



**Economic Regulation of Airport Services**  
**Second Submission to the Productivity Commission Inquiry**  
**Sydney Airport Corporation Limited ('Sydney Airport')**  
**22 July 2011**

**Sydney Airport - Gateway to Australia**



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## **Purpose of this submission**

A number of submissions to the inquiry include comments about Sydney Airport that are factually incorrect. In some cases Sydney Airport's original submission included the correct information – for example, in relation to the options for airport access. This submission has been prepared to correct other specific errors.

In addition, new information is presented on the impact of the removal of the station access fee from Mascot and Green Square stations in March this year.

Finally, further information is presented on aspects of Sydney Airport's commercial agreements with airlines, in response to questions raised by the Productivity Commission. Some information in this section is confidential and has been omitted from the public version of the submission.

## **SECTION ONE – FACTUAL CORRECTIONS**

### **Submission 52 (Qantas), Section 3.3.5.2 Charging for services not provided**

Qantas states that it is paying for a service not provided because it does not get a rebate on the T2 charge for QantasLink aircraft which park on the T3 apron instead of the T2 apron.

Qantas is receiving access to all the services that it pays for under the T2 agreement, which includes the use of passenger processing facilities within T2 and access to aircraft apron within the domestic precinct (which will frequently, but not always, be adjacent to T2).

Qantas' use of the T3 apron reflects both its operational preference for the T3 aprons rather than alternative domestic apron areas east of T2, and its inefficient use of the T2 apron (the average aircraft parking time for QantasLink is substantially higher than the 45 minutes allowance included in the negotiation of the T2 agreement).

### **Submission 52 (Qantas), Section 3.3.5.3 Charging for services already paid for**

Qantas states that Sydney Airport charges an apron parking fee for international flights, which does not offset passenger aeronautical charges.

Whilst Sydney Airport does charge an apron parking fee, the international passenger service charges are calculated net of the forecast apron parking revenues (as they were in the ACCC Decision in May 2001<sup>1</sup>). Hence, Sydney Airport does not charge twice for the same service.

### **Submission 52 (Qantas), Section 3.3.5.4 Imposing charges on other businesses**

Qantas states that any fuel throughput levies and check-in-counter rents are not offset against the aeronautical charges. Qantas also claims the check-in counter revenue is treated as non-aeronautical.

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<sup>1</sup> ACCC: Sydney Airports Corporation Limited Aeronautical Pricing Proposal, Decision May 2001. Section 13.

These services are not included within the negotiation of the international passenger services charge or domestic runway charge, but have always been separately negotiated (as they were in the ACCC Decision in May 2001<sup>2</sup>). Accordingly there is no need to offset any revenues against the passenger service charge or domestic runway charge because the assets and costs associated with these services are excluded from the calculation of these charges.

However, in accordance with the Productivity Commission's decision in 2006, the revenues, costs and assets relating to these assets are reported as aeronautical within the ACCC monitoring reports.

### **Submission 54 (Virgin), Figure 13** **Airport pricing and costs since the 2006 review**

Virgin states that between 2005/6 and 2009/10 there was a significantly faster increase in aeronautical revenues (46%) than aeronautical costs (26%) for Sydney Airport.

The Virgin analysis excludes depreciation, and does not use the line-in-the-sand asset values in 2009/10. The omission of depreciation in particular is significant, given the 68% increase in depreciation resulting from the significant investment program during the period. The actual increase in aeronautical costs was 37%.

More importantly, the submitted Figure 13 only shows the increases in costs and revenues, and provides no evidence on the achieved return on capital. Sydney Airport's submission in April clearly demonstrated that its return on capital was not excessive.

### **Submission 54 (Virgin), Section 8.2** **Airports cherry-pick which services to include in the non-aeronautical till**

Virgin claims that airports freely select which services are classified as non-aeronautical, in order to maximise revenues.

For the purpose of negotiating the runway and terminal charges, Sydney Airport continues to use the same definition of activities that was used in the ACCC Pricing Decision in 2001.

For ACCC Monitoring Purposes, the activities considered aeronautical are clearly defined by the Airport Regulations Act 1997 (Part 7A).

### **Submission 9 (IATA), Section 1.3** **Allocation of aeronautical and non-aeronautical activities**

IATA claims that the rationale for changes between aeronautical and non-aeronautical activities are not clearly communicated to the airlines, and cites as the example a change in the reporting of Sydney Airport's non-aeronautical revenues in the 2009/10 ACCC Monitoring Report.

As noted above, Sydney Airport continues to use the same definition of activities that was used in the ACCC Pricing Decision in 2001 when negotiating terminal and runway charges.

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<sup>2</sup> Ibid. Page 14.

For ACCC Monitoring Purposes, the activities considered aeronautical are clearly defined by the Airport Regulations Act 1997 (Part 7A).

There was however a change in the reported non-aeronautical revenues between 2008/9 and 2009/10 within the ACCC Monitoring Reports. This is no way represented a change in the allocation between aeronautical and non-aeronautical revenues. Rather, it was a change from reporting a financing-related intra-group dividend as non-aeronautical revenue and a similar amount as interest expense (based on the SACL accounts) and reporting neither the dividend nor the interest expense (based on the SACL Consolidated accounts). The latter approach gives more meaningful information on the aeronautical business, and the change was accepted by the ACCC.

### **Submission 9 (IATA), Section 2.3**

#### **Asset beta for Sydney Airport was historically close to zero**

IATA claims that Bloomberg estimates that Sydney Airport's asset beta is close to zero based on the past decade.

Standard regulatory practise is to estimate the asset beta by looking at the observed asset betas of listed airports and airport groups, using 5 years of monthly observations. There are currently 21 listed airports or airport groups which have 5 years of data, of which half are in the Asian region (including Australasia). Over the past 10 years the average observed asset beta has been 0.70 (world) and 0.75 (Asia), and the estimates are currently higher. A chart of historic asset betas for listed airports is shown in Appendix 1.

Bloomberg could not provide a meaningful direct estimate for Sydney Airport's asset beta, since neither Sydney Airport nor any holding company for Sydney Airport has at any time been listed on any stock exchange. Neither MAP (which has invested in 8 airports groups over the past decade) nor Sydney Airport's hybrid debt (SKIES) are reasonable proxies for Sydney Airport, and in any case neither have an observed beta close to zero.

## **SECTION TWO – NEW INFORMATION**

### **The impact of fare reductions on public transport patronage**

In its submission, Sydney Airport sought a commitment "to remove the station access fee from the Domestic and International rail stations on the Airport Link as has just been accomplished for Green Square and Mascot stations."

Since then, new information about the dramatic impact that fare reform has had on public transport patronage has become available. The Sydney Morning Herald, in an article "*Ticket sales rocket on airport line as prices plunge*" (9 June 2011) reported that since the decision to remove the station access fee from Mascot and Green Square stations became effective in March, "more than 950,000 passengers have passed through the stations, a 70 per cent increase on the same period last year."

The chief executive of Airport Link, Mr Tim Anderson, was quoted as follows: "Those stations have always grown by 20 per cent a year, so I consider that the recent ticket price changes have increased passengers by 50 per cent."

Sydney Airport continues to advocate the elimination of the current station access fee from the stations serving the Domestic and International terminals, and believes that this recent evidence demonstrates that doing so would significantly ease congestion on the M5 corridor and the road infrastructure serving the airport, Port Botany and the wider region.

## **SECTION THREE – COMMERCIAL AGREEMENTS**

### **The Head Lease, the Conditions of Use and individual commercial agreements**

The Productivity Commission noted BARA's claim that the Sydney Airport Conditions of Use were 'draconian'. In this regard, we would note that:

- The Conditions of Use provide an appropriate response to the obligations placed on Sydney Airport by the Head Lease
- They are consistent with the Conditions of Use which applied prior to privatisation
- These conditions are available to all users, regardless of circumstance.
- The Conditions of Use were negotiated with BARA since privatisation.

#### The Head Lease

- Paragraph 3.1(a) of Annexure B to the Head Lease requires that Sydney Airport must provide for access to the airport by international, domestic and regional air transport.
- If Sydney Airport fails to provide access, then under paragraph 19.1 the Commonwealth can terminate the lease.
- The only grounds on which access can be denied are force majeure, a lack of runway slots (which is determined by an independent authority) or a failure of an airline to pay their airport charges within 21 days of the due date. Sydney Airport must also give the Commonwealth at least 14 days notice of its intention to refuse access.

#### The Conditions of Use

In response to the obligations placed on Sydney Airport under the Head Lease, the Conditions of Use provides for some protections:

- Paragraph 8 allows Sydney Airport to vary airport charges at any time, following a minimum of 90 days consultation and 30 days notice.
- Paragraph 2.2 requires that airlines must provide a bank guarantee for the estimated charges over the next 90 days
- Paragraph 7.6 states that charges must be paid before each aircraft departure, unless the user has a credit agreement with Sydney Airport
- Paragraph 9.5 states that Sydney Airport can refuse access to its facilities (or detain an aircraft – effectively refusing access to the runway for departure) if an airline is at least 21 days overdue on its charges

These conditions are necessary to protect the airport, given the obligations imposed by the Head Lease and the wide variety of different airport users. Most importantly, if Sydney Airport required the agreement of an airline to impose a charge, then the airline could boycott any agreement and still insist on access under the Head Lease – and therefore use the facilities for free. The requirement to pay before departure is intended for users such as charter airlines who may use Sydney Airport only once, whilst the 90 day bank guarantee is most important for airlines which are less financially stable.

Individual airlines can, and have, negotiated commercial terms different to those included in the Conditions of Use.

[CONFIDENTIAL CONTENT OMITTED]

### **Negotiation of the 2007 International Passenger Services Charge**

The Productivity Commission noted that several airline submissions characterised negotiations as ‘take-it-or-leave-it’.

It is important to point out that Sydney Airport engaged in negotiations with airlines and achieved signed commercial agreements with all. From the original proposal there were a number of changes arising through a combination of concessions being made by Sydney Airport or improved solutions being jointly identified.

The 2007 international charges agreement with BARA – which accounts for more than half of Sydney Airport’s aeronautical revenues – is a good example of this. During this agreement, Sydney Airport made concessions on both the asset beta and the traffic forecast (amongst other things) – these concessions are not recorded in the agreement but are implicit in the price and detailed modelling shared with the airlines. These concessions were made to reach a resolution, despite strong expert evidence supporting Sydney Airport’s position.

More recent data would suggest that the Sydney Airport proposals on asset beta and traffic volumes – even before the concessions – were generous to the airlines. In addition, it is clear that the debt costs assumed have been very favourable to the airlines.

	<b>Sydney Airport Proposal</b>	<b>2007 BARA Agreement</b>	<b>Actual / Evidence</b>
<b>Asset beta</b> (5 year monthly)	[CIC]	[CIC]	0.70 - 0.75
<b>International passengers</b> (2007/8-10/11)	[CIC]	[CIC]	43.7m
<b>Debt costs above risk free</b> (2008-11 average)	[CIC]	[CIC]	[CIC]
<b>International base charge</b> (BARA: excl NNI post Jun-06)	[CIC]	[CIC]	

### **Service level commitments**

Sydney Airport currently has agreed service level commitments with nine airlines representing the majority of passengers at Sydney Airport operated terminals 1 and 2, and intends to negotiate additional service level agreements in the future. The purpose has been to work collaboratively to improve service levels, and accordingly the commitments don’t include financial penalties for either the airport or the airline.

## APPENDIX 1

Evolution of observed asset betas

