect all structural and other maintenance, replacement, renovations and repairs with respect to the Facilities and Services;*

(d) *continue to improve Facilities and Services wherever justified and in accordance with our plans;*

(e) *ensure that a high standard of cleanliness of public areas and facilities is maintained by our contractors, tenants and concessionaires;*

(f) *continue to maintain and improve Facilities and Services (where possible) for special needs passengers;*

(g) *ensure that all Aviation Services, whether direct or indirect, comply with occupational health and safety standards in place from time to time;*

(h) *respond quickly to enquiries relating to our Facilities and Services; and*

(i) *continue to work closely with airlines and their representative organisations, aircraft operators and government agencies, both individually and through the airline operators committee, to ensure that terminal Facilities and Services are supplied and allocated in a mutually beneficial and equitable manner and with the public's best interests in mind.”*

DIA has not been directed to undertake specific customer satisfaction surveying but it does survey through regular forums and meetings with our customers, and airport stakeholders appropriate ways in which to improve service delivery in those key areas associated with customer satisfaction.

Key Point: DIA believes that the current QSM by the ACCC is not insightful into the level of customer satisfaction experienced by airlines and our joint passengers.

9 Classification of services

In its submission to this Review, BARA argues that fuel throughput levies should be included in the aeronautical charging regime. NT Airports disagrees for two reasons, as follows:

- The Government’s intention, since privatisation, has been that contracts entered into by the FAC prior to the privatisations would be excluded from any regulatory arrangements (whether a price cap or prices monitoring). This is clearly reflected in Direction No.27.
- NT Airports charges a fuel throughput levy on general aviation services at DIA and on RPT and GA services at Alice Spring Airport. DIA does not charge a fuel throughput levy on RPT services. Further, where a fuel throughput levy is charged, the rate is less than $0.005 per litre. The fuel throughput levies charged by NT Airports are clearly not excessive, and there would be limited value in including these levies in the prices monitoring regime.

We acknowledge that Fuel Throughput Fees are a contentious issue with airlines and that IATA has argued long and successfully to resist the application of these charges and other commonly charged taxes by Governments on aviation fuels in comparison to other transportation fuels. For example in Australia the excise duty on Jet fuel used in the domestic aviation market is $0.02854 per litre versus $0.38143 (plus $0.035289 extra GST) for distillate used for road and rail transport.

It should be noted that a fuel throughput levy operates no different to any other concession fee applied to retailers on airports. Fuel companies are charged fuel throughput levies or equivalent access fees on other business premises in other transportation markets. For example, NT Airports would be surprised if the major oil companies weren't contributing in some way back to the land and business owners for access to highly valued customer bases that exist at supermarkets and other third party owned or controlled locations like major arterial and highway and tollway locations that deliver substantial passing traffic. We would expect that those location and business owners are earning significant revenue streams for granting access to those passing or captive customer bases. In the case of major refuelling facilities on toll road, major arterials and private property, we understand that the oil companies are willing to participate in revenue, net profit sharing via the payment of fuel throughput fees and rebates paid to third parties based on sales.

The fact that the FTL was allowed for in the existing agreements with airports, both in the time of the FAC and post privatisation shows that the oil companies accept this as a legitimate cost of business to gain access to the aviation transportation market as they have been traditionally accepted on the ground transportation markets.

Key Point: The current land rentals for on airport aviation refuelling do not reflect the value of that land to the oil company concession holders. The application of fuel throughput fees or concession payments to land holders for the right to gain control of land and access extremely valuable market segments is a regular practice in the oil industry and is allowed for in the leases inherited from the FAC. Such concession payments should not be classified as aeronautical revenue.

10 Compliance Costs

The cost of complying with regulatory and statute requirements are constantly increasing. At present airports have to comply with:

- Price Monitoring (ACCC reporting)
- Security
- CASA
- Airport Regulations (Airports Act)
- DOTARS reporting

NT Airports is finding the underlying costs of this compliance are having an increasing impact on charges with the ACCC annual compliance costs alone amounting to $130,000 per annum ($100,000 in terms of man hours alone, i.e. the cost of one extra staff member and represents 12.5% of the finance and admin team at NT Airports).

For example under the NNAI regime in year 2000, my predecessor spent approx. $70,000 in consultancy and internal costs to get approx $350,000 of new investment approved by the ACCC. We as an airport and we feel sure our airline customers (who have reviewed and agreed our forward looking 4 year aviation investment program) would not wish to see a return to this process given the future call on capital that needs to be provided to meet future aviation needs.

The table below shows a comparison of how compliance costs have increased over the last five years.

Compliance Costs	Frequency	2001 ($)	2006 ($)
ACCC Reporting (Pricing and Quality)	Annual	120,000	135,000
CASA[1]	Annual	5,000	10,000
Security Screening	Annual	20,000	200,000
OH&S	Annual	5,000	20,000
Environmental compliance	Annual	50,000	100,000
DOTARS	Annual	50,000	100,000
PC Review	One-off	100,000	125,000

[1]*Note there is also the potential for a $50,000 audit fee*

Key point: Price and Quality of Service monitoring compliance costs are substantial for a small regional airport like Darwin.

11 Security

The ever increasing cost of complying with security has seen the security charges increase at DIA from $0.25 on average Per Pax in 1997 to $14.08 for the first six months of 2006. This cost is only likely to increase next year as further recommendations of the Wheeler report are implemented.

Under the security regulations Darwin (and Alice Springs) has to comply with the same security measures required by all other International Counter Terrorist First Response (CTFR) classified Airports. However, the passenger base for recovery of those costs is a great deal smaller than other capital city and major airports. This lower base for recovery results in a significantly higher per passenger security charge for DIA compared to other airports.

	SSC $	Pax 05/06
Darwin	14.08	1,432,600
Adelaide	7.05	5,400,000
Brisbane	5.90	13,427,772[1]
Melbourne	2.60	21,430,000
Sydney	5.05	29,108,300
Perth	6.13	7,135,449

[1]*Pax July - May 2006*

The DIA SSC increased from $7.17to $14.08 excluding GST on January 1, 2006 to cover the increased cost of 100% in line Checked Bag Screening. DIA expects this to increase by a further $7 per departing pax when further contemplated security measures are introduced within the next two years.

To put this in perspective the published increase in combined landing and terminal airport charges at Darwin International Airport will increase from $13.10 to $13.76 Per Pax over the financial years 2006 – 2009.

At Alice Springs Airport the effect on airport charges associated with implementing mandated and to be mandated security measures will be even more dramatic. The SSC will increase from the current charge of $3.00 excluding GST to a contemplated $36 per departing pax whereas the published combined airport landing and terminal charges will only increase from $12.05 to $12.65 Per Pax over the next three financial years.

Key Point: Proposed increases in airport landing and terminal charges at DIA pale into insignificance when compared to the increases in Safety and Security Charges for mandated security measures that have or will flow through to airlines and their customers.

12 Dispute resolution

NT Airports has a prescribed dispute resolution clause in its Conditions of Use , and believe that this has been used effectively in the past with all differences being settled at CEO level. The process is described below:

"*If a party considers that a dispute has arisen in connection with these Conditions (****Issue****), then the parties must follow the procedure set out in this Condition 20 to resolve the Issue. In particular before commencing court proceedings the parties must first comply with Conditions 20.2 to 20.6.*

a. Notice of an Issue

If a party considers there is an Issue, that party must give the other party notice of that Issue. The parties must then attempt to resolve the Issue.

b. Authorised Officers to meet

If the Issue remains unresolved for 14 days after a party receives the other party's notice of the Issue, then an Authorised officer from each party must meet at least two times at our office (or at another agreed location) to discuss and attempt to resolve the Issue in good faith. The meetings must take place between the Authorised Officers within 14 days following the issue being referred to the Authorised Officers.

c. Failure to agree

If the Issue remains unresolved for 60 days after the Issue was referred to the Authorised officers, or such longer period as the parties may agree, either party may refer the Issue to their respective Chief Executive Officers.

d. Referral to Chief Executive Officers

*Each party's Chief Executive Officer or their nominee (****CEOs****) must then meet at our offices (or at another agreed location) within 14 days of the Issue being referred to the CEOs to discuss the Issue in good faith with a view to resolving the Issue.*

e. Aviation Charges and Government Mandated Charges

If the Issue relates to the calculation and payment of Airport Charges or Government Mandated Charges, we agree that you do not have to pay the amount of any Airport Charges or Government Mandated Charges that are the subject of a bona fide dispute, unless and until and from such time as the Issue is resolved in accordance with this Condition. However, you must still pay any amount of Airport Charges or Government Mandated Charges which are not in dispute by their due date for payment.

f. Legal proceedings

*Nothing in this Condition 20 prevents either party from commencing legal proceedings for urgent interlocutory/temporary relief.****"***

DIA is currently updating its Conditions of Use to include a clause on Mediation, which will take place if the CEOs are unable to resolve the issue within 60 days. The issue will be referred to mediation under the rules of Institute of Arbitrators and Mediators Australia.

Whilst some parties have called for external parties like the ACCC to be the final (and no doubt intended to be used as regular) arbitrator, others have suggested that binding arbitration provisions that are supposedly common in the commercial markets would assist airports and airlines reach agreement and resolve disputes.

Such provisions are certainly not that common amongst major supplier customer relationships but in many instances parties in dispute do elect arbitration today as opposed to normal court processes for cost, expediency and privacy reasons if they believe their agreement is not being honoured. Indeed the standard terms and conditions of major suppliers normally contain provisions that allow them to restate prices if the continued supply becomes uneconomic or if changes or factors eventuate that alter the basis on which the prices were originally set. To suggest that the arbitration process can or should be used to create or force an agreement between parties would be way outside the normal expectation of competitive market conditions.

Key Point: During the past five years, all disputes have been amicably resolved with the existing dispute resolution mechanism and that the imposition of compulsory arbitration provisions will lead airlines to use this method as they did in the past (with the ACCC adjudicating on questions of Necessary New Aeronautical Investment NNAI).

13 Future regulatory arrangements

NT Airports has consistently behaved in accordance with the Government's Review Principles during the prices monitoring period. That is, NT Airports has:

- Earned revenues that are below the long run cost of efficiently providing aeronautical services, as determined using a building block methodology;
- Determined its prices, and other terms and conditions, through commercial negotiations with airport users; and
- Has established consultation mechanisms for the exchange of information with airport users.

Further, DIA is subject to competition from other airports, as well as significant countervailing power from airlines. This places significant commercial constraints on NT Airports, and compels it to behave in a fair and reasonable manner in its commercial negotiations with airport users, evidenced by the fact that long term pricing agreements have been achieved with all bar one airline. Therefore, NT Airports believes that it should not be subject to any form of prices regulation in the future.

Key Point: During the review period DIA has behaved in accordance with the Federal Government's review principles and because of the strong (and growing) countervailing power of airlines, should no longer be price regulated.