

ECONOMICS AND INDUSTRY STANDING COMMITTEE

INQUIRY INTO REGIONAL AIRFARES IN WESTERN AUSTRALIA



**TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
MONDAY, 11 SEPTEMBER 2017**

SESSION THREE

Members

**Ms J.J. Shaw (Chair)
Mr S.K. L'Estrange (Deputy Chairman)
Mr Y. Mubarakai
Mr S.J. Price
Mr D.T. Redman**

Hearing commenced at 11.41 am

Ms CAROLINE ANN WILKIE

Chief Executive Officer, Australian Airports Association, examined:

Mr GUY STEPHEN THOMPSON

Chair, Australian Airports Association, examined:

The CHAIR: On behalf of the committee, I would like to thank you for agreeing to appear today to provide evidence in relation to the committee's inquiry into regional airfares. My name is Jessica Shaw and I am the Chair of the Economics and Industry Standing Committee. I would like to introduce the other members of the committee to my left—deputy chair Sean L'Estrange, member for Churchlands; Yaz Mubarakai, member for Jandakot; Stephen Price, member for Forrestfield; and Terry Redman, member for Warren—Blackwood. It is important that you understand that any deliberate misleading of this committee may be regarded as a contempt of Parliament. Your evidence is protected by parliamentary privilege; however, this privilege does not apply to anything that you might say outside of today's proceedings. I also advise that the proceedings of the committee's hearing will be broadcast live within Parliament House today and via the internet. This broadcast may include documentation provided by you to assist the committee in its investigations.

Thanks very much for your two submissions to the inquiry. Before we begin with questions, do you have any questions about your attendance here today?

The WITNESSES: No.

The CHAIR: Would you like to make a short opening statement about your submission?

Ms WILKIE: Yes, please.

The CHAIR: Fire away.

Ms WILKIE: Thank you very much for the opportunity to speak to the committee today. The AAA represents some 320-plus airports nationally, including 40 here in Western Australia. These airports stretch from dirt strip airports in local councils right through to Sydney and Perth Airport. I have here with me today Mr Guy Thompson, who is the national chairman of the AAA. Guy is also the chief operating officer at Perth Airport and was previously the general manager at Karratha Airport, so his knowledge of aviation both nationally and in Western Australia is extensive. He was also the Western Australian chairman for, I believe, about eight years. I have been the CEO of the AAA since 2011 and bring with me a unique perspective on airports nationally, particularly around airport regulation and the national airport environment.

Your committee has already heard from and met with a number of our members and the feedback from our members is that they have greatly appreciated that dialogue. I want to take this opportunity to address a couple of issues that have been raised in other submissions to the committee. We all welcome the opportunity to work with the committee towards identifying potential solutions to what can be a complex set of issues—the cost of regional airfares and access to aviation as a driver of economic and tourism growth. I note earlier evidence provided to the committee by representatives from the Department of Primary Industries and Regional Development about the contribution of airport charges to the price of airfares. I draw the committee's attention to the fact that most airport fees and charges are fully disclosed on the

relevant airport or council websites. Ours is an open and transparent industry that in regional Western Australia is largely owned and operated by the electors of Western Australia in their capacity as ratepayers. Only three RPT airports in Western Australia are privately owned—Broome, recently Port Hedland and Perth.

The AAA estimates that regional airport charges make up between five and 13 per cent of the cost of a regional airfare in WA depending on how heavily discounted that fare is. These charges are used to cover the costs of operating the airport and maintaining and complying with the many safety and security requirements and regulations from the commonwealth. Most regional airports in WA currently run at a loss and will continue to do so for the foreseeable future given the softening in the regional aviation market in Western Australia. This softening is shown in figure 1 of our primary submission.

Subsidies from ratepayers are already required to cover these losses to keep our airports operational. A high proportion of airport costs are fixed regardless of the number of aircraft and passengers that utilise the facility. Expenses such as capital renewal, maintenance, security and compliance costs have to be covered from a relatively small base. Contrary to claims by Rex, most regional airports cannot be run for \$700 000 per annum; an overlay of a runway alone is on average in excess of \$10 million. Airports need to save for these capital expenses in the future.

The comments made by Qantas previously were quite interesting when they say they have seen a reduction of \$250 million in their profit over the last two years from here in Western Australia. That impact is on our airports as well. For every person who is not flying on Qantas or Virgin, that means one passenger fee that we are not getting at our airports. For our airports in this current environment, it is getting even more challenging to maintain the basis of the airport.

The councils whose airport supports commercial airline services whilst running at a loss are already supporting their local community and the airlines that operate there. Security charges are also a large part of costs of airlines in remote communities but in the current environment, this is unlikely to change.

I find the section of the Qantas submission interesting where they allege monopolistic behaviour by WA airports. I find it ludicrous that anyone would suggest that remote WA airports and their council owners or mayors are going to be at an advantage in commercial negotiations to Qantas. Apart from the fact that the airport knows that it must secure services for their community, is Qantas really alleging that its crack team of commercial negotiators, who hammer out deals with Changi, Dubai and Heathrow, are at a disadvantage to Geraldton Airport in negotiations? It is quite ridiculous. I also find some of their comments around the ACCC and airports also quite bizarre because the ACCC monitoring refers to the four airports—Perth, Sydney, Melbourne and Brisbane. It has absolutely no bearing on discussions here about Western Australian regional airports. The ACCC has not found that airports in Western Australia are some of the most expensive in the world, nor have they found that airports in the majors are the most expensive in the world.

The comment in particular that I find most galling is the comment that eight of the airports in WA are of the 15 most expensive here. There is a simple reason for it. It is expensive to operate in Western Australia in regional and remote areas. I see a comparison between airports on the east coast and airports on the west coast. You can almost double for most things. I mean you have higher staff costs, higher costs to get the staff to Perth or to the east coast for engagement with CASA and OTS. You have higher costs to get equipment up there. You have higher costs to get pavement up there, and higher costs to get engineers. The list goes on and on. There is a reason it is so expensive to operate and it is no different to the airlines in these remote communities. Comparing Cairns, which has passenger numbers of three million, with Broome, which has passenger number of

300 000, is also ridiculous. In our submission you saw that we made some comparisons between Queensland and Western Australian airfares. It is not about airport costs. It is really transparent and I would be quite happy to provide additional information to the committee as to why Western Australian remote airports are more expensive in terms of their landing charges than Cairns. It is really simple basic economics.

In terms of airports, obviously we want to work with our airline partners. Airports are a volume-based business. The more people we get through the airports, the less expense that the local community has to pay to maintain that. In order to foster increased confidence in the tourism industry, it could be open to government to reconsider its tendering arrangements for government travel. While price should always be the most important determinant when selecting a contractor, government could consider offering a whole-of-government contract for interstate and intrastate travel to an airline on the basis of price and their proposed spending on and promotion of WA regional tourism attractions and activities, including regional fare levels.

[11.50 am]

Between them, our members in WA have invested over \$500 million in aviation infrastructure in recent times. Most of that investment at regional airports has been to comply with safety and security requirements. Most of the investment at Perth Airport has been to develop new terminal infrastructure, including Australia's only dedicated regional terminal—Terminal 2. A number of people who have made submissions to the committee have made a number of worthy suggestions. From an airport perspective, areas that this committee might focus on include, whilst not the RPT airports, the importance of maintaining and potentially increasing funding as part of the RADS program has been critically important to airports in Western Australia. There is also an opportunity to look at the funding arrangements in Queensland. Queensland has number of funds which are done in partnership with airports and local tourism bodies to increase and underpin routes. And whilst out of the purview of this committee, the AAA is asking the commonwealth for funding for regional and remote airports with less than 200 pax per annum as part of the next budget process. If WA was able to match this funding, I am sure the commonwealth would be more interested in establishing such a fund.

The CHAIR: Did you say 200 people or 200 000?

Ms WILKIE: It was 200 000, sorry.

The CHAIR: Sorry. Thank you.

Ms WILKIE: It is 200 000 people. So we have had a preliminary positive response from the commonwealth because they also have very similar funds for other areas in regional Australia, and they do not currently support regional aviation. But their argument is that they want the state governments on board, so we are approaching all of the state governments.

For our members, aviation, tourism jobs and security are core business for us, and we take our commitment to the people of WA, the state's economy and the safety of the travelling public extremely seriously. Guy and I would welcome any questions the committee may have.

The CHAIR: Thank you, Ms Wilkie, for a very comprehensive opening statement and for your rebuttal of some of the points that were just raised by Qantas in its evidence to us. There is one thing I would like to pick up. Qantas spoke about the discounts that they have just offered six regional centres, and talked about Kalgoorlie airport's response in offering to discount its airport charges, and commented on the deafening silence from the other regional airport centres in Western Australia. What is your members' views on their ability to cut costs to match Kalgoorlie's

actions, and their ability to either control or reduce their charges as a way of mitigating high regional airfares?

Ms WILKIE: Those members will engage themselves with Qantas, but from an overall observation I think it is really inappropriate that Qantas requested the airports to do this. I think these airports are already providing as cost-effective operations as they possibly can. One airport that had been asked has already provided a discount to Qantas over some five years in terms of their operations. So I think it was an unreasonable ask. I think how it was asked was unreasonable. Basically, Qantas announced it and then as an after-fact then engaged with the airports, so it was not a legitimate discussion. I totally appreciate that Qantas is trying to do the right thing by the community, but I do not think—all that has been asked is—so any of those airports that have been requested could well say, “Sure, we won’t charge for that”, but then ultimately when they do not have the money to keep the airport open they are going to go to their ratepayers and say, “Your rates go up.” So the people in the community are going to pay for it one way or the other. Also, it is very galling to say, “We will reduce your fare by, say, \$30 off a \$1 000 airfare”, when Qantas has just announced a \$1.4 billion profit. I do not think it would sit well with many in the regional communities.

The CHAIR: So just to clarify: Qantas did not engage with any of your members about its intended reduction to the airfares that it has just announced?

Ms WILKIE: My understanding is that the airports received an email the night before the announcement, asking them to sign an in-confidence disclaimer before they were going to be shared with any of the information, and the article then ran in *The West Australian* the next morning before discussions were had. My understanding is that a phone call may have occurred on, I think, the Thursday evening. But in terms of legitimate discussions, I do not think that really passes the pub test.

The CHAIR: Is that typical —

Mr D.T. REDMAN: So there was a direct discussion with Kalgoorlie. So Kalgoorlie negotiated that, and then the others were not in the mix?

Ms WILKIE: My understanding from the other airports is that they did not know about it.

The CHAIR: Is that pretty typical of the way that the airlines tend to deal with regional communities’ airports?

Ms WILKIE: Yes.

Mr THOMPSON: Yes.

The CHAIR: That is interesting.

Mr THOMPSON: If I can perhaps add to that. So even were you to adopt the model that Qantas has put forward for their discounting regime—noting that airport charges are the same whether the fare is the discount fare or the full fare—the cost of the airport service based on the cost of operating the airport is the number. It is the number all day, every day. Seasonally off peak, on peak—it is the same number. So if you were to say that is the lowest figure that an airport charges and take 10 per cent off it, to use Broome as an example, take the princely sum of 10 per cent off their charge at around \$60, that reduces the airfare to Broome by \$6. So it is \$984, not \$990. I am not sure that gets you very far. The reality is that the Broome cost curve, which is open and accountable and transparent and published on their website, is part of a longer term pricing negotiation with all airlines that operate, and they, like others in the industry, end up with the terms-no-less-favourable comment. That says they cannot offer a discount to one airline when they do not offer a discount to another. It is not an argument not to offer the discount, but it is not that simple. It gets you to—

you cannot offer a discount fare to a Qantas passenger that you cannot offer to a Virgin passenger or a Rex passenger or another airline, and we generally only have three operating in Western Australia really.

Mr D.T. REDMAN: You see, the argument that was put to us around that was that it is about growing the pie. Do you accept that argument, if you can get more people on —

The CHAIR: Just before we move on to that, I want to focus on these local charges. The point you have just made about you cannot offer one deal to one airline provider without offering it to another, does that mean that in Kalgoorlie that Kalgoorlie airport will have to reduce its charges for Virgin as well?

Mr THOMPSON: I am not sure. Not all deals are the same, and not all agreements are the same. So to Qantas's point, where they negotiate commercial terms with airports—those processes are long and time-consuming—they are not all the same. The starting and end positions are not all the same. But if you end up in any one of the agreements at your airport with—so an agreement with Qantas that says “conditions no less favourable”, it means you cannot give Virgin a discount if you do not give it to Qantas. Once you have one it applies across the board. It does not actually matter if the Virgin deal says the same thing; you are obliged not to play a tune playing one off against the other.

The CHAIR: I will ask one more question and then I will throw to you, Terry. As to transparency and accountability, as we have moved throughout Western Australia with the regional airports they have been very forthcoming with their charging structures. Is that because there is some sort of regulatory framework or licensing or mandatory reporting obligation on you, or is that a way that the airports just want to do business? You just want to be transparent about publicising the fees. Are you compelled or are you volunteering?

Mr THOMPSON: So it is a little bit different. Certainly capital city negotiations are different, so speaking about regional airports—my experience is now dated a bit—in Karratha it was around two things. So publicising fares gives you some relief as a local government on in fact gathering the revenue. So you can charge a fare, but if they do not pay the bill, what do you do? So published fees have the protection under the Local Government Act of being fees that are chargeable for a service in the community. It is a tenuous link that then says if an airline chose not to pay them, you can say, “Under the Local Government Act we can have a go at you about not paying the bill.” That is one reason.

The second reason is that councils are the predominant operators and owners of regional airports. As Caroline said, there are only two regional airports in Western Australia that are not council owned. One of those is Port Hedland that has only just been transferred to a longer term lease. The relationship there is around that all other fees and charges are disclosed, as is the process for calculating them. So the local governments will have a budget that aligns to a number of passengers or a number of aircraft movements that equals so much revenue based on these fees that we publish. Now, airports and airlines take passenger risk, so the more people who fly, the more money you get paid in a revenue sense. The cost curve does not change. Full planes versus half-full planes, apart from numbers of pieces of toilet paper in your toilets and how long they take to wear your carpet out, your facilities cost the same to run whether the plane is full or whether it is half full.

[12 noon]

The reality with fixed infrastructure is that your cost base is your cost base, and airports, certainly local government airports in my experience, calculate that fee based on next year's anticipated passengers, probably with a hope that last year's will improve, and usually by small margins, and then they carry the risk in that space, and pay the bills. The model, hopefully, gets them a return on

their investment that lets you pay for your infrastructure as it wears out. In most cases they are seeking to fund depreciation of assets.

There have been comments in other submissions around depreciation as this magical finance term. It has got nothing to do with the accountant's equation; it has to do with your runway wearing out, and if you do not put the money in the tin as you are using it, you cannot replace it, and when you cannot replace it, people cannot fly to and from your community. Those are the realities, so funding your depreciation is part of your cost model, and having \$10 million, if that is the number, in the tin in 14 years' time when your runway needs resurfacing, you have got to charge X dollars per flight from now until then to hopefully have that much money in the tin to pay for the new runway, and then hope that inflation and the costs of regional operations have not made \$10 million into \$13 million, so you still cannot afford to pay for your runway. That is the challenge, and, from conversations I have had, and having been there and done the equations, the maths is the same. You kind of know what your cost base is, you can work it out, and airports would be able to show—they will have the same reciprocal issues around commercial deals, but in terms of building up their cost base, I would be very surprised if there is an airport that cannot show down to the dollar where the money comes from and goes. That is how it works.

Mr D.T. REDMAN: This might have gone past that a bit, but the deal that was announced by Qantas and Kalgoorlie, and by default, others have been asked, I thought was almost an incentivised strategy to try to grow the pie. If we can grow the pie of how many travel by virtue of having some sort of flight pool arrangement in place, then there is a certain amount of shared risk going forward. Does that have some merit, putting aside the competitive issues that you have just raised with us? Does that have some merit, and is that something that is underutilised as a strategy across regional Western Australia?

Mr THOMPSON: I think it all hinges on whether you can actually grow the pie. If you are discounting in order to grow a market, and you actually grow the market, it is usually successful, and people say, what a great idea, well done. If the market does not actually grow, all you do is reduce your income on an asset that is wearing out. Again, full or half-full planes still cost the same for the operation of facilities.

Ms WILKIE: It is not growing the pie, because it is not aimed at tourists. It is aimed at locals for short-term emergency need-type situations. It has got nothing to do with tourists, so the airfares will remain exactly the same as what they are, so I do not think it would grow the pie.

Mr THOMPSON: If I put a local government hat back on, having spent a long time working as an officer in a local government, effectively it is a subsidisation from the community for a community service, and they are prepared to say the whole community will pay, because those who fly will get it marginally cheaper. I do not say it is without merit; it is something that in Kalgoorlie's eyes they must view as a positive in terms of their overall equation. I am not sure exactly what their capital profile is in terms of asset renewal. Perhaps they are at the point where they need to shore up the revenue in a general sense. I do not know. They would be able to explain that. I am sure we can find out some more information on that space that is particularly relevant, and provide that at a later date. It will not be hard for the Airports Association to talk to the airports about these things, then obviously commercial sensitivity can be—as someone pointed out earlier, something can be locked in a vault for 30 years we should not be overly stressed about leaking information. I suspect it can be looked after.

Mr D.T. REDMAN: Just to take a slightly different direction, one of the comments made by a previous witness presenting was the challenge of having planes full on routes that have a strong FIFO market. It goes up full and comes back two-thirds empty. Has your organisation and/or Perth Airport, if you

are able to comment on behalf of them, had a crack at negotiations around the linking of flights and planes and so on to try and better match the struggling resources sector here in Western Australia, which underpins the demand, but does not seem to intersect very well with a local market and/or a tourism market?

Mr THOMPSON: To answer the question around the disconnect for the FIFO stuff, I am not sure I fully agree that it is one-directional. Certainly, that is not the experience in the oil and gas sector, so all of the offshore stuff in Karratha, those that fly in are replaced by those that are flying back home. A lot of the mining operations are the same. They share beds, so I am not sure how the two lots of workforces stay on-site for one night. The answer is that they do not. They hot bed in most of these camps, because mining companies cannot afford to have two lots of accommodation—one lot sitting idle for 26 weeks of the year. It does not work. So there may be a disconnection in a market like Karratha, if you talk iron or resource mining, where they are not doing a direct handover as they are at the airport. Port Hedland is probably the same. In Newman, the aircraft sits on the ground until those who are not occupying tonight's bed are back on it. I am not sure it is in every route, I suspect it is where there are multiple sectors. The mining houses want to fly early so that their people can do the handover and be back.

We at Perth Airport, when we talk to mining companies, on the peak times, about the challenges that was creating for us in terms of runway capacity and terminal capacity, moving aircraft out of the peak period is not possible because it upsets those that are on the return roster, because the time they spend is their own time. They get massively grumpy about the fact that the company is saying, "We'll take half an hour longer to get you back from Karratha" because the half hour longer is half an hour in the two-week off swing, and every minute in that two-week off swing belongs to them, and they get very grouchy if you hold them on the ground for a long period of time.

I do not fully understand that, but perhaps I was not quite picking up on the comment. To the extent that there is massive variance, I suspect that is only on scheduled stuff, and may well be the case in a construction period, where people fly less. They stay longer on site. They fly more of them but they stay longer. On a construction roster it is different—six on and one off typically—and operational rosters are two on, two off. It is a matched pair. It can only be hours difference on the ground.

The CHAIR: The real challenge for us is information, because we have had several submissions to this inquiry to say it is all unidirectional, but there is very little quantifiable—we have no information where we can test that, right? Are your airports in a position to potentially provide us with some information on traffic through, and whether these things really are unidirectional, that there is this sudden influx of people on the way in and no-one coming out? You guys seem to be very well-positioned to potentially provide us with that information.

Mr THOMPSON: The answer is, anecdotally I suspect, yes. Actually, I suspect no because the airports do not get passenger information. At Karratha you could count the number of yellow hi-vis vests going out, and the yellow ones going in, so in and out —

The CHAIR: Security screening?

Mr THOMPSON: Security screening, again it is hard to tell, at a port like Karratha, who is in hi-vis. I flew up there myself about three weeks ago, and I had a hi-vis vest on for the day, and I flew back again. I am not a FIFO worker, but I was up and down in a day.

The CHAIR: But you are able to know how many people are coming through.

Mr THOMPSON: Absolutely, so airports will have load factors on aircraft the same as airlines do, but they do not know who the passengers are. You will not be able to tell that it was 40 Rio Tinto workers on a flight.

The CHAIR: But that is fine. That is one step ahead of where we are right now, Mr Thompson.

Mr THOMPSON: I am surprised that that is hard to get. The information exists. It is fully accurate, to plus or minus 20 passengers a day. I suspect it is that level of accuracy, but it is not that far away. Airlines report the information to airports, because that is how the fees are derived, and then ticket sales and other measures. Certainly screening points will count how many people go through, but screening points are not just passengers. Screening points admit meeters and greeters, although in a regional port a lot lower proportion of those.

The CHAIR: I guess there is a difference between the regulated and unregulated routes. There are reporting obligations on the regulated routes but not so much on unregulated routes.

Mr THOMPSON: Some mining companies have their own airports as well so the volume of fly in, fly out traffic is not necessarily linked to RPT airports entirely. There is certainly a lot of throughput—Karratha, Hedland, certainly Newman and increasingly Broome with the numbers of FIFO with the offshore stuff. They have a big peak coming up with construction which will be a real spike for their figures, I am sure.

[12.10 pm]

The CHAIR: I would not mind understanding about the community engagement that we, I guess, touched on. One of the things that has been alluded to, particularly in these destinations where we are trying to grow the pie, is the degree to which local governments, airports, airlines and the local tourism industry work together. Have your members had experience of working to try to put these destination-specific packaging initiatives together? What have been the experiences of your members through those processes?

Ms WILKIE: Broome would definitely be active in this place, but I think it is probably best to talk to them directly about their experience.

The CHAIR: Sure. We will be making a series of recommendations as part of our report. What recommended actions would you suggest the state government take to address the high cost of airfares?

Mr THOMPSON: Wow! Is that the three wishes?

The CHAIR: Now is your chance.

Mr THOMPSON: Spend them wisely.

The CHAIR: Given your background in aviation —

Mr THOMPSON: Where could the state government make a difference? I think the philosophy around understanding the transparency of the way the costs are charged is a good step. I wish the committee and the government luck in getting an answer for that. It would be nice to know the answer. I think that is in the right space. The reality is that it is illogical as to why a very short-term fare is more expensive. It is only explained in the supply and demand curve. We do not have to discount it because you need it more than you need that discount. That, unfortunately, is a reality. What do you do about that? I am not sure how you regulate that because I am not a regulator. I suspect that it is understanding the basis for costing and understanding why there is such a range of charges in terms of airfares.

The observation that two per cent of people are using those last three days and therefore it is such a small margin. If it is such a small margin, give them the cheapest fare on the plane that day, if it is only two per cent of people. I think I know the reason why they do not. If I had been able to do that when I lived in Karratha I would never have booked a ticket. I would have rocked up and taken my chances because there is enough of a schedule out of Karratha that you could. It will fall down in a place like Karratha—having the cheap seats sold right at the end because the whole town will work out in about three minutes but that is how you get to and from Perth cheaper. Unless there is a footy game on on the weekend, you might run the risk of not getting to Perth. I am not sure that that is the solution.

Somewhere in there is something that says that with enough criteria or boxes ticked, you ought to be able to access a cheaper fare. I think that has got a reality. I think the questions the committee asked earlier about understanding fare structures were right on the mark. Those are the things about which answers are yet to come and are questions that require to be answered. That is one thing.

We have mentioned the use of the government purchasing power and thinking about how that might be brought to bear. If it is about making regional travel more affordable, you will grow the pie and that is a good thing—whatever you can do to leverage that.

We had simple maths in Karratha. If there were three of you going to Perth, you drove because it was cheaper. It is pretty easy maths. It is a 3 000-kilometre round trip. If it was three of you going, it was cheaper to drive your car. If it was two of you going, it was neck and neck. If you are flying on your own, it was cheaper to fly—even at \$600 or \$700 return. Anything the government can do to look at leveraging its purchasing power, which is significant—the mining companies and the resource sector and the bigger businesses influence our travel and the way it works and the government can. I am not sure how to do that but I think there is an opportunity there. If linkage to that amount of travel was based on regional incentives or participating effectively in growing the regional market, I think there would be an opportunity there.

Ms WILKIE: I also think that local councils and communities—airports are volume-based businesses—absolutely want to grow the pie and they want to grow it because they know it is good business sense for their local community. I think you get more bang for your buck if you have a local council, airline and tourism bodies partnering together to either underwrite services or do marketing campaigns than you would have with an airport giving a \$6 discount off a one-way airfare. You have to look at the experience of Queensland. They do this very well and we are seeing a number of services—even if it is just short-term—to underwrite the service to prove that it can be profitable and work. I suspect that that two per cent number is not right either. I know that if I was looking at last minute airfares, in many of the Western Australia communities you just would not even bother to try.

Mr D.T. REDMAN: On the broader question about deregulated routes versus re-regulating some routes, does your membership have a view about whether there are any routes in WA that you think should be re-regulated that are currently deregulated? I am assuming they would have some feedback about the price impact on the propensity of people to travel and the service that that provides.

Mr THOMPSON: I think the regulation question is a question of how and why and how it works. In a general sense, for the smaller or the narrower routes that are currently subject to regulation, it seems to have been a success story. Again, the committee will clearly be privy to what the underlying economics for the government are of that. I do not know what they are but there is an underwriting of a service that says that airlines have got some freedom to try to grow a market, to

offer reasonable fares in order to increase demand and I think that has proven successful. The challenge, I think, is that it works on those very narrow routes.

I do not know a good number—200 000 has been mentioned. If you use a 200 000 figure there are not that many airports above it in Western Australia, which kind of says that you have a lot of regulation so maybe that is not the right number. The answer is that in those spaces, if it could generate increased flying, then I think it has a space. I suspect that the local governments and the owners of the airports do not much care what it does to improve the scenario in terms of the volume and therefore the economics of running their airport. There is a direct correlation.

Below 200 000 passengers, almost without exception, their airports will not be breaking even and they will not be covering costs. The community purses are already paying a community service obligation to keep the facility alive—whatever that is, whether the staff are charged to the town or the gardening crew do the gardens or whether the maintenance crew do the maintenance and it is not booked to the airport. There will be a system and it will be different everywhere but the reality is that those airports are probably not making money. A regulated route that sees guaranteed services probably does not drop their cost base very much but it lets them utilise that increased opportunity of flying to spread the load. Larger than that, as it is manifested, it ends up with one operator out of two in a larger airport because it will not sustain two if one is being subsidised. You end up with a single operator.

In my Karratha experience—I happened to be there in the tragic days when Ansett ceased to exist and the airfare transition in those periods was scary. The cheapest fare return to Karratha the day after Ansett finished was \$750. That is a tragic event in a crisis sense from a regional operation. The council lost \$340 000 in the Ansett fall-down. A significant amount of money changed hands and then the reality is that airfares went up, and it was only when Skywest started to operate in their own right that some normality came back. Karratha at that stage was 300 000 passengers a year. They are half a million now. They were as high as 900 000 in the peak. They are back down to half a million. Their cost base is their cost base. So, I think the challenge with the regulatory thing is finding the line and, inevitably, when you find the line for above or below you get a grey area each side, and it does not quite work beautifully each side. But I do not think the model is fundamentally wrong. It is just understanding how it plays out.

[12.20 pm]

I can tell you in a regional airport, if the difference between a service and no service at all is it needs to be regulated, they will sign up. “I’ll have one, thanks.” Because if your choice is no plane, then that is Hobson’s choice. You cannot possibly take that forward. Derby has had an interesting challenge with on-again off-again and it sort of feels like it has grown itself out of regulation; it could live on its own and then it does not. There will be a whole range of other reasons for that, but Derby would be right on the borderline of should you or should you not? I do not know the right answer. It feels like at least when they knew a plane was coming, they could build something off that. They now do not have that certainty. They then face the perils of negotiating with an airline when it is lose-lose. You either guarantee not to earn enough money to pay for your facility or you do not get a plane at all. As the mayor of Derby, you cannot go back to town and say, “Well, look, I wouldn’t give away the last \$2 because we were going to lose money, but, sorry, there is no plane.” It does not get you there.

The CHAIR: I want to explore something, perhaps, Mr Thompson, in your capacity as an employee of Perth Airport, but something that has come up in this context. We have spoken with a number of regulated routes and small airport operators, and there have been deals done where between the local government authority or the airport, there has been a capped cost on airport charges, and

recognising that on some of these routes the airport cost as a proportion of the total fare is quite high. One of the things they have said to us is, “We’re not the problem; it is Perth Airport. Perth Airport has the expensive airport landing fees and charges.” Can you take us through the differences between the way Perth Airport constructs its charges and maybe give us a bit of a view on Perth Airport’s position on the way it is charging and the impact its charges have on high airfares?

Mr THOMPSON: Happy to do that.

The CHAIR: Thank you.

Mr THOMPSON: The model is largely the same. So, the way Perth Airport prices is not radically different from the way a regional airport will price. We have the difference of longer-term pricing agreements. Not all regional ports have long-term pricing agreements. Some are done annually with an increase that is, effectively, negotiated each year. Ours is a longer-term agreement. The current agreement was seven years. It was a two-and-a-half-year conversation to reach an agreement that then ran for seven years. So, they are not easily talked about. They are complicated and they are difficult. Ours had the slight challenge of \$1.2 billion worth of capital investment in the last one. That makes it challenging. Typically, it is the capital cost of things you need to build, agreed with the airlines, and that is hotly debated. In our case at Perth, 29 airlines, I think, at last count—might be 30 airlines now—having a conversation about what you need to build, they do not always all agree. They do not always all agree how much and what standard. It is a conversation to get to what do you need to build and then what is the standard at which you want to operate your facilities.

So we agree the capital cost. We agree the life of the asset. We agree the operating costs per year based on what we think we need to do, and then the last piece of the puzzle is we haggle over the risk of passengers. How many do you say you think will fly in the next five or six years? How many do we think will fly in the next five or six years? That becomes the numerator and you divide it and then it becomes a dollar figure per passenger.

The CHAIR: Pretty consistent, then, with a lot of regulatory regimes around monopoly assets. But your fees and charges are 100 per cent negotiated; you are not subject to some sort of tariff regulation, access arrangements?

Mr THOMPSON: It is a monitored regime, but price is entirely negotiated with the airlines.

The CHAIR: So it is monitored by the —

Ms WILKIE: ACCC.

The CHAIR: — ACCC.

Mr THOMPSON: So we are one of the top four airports. We still have a monitoring regime that looks at our fees and our charging relative to the services we offer. I am pleased to say the ACCC rates Perth Airport equal best in Australia.

The CHAIR: I guess we keep coming full circle all the time to this transparency, accountability, the ability to come in and have a look. What is the ACCC doing as part of that monitoring? Do they have the power to compel certain types of information? Do they look behind the commercial-in-confidence obligations to see how these things are structured? What is the ACCC’s function?

Ms WILKIE: It is predominantly around service levels. We would need to take on notice to provide you with more detailed information. But each of the airports provides extensive information to the ACCC for the development of that report each year. Separately, the other monitoring that we have, the Productivity Commission undertakes a review into airport economic regulation every period of time. So, the last one was 2011–12 and we are expecting our next one next year. So, we are reviewed by both the ACCC and the Productivity Commission.

The CHAIR: So you have an incentive to behave yourselves.

Mr THOMPSON: The answer is you still have to do a deal with the airlines.

The CHAIR: Yes, of course.

Mr THOMPSON: So the reality is the monitoring is interesting if you still have to—the model is called the building block model and it literally starts from the base: What is the current asset? What other stuff do we need as an airport to match demand or the services that airports would like to offer? What does it cost to operate at the standard we agreed divided by the number of people who will use it? It is reasonably formulaic.

The CHAIR: Your rate of return is presumably something else that needs to be negotiated as well. In regulatory environments your return is a regulated figure.

Mr THOMPSON: No, our return is negotiated with the airlines.

The CHAIR: Your return is negotiated.

Mr THOMPSON: We spend a lot of time on that particular line.

The CHAIR: I am sure you do.

Mr S.J. PRICE: Based on what your owners want, I suppose. Whilst you are doing the negotiations with the airlines, so essentially we are looking at our unregulated routes within WA, which is Virgin and Qantas. Do the regional flights get included in the national conversation about the costs associated with using Perth Airport particularly or—I think QantasLink is separate but still part of Qantas. But even looking at other states, from your members in other states with the AAA, are regional flights treated differently when flying back into a major airport within the state or is it, essentially, the same costs; it does not matter where they come from?

Mr THOMPSON: No, it makes no difference. We have a fee structure which is per passenger and then a component which is per aircraft. There is a landing fee and then there is a passenger service fee.

Ms WILKIE: It is different for domestic and international as well.

Mr THOMPSON: Yes, so there are different fees for different things. So international has a different fee structure and it is divided by the number of international passengers. So, a domestic aircraft from Sydney landing at one of our terminals is charged no differently than a domestic aircraft flying from Karratha or Broome. They are an arriving aircraft that arrives at the terminal. The only thing that would be a differentiation would be on the size of aircraft. They do not use an aerobridge. A component of the terminal charge is an aerobridge charge. If you do not use an aerobridge, you do not get charged for using an aerobridge. If you happen to be parked remotely and you use a bus, there is a bussing component.

Mr S.J. PRICE: Should be a discount not a component.

Mr THOMPSON: It is negligible, I have to say, because from our perspective it knocks around your passenger experience. So the answer is it is the least favoured of the two. But a Sydney aircraft stopping—the same size aircraft, a 737 flying from Sydney, landing and parking at one of the stands at Perth Airport is treated no different to a 737 from Broome.

[12.30 pm]

It is the same aircraft. The only other one that is a Delta is mining company arriving aircraft where they are not screened. So for a mining company at Barimunya, for argument's sake, in the Pilbara, if you fly from Barimunya to Perth you are not screened at Barimunya, so when you land at Perth we have to keep you separate from the screened, outbound passengers. Ordinarily you would land

and you walk in through the lounge and you come down downstairs. If you have come from a non-screened port, we have to keep you separated on arrival, so you do not mix with—it is a security regime. Rex's services from the south west, they fly and land at Terminal 2. They come in through a different end of the terminal and walk along the front of check-in to get their bags.

Previously, when it was a Virgin service to Esperance, they flew in, screened and they could walk in through the lounge and turn left to get their bags; it is just the direction you walk when you land on the ground. There is no change to how we process the aircraft and, again, the outbound journey, because we screen all flights out of Terminal 2. It is too hard to separate screened and non-screened outbound in our terminal, so we screen them all. What that actually gets you to is the screening charge is divided by a higher number of passengers and is actually lower per passenger. The cost to have them separated is more expensive than to not have them separated. We would have to build different terminal facilities and then still have them staffed, so it is a cheaper scenario, but we do not treat them any differently.

The CHAIR: I have one last question. There was some evidence put to us in the previous hearing from Qantas about cabotage and apparently the real safety and security concerns with allowing international carriers to land and then take off again from domestic airports. From an airport perspective, are there any significant risks or dangers or additional problems associated with cabotage?

Mr THOMPSON: From an airline and aircraft safety perspective, if they land at Perth Airport today I do not understand the issue. They fly and land at Perth Airport quite comfortably. If the same airline has an arrangement to fly Broome to another destination internationally, they can land. I am not sure it is about the safety stuff; I do not understand that. That is not to say that there is not a point in there somewhere, but I do not get it. We do not have any Deltas. Aircraft that operate internationally to Australia have a set of rules they have to comply with.

The significant challenge in the cabotage space will in fact be around air services and fire regulations, so landing international aircraft in regional centres, the ICAO standards call for fire services. The cost for fire services will absolutely crush any discount you are going to get by putting 20 or 30 per cent of a plane on in a regional port. That needs to be unlocked if you are going to talk about the cabotage space, because the current rules say that if you are international, you need to have a fire service, and there is only one regulated fire service in Australia and that is Air Services, and they have a single model that costs X dollars. We had history around the cost of regional fire services and it is like security—it has had every different definition you can come up with for why you need a fire service; the only one not used is pilot toothbrush colour, so far. They have had just about everything else. It is numbers of passengers and numbers of aircraft et cetera.

But at a point, they changed the regional fire service to location-specific. We had a fire service at Karratha at the time, and at the time I think it was about \$4 a tonne—the cost of fire services across Australia. Sydney paid \$4 a tonne on lots of tonnes, and was not very excited about it. They reduced to 40c; Karratha went from \$4 to \$48.50 a landed tonne for a fire service. Those numbers are 14 years old; I suspect they have not got cheaper, so it is an ugly number.

Mr S.J. PRICE: We have heard some evidence in some of the other hearings in regard to some of the reasons towns are looking to attract international tourists, so that requirement for a fire service —

Mr THOMPSON: It is a real barrier to entry. That is not to say it ought not to be unpacked, but it is very difficult to unpack. From Perth Airport's perspective, we looked at Kalgoorlie being an alternate airport because we thought it would mean airlines from international could carry a bit less alternate fuel. They currently fly to Adelaide if they cannot get in at Perth. The maths did not work because it

needed a fire station. We even got to we could fly firemen to Kalgoorlie to have the aircraft land, but it did not get there; it just cruelled the economics of it.

Mr D.T. REDMAN: Let us just open up where my question was going, which is a little bit of private sector work on the Cunderdin Airport as to whether it could be used as a potential alternative landing point should planes come in that cannot land in Perth for reasons of fog or whatever. Is that something that is still moving through the system, and is that likely to have a positive impact on airfare prices; and, if so, is it a big factor in having to carry more fuel? Is that a big factor in price?

Mr THOMPSON: No, surprisingly it did not make a lot of difference to fuel stuff. We thought the airlines would knock us over; the logic being, if we invested a few million dollars at Kalgoorlie airport to develop the facilities a little larger, help them with their operating costs and have it as an alternate, the cost would be cheap compared to the fuel you saved. The challenge with that is a lot of our operators are Middle East operators, and the cost of fuel in the Middle East for the chap who owns the airline is considerably cheaper than the cost of fuel in Perth, so they bring a lot of fuel with them. They fly full fuel so they buy the least amount when they are in Australia. That was one of the things that cruelled it.

The second one we thought was you could add freight. If you are carrying less fuel, you could carry more freight. You earn more money; it means the service could be cheaper for the passenger. In reality, the freight market is the freight market; it is not for want of space particularly, the one exception being fresh produce going out. There is a limit on that, where more bodies under aircraft would be good for those parts of the business, fresh flowers and fresh food going out, there is capacity, but it did not quite get there. We were surprised; our business development guys thought, "This is fantastic; they'll knock us over in the rush", and it did not quite add up, so I am not sure the economics are there.

But for Kalgoorlie, the other issue in terms of the alternate stuff is the alternate is typically weather-based at Perth, and because we could not get an alternate that worked that was nearer, we have invested, with agreement from the airlines, in putting in category 3 lighting, which turns on in about four months' time, and you will be able to land at Perth Airport in pea soup, so the numbers that will actually divert will go down, not up. By this time next year we will be able to land with about 100 feet of visibility; currently it is about 600 feet. The days that will be impacted are about three or four a year on average now; it will be none a year, but the odd crazy weather pattern that will say we have a challenge. It is a downside from a regional imperative, but unfortunately we were not faced with any other alternative.

The CHAIR: All right, thank you. I will proceed to close today's hearing. Thank you for your evidence before the committee today. A transcript of this hearing will be emailed to you for the correction of minor errors. Any such corrections must be made and the transcript returned within seven days of the date of the letter attached to the transcript. If the transcript is not returned within this period, it will be deemed to be correct. New material cannot be added via these corrections and the sense of your evidence cannot be altered. Should you wish to provide additional information or elaborate on particular points, please include a supplementary submission for the committee's consideration when you return your corrected transcript of evidence. Thank you.

Hearing concluded at 12.38 pm
