



**Economic Regulation of Airport Services
Fourth Submission to the Productivity Commission Inquiry
Sydney Airport Corporation Limited ('Sydney Airport')
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Sydney Airport - Gateway to Australia



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1. Overview

This submission is in response to the Productivity Commission’s (“PC”) Draft Report into Economic Regulation of Airport Services (the “Draft Report”). Sydney Airport welcomes the overall recognition by the PC that:

- Investment outcomes continue to be strong
- Pricing outcomes appear to have been within reasonable expectations
- Quality outcomes are satisfactory
- Commercial negotiation continues to develop
- Australian airports perform quite well relative to overseas airports

Commercial negotiation continues to be the best mechanism for delivering the right facilities and services to a wide variety of airlines with different priorities. Sydney Airport agrees that some improvements to the light-handed regulatory regime are desirable – and in particular the monitoring regime. Such improvements should render unnecessary any additional regulatory tier, such as the proposed show cause mechanism.

This submission responds to many of the information requests in the Draft Report, and also comments on some specific recommendations, as set out in Appendix B. In particular, the submission comments on specific proposals for:

- The operation of a show cause mechanism
- Enhancements to the pricing principles
- Refinements to the monitoring regime
- Landside access

Some issues specific to Sydney Airport are dealt with in Appendix A.

2. Operation of the show cause mechanism

Sydney Airport does not believe there is any need for a show cause mechanism.

- Most importantly, the current regulatory regime has delivered positive outcomes – as recognised by the PC. These outcomes are only consistent with a conclusion that the joint interests of airports and airlines temper any incentive to exercise market power, and that the airports believe the existing threat of re-regulation to be very credible.
- There is already a credible threat of re-regulation, arising from Parts IIIA, IVA and VIIA of the Competition and Consumer Act and the potential for political action in response to extensive media attention.
- Airlines have significant countervailing power¹ to offset any market power possessed by the airports – demonstrated both by the concessions made by Sydney Airport and other airports in negotiations, as well as by the multiple occasions on which airlines have refused to pay and/or withdrawn services.
- The inadequacies in the quality of the information received by the government are better addressed by improving the quality of the monitoring reports and information disclosures by airports. The Draft Report recommendations (discussed in section 4 below) recognise and address this issue.

The proposed show-cause mechanism might further increase the threat of re-regulation. Since the airports already believe the threat to be credible, this can have little benefit. Set

¹ For example, the 3 main airline alliances represent 68% of global international traffic (RPKs).

against these limited benefits, Sydney Airport has significant concerns that, if not carefully implemented, it would undermine the objectives of the current monitoring regime. In particular, it could:

- Significantly increase the risk of regulatory truncation
- Undermine investment, as recognised by the National Aviation Policy White Paper²
- Undermine an airport's incentive to take risks and innovate
- Further strengthen the possible damage to an airport's businesses and brand
- Disrupt the improving experience of commercial negotiations

2.1 Current threat of re-regulation

In support of the need for a more credible threat of re-regulation, the Draft Report notes that:

Despite complaints from airport users and the public stance on airports taken by the Australian Competition and Consumer Commission (ACCC), existing safeguards have been very little used

A regulatory sanction does not have to be used in order to affect behaviour. Moreover, rather than being evidence of Ministers' unwillingness to act, the lack of Ministerial intervention has arisen arguably because Ministers have never been provided with reasonable or persuasive evidence that action was warranted. As demonstrated in Sydney Airport's first submission, and supported by the Draft Report:

- *Recent quality of service monitoring for the overall and passenger survey results alone do not indicate any persistent trends that would suggest the misuse of market power. (Draft Finding 6.2)*
- Airport returns have been well within a reasonably expected band of outcomes

Precisely because there hasn't been any reasonable evidence that action is warranted, it is impossible to assess what would be the government's response were such evidence to be presented. Despite the lack of evidence, the ACCC has asserted that such behaviour "might be" or "could be" happening throughout their monitoring reports and their submission to the PC³. If substantial evidence existed it is certain that it would be made clear to the government.

2.2 Proposals for an effective and balanced show cause mechanism

Sydney Airport has concerns that the proposed show cause mechanism could both undermine the objectives of the current monitoring regime and unfairly damage an airport's businesses. If a show cause mechanism is considered necessary, then as a minimum it should include the following protections against unintended consequences and regulatory adventurism:

- The minimum requirements for the initiation of a show cause process need to ensure that asymmetric truncation is avoided. The logical outcome of a regulatory system in which airports cannot expect to earn at least the WACC on average is for airports to avoid investment and to pass all risk to the airlines by operating entirely on a pass-through basis – which would include the need for charges to increase in proportion to traffic declines (precisely at the time when airlines are least profitable)

² "In light of the concerns expressed by stakeholders regarding the draft guideline, the Government is not proposing to introduce the annual 'show cause' assessment at this time. The Government is sensitive to any potential impact a show cause assessment could have on airports' ability to attract capital". Page 180.

³ In fact, the word "could" appears 74 times in the ACCC's first submission. The word "did" appears once.

- The minimum requirements for the pursuit of a Part VIIA inquiry needs to avoid creating a disincentive to take risks or innovate. For example, the centralisation of CUTE at Sydney Airport increased both airline and airport profitability and enhanced the service levels. It would be unfortunate if similar initiatives increased the risk of re-regulation because of an inflexible “expected band of outcomes”
- The show cause process itself should be confidential between the ACCC and the specific airport involved – to avoid unwarranted business damage, and as it is for other show cause processes
- Whilst the ACCC is best-placed to issue a show cause notice or recommend a Part VIIA inquiry, an independent authority (potentially the NCC) should conduct any Part VIIA inquiry to avoid the conflict of interest identified by the PC

2.2.1 Minimum requirements for initiation of a show cause requirement

A show cause order, and to an even greater extent a recommendation for a Part VIIA inquiry, represents both a significant administrative burden and a regulatory risk. In addition, it would cause significant uncertainty for refinancing and investment, and would affect both the timing and outcomes of negotiations. It is important that these costs are avoided wherever possible.

The PC has recognised this need in recommendation 11.1:

“To issue a show cause direction, the ACCC must form a view that there is prima facie evidence that an airport has, over time, demonstrated a consistent pattern of achieving aeronautical returns in excess of a reasonably expected band of outcomes, ...”

The regulatory risk of asymmetric truncation⁴ is critical in assessing both the relevant time period and the reasonably expected band of outcomes. In the context of the current regulatory regime for airports, asymmetric truncation could arise through a variety of causes:

- Ex-ante expectations that rates of return will in any case vary over time due to traffic growth within the term of a commercial agreement or over the investment cycle. This risk is illustrated in Figure 5.4 of the Draft Report, and demonstrates the importance that ex-post returns are assessed over a very long period of time
- Ex-post rates of return will vary from the ex-ante expectations. The importance of this is reflected in Box 11.2 of the Draft Report and in the PC’s 2004 Review of the Gas Access Regime, which demonstrate that a very high threshold is required for any assessment of ex-post returns
- Ex-post returns vary between different activities, with some but not all activities earning higher than expected returns

What is the appropriate period over which to assess returns?

Figure 5.4 of the Draft Report illustrates the expected variation in rates of return for a stylised business over several investment cycles. In the context of Sydney Airport, the expected variation over time can naturally arise due to:

- The investment cycle – which tends to result in higher returns immediately before significant investment, and lower returns after investment. In addition, as

⁴ Asymmetric truncation is the risk that a regulator significantly reduces the expected ex-ante returns of a regulated business by truncating ex-post returns above a maximum threshold without truncating ex-post returns below a minimum threshold.

acknowledged by the Draft Report, efficient financing of major investment could include the transfer of returns between different years (as was the case for the financing of Heathrow Terminal 5)

- Expected traffic growth (included in the pricing of long term contracts) – which tends to result in higher returns at the end of the contract, and lower returns at the start. The longer the term of the agreement, the larger is the likely variation between the returns in the first and last years
- Other expectations at the time of commercial negotiation, such as the timing of productivity improvements or the price-path of charges negotiated – there is no clear pattern to how these expectations would affect returns over time
- Negotiation of charges using a real WACC and indexed asset value, which are then assessed using the un-indexed asset values (and measured against a nominal WACC) – this tends to result in higher returns in the long term and lower returns in the short term (and from May 2001 to the present)

An individual year's ex-ante rate of return could therefore vary significantly from the WACC. Given the length of the investment cycle and the length of the commercial contracts (some of which are for up to 17 years), it is likely that there will be periods of several years in which the ex-ante returns vary significantly from the WACC.

In fact, given the mismatch between the treatment of inflation in negotiation (an approach that was established in the May 2001 Pricing Decision by the ACCC) and in the line-in-the-sand monitoring (established in 2006), the appropriate period for assessing whether excessive returns have been earned by Sydney Airport is from July 2001 to the date of the assessment.

What is the reasonably expected band of outcomes?

Box 11.2 of the Draft Report shows a variety of different rates of return used by different UK authorities – and includes Littlechild's observation that competition authorities tended to accept higher profits than did regulators. One possible reason for this difference is that whilst regulators decide prices based on ex-ante expectations of returns, competition authorities are more likely to be assessing ex-post returns, and are careful to avoid asymmetrical truncation when doing so.

The PC Review of Gas Access Regime in 2004 considered the risk of asymmetric truncation, and both quantified the magnitude of the risk and proposed potential remedies. Table B.1 of that report demonstrated that the ex-ante return can be significantly reduced below the WACC, even for ex-post truncation of rates of returns to 20% or more. In this context, Sydney Airport notes that thresholds used by the UK competition authorities for assessing whether ex-post returns are indicative of the abuse of market power are 20% real (Office of Fair Trading) and 35% real (Competition Commission).

Whilst the analysis in that review was of a single period of returns, airport returns tend to be serially correlated – reflecting the long term investment cycle and the relationship between airport returns and traffic levels (rather than traffic growth rates per se). In this respect, the reasonably expected band of outcomes for assessing an average return is not likely to be significantly narrower than the reasonably expected band of outcomes for assessing the return of a single year.

In addition, the development of more innovative and varied commercial contracts between airports and airlines is giving rise to an increased risk of regulatory truncation. Longer agreements increase the likely magnitude of any variance between ex-post outcomes and ex-ante expectations, and therefore a greater chance that an ex-post assessment of returns exceeds any specific threshold.

Collaboration with airlines creates opportunities for win-win innovations, with the airlines benefiting from increased traffic, lower operating costs and/or increased revenues (arising from improved product), and the airport benefiting from increased non-aeronautical revenues and/or the airlines agreeing to increased aeronautical returns. It would be a perverse regulatory outcome if the higher aeronautical returns arising from collaboration with the airlines were to be routinely truncated, and in the process limiting the incentive to collaborate.

Dealing with multiple activities and commercial agreements

Draft Recommendation 11.1 proposes that the ACCC would need prima facie evidence that an airport has achieved *aeronautical returns* in excess of a reasonably expected band of outcomes (*emphasis added*). The risk of asymmetric truncation is reduced by the test being applied to *total* aeronautical returns, rather than the aeronautical returns on any one activity.

It must be remembered that commercial agreements are negotiated between a well-informed airport and one or more well-informed airlines, when the future is uncertain to all parties. It is critical that the conduct or outcomes of any Part VIIA inquiry do not allow airlines or regulators to cherry-pick activities or agreements to reassess with the benefit of hindsight. At any one time, it is likely that an airport will have several agreements performing better than expected and others performing less well. It would be inappropriate to intervene in the former (to some airlines' advantage) without also intervening in the latter (to other airlines' disadvantage).

For Sydney Airport, there is already an apparent asymmetry that has been potentially introduced by some of the ACCC's reasoning in its 2010 decision to object to Sydney Airport's proposal to increase regional charges by inflation. In part, the ACCC was minded to object to the regional charges because the ACCC thought that Sydney Airport might be earning excessive returns on its domestic and/or international charges^{5 6}. In effect, the ACCC was willing to subsidise the airport's inadequate profits on regional activities from what it suspected were excessive domestic and international profits. This offends economic efficiency.

It represents asymmetric truncation of the airport's return on the domestic and international activities – unless, as would seem unlikely, the ACCC were also willing for regional activities to subsidise any inadequate profits on the domestic and international activities. Whilst the Terms of Reference explicitly exclude the pricing of regional services at Sydney

⁵ “Therefore, if the charge for domestic users is taken into account in SACL's model, SACL is not under-recovering combined costs for the provision of terminal and check-in services and there is no justification for the increased charge for apron parking for regional air services”. ACCC Decision – Sydney Airport Corporation Limited's price notification for regional air services, p51.

⁶ The ACCC's claim of excessive returns was made despite the evidence within the monitoring reports that aeronautical returns had been far from excessive.

Airport, it is clearly inappropriate for the pricing of a notified service to take into consideration the outcomes of other activities that are subject to commercial agreements.

2.2.2 Confidentiality of the show cause process

As it is with all other regulatory show cause processes, the notice to show cause and the response should be confidential between the ACCC and the airport (and potentially the Minister). Confidentiality is appropriate because it allows the ACCC to test its concerns with the airport concerned without giving rise to a substantial risk that the general public will prematurely infer guilt. In the event that the ACCC is satisfied with the response, the airport will have been protected from unjustified criticism and damage to its reputation – and in the event that the ACCC is not satisfied, the resulting Part VIIA inquiry will be in the public domain.

Media reporting and public opinion has a direct impact on the airports' commercial businesses and the ACCC's media "escalation" is well documented in the Draft Report (p148-151). It would be unsatisfactory and unfair for airport businesses to be damaged in the absence of appropriate evidence. In this regard, it is worth highlighting that the ACCC reversed its position on Sydney Airport's car park prices in the 2009-10 report, and the Draft Report found no compelling evidence to support the ACCC's concerns in its monitoring reports. The reputational damage if these unsubstantiated concerns had given rise to a formal and public show cause order could have been considerable, without the airport having any legal recourse.

2.2.3 Initiation and conduct of a Part VIIA inquiry

The ACCC is the best-placed authority to recommend a Part VIIA inquiry through a show-cause notice, if such a new regulatory tier were introduced. It falls within their intended responsibilities, and they have available to them the detailed information provided to them for the preparation of the monitoring reports – as well as the analysis they perform in drafting their commentary.

However, the ACCC is not a suitable party to conduct the Part VIIA inquiry, principally because of the potential conflict of interest identified by the PC. It is the experience of Sydney Airport and of its directors⁷ that a significant minority of regulators appear ambitious to increase their responsibilities. Under these circumstances, Sydney Airport concurs that it would be a clear conflict of interest for the ACCC to have the power to both recommend and conduct a Part VIIA inquiry which could affect its future powers and responsibilities.

It is important that the authority conducting the Part VIIA inquiry not only be competent and independent, but that it also has the confidence of all industry participants. The deficiencies in the monitoring reports, which have been recognised in the Draft Report, have not inspired this level of confidence.

Both the Productivity Commission and the National Competition Council (NCC) also have the competence to conduct a Part VIIA inquiry. If the PC believed that its undertaking of a Part VIIA inquiry would undermine its perceived independence at any subsequent review of

⁷ Sydney Airport's directors have experience with the management and/or significant ownership of airports in Australia, New Zealand, Belgium, Denmark, England, Italy, Germany, Greece, Hungary and Albania.

the broader regulatory framework, then the NCC would remain a competent authority. This would create a desirable separation between the ongoing monitoring (ACCC), industry reviews (PC) and specific investigations into airport (NCC, whether under Part IVA or Part VIIA).

3. Enhancement to the pricing principles

Sydney Airport agrees that commercial negotiations should continue to be guided by the overarching pricing principles – and that any Part VIIA inquiry should be assessed against the pricing principles. Overall, Sydney Airport believes that the current pricing principles provide sufficient scope for genuine commercial negotiations, encourage innovation and productivity improvements, whilst requiring genuine negotiations and information sharing. Most importantly, the pricing principles consistently promote the interests of the industry overall, and place obligations for information sharing and good-faith commercial negotiations on both airports and airlines.

Any enhancement of the pricing principles needs to balance the increased guidance (and potential faster agreements) with the reduced scope for negotiation (and reduced flexibility to adapt to circumstances). There are a number of areas in which the principles could be expanded to provide more guidance, but it is not clear whether the principles would always be enhanced. For example:

- **‘Pre-funding’**: an explicit reference could be made to the effect that increases to charges immediately before or during major investment can be efficient. This comment might be unnecessary. A stronger comment that the airlines benefiting from the scarcity rents arising from capacity constraints prior to investment should result in higher charges reflecting those scarcity rents might promote major investments, but potentially limits the scope for commercial negotiations
- **Legal enforceability**: under the Head Lease the airlines have a guaranteed right of access. In addition, their passengers are the primary source of income for the airport, and an airport cannot prevent access for non-payment without damaging its own business. The principles could explicitly make it clear that airlines must continue to pay charges during a dispute

The PC has specifically requested information on whether the pricing principles could be modified to facilitate both information sharing on the efficient deployment of assets and negotiation of SLAs. Regarding the first, Sydney Airport believes it has very effective consultation processes to communicate the information on the efficiency of asset utilisation – a belief that is supported by Qantas’ first submission. To the extent that this process can be improved, the improvement is most likely to come from Sydney Airport better understanding any additional informational needs of the airlines. This bi-directional information exchange appears to be well-covered by aeronautical pricing principle c (i).

Regarding the negotiation of SLAs, it is apparent to Sydney Airport that there is a wide variety of expectations between and within airlines. Several different preferences for SLAs have been expressed at different times, ranging from SLAs which include substantial financial penalties (but at the cost of higher airport charges) to collaborative SLAs which focus on aligning expectations and improving service levels (and would be part of multi-lateral SLAs which also include government agencies).

The focus and emphasis of SLAs also needs to respond quickly to circumstances. For example, if a high priority issue has been resolved through investment the focus should be redirected to other areas.

Sydney Airport has already developed SLAs with several airlines and intends to further expand the SLAs. Given the differences between airports and airlines, there is no template for the right SLA. Instead, SLAs are best negotiated between each airline and each airport.

Nevertheless, Sydney Airport would welcome any processes that helped it meet the airlines' priorities. It is likely that any such process would include, as a first step, a clear understanding from each airline of its priorities. One option would be to reword Principle E to read:

“that service level outcomes for aeronautical services provided by the airport operators should be consistent with users reasonable expectations and the efficient costs included within the commercial negotiations. Assessment and delivery of the airlines reasonable expectations should be promoted through an open exchange of information on each airline's priorities and, where appropriate, the cost of providing the service”

Sydney Airport is unclear what benefit would be provided by a voluntary industry code. All of the airlines can and do discuss these issues directly with the airport during commercial negotiations. A 'one-size-fits-all' code is inconsistent with the joint objectives of the airports and the airlines to tailor agreements to the priorities of the airlines and the circumstances of the airport.

4. Refinements to the monitoring regime

The Draft Report proposes a continuation of the monitoring regime, with a number of improvements. These specific improvements primarily relate to the service quality monitoring, although the Draft Report questions whether there is additional financial information that could usefully be included in the monitoring.

Just as significantly, the Draft Report clearly identifies that:

“... the objective of the monitoring program is to serve as a 'look out', to draw attention to potential misuse of market power that may warrant further investigation, or the application of additional regulations over and above the existing light-handed regime.” Draft Report, page 133

Whilst Sydney Airport continues to believe that much of the monitoring is both unnecessary and has the potential to mislead the reader (as set out in section 7.2 of the airport's first submission), it supports many of the proposals in the Draft Report.

Sydney Airport believes that the general principles set out in page 244 of the Draft Report for the show cause process should also apply to the analysis within the monitoring reports. Specifically, in preparing the monitoring reports, the ACCC should only draw analytic conclusions that are:

- Robust
- Explicit and definitive
- Not based (or reliant) on any one year (or other specific time period)

- Concerned with consistent patterns of returns, benchmarked against a reasonably expected band of outcomes
- Have regard to price, investment, quality and market conditions

4.1 Service quality monitoring

The Draft Report identifies “significant reservations about the derivation and reporting of quality of service monitoring” (page xxxvii). The improvements to the service quality monitoring proposed in the Draft Report might be briefly summarised as:

- The objective criteria should be reviewed and updated
- Passenger surveys should be standardised, potentially using the ACI ASQ
- If an airport has adequate SLAs with all of its airlines, then airline surveys should not be required for that airport. In reaching this conclusion, the Draft Report notes that airlines “*may have incentives to ‘game’ the regulatory system by giving low scores for airport quality*” (page xxix)
- Government agencies should not be surveyed
- The ACCC methodology should be made as public as practically and legally possible
- The focus should be on time series trends, instead of comparisons between airports
- There should be a further review of monitoring in 2018
- When interpreting results, passenger surveys should be given at least as much weight as airline surveys or SLAs (implied from the discussion on page 147)

Sydney Airport supports these recommendations, which have the potential to resolve many of the concerns that it has had with the current monitoring regime, with the following comments:

- The objective criteria should be reviewed and updated periodically, in consultation with the airports. Objective criteria should be removed where there is a more comprehensive measure in the passenger surveys or where it is foreseeable that it will be misleading in the near future as a result of technological changes
- The ACI ASQ is the most cost-effective and robust of the standardised passenger surveys. For most airports, adoption of the ACI ASQ would reduce compliance costs
- The surveys and ACCC report should be conducted and published in line with the requirements of the Australian Standard for Market, Opinion and Social Research (AS: ISO 20252). Compliance with an accepted methodological standard will build stakeholder confidence in the process
- Sydney Airport continues to believe that publication of the coverage of, and performance under, service level agreements would better communicate the actual performance of airports relative to the airline priorities than does the current airline survey. Requiring airline surveys to continue until SLAs are in place with every airline is neither practical nor appropriate – a more reasonable threshold might be to require airline surveys to continue until SLAs are in place with at least half of the airlines and with airlines representing at least two-thirds of passengers (further comments below)
- When focusing on time series, the longest time series available should be used. The past focus on only 1-5 years has frequently raised false concerns that would have been avoided with a longer time series. Where the data is available, there is no reason not to commence the time series from the introduction of the light-handed regime

The cessation of airline surveys in the presence of sufficient and adequate SLAs reflects the recognition that individual SLAs will always more closely reflect each airline’s actual preferences than any standardised survey – and is also an effective incentive to negotiate

SLAs. In practise, the requirement that SLAs are required with every airline would undermine these purposes.

The aims of SLAs are manifold, including the alignment of expectations between the airport and individual airlines, improving service, and potentially incentivising the airport and airline to deliver the agreed service level objectives. Agreeing an SLA with these objectives necessarily follows extensive discussions on both parties' expectations and priorities. As a result, it is unlikely that an airport will have a satisfactory SLA with an airline that has recently commenced operating from the airport, since prior to commencement the airport and airline are both focussed on ensuring a successful operation.

In addition, in the presence of a requirement that an airport has agreements with every airline, the smaller airlines are provided with an opportunity to 'hold-up' the airport in the pursuit of particularly favourable terms – or simply to ensure that they continue to have the opportunity to use the airline surveys for regulatory gaming. The 'hold-up' power would be strengthened for those airlines which are also covered by the price notification regime for regional services.

The manner in which the airline surveys have been conducted and reported has damaged Sydney Airport's brand and represents an ongoing regulatory risk (albeit hopefully a significantly reduced risk if the recommendations of the Draft Report are implemented). Whilst the airport intends to progressively expand the existing SLAs and agree SLAs with more airlines, the prospect of removing this regulatory risk would be a strong incentive to give the SLAs a higher priority. This incentive is undermined if the airport does not believe it will ever achieve the minimum threshold.

4.2 Financial monitoring

The Draft Report proposes the continuation of the existing financial monitoring, largely unchanged, although it raises the question of whether additional financial information could assist the ACCC.

Sydney Airport believes that the monitoring report should include the average aeronautical return on capital employed (ROCE) since the introduction of the light-handed regime. This average ROCE should be the primary criteria on which any show-cause is assessed.

As presented in section 7.2 of the airport's first submission, the remainder of the financial reporting presents partial indicators that are captured in the ROCE. Whilst these partial indicators are not incorrect, they can be (and have been) easily misinterpreted. The proper role of the partial indicators is to help the ACCC understand what the causes are of any unusually high ROCE – if there is in fact an unusually high ROCE. For example, in the absence of an average ROCE that is outside the reasonably expected band of outcomes:

- A high ROCE for an individual year is potentially indicative of the airport being in a stage of the investment cycle where capacity is tight, or of the airport being towards the end of one or more large commercial agreements
- Price increases or increases in EBIT per passenger may indicate significant recent investment
- Increases in the EBTDA margin are likely to indicate productivity gains

Beyond the average ROCE, Sydney Airport doesn't believe that there is any additional 'standardised' information that would assist the ACCC. The ACCC already has comprehensive financial information – including interest expense. This information is sufficient to raise a concern, and it is likely that any additional information required to decide if a show cause is necessary is best gathered directly from the airport to reflect the specific circumstances.

4.3 Monitoring of car parking and landside access

The information included in the monitoring report, months after the fact, is continually published on Sydney Airport's website for the benefit of passengers before they travel. Hence, Sydney Airport sees no value in the ACCC continuing to report this information – except as an early warning to the Minister. Even in this regard, given the extensive media focus on car parking it is unlikely that an ACCC 'early warning' would be necessary or timely.

However, Sydney Airport has no objection to the secondary publishing of this information by the ACCC, provided that it is done holistically and non-selectively. For example, a true picture of car parking prices should incorporate all time bands (including any free periods), not just selected time bands, and should also include discounts available for internet booking, weekend rates or other special offers.

Sydney Airport is concerned, however, by the damage that can be done to its car parking business by the ACCC as a result of misleading or selective interpretation of this information. For example, despite both the ACCC's withdrawal of its claims in its 2009/10 monitoring report, and the Draft Report's conclusion that it found no evidence of excessive pricing in the car parks, the media continue to report the ACCC's claims on page 1 of its 2008/9 monitoring report that "*the indications are that car parking prices likely reflect an element of monopoly rent*". It is not credible to assume that the ACCC's repeated statements have no impact on passengers' choice where to park, or indeed on the responses to the passenger survey – particularly when the comments in the written report are escalated on breakfast radio.

4.4 Purpose of monitoring as an 'early warning'

The Draft Report noted Sydney Airport's proposal that the ACCC ought not make claims against the airports that it could not substantiate, responding that:

The Commission disagrees. As noted above, it considers the objective of the monitoring regime is to serve as an 'early warning' system to identify any potential misuse of market power that may warrant further examination. Therefore, the role of the monitoring regime is not analogous to a criminal court. As such it need not 'prove' offences beyond a reasonable doubt. Instead, all that is needed is a sound basis for concern that a misuse of market power may be present. Monitoring then serves as a trigger for a range of other processes, whose evidentiary burdens should increase in line with the consequences at stake (chapter 11). Draft Report, p. 151

Sydney Airport had not intended that its comments be interpreted in this fashion. It would, for example, be satisfied if the language of a monitoring report truly met the PC's test of "a sound basis for concern that a misuse of market power may be present". This would obviate the need for a 'show cause' mechanism. Past monitoring reports have not met this test, and

have not been focused on providing early warnings to the Minister. Instead, the primary effect has been to convict the airports in the media and in the broader general public.

To achieve the PC's test of "a sound basis for concern", any airport which is of concern to the ACCC should have the opportunity to present its evidence to the ACCC before the monitoring report is published. This would require that the airports be provided with a draft for comment of all of the relevant sections of the monitoring reports before they are published.

Given the purpose of the monitoring reports, and the corresponding threshold of evidence, it would seem clear that the audience for the monitoring reports is the Minister and not the general public. This is also consistent with the Draft Report's recommendation not to require service level monitoring in the airline-operated terminals – which would be of interest to the general public but not the purpose of providing an early warning. As noted in section 8 of its first submission, Sydney Airport proposes to publish relevant information on financial performance, car park prices, passenger service levels and airline SLAs.

Since the primary audience is the Minister, and the threshold of evidence has been set sufficiently low that significant damage can be done to an airport's business prior to a full investigation of the evidence, it would perhaps be more appropriate for only the Minister (and any cited airport) to receive any section(s) which include unsubstantiated suspicions or early warnings. The public would continue to see all of the factual information, as well as all of the analysis and conclusions supported by factual evidence.

5. Landside access

5.1 Integrated plan for transport in the Botany Region

The PC has in Sydney Airport's opinion correctly identified that, aside from potentially insufficient investment in road infrastructure, congestion of the roads to and around Sydney Airport appears to have arisen from three sources of policy failure:

- A failure to price roads to reflect the congestion costs associated with road use, which encourage car travel (particularly in the M5 corridor as a result of the Cashback)
- The pricing regime applying to users of the Airport Rail Link, which acts as a strong disincentive to access Sydney Airport by rail
- A failure to provide adequate government bus services to the airport (there is only one)

Sydney Airport notes that Infrastructure Australia (IA) has similarly identified a need to improve land transport access to Sydney Airport (and the adjacent Port Botany).

The effectiveness of the airport's operations needs to be complemented by good ground transport. The airport environs are also expected to see increased freight traffic as a result of increased container movements to and from Port Botany. An integrated plan for handling these key transport flows is urgently needed, not just for Sydney but for the country.⁸

Sydney Airport supports the preparation of such an integrated plan.

⁸ Infrastructure Australia: June 2011 report to the Council of Australian Governments (COAG), *Communicating the Imperative for Action*, page 49.

5.2 Airport Rail Link: an updated estimate on the effect of rail fares

With respect to the pricing regime applying to users of the Airport Rail Link, the Draft Report notes that, in 2010, Booz & Co. estimated that removal of the station access fee (currently \$11.80 per single adult ticket and \$18.00 per weekly adult ticket) would result in an initial uplift in patronage to the airport train stations of 26%. The PC suggests that given the initial uplift in rail patronage that occurred when the station access fee was removed for users of the Green Square and Mascot train stations, this estimate “may be considered conservative”.

Sydney Airport asked Booz & Co. to update its 2010 estimates, based on the experience at Green Square and Mascot. A copy of its updated report is attached to this submission. In summary, Booz & Co. forecast that:

- An additional 1.7 million rail journeys would be undertaken in the first year following removal of the station access fee. This equates to a 35% increase in rail patronage and is equivalent to 4,657 fewer road-based journeys each day
- An additional 4.1 million rail journeys would be undertaken in 2034/35, equivalent to 12,055 fewer road-based journeys each day

It is noted that the estimated patronage uplift at the two airport stations (35%) is lower than that observed at the two non-airport stations (50% attributed to the removal of the station access fee). Booz & Co. advise that this reflects differences between the two passenger transport markets. In particular, a proportion of the airport ground access passenger market is not contestable from an airport rail perspective in the sense that price signals are not as relevant to mode choice decisions. Nevertheless, achieving 4,657 additional rail journeys per day in the first year rising to an additional 12,055 additional rail journeys per day in 2034/35 represents a substantial mode shift from road-based travel options.

Sydney Airport will therefore continue to advocate to the NSW Government that the station access fee for users of the two airport stations be removed. It is clear that doing so would have an immediate and beneficial impact on rail patronage which, in turn, would help to alleviate road congestion on the road network around Sydney Airport and Port Botany.

5.3 Funding of land transport infrastructure

The Draft Report sought views on whether an airport should contribute to the cost of infrastructure outside its boundary as a result of future on-airport non-aeronautical development.

As noted in section 5.2 of its first submission, Sydney Airport does not believe that it should contribute to the cost of infrastructure beyond its boundary.

Sydney Airport is aware that the NSW Government has previously argued that if better land transport infrastructure and services are needed to accommodate growth in aviation activity at Sydney, the airport operator, as the ‘beneficiary’, should be contributing towards the cost of doing so. Sydney Airport has consistently rejected this view. Numerous other organisations besides Sydney Airport benefit from increased aviation activity at Sydney Airport, including airlines, freight companies, hire car companies, tourism operators, importers and exporters –

as well as the customers of these organisations. The NSW Government does not appear to expect these other organisations to make an ‘appropriate contribution’.

Most importantly, the primary economic beneficiary of air travel is the state itself – via increased tourism, trade and employment and the related revenues from GST, payroll taxes and other taxes. As noted in section 3.1 of Sydney Airport’s first submission:

- It was independently estimated that Sydney Airport contributed 120,000 full-time equivalent jobs (direct and indirect) in 2007
- It is estimated that these jobs would deliver payroll tax of \$250 million to the NSW Government in 2011-12

It is also clear that the entire community would benefit from less road congestion across the CBD-Green Square-Port Botany-Airport-M5 corridor.

It is because of these benefits that the NSW Government is, and should be, responsible for the road and rail infrastructure required to facilitate this benefit. The Draft Report confirms this responsibility in Table 12.2. Airport contributions to road and rail access would need to be appropriately recovered through road tolls and/or airline charges.

Despite the incidence of the benefits, Sydney Airport already provides and maintains a 4-6 lane road which is heavily used for non-airport traffic, for which it receives no compensation from the state government or local councils. In the absence of non-airport traffic, it is probable that this road would need fewer lanes along most or all of its length.

Even if the benefits to the state were not so substantial, it would be inappropriate now for the cost of road and rail provision to be transferred from the state governments to the airports. The shareholders of Sydney Airport (and other airports) included no allowance for subsidising state government or local council infrastructure in calculating the consideration paid to the Commonwealth Government at the time of privatisation. Hence, if it were considered appropriate for the states to receive assistance in funding road and rail access in the future, this assistance should be sought from the Commonwealth Government. It is noted that the Commonwealth is in fact already providing such assistance, as evidenced in Table 12.3 of the Draft Report.

Appendix A Setting the record straight

The Draft Report contains several references to Sydney Airport being singled out by the airlines, with the potential implication being that Sydney Airport's behaviour has differed significantly from other airports. Appropriately, the PC does not appear to have allowed its judgement on industry-wide regulation to be influenced by largely non-specific claims made in some submissions (or potentially in confidential submissions or private conversations).

The Draft Report's claims that Sydney Airport has been singled out don't always reflect the submissions. For example, the Draft Report's claim that the "Toll Group also reserved special criticism for Sydney Airport" (p 199) doesn't seem to be justified by the Toll Group submission, which does not focus on Sydney Airport any more than several other airports.

Whilst Sydney Airport has not been faultless, the majority of the airlines' claims are vague, unsubstantiated or excluded from the public versions of the submissions so that Sydney Airport cannot address these claims. Of the claims that can be tested, Sydney Airport has already demonstrated that most or all are false.

The airport is concerned that the existence of the airlines' claims in this review will be quoted as if they were factual evidence in a future review. This concern is, in part, founded in the reliance placed by the ACCC, IATA and BARA in their submissions on unsubstantiated claims made by the ACCC in their monitoring reports (made without providing Sydney Airport any opportunity to explain or respond) and unspecified claims made by BARA in the regulatory review in 2006. For example:

BARA made it clear to the Commission in its 2006 Inquiry that a failure to deal with SACL would undermine the credibility of the prices monitoring regime. As no action was taken at the time, it is clear SACL has assumed little probability of being held accountable for its poor commercial conduct. (sub. 19, p.4)

[IATA] Sydney airport has indeed increased profits by permitting service quality levels to fall below that which could be expected in a competitive environment over a sustained period. This fact appears under the key points of the ACCC's airport monitoring report 2009-10 which lead the government to bring forward a planned review of the current regulatory model. (sub. 9, p. 9)

[ACCC] The ACCC's monitoring program found indications that Sydney Airport has increased profits by permitting service-quality levels to fall over a sustained period of time (2002-03 to 2008-09). (sub. 3, p. 11)

As detailed in the airport's previous submissions, the verifiable evidence demonstrates that the airport's behaviour has been generally reasonable and constructive:

- Rates of return have been amongst the lowest of the airports, well within any reasonable band of outcomes, and reflect forecast assumptions made during negotiations that have proven to be overly generous to the airlines
- Prices have increased broadly in line with inflation
- Service levels, as measured by passengers (the only impartial respondents), have increased
- Qantas' first submission acknowledges that Sydney Airport has a good consultation process for new investment, and the best consultation process of the major airports

While the airlines and airline associations have made a large number of non-specific claims (such as those quoted above), the public submissions include very few examples that could be tested – and Sydney Airport’s previous submissions have demonstrated the invalidity of many of these.

It is Sydney Airport’s belief that at least some of the complaints arise from conflicting priorities between airlines and within airlines, and from a genuine misunderstanding by airlines and airline associations of airport economics. In particular, airlines appear to focus on airports’ passenger growth relative to the previous year and on the relative stability of airports’ EBITDA when compared to airlines profits. In the context of commercial agreements which incorporate traffic forecasts, and significant fixed assets and ongoing investment, the focus should be on airports’ traffic growth relative to expectations and airports’ profitability.

The focus on Sydney Airport is also natural, given the greater number of passengers and airlines at the airport, the more constrained site, and the higher average airport charges (which in large part are due to the higher proportion of international passengers and the higher land values arising from its location well within the Sydney metropolitan area). For example, all the issues raised by the Toll Group result from the constrained site.

Apron capacity and investment

One particular claim which is referred to more than once in the Draft Report is Qantas’ claim regarding aprons.

In February 2009, the Qantas Group advised the airport that it did not support the proposed deferral of the investment in new aprons. BARA also did not support the delay in the aprons ... Regardless of the airlines’ objections to the delay ... Sydney Airport deferred the investment. Now, almost two years later, and well after Australia has recovered from the effects of the GFC, the investment in aprons at Sydney airport still has not occurred to the level required. (sub. 52, p. 32)

It is true that Qantas and BARA opposed the deferral in February 2009. However, after further consultation (and further deepening of the impacts of the GFC) both Qantas and BARA agreed to the deferral in July 2009⁹. Sydney Airport has in fact continued to invest in aprons during and after the GFC, as shown in Table 1. Sydney Airport has or plans to invest over \$100 million in aprons over the period from 2010-15.

It is also not true that investment is below the level required – Sydney Airport continues to have sufficient aprons to accommodate the demand for aircraft parking, as shown in Chart 1. Chart 1 shows the analysis of the planned apron utilisation of Sydney Airport by Airport Coordination Australia (ACA)¹⁰. The ‘highest peak’ does not represent a single peak day, but rather the highest peak for that hour regardless of which day it occurs on. The chart

⁹ The outcome of the July 2009 workshop regarding capex deferrals was included as Table H6 within the confidential Appendix H of Sydney Airport’s first submission. Sydney Airport is willing to provide further supporting evidence of the outcomes of this workshop in confidence to the Productivity Commission if required.

¹⁰ ACA, which is an independent authority, is responsible for scheduling flights at Sydney Airport – taking into account the capacity of the airport including aprons.

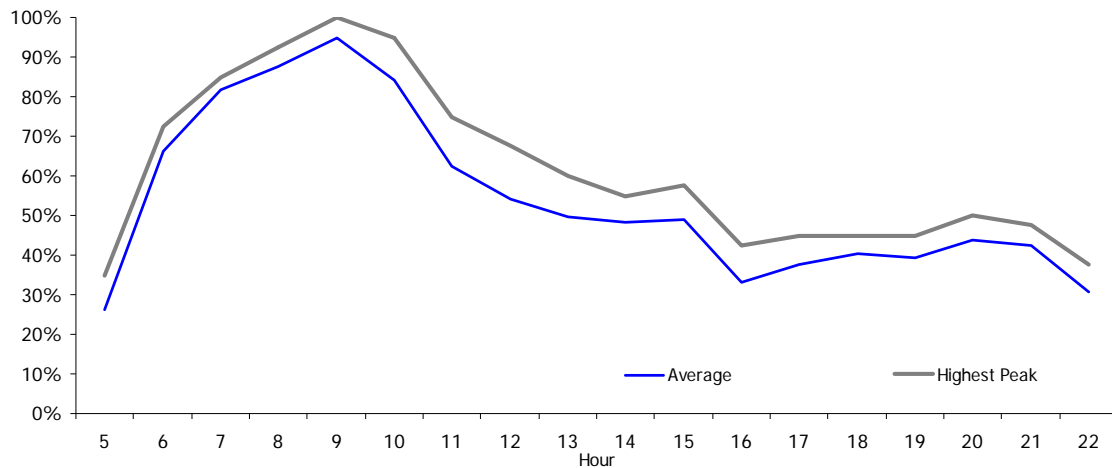
shows planned demand against capacity available for planning – an additional two aprons not included in the analysis are available for off-schedule aircraft movements.

Table 1 – Summary of Apron Works

Project Name	Project Start Date	Project Finish Date	Increase in Capacity Description
Completed Projects			
Bay 84/85 Northern pond upgrade	1-Oct-09	30-Apr-10	Convert Layover to Arrivals bay
T2 Foxtrot bays F4 and F5	1-Apr-10	30-Jun-10	Upgrade from small code C to large code C
T2 - Bay 39 & 40 - Temporary	1-Jan-11	31-Mar-11	Upgrade Code C to an E
Bay 100 (Dom 6 apron)	1-Jan-11	31-Dec-11	New Code E stand off
Current works in Progress			
Bay 83 Northern Ponds Apron - Arrivals Bay	1-Apr-11	31-Dec-12	New Code E Arrivals
Apron Development linked to T2 Pier A expansion	1-Jan-11	31-Dec-12	5 New Code C Positions
Qantas Jetbase - A380 upgrades*	1-Jan-12	31-Dec-12	Upgrade from 2 code E to 2 code F
Bay 1A	1-Jan-11	31-Dec-13	New Code E Full Service Bay
Future planned works and open for consultation			
Bay 8/37	1-Jan-13	31-Dec-13	Upgrade to Code F
Bay 76/77 Layover	1-Jan-13	31-Dec-13	2 New Code E
T2 - Foxtrot bay 6	1-Jan-13	31-Dec-13	Upgrade from small code C to large code C
Bay 86 Northern Ponds Apron	1-Jul-12	30-Jun-14	New Code E
Bay 76/77 Arrivals	1-Jan-14	31-Dec-14	Convert Layover to Arrival
T2 - Bay 39 - Permanent	1-Jan-14	31-Dec-14	Upgrade of Code C and E
Upgrade of Bay 37 to Code F Capacity	1-Jan-15	31-Dec-15	Upgrade of Code E to an F

*Subject to commercial agreement. The investment may be made by Qantas or Sydney Airport.

Chart 1 – International Apron Utilisation



Appendix B – Response to the Draft Recommendations and information requests

Draft Recommendation (abbreviated)	Response
<p>11.1 The ACCC, on publication of its monitoring reports, should be empowered to issue a direction that an airport has six weeks to show cause why its conduct should not be subject to scrutiny under a Part VIIA price inquiry.</p>	<p>This recommendation is discussed in section 2.</p>
<p>11.2 Assessments of airport behaviour during the next period of price monitoring should continue to be governed by an overarching set of principles. All the current ‘Pricing Principles’ should be retained.</p>	<p>Sydney Airport agrees with the benefits of an overarching set of principles. Specific suggestions on improvements are discussed in section 3.</p>
<p>11.3 An airport-specific arbitration regime activated by deemed declarations of airports under Part IIIA should not be introduced. Similarly, mandatory codes of conduct and mandatory guidelines to specify matters, such as the allocation of costs to aeronautical and non-aeronautical purposes and building block parameters, should not be introduced.</p>	<p>Sydney Airport agrees there is no need for airport-specific arbitration or mandatory codes of conduct.</p>
<p>11.4 There should be a further period of price monitoring until June 2020 and be subject to a review in June 2018.</p>	<p>Whilst Sydney Airport sees no need for a further scheduled review, a seven year period prior to the next review is an improvement on five years.</p>
<p>11.5 Quality of service monitoring should continue to apply to the price monitored airports until June 2020. However, specific improvements are warranted.</p>	<p>Sydney Airport agrees that there is value in service monitoring. Specific suggestions on improvements are discussed in section 4.</p>
<p>11.6 In administering the monitoring regime, the Australian Competition and Consumer Commission should:</p> <ul style="list-style-type: none"> - take steps to make as much of its methodology publicly available as possible (subject to a review of statutory requirements) - focus its conclusions on trends over time at a given airport, rather than comparisons across the five monitored airports. 	<p>Sydney Airport generally agrees with these recommendations and recommends that the methodology should comply with the relevant Australian Standard (AS: ISO 20252). Further comment is included in section 4.</p>

Draft Recommendation (abbreviated)	Response
<p>11.7 The ACCC should continue to monitor and publish information relating to car parking and ground transport.</p>	<p>Sydney Airport sees no value in the ACCC monitoring selective information (almost a year after the fact) which is published on Sydney Airport’s website in advance of passengers (and other users) decisions. However Sydney Airport has no objection to the monitoring and re-publishing of this information by the ACCC, providing that a holistic and non-selective approach is taken.</p> <p>As discussed further in section 4, Sydney Airport has concerns about the potential for the ACCC to damage Sydney Airport by misinterpreting or selectively quoting this information.</p>
<p>11.8 Mandatory Part IIIA access undertakings setting out prices, terms and conditions for surface transport operators to access airports should not be introduced. The price monitored airports should be required, however, to publish on their websites the general prices and terms and conditions of access for transport operators.</p>	<p>Sydney Airport agrees that mandatory Part IIIA undertakings are both unnecessary and unworkable in practise.</p> <p>Sydney Airport will continue to publish on its website the general prices and terms and conditions for transport operators.</p>
<p>12.1 The recent changes to master plan requirements and the introduction of the consultative forums should be allowed to take their course before other policy options are considered. The efficacy of these measures should be reviewed in 2015.</p>	<p>Sydney Airport agrees that it is appropriate to assess the recently changed arrangements after a few years.</p>

Information Request	Response
<p>The Commission requests additional information on whether an airport’s ability to earn non-aeronautical revenue provides an incentive to constrain aeronautical charges, and if so, to what extent this currently occurs.</p>	<p>Aeronautical charges are naturally constrained as a result of non-aeronautical activities sharing the cost of shared facilities that would otherwise be fully-funded by aeronautical activities.</p> <p>In addition, airports regularly incentivise the growth of new markets, or significant expansion of existing markets, in order to promote short and long term non-aeronautical profitability.</p>

Information Request	Response
<p>The Commission seeks participants' views on the appropriateness of including capital costs, such as the cost of borrowing, in the ACCC's price monitoring program. Are there reliable measures that can be collected with relatively low compliance costs? If so, which is the best measure?</p>	<p>The ACCC already receives information on interest expense, which is included within its financial monitoring. This is of limited value, however, because there is little value in including only one component of the cost of capital. Instead, the focus should be on the aeronautical return on assets (EBIT / assets). This is discussed further in section 4.</p>
<p>The Commission seeks more information on the nature of the off-airport parking market, particularly in Perth and Adelaide.</p>	<p>Sydney Airport's first submission, and the NERA car parking report attached, provides comprehensive information on off-airport parking.</p>
<p>The Commission seeks comment on whether the ACCC should be responsible for both issuing show cause directions and conducting any subsequent Part VIIA inquiry.</p>	<p>Sydney Airport does not believe the ACCC should be responsible for both, and specifically should not be responsible for conducting any inquiry. This is discussed further in section 2.</p>
<p>The Commission is seeking information on whether guidelines on matters that could improve commercial negotiation — such as information on whether existing assets are being deployed efficiently prior to new investment and processes to facilitate effective service level agreements — should be:</p> <ul style="list-style-type: none"> - devised by the Productivity Commission and incorporated into the Pricing Principles, or - encapsulated within a new voluntary industry code — a committee comprising representatives from the Australian Airports Association, the Board of Airline Representatives of Australia, the Regional Aviation Association of Australia, Qantas, and Virgin Australia (and possibly with guidance from the Australian Competition and Consumer Commission) could be tasked with this. 	<p>Specific suggestions for improvements to the Pricing Principles are discussed in section 3.</p>

Information Request	Response
<p>The Commission is seeking information on whether there are additional readily accessible financial or other data that would assist the Australian Competition and Consumer Commission to determine if a ‘show cause’ direction was warranted.</p>	<p>Sydney Airport doesn’t believe that there is any additional ‘standardised’ information that would assist the ACCC, other than a calculation of the average return on assets from the commencement of light-handed regulation.</p> <p>As discussed in section 4, Sydney Airport believes the ACCC has the necessary financial information – in particular the return on assets – in order to raise a concern, and that any additional information required to decide if a show cause is necessary is likely to be best gathered directly from the airport to reflect the specific circumstances.</p>
<p>The Commission seeks participants’ view on the potential means to standardise passenger survey methodology, such as the use of ACI Airports Service Quality information, without incurring substantial increases in compliance costs.</p>	<p>Sydney Airport continues to believe that the ACI ASQ is the best existing standardised survey methodology, and is compliant with AS:ISO 20252, as set out in its first submission.</p>
<p>The Commission invites participants’ views on its proposals in relation to airline surveys and service level agreements. In particular, would annual publication of the coverage of, and performance under, service level agreements improve regulatory outcomes?</p>	<p>Sydney Airport continues to believe that publication of the coverage of, and performance under, service level agreements would better communicate the actual performance of airports relative to the different airline priorities than does the current airline survey, which is also subject to regulatory gaming by airlines.</p>
<p>The Commission is seeking views about the adequacy of communication between airports and the tiers of governments in relation to the provision of information such as estimated traffic volumes, travel time projections and other key performance indicators relevant to current and future efficiency of access to airports.</p>	<p>Sydney Airport believes that communication can always be improved, which will in part be supported by the new master plan and consultation arrangements. In particular, the Sydney Airport’s Planning Coordination Forum was established in 2010 and has met twice. It allows for a high level interaction between Sydney Airport and relevant NSW Government agencies.</p>

Information Request	Response
<p>The Commission seeks views on whether an airport should contribute to the cost of infrastructure outside its boundary as a result of future on-airport non-aeronautical development.</p> <p>If funding is viewed as necessary, the Commission also requests information regarding:</p> <ul style="list-style-type: none"> - the basis for funding such infrastructure including the benefits - the form of funding (such as upfront financial contributions, rate payments or land transfers) - the method of calculating contributions and how the contributions would relate to existing developer charges levied by local governments - how such funding would align with the conditions under which airport leases were granted 	<p>Sydney Airport does not believe it should contribute to the cost of infrastructure beyond its boundary:</p> <ul style="list-style-type: none"> - The primary economic beneficiary of air travel is the state (eg via GST and payroll taxes), and the state should be responsible for non-airport infrastructure required to facilitate this benefit - Sydney Airport already provides and maintains a 4-6 lane road which is heavily used for non-airport traffic, for which it receives no subsidy from the state government or local councils - The shareholders of Sydney Airport included no allowance for subsidising state government or local council infrastructure in calculating the consideration paid to the Commonwealth Government at the time of privatisation <p>This is discussed further in section 5.</p>
<p>The Commission seeks information on the potential costs and benefits of extending the Pricing Principles to regional airports. How might the principles be applied, and is the problem of sufficient magnitude to warrant any potential enforcement mechanisms?</p>	<p>Sydney Airport does not have direct knowledge of the experiences of regional airports or the airlines which fly to them, and will not speculate on the costs or benefits. Sydney Airport's first submission incorporated an Ernst & Young report on aeronautical fees for regional services.</p>