



**TRANSCRIPT
OF PROCEEDINGS**

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PRODUCTIVITY COMMISSION

INQUIRY INTO PRICE REGULATION OF AIRPORT SERVICES

**PROF R.H. SNAPE, Deputy Chairman
DR N. BYRON, Commissioner**

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON TUESDAY, 3 APRIL 2001, AT 9.05 AM

Continued from 2/4/01

PROF SNAPE: Welcome to this, the third day of the public hearings, the second day in Melbourne, of the inquiry into prices regulation of airports, conducted by the Productivity Commission. I'm Richard Snape, and on my right is Dr Neil Byron. There are staff members present who will be pleased to give advice on procedures, et cetera, should it be required. The terms of the inquiry are specified in the terms of reference sent to the commission late in December last year by the assistant treasurer. The commission has circulated an issues paper that sets out what we perceived to be major issues. Copies of the terms of reference and of the issues paper are available just outside the entrance to this room. We anticipate issuing a draft report in August, while the final report is due with the government in December. We plan to hold a second round of hearings after the draft report has been digested.

The purpose of this inquiry is to examine whether new regulatory arrangements targeted at those charged for airport services or products, where the airport operator has been identified as having the most potential to abuse market power - whether new regulatory arrangements are needed there to ensure that the exercise of any such power may be appropriately counteracted. The commission is to report on whether there is a need for prices regulation of airports and, if so, the appropriate form of any prices regulation, taking into account a number of principles that are set out in the terms of reference.

The public hearings provide the opportunity for interested parties to make oral presentations. Generally this is in the form of speaking to written submissions, these being available on the commission's Web site, as well as in hard copy. Hearings also provide an opportunity for the commission to seek clarifications and to pursue with participants matters of interest to the commission. Transcripts of the hearings are sent to the relevant participants to check for accuracy of reporting. They are normally available on the commission's Web site within a few days of the hearing. At the end of the scheduled hearings for today I shall invite any persons present to make unscheduled presentations should they wish to do so.

First up this morning we have Australia Pacific Airports Melbourne. We welcome them and we would ask the three representatives to identify themselves separately for the purposes of the transcribers and to speak to their presentation.

MR BARLOW: Good morning. Thank you. I'll introduce myself first. My name is Chris Barlow. I am the Chief Executive Officer of Australia Pacific Airports Corporation, and I'll ask Warren on my left to introduce himself.

DR MUNDY: Dr Warren Mundy, Manager, Strategy, Australia Pacific Airports Corporation.

MR TOMS: Michael Toms. I'm Strategy and Regulation director of BAA PLC.

PROF SNAPE: Thank you very much. So who is to speak to the submission?

MR BARLOW: I'll start off, thank you, if that's all right, Prof Snape. The two experts either side of me will go into some detail on our submission if you should wish afterwards, but I'm just the very simple airport manager and I want to portray the story of Melbourne Airport, principally, although APAC does, of course, as you know, operate Launceston Airport in Tasmania. We would like to take around about 20 minutes to sort of set the scene for you.

Can I start by just reminding you who APAC is. 50 per cent is AMP, 25 per cent Deutsche Asset Management, 15 per cent BAA and 10 per cent Hastings Fund Management. I should start by saying that I think the privatisation exercise in Australia has been extremely successful, as of course it should have been, because they learned from all the mistakes and the good points made by other airports throughout the world. We think, however, it can be improved marginally round the edges, and that will form part of our submission this morning and of course our written submission.

I run a company which is a commercial business. It just happens to be an airport and an airport is a platform from which airlines can ply their business and be competitive and provide good services and competitive services for the people of Australia and people flying into Australia. The philosophy that we run our company on is that we would like to make profit but we want to make profit through quality and through growth.

As I said, I'm talking principally about Melbourne this morning. Other airports have operated in slightly different ways, and you will obviously take your own view about how they operate, but I think it's fair to say that Melbourne has a good track record in working with our customers. We have good relationships with the airlines. Don't take my word for it. I know you're seeing other airlines. Ask them. The success I think has been translated into hard facts. Before privatisation traffic at Melbourne was 2.4 million; it's now 3.4 million. That's 46 per cent up in that period, and that includes of course the "Asian crisis".

This year to date our international traffic is up by over 14 per cent, and I don't think that's coincidence. We work very hard with our customers, the airlines, and with the state and with all our other stakeholders in Australia, and that hard work has been translated into those particularly international figures rising I think higher than any other airport in the region. We've not only been successful in passengers but in cargo facilities. They are improving. Just recently both Menzies and DHL have opened new facilities at Melbourne and are trading successfully.

One of the good examples I think of how we perform is our new domestic express terminal which we built for the new low-cost airlines. That is a relatively low-cost facility but a very high quality facility that was built exactly to our customers' needs and is operating very successfully, and I think you, commissioners, have already seen that facility and I hope you agree it's very successful.

Sticking with quality, the Business Traveller magazine ran a survey a while ago of airports throughout the whole world and we were delighted that Melbourne Airport came fourth in that study. We were pipped at the post by Singapore, Hong Kong and Schiphol. None of those airports of course are privatised. They all rely on a significant amount of funds coming in from the government. But I think, very importantly, not only were we fourth in the whole world, but if you look at the charges that the airports in the top 10 apply to the airlines, Melbourne is significantly - significantly - lower than those others, and certainly the first three are way above the charges that are applied at Melbourne. So I think what that means is that we provide a high quality service at a reasonable and low cost at the moment.

We also conduct regular what we call quality service monitor surveys, on a very regular basis, and we achieve consistently high scores in that area. One of those questions that we ask our customers is how does Melbourne compare to other airports throughout the world that you fly into, and those statistics are available if you want to have a look at them, and consistently we are scored by our customers as being their favourite airport, and other airports don't compare as favourably. So we think our customers, both in the airlines and in passengers, actually like us.

Can I now turn briefly to market power and airports' market power. A lot of our activities are competitive and they are not the monopoly - carparking for instance: you can park on airport or off airport. You don't need to use your car to get to the airport. You can go by taxis or buses. Car hire is available on airport and off airport very easily. Shops, and particularly duty-free shops, are available at both ends of a passenger's journey, so we are competing with other airports directly in that region.

I would like to touch on airline power as well. I think it's fair to say that certainly our larger customers have a large degree of power in the market and their power profile is high, and this power gives them the ability to resist any unacceptable move by ourselves or any other airports. Michael can talk to you in more detail about examples of this throughout the world, and I think it will be interesting, but I think it's fair to say that certainly the larger carriers, particularly in this country, have the ear of politicians and therefore have significant power over and above that which I enjoy at an airport.

Can I now turn to how we would like to see the successful privatisation improved. I spoke earlier on about satisfying our customers' needs. The airport and airline industry is a rapidly changing industry, and we need to respond flexibly and quickly to those changing requirements of the customers. The present system, as our submission talks about, is bureaucratic and very time-wasting. Some of the airlines play the game against us, and that in turn puts more bureaucracy and more time into our ability to get particularly new construction under way. That of course is one airline trying to oppose another airline because of the market forces and because of their need to keep ahead of their competition.

That's all lovely motherhood statements but can I actually put some examples in front of you and turn again to our domestic express terminal. Our board looked at the needs of the low-cost carriers and agreed that a new facility was needed. As everyone is aware, the new low-cost carriers are unable or unwilling to use the existing domestic terminals which are owned and operated by the two major airlines in the country. The governments, both state and federal, were supporting the need for low-cost carriers to have access to airports, and so our board approved the project and went ahead full speed to meet our customers' needs. We did that at full speed, knowing that in parallel we had to apply to the ACCC to get our NNI approvals, which we did.

Those approvals came back, which were totally unacceptable to our board, and at one stage the project was in grave danger of being cancelled. We actually had to go out and achieve further agreements with our customers. One customer in particular, Impulse, was strongly supportive of us all the time in this exercise, and having got a more detailed agreement with the airlines we were then able to persuade the ACCC that the agreement that we had in our original request was correct and the ACCC then changed their draft decision in light of that agreement we had with our customers.

I have to say that if that process was ever repeated - and it is likely to be repeated, because that facility is so successful - we will probably need to be expanding it in the near future. Our board will not - will not - go ahead on that time scale ever again. They will not put their funds and the company at so much risk. The process as it stands now will therefore introduce a six to nine-month delay in meeting our customers' needs, and that's not the way we want to run business. If we had taken that more rational approach, 300,000 passengers from Victoria would not have had the benefit of using that facility and the benefits of low-cost travel through Victoria in the last six months.

So we think whilst privatisation has been hugely successful, we think it can be improved by dropping that type of regulation and allowing us to continue with our track record of meeting our customers' needs and working with our customers. Let us trade with the airlines, let us agree what we want to jointly achieve, but let us get on with our work. There is substantial existing legislation which gives the airlines plenty of power to stop us in our tracks if we are abusing our position, and we believe that working with our customers and trading with our customers is a way to run a business. As I said earlier on, the airport is simply a business. Before wrapping up, I'd just like to briefly hand over to Warren to say a few words, and then Mike.

DR MUNDY: Thanks, Chris. I just want to make four brief comments essentially in relation to some developments that have occurred since we lodged our submission. The first is: in our submission we indicated that a separate submission would be coming from Launceston Airport. That will be coming to the commission in due course. It will be brief. It will not raise any new issues of economic principle, but

rather will just address the issues that airports in that market in particular find themselves, and I think it's probably fair to say that, if you like, the small airport problem that's been identified by airports such as Townsville and Hobart and, to a lesser extent, I suppose even Adelaide - the general comments and thrusts of those submissions are something which we generally associate ourselves with.

The second point I want to make is that we have had a chance to very briefly review the commission's reports on the national access regime and Part IIIA in the Prices Surveillance Act. I think it's probably fair to say, as both commissioners have been involved in that inquiry, one way or another, it will come as no surprise that we generally support the thrust that the commission is going down in relation to those matters, but we will make a more detailed submission on both those matters once we've had a chance to review them fully.

PROF SNAPE: And you will also have a look at the telecoms one?

DR MUNDY: Yes.

PROF SNAPE: Because there are some relevant things in that as well.

DR MUNDY: Yes, I will. I've avoided telecoms because it's all a bit too hard for me.

PROF SNAPE: It's too hard for me, too, but unfortunately I had to do it.

DR MUNDY: Telecoms are something that are very, very hard. Just on the question of national access regime, it may interest the commission that we have been served or advised by the ACCC that Virgin has sought under section 192 of the Airports Act to have the domestic express terminal declared for the purposes of Part IIIA, that being the substitute set of arrangements in the Airports Act to the general declaration provisions in IIIA, and we will be proceeding to make a submission to the ACCC in relation to that application for declaration, and I think we will highlight in a very practical way some of the issues particularly about significance, about efficiency, that the commission is raising, putting the question in relation to its inquiry to the national access regime.

PROF SNAPE: You said the domestic express terminal.

DR MUNDY: That's right, yes. The fourth thing I would just like to say again, in relation to access issues, is that in chapter 6 of our submission we briefly touched on what may be, if the commission wasn't swayed by the efficacy of our arguments for the discontinuation of regulation in its entirety, a way of going forward in terms of some form of an undertaking, a pricing undertaking. We note that in the submission from Sydney Airport there has been a bit more work done in how such a structure might look, and the general thrust of that approach that has been developed, I think, would be generally consistent with what we had in mind, but just didn't perhaps

develop as fully as we may, sort of going forward, in relation to that issue. So I just wanted to let you know that the suggestions by Sydney would seem, at least on first inspection, to be a consistent development of those propositions which we very briefly alluded to in chapter 6 of our submission.

PROF SNAPE: You may in fact choose to develop them even further. Is that what you're saying?

DR MUNDY: In all likelihood we will make some further submissions in relation to that matter in the fullness of time, yes.

MR BARLOW: Mike, would you like to say something?

MR TOMS: I'm embarrassed to confess that I have been involved in airport regulations since 1984, when I started working on the BAA privatisation. Since then I've been involved continuously in the subject, both as BAA's chief economist and on secondment as the chief economist to the Airports Council International - ACI - in Geneva. Just spending a second looking back, when airports were first privatised I think it's the general message that the regulatory framework was built around two main objectives. The first was squeezing our cost efficiencies, and the second was protecting airlines against overcharging by airports. That gave rise to a standard model: the CPI-X model, based on a return on capital equivalent to the cost of capital.

I have to say, looking back from a general industry perspective, it was very effective in the short-run. It did squeeze out efficiencies and it did protect airlines. Charges were pushed down. But I think as I look around my fellow airports, it's clear that it's now starting to create its own problems and the agenda is moving on. Priorities are changing and they're changing as a result of our experience and our learning in four significant areas. The first is that it's gradually becoming evident that the single dimension focus on short-term charges reductions benefiting existing airlines is becoming in danger of creating a spiral of low prices leading to low capacity, leading to low scope for competition between airlines using airports.

Secondly, it's becoming increasingly evident that airlines have been able to look after their own interests and match the power of airports across the negotiating table with or without regulation. If I can characterise that very briefly, in our first consultation with airlines following privatisation, I found myself sitting across the room facing 40 airline representatives, including a large contingent from the United States with general counsel and note-taking counsel, for a commercial discussion. On going home in the evening I found that our threat to raise charges by 3 per cent was the second item on the news bulletin put in by the airline group, and that I had been characterised not as BAA's chief economist, but as its chief extortionist. So you get a sense there of the pressure.

The third dimension, I think, is that there has been an increasing questioning

of the benefits of monopoly regulation in principle as against its costs. We've commissioned work by Prof Dennis Carlton at the Chicago school showing the benefits of deregulation of, for instance, the US rail industry, and cable TV where even natural monopolies have shown benefits in terms of social welfare from deregulation.

Finally, the importance of airport investment to meet demand, and the benefits of the competition between users that that creates, between airlines that that can create, has become more pressing, has become more evident. This very substantial shift in the agenda has crystallised into a couple of major policy areas which I think are directly relevant to your considerations today. The first is within the CPI-X framework. It's clear that the single till is losing its currency. It was often portrayed as being universal. It never was. Seven out of 10 of the top US airports didn't operate a single till over the last 20 years.

It is now being challenged in South Africa, it is being challenged in Europe, Frankfurt, Amsterdam and at Zurich. The UK regulator has put out an issues paper on it and he's clearly very concerned about the structural underpricing it can lead to. ICAO, the International Civil Aviation Organisation, after an extended debate of 5 or 6 hundred people, has issued new guidelines which clearly show much less commitment to the single till and that airports and airlines have now interpreted those guidelines to give far less prominence to the use of commercial revenues. But that's within the CPI-X framework.

I think it's fair to say that the overall framework is now being questioned as well. People are looking at the lessons of Scotland, the three airports owned by BAA in Scotland, which have been self or co-regulated since BAA's privatisation. The regulator has been well hidden from the negotiating table since 1987. The consequence has been that prices in Scotland are a little higher than they are in our London airports.

If we were able to measure them on a regulatory basis, profits would probably be a little higher, returns would probably be a little higher in Scotland, but what you have seen is rapid, energetic, unfettered investment in the two main Scottish airports. Glasgow has been substantially remodelled, and as soon as we downed tools on Glasgow, having spent about 60 million pounds, we started on Edinburgh and we have now just completed the remodelling of Edinburgh. Together with that in Scotland you've seen product innovation and differentiation at the request of users and, very interestingly, you've seen much less gaming across the table, because the regulator has not been there to listen.

I think now you see this thinking developing in other countries. You may be aware that in Copenhagen the Danish government has announced an experimental lifting of the price cap for two years and has told the airport and the airlines to get on with it. The CAA in the UK is now looking for other alternative, more creative and efficient ways of regulating BAA. We certainly need these two approaches.

If I can tie this all up by one analogy at the end, I look at the UK rail industry - a perfectly regulated industry; a regulator, a highly experienced lawyer with an enforcement culture; detailed service quality regulation; a book full of service quality measures, penalties and rewards for each, each creating its own distortions; a very carefully calculated CPI-X formula designed to achieve the measured return on capital equivalent to the cost of capital, therefore providing relatively little to invest - I guess I don't need to describe to you the consequences. It's a perfectly regulated industry which is in crisis with one exception. One railway in the UK is exempt from regulation. It's outside the rail regulatory system. It has had £500 million worth of investment - - -

PROF SNAPE: Which is that one?

MR TOMS: I was going to come to that at the very end, if I may.

PROF SNAPE: Certainly.

MR TOMS: It has, I think, the highest punctuality record in the whole UK network and the highest reliability record. It has certainly the highest public perception record. It's not the cheapest, but it's certainly the best, and it's the Heathrow Express Rail Link. I think that's a little model of what happens in an unregulated, or deregulated, environment, compared with what happens under tight regulation.

MR BARLOW: Mike, thank you. Can I just briefly summarise and wrap up.

PROF SNAPE: Yes.

MR BARLOW: For anyone that doesn't realise why Mike is here today, one of the benefits of the organisation that we have in APAC is that we have unfettered access to the whole of the expertise within BAA, and of course BAA runs around about 16 or so airports worldwide and Mike's and his colleagues' expertise is of huge importance. There was some benefit to us when we have been preparing our case. Just picking up on one of the things that Mike said, I guess if we're saying that we don't want regulation, how can we actually demonstrate that we're going to behave ourselves? I can. I actually ran one of those Scottish airports and so I've actually practised what I'm preaching here today.

So really, in summary, privatisation has been excellent - some really good results coming through. We think it can be better by some changes. What we need is an incentive solution to grow air travel in Australia. I think at Melbourne we've proved that we behave. We look after our customers. I think our submission, and Mike's comments and examples throughout the world, do prove that airlines have power, as of course they should, and we would like to be given a chance to run our business without regulations. We think it's a low-risk trial, if you consider that aspect, and if we get it wrong then there are adequate powers to bring us back into

line. So our suggestion is to relax regulation, let us get on with dealing with our customers and let's continue to improve the air transport industry in Australia even more than it is now. Thank you.

PROF SNAPE: Thank you very much for your interesting and detailed submission, as well as for that very interesting presentation. I suppose one of the problems with trying to compare the regulated environment with the unregulated environment is that there is, in a sense, no really unregulated environment. In the case of the Scottish airports, as Prof Forsyth was pointing out yesterday, there's always the regulator in the background who would come in if in fact there was perceived to be misbehaviour.

Copenhagen, as you pointed out, was a two-year experiment, and clearly it's, "Behave, or else you will be regulated again," so can we really get a comparison with an unregulated environment? I mean, one answer might be, of course, to say that even in Australia there would always be Part IIIA in the Trade Practices Act unless there was exclusion, and the threat of reregulation, but can one get a valid comparison with an unregulated environment?

MR BARLOW: Can I just pick up one point before I probably hand over to my two experts on this. I think you've picked up a very important point, which I think we recognise and is part of our submission. We believe that our customers do always have a fall back if we ever misbehave, but the important thing is to be able to get on with our business, albeit we know that threat is there, but at least we won't have the time imposition which will stop us responding to our customers' needs. Now, your specific question about is there another model throughout the world - Mike, do you want to take that one?

MR TOMS: Perhaps I can just return to the Scottish airports first and say I think Prof Forsyth's notion, as I understood it, was that Scottish airports were really like the south-east airports, because everyone knew that if they were regulated the same rules would apply, therefore they conducted themselves as if they were regulated. I don't think that is actually true - - -

PROF SNAPE: Or at least that they were on a short leash.

MR TOMS: Yes, the - - -

PROF SNAPE: They're not precisely the same, but there was always the threat of coming back in, I think.

MR TOMS: I think one could overstate how short that leash is. The regulator is in the deep background in Scotland. There's a tradition there of the airport doing business with its customers and, as a person who goes there every year and does these negotiations, everyone doesn't play, everyone doesn't game with the regulator, because both sides need to come to a deal. So I think it's actually quite a fair

reflection of an environment in which the regulator is very much in the distance.

Another analogy which might be worth considering is the analogy of our airports before privatisation, when they were effectively unregulated institutions. There was no regulatory framework in the UK. There was no requirement for BAA to apply to government for consent for its charges, we simply charged. In the five years before we were privatised, despite the fact that we were not paying a dividend and that our returns on capital were considerably below the cost of capital, we found it extremely difficult to extract any price increases from our airlines, not because of threat of regulation but actually because of threat of litigation and threat of corporate reputation or damage. So that gives you a pretty good feel of how balanced the environment was then. I think in five years we took one price increase of 1 per cent, and that was in a period where UK price inflation was about 5 per cent a year. So my guess is that if you ask me what an unregulated environment would be like, it would still be a very tough negotiating environment.

MR BARLOW: Just to add a bit of flesh to those bones, speaking from personal experience, when I was running one of those Scottish airports - Mike is exactly right - we were dealing with our customers and we had to make sure our customers were happy because those airports were not large, and the market there we had to fight very hard to get, and we wanted to keep it. So the reality was, absolutely we behaved ourselves. Absolutely we knew that regulation was a possibility in the background, but it never really came into our discussions and our thoughts when we were negotiating with our customers. Warren, do you want to add something?

DR MUNDY: It's an interesting question in a broader industry policy sense about the potential for regulation. It's fairly easy to cast your eye around the Australian economy as a whole and find a whole pile of industries which would be reasonably characterised as oligopoly. The banking industry is one, for example, where the threat of regulation does actually manage conduct, but the difference between something like IIIA or Part IV and what we have in airport regulation now is that they are, in a sense, devices that deal with a market power incident or a market power act, whereas the arrangements that we have now work on an assumption that market power will be abused, that we need to have the regulator in there today making sure that certain things don't happen.

Now certain things may or may not happen but there are consequences of that and significant costs associated with it, so I think it's a different analogy that arises from a device that says, "Market power will be abused and therefore we're going to do, A, B, C and D today," and an alternate world which says, "In the event that A, B, C and D occur, then there will be certain remedies available either to the crown or to affected parties."

MR TOMS: Could I just add a follow-up to that, not from a regulatory point of view but from a strategy point of view, which is that I think it has become clear over the last 10 years that if your fear is that an unregulated airport would gouge its

customers, that short-term gouging is not a sustainable strategy for a privately owned company operating in a very public and political environment. Again rail track is probably the classic example: you simply can't gouge continually because your corporate reputation is undermined. It goes to the valuation of your equity. It's not sustainable.

PROF SNAPE: I would like to pick that point up because when you were talking about the countervailing power of the airlines - and I'll try to get it right today - you in fact drew upon a political countervailing power, and - as you are just now - you are talking about the public perception and what that would do rather than any countervailing power in, if you like, the economic market rather than the political market. Would you like to give some attention to the question of whether there is countervailing power of the airlines in the economic market rather than the political market.

MR BARLOW: Mike, do you want to take that, with your worldwide experience?

MR TOMS: Yes, I'll start but I think I'm going to pass that one onto Warren in due course, as the economist. There certainly is some economic countervailing power but in a sense airlines have not had to test that. They've not had to exercise economic muscle in terms of withdrawal of service or transfer of service because they've been so successful at the legal and political level. I think if you look at the IATA submission to this hearing, it's interesting that they say, "If there isn't regulation, then we have to litigate or we have to sensitise the public" - steps 1 and 2. But there is step 3 after that, and I think it's certainly true that an airport that has a poor reputation with its customer airlines finds it much more difficult to attract footloose service, and obviously airports want to do that. They make money at the margin out of footloose service, so that threat is still there.

PROF SNAPE: Out of which, footloose service?

MR TOMS: Out of footloose service, yes.

PROF SNAPE: Which are?

MR TOMS: Any service which could either not operate or operate from somewhere else, and there are those services at the margin.

PROF SNAPE: You don't see evidence of that being used at this stage. Is that right?

MR TOMS: I have to say I have seen evidence of that being used in the UK where the growing low-cost market has certainly been quite aggressive with airports on, "You give me the deal or I don't fly from your airport."

MR BARLOW: Can I just come in here before Warren picks it up. I think you

may well find some good examples of this happening in Australia in the very near future. If some of my work is successful, - and my colleagues' work - you will, because of the probable price increase in Sydney, absolutely Melbourne is in competition with Sydney and we are actively going out and trying to persuade airlines not to fly into Sydney and come into Melbourne. I'd like to put your question the other way around. Certainly at an airport like Melbourne we are fighting and struggling for every - particularly international - traveller to come into this region that we possibly can.

Part of the reason for the black bags is, I have just come back from Singapore, talking to Singapore Airlines at the highest level, to try to persuade them to put more services into Melbourne. Now, I can't succeed in that if I am gouging the prices and if I'm not providing a very good service to them. And, by all means, ask them. I think you'll find we are providing a good service and we are providing a cost-effective service to them. So absolutely they have powers, particularly at an airport like Melbourne, and that would apply to so many other international airports in Australia - we are fighting for every passenger we can get. So the airlines absolutely do have economic power. They have a great choice of whether to fly into Australia or into other parts of the region, and they certainly have a choice of whether they fly into Melbourne or one of the other major gateways.

PROF SNAPE: Is the price of aeronautical services, rather than the quality, a significant factor in that competition?

MR BARLOW: I think it is a factor. I think Mike made the point earlier on that, actually the service is probably more important to them. The airport charges are something like 4 per cent of their overall costs, so they do have an effect. But it is a combination, I think, as in any business, of quality and price.

DR MUNDY: I think the reality basically on this question of price is that the real thing that's driving airline routing decisions, if you like - which airports do they use - is their overall cost structure. The price of aeronautical services is a component of the total cost of the use of aeronautical services. For example, if an airport is closed for a period of time because of a curfew or some other arrangement, then there is a significant cost associated with aircraft not being available to be used by the airline concerned. If an airport has a capacity constraint in relation to its parking arrangements or its aerobridge servicing arrangements, then aircraft will have to be towed away to remote location to be held, to then be brought back.

Now, there is a cost associated with that, and there is obviously a calculus there by which the airport says to the airlines, "We can fix this. We can put up prices. We can invest to provide you with some additional capacity so you can avoid those towing costs," and then presumably the airline takes a view as to which, in the overall scheme of things, is a cheaper and better quality service for them in relation to how they manage their labour and so on.

One of the points we made in our submission is that a lot of these issues about the quality of the services provided to airlines as opposed to passengers are actually about the cost of operating through airports of airlines rather than some sort of ephemeral value associated with a good experience, which may well be the case with passengers. Quality directly impacts upon their cost structure, so in a sense it's a false decision for airlines in some cases simply to oppose a price increase of funds investment which may actually be cost producing for them.

Just on the point of footloose investment, there's one very clear example, and that's when you drive up the Tullamarine Freeway and you observe Ansett maintenance bases located off the airport. I think it's probably fair to say that that was a response to a situation in a property market that existed in the time of the FAC, and Ansett discovered that land was cheaper over the fence, so that's what they did. You can extend that to locational facilities. Some flight caterers actually keep their kitchens off airport rather than on airport and just truck it in.

PROF SNAPE: Those are examples in which things that could have been located on the airport are located off the airport but has Melbourne any experience of those footloose activities being used as a lever on aeronautical charges or services?

DR MUNDY: We have had some discussions with people wishing to locate what you might call aeronautical facilities at Melbourne Airport, and the question of the level of aeronautical charges has been an issue.

PROF SNAPE: So no very strong cases but some little bit of evidence. Is that what you're saying?

DR MUNDY: Yes.

PROF SNAPE: We are trying to see economic levers for countervailing power. Okay, if they want to come to Melbourne, they have to land at Melbourne, as the airlines tell us. So we're trying to see if there other levers that are used as countervailing power with respect to the aeronautical charges.

DR MUNDY: For commercial reasons I can't identify the parties concerned but there was certainly one party that was looking to locate an aeronautical facility at Melbourne Airport and the level of aeronautical charges was a matter that they wished to discuss and work through.

MR TOMS: We have had the same experience elsewhere, particularly with office accommodation being based at the airport.

DR MUNDY: Just harking back to the establishment of the domestic express terminal, I think it was reported in the media that Virgin saw their decision to headquarter in Brisbane as opposed to Melbourne as being affected by the costs of operating through the domestic express terminal. That's a matter on the public

record.

PROF SNAPE: You said that Virgin is now seeking to have the domestic express terminal declared. That's presumably because they're not happy with the charges.

DR MUNDY: They appear to be unhappy with certain contractual arrangements associated with the facility as opposed to the charge itself, but of course obviously if the facility is declared, then all terms and conditions then become subject to arbitration by the ACCC.

MR BARLOW: It is also fair to say that the major operator from that terminal, Impulse, is highly supportive of the service we provide.

DR BYRON: We had some discussion yesterday about the differences between section 192 and the Airports Act and IIIA. I'm guessing but it would seem to me that the criteria for a declaration under 192 are quite different, and something like that couldn't be sought under IIIA. Is it likely that the multi-use of the domestic terminal would qualify under the national significance materiality test?

DR MUNDY: That's a fair point. I would doubt that you would be able to convince a National Competition Council that that terminal was of national economic significance; I think you'd struggle in relation to that. Of course 192 applies to all core regulated airports, so you could in principle seek the declaration of a minor facility, a road facility, for example, abutting the terminal in Townsville. So the tests in 192, being essential for civil aviation and uneconomic to duplicate, whatever view of what that means that you have, do seem to be significantly less stringent than what you would have to show under IIIA as a general principle.

DR BYRON: One of the things that we've been looking at already, and it has come up in the hearings yesterday - the differences between 192 and IIIA and what the rationale is for having a special airport specific access regime and if so what differences between that and IIIA are really necessary or justified.

DR MUNDY: Our view is if you want to have a national access regime, have one. I think we've made it fairly clear that we think 192 is unnecessary and overkill and doesn't get you any further than what you would get under IIIA, and in fact to an extent invites matters being brought under 192 for which, as you say, may not be material. The Delta case is another case in point. It is unlikely that the declaration in relation to Delta would have been sustained under Part IIIA of the Trade Practices Act, in our view.

MR BARLOW: I think the last two minutes have actually just demonstrated it's much better to have one act that will cover everything rather than a two-tier system which is complicating things.

PROF SNAPE: You've made the point - there's a number of other airports making

it too - that the starting prices of CPI-X were, in your view, too low, and yet those prices were known at the time of bidding and that presumably means that you bid on the knowledge of what those prices were, so didn't the bid price, and therefore the cost of the airport and the capital you had to raise and all that and the return you have to get on it - wasn't that already taken into account? So how can you argue that they were too low when you knew what they were?

MR BARLOW: I think probably the answer is in hindsight we realise that and the fact that we are being successful and traffic has increased so much.

PROF SNAPE: You bid too much for the airport?

MR BARLOW: You could say that, but I think more realistically, going forward, what we are saying is that we need to have a commercial return on new investments, and I think that's the problem that we have.

PROF SNAPE: So it's a concern on new investment rather than the past investment.

MR BARLOW: No, I think, looking back on what you could get for the money investing it in other areas, probably it was too low for it.

DR MUNDY: We bought the airport on the basis of what we thought the cash flow arising from the airport was and what the risks were, and that determined the price, but the question are the prices are too low I guess begs the question too low for what? It is our view - and I think it's fairly easy to demonstrate - that the starting point prices were set on a single till basis across the network as a whole. I think we've dealt with the arguments about why those prices could be seen as being too low in an economic efficiency sense.

It's our view that there is a significant divergence in relation to what efficient long-running incremental costs may be and the problem that arises is a forward-looking problem. It's not a question of are you earning more or less than what you paid for the airport or whether you paid too much, or some might say you didn't pay enough. But the issue from our point of view and on our analysis is if you want airports to invest at the right time in the right place in the right way, then the first best solution is to ensure that the prices that they charge for those services send the right signals.

The necessary new investment arrangements exist, in our view, solely because without them airports would not invest because airports require a price increase across the cost base as a whole to justify investment, because at the current prices you would not invest at all. So the necessary new investment arrangements, in our view, have to be seen very clearly as a fix for the problem of prices being below what you might call efficient investment prices.

PROF SNAPE: But now you're arguing that there shouldn't be any regulations so you can set the prices as you like, which means that you can - to put it fairly bluntly - correct for the past mistake of bidding too much for the airport.

MR BARLOW: No, we are not saying we can set the price as we like. What we're saying is we can set the prices in discussions with our customers and take a commercial decision on matching quality and quantity with price.

DR MUNDY: The necessary new investment arrangements will see prices rise in real and nominal terms. They will see that happen. We've seen prices rise in real and nominal terms above the cap because of it anyway. So that there won't be price rises is not the case. I mean, what we're saying is, what's the efficient way to get these prices to where they're going to be? Our view is that the current arrangements are inadequate for that purpose.

MR BARLOW: But the concrete example, the domestic express terminal - if we need to expand that, I want to, with our customers, say, "Right, when do you want it? What do you want?" and get on and do it, not have to go through the delaying process that we have to endure now.

PROF SNAPE: Although it's fairly clear that your two customers for that have rather different views as to what is necessary.

MR BARLOW: Yes, they do.

DR MUNDY: That raises an interesting question as to why that might be.

PROF SNAPE: Ultimately you will go ahead, presumably, in an unregulated market. Even if they disagree you will have to.

MR BARLOW: We would take a balanced business approach to it and we would take into account what our two customers were saying. I have to say that the two customers, absolutely from day one - even before I came to Melbourne - took diametrically opposed views as to what was wanted. When the facility was actually complete both of them were over the moon about it and if you watched the news when we opened it Brett Godfrey was confirming that.

DR BYRON: I was just wondering when you purchased the leases for the airport what were the general sort of investors' expectations regarding how non-aero charges would be treated under the cap and did you have any particular basis for those expectations?

DR MUNDY: We have relied on the representations to the Commonwealth in relation to non-aeronautical charges. We were advised of the content - so I'm informed - of Declaration 87 as to which services would be within the cap and by and large that has carried through, I guess, with two notable examples, one of which

we haven't had an involvement with and one which we are intimately involved, as any resident of Victoria would know.

In relation to fuel throughput levies, it is our view that in the information memorandum to bidders the Commonwealth did represent that that was a source of revenues available to them that would not be within the cap. We note that the ACCC conducted an inquiry, in our view quite properly, as to whether there was a market power issue there. It made a report to government and we note that the government has declined to act upon that report and declare the service. Our view is that's a correct and proper process.

In relation to the matter which we're intimately involved in, that being the question of charges in general for ground access, it was again represented in the information memorandum that ground access charges would be an additional source of revenue available to airport operators. We note subsequent to that that documents have been issued by, I think the Department of Transport and Regional Development, and recently senior officers of the Department of Transport and Regional Services, who with a different hat appeared before you yesterday and made it entirely clear that the government's view was that these charges were never within the cap.

We have contractual arrangements with the Commonwealth to comply with the government's pricing policy. We're good to those, but we do feel that in relation to the taxi parking issue - which we by the way can justify under the necessary new investment arrangements anyway, so there's no question in our mind whether there's a market power abuse here - we're just trying to recover the costs and provide efficient traffic management at Melbourne Airport, but we do feel that, irrespective of the resolution of the matter in the Federal Court in Canberra, the government, now having discovered that Direction 87 does not give effect to the representations it made at the time of sale, should do the right thing and have those directions corrected so it does reflect the representations that they made at the time of sale.

But with the exception of those two issues, in relation to freight sheds, with relation to carparks, with relation to retail and so on - all those areas which are important parts of our business, which we feel add value to our business, but also to the airport and to the north-western suburbs of Melbourne, which, you know, are not the most economically vibrant of the city, and indeed to the state of Victoria - you know, we get on with that, we get on with our business partners and we have no truck with the Commonwealth, except really in the non-aero area with relation to taxis.

PROF SNAPE: That taxi decision in Canberra - is it your view that you would be covered by the same decision or that your arrangements are sufficiently different to push it over what the judge said was a pretty close call?

DR MUNDY: Yes, the judge said it was a pretty close call. There doesn't seem to

be a fine point in law here. It seems to frankly rest on his view of how traffic moves on that bit of tar at Canberra Airport. Our view is that the decision in Canberra rests on the peculiar facts in Canberra. Our view is - and it's a view that we've now put to the ACCC - that on balance if the facts were put to a judge that he would find in our favour. However, we do not intend to go through the significant legal costs. We would simply prefer the Commonwealth to - the judge now having established the principle that these sorts of charges can be caught - the Commonwealth should now do the right thing, correct the instruments and give effect to the representations they made at the time of sale, because if they can't it raises the question in future airport sales, or in future asset sales, or indeed anyone who is having commercial dealings with the Commonwealth, of the extent to which it can be relied upon to make good its representations.

MR BARLOW: Can I just come in here. As I say, as a simple airport manager, it is extremely confusing to be told by one section of government that this is allowed and then to go through the hoopla that we're having to go through now. Melbourne Airport deliberately took a decision not to impose a fuel levy charge and continues in that process. We deliberately took the decision, unlike many other airports, not to impose a taxi charge; to keep on wearing that subsidy ourselves for as long as we possibly could.

In a way we're hoist by the petard of timing in delaying those charges coming in until we had to build significant - very, very significant - new facilities to service the taxis, to then bringing it on board at a late stage, and that being compounded with the difficulties the taxis were having with the toll roads, with the City Link and the general problems the taxis were having in Victoria at that time. In hindsight it may have been better to have introduced the charge earlier on, but the decision was absolutely taken not to do that because we wanted to keep charges down for as long as we possibly could, and actually I think that argues well and consistently with our case for no regulation.

PROF SNAPE: So you would see that the taxi association makes a strong case against the timing, apart from anything else, of the introduction of it.

MR BARLOW: You're quite right. The timing is such that the success that we've had, particularly with the domestic express terminal with the many thousands of passengers that are going through that - unfortunately they have no carpark within easy walk and the available space is used by taxis now and, in our opinion, it's unfair for those customers and our airlines at the moment to subsidise those services that are provided to the taxis. We think it should be user pays.

DR MUNDY: There is one important point to remember in this debate about taxi charges, that if the taxis don't pay the airlines will, because if the ACCC's view is the correct one then this is a charge - these are costs that can be put on to the general landing charge. It's our very strong view that people who conduct business at our airport should pay for the services they enjoy, and they should not be paid for by

other users. I mean, that is a fairly simple principle that seems to escape - I mean, we incur somewhere in the order of three-quarters of a million dollars a year in labour costs, simply to call up taxis and push them through. At the moment, the bulk of those costs are being paid for by tenants, and, in particular, domestic terminal lease tenants. So we think this is actually a way of improving a bit of allocated efficiency around the place.

PROF SNAPE: In an unregulated environment - or as unregulated as one could foresee it - then how would you structure your aeronautical charges? Would you continue to use it on a weight basis for landing? Do you care about the size of planes? Would you try to unpack the charges so that you separate the landing charges from the terminal charges from the aerobridge charges, et cetera?

MR BARLOW: Let me just - you can answer it in detail now - I think we have really inherited these charges and we have endeavoured, not to confuse our customers, to keep them as they are for some time. I think we have some doubt as to whether they are totally efficient for both us and the customers but, more importantly, to the customers, and I think we will probably be reviewing the way we make those charges, whether regulation is there or not. That isn't an issue as far as regulation, I think, is concerned.

As an example, if we're trying to attract new business and new airlines, to charge by weight is probably not a good incentive for them because if they're carrying low loads when they first operate, they're still paying that charge, and if they're starting off carrying low loads then perhaps they should be paying low charges, and as they get successful they'll be able to pay the higher charges.

DR MUNDY: I guess there is the old conundrum here of, in the first instance, I guess the airlines would expect - and its sort of guiding principle, if you like, that charges should be cost-based. There's the alternative to that, whether you should actually efficiently price in relation to elasticity concerns. I guess at the end of the day in a practical world you end up with some halfway house. But I think it's important to ensure that, for example, if you are running into a situation where you may have apron congestion, that aircraft are sitting, parking, for many, many hours on end because they know they can at Melbourne, but perhaps it's a bit more expensive somewhere else to do this - that you've then got to ask yourself, "Well, do we want to carry that situation forward?"

I think one of the challenges which my colleagues and I are starting to turn our minds to is, how do we - as certain parts of the airport infrastructure become congested, what is the best way of sending that pricing signal? Can you send it at all? And, also, to be honest with you, we regularly bump up against the - you know, we have a landing charge and a terminal charge. You constantly run up - and it's a legitimate concern of, "Well, why should we have a general increase in the landing charge to pay for that when we are never going to use it?"

So in terms of conducting your commercial negotiations there is some benefit, I think, from all parties to those discussions to have a pricing structure that enables in some sense you to be able to say, "Well, this is a charge for these sorts of things," and remove from it, if you like, the involvement of those who aren't going to use the infrastructure. So there's a sort of a balance of cost, sensible elasticity-based pricing - at least have some attention to that - and to how working with your customers, the pricing structure may assist all parties in that negotiation.

MR BARLOW: I think that's the key to it. The key to it is that, with or without regulation, if we made any changes we would only do it after full consultation and agreement, or a consultation with our customers. We would very much take on board what their views were. Mike, you wanted to add something here?

MR TOMS: Yes, I'd just make a general observation, having watched the development of user charges in Australia over the last 10 years or so, the general international trend that where airports are relatively uncongested on the runways, a weight-based charge is a very effective piece of Ramsey pricing; in other words, it meets the revenue requirement without discouraging demand above short-run marginal cost. When runways become congested, it becomes progressively more inefficient, and you do see now I think internationally a greater trend towards fixed fees on landing, or minimum charges irrespective of weight.

The ultimate exponents of that, as you probably know, are BAA, where, if you use a peak period slot at Heathrow in London, you pay exactly the same amount if it's a Cessna 412 as if it's a Boeing 747-400 - it's £500, whatever. And I'm not counselling that in this case, but I think you see places like New York and Frankfurt starting to move towards a fixed fee element on landing because it's the efficient thing to do as you move towards a congested situation.

PROF SNAPE: So I guess there is a problem of making a transition from one to the other, and I was making the point yesterday in talking to Mr Forsyth, that congestion isn't something that is a switch-on or switch-off - there's congestion at certain times of day or there may be congestion of taxiways rather than runways, et cetera, so there is a problem of looking at it in that black and white framework.

MR TOMS: I think there are two associated problems. The first is that the process is very bloody in the sense that these are sums of money which are paid by real carriers, and some of them don't want to pay them, so change is quite difficult to get, because there are losers for every gainer. The losers complain, the gainers stay quiet, which is a rational piece of behaviour. But, nonetheless, if the problem is great enough and the situation needs the attention, it can be done.

PROF SNAPE: So while Melbourne, of course - and any airport - would say it would discuss it with its users and that it would be agreed with them, nevertheless, you would come in with a position in those negotiations and in those negotiations you would come in with what you would perceive to be an efficient or, from your

business point of view - a structure of charges. Would you see those as - well, first of all, how would you structure that? Secondly, would you see that as an efficient structure of charges from a more general economic perspective?

MR BARLOW: We would see it as an effective structure for our airline business, and that means that they would have the best use of the best facilities that would best suit their operations, and that will be the only reason for us changing the charges from the way they are now. I mean, Warren has highlighted a few examples. That's not for the benefit of Melbourne Airport, that's for the benefit of the users, so that if we have areas of congestion and we need to expand in those areas, then the charges can reflect that properly. Warren, do you want to come in?

DR MUNDY: The best example, I guess, for us is terminal capacity. We're going to have to expand the international terminal at some point in the not too distant future. At the moment we charge on an MTOW tonnage basis for terminal use. We haven't changed that because, well, quite frankly, we just took a view that it wasn't at the time a big issue for us. Going forward, I think it raises interesting questions as to whether you charge simply for standing at a gate, very much how Heathrow charges for runway capacity. I think, to be honest with you, at the end of the day our prime interest is ensuring that we bring on profitable capacity when it is required, and that's our overriding commercial interest. If the capacity isn't profitable, no-one is going to use it, if the pricing signals are wrong. So I think we'll go forward on that.

I mean, I think at the end of the day with a reasonable amount of - I mean, I think it's an interesting question. If you have a relatively concentrated use of those facilities, as we do, with the bulk of the revenue being derived from a relatively small number of parties, I guess it's a fair question to ask, are you just chopping up the cake in a different way and everyone ends up with - you end up with eight slices of cake rather than four, but at the end of the day you've still got the same quantity of cake, but - - -

PROF SNAPE: Well, we're concerned, of course, with the efficient use of that cake.

DR MUNDY: Yes.

PROF SNAPE: And of course, as we've discussed before - two different questions. One is, simply, who gets the dollar? But also, what are the efficiency consequences of who gets the dollar?

DR MUNDY: I think what it does is, it actually provides us - a decent pricing system might actually provide us with better investment incentives as well as signalling to users.

PROF SNAPE: Is efficient pricing from your perspective being inhibited by regulation at the moment - leaving on one side the necessary new investment -

I appreciate that, but - - -

DR MUNDY: Look, in the sense that if we felt that there were more - that there would be significant efficiency gains by restructuring our pricing structure today in a revenue-neutral sort of way - I mean, it's our understanding and it's from the directions that the ACCC has generally directed to allow that to occur - we haven't chosen to do so because we haven't felt that it would lead to significant improvements. I think that's largely because of the fact that we've had slack capacity. But, as capacity constraints start to bind, I think that will be an issue which will become more important to us.

PROF SNAPE: Yes.

DR MUNDY: And terminal is the place where that's going to occur.

MR BARLOW: So, as I said before, I think it's irrelevant whether regulation is there or not. We have the ability to restructure those prices, whether regulation is there or not.

PROF SNAPE: And you haven't yet gone to off-peak discounts? Are you contemplating that?

DR MUNDY: No, not - - -

PROF SNAPE: Or - as sometimes called - peak load pricing? But I've been taught that it's better to say "off-peak discounts".

DR MUNDY: Well, not in the runway, because there's no capacity question in the runway anyway. We have given some consideration going forward to pricing in a differential way - parking charges - I mean, if aprons are becoming congested - I mean, the economic principles are essentially the same, be it an apron or a runway, and also issues about aircraft that are being laid over, and where they actually park - whether they park on the term bridge or whether they're removed to a nearer or a more remote location is an issue that we need to work through, and obviously how you manage that and how you allocate that becomes an interesting operational question which we haven't thought through.

MR BARLOW: Can I ask Mike to comment on that?

MR TOMS: A general remark on that: I think it's fair to say that there is worldwide opposition in principle by airlines to peak load pricing, and not quite so much opposition to off-peak discounting. But, as a question of principle, there's opposition, therefore the case has to be very strong to be able to make it stick.

PROF SNAPE: Yes. Well, one can understand why - that it would be the first step to charging for the slots, perhaps.

MR BARLOW: So the original question is, do we have any plans for doing that now? No.

PROF SNAPE: No. Good, thank you.

DR MUNDY: I think just the other thing in relation to Melbourne Airport - of course whatever pricing signals you send for existing assets, at some point it does become profitable to put a new runway in. There is no physical limitation to the capacity of Melbourne Airport in the next 100 years, so the issue of slots, of peak pricing, is in a sense one which would be a temporary thing until such time as it became economically viable then to put in a new runway or to undertake what you might call major terminal expansion works.

PROF SNAPE: I suppose that the system which is said to operate at Heathrow of exchanging so-called - exchange of slots at good times for bad times, plus a large payment under the table - a very large payment under the table - is already an example of peak pricing.

MR TOMS: It is. Of course, if we have the luxury of setting fully efficient prices, the need for that kind of under-the-table slot trading would evaporate. It does take place and of course it's not fully efficient inasmuch as there are still problems of friction in the market, insufficient slots coming available, uncertain property rights, and there is always in the background the fear of hoarding that may be distorting the market. I think the most efficient first response would be to have airport charges which were up closer to the market clearing level.

PROF SNAPE: That of course would mean the airports would get the dollars rather than the airlines.

MR TOMS: Yes, and there's an attraction to that. I can see in the first instance airlines not warming to this idea but, of course, to the degree that the charges are higher, the incentive to invest is higher and the incentive to bring forward investment and there is actually a utility gain across the board because if we invest more quickly we create capacity more quickly, that creates more competition - the scope for more competition between airlines because we have a more competitive platform for them - so there is, I think, considerable net public benefits in that approach.

PROF SNAPE: Two or three years ago I heard the figure of the order of 10 million pounds being spoken of as the under-the-table payments. Does that accord with your - - -

MR TOMS: It's a figure I have heard of, too, but I wouldn't treat it as being an across-the-board valuation. It's a very specific market. These things don't come up very often. People can be driven by special circumstances.

PROF SNAPE: That would have been for a good time in exchange for a bad time, however.

MR TOMS: It may simply have been the purchase of a time rather than an exchange.

PROF SNAPE: I didn't think that was allowed without an exchange.

MR TOMS: It's difficult to comment with absolute knowledge, but certainly you do note new services appearing by airlines and old services not going, which means they have made a net gain of slots somewhere.

DR BYRON: Without wanting to pre-empt the Launceston submission, I would like to come back to the very sort of fundamental issue of what airports have what monopoly power for what functions, and you mentioned very briefly the so-called "small airport problem". If a line had to be drawn between airports that have fairly substantial market power - whether they choose to exercise it or not - and small ones, the first question is, do small airports have substantially less market power than large ones and, if so, where might a line be drawn?

MR BARLOW: Certainly smaller airports have less market power. We're experiencing this right now at Launceston where - as you know Impulse have started flying into Hobart and we're trying to attract them into Launceston, so clearly we are the beggars. We're going around cap in hand, absolutely, but I would say that applies as well at Melbourne. I spoke about international traffic earlier on. We do have to attract additional traffic and the airlines have a substantial power in that respect, so I'm not convinced in the airports that I am talking about it's actually very easy to draw that line because airlines do have that market power. Mike, do you want to give some examples?

MR TOMS: Yes. I think it is worth remembering the other side of the equation as well, which is larger airlines have more market power than smaller airlines. And just a couple of examples of that: Hong Kong I think we referred to in our submission, where the negotiation for the new Chek Lap Kok Airport - the airport authority wanted to raise the prices gradually during construction. The airlines, large airlines, joined together under the IATA banner and managed to frustrate those early price increases on the basis that the airport should be paid for after opening. Of course when the airport opened the airlines said they couldn't face the big price increase, so in that case the airport neither got it before nor got it after.

You see the same in other large airports. Los Angeles, for instance, has suffered from considerable market power by its users litigating it effectively. I think Denver has as well. The same is true of a number of major European hubs which have been thoroughly shaken by litigation by airlines, including Brussels, Helsinki, Lisbon. They all have been subject to challenge by airlines to their pricing structures. It's not just the small ones where the market power doesn't exist.

DR MUNDY: In answer to your question, in relation to Tasmania there are four airports basically serving that state all within about two, two and a half hours' drive of each other, and in addition to that there are ferry services and so on. There is a pretty reasonable degree of substitution there. On the bigger question I think it is interesting to reflect on the UK experience whereby Stansted is the smallest airport subject to regulation and it is about - - -

PROF SNAPE: In your submission you say it's the largest.

DR MUNDY: No, it's a typo, Richard.

PROF SNAPE: I was puzzled.

DR MUNDY: You may well argue that Stansted is only regulated because it is part of the BAA South-East Airports Group. That being the case, if I had to - if you said, "Draw a line which ones you would and which ones you wouldn't," of course I would say none, but if you were going to draw a line I think you can - the tricky one, in my view, is Perth, because its isolation confers upon it a degree of market power - it doesn't have the substitutability characteristics that Melbourne, Brisbane and Sydney have against each other. Adelaide I think you could happily let go. I think Canberra you could happily let go. I think the isolation of Perth raises an issue about it but, frankly, the others - Townsville, Hobart - I think you could safely let them go.

PROF SNAPE: You said you had had a quick look at the draft reports last week. Would you like to comment on the monitoring that was mentioned there as a halfway house to declaration or to be halfway house out of declaration?

DR MUNDY: Monitoring in a very real sense - I mean, we are subject to monitoring now under the PS Act anyway, but there's a whole pile of things that arise out of the Airports Act which are effectively monitoring, as well. I mean, it is the obligation upon us to provide financial accounts and quality of service monitoring. I would think that's a set of arrangements which we would accept, subject to the detail - but the idea of monitoring is something which - I mean, what I might call "reporting" and having to make statutory compliance reporting is, subject to it not being incredibly overburdensome, something I would be entirely relaxed about. We have to do it in a range of areas. I mean we have to make statutory reporting all over the place and we do it now and we would be comfortable in doing it.

The only thing I would probably say is that we would like to think that the people who were charged with looking at these things and presumably then publishing them and putting them into the public domain thought they were important, significant matters and not minor, trivial and irrelevant, and they were structured in a way that they could be used to give real import or impact onto the public policy purpose they are designed to achieve because I'm not sure that that is the case at the moment. I think there is a compliance reporting regime for economic

regulation for airports in Australia at the moment which, frankly, I don't think is particularly efficacious in its use. I just think it is something we do because the parliament in session deemed that it should be so.

DR BYRON: Reporting without subsequent analysis or use of what is reported?

DR MUNDY: Yes. I mean, we produce statutory accounts. We have to allocate across our whole cost structure. Essentially every transaction that we undertake gets chopped up into being an aeronautical bit or a non-aeronautical bit and some of it is and some of it isn't or it all is or it all isn't. We do that. We have to have those reports audited. All this is costly, and they're just appended and published. That may be what the intent is - that may be enough. It goes to "What's your purpose?" and at the moment it seems the purpose is to place into the public domain a set of audited accounts for airports. They don't appear to be constructed on a consistent basis. It's not necessarily possible to hold one up against another and then, once these documents are submitted, presumably the information has value because that's why the parliament has required it to be provided.

The regulatory reports for last year - the fiscal year 1999-2000 - have still not yet been released by the ACCC nine months after. I would have thought there would have been something that the timeliness of these things - we're required by law to present them within three months, subject to fine, for a public purpose, so that the information is provided in a timely way, and then they don't come into the public domain. It would have been very helpful for the purposes of this inquiry for not only yourselves but certainly for those of us making submissions to you for that information to be available. This industry is dynamic and things change and things move on.

DR BYRON: Presumably one of the rationales for having that is not so much to change the behaviour of the reporting entities but simply to reassure the parliament and the public at large that everything is fine.

DR MUNDY: And presumably also for other interested parties such as our customers and so on nine months after the event.

DR BYRON: Yes.

PROF SNAPE: I think I will just finish with a question of illumination of a sentence that is written here on page 58, and it says:

To contracting: if an airport contracts with an airline to provide an existing service at a price lower than is normally charged the volume in question would be reported for compliance purposes at the normal price.

Why is this?

DR MUNDY: It is what happens now in effect.

PROF SNAPE: But why? Why isn't it reported at the actual price?

DR MUNDY: Why isn't it reported at the actual price? Because the way it's reported at the moment is volume against the full declared regulatory price. I guess it depends on whether you see the price cap as a revenue device or as a pricing device. I think if you saw it as a revenue cap you would then presumably, if you reported it at the actual price, be able to trade it off against some other item. That may not necessarily be the purpose of the arrangement. I mean, I can see you would have an argument to do it the other way - - -

PROF SNAPE: I am just puzzled at why it is. Is this because you think another airline might come on and say, "We want it at that price, too"?

DR MUNDY: It goes to your ability to price discriminate. I mean, you may well decide that one customer's demand is less elastic and the revelation of that may lead to some of the problems that we identified with airports efficiently price discriminating.

PROF SNAPE: So it's that you want to price discriminate but you wouldn't want to make it very clear that you were?

DR MUNDY: Yes. I mean, we see the sanctity of our commercial relationships as a matter between us and our customers, not all our customers.

PROF SNAPE: I thought that might have been the implication of the sentence but just in case there was something else there I thought I would ask.

MR BARLOW: There is no mischievous motive beyond that one.

PROF SNAPE: Okay. Is there a final statement you would like to make?

MR BARLOW: No, it's fine. Thank you.

PROF SNAPE: Good. Thank you very much for a very helpful submission and a very helpful discussion that we've had with you. We will now adjourn for morning tea and resume at 11 o'clock. Thank you.

PROF SNAPE: We resume our hearings and we welcome representatives of Adelaide Airport. I would ask you each to introduce yourself for the transcript and then whoever is to speak to the submission, for which we thank you, could introduce your submission.

MR GOLDSMITH: Robert Goldsmith, general manager, business development.

MR GOFF: Len Goff, company secretary.

MR FAHRER: Jerome Fahrer, Allen Consulting group, consultant to Adelaide Airport.

PROF SNAPE: Thank you very much.

MR GOLDSMITH: It's myself, Robert Goldsmith, who'll be speaking initially. Firstly, I'd just like to register an open apology from Phil Baker, our managing director, who was intending to be here today. He's had a nasty bout of flu and can't fly because of his ears at the moment. As I say, he sends his apologies.

From our perspective we've identified perhaps two key issues which we'd like the commission to consider when evaluating the future need for regulation at our particular airport: firstly, the extent to which Adelaide Airport commands market power; and, secondly, the extent to which Adelaide Airport is actually able to abuse any such perceived market power. In our submission we've argued that, firstly, our market power is highly limited and, secondly, we have very little scope to actually abuse that market power, even if it does exist. On this basis we believe that the future regulation of prices is unnecessary and that Part IIIA and section 46 of the Trade Practices Act are more than sufficient to regulate the commercial activities of our business in the future.

A little background information firstly about Adelaide Airport. Adelaide is Australia's fifth largest airport. We currently handle around 4.3 million passengers a year versus, say, 23 million at Sydney and 15 million-odd at Melbourne. We only have 1.6 per cent of the international market to and from Australia, so that we believe is quite a significant point in terms of market power. We've proactively pursued a growth strategy at Adelaide to attract new airline services with international carriers, domestic incumbents and of course the new entrants, of which we've attracted Virgin.

In terms of finances, we've yet to return a profit. In the first year we made a loss of \$13 million after privatisation. That improved to a \$7 million loss last year but, as I say, we're a long way off making reasonable rates of return. The aeronautical side of our business is making a considerable loss at the moment. Having said that, the structure of our business is changing. Aeronautical revenue is becoming less important year on year. In 1996 aeronautical income constituted around 45 to 46 per cent of our total revenue. Now it's down to about 27 per cent.

Having said that, we see volume growth in passenger throughputs as the best way to improve our long-term financial position because of the flow-through effect on the many other revenue streams in our business.

Coming to the issue of market power, we would firstly accept that our geographical location does grant us some market power, particularly in relation to domestic and regional services. We clearly don't have that market power in the international context where we're competing very fiercely to attract and even keep the airline services that we already have. We're competing very fiercely with all the other Australian major gateways for new international traffic and we regard our international network as fairly fragile at the moment in these competitive times.

The key question we hope the commission will consider is the degree to which Adelaide Airport is capable of abusing any of this perceived market power. We believe this market power is very small because of the countervailing market power of the airlines, particularly for a small airport like Adelaide. We must stress that we're not another London Heathrow, a Tokyo Narita or even a Sydney or a Melbourne. Therefore, we're not actually a strategic hub base for at least one national carrier, nor is our city a major economic or cultural capital for our nation here in Australia. Adelaide is very much of secondary importance to our largest customer groups. These are very important drivers of market power in our perception.

There are also many other aspects to countervailing market power of airlines in a deregulated environment, if that's the way things go. Adelaide, unlike many examples of airports quoted yesterday, is not capacity constrained - nor is it likely to be - in regard to runway slots in the foreseeable future. The major carriers are huge in relation to the size of our business. They're, in comparison, multinational giants with substantial resources and experience, particularly when it comes to negotiating commercial arrangements. As an example, Qantas's profits last year were over 10 times larger than our total turnover. The development of airline alliances is further concentrating our customer base. The top two customers currently contribute 90 per cent of our passenger base, which we believe gives them substantial leverage in commercial negotiations.

It's already been mentioned by other parties that the major carriers also have considerable political leverage in this country which they can use in any potential dispute. They have the ability to take ancillary facilities and services elsewhere. They can reduce services or use smaller aircraft, particularly in off-peak times. More importantly, from our perspective, they can delay future growth, which is a key concern for us. What they may regard as adjusting their margins is actually a significant impact on our business. There are many examples elsewhere in the world where airlines have actually reduced services or threatened to reduce services in the light of charging negotiations. I think Melbourne Airport mentioned the UK examples, particularly easyJet and RyanAir, for example, and I think Len has an example which he's going to mention in a minute.

Airlines can pursue legal action and delay payment, which can cause businesses of our type and structure significant distress, and they are better able and resourced to sustain any sort of commercial dispute if it actually came to it. Obviously they can also frustrate and delay investment decisions. A good example of this is obviously Adelaide's proposed multi-user integrated terminal, which is our key infrastructure development for our growth plan for the future. We clearly believe it illustrates where market power lies. We've been negotiating for two and a half years since privatisation, still without a final result.

The incumbent carriers have used the negotiations to extract concessions on a wide range of totally unrelated commercial issues, more or less as a package which has nothing to do with the actual construction of the facility or the operational relationships within it. At the end of the day though, putting this aside, it's not in our interests as a business to fall out with our main customers when they're so important to us. At the end of the day they are far more important to us than we are to them, and it's not in our interests to have that sort of level of dispute with customers.

We then perhaps move on to ask the question, what is the purpose of regulation and what are its end goals? Firstly, is it to protect airlines from potentially large increases in charges from airports? If so, we would argue that the current system merely has helped to transfer rents from airports to airlines and our negotiating position is too weak to change the situation in any dramatic way in the foreseeable future anyway. If regulation is really designed to protect airlines we would ask why have the benefits of regulation not been passed on to the customer in terms of lower air fares? Certainly the evidence has been to the contrary with this regard.

Conversely, if regulation is currently designed to protect the public or the consumer, then it raises the question of the materiality of airport charges overall and the need for regulation. If you take a typical route like Melbourne-Adelaide or Sydney-Adelaide, the airport charges element of the standard ticket price has generally been around \$2 to \$2.70, as I say, as a proportion of a total ticket price historically. It's obviously a lot less for international routes. Meanwhile, just as an illustration, Airservices Australia charges levied by the government are almost double this level.

The effects of the first five years of regulation at Adelaide have been, at best, marginal in terms of helping the consumer. In theory, they have reduced air fares over that five-year period by around 50 cents per passenger, if expressed over the number of passengers in the final year alone. There is no evidence, as I say, that these savings have actually been passed on to the customer.

If you also look at situations like the future development of our multi-user terminal at Adelaide, again there's been no significant - or no statement at all, in fact, from the airlines that they intend to pass on the major costs savings that they will make in such a facility on to the consumer in the form of lower air fares. In contrast to this situation, huge consumer benefits in lower air fares have been brought about

by the introduction of new domestic airline competition. At Adelaide, for example, Virgin Blue's fully-flexible full economy fares cost only around 50 per cent of the levels charged previously by Ansett and Qantas. In the last week Qantas have brought out a new range of fully-flexible economy tickets which match those of Virgin and provide a similar proportional benefit to the consumer in terms of lower air fares.

So why do we want deregulation? Really it's a case of removal of the current costly restrictions on the development of genuine commercial relationships with our customers at Adelaide, and we believe that removal of regulation would encourage innovation and improve services across the airport. Also, there is an onerous administrative burden with the current regime which we'd like to see removed.

In conclusion then, I'd just like to make a number of points. All airports are different and we therefore urge the commission to look at each on its own merits on a case-by-case basis. Adelaide Airport is highly conscious of its competitive position and the need to act accordingly in any future behaviour in a deregulated environment. It's just not in our interests to try to increase prices by substantial margins, even if we had the power to do so, which we believe we haven't. As I said before, we need our major customers much more than they need us. Given the limitations of our current bargaining power with the major customers, it's inconceivable that we can actually raise the charges to a perceived monopoly profits position from our current starting point of low charges.

We identify volume growth as our main profit driver for our business success in the future, which is reflected in our plans for our \$220 million new terminal, and so-called abuse of monopoly power will be totally counterproductive to this strategy of proactively attracting new business. The real driver of public welfare, we believe - ie, lower air fares - is effective competition between the airlines. Airport charges pale into insignificance in comparison by a factor of many tens to one.

We believe that Part IIIA and section 46 of the Trade Practices Act are more than sufficient to regulate the commercial activities of our business. We believe that industry-specific regulation is unnecessary. The current regulatory regime is intrusive, heavy-handed, encourages gaming, as many parties have already said. It imposes unnecessary compliance costs and stifles progress with new investments. Most importantly we urge the commission to recommend a policy of "innocent until proven guilty," since any abuse of market power, as I say, would be totally counterproductive to our interests.

PROF SNAPE: Thank you very much, Mr Goldsmith. Are other members going to speak?

MR GOFF: I will just make a few additional points. I notice under the Melbourne submission that the commission has asked about the countervailing economic power of the airlines. Two examples spring to mind: the first one was in the very early

days of privatisation the airlines took umbrage at the increase in the costs of the recovery of CTFR - counter-terrorist first response - charges which were clearly 100 per cent recoverable under the pricing guidelines. The airlines' reaction on this was merely not to pay the airports. In that particular instance we were able to pass that on to the government agency, the APS, who were providing the service and didn't pay them in return.

PROF SNAPE: You didn't pay them because you hadn't been paid.

MR GOFF: That's right. We were able to pass the payment on in that particular circumstance, but in normal aeronautical charges we wouldn't have that avenue and we would have to absorb that decrease in cash flow which, in a company our size, is quite substantial. The second one, which Rob has already pointed out - the delay in the new terminal negotiations - under the domestic terminal leases the domestic terminal at Adelaide should have been redeveloped around about 1996. The sale process got in the way of that, but we have still added another two and a half years in negotiation. What this does, of course - that capacity which should have been brought on-line several years ago isn't there, to the discomfort of the passengers who use Adelaide - it also increases the cost of that project quite considerably. The further the project is delayed, the higher the cost in providing that additional capacity will be.

I notice in the Melbourne submission that you're also concerned, as they pointed out in their submission and we did also, that we disagreed with the initial prices under the CPI-X price cap. I would just like to say that our point on that really is that the prices were in fact more or less a free kick to the airlines. At the beginning they weren't paying a full economic price for the services provided, as they did not actually reflect the cost incurred at Adelaide. That in itself is sufficient to cause Adelaide Airport to react, to become more efficient to cover that, because we knew obviously what the prices were going to be at bid time and took that into account.

PROF SNAPE: Thanks very much.

MR FAHRER: Most of the points have already been made, but we would urge the commission not to get caught up too much in the minutiae of how airports should be regulated, but think first about the threshold issue, about whether they should be at all, particularly in the case of a small airport like Adelaide. As Rob said, the major driver of consumer welfare in this industry, defined broadly, is the structure of the airline industry itself and competition within it, not charges levied by airports.

Secondly, we note that just last week the commission brought down a draft report recommending a movement away from industry-specific regulation in telecommunications. This is an industry where one player has 80-odd per cent of the market and there really are issues of market power. It's our view that if general competition policy and laws are good enough there, then they're certainly good

enough in the case of Adelaide Airport.

PROF SNAPE: We should correct that. We in fact didn't say that there should be removal of the industry-specific regulation in telecoms.

MR FAHRER: No, I didn't say that either. I said a movement away from it.

PROF SNAPE: We suggest that part of it should in fact - we did quite explicitly say that there was still a case for industry-specific regulation in telecoms.

MR FAHRER: The conditions that apply to those industries where there are industry-specific regulations don't apply in this case.

PROF SNAPE: You're right. We gave very explicitly the conditions that warranted it in that case. That's right. Thank you very much. The question of market power: you did say that you might in fact have some market power with respect to regional, less for domestic and none at all for international. Yet any prices that you might charge, any increases in them, would presumably fall more heavily as a proportion of fare on the regional than they would on the international. That is, if you increase by \$3 it's a minuscule amount on an international ticket and it's a substantial amount - rather larger - on a regional ticket. That would suggest your ability to increase prices on the international ticket might be rather greater than on the regional ticket. So viewed from the perspective of ability to raise the price without anything nasty happening as a consequence, you may in fact have more ability, more market power on the international than the regional.

MR GOLDSMITH: I think there are a couple of points on that. We feel we're already in quite a tough competitive position with regard to our international network. I think we've provided quite a few illustrations of that in terms of our number of direct services per head of population in Adelaide versus some of the competitor airports we're competing against in the rest of Australia. Added to that we have some of the highest air services charges in Australia. As I say, they're actually nearly double the total amount of levied airport charges and there are many features of Air Services Australia charges which act in a monopoly type position.

On top of that we have a curfew and on top of that we have, shall we say, noise-related charges as well at Adelaide, many of these elements are ones which our competitors don't have. We also have, under the plans for the new terminal, a quite considerable, shall we say, cost recovery passenger charge associated with the funding of the new multi-user terminal, which will fall proportionately much more heavily on the international market. When you throw all of this into the competitive mix, we're extremely conscious of the need not to put additional cost burdens on our fragile international network.

We see obviously international growth because of the greater revenue flows from duty-free and other commercial spend in our international business as an

important growth area for us in the future, and the last thing that we want to do is to deter that traffic growth by imposing punitive charges on that particular market - even if we had the ability to do it. I think even in commercial terms that is not particularly realistic because we are already under pressure - even with our existing low charges, which are some of the lowest in Australia - from our existing international carriers to keep those costs at an absolute minimum. Only recently we had a meeting with Singapore Airlines where that point was brought out extremely firmly after they had reduced services. In that context I think it would be totally counterproductive to our interests and our growth strategy.

PROF SNAPE: The charges which you're going to impose, or are imposing, for the new terminal are in fact inversely related to what you said was your market power - that is, those charges will be highest on the international - at I think around about \$6 per passenger and around \$4 for domestic and \$1 for regional. I know that was something which was put upon you by the ACCC, I think, but it's inversely related to what one might have expected according to your market power.

MR GOLDSMITH: I think that's true, but it also tries to reflect the fact that in terms of building facilities it's more expensive to build for international traffic than it is for domestic traffic because of the additional facilities that are required.

PROF SNAPE: You see it as cost recovery rather than efficient pricing.

MR GOLDSMITH: Yes, to an extent. It's reflective of that point, and the airlines' general desire for charges which reflect cost.

PROF SNAPE: The costs presumably for the domestic and for the regional would be about the same, wouldn't they?

MR GOLDSMITH: We've had internal debates about the balance there. Again, we regard regional carriers as particularly fragile. We've seen them come and go. They fall by the wayside quite easily. It's just totally counterproductive to our interests to damage our regional feeder network in our state.

PROF SNAPE: In that case your monopoly power is least with respect to them, not greatest.

MR GOLDSMITH: Yes.

PROF SNAPE: You go the other way in your introductory remarks.

MR FAHRER: On the face of it.

MR GOLDSMITH: On the face of it, yes. That's what I'm saying - that in reality our ability to act on what is a theoretical amount of market power in those markets is highly limited because it's counterproductive to our business interests.

PROF SNAPE: Theory doesn't match up to the practice. The theory is not too good, though.

MR FAHRER: On the face of it, it looks like there's a monopoly. It looks like there's a monopoly power, but in practice, given what's occurring on the buying side, that's not the case.

PROF SNAPE: Why should airlines want to take action to delay or retard your market growth? You referred to delaying tactics. Why would they want to do that?

MR GOLDSMITH: I was referring to it only as a potential dispute tactic. Again, it has been the case with the multi-user terminal situation. I don't know if you'd like to say something, Len. You've got a longer history with it than I have.

MR GOFF: The passenger growth will still occur. It's the provision of facilities that are being delayed in that particular circumstance. It's a tactic by which they can apply negotiating pressure to us to gain an advantage. But it doesn't decrease our overall capacity because the airlines will bring the passengers in, providing they have the facilities to put them through. But it does crowd the facilities.

PROF SNAPE: Are new facilities more important to you than they are to the airlines?

MR GOLDSMITH: I think that's clearly been the case over the last two years.

PROF SNAPE: Why are they important to you? What will they do for you?

MR GOFF: The current facilities at Adelaide are pretty old. Adelaide has not had major terminal redevelopment, as all the other major capitals have. The state government, back in the mid-1990s, was applying considerable pressure to the FAC to provide a new terminal. Unfortunately, as I said earlier on, that process got delayed because of the privatisation process, and there was an undertaking in our sale agreement with the federal government to provide a new terminal if it was commercially viable. We have tried to keep that obligation, and also to provide that service to the state and to the passengers in South Australia.

PROF SNAPE: Do you have a lot more retail premises or office space or space for other ancillary services within the new terminal?

MR GOLDSMITH: Under the current arrangements, of course, the airlines control the existing facilities and the retail spend within it. So, yes, we would be bringing a lot of that potential revenue earning capability in-house. But in the provision of the new terminal facility itself, we're also producing considerable cost savings to the airlines, compared with what they would have to invest if they were to redevelop their own facilities themselves.

PROF SNAPE: What's the state of negotiations now?

MR GOLDSMITH: We're hoping for a resolution in the next few weeks, but we have been here many times before.

PROF SNAPE: Including resolution with Virgin?

MR GOLDSMITH: With all parties, yes. But, again, we've said that many times before. We've got to the point where our board cannot justify, because of the ongoing costs of the project - the project feasibility - to maintain that position for any longer. We have to resolve this issue after this highly protracted period of negotiation because it is damaging our business quite substantially at the moment to keep this process going.

MR GOFF: Can I just point out that this particular project has had wide publicity in South Australia and has had very large support from the South Australia public - to have a new terminal. It seems to carry a lot of weight in the state itself. There's a recognition that the facilities that we have are poor and are not a good entrance to South Australia for doing business or for visitors. There's extremely strong support both from the public at large and from the business community to have a new terminal.

PROF SNAPE: Yet a significant portion of that community are currently using a marquee.

MR GOLDSMITH: It's only a very small proportion and they're no longer in a marquee. But we conducted market research before we went to the ACCC for the original approval of the passenger facilities charge for the new terminal, and there was overwhelming public backing following the many years of distress, shall we say, that passengers in South Australia have suffered with the current facilities.

PROF SNAPE: Is that the existing passengers were surveyed or potential low-income new ones?

MR GOLDSMITH: No, at the time, obviously, it was before the new entrant situation.

PROF SNAPE: So it was existing passengers who were surveyed, not the potential new ones.

MR GOLDSMITH: Yes. But there was an overwhelming flood of support for the funding of a terminal at that time and the methodology that was going to be adopted and it's a bit of a state joke about the fact that we've got the only airport in the country, the only capital city airport, without a single air bridge for domestic travel.

You know, there's a strong feeling of state pride associated with getting this terminal up and running.

DR BYRON: You mentioned "yet to earn a profit", which doesn't sound very much like the classic textbook situation of a monopolist who's gouging and earning excessive profits through abuse of market power. I understand the logic behind the strategy of expanding the volume of traffic rather than just seeking a dramatic increase in prices, but even allowing for both the landing fees from additional movements, plus the additional spend in retail and so on, how much increase in throughput do you need to break even on these sorts of charges?

MR GOFF: Without quoting exact figures, obviously from our business plan that we were using at the bid time we were relying basically on the average Australian growth through passenger airports to eventually provide the required return over the period of our lease. The strategy of trying to increase those volumes is a plus and does not necessarily underpin the purchase price that we paid for the airport.

DR BYRON: Did I understand you correctly to say that you think that the current price regulatory system over the last few years has, in effect, reduced your charges by something like 50 cents per passenger.

MR GOLDSMITH: That's correct.

MR GOFF: Our reduction is 4 per cent over five years, a 20 per cent reduction. Just in rough numbers our annual income is 10 million and our passengers are 4 million. Hence, at the end of that regulatory period, the effect is approximately 50 cents per passenger.

DR BYRON: But if the price controls hadn't been applied - I mean, it's hypothetical whether the customer would have seen that 50 cent saving on the ticket price.

MR GOLDSMITH: That was going to happen anyway, but that's a different matter.

DR BYRON: I'm just trying to get a handle on the magnitudes. If you were to increase landing fees in order to at least break even on aero, are we talking another 50 cents per passenger on a ticket or a dollar on a ticket? Is it less than 10 or less than 20?

MR GOFF: I can't quote you a precise figure on it. We haven't done any detailed costings since privatisation, but going back to the FAC ones, it would suggest that our landing charges are probably around about 50 per cent of what they would be on a cost-recovery basis.

MR GOLDSMITH: Before efficiency gains.

MR GOFF: Before efficiency gains.

MR GOLDSMITH: But having said that, of course, that's on the premise that we were in a position to actually extract an increase in charges of a proportion of that nature and, clearly, we believe that the countervailing power of the airlines would prevent us from making gains of anywhere near that sort of order anyway. On the one hand, we could obviously seek through negotiation to improve, shall we say, the distribution of rent between the two parties, but we believe our ability to actually achieve that end - as I think Melbourne have already stated - in the realities of the market, particularly for a smaller airport like ourselves, is highly limited.

DR BYRON: So even without regulation, the strategy would still be to try and increase the traffic throughput at the airport at approximately current landing fees and passenger handling charges?

MR GOLDSMITH: Obviously, as we said, there's scope for commercial negotiation to try to address that "free kick", as Len put it, which the airlines have received over this stable five-year period for them, but our ability to address that balance in any significant way, we believe is highly limited and from an end consumer point of view would be much less significant, especially when you set that against the benefits to the end consumer of airline competition, which is only really becoming a reality now.

DR BYRON: Towards the end of your presentation, you mentioned the onerous administrative burden, and I guess what I'm leading towards is the relative benefits and costs of the regulatory framework. If the consequence to the price control has been a reduction in the order of 50 cents per passenger, whether that's passed on to the passenger or not, can you elaborate a bit more on what you see as the cost, the downside of the price regulation mechanism?

MR GOLDSMITH: In terms of the bureaucracy side, there's obviously a lot of manpower and resources that go into the actual compliance issues themselves. There is substantial effort and time resources going into the issues of the new terminal. I don't know if you want to speak about dealings with ACCC directly.

MR GOFF: Other than that the airlines do tend to try to use the regulation, whenever we talk to them, as a negotiating ploy. That's certainly an effect. We have to comply with the regulations and reporting requirements, preparation of statutory accounts, audits and so on, so there are number of direct costs that we incur from the regulation and, as we see it, there would be no difference in the end price to the consumer if there were no regulation. We would still be held fairly firmly on prices by the airlines. We wouldn't be able to adjust them significantly to the detriment of the passengers.

DR BYRON: In our Prices Surveillance Act inquiry, which is related to this

because the CPI-X is exercised under the Prices Surveillance Act, we were asking for evidence from any regulated parties about whether the existence of the regulation has actually inhibited additional investment or innovation. I was just wondering if you could think of any examples of where that has happened, or if it hasn't happened, that would be fine, too.

MR GOFF: We made some investments which we have not as yet recovered through price increases, but that's mainly been because of the new terminal negotiations and a close association with the PFC, so we've not put those price increases before the ACCC for their consideration, but they're fairly minor. We provided some international apron and some additional lighting, fairly small matters, but because the international apron was tied very closely to the new terminal, because it will ultimately provide part of those facilities, it will be recovered within the PFC, so we just haven't gone ahead - and I don't think we would get much support from the airlines at the moment for increasing the international apron on 18 services that we have per week there at this time, but it has proved beneficial because it's been to the advantage of new airlines when they've arrived that we've had that capacity there.

DR BYRON: We had some discussion yesterday afternoon about whether the requirement with the NNI to basically have a consensus amongst all the users effectively gives each user a sort of a power of veto, and given that with any new investment not all parties are likely to benefit equally, even if all parties benefit the one who benefits less may well choose to exercise a veto. Is any of that consistent with your experience, particularly with regard to the new terminal?

MR GOFF: I think it would be difficult to answer without giving specific details to you and there are some details that I think we've provided within the written submission to you that point out some of those points.

PROF SNAPE: I was also going to ask if, without compromising commercial-in-confidence matters, you could elaborate a little more on any levers that the major airlines have been putting on you in the context of that, but perhaps you don't wish to.

MR GOLDSMITH: What we can say is we believe that the type of arrangements that have been used during the negotiations, tactics, during the last two and a half years, have basically been based around a whole package of concessions on our part. Well, they tried to force concessions on our part over issues which have absolutely nothing to do with the actual process of moving from one operating arrangement, where they have quite a lot of control in their current lease arrangements, to the new situation where they save considerable amounts of money but have a different operating arrangement. As I say, the range of concessions that have been sought are totally unrelated to that sort of operational arrangement and the cost benefits of the direct operational transition move directly into the commercial wider scope of the debate, but it's very difficult to comment further than that at this stage.

MR FAHRER: Perhaps as a general point, I could summarise by saying that the existence of the regulations, the shift of the balance of bargaining power even further towards the airlines, who had most of it to begin with - - -

PROF SNAPE: Why is that?

MR FAHRER: Because they're able to use the regulations, as Rob said, as part of a package to open up discussions on other ostensibly unrelated matters.

PROF SNAPE: As I understand it, the charge for the new terminal will be an explicit charge on tickets.

MR GOFF: Yes, at the airlines' request.

PROF SNAPE: At the airlines' request. So it will be a separable item on the fare and one would expect that that should help the pass-through of it, but despite that the major airlines are not happy on the charges unless all airlines are obliged to use that terminal. Is that correct?

MR GOFF: Unless all airlines are obliged to pay the PFC.

PROF SNAPE: I'm sorry, are obliged to pay it, whether or not they use that terminal.

MR GOFF: Correct. Yes, that is a point at the moment. With regard to PFC, I suppose we could mention, for instance, that a review of the PFC went before the ACCC a few months ago. Obviously costs have escalated and there have been changes during the period of negotiation. Part of those changes related to operating costs of the new terminal. Now, one airline did not submit at all to the ACCC and one airline merely made some comments and, effectively, that process is now stalled in the ACCC because of lack of response from the airlines, so again another stalling tactic in the negotiations from our point of view.

PROF SNAPE: You mentioned the commission draft reports which came out last week. In part of that you'd have seen that we raised the option of monitoring as a halfway house - we've raised this question with other participants - between declaration and no declaration or of removing declaration and obtaining it. Do you have any reaction to that?

MR GOLDSMITH: In principle, we've got, I think, no fundamental problems with monitoring, providing it's not too onerous.

MR GOFF: Mainly whether it's onerous and what the triggers might be that might come as a result of that monitoring: at what stage would it actually trigger a change back to regulation or what might be involved from an enforcement point of view.

DR BYRON: We have had a number of discussions about how landing charges are a relatively small percentage of the total fare and that airlines' decisions of what routes to fly, the frequency, gauge of aircraft, et cetera, are basically determined by passenger demand or whether the volume is there, not very much by what the landing fees are and that substantial increases in landing fees might not alter their route structures at all, but I'm wondering about the converse of that, whether a substantial reduction in landing fees is likely to alter their behaviour very much either, for exactly the same reasons: that it's a relatively small amount, particularly on an international fare. That leads to the question of whether or not you would offer discounts for a year or two to a new carrier, a new international or something that came in. Is that likely to be a significant consideration in their decisions to fly out of Adelaide relative to traffic volumes?

MR GOLDSMITH: It is a factor. We don't believe - again I think Melbourne made the point this morning - it's a factor in the basket of many factors which determine route developments, but across the board now, particularly in Europe and the States, airlines are increasingly looking to gain incentives from airports. It's becoming the norm rather than the exception now to expect some sort of incentivisation when new markets are opened up because of the investment costs from the airline side and the risks that they carry in starting up these services, and obviously, generally speaking, it takes a while for those services to move into profitability.

So our attitude to incentives is that they may not actually make or break a decision but they can actually contribute to tripping you over the marginal line from, shall we say, an unfeasible position into one which is worth exploring or even going for. On top of that the incentives also provide top-up funds for marketing purposes so the airline can better promote its services in the difficult start-up period. So we believe that they do have a role and we actually do provide incentives.

DR BYRON: I was wondering if it was more as a symbolic value as a sign of good faith that the airport was committed to growing that route and publicising it, underwriting the viability of the route and the commitment to working together with the airline that might actually be as important or more important than the actual cash value of it.

MR GOLDSMITH: I think that's very important. I mean we've always tried to pride ourselves on our relationships with our customers, as have other airports. It is very important in developing that business understanding of demonstrating your commitment to helping their business grow, and we're firmly behind that principle, but at the end of the day it can't convert a fundamentally unprofitable route concept into one which will work. We wouldn't in our wildest dreams suggest that.

DR BYRON: If the business just isn't there it's not going to - - -

MR GOLDSMITH: No way would it work.

PROF SNAPE: Am I right in calculating that if Adelaide with the new charge on international passengers of \$6, I think it was, per person, and a 747 rate is about a tonne per person, approximately, give or take, then that would make Adelaide - assuming current Sydney charges, not their proposed - the most expensive airport in Australia for a 747. What I'm doing is looking at your table 4, on your page 13, which is a very interesting table showing that Sydney, for example, has the lowest charges in Australia for domestic passengers, which is rather curious for the most congested airport. It's a very interesting table that one. Then if you look in the second part of that table, across to the international, and you are now saying that you're going to put another \$6 on per person, and I'm therefore converting it to two per tonne here on a one for one basis. That would make Adelaide the most expensive.

MR GOLDSMITH: I can't actually say without looking - I mean, for example, these were pre-price increases at Sydney.

PROF SNAPE: Yes, I understand it's pre-price increase.

MR GOLDSMITH: Also the situation at Adelaide is a little bit more complex because the majority of our - or a large proportion of our international services are actually multi-sector - you know, triangular-type services - so the passenger load on our aircraft is typically only half a plane load, of which we're only getting, say, 70 or 60 per cent seat factor share of that. So in theory you're probably - - -

PROF SNAPE: If you were filling one up in Adelaide it would.

MR GOLDSMITH: Yes, in theory.

MR GOFF: In relation to that there is also a terminal charge currently charged which will actually drop with the new terminal. It's a \$1.05 per tonne terminal charge, and that will cease with the new terminal because the PFC effectively replaces that.

PROF SNAPE: So it wasn't quite a valid - no.

MR GOLDSMITH: Yes, it will make us significantly more expensive.

MR FAHRER: Assuming that that's true, or even if it is true, these inherited prices are historically determined based on publicly owned airports, when who knows how the prices were determined. This is a significant new investment run by a commercial operation now. As other airports over time undertake those kinds of investments they will have to recover those costs in a normal commercial fashion, which perhaps they haven't had to do in the past.

DR BYRON: This is a bit speculative, and you may or may not wish to comment,

but Townsville Airport, when we spoke to them in Sydney last week, seemed to be pretty much in favour of price regulation because they thought that it would increase their bargaining power, vis-à-vis the airports, and the alliance.

PROF SNAPE: Not necessarily in its current form but they saw it as a protection against the airlines.

MR GOFF: I think we would have to disagree with that. Our experience has tended to be that the airlines do use the regulation against us and it's very difficult for us to use it against them.

DR BYRON: I think their argument was that without some sort of price regulation they would be even more exposed to the airlines countervailing power. I'm just wondering if you had a reaction.

MR GOLDSMITH: Yes, I can see where you're coming from but it's just - - -

DR BYRON: I don't think our terms of reference allow us to recommend price regulation in order to protect airports from airlines but it's just one of those sort of exceptions or counter-intuitive things that pop up sometimes.

MR GOLDSMITH: Yes. I think we try to rely on our experience to date with protracted negotiations to at least attempt to come to more mutually beneficial commercial arrangements with our customers. Whether we can ultimately gain any significant benefit for us as a company out of that, in terms of pure financial terms, is a highly debatable issue, and I think our powers are limited, but we may not be in a position where ultimately we would, at least in terms of our aviation charges, directly be in a worse position than we are now, but it's very hard to make that judgment at the moment. But, yes, I can see what you are saying but we would prefer to have an unfettered sort of arrangement where we can conduct commercial negotiations on a whole range of issues on a one-to-one basis without this sort of relatively heavy-handed regulatory burden in the background.

PROF SNAPE: I think I'm through and it was a very clear submission and it had some interesting data in it, as I indicated, and a good exposition of it. Is there any final point that you would like to make?

MR FAHRER: No, we were tossing up whether to raise another issue but have decided that we won't.

PROF SNAPE: We will wait for a supplementary submission.

MR FAHRER: Well, in fact - - -

PROF SNAPE: You are going to raise it?

MR FAHRER: Yes. On the vexed issue of dual till versus single till, Peter Forsyth in his submission made the point that you can argue either way. That's not our opinion. Our opinion is that as a matter of principle only the non-contestable services should be regulated, and that, certainly in Adelaide Airport's case, excludes non-aeronautical services, shops, car parks and the like. Adelaide Airport is located very close to the city. A taxi ride from the city is a close substitute for parking at the airport and the airport has had the experience in the past of passengers checking in and then going off to get a cup of coffee at Glenelg because they don't like the service that they're currently getting at the café service at the airport. So there is no hint of market power and non-aeronautical services at Adelaide, and certainly if you're going to recommend that regulation be continued we would urge strongly that the dual till system be adopted, and a real dual till not the quasi-dual till that the ACCC is recommending.

PROF SNAPE: Thank you very much. Thank you again for your submission and we will now move to Brisbane Airport as soon as we can get restructured.

PROF SNAPE: We now welcome Brisbane Airport, and as in past cases we would ask you to identify yourselves separately so we have each of the voices for the transcribers. If you could indicate your positions with respect to Brisbane Airport.

MR ROTHWELL: Tim Rothwell, chief financial officer.

MR ROOIJMANS: Koen Rooijmans, managing director.

MR RYNNE: Brendan Rynne, consultant at KPMG and adviser to Brisbane Airport Corporation.

PROF SNAPE: Thank you very much for your submission. Who will speak to it?

MR ROTHWELL: First of all, Brisbane Airport Corporation welcomes the opportunity to address the commission. Our written submission takes the form of an executive summary, followed by a general discussion on price regulation for airport services in Australia. It then goes on to provide a response to each of the questions raised by the commission in its issues paper. Today, I'll briefly outline our broad conclusions, discuss the background to where we find ourselves today and highlight our response to a few of the questions raised in that issues paper.

Market power can be defined as the actual ability of a firm to raise and maintain prices above the level that would prevail under competition, resulting in reduced output and a loss of economic welfare. The extent to which airports possess market power will depend upon the degree to which they possess monopoly attributes, being barriers to entry, the substitutability for other transport modes and existence of economies of scale and scope. BAC notes, however, that the mere existence of these attributes does not necessarily indicate that airports have the ability to raise and maintain prices above the competitive price level.

Further, BAC contends that there is little scope for airports to abuse their theoretical market power and there is no evidence during the years since privatisation to indicate that they have done so. This is due to three factors. Firstly, competition between individually operated airports in Australia that takes the form of competition to keep existing and to attract new airline services - both passengers and freight; competition for a role as a hub airport and for transfer between hubs; competition between airports within urban areas - in the case of Brisbane, the existence of Coolangatta and Sunshine Coast airports is relevant - and generally the competition for the provision of services of airports.

Secondly, and probably most significantly, the significant countervailing market power from the major users of airports; and thirdly, airports' inability to withhold service. These points highlight the fact that airports, rather than needing specific price and conduct legislation, are in fact subject to sufficient competitive and structural market influences that they don't require specific legislation or provisions within existing legislative frameworks. The ability of regulators to take action in the

event of actual abuse of market power is quite sufficient.

BAC believes that the current regulations fail to meet the objectives outlined in the Department of Transport pricing policy paper, particularly with respect to the promotion of commercial arrangements. Specifically, the current regulatory framework involves lengthy, inefficient and expensive processes, deters and delays new investment and favours incumbent airlines, operates to the detriment of new airline entrants and ultimately the travelling public. It provides no certainty that any price reduction generated at the airport services level is actually passed on to customers.

BAC has yet to finalise its position with respect to what type, if any, of prices regulation it considers appropriate for the airport industry in Australia. However, there are several broad principles that we would expect to be part of any framework for regulating prices, including the ability of the investor to achieve a fair return on existing and new investments, acknowledgment of the need for early pricing decisions in relation to long-term projects such as runways and terminal buildings, the endorsement and rewarding of efficiency and innovation and, importantly, that any system be simple to administer for both regulators and regulatees.

I would like, if I could, to go a little bit into the background now as to where we find ourselves today. I think that's important in the context of some of the issues. I think it's fair to say that the privatisation of Australia's airports, commencing with Brisbane, Melbourne and Perth in July 1997 has, in general, been an outstanding success. The break up of the former federally-owned network of airports and the establishment of independent airport businesses under the Airports Act is seen around the world as a leading example of privatisation.

The associated pricing framework administered by the ACCC has achieved some of the government's objectives, although there are still areas where improvement is possible. Airports were sold on the basis that operators would be required to reduce aeronautical charges significantly in real terms in each of the first five years. These reductions reflected the early efficiency gains that were expected from privatisation in what was, at the time - pre-Asian crisis - expected to be a very high growth environment. However, increases in charges were permitted within the five-year price-cap period for new investment.

The government has very clearly stated intentions that at the end of the five-year period the CPI-X price cap will no longer apply. This is based on the expectation that airports and airlines reach commercial agreements on charges to apply from 2002. The commission is now required to recommend an appropriate pricing framework to government in the absence of such agreement. I would like to perhaps provide our understanding of the basis upon which initial charges were set, what occurred during the sale process and what has happened in the period since privatisation.

FAC charges on 1 January 1997, as subsequently reduced by CPI-X, were used as a basis for the first five years. These charges were the former network charges of FAC adjusted in the 1996-97 financial year in a move towards airport-specific charges. No comprehensive review of asset values was undertaken at the time and consequently starting charges bear little relationship to the value of the assets utilised by the airlines. BAC contends that current charges at Australian airports are so far below fair levels that any concerns held by regulators regarding airports' ability to earn monopoly profits is unwarranted.

Whilst BAC took commercial risks on the profitability of Brisbane Airport during the first five years post-privatisation, BAC consider that it's now imperative that a new pricing framework deliver fair commercial outcomes for airport investors - fairer than those achieved under the current framework. Brisbane Airport was purchased from the federal government in July 1997 for \$1.4 billion. The purchase price represents the value of assets acquired and a significant premium of some \$600 million paid for certain existing businesses such as carparking, car hire, duty-free concessions and the future growth potential in property and other non-aeronautical businesses.

Airport operators had a clear expectation that they would, over time, be permitted to make fair, and not monopoly returns on aeronautical assets. I repeat, not monopoly profits, but fair profits. Similarly, they expected that like any other Australian company, subject to complying with the Trade Practices Act and the Prices Surveillance Act, they would be able - and indeed were actively encouraged by the Office of Asset Sales - to grow the non-aeronautical businesses on airports. One of the reasons why airports and airlines have such appalling relationships around the world is that the definition of aeronautical and non-aeronautical activities has been unclear. However, much to its credit the Department of Transport and Regional Services established a largely clear definition of aeronautical activity, specifically to provide clarity for bidders and for the existing airlines during the privatisation process.

Whilst both airports and airlines have thoughts on certain minor changes to that definition, the industry is now in a position to move forward. Any significant change in the definition of aeronautical and non-aeronautical activities would result in a massive reduction in the value of investment in the privatised airports. This would expose the federal government to multimillion dollar legal actions from airport investors - many of whom are Australian superannuation funds - and do untold damage to Australia's international reputation for fairness.

Post-privatisation progress on commercial negotiations between airports and airlines has been slow for a number of reasons. Expectations of airports and airlines from privatisation were quite different. Airlines were happy to accept the reduction in aeronautical charges each year, although these were not passed on to domestic customers. In fact in the five years ended 1999, domestic airfares rose between 38 and 42 per cent based on Bureau of Transport Economics figures. Indeed, the two

major domestic airlines have only reduced fares when forced to do so by the two new domestic operators.

On the other hand, when Brisbane and Perth Airports introduced a fuel throughput fee under a contract entered into by FAC, the airlines were quick to pressure the ACCC and the government to take action. Importantly, BAC did not enter into the contract with the oil companies. It was the FAC, a government-owned enterprise, which deliberately entered into the contract that provided for a fuel throughput fee. This contract was signed in April 1997, just as final bids were being negotiated to purchase the airports. Given that FAC would have no future involvement in the airports, it's inconceivable to think that it was not the government's clear intention that the airport sale price would rise if this contract was in place prior to privatisation.

Although it was clearly the government's stated intention that aeronautical charges could be increased outside of the price cap for new investment, it was not until April 1999 that the Department of Transport issued a letter clarifying the position. Until that time the airlines had been using their significant market power and refusing to agree to price increases outside of the price cap. Even then, it was not until March 2000 that the ACCC finalised a suitable definition of necessary new investment. This enabled Brisbane Airport, along with Perth Airport, to be the first airports to reach agreement with the airlines and the ACCC to increase charges outside of the cap for new investment, some 34 months after privatisation.

A similar situation occurred with the airport operator's ability to recover costs in respect of new government-mandated charges. In December 1998 the Department of Transport mandated that airport operators were to be responsible for international passenger and baggage screening at international terminals by 1 October 1999 and 1 June 2000 respectively. It was not until March 2000 that ACCC finalised the definition of cost recovery for these purposes, well after work on these projects had to start.

In summary, I think airport owners and users find themselves in a position where there was no fundamental basis for the aeronautical charges originally set at the time of privatisation and therefore prices are not reflective of an efficient pricing framework. The privatisation process created a framework from which future price negotiations could take place, but the involvement of regulators has stifled the negotiation process and the development of aeronautical facilities. In the submission we go on to discuss the stated Department of Transport objectives in the pricing policy, but I think we can leave that out in terms of our comments.

What I might do now, if I can, is just to cover a few of the questions in the issues paper and our brief responses to them. The first question in the issues paper is: is the potential for abuse of market power an appropriate rationale for specific regulation of airport services? Are there other appropriate rationales? In the context of prices regulation, BAC considers that the only appropriate rationale for regulation

should be the redress of an actual market failure. This means that specific prices regulation of airport services should not exist to merely protect against potential abuse. Rather, if the government is merely wishing to achieve a mechanism by which to protect against potential abuse, BAC contend that the existing Trade Practices Act is quite sufficient.

Another question: currently what is the extent of competition between Australian airports? Do airports compete on quality and/or price? We contend that major airports in Australia compete very much against each other at several levels. This includes competition to attract new airline services. Airlines are increasingly looking to airports to demonstrate their partnership approach and share the risk associated with new services. A good example would be that Emirates or Singapore Airlines, or any of the major international airlines, will simply say to the airport, "We have a \$250 million aircraft. We could put it on a route to Brisbane or one to Sydney. What's the deal?" That's the way the industry has now moved, so that there is undoubtedly competition between various airports for services.

We need to ensure that any mechanism we introduce is capable of being offered to all airlines, is fair and is easy to administer. The other area where we compete is as a hub airport for transfers between hubs. It is obvious that airports are actively engaged in competition to be hub airports for various international carriers. In the case of Brisbane, based on anecdotal evidence - and we can't get the true figures because we can't get it from the domestic airlines - we would have something like more than 50 per cent of South-East Queensland residents travelling internationally who fly through Sydney, a congested airport. That seems to be a crazy situation.

There is also competition between airports within South-East Queensland. At the general aviation level that competition certainly exists, but it's relatively small. But in the case of Coolangatta and Sunshine Coast airports there is real competition. Research on Brisbane Airport performed by Standard and Poors noted that:

“Over the longer term Coolangatta Airport may develop as an alternative arrival point for leisure travellers to South-East Queensland. While a low likelihood in the medium term, potential expansion at Coolangatta Airport presents a risk to both domestic and international tourist traffic at Brisbane over the longer term.”

Then there is competition for the provision of services at airports generally. BAC competed with virtually all major airports to try to secure the operation of a maintenance headquarters of Virgin and Impulse. Further, BAC successfully attracted new maintenance facilities for Qantas in Brisbane. This approach has involved bidding actively against other airports in Australia and New Zealand.

Another question: what is likely to happen to competition in the future? What factors other than regulation are likely to be the most influential in curtailing or

promoting competition? I think competition between major airports in Australia is only going to increase into the future. However, BAC knows that unless returns to aeronautical investment improve from those currently achieved, the focus of competition will likely be on non-aeronautical activities where the potential to earn a return is greater and more appropriate to the risk involved.

What are the concerns - that certainly the ACCC seems to focus on - is how significant are common costs in the provision of airport services. We would contend that the vast majority of costs incurred by airports are readily identifiable as either aeronautical or non-aeronautical and where there are common costs these are relatively insignificant in the scheme of things.

A question was: how pervasive are demand complementarities in the provision of airport services? How do they affect pricing? Really, this starts to get into the single till/dual till issue.

I won't go into that in too much detail, but airline operators often argue that a single till approach provides an appropriate mechanism for the sharing of benefits generated by non-aeronautical related services through airline passengers - that is, airlines argue that as they provide customers for the total airport, both aeronautical and non-aeronautical services, landing charges should be subsidised to reflect the additional income earned by airports through the airline customers.

This argument is ludicrous and assumes that the airline companies are the sole originators for passenger movements in and out of Australia - that is, the tourism industry, the appeal of the destination, the enormous investment by theme parks, hotels, golf course owners and the like, is not relevant. Should Qantas, Ansett, Virgin, Impulse, for example, be required to hand over some of this week's revenue to the Productivity Commission? The only reason we are here today is the existence of this commission's hearing and the logical extension of the airlines' argument is that they should share their revenue with you.

PROF SNAPE: We had actually contemplated having it in Broome to help them along.

MR ROTHWELL: I just think the airlines' argument for a single till is laughable.

Probably the main area is the countervailing power of users of airport services. Do airlines and/or other users have any countervailing buying power when negotiating with airports? Is there any relevant Australian or overseas experience? It is clear from all the analysis that airlines have significant countervailing buyer power and, in contrast to airports, generally fully exploit this whenever the opportunity arises. There are numerous examples of this happening in the Australian airport context, primarily associated with the necessary new investment process.

There would not be one airport in Australia that has not been obstructed by

airlines in the development of new facilities since the actual introduction of the current price regulation. The change in domestic activities in Australia provides additional incentives for the incumbent airlines to do everything they can to make it difficult for new operators. The market power historically has been in relation to Qantas and Ansett as domestic operators, but increasingly on the international field the growth in alliances is now effectively creating an international duopoly in Australia as well.

Are there any constraints on or disincentives to airlines and other users in exercising such power? In contrast to airports, who are price-regulated by the Price Surveillance Act, airlines are not subject to any specific prices oversight regime. Given this relatively unregulated position, airlines have traditionally exercised their market power and priced their services according to monopoly-pricing principles. It is only since the introduction of competition in the domestic industry that we have seen any real reduction in the cost of air travel to the travelling public.

Further, it is only on those routes where competition has occurred that we have seen reduction in the price of travel. It may have changed in the last few days but the full fare for a return trip between Brisbane and Darwin, on which Virgin and Impulse do not operate, was and maybe still is \$1577.40 for Qantas, and \$1577.40 for Ansett. This route has not been subject to competition from airlines and, as such, the incumbent airlines have been able to maintain duopolistic pricing on this route.

Another question: are airports different from or likely to have more market power than other industries with some natural monopoly characteristics? In what respect, if any, do airports differ? Industries that have been traditionally regulated to use their ability to exhibit natural monopoly characteristics - such as gas, water, electricity and communications - are generally characterised by a small number of providers, a large, diverse range of customers and the products and services are generally key business inputs and basic community necessities.

In the case of airports these characteristics are significantly different. That is, whilst airports might comprise only a small number of providers the other characteristics are not met because airports provide intermediate, industrial services that constitute a smaller component of the end price paid to the consumer - somewhere in the order of 3 to 5 per cent of costs. As mentioned earlier, conversely, a small number of airlines possess and utilise significant power. The immediate consumers of services provided by airports are a group of highly organised corporations that have multinational reach and significant political power. Airlines are much larger employers of people than are airports and, as such, have considerable influence with government at all levels.

About the current prices regulation, the question was: are these objectives appropriate? Has the current regulation met these objectives? The promotion of efficiency is central to the ongoing commercial operations of Brisbane Airport. However BAC considers it is inappropriate that this requirement be specifically

legislated. BAC currently faces considerable competitive market forces and fully expects these forces to increase in the future. Therefore the impetus for efficiency will necessarily come from commercial pressures rather than legislative

requirements.

We again say that any government arrangements with respect to protecting the abuse of market power should not be based on theoretical potential, as is currently the case, but should be based on evidence of actual abuse. We believe the current regulations fail to meet the objectives outlined in the Department of Transport pricing policy paper, as we have mentioned earlier.

Has the delineation of services under the current pricing system been appropriate? Has there been pressure to shift costs and prices across services? I think we believe the delineation of services between aero and non-aero in declaration 83 remains appropriate. However, during the first period of regulation under the price cap arrangements we have experienced significant pressure from the ACCC in respect to the classification of new charges at Brisbane Airport - specifically ground facility fees or taxi fees and fuel throughput fees.

We believe the approach taken by the ACCC in considering these fees was a blatant attempt to alter Commonwealth government policy and change the playing field on which airport owners have based their investment decisions. That is, despite advice from the Department of Transport confirming the ground facilities fee introduced was a non-aeronautical revenue stream for pricing purposes, the ACCC has chosen to pursue this and has now sought to incorporate this revenue stream under the aeronautical services price cap. Again, I have already said about the fuel throughput fee before. I won't repeat that.

On investment, which is probably one of the most important issues: how have the investment provisions operated in practice? Have they facilitated appropriate investment at airports? What have been the major issues involved in applying the investment provisions in practice, price determination, rates of return and so on? BAC has strongly argued that the ACCC interpretation and application of the investment provisions in declaration 13 is wrong. Airlines have been using the procedural aspects of the necessary new investment provisions as their primary means by which to undertake regulatory gaming and therefore stifle new investment activity at airports.

The ACCC has incorrectly interpreted the scope of necessary new investment provisions to exclude replacement capital expenditure. It is clear that the Commonwealth government's policy intention was that replacement capital expenditure was to be considered new investment for the purposes of the increased charges under the price cap. KPMG's advice to us was that new infrastructure investment be defined as either the creation of a new asset, the complete replacement of an existing asset that has reached the end of its useful life, or a material change in the nature of an existing asset. This view is entirely consistent with the advice provided by the Department of Transport in April 1999, which stated that new investment must be demonstrably not part of ongoing maintenance of existing capital stock. The impact of this incorrect decision by the ACCC has been the rejection and

deferral of investment in replacement aeronautical infrastructure as airport owners are unable to justify capital expenditure on assets that do not allow for the recovery of full cost and a return on capital.

The other issues that were raised: has prices regulation facilitated competition and the provision of services within airports? Has it impeded competition? We believe it has actually impeded competition. Specifically where airports would have normally invested in new facilities in order to attract new airlines or new services from incumbent airlines they're now not prepared to do so prior to final necessary new investment decisions from the ACCC due to the high level of regulatory uncertainty surrounding these processes.

This is evidenced by the recent decision in relation to the domestic express terminal in Melbourne, which I am sure was talked about early this morning, but the idea that the ACCC would set aside a commercial contract is quite astonishing. For your information, Brisbane's common user domestic terminal has been largely idle for 12 years and yet the ACCC has the audacity to determine what it considers a fair price for a service to new domestic airlines operating for around three months.

To what extent does the current price regulation provide a basis for the development of a more commercial approach to pricing and investment decisions? Has it facilitated or hindered commercial negotiations? We have attempted to develop positive relationships with all airline users of Brisbane Airport since privatisation. Through cooperative approaches with the Brisbane Airport airline operating committee we have, in the most part, successfully worked with airlines to enhance the facilities and services provided at Brisbane Airport. While we are critical in this submission of the regulatory gaming approach taken by airlines in necessary new investment proposals we note that the instances of such behaviour are generally less common than instances of mutual agreement to projects.

Further, we have found that many of the projects that are obstructed are projects that would assist all major airline users of the airport, including new entrants. Clearly, while price outcomes are a fundamental driver in the bargaining conduct of incumbent airlines, frustrating new industry entrants is currently a major incentive to disrupt the new investment processes at airports.

Then lastly, on future prices regulation, we have yet to finalise our position but we will be submitting a paper in due course on what type, if any, of prices regulation is appropriate. But, as we said earlier, we would like to see something that provides the ability for the investor to achieve a fair return on existing and new assets, acknowledgment of the need for early decisions in relation to long-term projects, the endorsement and rewarding of efficiency and innovation and something that is simple to administer for both the regulators and regulatees. Thank you.

PROF SNAPE: Thanks very much, Mr Rothwell. I wonder if, in talking about gaming, you can give examples that are actually at Brisbane in which you have seen

the regulatory - at least the gaming that you talk about by the airlines. We know about the Melbourne one - we've been told about that - but are there any examples at Brisbane?

MR ROTHWELL: A good example would be in relation to projects that are neither purely aeronautical or non-aeronautical. In the case of Brisbane we are looking to improve the domestic road network at the domestic terminal. The reason is that there has been rapid growth with Virgin and Impulse - and indeed other airlines as well over recent times - causing congestion. That road improvement is partly aeronautical, partly non-aeronautical. Whilst we generally have agreement to the need for that work to take place the airlines are happy to let the ACCC be the arbiter on what is a fair split between aeronautical and non-aeronautical investments. We provided a paper to the airlines back in early December. We still haven't had any written response from any airline in relation to that matter, in that they probably believe they can get a better deal by letting the ACCC be the arbiter.

PROF SNAPE: What would you envisage should happen in the circumstance where it's clearly something that has the use of aeronautical and non-aeronautical. In the absence of regulation, what would you have envisaged would happen there?

MR ROTHWELL: What's happening now, which is that we're not undertaking investment until such time as we have a sign-off on what increase in charges we'll receive for this project, so it's not a lot different in a way. We, as a matter of policy, are not investing in aeronautical projects until such time as we have sign-off by the ACCC on the appropriate charges.

PROF SNAPE: But in the absence of any regulation you would be in much the same situation. Would it be more protracted; less protracted? Why would it be less protracted in the absence of regulation?

MR ROTHWELL: It depends really what the basis of the future pricing regime is. For example - - -

PROF SNAPE: In the absence of regulation of prices. Take yourself into the sort of scenario that you would like - that is, you're just depending upon the Trade Practices Act in general. You don't have any regulation, apart from that. You would prefer not to be declared. You would prefer to be treated like any other industry. Would you think that anything would be different in regard to that particular negotiation in those circumstances?

MR ROTHWELL: Possibly not.

PROF SNAPE: In that case, regulation as such - even though as you say the airlines are hoping to get a better result out of the ACCC, nevertheless you're saying that it has not really delayed it. Things would be much the same in the absence of any regulation.

MR ROOIJMANS: That is questionable, of course, as to who has the ability to set the price at the end. If it is ours, the airlines could argue afterwards that we set a too high price, but I would prefer to have some ability to set the price. I would like to draw the line to the future, to major investments. I fear that future considerably. We will face, let's say within seven to 10 years, a huge investment at Brisbane Airport if we have to increase our capacity in our runway system because we surpass the present capacity. Our projection is that it will be within seven to 10 years.

We talk about investments of \$300 million to \$400 million. The lead time of such an investment is about seven to 10 years, with all licences and discussions and environmental impact studies as such. If it is not clear who can, at the end of the day, set the price, if it is not clear that there will be some return on an investment, I fear the situation that we cannot afford to do these investments and there will be a considerable constraint on the growth of Brisbane Airport. It has not only an effect on Brisbane Airport itself - perhaps we can cope with it - but it has an - - -

PROF SNAPE: I see that. But if you have no regulation at all, you're going to have to come to an agreement. Are you saying that that scenario is so uncertain to you that you're not really satisfied? You want to have some regulation to say who can set the price?

MR ROOIJMANS: Yes.

PROF SNAPE: You want a regulation?

MR ROOIJMANS: I don't know whether you call that regulation or not, but in other countries the price is mostly set by the airports and the reasoning is judged afterwards. I think I would prefer that system more than to have no regulations at all, or to have no powers at all.

PROF SNAPE: Presumably you like to keep your customers happy. You would want to talk to them before you go ahead with this.

MR ROOIJMANS: Yes.

PROF SNAPE: You'd want to know the specifications for the new runway and so on.

MR ROOIJMANS: Yes.

PROF SNAPE: So you'd be talking to them. It's a normal commercial relationship, isn't it, that firms talk to their large customers before going ahead with an investment, and they work out a situation there? Sure, you're going to be setting a price, but you would want to have some sort of understanding on that price before you go ahead with the investment.

MR ROOIJMANS: Yes.

PROF SNAPE: I think you're tending to say that the regulations in fact are not really holding these things up; that it would take just as long anyway.

MR ROOIJMANS: In theory the regulation is not holding up, but in practice it is, because up until now our experience is that there is not much pressure on the airlines to agree with us. With the absence of this pressure to come to an agreement, and with the absence also within the airlines to have a long-term view on what has to happen, it is very difficult to come to an agreement on such a long term.

MR RYNNE: I think Tim mentioned earlier that in most instances the airport has a good relationship in discussing new investment with airlines through the airport operating committee. It's only in smaller instances where they're having trouble negotiating particular projects. In some instances those projects are projects that provide benefits to new entrant airlines either greater than the incumbent airlines or to an equal extent. So they're using those mechanisms, or the NNI mechanism, to stall those projects that could provide some benefits to their competitors.

PROF SNAPE: Would there be any difference in an unregulated system? Again, your large existing customers would possibly not want to encourage competition or to facilitate competition with them.. Would there be any difference in the process, in the absence of regulation?

MR ROOIJMANS: Perhaps you are right. Perhaps it is not.

MR RYNNE: If the airlines know that there's no fall-back mechanism by which to take this as a matter of first instance to a regulator - and I think that the bargaining process may change in the future, without this fall-back position that they immediately go to.

PROF SNAPE: Thank you.

MR ROTHWELL: The issue of whether you regulate or not is a complex one in relation to some of the longer-term assets. Forgetting the commercial interests of airports or airlines, historically at most airports around the world major pieces of infrastructure have been built by government in the past, who implement charges, and so it goes on. In a privatised environment, Brisbane Airport Corporation would probably be far wealthier if it never built a parallel runway. You have to question whether the framework that exists is appropriate to make sure that large pieces of infrastructure get built. I think that's an issue for the industry - whether there is price regulation or there is not - but certainly it's a consequence of privatisation.

PROF SNAPE: Yes. I'm trying to think of other lumpy investments that have been in the private sector, and there are a lot of them. If you're contemplating building a

new blast furnace or something like that, it's a very big investment. You talk to your customers. You try to get some agreement on parameters, possibly some long-term contracts - all of that. That's in the nature of things.

MR ROOIJMANS: It's in the nature of things. That's absolutely right. But we can say now the future will tell, but is that the situation that is wanted - the demand?

MR RYNNE: I think it is necessary to make the point that I think what you're focusing on are those projects that are in disagreement. Certainly what we're focusing on is working in a partnership with the airlines and the major users to provide projects that they definitely need, require working with the airport to identify that they need those going forward.

PROF SNAPE: What I'm trying to find out is in your experience whether the existence of the regulator in fact delays the agreement or changes the outcome.

MR RYNNE: Yes, it does, because it slows the process down when the airlines choose to follow that route of questioning a project and taking it to the regulator for arbitration. So, yes, it does.

MR ROTHWELL: But at the end of the day the airport doesn't want to build infrastructure that doesn't benefit its customers. So our preference is to negotiate an outcome that our customers are happy with and that we are happy with, and given the rates of return on aeronautical investment there is no real incentive to build unnecessary projects. We'd be far better investing our limited capital in other more profitable assets.

PROF SNAPE: You speak early on about screening - it's on page 7 - international passenger and baggage screening, and you talk about the delay that was brought by the regulatory system there. Did that change the nature of your investment at all? We've had evidence from Melbourne that that delay actually affected the nature of their investment and, in fact, it was as I understand it more labour intensive than it would otherwise have been because of the delay in getting any approval for necessary new investment. Did it affect the nature of what you installed?

MR ROTHWELL: The physical solution that we installed was the one we wished to install. The extent to which it changed was the fact that because the ACCC would not permit a fair rate of return on the value of the asset created, we simply leased the asset and passed those charges on in full to the airlines. In other words, we were not prepared to invest our capital at the rates of return the ACCC felt were fair, so we simply leased the asset from somebody else. So it did change the outcome in terms of how we went about creating that asset. We have made it clear that in relation to government mandated charges, where the ACCC believe we should get an even lower rate of return than we do on other aeronautical investments, we will not be investing our capital in those sorts of assets. We will simply lease them. It's cheaper and more sensible from our point of view.

DR BYRON: In the summary table in the submission you mention in a couple of places - page 13, I think - about the airport's competition with Coolangatta. I'm just wondering if you could elaborate on the extent of your competition with Coolangatta, perhaps also Maroochydore, and the extent that you compete with Sydney for international passengers. I'm reminded of your comment at the end of the SACL hearing of the ACCC in Melbourne last December where you said that Sydney's second airport already exists and it's in Brisbane. Could you elaborate a bit more on the extent of that competition.

MR ROTHWELL: Coolangatta is a small airport site. It's nothing like as big as Brisbane. In reality it would be very difficult for the owners of Coolangatta to develop that airport into a fully-fledged international airport. Nevertheless, at the margin, they can attract services from Brisbane very easily. Whether people travel from Melbourne to Brisbane or Sydney to Brisbane or Melbourne-Coolangatta, Sydney-Coolangatta domestically is a matter for the airlines. I guess they have the ability to use Coolangatta for a significant part of our traffic, if they choose to. Likewise, with trans-Tasman traffic, Coolangatta has the potential to take some of our business over time, and already operates a number of charter services to New Zealand at the present time. If I had to invest in one or the other, I'd invest in Brisbane. Nevertheless, Coolangatta do have the ability to attract services from Brisbane over time, so if we were to increase charges dramatically and make life difficult for the airlines, then it's conceivable they would look more seriously at increased services through the Sunshine Coast and through the Gold Coast airports.

DR BYRON: Hypothetically, if Impulse flew out of Coolangatta but not out of Brisbane, do you think that you'd see more of your current passengers taking the train down to Coolangatta and flying off from there?

MR ROOIJMANS: There's no train to Coolangatta.

MR ROTHWELL: It doesn't quite go that far. We know that now. In other words, during this period of domestic competition, Brisbane Airport's figures are growing fairly rapidly and some of those are at the expense of Coolangatta where, because of lack of competition through Coolangatta, prices have remained higher than they have through Brisbane. People from the Gold Coast are driving to Brisbane and flying out from Brisbane, rather than paying the higher prices to fly from say Coolangatta to Sydney or Coolangatta to Melbourne, so the reverse could happen.

DR BYRON: This also brings in the question of landing charges and how significant or insignificant they are in the grand scheme of things. You probably heard the discussion we've had with a number of other airports and one airline so far. What would you expect would happen if Brisbane Airport was to double or halve its landing charges? Would we see substantial changes in routes, frequency, type of aircraft, or would it simply not affect anything very much?

MR ROTHWELL: I think I agree with the earlier comments that were made about the fact that it's part of a bundle of things that influence a decision. If Brisbane-Sydney is a highly competitive route, plenty of passengers, the airlines are not going to not fly that simply because Brisbane's charges might be slightly higher, but at the same time at some point airlines have a choice and, as I said earlier, international airlines will say to you, "We have a \$250 million aircraft. We can choose to fly it from the Middle-East to Brisbane or to Perth or to Melbourne or to Sydney. Why should we choose Brisbane?" So as well as the tourism destination type of issues, airport costs are just another part of that decision-making process.

DR BYRON: In Virgin's decision to be based at Brisbane, was that affected by carrots from Brisbane Airport or was that the Queensland state government or all of the above?

MR ROOIJMANS: I think either/or, if you look at - but you have to ask it of Virgin, of course. I think what the state did was quite normal for new businesses setting up in the state. They were competing with Victoria, who are interested to have a new company in Victoria, but I think it was the total concept that made it quite attractive. The attitude of the state and the city and the airport combined to make proposals: where to have their head offices, what facilities could we offer, how could they start up, et cetera, the capacity we could offer, et cetera, was in total more attractive than Melbourne could offer, and I think that is the case. We did not change our landing charges because they are equal for all, so in that respect there were no carrots of course, and we do the normal things in our terminal charges.

As the other airports do as well, we had to calculate our costs and we try to make a fair return in the future on our investment there. But you have to realise that the common user part of the total domestic terminal is an investment from 12, 13 years ago of \$17 million - is it \$17 million in total? About that - which was hardly used during 13 years of time. The remark of Tim that we were very surprised by the attitude of the ACCC that they thought that the risk of the investor is hardly there by making their judgment about the investment in Melbourne surprised us totally because if you look at the evidence, at the \$17 million investment, that was done by the former owner, the risk was quite substantial. We had hardly any use of it. Now we are very happy that we get at least a start-up of a return, and we are still not there and in the start-up phase we make it attractive, of course, for the airlines, but we agreed already what will happen in the course of the years.

DR BYRON: So again that is the normal commercial practice that we are talking about?

MR ROOIJMANS: Commercial practice, yes.

DR BYRON: Trying to set up long-term contracts?

MR ROOIJMANS: Yes.

PROF SNAPE: On page 42, when talking about quality monitoring in the context of price regulation, you say that quality monitoring is necessary to ensure that airports don't run down the quality of services. Is this suggesting then that Brisbane Airport would run down quality if it had the opportunity to do so, and if not, then why is such monitoring necessary, as you say it is?

MR ROOIJMANS: I think we would have chosen a monitoring system by ourselves. It was already in development before the ACCC chose their system. We gave a lot of input to their system as well. In the practice of Amsterdam Airport we looked at at that time, there is a monitoring system, a quite open monitoring system there, without the pressure of government. That is good business practice I think as well.

PROF SNAPE: Well, I can understand that people will self-monitor, but that's not what this says here. What it's saying here is that quality monitoring - what was meant was external quality monitoring - will be necessary, otherwise, to quote you:

“in order to ensure that airport operators do not attempt to maximise profits through reducing necessary expenditure, thereby running down the quality of the services provided at the airport – ”

which is saying that unless you had the Big Brother watching you in this scenario that a profit-maximising action would be to decrease quality.

MR ROTHWELL: That wasn't said in relation to Brisbane Airport. It was said in relation to airport operators. It was in a general sense.

PROF SNAPE: It says that BAC believe that it is necessary.

MR ROTHWELL: In relation to airport operators in the framework of pricing.

PROF SNAPE: I understand in the framework of prices regulation but, I mean, a lot of people have been saying that the competition occurs as a package of things. As you were just saying that you're going to be constrained on prices so you will compete on other things, and I would have thought that the line of your argument might have been to say that the pressure of the competition would drive you to compete on quality, but here you're saying that in fact in this scenario you'd have to have the Big Brother watching you or else the quality would go down.

MR ROTHWELL: I think the statement is in relation to, in a framework of price regulation, we welcome quality monitoring, and indeed we think it's necessary in a framework of pricing regulation because it demonstrates that we are maintaining and improving quality throughout the airport, so it works in our favour. We would not like the suggestion at the end of the five-year price-cap period that we have been

running quality down, so we're happy to see that in there because we believe that demonstrates that we are very serious about maintaining and improving the standards at the airport.

PROF SNAPE: What that first sentence says there - - -

DR BYRON: But absent a system of prices regulation, then the need for and the type of quality monitoring might be different.

MR ROOIJMANS: Yes. May I still make my remark. We would have done anyway, because I think it is necessary to monitor your quality if you have the price set, because it is a price set against a quality - what you think you will offer. In the case of the situation in the Australian airports, it is very odd to me that the airport operator has to be monitored in the airport and in the international terminals, but not in the domestic terminal, and that is very odd to me because the same counts for the airline operators who are the operators of the big part of the domestic terminal, so that is what I think what is quite odd in the situation here in Australia, and I would think that what counts for the operator of the international terminal should count for the operator of the domestic terminal as well.

MR RYNNE: What was also meant by that statement is that advocates of a light-handed regulatory framework understand monitoring of outputs, as in prices and quality, as opposed a cost-based regulatory framework where you monitor costs and assume that the costs have some relationship to those outputs. So certainly advocating a light-handed regulatory framework, it is understood that you need to consider the service quality provided by airports or other utilities, to consider that they are delivering on their outputs.

MR ROTHWELL: We'd be happy to change the word "ensure" to "demonstrate" to clarify our intent, if that's - - -

PROF SNAPE: You might want to reconsider the way that was expressed, I think.

MR ROTHWELL: Yes.

PROF SNAPE: It did seem to be somewhat at variance with the other arguments you've been putting forward. You've spoken about the bid process you had to secure the Qantas maintenance facility. To the extent that you're prepared to speak about it, was that negotiation confined to that facility itself, or was it in fact part of a package of things, that is, "We will locate there, provided you do such and such and such and such and such and such elsewhere"? You may not want to comment.

MR ROOIJMANS: I think both parties have chosen to focus on the maintenance facility as such.

PROF SNAPE: So it was separated from other activities?

MR ROOIJMANS: Separated from the normal airline activities, that is correct.

PROF SNAPE: And separated from any other activities that were not core airline activities?

MR ROOIJMANS: Yes.

DR BYRON: Just one last one. Melbourne Airport told us this morning that they thought that the primary objective of prices regulation had been to squeeze out any inefficiency and to protect the airlines from gouging, and they also said that the CPI-X system had done that quite effectively. I was wondering if you would agree with that assessment? And then the question for the future, I guess, if you agree, is whether those are still sensible objectives or whether they're still the most important objectives or whether there's something else that might need to be added to those, such as getting the appropriate sort of investment for continuing growth in capacity?

MR ROOIJMANS: Both airports have a hindsight at the moment, and I think both situations are totally different. Melbourne might be very happy about the growth in Melbourne. It's totally different to the situation in Brisbane. We were severely influenced by the Asian crisis, but it was not the case in Melbourne. The market situation was totally different. To give an example, in the first year of our operation, in March 1998 we were 15 per cent below traffic the year before. We had expected to be 10 per cent higher. That's a gap of 25 per cent.

In all the years we did not complain about the CPI-X regime because it was a fact, but we did not get sympathy from one airline to discuss how we could cope with this negative effect. On top of that the airlines, especially Qantas, rationalised their schedules substantially and that was another hit on top of the Asian crisis. Although perhaps Melbourne is quite happy about the situation, we are not. It did not fit our situation. I think if you look into the future I would prefer to have a system where you see that you can have a fair return on your investments, as a guidance, than the very subjective choice of a CPI-X regime where you might think that the forecast is X but the forecast is totally different to X.

PROF SNAPE: On page 20 you refer to Gulf Air. I don't think Gulf Air has been mentioned before. Would you like to comment on the competition that existed, the process that existed to secure the initial Australian destination for Gulf Air - what the competition was and what was involved in this competition?

MR ROTHWELL: I don't particularly want to comment on that specifically. I think it's really no different to any of the other international operators that are seeking to fly into destinations in Australia. They are all tending to adopt the same attitude which, as I said earlier, is that for them to make a decision on a new route is very expensive and they are looking for some form of reduced charges, some form of marketing incentive and so on. There is a whole raft of different things that different

individual airlines look for to try and make that final decision. In some cases it may well be that the decision has already been made to fly to Sydney or to fly to Melbourne or to fly to Brisbane, but clearly in terms of negotiation you wouldn't necessarily know that, and all of the airlines are using their position to try and get the best possible deal they can through whichever airport they fly. I think we heard comments earlier about the fact that this is what is happening in Europe and the US as well.

PROF SNAPE: No, it wasn't specifically Gulf Air. It was just that it was the most recent example perhaps of it. I was wondering if there was anything new on the block in terms of competition.

MR ROTHWELL: Not really.

PROF SNAPE: I think that has been a very helpful submission and discussion and we thank you very much for coming to Melbourne for it. We will now adjourn for lunch and resume at 2 o'clock when the Board of Airline Representatives of Australia will make their presentation. Thank you.

(Luncheon adjournment)

PROF SNAPE: We welcome the Board of Airline Representatives of Australia and ask the four representatives to identify themselves for the purpose of the transcript - and the positions you occupy, thank you.

MR BENDIXSEN: Axel Bendixsen, Chairman, Board of Airline Representatives.

MR BENNETT: Warren Bennett, executive director, Board of Airline Representatives.

MR WOODBRIDGE: Graeme Woodbridge, consultant assisting the Board of Airline Representatives.

MS HARRIS: I'm Anthea Harris, another consultant assisting the Board of Airline Representatives.

PROF SNAPE: Thank you very much and thank you for your submission. Who is to speak to it?

MR BENNETT: The structure of the presentation today will follow me making a very short preliminary statement and then Graeme Woodbridge going through the pertinent details of our submission to give you an idea of the sort of arguments that BARA is mounting in terms of future regulation of airport services. To start with, I think it's important to clearly define who BARA represents in this exercise. It represents international airlines operating to and from Australia. We have 48 members, which is virtually all of the international airlines that fly to and from Australia. There are about three or four who aren't members of BARA, so we certainly represent the great majority of those operations.

As an organisation representing international airlines, we only deal with a fairly limited number of airports in Australia. In fact we only deal with seven. It's Cairns, Brisbane, Sydney, Melbourne, Adelaide, Perth and Darwin. As regular international flights don't occur at the other airports, we don't have any detailed or intense interaction with the operators of those other airports. In terms of the services that our members access or consume at airports, it includes runway services, taxiway services, apron services, terminal services, the provision of offices and lounges, the provision of staff carparking, the provision of check-in counters and such like. So that's the broad package of the sorts of services that we see being supplied by the airport operator to our members. The extent of the services that are covered by our submission will be gone into in a little more detail by Graeme in his presentation.

Just before he moves on to that, there are a number of matters that were discussed this morning by the airports that I think it would be useful to comment on. One of the main themes in this morning's discussions was the extent of countervailing power and who wields it, who has it and to what extent. As you would expect, we don't believe that international airlines operating to and from the international airports in the absence of effective regulation have a great deal of

countervailing power. It was interesting to hear the comments, particularly from Melbourne Airport and the BAA representative about the extent of countervailing power that airlines wielded supposedly with airports in the UK and Europe.

One of the main outcomes of the consultations or commercial negotiations that proceeded in Europe and the UK, if you believe BAA, seem to be litigation by the airlines as the only means of exerting any sort of countervailing power. They also made mention of political pressure, public perception in the countervailing power argument, and you quite perceptively noted that there didn't seem to be a great deal of economic countervailing power. I think it's worth noting that political outcomes and litigious outcomes - you wouldn't expect to generate economically efficient outcomes in the commercial arrangements that might be put in place between airlines and airports.

If the objective of regulation is to try and simulate a competitive outcome, you would expect that regulation under those circumstances properly structured would in fact edge towards a reasonably competitive outcome for the sector. You would not expect to get that either by political intervention or legal intervention, I would expect. One of the other main themes was starting-point prices and the extent to which they provide airports with a reasonable rate of return on their existing aeronautical assets. Again it was quite perceptibly noted that the airports were fully aware of the starting-point prices at the time of the purchase of the airports. So they should have been taken into account in setting the prices that were paid.

Just to settle one matter of confusion, the starting-point prices at the airports at the time of privatisation weren't totally set under a single till on a network basis. They were in fact single-till based but they weren't set on a network basis. In fact, there were adjustments to aeronautical charges at the phase 1 privatised airports in 1977 to give them differing aeronautical charges as starting-point prices. Another theme of this morning's discussions was what would the airports do, and what would be the structure of their aeronautical charges in an unregulated environment? It was interesting to note that they couldn't answer that question. We got some weasel words that didn't really add very much to the debate. Certainly they didn't answer that question. One of the responses that they gave was that they would only make changes to the structure of charges after consultation with customers.

That brings us to the point of what sort of consultations have airlines had experience with in recent times with airports. There have been three types of consultations, or consultations that have been undertaken under three different scenarios. We've had consultations with privatised airports under the CPI-X, price cap and NNI arrangements. We've had consultation with Sydney Airport under a prices surveillance-type environment and we've attempted to have consultations with Cairns Airport under a no regulation-type environment.

There have been various degrees of success in consultation under those scenarios. The privatised airports have tended to draw on the poorer outcomes, if

you like, of the consultations that have taken place in recent years, or since privatisation anyway, between the airlines and the airports. They've dwelled on the downsides. They haven't really lauded very much the upside, and we believe that there has been genuine progress in the consultation exercises that have gone on between the airport operators and the airlines during that time. It has taken some time for the rules of the game to be set down and it has taken some time for both parties to understand what the rules of the game might be. But nonetheless, the consultation on those arrangements has been reasonable.

If we go to Sydney Airport - that was a little different in the latest proposal that Sydney Airport made for adjustments to aeronautical charges; they gave us their proposal, they told us what it was, we made comments on their proposal, they went away and they came back and they gave us their proposal again with some very, very minor adjustments. We gave some further responses and they said, "We'll take it to the ACCC." It was portrayed this morning as being always the airlines who run to the ACCC in some sort of gaming exercise. In fact, in the case of Sydney Airport Corporation, Sydney Airport Corporation went to the ACCC and did not pursue any sort of detailed commercial interaction between the airlines and themselves. So it works both ways.

Then with Cairns under an unregulated environment, we just haven't been able to achieve any sort of consultation whatsoever. They've studiously ignored our requests for the establishment of a regular consultative process similar to that which has been put in place for the privatised airports. We haven't had any success whatsoever there in achieving that. They're the three sorts of outcomes that we have noted as airlines in attempting to have commercial consultations with the airport operators.

Another area of misunderstanding, I think from this morning's exercise, was a reference by Adelaide Airport to the CTFR dispute. I think from memory they used that as an argument to show the sort of countervailing power and the sort of commercial advantage that airlines might achieve in the absence of regulation. I can't recall exactly what the context was now. There's a little bit of misunderstanding there. In fact, the dispute the airlines had over the CTFR matter a couple of years ago now was as much a dispute with the Australian Protective Service as it was with the airports. In fact, there was a very significant lack of transparency about what was happening with CTFR charges at that time, with the movement from a 75 per cent cost recovery to 100 per cent cost recovery. The numbers, so far as we were concerned, that the APS and the airports were giving us just didn't add up. We wanted to make sure that we were in fact only being charged the correct amount for CTFR service, so we continued to pay.

I think Adelaide Airport hinted that we didn't pay. We continued to pay at the old rates. We just didn't pay the increased rates. The APS understood that and they worked with us to resolve the issue and, as Adelaide Airport said, they didn't pursue the airport [sic] for those shortfalls. At the end of the dispute the bills were settled.

So it wasn't a great exercise of countervailing on the part of the airlines. We were in dispute with the APS about the amount that was being charged and we wanted to have it resolved.

The other main theme I think was probably competition between airports - and single till got a run too. It was interesting though that Brisbane Airport finds the single-till argument laughable. Of course we don't. We think it's a very logical and strong economic argument, but then we think the airports' arguments about competition between airports is a little bit funny as well. But that's not a problem. It augers well for the future. As long as we can keep ourselves amused, then I think we'll be able to progress commercial negotiations into the future.

From our point of view we don't see a great deal of competition between airports. We didn't mention specific aspects of competition between airports in our submission in great detail, but one that was mentioned this morning was Brisbane versus Coolangatta. In the arguments that were mounted this morning about whether that competition exists, it was interesting to note that - it seemed to me, at least - it was more the actions of the airlines that were generating the competition than any action whatsoever on the part of the airport. It's worth bearing in mind or asking yourself: who is generating the competitive element, if any competitive element exists?

I think it was worthwhile to at least get some comments on the record from the airlines in response to a number of the arguments that were being made by the airports this morning ahead of the presentation we make in our submission. Having done that, I might hand over to Graeme to run through the principal points of our arguments.

PROF SNAPE: Thank you for that. It is useful to have responses, as you say, and over to Graeme.

MR WOODBRIDGE: What I thought I'd do is just go through some of the economic framework that's built into the submission. The submission is somewhat preliminary. It doesn't actually focus on specific views. It tries to think about a framework for thinking about two questions. One is: should there be regulation of airport services or the pricing of airport services? The second question is: what form should that regulation take? I think they're interdependent questions.

I suppose the framework that we think about is one of economic efficiency and basically it recognises that charges for airport service are going to affect a range of economic decisions. It's going to affect who uses the airport, how much they use it, when they use it. It's going to affect investment in airport services, replacement of existing capital, enhancements of capacity. It's going to affect what services are provided at the airport, how they're provided, and it also will affect to some degree who will enter and compete in related markets. I suppose where we always get to with decisions of whether to regulate and how to do it is trade-offs. Failing

regulation you're not going to achieve the perfect outcome. There's market failure. Regulation is also not a precise tool and it's not going to necessarily promote economic efficiency in the first best outcome, so there are trade-offs to be thought through when thinking about those two questions.

I suppose the first one we started to think about what was: if you're considering regulation, what's the economic basis for considering regulation of airport services? I suppose there are three issues. One is that airport services are an essential input to providing air travel. Without an airport you can't provide air travel. There are no viable alternatives to provide that service without access to airport services. The second is that there are poor or, in fact, no substitutes in the product market - which is the sort of air travel product market - to constrain any market power of airports. The third is that the provision of airport services is really not contestable. Either it's unfeasible or uneconomic to build a competing airport, or there's no provision for any competitive tendering of the bottleneck elements of airport services. Those three things make you ask the question: should there be some sort of regulation to address the market power associated with those?

The next question is: what are the likely implications of not regulating? The first is that even the privatised airports are profit-maximising. You would expect that prices for these services would be pushed well above economic cost and that will discourage air travel at the margin. In fact you've got an additional problem in the sense that the airport at the start of the journey and the airport providing the service at the end of the journey are different owners, so you get what's called "the double marginalisation". They both set prices independently of the other and so you get a double deadweight loss because of that.

Monopoly pricing is also going to lead to underinvestment in airport services. Investment is about providing the service in the future. The monopoly pricing will discourage air travel today and in the future and hence you will get the underinvestment. There's also, especially for the government-owned airports, lack of pressure. There is no competitive pressure to be vigilant over costs and that can result in further economic loss. The next is again related to pricing but the quality of service is likely to be below the optimal level. Finally, there's potential for competition and individual services on the airport to be discouraged.

The question is: what is the bottleneck? What is the problem? If you're going to regulate you have to work out what's the actual bottleneck service you're trying to regulate the price of. What do airports do? Really their core activity seems to be to provide runways, taxiways and apron infrastructure and access to that infrastructure and access to the space around that infrastructure. It's that access which is the bottleneck, it's the combination of the two. Airlines, they purchase services from airports directly - landing and take-off services, for instance. They also purchase services from service providers who seek access to the airport in order to provide them - refuelling of aircraft, catering, ground handling. All those service providers who provide those services to the airlines have to gain access to the airport, so it's the

issue of the space surrounding the airport that's the bottleneck as well as the runways and taxiways, et cetera.

When you think about it - if that's a bottleneck what's their market power? Then you start thinking about how you might want to regulate, if you find regulation justified. Then you've got to start off thinking: what's the market in which airports provide these services? The way we think about that is that airlines really buy a package of services, a bundle. Once you decide to fly into Melbourne Airport you buy a bundle of things. You buy the landing and take off. You might buy the terminal access. You are going to have to, on the airport site, purchase things like refuelling, as I said before, ground handling, access to terminal lounges, office space. So once you've decided to actually fly to a particular port you're actually buying a bundle of services from the airport or from businesses that operate on the airport. You can't just simply say, "Well, I'm going to land in Melbourne, but buy my refuelling services from somewhere else," or "my catering services from another location". It doesn't happen.

Airline travellers also demand a package of services. They demand access to an airport, use of terminals, the air travel itself, access to waiting areas and so on. They buy those things as a bundle. So in some sense airport services, or nearly all airport services seem, in my view, to be part of the same market. If you could imagine a field of rivalry, if there was a competing airport, what would they compete in providing? They would compete in providing a bundle of airport services. An airport just providing a runway wouldn't be really competitive against one providing the package. That's the market within which the market power lies.

So where does that lead one? If one is going to regulate airport services this tends to indicate that there should be some global constraint across a broad range of airport services. For example, if you only regulate one or two and there's no constraint on the others since they're purchased as a package, you would expect the other prices to increase to make the price of the bundle into a monopoly price, so jumping on one doesn't seem really to have much effect. Also it's difficult to set individual prices at an airport. The efficient prices are not independent of one another. Regulating one particular service on an airport - it would be very, very difficult to determine what the efficient price of that is given it's dependent on what the other prices are.

The last issue is: what airports should be regulated? As Warren said, BARA members really use seven major airports in Australia. I suppose what we really say there is it's really a weighing up of the costs and benefits of regulation. The costs of not regulating really depend upon firstly, the size of the airport. The size of an airport is pretty important in thinking about which airports to regulate.

PROF SNAPE: Thanks. You raised the question of to regulate or not to regulate. You didn't really address, at least in those remarks, as to whether the regulation - having ticked off on that question - whether the general provisions of the Trade

Practices Act were sufficient. Your check list in fact was a check list that in part is in the access provisions and was covered by them. You may wish to consider what were any special features of airports that might or might not warrant special differential or industry-specific regulation. Your check list simply led to, I think, Part IIIA of the Trade Practices Act and not to industry-specific regulation.

MR WOODBRIDGE: Possibly. As IIIA works at the moment, if the decision is that it decided to regulate, would it do a good job - I guess there are decisions here. There are decisions between regulating and not regulating and there's good and bad regulation within that.

PROF SNAPE: IIIA, of course, as amended in accordance with the recommendations of the commission last week.

MR WOODBRIDGE: Clearly a better IIIA.

PROF SNAPE: Of course.

MR WOODBRIDGE: But I will go back to the old IIIA. You can correct me because I must admit I haven't read the report in detail. But here are the difficulties and here is where the distinction may lie: one is that there are a large number of services provided on the airport, so if there is a negotiate-arbitrate model of access one could imagine extreme difficulties in just administrating that. I have a lot of service providers, refuelling companies, catering companies, ground-handling operators who seek access to the airport, so that would be one set of services that potentially could be declared under IIIA. You've got the airlines using the runways, taxiways, infrastructure, et cetera, which is another set of services. Administratively it might be difficult.

But where I think it's difficult from an economic perspective goes to the fact that, as I said, airport services are purchased as a bundle. Airlines coming into an airport and passengers using an airport drive demand for other airport services, so you've got a very difficult pricing problem. You've got a lot of common costs and you're going to price a lot of these services above marginal cost. How you should do that - for a regulator it would be extremely difficult. It would be Ramsey pricing plus cross-elasticity of demand. The matrix would be just insurmountable. I would tend to suggest that a regulator picking one service off and arbitrating over the price of that service really is unlikely to get the efficient price. It's really a global issue rather than an individual one. I can see difficulties in actually coming up with an efficient price if you did it under IIIA. It's the multi-product nature - - -

PROF SNAPE: Whichever way you handle it the problem remains, one way or another. I think the key, when you talked about a bundle of products - clearly you need a taxiway if you're landing, and so they're right shoes and left shoes in terms of complementarity. On the other hand, some of the other things you mentioned were not right shoes and left shoes. The special lounges and the office space you

mentioned, the shopping facilities - there is a degree of substitutability there. You can choose to take those, the passengers can choose to use the shopping space or the parking space or not. Airlines can choose to have office space there or lounges there or not. There's quite a distinct degree of substitutability there, and one can't just treat all those together, I wouldn't have thought.

MR BENNETT: I'm not sure it is entirely accurate to say that the airlines have a great deal of choice in terms of locating their office spaces and their lounges, either at the airport or off the airport. Certainly the lounge facilities are facilities that are demanded by airline customers and hence it is felt necessary to supply those services to the customers to meet that demand. It's only viable to have an airport lounge and to provide those services if that lounge is in fact in close proximity to the actual gate the passengers are going through.

PROF SNAPE: The quality of lounges varies very greatly. There's obviously a choice as to the quality and how big it is. Airlines differ in their demands as to what they want in lounges. Some don't want them at all. As to whether they need offices, of course, there has to be some office on the premises but the extent of the office on the premises is something in which there's quite a choice. So my point was that with respect to those type of things there's a degree of substitution that is quite distinct from the degree of substitution between the landing strip and the taxiway.

MR BENNETT: Yes.

PROF SNAPE: I don't think that one can bundle them all together in the analysis of the facilities. At least, I should say that many of the participants either implicitly or explicitly are saying that you can't bundle those things together and just say, "They're all part of the package" - full stop.

MR WOODBRIDGE: But there are choices about what you do and what you don't do. But, in some sense, that just tells me the demand slopes downwards. That doesn't mean there isn't market power associated with it and pricing that above the economic cost and making use of the market power won't lead to an economic loss. That doesn't follow, as far as I can see.

PROF SNAPE: At page 10 you list some of the factors that you were talking about as the potential areas in which monopoly power can be exercised and the losses that might come from it and so on. That's an interesting question. But the other interesting question is: is this potential monopoly power actually being exercised, or would it be exercised? Are there any signs that where there is scope to exercise this that it is being exercised? Are there signs elsewhere in the world - with less regulation - that they're being exercised? Is there any evidence in unregulated airports in Australia that they're being exercised? It's not sufficient to say, "These are possibilities."

MR BENNETT: It's probably true to say, "Yes, we can point to examples where

monopoly pricing is being exercised." If you go back to the lounge and the office space scenario we would claim that there isn't a great deal of choice, that the airlines do in fact need to maintain in most instances a reasonable level of office space at the airport and they need to maintain, as a result of customer demand, a reasonable standard of lounge at the airport as well. It is part and parcel of the package that the passengers purchase from the airlines. Given that, we have to have those sorts of facilities at airports as airline operators.

Admittedly some choose not to. There are larger users of particular airports than others, so the larger users tend to need those sorts of facilities more than the smaller ones. Very often the smaller users will piggyback on to the facilities that the larger operators have at the airport. Nonetheless, there is a need for those facilities. What you tend to find is that the charges for those facilities are very much higher than you would expect from looking at the cost of the construction of the facilities. It's not cost related and it's very much higher than the marketplace for similar sorts of commercial premises in the surrounding districts.

PROF SNAPE: These are clearly locational rents and I don't think you've got any disagreement - I should say clearly there are locational rents associated with being - - -

MR BENNETT: I'm not sure that they are locational rents. Locational rents exist where you have a choice. You can choose to locate in a high-rent area as opposed to a low-rent area, if that choice is available to you. In the case of airports, we would contend that airlines in fact don't have that sort of choice. They need to locate lounges at the airport terminal; they need to locate offices at the airport terminal. They can't have a lounge at a building off airport, they can't have their offices necessarily at a building off airport. It is vital for their operations - - -

PROF SNAPE: As I said before, there are choices to the extent that they have these. Even if it is necessary for, say, Qantas to have a lounge, they have choices as to how big that lounge will be and presumably the rent will in fact determine how big that lounge will be, so there is a choice. It's not just a binary choice of whether there's a lounge or not a lounge. There's a choice of the size of a lounge.

MR BENNETT: But the choice of the size of the lounge doesn't affect the unit rate of the rent that is being imposed upon the airline by the airport operator and that is what we claim is the monopoly pricing.

PROF SNAPE: But won't it go the other way, that the choice of the size of a lounge will be related to what the rental is? If a rental is very high, they will choose a small lounge, if the rental is very low, they'll choose a large lounge.

MR BENNETT: They still have no choice but to pay that unit rent.

PROF SNAPE: They need some minimum, but they've got a lot of choice as to

how much of that they purchase.

MR WOODBRIDGE: I think the point I'm trying to make is that the market power will lead to an inefficient size of the lounge in that example.

PROF SNAPE: What I'm trying to do - I'm sorry I'm interrupting, but I'm trying to narrow the extent of disagreement and to focus on where the question is and I don't think any parties are denying that there are locational rents associated with airports. The question is: is there somewhat more than locational rents involved? Is there monopoly pricing in addition to that locational rent? So are there monopoly rents in there, as well as locational rents? That's what I'm trying to focus on, because as I see it, that's the area of disagreement.

MR WOODBRIDGE: The way I think about that issue is a bit like this, that you have an economic rent if you're paid above your opportunity cost, what else you could do with what you have. Sometimes economic rents are good things, sometimes they reflect market power. If there are high prices for a product in the centre of a CBD, that's probably the case because - is that person earning economic rents? They're probably just earning the opportunity costs of the property. So if I've got a carpark in the centre of the city, that space around that area is scarce. If I didn't use it as a carpark, I'd use it for something else and I'd be able to achieve the same return, so the market in that case generates prices equal to the opportunity cost. In the case of the airport, the issue as well is if there wasn't airport, what could you do with that space? In other words are the returns to using that piece of land as an airport greater than the opportunity cost? That's the issue.

PROF SNAPE: As we know, that's one issue. That's treating the airport as a whole, but we know very well that there are alternative uses of airport land and for any particular use of airport within the airport. We've been talking about it just now. We've been talking about using it for office space or for shopping or for parking or for a terminal space and so on. All these are alternative uses and each of those has an opportunity cost associated with the alternative uses.

MR WOODBRIDGE: That's true.

PROF SNAPE: So just looking at the airport and saying, "This is an airport, full stop," is not, I would have thought, an adequate way of addressing the problem, because the airport land can be used for a great number of different uses and, indeed, there are substitutions between on-airport land and off-airport land as shown in the freight handling, et cetera, or in the freight storing, et cetera, at Sydney Airport and so on. There are alternative uses of the land, so if you're looking at locational rents, one wants to be thinking of the alternative uses on the airport, of retailing versus office space versus lounge, et cetera.

MR WOODBRIDGE: I think that's an issue of the allocation within the airport, but the question is does the airport itself have market power? The airport itself, as

I try to define it, is the runways, the taxiways, the aprons and the access to the air surrounding that; that's where the market power comes in.

PROF SNAPE: But to come back to other thing, airport - you know, market power in what?

MR WOODBRIDGE: In the provision of those services.

PROF SNAPE: Does it have market power in retailing or is it simply locational rent? Does it have market power in other things? Here we come to the degrees of substitutability between the various things that you're talking about.

MR WOODBRIDGE: You asked the question is there any substitute that constrains that power? That's the question.

PROF SNAPE: And for retailing?

MR WOODBRIDGE: It depends on the product. The way I try to think about it, again, is someone who's going on an international air travel buys these things as a package.

PROF SNAPE: They can do their duty-free shopping downtown, they can do it at the airport; it's not a package there. They can park. The airports have been giving these arguments and I'm just repeating what is put to us from them, that these things are not a complete fixed package. They can be unpacked and there are substitutes for a number of the products you are talking about.

MR WOODBRIDGE: Right.

MR BENNETT: The airlines, however, don't buy retail services. They buy the package of goods that Graeme outlined in his presentation which extends from the runway through to check-in counters at the terminal and part of that package, as we mentioned, is the office space and the lounge spaces that the airlines require to provide to their customers, so again the degree of choice is not terribly great. They have to maintain offices at the airport terminal. They have to maintain lounges at the airport terminal, simply because that's what their passengers and their customers are demanding, so the extent of the choice is not as great as it appears that you're trying to point to.

PROF SNAPE: I'm trying to give it that there are choices there and that it's not a fixed package and Graeme, in his outline, went beyond in fact the check-in counter, he went through to the offices, et cetera, and it is my point that he knows there are choices and even if you stop at the check-in counter, there are airlines that are choosing not to have nose in, push-back, but in fact to stand and turn around itself; are choosing to purchase some facilities and not other facilities. But I agree that right up to when you get off the plane, there are fixed packages, but thereafter there

are degrees of substitutability.

MR WOODBRIDGE: If we agree that there are degrees of substitutability, the question is does that put them in the same market or not? It doesn't have to be left and right shoes; they don't have to be perfect complements to be part of the same market.

MS HARRIS: It's a bit like householders being connected to gas. You don't need to be connected to gas, you can use electrical appliances in your house, yet we still regulate gas prices. We regulate gas transmission and gas distribution prices, because government has decided that they're not a close enough substitute, so it's not a, yes, they have market power or, no, they have no market power whatsoever, it's obviously shades.

PROF SNAPE: Could we then say in what areas that you listed, say on page 10, has there been exercise of market power? Are some of the things that are supplied being restricted artificially to a low and efficient level? I won't use the term "competition"; obviously this is not something in which one can use competition as a counterfactual - one uses, perhaps, an efficient allocation of resources, rather than using the term "competition" and so is there any evidence that the various things that you list here are being restricted by airports in a way which would be regarded as exercising their monopoly power?

MR WOODBRIDGE: What page number?

PROF SNAPE: I've got page 10. It's section 6, and you list monopoly pricing, inefficient costs, lower quality of service and distorting the development and then you go on:

In particular, they are likely to lead to underconsumption and use of airport services, underinvestment in airport infrastructure -

And so on -

resource wastage in the provision of airport services.

Can you point to any of these in which the airports are in fact exercising their monopoly power to induce these inefficiencies?

MR BENNETT: It's a question of the extent to which they're exercising a monopoly power, but certainly those sorts of outcomes have been evident in one form or another.

PROF SNAPE: Where? Can you give examples of that, please.

MR BENNETT: Monopoly pricing, as I referred to before. We firmly believe that

the level of rents charged for offices and lounges in terminals doesn't just reflect locational rents, it reflects monopoly pricing of those facilities. Inefficient costs - we've looked at the cost structures for the various airports around Australia to see which are performing better and which are relatively more efficient than others and we've tended to find that, so far as operating costs are concerned at least, there is quite strong evidence to suggest that the privatised airports under the existing regulatory arrangements have performed quite considerable improvements in efficiencies relative to the likes of Sydney Airport, whose operating costs by any measure have increased very substantially over the last few years.

The lower quality of service - we've found that at Sydney Airport, the quality of the baggage handling systems is particularly poor. It has been a constant source of trouble there and it hasn't still been sorted out. There are still problems in the interface between check baggage screening and the general baggage handling system at Sydney Airport.

PROF SNAPE: Is it worse than other airports of similar size in other countries?

MR BENNETT: We believe so, yes. The breakdowns that occur in the baggage handling system at Sydney Airport have been endemic and far worse than our members have reported experiencing at overseas airports. We've had similar sorts of problems with the aerobridges at Sydney Airport as well. Since the new investment at the airport and the SA 2000 project, the quality of service delivery so far as aerobridges is concerned has been particularly poor. One of our members recently had an aircraft door ripped off as a result of a malfunction of the aerobridges at the airport. There have been other problems with aerobridge malfunctions at Sydney Airport.

PROF SNAPE: Are they the sort of things you encounter elsewhere?

MR BENNETT: According to our members, they don't have those sorts of issues to anywhere near the same extent at other airports in Australia and similarly overseas.

PROF SNAPE: Underconsumption and use of airport services?

MR WOODBRIDGE: It's a pricing issue at the moment with regulated prices.

MR BENNETT: I don't think you'd observe necessarily a denial of a provision of a service if you're facing a monopolist. What a monopolist does is increases prices.

PROF SNAPE: But if the price is fixed, then they'll lower the amount of a service they supply.

MR BENNETT: That's right.

PROF SNAPE: Has that occurred?

MR BENNETT: If they lower the price, they'll do which - sorry?

PROF SNAPE: If the price is fixed, then they'll try to adjust the quantity in some way, presumably.

MR BENNETT: In which way?

PROF SNAPE: They may lower the quality of service, for example.

MR BENNETT: We believe that the quality of service has been lowered in particular examples. Move on from Sydney to Melbourne Airport, the baggage screening system that was put in place at Melbourne Airport is considerably lower quality than was originally proposed. It was meant to be an in-line system originally at Melbourne Airport. They didn't put in an in-line system as it subsequently progressed. They blamed the fact that the ACCC wouldn't give them a high enough return on the investment.

In fact, the ACCC did give them a lower return on the capital that they were proposing to invest at Melbourne Airport, but that was simply to reflect the fact that there was no risk associated with that project. It was a government-mandated project, the airlines had to pay. If one airline didn't pay, it all went into a pool at the end of the year and the airport got their money anyway, so there was absolutely no risk associated with that investment. It is government-mandated one, the airport has to do it. They provided a lower quality of service in response to a price being fixed.

DR BYRON: Sorry, I'm just a little bit confused because the text there says that the "immediate consequences of allowing airports to take advantage of their market power" - but what you've been describing are examples that have occurred under the current regulatory framework. I thought you were talking about, "These are the things that we would see if regulation was relaxed."

MR BENNETT: We believe that that would see far more frequent and severe examples of those sorts of examples that I've given.

DR BYRON: But surely you're not suggesting that even over the last few years, the regulated airports have been exercising their market power in all these ways already, even under the existing regulatory framework.

MR BENNETT: For those services that aren't regulated, to a large extent, yes.

PROF SNAPE: You are suggesting that the privatised airports in their unregulated activities are offering a lower level of service than before?

MR BENNETT: No, I didn't necessarily say that. What I was saying was that

there have been particular examples of each of those in the existing environment. Some of them have related to regulated services and some of them have related to unregulated services. The check baggage screening one, for instance, is a regulated service. The quality of the services I have demonstrated, hopefully, has been lower than we would otherwise expect.

The monopoly pricing has, we believe, occurred in the provision of non-aeronautical services such as lounges and office space; the inefficient costs we believe have been shown to apply at the airport that isn't under the same sort of regulatory procedure that the privatised airports are under. Our point is that if you move to an unregulated environment then those sorts of practices, those sorts of outcomes, are likely to become far more frequent and far more severe.

DR BYRON: Would we learn anything by looking at say lounges that are provided at an unregulated airport like Cairns? I mean, is that substantially different? We have got very few examples of an unregulated airport in Australia which we can use as a benchmark to compare the regulated airports and their behaviour but, presumably, if there are lounges in Cairns does that airport owner behave in a vastly different way than those that are regulated?

MR BENNETT: Actually I can't answer that question. I don't know what the level of rents are at Cairns Airport for lounge and office space, so I can't make any comment. I would be very surprised if it wasn't related to some particular area of Cairns or some other indicator of rents that was well above the normal rents that you would expect to pay in Cairns. I can't answer it with any precision, I am sorry.

DR BYRON: This morning and yesterday we were also being sort of taken offshore in search of unregulated or less regulated environments to try and get some sort of insight into what might happen in Australia and so Scotland came up, New Zealand came up. Does BARA have any knowledge at all of the sort of behaviour that occurs in those places with regard to these - - -

MR BENNETT: In New Zealand, in very general terms certainly, the increases in charges at Auckland Airport that have been sought have been well above the sorts of levels that the airlines would have expected in terms of relating a normal rate of return to the investment that has been made at the airport. They're seeking increases in charges that would run well ahead of that. There have been some discussions between the airlines and the airport operator there to try and peg that back and some arrangements have been put in place that are considerably less than the first round of negotiations, but in the first instance certainly there was an action on the part of the airport operator to try and achieve a very, very substantial increase in aeronautical charges at the airport.

DR BYRON: But that also sounds like normal commercial practice, that, you know: if you want something, I've got it. We haggle.

MR BENNETT: The haggling has not been resolved and the matter of airport regulation of the outcome of Auckland has been referred to the Commerce Commission, so it is not a satisfactory commercial arrangement and no agreement has been reached.

PROF SNAPE: Coming back to the actions of a privatised monopoly, back on page 3 you have a sentence there, "Airports with market power have reduced incentives to provide the quality of service demanded by airport users." What are the incentives that a private monopolist would have to under-supply quality?

MS HARRIS: What incentives have they got to maintain high quality? If you've got to go to that airport anyway, whether they provide good, bad or indifferent quality, why would they spend the extra money to provide good quality services unless they can get at least that much money back from the airport operators.

PROF SNAPE: Yes, but if we're looking at airports isn't the incentive of airports to get as many people through the airport to do their shopping, et cetera, as they can? Doesn't that then provide them with an incentive to have high quality?

MR WOODBRIDGE: I think it has an incentive to get them there. Whether they have aerobridges that attach to a terminal or whether you have got to bus them in probably doesn't really matter to them. Where quality of service really can be an issue is those incentives to maximise retail space within the terminal, reduce waiting areas to maximise the value of your shopping space - things like that.

PROF SNAPE: It's generally to get a happy customer who spends money rather than an unhappy customer who zips up their purse.

MR WOODBRIDGE: Or reduce waiting areas so people walk around. I don't know. It was a strategy of the airline.

PROF SNAPE: I have never had the incentive to buy things because I have been kept waiting. I get so cross that I don't buy things.

MS HARRIS: You're not a woman.

MR WOODBRIDGE: Just the other comment about quality of service: a lot of quality of service issue is about agreements. "I contract with you to undertake a task and we agree to a certain minimum level of quality" and then, you know, before the payment is made, "If you don't deliver the quality then I don't pay", that type of arrangement, and so they spend a lot of money on something - in many circumstances they'll sort of have an expectation of that quality level. The question of whether we're in a monopoly environment is when you will get such agreements.

PROF SNAPE: Who is paying for the repair of the Singapore Airlines plane that had the aerobridge drop on the door?

MR BENNETT: I presume it would be an insurance claim.

PROF SNAPE: And what will happen to the airport's insurance premium as a consequence?

MR BENNETT: Presumably it will increase.

PROF SNAPE: So they have quite an incentive, I would have thought, to get their quality right.

MR BENNETT: You would think so but, unfortunately, in the case of Sydney Airport it has taken an absolute age to actually get any progress made in improving the baggage handling system and the aerobridge arrangements. It is taking them what the airlines believe would be an incredibly inordinate amount of time to get it fixed up.

MR WOODBRIDGE: The other thing, I suppose, is whether the airport actually sees the signal, the costs of delays to aircraft due to their actions.

PROF SNAPE: Isn't that a matter of contracts in private? I mean, here you've got two big parties on either side essentially. I know a lot of your members are small parties but insofar as they're dealing with BARA they become a big party and in terms of the conditions this is surely something that can be negotiated with the airport that in fact you negotiate conditions of service and, if you don't get those conditions of service, then there are penalties in accordance with them. This would seem to be absolutely normal commercial practice and yet we've got each party behaving towards the other like kids do in the school yard.

MR WOODBRIDGE: Certainly that's the way to resolve it - by having those contracts.

MR BENNETT: There has been no demonstrated enthusiasm on the part of the airport operators since privatisation to put in place what you might consider to be a reasonable commercial access arrangement for airlines. Two of the privatised airports attempted to do that in accordance with Government directions post-privatisation. The documents they came up with, from our point of view at least, were a simple listing of the rights of the airport operator and the obligations of the airline customer. There were no balanced rights and obligations on either side.

PROF SNAPE: Why didn't the parties then get together and negotiate from that point?

MR BENNETT: We have tried that and again it has proven intractable. We have tried to suggest to airport operators that given the government mandated security requirements at the airport, such as check baggage screening, they specify a certain

standard of service that has to be met by government regulation. And presumably the airport operators have in place with their service providers a series of key performance indicators that need to be met to ensure that those regulated standards are effected, that it would be simple for the airport operator to be able to assure their airline customers that in fact that level of service will be delivered to them. We have asked for a service level agreement of each of the airport operators to effect that sort of arrangement and they have all refused to enter into any sort of service level agreement to ensure that their airline customers receive the guaranteed standards that presumably are in place under the contracts with the service providers.

PROF SNAPE: In other industries in which there isn't a regulator in the background - you have got two big parties and each puts forward a proposal that the other thinks is ridiculous. You then start to talk down and you knock something out. Now, is it the existence of the regulator in the background that each party thinks they can go along and be bailed out, you know, rather than sit down and negotiate like consenting adults?

MS HARRIS: It's pretty difficult to think of other commercial situations where it is a monopolist doing the negotiating, Normally in most commercial negotiations the seller knows that if it can't reach agreement with this particular buyer there are other buyers out there and, similarly, the buyer knows that if it doesn't work out with this seller there are other sellers out there, and that constrains both parties' behaviour in the negotiations.

PROF SNAPE: But there are big parties on both sides, are there not? I mean, each party in this case is saying that the other party is a type of monopolist, so there are big parties and there are in fact big parties on both sides - there are in many industries - but they get together and they negotiate something, so what is wrong in this one?

MR WOODBRIDGE: The size of the parties is important but also it's the outside options which I think is where Anthea was coming from.

PROF SNAPE: The outside options?

MR WOODBRIDGE: Outside options.

PROF SNAPE: Did you mean the regulator in the background?

MR WOODBRIDGE: No. It could be that option they're thinking about. Clearly the appeal to a regulator is going to affect the negotiating environment. The question is, will it affect it in an improved way or will it do it in a way that reduces economic efficiency? Without a regulator you know that commercial negotiations aren't going to get to the efficient outcome.

PROF SNAPE: Say that again.

MR WOODBRIDGE: In the case of a monopoly negotiating with a player, it's the form of the regulation and how the regulator can intervene which affects the negotiating environment.

PROF SNAPE: What about if you have got a bilateral monopoly? If you've got monopoly power on both sides?

MR BENNETT: You don't have monopoly power on both sides, in this instance.

MR: What if?

MR WOODBRIDGE: It's a good question about the "what if". I think the way some people think about it, and I think there are some models that support it, that if you have a monopsony buyer against a monopoly buyer - is that the circumstance you're thinking of? - you will push towards the efficient price. It does not mean you will get there. There are other models to suggest you will just get what is called double marginalisation, one monopoly price on top of another, and you get an incredibly bad outcome. The question is: is that the situation here? In an unregulated environment, I doubt it. Certainly you've got a number of parties on the airline side.

PROF SNAPE: As you were pointing out before, there are degrees of monopoly that are associated with the airport, and packages will be negotiated, so it's not just a matter of negotiating, say, for landing, full stop. It can be negotiating on a whole package of things, some of which have got substitutions, so that in fact affects the nature of the negotiations which would occur.

MR BENNETT: The nature of the negotiations aren't necessarily for a package. The aeronautical charges are often presented as a package.

PROF SNAPE: They can be as a package is what I'm saying.

MR BENNETT: They could be, but they're certainly not at the moment.

PROF SNAPE: You could even tie in things like heavy maintenance into that package, for example.

MR BENNETT: You could, but at the moment they're unbundled.

PROF SNAPE: Yes, but I mean in a freely-negotiating system, then each party would presumably try to be finding packages of things which would in fact improve their negotiations, and eventually you'd get packages which would result in an agreement. That's what happens in other industries.

MR WOODBRIDGE: Might be an agreement - - -

MR BENNETT: How efficient would it be?

MR WOODBRIDGE: Whether it's the efficient one is the question.

PROF SNAPE: We then come to would it be more efficient than something else? Perfection is not going to be possible.

MR BENNETT: No, that's right.

DR BYRON: I was just going to confess that I'm still having trouble with the notion of the problems with Kingsford Smith baggage handling as an example of the abuse of market power.

PROF SNAPE: That's because they lost our sign the other day. It was the airline that lost it actually, come to think of it.

MR BENNETT: I was using that as a demonstration of the lack of incentive of a monopoly service provider to provide a totally efficient service in a cost-effective way to its customers.

DR BYRON: I would have thought, particularly at the moment with the prospect of privatisation, they would be doing everything they could to get every possible wrinkle out of the system before it's sold. I would expect so.

MR BENNETT: You would think so, but the problems with the baggage handling system and the problems with the aerobridges still persist.

DR BYRON: Can I change the subject back to half an hour ago when we were talking about the starting point prices for the CPI-X regulation. You've said that they were the FAC prices that were single till but not totally network, that they were adapted for the Phase Is. Do we have any evidence that the prices that the FAC set, even after modification, were the efficient prices, that they were prices that would have enabled those airports to be sustainable in the long-term?

MR BENNETT: I think to the extent that the ACCC approved them, that they thought they were sustainable.

DR BYRON: Well, they thought that they were based on unit costs?

MR BENNETT: I presume so. I haven't actually read that decision going back to 97. I wasn't around.

DR BYRON: I thought it relied on the unit cost directive.

MR BENNETT: Yes.

MS HARRIS: I think for the airports that have been sold, given that bidders knew what the price path was going to be going forward, at least for the next five years, we wouldn't have seen the sale prices that we saw if certainly bidders had thought that those prices were insufficient. To the extent that they were, and that came off sale prices, that has already been taken into account and the sale price was the adjusting factor.

DR BYRON: But if the bidders were actually paying the present value of a capitalised stream of expected future rents, if they had been told that, "There are no rents in the future. You will not get more than 8 per cent per year no matter what you do," I imagine that the prices that they would have bid would have been substantially less than what they did actually bid.

MS HARRIS: They bid with a lot of uncertainty, and uncertainty certainly costs. They knew a price path for five years, they didn't know what was going on after that. Uncertainty has got a cost on the bid price and yet we still got excellent sale prices.

DR BYRON: The argument is that the premium was actually the capitalisation of the expected future rents. So does it then make sense to turn around and say, "Thank you very much for having paid a lump sum for all those expected future rents. We're now going to take them all away from you as well."

MR BENNETT: The problem is that we aren't privy to the representations that were made by the Government to the bidders of the privatised airports, so we can't assess, one way or the other, the extent to which they were led to believe that those rents might have been there. We have no basis, in fact, of knowing what representations were made to them. We would have expected that the sale prices that were achieved would have adequately reflected the arrangements that were publicly available, the conditions that were publicly available.

DR BYRON: Have you seen any of the charts that are in some of the submissions that we've received and, I think it's publicly available information, the reports from the ACCC in terms of the commercial performance of the airlines? It seems to me that the tables suggest that many of them - - -

MR BENNETT: Airlines or airports?

DR BYRON: Many of the airports are not terribly profitable at the moment. That, to me, doesn't jell very well with the notion that these are organisations that not only have enormous market power, but are out there actively using it already. They're either very incompetent or very silly monopolists if they have all that power and yet they're still generating losses.

MR BENNETT: But they're operating in a regulated environment at the moment.

PROF SNAPE: Only on their aeronautical charges.

MR BENNETT: Yes, and with existing contracts in place for a large number of other non-aeronautical services. In cases where those contracts for non-aeronautical services have been revised you have tended to find that the increases in the charges that they are seeking to impose have been very substantial. If you take account of staff carparking charges at Sydney Airport for instance, the net result of the consultations that took place with SACL in that regard was something in the order of a 300 per cent increase in the amount that the airlines are paying for staff carparking spaces.

DR BYRON: That sounds like a lot, but I would also need to know what the starting point was.

MR BENNETT: The starting point was low, but - no, sorry, it wasn't very low, it was reasonable. It was considerably lower than it is now. The stream of revenue that the airlines now have to pay for staff carparking is quite significant.

PROF SNAPE: That land, presumably, has high opportunity costs.

MR BENNETT: It has the same opportunity costs as - the opportunity cost isn't any different now to what it was three years ago when the prices were - - -

PROF SNAPE: But I'm saying that simply to say it has gone up doesn't mean that that's an inefficient charge from an economic efficiency point of view. I mean, the land has opportunity costs, and if they're not earning as an airport on it what they could use it for other alternative purposes, it's not an efficient pricing system. I mean, that just says it has gone up. It doesn't really tell us that they're exercising monopoly power in an inefficient manner. It may be that they're simply moving towards a more efficient charging system for that land.

Could I pursue that sort of thing a little bit more, in that on page 11 you say that the - you point out that the aeronautical charge is a very small proportion of the total air services. Of fares, for example, we've heard of figures of, say, 3 or 4 per cent or something like that, and it seems to be fairly common, of that order, which means that they could be put up, as you point out, very significantly without having much effect. That means they could be put up very significantly without affecting efficiency.

MR WOODBRIDGE: That's right.

PROF SNAPE: So here it's simply without any adverse effect upon the community as a whole, that it would simply be dollars going to the airports instead of to the airlines.

MR WOODBRIDGE: That's right. It's an empirical issue about what that demand

is, but clearly it's a function of a proportion of the total cost of air travel. There's a few issues to be thrown into that. 3 or 4 per cent might be a touch low. You look at both ends of an air ticket. You've got two airports. You've also got to add in any charges that an airport would levy on a refuelling company fuelling an airline, a ground handling company doing ground handling, a catering company seeking access to the aircraft. They're all part of the costs of travel, of an airline travelling from A to B and hence they're all part of it. So yes, you would probably find that you need to push the price up a fair bit, and it would be interesting to do the exercise on what proportion of costs of travel between A and B really go to the airport - both airports, I would have said. So you might be up to 5, 6, 10 - who knows?

I suppose the other thing is though, I imagine you get some price response as air tickets go up. Some people won't travel that otherwise would have. Unconstrained, my expectation would be that the price would go up quite significantly until it did discourage travel. That's what a monopolist will do, keep moving it until it does discourage travel. The fact that you're at a point where the demand curve is kind of elastic tends to suggest that the price (1) would probably go up by a lot and (2) to get to a monopoly price the deadweight loss would be enormous, because the deadweight loss is a function of two things, the decrease in quantity and the difference between the price and the cost. So you have got two things there.

PROF SNAPE: Between the price and?

MR WOODBRIDGE: The cost, the marginal cost.

DR BYRON: That's what the textbooks tell us, Graeme, but I'm looking around for an example anywhere in the world where I see something like that - you know, where you've got an airport like Kingsford Smith that has one visit a week from Saudi Air or the Sultan of Brunei, because they're the only two people who can afford to pay the landing fees. We just don't see that sort of example of astronomical prices and very, very low usage. What we do see is in fact a number of airports, both here and overseas, that are trying to increase the volume of traffic, and that their profit increase comes not from increasing prices, but from exploiting the declining unit costs as the traffic expands. I mean, all the textbooks tell us that the monopolist will exercise his market power by putting up prices ad infinitum, but that just doesn't seem to me to jell very well with what we observe in practice.

MR WOODBRIDGE: I suppose what we observe in practice - I haven't had a decent look at all the airports. It's a question of under what conditions are they operating? What is their regulatory framework? That's the question. The counterfactual that one would like to see, if one could see it, would be one operating in an unregulated environment with no threat of intervention. I suppose that is what you would like - - -

DR BYRON: We have a shortage of examples of that sort of thing.

MR WOODBRIDGE: That's right, that's the issue.

PROF SNAPE: And we have been told that even those that appear that way are not really so, because there is a threat of reregulation.

MR WOODBRIDGE: Yes, that's probably always the case when you've got a government who can change laws.

PROF SNAPE: But I think that when you measured your efficiency costs just before, you did run into a little bit of a problem with the declining cost industry, if it is a declining cost industry, and it was not so much about marginal costs, you have an investment problem, don't you, a long-term/short-term problem?

MR WOODBRIDGE: If price doesn't cover your average costs, that's right.

PROF SNAPE: Yes, where you were measuring your efficiency cost then in terms of marginal cost that was not necessarily so.

MR BENNETT: If you're searching around for examples of inefficiencies in an unregulated environment and the exercise of monopoly power, if you like, or at least the exercise of pig-headedness, then you perhaps go back to the case of Cairns Airport. As I understand it, in the early 90s there was a fair expansion of the terminal capacity at Cairns Airport and I'm advised that that expansion of terminal capacity at Cairns Airport was directly against the advice and the better judgment of the airlines who were operating to Cairns at that point in time.

Nonetheless, Cairns Airport went ahead and undertook the investment that the airlines told them was not necessary and would be uneconomic. Sure enough now we have the situation at Cairns Airport where we have very high passenger charges for terminal facilities and a two-terminal operation which can't fill one terminal. That's perhaps one example of inefficiencies that occur in an unconstrained environment. There was no regulation to take account of what the customer support was for that particular investment option. It went ahead, and it has proven to be a financial millstone for that particular airport.

DR BYRON: But then again they might have been caught out by the Asian financial crisis.

MR BENNETT: No. That was certainly a factor, but they were having difficulties before the Asian financial crisis.

DR BYRON: If, on the other hand, traffic into that airport had grown at 10 per cent or something each year for the last five years, the airlines might now be screaming for more capacity additions and criticising having to - - -

MR BENNETT: The airlines told them that that growth would not occur, that it wasn't going to go ahead, that they shouldn't make the investment, and yet it did go ahead.

DR BYRON: That raises a very good question of who has the information to advise on whether capacity-adding investments ought to go ahead. I would have thought that airlines probably know a great deal more about the potential traffic from Singapore or KL to Cairns than people in Cairns do. But I may be wrong on that.

MR BENNETT: Sorry. I didn't say yes, you're wrong; yes, you're right. But the investment went ahead and it's now a serious problem for Cairns Airport.

DR BYRON: If they made the decision, presumably they wear the cost, and that's what's called private enterprise.

MR BENNETT: It was a serious example of gold plating and what Adelaide Airport referred to this morning perhaps as state pride.

PROF SNAPE: We've covered most of the points that we had to ask. I'll just check through for a moment, if I may. You mention on page 3, "The incentive and scope for airports to frustrate off-airport competition in downstream operations such as carparking". To what extent does this occur? Do you have examples of this?

MR BENNETT: The example that I'm aware of has been valet parking at Sydney Airport. This isn't in the context of international operations; it's in the context of domestic operations. The airport operator apparently has placed all sorts of conditions, as we understand it, on airline operators there in order to, seemingly, allow better promotion of their own airport-operated valet parking arrangement. I think that was one particular example that existed.

PROF SNAPE: What do the airlines charge for their valet parking at Sydney?

MR BENNETT: I don't know. I can't afford it.

PROF SNAPE: Is it more or less than the airport charges?

MR BENNETT: The airport charges, as I understand it, are \$10 over and above the daily rate, which is 34-odd dollars plus \$10, which is \$44. I think that's roughly what the airlines charge, too.

PROF SNAPE: The airlines then charge the same amount?

MR BENNETT: No, the airport then charges the same amount. The airlines were there first.

PROF SNAPE: My point then is that when there was no airport valet parking, the

airlines were charging a rate which the airport then matched.

MR BENNETT: As I understand it, yes.

PROF SNAPE: Does that mean that the airport is charging a monopoly price?

MR BENNETT: No.

PROF SNAPE: When it matched your price?

MR BENNETT: It's not a question of monopoly pricing. It's a question of imposing constraints on the capacity of the original operators of valet parking, being the airlines, to expand that operation and improve that operation.

PROF SNAPE: Yes. I was changing the direction slightly. It has been suggested, I think, that in parking it's more than locational rent, that there is a monopoly rent. In this case it would seem, for the valet parking, you set a price which the airport then matched, which would seem that if there was monopoly pricing going on it was the airlines that were doing the monopoly pricing, which then the airport matched.

MR BENNETT: It's hardly a monopoly price. They are charging for a service, being valet parking, which was more than the carpark was charging. People had a choice of either putting their car themselves in the carpark or letting someone else put the car under cover at the valet parking area at the airline.

PROF SNAPE: They're charging the same anyway.

MR BENNETT: The point of the statement was the exercise of power in trying to restrict the ability of the airlines to operate their valet parking.

PROF SNAPE: Their ability in what manner?

MR BENNETT: To expand and impose greater conditions on the operation of that service.

PROF SNAPE: Presumably the expansion was on to land which had an opportunity cost.

MR BENNETT: It's at the domestic terminal facility, so I guess it's land that's already leased by the airlines. I'm in foreign waters here because it's domestic services and we're international. I only get the periphery of those sorts of commercial arguments.

DR BYRON: You may not have heard, but I was asking this morning whether there's a size factor in terms of the market power that airports possess because the fundamental question that we're looking at is whether airports should be regulated

and, if so, which services at which airports and whether all airports, from the very large to the very small, have similar degrees of market power or whether there is a line or a number of lines that can be drawn to separate, say, the phase 1 airports from the phase 2 airports, or that the international gateways need to be regulated but Kalgoorlie, Launceston and Broome International don't. I don't know. Maybe Broome International needs to be regulated more than Kingsford Smith. I have no idea. I was just wondering if you have any thoughts on if there are differences of degree and the need for regulation.

MR BENNETT: It would probably be true to say that there are differences of degree in terms of market power, depending upon size, but from the point of view of our members, if there's any line drawn then the highest that it gets drawn is under the seven airports that we deal with.

DR BYRON: Hobart is not one of them, is it?

MR BENNETT: No.

DR BYRON: Darwin, Adelaide and Cairns have enough market power to require regulation - all of the seven?

MR BENNETT: Yes, all of the seven. It was interesting that you commented this morning that the meal charge at Adelaide Airport for international passengers makes Adelaide one of the most expensive airports in Australia. So there is a certain amount of market power there.

PROF SNAPE: In our three draft reports which were released last week we did discuss monitoring as a halfway house between no regulation and declaration, or as a halfway house down from declaration to no regulation. That was, as I say, only released last week. But if you have thoughts as to how that would stand in your assessment of a form of semi-regulation or whatever you might call it, whether that in fact would satisfy your members, then we'd be interested in any reaction which you'd have to it.

MR BENNETT: We haven't had sufficient time yet to go through and digest those reports in detail, but we certainly will and we'll make comments on the proposals that appear in those reports as they have relevance to this inquiry into the airports.

PROF SNAPE: That point was in the PSA and the Part IIIA reports and the telecoms report which, along with the IIIA we've spoken about - trying to get convergence within the industry-specific, that they should converge on the principles of the generic scheme in terms of access, et cetera. But in the telecoms we specify why, in an industry-specific regime, it would still be required for the time being for that - in our view - and we state the criteria. This is why I was teasing out Dr Woodbridge earlier about the IIIA and the criteria there. You might give consideration as to whether you think that there are special conditions for airports

which would warrant the continuation of industry-specific regulation as against the generic regulation or the generic potential regulation of Part IIIA and section 46.

MR BENNETT: We foreshadowed that we'd be making further submissions to the inquiry as time progressed and after the public hearings. Certainly one of those dot points that we highlighted as being the subject of further submission would be the form of price regulation and the basis upon which that price regulation should be developed. Certainly that submission will cover those sorts of thoughts.

PROF SNAPE: If you could address that, it would be helpful, not just for this inquiry as a matter of fact but for the other ones as well. Thank you very much for your help in this and for your submission, and for your discussion and being very patient with some fairly aggressive questioning at times.

MR BENNETT: Thank you for the opportunity.

PROF SNAPE: Thank you very much for that. We will resume with the MTAA Industry Superannuation Fund and after that we will have Qantas. Thank you very much.

PROF SNAPE: We now resume the hearings. We have the Motor Trades Association of Australia Superannuation Fund Pty Ltd, and we thank you for your very thorough submission, which I must say took me a very long time to read.

DR CHESSELL: Is that a good sign or a bad sign?

PROF SNAPE: Well, there were moments, but thank you for such a thorough analysis; it was very good of you. We would now invite you each to introduce yourselves separately for the benefit of the transcribers, and then I'm not sure which of you is going to speak, or perhaps both, but over to you.

DR ABRAHAM: I'm Darryn Abraham, Senior Economist at Access Economics.

DR CHESSELL: David Chessell, Director, Access Economics. Thank you, Chairman. We're here today as the asset consultant and the investment adviser to the Motor Trades Association of Australia Industry Superannuation Fund. Access Economics has performed that role for the fund for about the last five years. The fund is a middle-sized industry superannuation fund. It has approximately a quarter of a million members and it has assets of about \$1.2 billion. Quick arithmetic would suggest that the average balance of a typical member is relatively small, but aggregated across such a large number of workers who are represented right across the retail motor trades of Australia - when those small balances are aggregated they become a major force in the investment arena.

The fund is a significant investor in infrastructure, including in airports, both directly as an investor in the Brisbane Airport and the Adelaide Airport, and indirectly as the holder of units in pooled trusts that are run by large fund managers. The MTAA fund is not alone in this respect. There are number of superannuation funds that are investors in airports and it's partly a reflection of the fact that superannuation funds are able to take a long-term view, which is the view that is required for an infrastructure investor.

The basic proposition of our long submission is that it's inherently difficult to devise a regulatory approach to airport pricing that delivers efficient and equitable outcomes, and it follows from this that the balance of risks suggests that a reliance on generic Trade Practices Authority-type oversight will result in better economic outcomes than the current regulatory regime. There are a number of factors that support our argument and let me just briefly mention those and then we'd be happy to answer questions.

I should say that I'm accompanied here today by Dr Darryn Abraham, who has been the primary author of this report. The report also benefits from input from Graham Matthews, who works on the investment side and has a thorough understanding of the two airports that are mentioned in particular - Adelaide and Brisbane - and also input from Stephen Corcoran, whose expertise is probably most actively displayed in section 3 where there's a discussion of the airline industry in

general.

The reasons that we advance in the submission for arguing in favour of what we come out at, which is a light-handed form of regulation rather than the current what we could describe as a hybrid-type form of regulation - there are lots of dimensions to them. First of all, the airports don't operate in a vacuum in the marketplace. They depend on the airlines, the airlines depend on the airports; both are very big players, both have a lot of economic power. Anyone who said that there was no countervailing power at all on the part of the airlines would, I think, be somebody who hasn't had a direct involvement with the industry. Secondly - - -

PROF SNAPE: We have had a few people say that.

DR CHESSELL: I would be interested to debate that issue. Our second point is that airports operate in a growing but a very rapidly changing market. The price regulation is inherently difficult to apply in that kind of a situation and it's our contention that if it's continued it's likely to lead to underinvestment in aeronautical services that will result in costs, real economic costs, in the form of congestion and delay.

Also regulators need detailed information about airports, which it's intrinsically difficult to obtain, in order to make the CPI-X regulation actually work efficiently. It's a theoretical construct. We believe it's better than the heavy-handed direct regulation approach that's adopted in the US, but in a dynamic industry like the airline industry we believe it's misplaced and will inevitably involve its own costs. The efficiency costs of regulation - can be quite large relative to any potential abuse of monopoly power by the airports. In a situation such as we have in Australia today where there is no strong case that the regulated firm - in this case, the airport - is earning supernormal profits or it has padded its costs or that it's building airports that are Taj Mahals or approaching them - so it's our contention that none of those conditions exist in the Australian airport environment.

One of the problems that we face is that the CPI-X regime was introduced partly as a means of facilitating the smooth privatisation of the airports from a political point of view and to achieve a transition. It certainly resulted in an underrecovery of aeronautical services costs and it forced the government to combine a kind of a light-handed CPI-X approach to aeronautical prices but with a heavy-handed regulatory approach to new capital spending, and we believe that the commission itself has recognised this as recently as 1999, and I quote from that 1999 report which says:

A price cap can compound an inefficient aeronautical charging structure - in the form of underpricing - that existed prior to the implementation of the price cap.

PROF SNAPE: The International Air Services report.

DR CHESSELL: We demonstrate in the submission that airport profitability in Australia is low. The ACCC has made statements about airport profitability, saying that the apparent lack of profitability is disguised by interest payments. We've adjusted for those, and on page 49 of our report we show that for both 1998-99 and 1999-2000 across Brisbane, Melbourne, Perth and Adelaide, there was only one airport in those two years that made a positive profit, positive return to equity, and it was a very minor amount for Melbourne in 1999-2000 of 2 and a half million dollars. So that it seems indisputable to us that the situation at the moment is a situation where airport profitability is low and therefore it's not a situation that calls for regulation to curb the abuse of monopoly power.

The current CPI-X also fails to take account of all the appropriate influences that it would need to in setting the various X factors. The price regulation of incremental investment leads to airports having to risk making mistakes in forecasting passenger numbers; it certainly tends to make airports risk averse when they're considering this.

In chapter 3 of our submission we consider the equity issue. The airport landing charges tend to fall proportionately across fare types. Certainly increases in costs to passengers that might arise from an increase in aeronautical charges are more likely to be paid by higher fare paying passengers than lower fare paying passengers.

Of course, finally, aeronautical charges are a very small fraction of the cost of air travel today - something in the order of 1 per cent to 3 per cent of fares - and it would seem to us that the risks inherent in moving to our preferred model of light-handed regulation are extremely low.

We'd be happy to address any questions that you had.

PROF SNAPE: Do you wish to add anything, Dr Abraham?

DR ABRAHAM: No, I'll take questions as they come.

PROF SNAPE: I suppose in reading this the thing that struck a number of us was, here is a superannuation fund with large investments in two airports, and so essentially speaking for the airports, advocating what appeared to us to be a single till, whereas what we've got in fact in general - and I'll try to get this right for those who have been here yesterday as well as today and know that when I say "airports" I usually mean "airlines" and vice versa, but I'll try to get this one right this time - the airports advocating the dual till and the airlines advocating a single till, and that's not just in Australia that that occurs. Yet you appear at first blush to be breaking ranks here and in fact are advocating a single till. Now, perhaps you would like to elaborate that - and I understand that what I'm saying is a simplistic version of what you are saying, so perhaps you could enunciate the sophisticated version.

DR CHESSELL: I'll enunciate the simple answer and Darryn might enunciate the more sophisticated answer. I think the simple answer is that theoretically there's a case to be made - if there's going to be regulation - there's a case to be made for a single till approach. It's difficult enough meeting the informational requirements for appropriately setting the CPI-X regime when you're looking at all the fixed costs, but when you've got another dimension of having to decide which component of fixed costs or services are going to contribute to fixed costs and which component is not, that just adds another layer of complexity and introduces a distortion which we believe has existed through the life of the regulations to date in airports decisions relating to investment in the regulated area versus the unregulated area.

I think the answer to the conundrum that you've posed is that we are not advocating regulation, so therefore we are not advocating a single till. We're advocating a very light-handed form of oversight and because the current non-regulated aspects of the airports operations clearly are subject to considerable competitive pressures and therefore it would be inappropriate to include those within the regulations, that in a sense is an argument for going to what our first best policy solution is.

DR ABRAHAM: Thank you for the short answer, David. The longer answer is, as David says, we first of all advocate less oversight rather than more, so less direct price control in the form of a price cap or any other restraint on pricing. To the extent that that might be continued, we would argue that it should be a broad-based control and that there shouldn't be the artificial divide between aeronautical and non-aeronautical and so forth.

PROF SNAPE: That is, to the extent that the current type of control continues, there should not be the division.

DR ABRAHAM: Yes.

PROF SNAPE: So it should be a single till.

DR ABRAHAM: There are various reasons why trying to, as David has already said, control one small part, or relatively small part, of revenues is likely to lead to more distortion than a broader based control over the whole of revenues and the whole of the operations. That's not to say that you'd be giving the airports any greater flexibility to set aeronautical charges than they have now, because clearly they would be still constrained on the non-aeronautical side by competitive pressures, but you would get a more holistic approach to their pricing. That way you get efficiency gains through that process, while still monitoring their overall profitability.

PROF SNAPE: The way that a single till is often perceived by the airline advocates of single till is to say that there are all these associated activities, such as retailing and parking at airports and so on, and that in fact they're profitable activities

for airports, and that the profits that are being made or the revenue that's being earned on those, that those activities should be used in fact to cross-subsidise or to keep low the aeronautical charges. That's the sort of argument that you get. Sometimes it goes into a distributional argument and, "We're bringing the passengers in and so we should get some benefit from the other," but that's probably a separable argument.

Your argument, as I understand it, is a little bit the other way around. As I understand it, what you're saying is that retailing and parking at an airport, et cetera, is contestable, and that these are activities in which you're not going to get a very substantial return or a greater than normal profit, taking into account locational advantages because they're contestable, so you're not going to get pure economic rent above the locational rent from these activities because of the contestability of it. So you have a competitive pressure that is constraining those and so to cover the costs generally you should be Ramsey pricing on whether price elasticities are low, and that is aeronautical.

You in fact see the cross-subsidisation - if one calls it that - going the other way. You are in fact going to get extra revenue on the aeronautical, and that would be efficient because of the low elasticities and so it's not going to be highly distortive to raise the prices there, and on doing that it will cover the fixed costs on the whole enterprise, so in a sense the flow of excess revenue or quasi rent - call it what you will - is the other way to the way that it's normally pictured. That was what I saw was the sophisticated version of it, or at least as sophisticated as I could get on it.

DR ABRAHAM: It's certainly close to the mark. What we see is that the level of aeronautical revenues has been held artificially low. It's a by-product of the FAC pricing policies ahead of privatisation. Privatisation by itself should have undone some of the efficiency consequences of that, in the sense that aeronautical assets would have been priced down so that returns on those assets came back to commercial levels. But the long-term effect is still that while those charges are artificially low there's less incentive to invest in aeronautical facilities, and that leads to distortions that we're worried about.

One way to address that is to allow revenues to be balanced across all sources and, while it's certainly true that there's scope for a margin above what we might call ordinary competitive pricing in the non-aeronautical side because of the tied nature of retail and parking and the like to the airport itself, it would be more efficient to raise the whole of the costs of the airport in a greater proportion from the aeronautical side where, as you say, the elasticities are lower and the distortions would be smaller.

It's not clear to me from the information we have available that that would necessarily happen. There are interactions between the costs of supply and interactions particularly between the demands for the various services, which means that the pattern of cost recovery, the pattern of revenue contributions to fixed costs, is

never going to be obvious. What we're saying, first and foremost, is because it's not obvious, there's no way that a regulator should presume to decide which way the balance should go, and certainly not to preserve the existing what we see as imbalance between aeronautical and non-aeronautical revenues. There should be more scope for the airports to decide where it's appropriate to raise their revenues and the regulator should perhaps stand aside and step in only where it's clear that revenues have more than exceeded the costs of the whole of the operation - that is, to step in only where there's been a demonstrated abuse of monopoly power.

PROF SNAPE: You would apply this argument to both what have been artificial and partly artificial distinctions between congested airports and uncongested airports?

DR ABRAHAM: No, not entirely. We do not address the issue of congestion in the submission. It would be nice if we'd had the time to talk about Sydney particularly. I probably agree with Professor Forsyth's assessment there - that they do need to be treated differently; certainly Sydney needs to be treated differently. In the uncongested airports, I think the biggest danger is that the congestion will appear where it need not, because at the present we have a situation in which there is less incentive to invest in aeronautical facilities and it's that which is going to lead to inefficiencies in the long run, not so much the dangers of under or overpricing necessarily. What is needed is a means for the airports to fund and have adequate incentives to invest in aeronautical facilities.

PROF SNAPE: The argument is a little bit different from some of the other arguments that have been put forward and I would draw the attention of other participants to this. They may wish in their submissions to comment upon this, because it is a newer or slightly different perspective on the problem.

DR CHESSELL: I think your summary of the sophisticated argument, Chairman, possibly adds elements that are not in our submission. Our submission is certainly not advancing the single till as the preferred outcome. Our preferred outcome is quite clear, which is a very minimal form of regulation. Some of the elements of the argument that you put are in our submission, but you have I think - - -

PROF SNAPE: Embellished it.

DR CHESSELL: Yes.

PROF SNAPE: I was trying to draw out for my own understanding the implications of this and perhaps I drew out more than should have been drawn.

DR CHESSELL: I think in the submission we do acknowledge that with the non-aeronautical services the airports do have some market power in relation to those services which, other things being equal, would tend to undermine the force of that argument.

PROF SNAPE: You've been referring to an oversight, or a pretty light-handed oversight perhaps. I've been mentioning to other participants - people are getting sick of hearing this - the three draft reports which we released last week, in which the Part IIIA and the PSA draft reports there was raised the possibility of monitoring as a step between no regulation and declaration for access, or as a step back from declaration. If in a subsequent submission you might like to consider that, as to whether that is lining up with your proposal or not, that would be helpful.

DR ABRAHAM: I think it's certainly consistent. I've only looked at the telecoms report of those three at this stage.

PROF SNAPE: That's not a bad one to start.

DR BYRON: Just following on from that point, with the aero or non-aero charges, in a hypothetical deregulated market, do you think there would be pressures for aero charges to be significantly higher than they are now? I'm wondering if you're familiar with the writings of Starkie in the UK who seems to be suggesting that even an unregulated airport operator would have an incentive to reduce his aero charges purely out of commercial profit maximising. Is that what you're getting at on page 35?

DR ABRAHAM: It's certainly the point I was alluding to earlier, about not being able to predict the pattern of prices. Can I just ask which version of our submission you have.

PROF SNAPE: It's just above section 3.3.

DR ABRAHAM: The point I was getting at, I guess, is that it's not clear, because of the strong complementarity between aero and non-aero demands, that you wouldn't see incentives to not so much cross-subsidise but perhaps reduce the contributions of aero charges to total revenues, precisely for the reasons you suggest - that you get flowthroughs through the airport and that in itself is intrinsically valuable and consequently generate more demand. This is the paragraph, "The fixed nature of most airports' costs":

The profitability of airports, in practice, derives more from realised passenger flow than direct landing charges.

I think that's right. We've also argued that passenger flows aren't necessarily directly related to landing charges either. One of the important features is that the airports are essentially at the mercy of international trends and changes in tastes and incomes and the like which drive passenger flows through airports as much as anything else. They have very little control over demand through their airports, solely on the basis of changing their prices.

DR BYRON: And the spending patterns of those passengers passing through also vary, depending on whether they're leisure market, business travel, et cetera.

DR ABRAHAM: That's right, but that's an aspect which you can capitalise on by providing the appropriate facilities, putting the retail areas appropriately in relation to the departure lounges and the like. So it's that sense of rearranging the facilities, investing and designing appropriately that influences their profitability, as much as the flow through. Certainly I would agree that it's not clear that the airports would necessarily have to raise aeronautical charges, although you would expect that they would at least go to cost recovery. That is, you would see something closer to the long-term marginal costs of aeronautical services being recovered and, to the extent that they have fixed costs over that, perhaps the smaller margin being contributed on that point because of the complementarity.

DR BYRON: And on page 16, if we've got the same volume, the one-off increase in section 5.2.1.

DR ABRAHAM: Yes.

PROF SNAPE: It's 58 on the other version.

DR ABRAHAM: I think the section numbers would stay the same - 5.2.1.

DR BYRON: Yes, "To ensure cost recovery for aero services, a one-off increase may be required and this may create pure profit." If the airports' expectations were for aero prices to ultimately cover costs, I guess what we're looking at is how much of this anticipation was built into the purchase price. It's purely conjecture for us to - you know, what was going through the minds of the bidders at the time and what expectations they had. Do you think this pure profit may have already been captured in the bid price?

DR CHESSELL: It's difficult for us to provide any direct insight into that. While the MTAA Fund is an investor in both these airports, in fact it did not participate in the bid in either case. It became an investor subsequent to the privatisation, so I'm not sure we can be of any direct assistance.

DR BYRON: Your conjecture is like our conjecture.

DR ABRAHAM: I guess the only comment I would make is that the section you're referring to is in the context of how price controls might be adjusted if they were to continue, the idea being to undo or to redress the imbalance between aero and non-aeronautical charges. Some assessment would be made. A one-off increase, as we say, would be one approach to that. You would have to presume that the airport owners factored in a review of the price controls five years after their leases were issued which would be generous enough to basically the reverse the imbalances that were built in at the time of privatisation. I think that would probably be overly

optimistic on their part, but that's probably presuming the results of the inquiry.

DR BYRON: That might well have been their implication.

DR ABRAHAM: Yes.

PROF SNAPE: On the following page you speak about the light-handed regulation. You say that, "The ACCC would still periodically have to pass judgment on the overall profitability of airports." That is the last sentence of section 5.2.3.

DR ABRAHAM: I think the idea would be that if the price controls were continued, like all CPI-X controls, at the end of each five or three-year period or whatever is set, the X has to be set again. In doing so you almost inevitably have to assess profitability, and this is a point I think, probably, Peter Forsyth made in his submission. My experience of the controls on Telstra was that in trying to make recommendations on the X to apply for subsequent periods of regulation, you inevitably have to look at past performance and expectations of a future profitability.

In the case of Telstra it was easier because there was a clear case of slack or supernormal profits still existing in that case. Here, as we've argued, the case is much harder because you're basically dealing with airports which are on a knife edge of profitability. Setting the X is crucial to profitability in the following years and, if the price controls were to continue, X would have to be set very carefully with some assessment of profitability inevitably being part of that.

PROF SNAPE: So could you inevitably converge to a cost base or rate-of-return regulation?

DR ABRAHAM: Yes, to some degree. You're almost certainly faced with those problems at the time of the review. As we argue, the price cap can sit anywhere between a cost base regulation where you just simply pass on the revenues that have existed in the past or you can make a considerable effort to assess what the minimum cost of production ought to be, and try and drive out excess profits. In this case it may actually be that driving out excess profit means that you set a negative X but you allow some additional scope to increase charges, at least for a narrow cap, to allow aeronautical costs recovery. As we've argued in the case here, clearly the cap should be broader. There should be a broad basket and in that case it's less obvious how the X should be set.

DR CHESSELL: Chairman, maybe there are too many sections in the submission but the advocacy of the light-handed approach is actually in section 5.3.

PROF SNAPE: Yes, I'm sorry. I shouldn't have said "light-handed" when I introduced that. You say on page 53 that the fuel levy charge and the taxi charges are inefficient. Can you tell us why?

DR ABRAHAM: I don't have a lot of experience with the air services industry so I have to be very careful what I say about this, but on first impression it strikes me that they are charges which have been brought in precisely because they can be brought in, rather than because they're useful or necessary; that is, that the regulation has actually encouraged the airports to seek out means of gathering revenue which is outside the regulated cap wherever possible. That's simply a reflection of the extent to which they've been squeezed by the controls but also, I guess, a natural reaction of any firm with a degree of market power trying to exercise it at whatever margins it can.

It just strikes me that the taxi charges are not necessarily a very efficient way of gathering revenues because of the monitoring or processes needed just to keep track of how many taxis have gone through. It may be that they're quite lucrative, but perhaps it's better to charge an extra dollar or two per ticket, rather than put it on the taxis.

PROF SNAPE: Some airports I guess would argue that getting people into the airport and out of the airport efficiently is in fact a very major part of their business, and running an efficient airport. They then invest in facilities to make that happen, or try to make that happen, with holding areas and some facilities at the holding areas, refreshments, rooms, and that it is then efficient to put the cost of that onto the people who are going to be using it, which are the people who are using taxis.

DR ABRAHAM: I guess the question then becomes: is there still a margin of return, in the sense that there's no point putting in facilities to encourage people through the airport if you then price them to the point where there's no net return to those people. It may be better then to provide the facilities, encourage pass-through and hide the costs or absorb the costs elsewhere. Also, certainly to the extent that they tend to be fixed investments, it's possibly better not to try and charge a markup cost to the passengers.

The other point I would make about those is that it's not clear whether they're inefficient or not. One of the weaknesses of the current arrangements is that it's not clear that airports have an incentive to introduce efficient new structures of pricing. Certainly the uncertainty surrounding the inclusion of those charges in the cap is a better reflection of the problems than whether those charges are necessarily efficient themselves.

PROF SNAPE: So it's not that they're necessarily inefficient. It's just that in view of the constraints on what charges can be made, they are suspect.

DR ABRAHAM: They are suspect, that's right. Now, if you had a single-till approach it wouldn't matter. They could charge where they liked and hopefully would choose to charge where it was most efficient to them and most efficient to their passengers - their customers, in other words.

DR BYRON: I noticed that - I think it was the International Air Transport Association in their submission frequently describes airports as inherently low-risk businesses. Your analysis suggests that might not be so.

DR ABRAHAM: I don't know. I'm not familiar with the quote but it does actually surprise me.

DR BYRON: It may have appeared in a few other submissions too.

PROF SNAPE: The superannuation fund wouldn't be investing in high-risk investment, would it?

DR CHESSELL: If it was being suitably rewarded and it fitted with its investment strategy, it would consider such an investment. I think one of the things that comes out of this submission is the experience of Brisbane during the Asian downturn. In the normal context of growth there's an inbuilt bias, as I'm sure you know, of the CPI-X arrangements in favour of the airport. However, in that episode demand fell away unexpectedly and, of course, then with having negative growth the bias inherent in the arrangements actually worked against them. It magnified itself in the profitability results. I suppose that's an experience that we're familiar with of where there is considerable risk.

There's also, in the case of Adelaide, been a lot of risk involved in the redevelopment of the terminal there - the so-called MUIT, the multi-user integrated terminal. The impact on investors has certainly been different from that which they expected when they embarked on the enterprise. We certainly don't regard airports as boring investments.

DR BYRON: I was also thinking about the evidence that we had earlier today that an airline might, for very good reasons, decide that it has to unilaterally withdraw a service to a particular airport, and the airport basically just has to wear that.

DR CHESSELL: There's a whole range of risks. There are market risks, there are environmental risks, there's what we address in here of the regulatory risk, which has been a significant factor in the case of Adelaide Airport with the MUIT. It affects a range of airports considering their new investments. It's an area where in the case of the MTAA we find, when we report on airports, we can write a small book on what has happened and if we do these reports quarterly there's a huge number of factors that affect their bottom line.

DR BYRON: I was just going to ask you about the way your models and reporting look at regulatory risk in the case of airports.

DR CHESSELL: I suppose with all these infrastructure investments - and airports are just one example - the key ingredient in terms of assessing the commercial attractiveness or otherwise of the investment is the financial model. The financial

model is generally quite a large scale, reasonably complex representation of the business enterprise. Within it are attempted to be represented whatever the regulatory outcomes are that are considered to be most likely. But the financial model does provide an apparatus for assessing different outcomes. This is in fact how, I believe, most investors would go about considering it. It's possible to model different scenarios - depending on different regulatory outcomes - and ultimately it's a matter of judgment as to what probabilities are attached to these various scenarios in deciding what - say at this point in time the issue might be: how do you value the airport? It's the same set of issues as when the bids were put together, presumably.

PROF SNAPE: If you back to page 54 - correct me if you've already gone through this, but I think not - you're pointing out, "Underpricing of upstream services in a vertically integrated firm may have negative consequences for the profitability of downstream markets." In the case of airports, "Preventing cost recovery of aeronautical services may have limited the airport operators' ability to get passenger flows through other facilities" - terminal, retail and parking, for instance.

DR ABRAHAM: I guess the case there is more appropriately applied to a congested airport, but in the case of an uncongested airport it comes down to the quality of services provided, the likelihood of perhaps delays, the likelihood of lost luggage, the quality and amenities of the lounge facilities and the like, the idea being that to the extent that those things are valuable to customers, you decrease the demand for flows through the airport, and consequently the profitability and the like of the retail and the parking suffers.

PROF SNAPE: Do you have any evidence of this happening at Brisbane or Adelaide?

DR ABRAHAM: Not to my knowledge. I think we were thinking in general terms of the likely possible consequences of the underpricing. I guess this somewhat goes against our argument in the sense that it suggests there might be incentives to invest in aero facilities other than directly through the returns from landing charges. Again it comes back to the issue of not being sure exactly how the revenues ought to be recovered.

PROF SNAPE: If you're really wanting to get people through that retail place then - - -

DR ABRAHAM: Certainly I think it is the case that the airports tend to see themselves these days more as property development and retail development than providers of aero services and one really has to ask whether that's a natural consequence of the technology and the nature of the business or whether it's a by-product of the regulation.

PROF SNAPE: What's your judgment on it?

DR ABRAHAM: I guess, with my limited experience, I would say that perhaps it's two-thirds regulation, one-third costs.

DR CHESSELL: I think it also varies from airport to airport.

DR ABRAHAM: That's depending on the initial quality of facilities and all that.

DR CHESSELL: For example, I think in the case of Canberra there is a distinct bias in favour of property development and it has almost been a reaction to the regulations.

PROF SNAPE: Is it a reaction to regulation or is it simply what one might expect to happen in an unregulated market? The fact they're doing it now rather than in the past was that the FAC didn't look at themselves in that way. Maybe it's a consequence of privatisation and what you would expect in a privatised airport.

DR CHESSELL: Maybe it's a question of the timing, so it's something that they can do; it's free of the regulations and therefore they've gone ahead and done it. I think from our experience with Adelaide and Brisbane there has certainly been interest in those activities but they haven't been taken to the same level of advancement as in Canberra. I think that partly reflects the greater frustration, if my reading is correct, of the Canberra Airport with the regulations than the other two airports.

Of course, in the case of Adelaide, the primary focus has been on trying to get the MUIT up and going but it certainly hasn't prevented consideration of other developments. I suspect there will be some interesting developments in airports over the next few years as to how they handle that. An issue for investors is: do they wish to have the additional calls on capital that might be required to actually undertake some of these developments? Do they want to have the exposure to that or the change in the composition of their risk exposure that's involved in altering the character of the investment or the balance of risk that's involved?

Maybe some airports are going to handle these problems by actually setting up separate entities and some subgroups of investors might invest in those entities that focus on developing the property side of the business. Of course we're also getting the interesting situation where the airlines themselves are looking at, in effect, their own leases within the airport, so I suppose - - -

PROF SNAPE: Do you know who they were going to sell them to? Were they going to sell them back to the airport?

DR CHESSELL: I only know what I've read in the paper but I suppose it all underlines one of the themes that I suppose we're trying to underline which is that it is a very dynamic business and there are a lot of changes. If you went back five years you would have been hard-pressed to have predicted the things that have

happened today. I suspect trying to set a regime that would apply satisfactorily for the next five years in that environment is a bit of an ask of the regulator.

PROF SNAPE: I think I'm about through with my questions. We've been trying to explore a number of these things and, as I said, some of the approaches appear a little bit different from others and so we would invite comments from others on them. Thank you very much for a very stimulating paper and for discussion.

DR CHESSELL: Thank you for your time.

DR ABRAHAM: Thank you.

PROF SNAPE: Thank you both. After just a moment or two for changeover we will then bring the day to a conclusion with Qantas.

PROF SNAPE: We welcome Qantas, from whom we don't have a submission yet. Just make sure it didn't get lost in the post or something. I trust we shall be getting a written submission. Thank you. Any questions we ask are going to be possibly out of left field, insofar as we haven't had something to read, but we'll see how we go on that. We would ask the Qantas participants to introduce themselves separately, so their voices are on the tape for the transcribers.

MR OLDMEADOW: Ian Oldmeadow, I'm a consultant to Qantas.

MR PEMBERTON: Chris Pemberton.

MR BYSOUTH: Peter Bysouth, Manager, Aviation Charges.

MR O'BRYAN: Michael O'Bryan from Minter Ellison lawyers as a consultant to Qantas.

PROF SNAPE: Thank you very much. Who is going to present it?

MR OLDMEADOW: I shall, Mr Chairman.

PROF SNAPE: Thank you very much.

MR OLDMEADOW: I begin by apologising for not having a submission in at this point, but there are a number of other inquiries - the Productivity Commission, the ACCC and there are also a number of other issues that are facing the airline industry at the moment, given the economic circumstances that we find ourselves in - however, we will have a submission in very shortly and have participated fully in the preparation of the BARA submission. I'd like to make some very brief comments. We have a number of points we'd like to make today, but from the questions that we've observed since we've been present and our reports on other sessions both today and earlier, there are a number of issues that we would certainly like to comment on and would welcome questions.

Having participated in the BARA submission, we clearly are supporters of that submission. We, like the rest of the airline industry, are supporters of the single till. We were not total supporters of the current regulatory regime - that is, the CPI-X and the new investment criteria. However, we have seen it operate in practice and while we would like to see a greater emphasis placed on interdependency in respect to new investment and while the ACCC went some way in addressing that in the recent SACL decision, we would have liked it to have gone a lot further. We believe, in the absence of the single till approach, it is a workable system and that the parties over the last few years have gone through the process of working out where the boundaries lie and that it would hopefully go forward in a more expeditious manner.

We're not advocates of a light-handed approach. Our experience on a

light-handed approach - certainly our recent experience - has not been a very happy one. I'd just like to make the point also that, at the end of the day, if there is a lack of regulation and airports as monopolies are able to exercise their monopoly power, the ultimate loser in this is the consumer. The recommendation that the Productivity Commission ultimately makes is really about - if there is any equity issue, the equity issue in the longer term is between the consumer and the owners of the airport. That needs to be, in our view, a critical issue. There are a number of points we'd like to make in relation to that during your questions, but we think it is an important issue. If airports are able to, in an unregulated way, jack charges up that impact on the consumer to allow airport owners to make excess profits, then while the airlines will feel the pressures in the short term as those prices are absorbed for a period and ultimately passed on, and there will be a short-term shock to the airlines; ultimately the consumer will wear the cost. Mr Chairman, if I could end there, my colleagues and myself would welcome any questions.

PROF SNAPE: You're probably not surprised I'd like to pick up the last point and explore that. You support the BARA position and you support a single till, which implicitly I think means that you're looking at the complementarities between the various things that the airports supply. It would then seem that if the airports are in fact very concerned to get people into their retailing and into their parking spots and so on, that in fact they won't want to put up their aeronautical charges to the extent that it's going to have a significantly adverse effect upon consumers. So where does the cost to consumers come that you were just speaking about?

MR OLDMEADOW: I guess if aeronautical charges were increased it would depend upon the elasticity of demand as to the impact on the reduction in demand, but if aeronautical charges go up significantly - we've had a recent example at Sydney Airport. In the absence of any regulation, the charges would have gone up from - I think it's 98 million to 210 or 215 million. That was pulled back significantly by the ACCC - I think it was a 120 or 130 million dollar increase over 98 million - would have ultimately fed its way through to the consumer. Whether it's through as a direct charge or into the cost base of the airlines, it ultimately will find its way to the consumer.

PROF SNAPE: It will come perhaps as an extra cost to the consumer and that would mean that there may be a redistribution of profits or at least a redistribution of surplus from the consumer to the airports, but that would not be, as you were describing it, a question on efficiency; it would be a question of distribution solely.

MR OLDMEADOW: Absolutely, Chairman, and I'm making the point that it is an issue about the consumer, as you rightly said, and a shift in the surplus from the consumer. Sure, we get squeezed on the way through to the airport owner, and when you look at what's happening in the community with the Reserve Bank and the ACCC's review of banking charges, you could say, "Look, they're only a small charge and they don't mean anything," but at the end of the day, the consumer wears that in terms of their surplus and it's a transfer issue. I guess we're saying while it

may look small in absolute terms on a ticket, it is an equity issue between the consumer, probably us a bit and also the airport owner, so sure, we're not saying it's an economic efficiency issue, but we are saying it's an important issue publicly from an equity perspective.

PROF SNAPE: But then, presumably, if the charges increase, those who value the airport most will in fact purchase it and there may be some substitution among consumers from those who are getting it a bit cheaper than they might to those who value it more and so there would be an efficiency question on the demand side of allocating the demand to those who value it most highly.

MR OLDMEADOW: There would certainly be an issue within each market associated with that, yes. Where it's totally inelastic, obviously the consumer will wear it, those existing consumers; where it's elastic, there may be some substitution.

DR BYRON: I would guess there's a fourth group involved in this as well as passengers, airline shareholders and airport shareholders, and that's taxpayers.

MR OLDMEADOW: Correct.

DR BYRON: If Sydney Airport isn't actually recovering its costs, then presumably there's some sort of transfer from taxpayers at large to passengers who actually use that facility.

MR OLDMEADOW: We would argue - and we're happy to provide our submission, the BARA submission, which would argue that Sydney Airport is not in a position where it has not made an effective return over the years. It's made an effective return and in relation to the new investment which was the other component of the increase, that when the new investment was contemplated, it was contemplated in an environment where the airlines, collectively through IATA, were told that the increase in revenue that arose from retail and volume through MTOW would generate sufficient income to give them a return on that investment for the SA2000 project. That was the basis on which we agreed with that proposal going forward.

DR BYRON: But that's a matter now before the courts.

MR OLDMEADOW: Certainly, it is. There were two components to it; one was the existing capital base and the other one was the new investment.

PROF SNAPE: We don't want to turn this into an inquiry into Sydney Airport. There have been enough of those around.

MR OLDMEADOW: I agree.

PROF SNAPE: A table was supplied in an Adelaide Airport submission this morning which showed Sydney's aeronautical charges for domestic traffic to be the

lowest of all the major airports per tonne, which would seem to be rather curious for the most congested airport in the country. A significant rise in charges from that level would not seem to be evidence of exercise of monopoly power.

MR PEMBERTON: I think in terms of Sydney Airport's pricing structure, the figures that perhaps Adelaide has put forward relate to a restructuring of charges which occurred - I think it was back in 98 or 97.

PROF SNAPE: The date of their figures as given in the table is July last year.

MR PEMBERTON: Yes, I'm going back to the restructure. When the FAC used to operate all ports as a network, it used to be about \$5.70 a tonne or thereabouts for landing fees. The FAC took a decision just prior to sale, where they restructured the international terminal charge and the landing fee to better reflect the costs of providing those facilities. The result of that was a significant increase in the international terminal charge and a significant reduction in the landing fee associated with unwinding the cross-subsidies that existed between the two parts of that.

PROF SNAPE: Be that as it may, to an innocent economist it does seem somewhat bizarre to have a domestic landing charge per tonne at the most congested airport in the country to be the lowest.

MR OLDMEADOW: It also has the highest volume and you would expect there would be a volume effect and there would be economies of scale.

PROF SNAPE: But this is a congested airport, at least at peak times, for several hours a day, in which case you would presumably want price to have something to do with rationing.

MR OLDMEADOW: I think that's an issue that hasn't been debated at this point and you have a range of regulatory issues affecting that. The 80 cap is a regulated cap. The use of slots is regulated also in relation to regionals and there are a whole range of complexities at Sydney that make it more difficult to deal with than you would have at most airports.

PROF SNAPE: As I say, I think Qantas were suggesting that the increase in the price for charges at Sydney Airport was evidence of monopoly power. I don't think that if you're in fact proposing to increase the price of anything from a very low charge - what has been a regulated charge — significantly, is necessarily evidence of monopoly power.

MR OLDMEADOW: We would argue that if there was an airport next door and there was competition between those two airports for traffic from the airlines, that the excess profits that are made on the non-aero side and aero-related side would be traded away to encourage airlines to come to the competing airport. The effect of that, through the interdependency, would be to trade those away and therefore we

would have expected in a environment such as Sydney that where you have got the very high volumes, you would expect the landing charges to be lower.

PROF SNAPE: I don't know if we're going to converge on that, but leaving those charges on one side, is there other evidence that you have of airports exercising what you are calling monopoly power?

MR PEMBERTON: Yes. I think during the course of the current regulatory framework there have been some cases where there has been, in our view, abuse of monopoly power. It has probably been discussed previously, but the fuel throughput levy - I think it was Brisbane Airport that initially led that - three days after taking ownership of the airport, they announced a fuel throughput levy. Subsequent to that, Perth followed suit. I think, in essence, the airports have been fairly open, saying that the fee doesn't relate to cost and I guess that really goes to what may or may not have happened during the sale process.

In terms of other areas, we have seen licensed fees charged on our catering operations, for providing catering to our aircraft. We have also seen the introduction of ground access fees that, as per the regulatory framework, are under CPI-X. Those fees haven't been pushed back into aeronautical charges. We've also seen a reduction in the quality of service at some airports, for example Perth International Airport. Some lounges have very few seats in the departure area. There has been a growth in retail on the departures level. Similarly, in terms of Sydney Airport, in terms of the number of seats, they have failed to deliver the expected number of seats in each of the boarding lounges.

PROF SNAPE: I have trouble seeing these examples as exercise of monopoly power as such. An airport presumably is trying to make a profit and has alternative uses for both the land and the buildings, and could be expected to be using those buildings and land for what yield gives them the best return. That in itself is not evidence of the exercise of monopoly power, I would have thought. It was simply allocating your assets where they're going to get the best return.

On the levies for various things that you were talking about, I guess also you can say a firm would have a choice as to how it is going to charge. If you go into a cinema, they may charge you for some things and give you free popcorn - or perhaps that's a bad example. You go into a French cinema or a French theatre and you're supposed to tip the person who takes you to the seat. That's part of - they're paid accordingly. So they're separating a charge for a service from the overall charge. In other words, the structure of fees and how they're struck, as to how they're separated, will be a commercial decision. Will you charge for luggage trolleys or not? That's just a commercial decision as to how you're going to strike your fees overall.

So if you're going to strike a fee for an input levy for fuel or for this or that or other thing, it would seem to be just part of how you're deciding to unpack or pack together, bundle or unbundle, the charging for particular services, and in itself is not

evidence of monopoly power.

MR O'BRYAN: Can I make an observation. Obviously the illustrations that Chris has been giving are illustrations in an environment where the airports have been subject to regulation over the past period. What I think the illustrations highlight best, though, is the lack of any other power - countervailing power, push-back power, whatever you want to call it - by various users of the airport. I think what it does illustrate is over the period clearly airports have looked for opportunities outside of the price cap, where they can increase charges. As you say, perhaps that's not surprising. Any profit maximising firm is going to do that and look for those opportunities to increase prices.

But what we have observed - and it has been fairly evident over a range of things - is there isn't any example of countervailing power. The airports have been able to increase those charges and have done it. I suppose from Qantas' perspective, you look forward to a world without regulation and what would you expect to occur. We do think the history of the last few years, even with regulation - and look to these illustrations - does evidence what is likely to occur. So you do have to take the illustrations, though, in the context of current regulation.

PROF SNAPE: Yes. Are you suggesting that the airlines don't have countervailing power?

MR O'BRYAN: Yes, we are.

PROF SNAPE: There was a comment from the last participant - I'm not quite sure if you heard it, it was I think just before you came in - and they suggested that anyone who suggested that the airlines don't have countervailing power have never had anything to do with an airline.

MR OLDMEADOW: I'm finding it a bit hard in the sense that there are a lot of things that many of us would have wished to have happened, Chairman, during the period of the last three years of the CPI-X, in terms of trying to reach some agreements with the privatised airports. There have been some agreements reached. But it is very difficult in a lot of areas when it comes to critical issues, and they usually surround conditions of use or price. The airlines have little power, if they want to go to that particular destination, of saying, "Well, we won't go there."

I mean, in an international terminal we do need offices for our staff. Now, there is an issue about how big the offices are, but certainly we need offices. We need rooms where our staff can have lunch. Now, you could say, "Well, you can stand up and have lunch and that's fair enough," but there's a necessity somewhere for those staff to go, and they're sort of a minimum size, given the number of staff that we have at the international airports.

There is a need to have toilets and change rooms. They are I think reasonable -

that people have a locker and a change room. There's a need for us to have controllers' offices down on the ramp. With respect to the offices for airlines, they tend to be in areas which by and large the alternate use is not retail. They tend to be right up the top in the gods, rather than areas sitting out on the finger where you would be competing with retail. It's not retail or offices for most of the staff officers.

As to lounges, sure, the airlines could go back to a position where there were no lounges, but certainly from a competitive perspective I think whether it's Qantas, One World Alliance, Star Alliance and the other alliances with individual airlines, they would want a facility or access to a facility, and the size of that facility is by and large driven by the passenger demand for that facility. So the size is driven by that and we attempt certainly, as Qantas, to provide what we think are excellent lounges for our members of our club and premium passengers. So there is some flexibility admittedly, on size, but those facilities are needed at an international terminal. I haven't mentioned the domestic, because in relation to the domestic obviously we - and most of the airports - occupy and have constructed most of the facilities.

PROF SNAPE: I saw a newspaper report yesterday that you were contemplating selling those leases. Would you like to comment on it?

MR OLDMEADOW: No, I couldn't comment on that, Mr Chairman, at this point.

PROF SNAPE: No comment? It was worth a try.

MR O'BRYAN: I'm not sure why that's actually relevant to what we're discussing - even that comment. I don't see the connection actually.

PROF SNAPE: The connection?

MR O'BRYAN: Yes, well, why - - -

PROF SNAPE: Between the selling of the leases - it's the question of the power, the countervailing power, to the extent that you have your own leases tied down for 20-odd years means that you don't have to negotiate with the airport for the leases for common user terminals et cetera.

MR O'BRYAN: On that asset, that's right. On that asset, yes.

PROF SNAPE: Yes.

MR O'BRYAN: But that's only one asset of many assets of course that are required.

PROF SNAPE: That was the relevance.

MR O'BRYAN: I understand, yes. No, I wasn't picking it up. Obviously there's a

capital management issue, but it is only one asset out of many assets, and of course it isn't just domestic terminals that the airline needs at the airport, and there are a vast range of other services the airline needs at the airport.

PROF SNAPE: Yes, and there have been various comments on the advantages and disadvantages of managing your own facilities, and indeed having long leases on your own facilities both ways, and that was the context.

MR O'BRYAN: Yes.

MR BYSOUTH: Mr Chairman, I might say, just in case that comment gets a lease of life in itself, our Chief Executive Officer was being interviewed on Business Sunday on Sunday morning and that response about the terminals was in answer to a question on what was being considered in the business review, in a series of hypotheticals. The Chief Executive Officer was asked would terminals be considered in that, and he said all areas of the company would be up for consideration for review. So to take it in isolation may give the wrong impression. The record should show that it was just an answer to a journalist's question.

PROF SNAPE: Thank you for that clarification. We won't take it too seriously then. Thank you, it was worth asking the question after all.

MR O'BRYAN: Mr Chairman, before we finish on the countervailing power - I'm not sure if we are finished on it or not - but could I just return to the comment that you made about Sydney Airport and the proposed increase in its aeronautical charges. It was apropos the comment I think from Adelaide's figures that Sydney Airport are currently the lowest charges et cetera, and the mere fact they want to increase them by 130 per cent is not any evidence of market power.

PROF SNAPE: It's the domestic that I was referring to.

MR O'BRYAN: Right, specifically. I must admit, I was struggling a little bit with that. It does strike me of course just why do economists expect to see higher prices arising out of congestion? It is because of market power that you expect to see that arising. When you have a restriction on supply, by definition that is also associated with market power. That's why you expect to see prices rise. When you look at Sydney's proposal of course and - - -

PROF SNAPE: Can I just stop you on that.

MR O'BRYAN: Yes.

PROF SNAPE: That's not necessarily so. I mean, there is a scarce resource. It's a question of who owns that resource. Now, it could be for example that it was declared that the Government owns the slots, in which case the Government might seek to ration those slots in various ways. One way might be to sell them. In other

cases there may be perhaps a natural - well, that's perhaps a natural constraint. It may be for the spectrum and selling of various spectrum - the 3G spectrum for example - and it commands a market price as a way of allocating that spectrum. Yes, there is a scarcity, but who gets the rent or who gets the scarcity rent is another question.

MR O'BRYAN: I think that's right, but the recognition there is a rent to be got is an important aspect of market power nevertheless. What the Sydney Airport situation illustrates is the inability of any airline to do anything about that. Basically whatever Sydney would have proposed absent regulation - it would have been the 130 per cent or whatever. There is no ability for the airlines, in a countervailing power sense, to prevent that. It still seems to me that that actually is an illustration of market power, and the market power arising of course - it arises from a number of factors. But the essential barriers that there are to the installation of a second airport, or whether you just even look at the individual airport - to the increase of slots there - but there are barriers. There is the ability to raise price as an outcome and the inability of any airline to prevent that. I feel that the situation is illustrated - - -

PROF SNAPE: In a hypothetical market in which price is being constrained at a very low level - indeed the Government might even say it has to be given away. Now, if you raise the price from giving it away or close to it, to something which is a bit above it, it would not seem generally because of an exercise of market power.

MR O'BRYAN: I think that may be right. Of course then I know as part of the BARA submission, as part of the ACCC process of course, there has been a lot of data put forward about what the returns at Sydney Airport have been - an analysis of those returns and looking forward. But obviously that's a separate financial question at the - - -

PROF SNAPE: I certainly don't want to get into the valuation of land at Sydney Airport today.

MR OLDMEADOW: The fuel for equity issue is an interesting one though, Chairman, because I mean, here's an example of where the airports have provided none of the infrastructure, none of the pipes. That's all been laid by the JUHI facility. They have met the costs. They pay an access fee. They pay a rent. Then suddenly out of the blue, to get some additional revenue, the airport says, "Well, it's 0.4 cents." Now, that went to the ACCC and they went with a recommendation to reduce it. I think they did comment in it about the misuse of market power. It was our submission, so obviously we agree with it. We're disappointed it didn't go down to zero. But the bottom line is that that has sat with the Government for a long while now, and the higher level is still in place.

I think that is an example of where from our perspective there was no justification for the charge, from a cost perspective. They just went ahead with it.

We had no power to prevent it. We have no countervailing power. We can't stop flying to Brisbane and Perth Airports, because that's where our passengers want to go. At the end of the day the networks of airlines are driven by where the passengers want to go, as distinct from what is relatively small - 1 or 2, 3, 4 per cent - of the total costs which are in airport costs. But it's driven from the revenue side, rather than that margin of whether it's 2 or 2.5 per cent.

PROF SNAPE: I understand what you're saying but I think there are many points that we probably don't want to get into too much there.

MR OLDMEADOW: Yes, sure.

PROF SNAPE: One is the existence of the literally sunk costs, in terms of the fuel airport facilities. I mean, they were costs incurred in the past. It's a question - - -

MR O'BRYAN: Who sunk them? Because of course the airport didn't sink them but - - -

PROF SNAPE: From an efficiency point of view it doesn't matter who sunk them. From an efficiency point of view they're sunk costs, full stop.

MR O'BRYAN: Except the airport didn't put in any of the infrastructure for those pipelines of course.

PROF SNAPE: I understand what you're saying, but that's in the past.

MR O'BRYAN: Sure, yes.

PROF SNAPE: There's also the question of what they thought they were purchasing. There's the question of how you unpack the bundle of things that you're supplying in order to - - -

MR OLDMEADOW: Does that mean, Mr Chairman, that the JUHI is entitled to charge whatever it likes to the - - -

PROF SNAPE: Sorry?

MR OLDMEADOW: The JUHI. It is a fuel provider, the person who owns the fuel farm. I mean, on that analysis the JUHI should be able to charge whatever they want to. I mean, we don't accept that, as a user of the JUHI. We think that they should only make a reasonable rate of return on that investment in the fuel farm.

PROF SNAPE: I can understand that that would be your position. I was trying to look at efficiency, rather than distributional questions.

MR OLDMEADOW: Sure.

MR O'BRYAN: But again, just to emphasise, I think one of the points we want to be making is what these illustrate is the lack of countervailing power. We would keep returning to that. There have been suggestions of great countervailing power, but the illustrations that you look at over the last few years does not show that; quite the opposite.

PROF SNAPE: Well, we're dealing with fuel input charges et cetera as relatively small beer in the totality of your costs. I guess the question is, do you have countervailing power when you come to the big questions. When you package things together, do you have countervailing power for example in saying, "Okay, we'd like to locate this facility at one of the airports along the east coast. Now, who's going to have it?" Will you in fact negotiate then with respect to aeronautical charges when you're packaging something else with it? It would seem to me when you're packaging something that's significant with it, and you've got those opportunities because of the business that you're in, that there could be a presumption of countervailing power.

MR OLDMEADOW: It hasn't worked in practice to date, Mr Chairman, and that may go to the fact that you are dealing with a monopoly and monopolies. We have not been able to package issues in that way to date and that's been the reality of dealing with monopolies. They are not forced to agree and each issue is dealt with independently.

PROF SNAPE: Does that apply to your dealings with Adelaide Airport on their new facility?

MR OLDMEADOW: I'm not sure of the question, Chairman.

PROF SNAPE: In the negotiations with respect to the new facility at Adelaide Airport, that there isn't a packaging of your negotiations - in your negotiations that goes beyond the use of - - -

MR OLDMEADOW: I don't think engineering facilities are involved in that package at all. As I understand it, it's the terminal-related facilities, Chairman, and exiting of the existing lease. But there are within the terminal a range of facilities. There's check-in and common user gates et cetera but I don't think engineering facilities or any facilities of that nature are involved in it, to my knowledge.

PROF SNAPE: It wasn't only engineering facilities that we were thinking of as a possibility. As part of a commercial negotiation generally you might have expected a company to be saying, "Yes, we will engage in that activity but we would like this, that and the other thing as conditions with it."

MR OLDMEADOW: I think it goes back to the - at the moment, Qantas has existing facilities within its own terminal and obviously if you go to a multi-user

terminal, the issues of your brand, check-in, lounges et cetera are issues that have to be negotiated. So certainly they were negotiated in the context of also I guess the cost of the passenger charge for the terminal.

MR O'BRYAN: I think that's right. There's probably a couple of points, Chairman. I thought where your question started did focus on the engineering type issues because - - -

PROF SNAPE: I was illustrating it through engineering.

MR O'BRYAN: Yes. But I think that's probably the best illustration though because as you were observing, there may only be one or two major engineering facilities that's required by an airline and therefore you have some choice as to where you locate that facility. As I think Ian said, that hasn't tended to be bundled with other issues to date and whether that can happen is probably a question of the cost of that facility compared with overall aero costs et cetera as to your ability to do that. But absent that example - I think that's about the only one I can think of - when the negotiation is purely relating to a domestic terminal and all of the aspects of that domestic terminal go with the domestic terminal there's no question of choice of maybe putting part of it somewhere else. A domestic terminal has certain functions and activities at that domestic terminal and can only be at that domestic terminal. I can't see that the illustration really holds in that way.

Clearly what you are observing - and it came back to a point we discussed earlier - insofar as there are long-term leases over domestic terminals, domestic terminals as assets are a little bit different from a number of the other assets at airports. I think that's right. That does go with the historical existence of these long-term leases. It does mean, of course, that as those leases come towards their end, new and real issues arise but it is pushing that out for a little period. I think that creates in a sense a special situation in relation to Adelaide Airport and I don't think the airline would deny that. But that is only relating to that asset, it doesn't obviously relate to the international terminal, the use of the runways and all the rest. So some observations can be made about that.

PROF SNAPE: That's come from a different direction. Suppose there's an extension of a roadway in front of the terminals which is of interest of course for traffic management both to the airport and to the airlines and it's commonly something in which there would be negotiation between the airport and the airlines as to who contributes what to it. Would that negotiation be completely divorced from anything to do with direct aeronautical charges in a market situation, and we're trying again to get this countervailing power. You're saying, "If you want to fly into an airport we have to fly into an airport." I'm saying that there are a number of other things that you're in fact involved in in an airport - contributions to roadworks and various other things - in which you can use those other things, and you have some negotiating power, you have some countervailing power on that and that you can tie it into bundles with the aeronautical things as well. So I don't see that this separation

of saying, "We have no countervailing power because we have to go to Brisbane."

MR OLDMEADOW: I think what tends to happen, Chairman, is in reality if there is a new road, often - particularly in the domestic or international side - you tend to have a view from the airlines that if it's to improve passenger management and access and egress for passengers that you basically find you have agreement and it's quite often the case where the airlines are advocating the change in advance - on some occasions - of the airport owner. So it's often an area where there is agreement that that be done. Then it's an issue of how it is funded. Certainly it is not - I mean, it doesn't create a major point of leverage because if everyone wants to build the road out the front, how does that create leverage for the airline, because we want it. We want it because our passengers are advantaged. I don't see how it creates leverage because if we want something I would have thought the leverage is with the monopolist.

MR PEMBERTON: I think the approach in addition has always been that the recovery should come from the airlines. Another example in case is perhaps passenger screening where there were other users of the screening equipment at international terminals and they're required to screen their goods by legislation, just as Qantas passengers and every other passenger have to be screened. Yet the full cost of that is borne by the particular passenger. There's no sharing or equitable sharing of that cost distribution and the airports' position has to date always been to seek 100 per cent from the airline with little or no negotiation.

MR OLDMEADOW: One of the drivers for the airlines seeking the leases for the domestic terminals was in fact to be able to make the decisions to build the facilities and expand, rather than in the old days when it was Department of Transport it was fairly frustrating being able to get expansion of the terminal. That was one of the drivers to be able to achieve that. Can I just comment on investment though. It has been raised and there's been some comments that sort of indicate that maybe there's a lack of incentive -and it came up in this earlier session. Under the current guidelines, the NNI guidelines, a lot of investment - current regulation investment is occurring. You have the Adelaide example with the MUIT. There's a lot of investment - - -

PROF SNAPE: That's been two and a half years in the cooking so far.

MR OLDMEADOW: I think the issue there has been, if you like, unscrambling the issues associated with the benefits that accrued to the domestic lease, Chairman, and that would have occurred with or without a regulation. That's been the driver of the delay there, not the regulatory issue in our view. Even since the decision of the ACCC it is still a matter of discussion between the parties. Also in a couple of the ports, agreement has been reached on a three-year capital expenditure plan and obviously the rules of NNI and the ACCC will apply in funding that capital expenditure. Those airports, I believe, are Melbourne and Brisbane. So on investment - and I haven't had a close look at the Productivity Commission decision

on Part IIIA but the sort of view that somehow investment is not going to occur or you get the wrong decisions on investment with regulation.....

Under the NII guidelines, investment is occurring, investment plans are being sorted out between the participants and they will go ahead. I don't think there is any evidence that the guidelines at the moment are restricting it and the assertion I think that's sort of been floating around that somehow there is a low rate of return and therefore people aren't investing, to our knowledge is not obvious.

PROF SNAPE: There were some calculations of the rates of return in the previous submission that you might want to have a look at - albeit they're in the short term rather than the long term - which didn't look all that rosy but perhaps you could address that in your submission. There's also several of the airports - and you might want to have further looks at their submissions and the discussions that we've been having - that have been claiming that there's been substantial gaming by the airlines of the regulations to delay investment, and Canberra is one of the examples - not that we have a submission yet from there but that's in the public domain, I think, of Canberra's view on that, both with respect to the apron and also to the walkway.

That has been a common theme, as you might perhaps have guessed it would be, from the airports. Melbourne's comment about the delays that were caused, both with respect to their screening and the way that the form of screening apparatus was made more labour intensive and less efficient than it would otherwise have been through the regulatory system, their claim that they will not in fact - their board will refuse to have any significant investment in the future before the ACCC has given its seal of approval, and their statement this morning that that would delay things by six to nine months for any significant investment. Had that occurred, had they waited for that process on their domestic express, that would have delayed that for several months and there would have been substantial costs in terms of the number of people who could not have travelled on the discount airlines because of that. Some of that has been with respect to gaming of the regulations, some of it has been a consequence of the regulations per se. But you may wish to address those claims because they're very common claims in the airports' submissions.

MR OLDMEADOW: Suffice to say we will address them, Chairman. We would urge you to pay regard to them. I think there's a lot of gaming going on at the moment and that's why we'd like to address them in detail, and the specifics. Perhaps Chris can deal with a couple of them. One of the delays I think was due to an industrial dispute, rather than anything to do with the regulator. But perhaps you could add to that, Chris.

MR PEMBERTON: I think the specific - Melbourne Airport originally came to the airlines with a proposal for check baggage screening, which I think is what you referred to, which in terms of cost was an in-line system and then they - because of their industrial concerns - withdrew that proposal and then came back to the airlines with a significantly higher charge which we were forced to pay and now Melbourne

Airport comes back and says, "We have a solution now to put it back in line, which was the original proposal, but we want to go outside the Government's direction," which is to say that they're not allowed any more than a direct return of the costs. They're seeking a rate of return in excess of what they would normally for security charges. They're saying, "If you don't agree to that rate then we're not going to go ahead and deliver cost savings." So really that to me seems to be Melbourne Airport gaming the system and the Government's direction.

I think in terms of Canberra Airport it was alluded to delays. I think the lack of consultation and the lack of transparency that has occurred is of great concern and I would suggest that that has led to considerable delay. It has also led to a situation in Canberra Airport where passengers that don't use facilities within the terminal building are in essence, under Canberra's submission, required to pay for the facility - the walkway and the stage 1 works in the centre area. So I would certainly be concerned that delays may have occurred but these are certainly due to perhaps information asymmetry, by the lack of transparency and in some cases the lack of consultation with the airport.

PROF SNAPE: There are two sides to just about every story. What I'm saying is we've heard one side in very many versions and we haven't heard the other side of the story. We've even got one airport in Townsville supporting a continuation of regulation as a protection against the airlines. We're not sure that that's within our terms of reference but we can approach these things imaginatively, I suppose, occasionally. So we look forward to, if you would in your submission - either the initial one or subsequent ones - of addressing those claims because as you say if we hear only one side of the story - - -

MR OLDMEADOW: I guess we don't - I mean, no regulation is perfect but our view is that a lot of the transition costs are out of the way. We know the parties now know the rules — and we believe things can be handled more expeditiously. There may be methods of making that more expeditious but we certainly are thinking of that, as to how get over some of those issues. But now that the rules are known we believe that things will go forward in - will significantly remove some of the delays in the past. It may not solve some of the problems though because there are investments that do take place where we as airlines don't support them. One of the examples that you mentioned is a case in point and we will certainly comment on that in our submission. Can I raise one other issue. I think the issue of warehousing of slots came up, an assertion that we were warehousing slots in Sydney?

PROF SNAPE: No, I don't think I said anything about Qantas and it wasn't even implied you will be relieved to hear.

MR OLDMEADOW: Good. I am relieved to hear because that would be totally incorrect. I'm interested in who it was.

PROF SNAPE: What I commented on was the extraordinary number of small

planes which were flying between Canberra and Sydney in a peak period and that someone had suggested, I think, that there was warehousing of slots - I'm not quite sure by whom - and when we were in Sydney, I think Impulse there admitted to having baby-sat some slots at one stage and that was in the transcript. So at least we've had one confession.

MR OLDMEADOW: We're a long way from the confessional. It's an invalid claim, it's a nonsense claim, Chairman. Sydney to Canberra we have 113 services with Eastern and 21 737s. We have a reasonable load factor on those services. We are increasing the size of the Dash 8s from 36 to 50 seats but we would be very happy to talk in detail on a confidential basis on why we have structured the market in that way - we haven't structured it, but why we have met the market demand in that way, because if you go back some years when they were all 737 operations - because it's very directional, it's very seasonal - not only was everyone - the two carriers at the time - not finding it an overly profitable route but the logical thing to do was to go for frequency rather than going for an infrequent with larger aircraft.

PROF SNAPE: So if the aeronautical charges went up significantly on smaller planes you wouldn't substitute larger planes and a less frequent service?

MR OLDMEADOW: I think they're issues that we would take on notice, Mr Chairman.

PROF SNAPE: In the context of that if you were prepared to address that - - -

MR OLDMEADOW: I think one of the issues is that we would welcome the opportunity to make comment on some of these issues - because they are a bit commercially sensitive - in that context.

PROF SNAPE: There has been a fair bit of running around this commercial-in-confidence question in some submissions and we remind participants that this is a public inquiry and that we are required to have a public inquiry which means that we will accept commercial-in-confidence but we want to make sure that it is strictly commercial-in-confidence and that if we have everything covered in that way then we don't have a public inquiry. Moreover we can't use it in writing a report, so that if things are commercial-in-confidence they can inform us but we cannot in fact of course use it as an argument, as a weapon, within the report. The report to that will be deficient in that and of course to that extent weaker from the point of view of the person who is in fact demanding the commercial-in-confidence. Therefore we would ask that as little as possible be requested as commercial-in-confidence, and we do have a look at that and say yea or nay.

DR BYRON: I wanted to follow up the observation you made in your opening comments - and we can go all the way back to there - about Qantas' experience with light-handed regulation, because that's something that we've had a few discussions on in the last few days and it's also a theme that is taken up in both our draft report on

the Prices Surveillance Act and Part IIIA. So I'd be very interested to hear any comments that you feel you can make on light-handed.

MR OLDMEADOW: I guess the first point is that fuel throughput was light-handed regulation but we are paying the fuel throughput and we're not very happy about that outcome. I'd turn to Michael just to comment on - and it's linked I think to a question that the Chairman asked one of the other groups about the Part IIIA and why we believed that airports should be treated separately and regulated.

MR O'BRYAN: I'll probably try to pick up both themes. I must say from my perspective - and it's an observation on regulation here, in New Zealand and elsewhere - that it's always hard to get a handle on what light-handed regulation actually means. To the extent it means regulation by frowning from a distance, I'm not quite sure what it really achieves. You intensify information disparities. Potentially you intensify dispute and mistrust. I do actually have a personal perspective: if you're going to do it you might as well do it properly and at least try and promote some transparency. It is a feature of competitive markets and a feature particularly of large infrastructure markets, I think, that more and more the commercial world in competitive markets has moved to more transparency in transactions. To my mind, actually light-handed regulation sometimes mitigates against that and in fact produces exactly the opposite outcome of what you might like to achieve and what you might expect to occur within a commercial market and a competitive market.

The observations about why industry specific regulation in the context of airports, what makes airports different and why don't we just rely on Part IIIA, I think there are two observations - - -

DR BYRON: And Part IV.

MR O'BRYAN: Part IV I think is more easily dismissed. I don't think you would find a competition lawyer in the country who would suggest that Part IV prevents monopolistic pricing in any sense at all, in other words, just pure exploitation of market power as far as the monopolist would want to exploit it. Part IV says not a jot about that. Section 46 does not touch that. It never has and never will.

I think to amend section 46 to try and do that would create all sorts of problems, in terms of notions of jurisprudence within competition law. I've never really seen a competition lawyer or an economist advocating such an amendment. You can sometimes speculate as to how you might amend section 46 to achieve that outcome. It doesn't do it now. It would have then quite bizarre outcomes on the rest of the economy if you were to pursue that course. So I would certainly never be advocating that course.

Looking then to Part IIIA, I make two comments about Part IIIA. First of all, I

actually think it's a misconception to suggest that Part IIIA, as it currently applies to what we know as the regulated industries, is kind of universal and not industry-specific. I think the best example of that is the electricity industry. To suggest that you do not have industry specific legislation for the electricity industry is just simply wrong. Part IIIA underpins what has been put forward as the national electricity code. But, you know, there is a sort of a tenuous connection - it's done through a legal mechanism - to in effect take the electricity industry outside of Part IIIA and have the industry regulated through the national electricity code and under the national electricity law. I think that's actually one of the great misconceptions that's often put out about the electricity industry and Part IIIA. The electricity industry is industry-specific regulation.

The second point I would make is, why is that so, and why would you also advocate it in the airport industry, for example. The feature of Part IIIA, and Part IIIA as a form of regulation, is of course it is a negotiate-arbitrate model. That means it is a transaction-specific model. It suits really, ideally, industries where you have relatively few transactions and that therefore this negotiate-arbitrate model can apply quite effectively and efficiently in that sort of scenario.

With industries where you have multiple transactions and multiple users and multiple transactions even within those users - and I would say that the electricity industry and indeed the airport industry are examples of those industries - Part IIIA on its own is not ideal, and will never be ideal for that. It will play a role. I think, as Qantas has submitted in the context of the national access regime inquiry - was it only Qantas or have BARA submitted as well - it will play a role. It is useful. There are issues that Part IIIA can address in that context.

But to suggest in an industry like airports, where there are many, many users - many airlines, particularly on the international side, and also many layers of transactions that must go on at the airport, and there are - to rely solely on Part IIIA would be an incredibly complex, incredibly difficult outcome to achieve. That's exactly why that hasn't been pursued in the electricity industry, for exactly the same reason, and I would suggest would not be an ideal outcome in the airport industry either.

DR BYRON: But a multilateral undertaking, like the electricity code?

MR O'BRYAN: Well, I mean, that's an interesting example to throw up. If you went to a kind of airport code like the national electricity code, you know, would that actually achieve the outcome? I would suggest in fact that effective price regulation is actually a similar outcome. That is indeed I think what Qantas would most be advocating. When you look at the national electricity code, that is what it really is achieving. I mean, although it's dressed up under notions of access, you know, access isn't really what it's all about. It actually is about price regulation, against a multiple of users in a multiple of environments, and trying to set some efficiency criteria associated with that.

If the airport industry went that way, I think that actually would be a desirable outcome. It would certainly overcome a lot of the shortcomings of the Prices Surveillance Act. The Productivity Commission has already commented on the shortcomings of the Prices Surveillance Act. I think we endorse those. Indeed again, in the context of that inquiry, I think both BARA and Qantas have made submissions along those lines. There are deficiencies, yes, and I think that sort of model could be looked at.

So yes, you can use Part IIIA as a mechanism, to achieve an effective regulatory outcome, but it's important to understand what you are doing in that. I think it is wrong to say that it's not actually industry specific. I think it is. I think there are reasons why it's industry specific. There are reasons why the gas code looks different to the electricity code. It's dealing with a different nature of transactions and environment in that industry.

PROF SNAPE: I think that if one looks at the IIIA and the telecoms and the PSA together then we have been concerned to say that there should be generic regulation as far as - or common principles. There should be a convergence, if you like, of it as far as possible. But of course it's recognised that for any industry there has to be specific application at some level. It's a question of when that specificity starts to occur in a sort of continuum. But nevertheless, we see efficiency advantages of having common principles as far as possible, so that there are not artificial distortions in investment decisions et cetera as between industries. That is the theme which is enunciated in those draft reports.

Also, in the telecoms one we give specific - as I mentioned earlier in the day - we give specific reasons why we recommend that there should be a continuation of an industry specific regime there. The reasons are in fact specific to telecoms and to a large extent they're historical and associated with the local loops. So if there are reasons for there to be specific rather than generic regulation for airports, then we would be seeking, similarly, specific reasons that are applying to airports to justify that.

On the first of the two points that you were addressing, and that is the transparency, one can see that there is a point - and we look forward to it being elaborated, if you would. It would be of benefit to all four inquiries. But the other side of that that we're looking at there is that in suggesting monitoring - and rather than declaration or no declaration, we were trying to think of minimising errors - that there may be errors in declaring industries which shouldn't be declared. There can be errors in not declaring industries which should be declared. Those are substantial risks.

I mean, when you've got a binary choice like that, there are substantial risks of error, of regulatory error. What we were trying to say there is, is there in fact an intermediate point that in fact will not bear such risks of error as that - of declaring

industries that shouldn't be declared and not declaring industries that should be declared. So taking your point about it may not be as transparent and all of that - but that's not the only dimension. It was those other dimensions that we were exploring in those reports, but we would very much value your comments on it. But if you could bear in mind the totality of the context in which this is put forward and not just one aspect, because of all the various - nothing in this area is going to be perfect. If one just concentrates on the imperfections of each, one will not get the best of an imperfect world. Neil, are you - - -

DR BYRON: I think I might save the rest of my questions for our next meeting.

PROF SNAPE: Yes. Were there any other comments that you would like to make?

MR BYSOUTH: No, just on a similar approach, the light-handed approach, just to confirm what Michael said. It depends on what you're actually talking about and what's involved. If the light-handed approach had recourse for example through a department or a minister then you could distort the process and its implementation for timing within a cycle, with an electoral cycle. So what is meant by it and what is used to it can confuse the issue. In simple terms, it does sound very good.

In other simple terms - and the example I think, Mr Chairman, that you were after - if there was an example of monopolistic behaviour or not, I think in our selection and chase for a new engineering site, where there was choice within the bounds of facilities - infrastructure, industrial things and what else have you - I think the airports and ourselves exhibited normal business behaviour. It was negotiated and it was dealt, because there was competition. It was open. That was dealt with in that manner. But in the other cases - and you spoke about a theoretical other airport on the east coast of Australia - it just doesn't exist. There is Sydney, there is Sydney and there is Sydney. So there's a difference in the behaviour.

My learned friends and your former students could probably articulate the reasons for that, but in simple terms the facts are that where there was competition there was open negotiation and it was straightforward to the best bottom price. Where there is no competition, this other behaviour is exhibited.

PROF SNAPE: Thank you very much.

MR OLDMEADOW: Just to conclude, this goes back to a comment earlier, Chairman. We would have liked to have come to a position now where we had an agreed position with the airports, on conditions of use, access agreements. We haven't been able to achieve that. I think the fundamental reason for that is that if you are dealing and you are negotiating with a monopoly and you haven't got much power, at the end of the day there's not much incentive for them to reach what I'd regard - as I think most people, independent people, would regard - as a commercial agreement.

At the end of the day, if there is misuse of market power, that goes on the price of a ticket, and the people who wear it unfortunately are the travelling public. You know, we would certainly ask - and we will do that in our next meeting - we'll reiterate that and put it in our submission. But we have a great concern that the travelling public, out of all this, is the potential loser if there is a move to allow airports to use their monopoly power unfettered. Thank you.

PROF SNAPE: Of course, our next meeting will be after a draft report so we would in fact be looking for a very substantial input to set us on the right track, as you perceive it, before then.

MR OLDMEADOW: Certainly.

PROF SNAPE: It's much easier.

MR OLDMEADOW: Yes.

PROF SNAPE: So thank you very much, for that Qantas. I shall just conclude by saying what I said I would say at the beginning of the day, and that is that I would invite any people present, who would like to make a statement or a submission unscheduled, at this time, to do so if they wish. If not, then I'll close the day's proceedings and we should adjourn until 9 o'clock tomorrow morning, when we'll gather back in here and we will have the Australian Council for Infrastructure Development at 9 o'clock in this room. Thank you very much.

AT 6.05 PM THE INQUIRY WAS ADJOURNED UNTIL
WEDNESDAY, 4 APRIL 2001

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