
# Fuel Throughput Levies

## Report Pursuant to the Commission's Monitoring Functions Under The Prices Surveillance Act 1983

**December 1998**

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## EXECUTIVE SUMMARY

As part of the economic regulatory framework for newly privatised airports the Treasurer, the Hon Peter Costello MP, has directed the Australian Competition and Consumer Commission (the 'Commission') to undertake formal monitoring of aeronautical related services at 12 airports, pursuant to section 27A of the *Prices Surveillance Act 1983* (the 'PS Act').

The airports subject to formal monitoring are Sydney (Kingsford Smith) Airport and 11 leased airports: Adelaide, Alice Springs, Brisbane, Canberra, Coolangatta, Darwin, Hobart, Launceston, Melbourne, Perth and Townsville. At this stage the Commission is reporting only on Phase I airports. It will report on Phase II airports after the first full year of their operation, 1998–99.

Aircraft refuelling services are one of the services the Commission is required to monitor.[1] The Treasurer has directed that the Commission report to him on its monitoring activities following the end of each financial year.[2]

### Reporting process

In carrying out its monitoring role the Commission is required by the PS Act to monitor prices, costs and profits relating to the relevant services.

In line with this requirement, and following concerns expressed by airlines and oil companies in relation to fuel throughput levies proposed by Brisbane Airport Corporation Limited (BAC) and Westralia Airports Corporation Pty Ltd (WAC), the Commission sought information about the levies in June 1998. The information provided by the two airport operators is presented in appendix C.

The Commission is also required to have particular regard to criteria set out in section 17(3) of the PS Act. These are as follows:

*(a) the need to maintain investment and employment, including the influence of profitability on investment and employment;*

*(b) the need to discourage a person who is in a position substantially to influence a market for goods or services from taking advantage of that power in setting prices;*

*(c) the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.*

[1] Direction number 14, 22 May 1998 and Direction number 16, 9 July 1998.
[2] ibid.

The Treasurer, in announcing the monitoring direction, emphasised the matters covered by 17(3)(b):

> *Price monitoring will allow the ACCC to collect data where the airport operator may have scope to exercise market power but where coverage of the services under the more formal price cap arrangements is not considered warranted. Any abuses of market power detected through the prices monitoring arrangements will be the trigger for consideration of stricter forms of prices oversight.*[3]

When used in this report, the phrase an "abuse of market power" refers to the term as used in the Treasurer's Press Release. The monitoring direction was issued pursuant to the Prices Surveillance Act and the ACCC has interpreted it accordingly. In particular, the ACCC has interpreted the term in the context of section 17 (3)(b) of the PS Act.

In assessing fuel throughput levies against the section 17(3) criteria the Commission drew on information and input from three sources:

- from airport operators on prices, costs and profits as discussed above;
- from BAC and WAC, giving them the opportunity to explain the reasons for introducing fuel throughput levies; and
- from submissions from interested parties.

The Commission released a discussion paper on proposed fuel throughput levies in July, to encourage and assist interested parties to develop submissions. The paper set out the monitoring framework, the issues relevant to the Commission's reporting role and information provided by BAC and WAC.

The Commission received 14 submissions from airport operators, airlines, oil companies and other interested parties in response to the discussion paper.

**Findings**

Given the criteria in the PS Act and the objectives of monitoring identified by the Treasurer, the Commission requested submissions directed to the following particular issues:

1. the extent of any increase in the price of refuelling services and airport profits due to increases in refuelling charges;
2. whether the introduction of fuel throughput levies can be justified through:
   (a) increases in costs; and/or

[3] Treasurer's Office, Press Release number 55, 25 May 1998.

(b) any offsetting reductions in other charges;

3. whether the imposition of a fuel throughput levy is an "abuse of market power" of the type referred to in the Treasurer's statement at the time of the monitoring direction; and

4. whether such charges should trigger consideration of stricter forms of prices oversight, consistent with the Treasurer's statement, and forms that may take.

A summary of the Commission's conclusions against each of the questions raised in the discussion paper follows. These questions are primarily directed towards section 17(3)(b) of the PS Act, namely the question of market power. They are discussed in detail in sections 5.1 through 5.4 of the report.

The report also has regard to section 17(3)(a) of the PS Act, which relates to investment and employment issues arising from fuel throughput levies. That discussion is included in section 5.5 of the report.

## 1. The extent of any increase in the price of refuelling services and airport profits due to increases in refuelling charges.

Airport operators levy aircraft refuelling charges under lease and licence agreements with oil companies. The current arrangements were negotiated and put in place by the Federal Airports Corporation (FAC) before the airports were privatised. They include provisions for fuel throughput levies, but these were not activated. Since then BAC has introduced a levy of 0.4 cents per litre (in July 1998), while WAC has announced that it will introduce a levy of 0.5 cents at the International Terminal to commence in June 1999. The levies will generate additional revenues of around $2.0 to $2.5 million annually for BAC, and more than $0.7 million annually for WAC.

A summary of revenue raised by the site leases before and after introduction of the fuel throughput levies at Brisbane and Perth Airports is provided in the following table:

**Table 1: Revenue from aircraft refuelling site leases at Brisbane and Perth Airports**

| | Revenue 1997/98 (before introduction of levies) $000's [a] | Revenue, first full year of operation of the levies $000's [c] | Percent increase (approx.) |
|---|---|---|---|
| BAC | 660 | 2,500 – 3,000 | 300% |
| WAC | 310 | 1000 [b] | 200% |

a Source: Information provided by BAC and WAC in response to notices issued pursuant to section 32 of the PS Act (see appendix C for details) and oil companies in submissions.
b The levy applies to international terminal refuelling only.
c Estimates, 1998-99 for BAC, 1999-2000 for WAC

Introduction of fuel throughput levies will significantly increase the price of refuelling services at airports where they are introduced.

The introduction of a fuel throughput levy at Brisbane and Perth airports is likely to result in some or all of that levy being passed on to the airlines refuelling at those ports.

**2. Whether the introduction of fuel throughput levies can be justified through:**

**(a) increases in costs; and/or**

**(b) any offsetting reductions in other charges.**

This question forms part of the Commission's consideration of section 17(3)(b) in the PS Act. The absence of increased costs or offsetting reductions in charges is an important step in assessing whether the airport operator is in a position to take advantage of market power that it might have in setting prices.

Neither BAC nor WAC attempted in their submissions to relate the imposition of fuel throughput levies to increases in costs of providing refuelling services. Data from BAC and WAC indicates that those airport operators recovered more from aircraft refuelling charges than the costs associated with provision of those services *before* introduction of the levy. The Commission has not been made aware of any other increases in costs since then or any cost increases anticipated in the future.

BAC and WAC have not identified any offsetting reductions in other charges.

BAC and WAC seek to justify introduction of the levies on the basis of the validity of contractual arrangements. The question of the validity of contractual arrangements between the airport operators and leaseholders is a matter for the relevant parties not the Commission. The validity of contracts is a separate issue from the relationship of fuel throughput levies to costs or reductions in charges elsewhere. As such it is not directly relevant to the Commission's monitoring role under section 27A of the *Prices Surveillance Act* or the section 17 criteria of the *Prices Surveillance Act,* which guide the Commission in conducting its monitoring functions.

The Commission notes that the Government has imposed additional costs on Phase I airport operators since the privatisation process was completed, for example, the annual costs of the Commonwealth appointed Airport Building Controller and the annual costs of the Commonwealth appointed Airport Environment Officers. Airport operators have a legitimate concern to recover these costs. However, the additional costs are likely to be substantially lower than the revenues raised from the fuel throughput levies introduced by BAC and WAC and do not justify the magnitude of the levies introduced and proposed.

The report concludes that the fuel throughput levies introduced by BAC and proposed by WAC are not justified in terms of increases in costs or through offsetting reductions in other charges.

## 3. Whether the imposition of a fuel throughput levy is an "abuse of market power" of the type referred to in the Treasurer's statement at the time of the monitoring direction.

The report considered a number of issues in assessing whether airport operators have market power in the provision of refuelling services, namely:

- the relevant market;
- substitution possibilities – land sites; and
- substitution possibilities – refuelling at other airports.

In relation to the relevant market, section 17(3)(b) defines market power in relation to a market for goods and services. In this case the relevant market is the market for aircraft refuelling services. Airport operators contribute one component of refuelling services – the land for provision of on-airport refuelling infrastructure and activities. It is the ownership of land that creates the potential for airport operator market power in the provision of aircraft refuelling services.

The extent of the airport operator's market power in the provision of aircraft refuelling services is determined by substitution possibilities, in relation to land sites, but also refuelling at other airports. In relation to land sites, the extent of market power that operators of large airports have where land is required to install JUHI facilities seems clear. There are no alternative providers.

In relation to substitution possibilities at other airports, there may be operational changes that airlines can make to avoid refuelling at a particular airport. The submissions indicate that there is some substitution possibilities. However, such alternatives involve costs to the airlines. Qantas submitted that the increase in costs per litre from refuelling at airports other than Perth and Brisbane is one or two cents. It follows that substitution possibilities are not relevant for refuelling charges of less than one or two cents per litre.

Conclusion:

There is a strong case that large airports have market power in the market for refuelling services.

When considered together with the monopoly nature of the market for land for refuelling facilities, the lack of alternatives to refuelling at some airports reinforces the airports' market power. When considered in light of the lack of any cost related justification for the levies, or offsetting reduction in charges, there is a strong case that the imposition of a fuel throughput levy is taking advantage of market power.

Conclusion:

There is a strong case that by introducing fuel throughput levies airport operators have taken advantage of market power that they have in the provision of aircraft refuelling services.

**4. Whether such charges should trigger consideration of stricter forms of prices oversight, consistent with the Treasurer's statement, and forms that may take.**

The Treasurer's press release made the following point about the Commission's monitoring role:

> *Any abuses of market power detected through the prices monitoring arrangements will be the trigger for consideration of stricter forms of prices oversight.*[4]

In short, the Treasurer has asked the Commission to consider the need for stricter forms of prices oversight as part of its monitoring functions.

In this report the Commission argues that there is strong evidence that operators, through the introduction of fuel throughput levies, are taking advantage of market power. Secondly, the report argues that the imposition of fuel throughput levies has a significant impact on the cost of refuelling services. Lastly it is noted that the introduction of fuel throughput levies at two airports could have a significant precedent effect at other airports.

In combination, these factors could erode some, or all, of the intended benefits of the price cap and potentially compromise the effectiveness of the present prices oversight arrangements. It follows from this that stricter forms of prices oversight should be considered, including whether to recommend refuelling services are covered by a price cap.

Recommendation:

The Commission recommends that stricter forms of prices oversight should be considered in relation to aircraft refuelling services.

The coverage of refuelling services by a price cap is not the only stricter prices oversight option to address concerns raised about the introduction of fuel throughput levies. A number of submissions also raised other options including declaration and arbitration under Part IIIA and the Commission seeking authority to conduct an inquiry into fuel throughput levy issues.

Having concluded that consideration of stricter forms prices oversight is appropriate, the report goes on to consider a number of options available.

[4] Treasurer's Office, Press Release number 55, 25 May 1998.

## Options for stricter prices surveillance and implementation

The report considers three alternative options for stricter prices oversight:

1. The option of the Commission seeking authority to conduct a public inquiry into fuel throughput levies.
2. Encouraging the use of access provisions in Section 192 of the Airports Act and Part IIIA of the Trade Practices Act (TPA).
3. Including refuelling services in a CPI-X price cap.

*Public inquiry*

A number of submissions suggested the introduction of fuel throughput levies was a suitable reason to hold a public inquiry.

The Commission does not consider this option appropriate at this stage. Although the conduct of a public inquiry would freeze prices and prevent the introduction of new fuel throughput levies or increases in existing levies for the inquiry's duration, it has the disadvantage that it would lead to a significant delay in the resolution of the concerns raised by the airline industry and the oil companies.

Furthermore, an inquiry is not necessary in order to consider the justification for the levies proposed. That issue is addressed in this report, and the process of issuing a discussion paper and calling for submissions is sufficiently similar to the inquiry process to raise doubts about the value that would be added by calling for another round of participants' responses on this issue.

There is a case for a public consultation process concerning implementation issues associated with the Commission's recommendation. However, consultation of this nature largely relates to technical issues and would not warrant a public inquiry.

*Access provisions*

The existing framework might be able to deal with industry concerns about refuelling charges through the access provisions. While not subject to the price cap, aircraft refuelling services at larger airports are likely to be subject to declaration under section 192 of the *Airports Act 1996* for purposes of Part IIIA of the *Trade Practices Act 1974* (TPA). Potentially this provides service users with a mechanism for addressing concerns about the introduction of fuel throughput levies.

There are arguments both for and against encouraging reliance on the access arrangements. But in the Commission's view there is uncertainty as to whether the access provisions will be used to provide an effective resolution to the concerns raised regarding the introduction of fuel throughput levies. The access framework is essentially about competition in markets downstream from the airport market. As the PS Act was specifically designed to address issues of market power, it might be better suited to addressing the concerns raised by oil companies and airlines.

One of the limitations of the access arrangements in this instance is the uncertainty associated with the access provisions. Interested parties do not know what decision the ACCC might make in a determination. Furthermore, the access path will require thorough consideration of all the relevant issues with significant inputs from the parties. The outcome of arbitration is also subject to appeal to the Australian Competition Tribunal.

An additional limitation is that while anyone can potentially approach the Commission to seek a determination that refuelling services are an airport service for the purposes of the Airports Act it seems likely that only the oil companies can notify a dispute under Part IIIA. To date the oil companies have been reluctant to notify. Continued reluctance from the oil companies would prevent the framework from addressing concerns raised by other parties, including airlines.

*Include refuelling services in a price cap*

The third option for stricter prices oversight considered in the report is inclusion of aircraft refuelling services within a price cap.

This approach has a number of attractions. Firstly, a price cap has the advantage of effectiveness. The existing price cap has been effective to date. Private airport operators have complied with the price cap and it has been relatively straightforward to administer both for the Government and airport operators.

Secondly, the legislative base for a price cap, the *Prices Surveillance Act 1983*, was designed specifically to address issues of monopoly pricing. As such the Commission considers that a price cap is a direct and appropriate mechanism for addressing the issue of airport operators taking advantage of the market power they may have in the provision of aircraft refuelling services.

Thirdly, inclusion of aircraft refuelling services in a price cap is consistent with the existing regime and would not involve a new regulatory element.

Finally, inclusion of refuelling services within a price cap may also have advantages in terms of certainty of revenue for airport operators. By contrast there is likely to be some uncertainty about the outcome of an arbitration process should an access dispute be notified to the Commission.

**The Commission's recommendation**

The Commission concludes that it is appropriate to recommend the inclusion of refuelling services provided by airport operators within a price cap.

In making its recommendation the Commission considers that fuel throughput levies have the potential to compromise the Government's stated objectives in establishing

the prices oversight arrangements applying to leased airports as expressed in the Pricing Policy Paper:

> *Pricing oversight arrangements at airports post-leasing have been designed to achieve an appropriate balance between public interest and private commercial objectives.*
>
> *Pricing oversight arrangements are intended to promote operation of the airports in as an efficient and commercial a manner as possible. Pricing is fundamental to the efficient use of airport infrastructure. It is in the interests of airport users in particular, and the national economy in general, that commercially-driven decision be made about maintaining existing airport infrastructure, and building new infrastructure.*
>
> *The arrangements should also aim to protect airport users from any potential abuse of market power by airport operators.*[5]

The real price reductions that the price caps deliver will, at least in part, be offset by introduction of fuel throughput levies (see for example, appendix C and D). As explained in sections 5.2 and 5.3 of the report the Commission considers that there is a strong case that airport operators have market power in provision of aircraft refuelling services and that there is a strong case that introduction of fuel throughput levies is only possible because of the market power that they have.

| Recommendation: |
| --- |
| The Commission recommends that refuelling services are included within a CPI-X price cap. |

**Implementation**

The Commission's recommendation that the Treasurer declares aircraft refuelling services so that they can be covered by a price cap raises a number of issues in terms of the details of implementation. These include the following:

- whether to apply a separate cap to refuelling services or include them in the existing price cap;
- starting point prices for aircraft refuelling services;
- the X value to apply to aircraft refuelling services;
- the start and finish date for inclusion of aircraft refuelling services in a price cap; and
- which airports the changes should apply to.

This report discusses each of these issues setting out some of the options available to the Treasurer. Resolution of these issues would require the views of affected parties to

[5] Page 2 of the Pricing Policy Paper, Department of Transport and Regional Development, November 1996.

be taken into account. For this reason this report does not make recommendations in relation to implementation. Importantly, though, there do not appear to be significant issues which would prevent effective implementation of the Commission's recommendation to have aircraft refuelling services covered by a price cap.

# 1 Introduction

The Australian Competition and Consumer Commission (Commission), in July 1998, released a discussion paper on fuel throughput levies, pursuant to its formal monitoring functions under the Prices Surveillance Act 1983 (PS Act).

That discussion paper sought submissions from interested parties concerning the introduction and operation of fuel throughput levies at privatised airports. Given the criteria in the PS Act and the objectives of monitoring identified by the Treasurer,[6] the Commission requested submissions directed to the following particular issues:

1. the extent of any increase in the price of refuelling services and airport profits due to increases in refuelling charges;

2. whether the introduction of fuel throughput levies can be justified through:
   (a) increases in costs; and/or
   (b) any offsetting reductions in other charges;

3. whether the imposition of a fuel throughput levy is an "abuse of market power" of the type referred to in the Treasurer's statement at the time of the monitoring direction; and

4. whether such charges should trigger consideration of stricter forms of prices oversight, consistent with the Treasurer's statement, and forms that may take.

The Treasurer has directed that the Commission report to him on its monitoring activities following the end of each financial year. This report forms part of the Commission's report for the end of the 1997/98 financial year. The Commission will also be issuing separately a monitoring report for each of the Phase I airports as part of this process.

Phase I airports have recently completed their first full year of operations since being privatised. This report therefore is immediately relevant to the three Phase I airports: Melbourne, Perth and Brisbane. It also raises general issues that may be relevant to other privatised airports.

The report proceeds as follows. Firstly, the Commission's formal monitoring role is described. Secondly, some background to the proposed introduction and operation of fuel throughput levies is presented to provide context for subsequent discussion. The body of the discussion proceeds by considering each of the issues raised in requests for submissions to the paper. As required under section 17(3)(a) of the PS Act the impact of fuel throughput levies on investment and employment is considered. A discussion of options for stricter prices control concludes the report.

[6] Treasurer's Office, Press Release number 55, 25 May 1998.

## 2 THE COMMISSION'S FORMAL MONITORING ROLE

As part of the economic regulatory framework for newly privatised airports the Treasurer, the Hon Peter Costello MP, has directed the Australian Competition and Consumer Commission (the 'Commission') to undertake formal monitoring of aeronautical related services at 12 airports, pursuant to section 27A of the *Prices Surveillance Act 1983* (the 'PS Act').

The airports subject to formal monitoring are Sydney (Kingsford Smith) Airport and 11 leased airports: Adelaide, Alice Springs, Brisbane, Canberra, Coolangatta, Darwin, Hobart, Launceston, Melbourne, Perth and Townsville. At this stage the Commission is only reporting on Phase I airports. It will report on Phase II airports after the first full year of their operation, 1998–99.

The Treasurer also declared aeronautical services provided at privatised airports for prices surveillance under the PS Act and issued a direction setting in place a price cap for declared aeronautical services. Aircraft refuelling services are not subject to the price cap. Prices for aircraft refuelling services can therefore be increased without formal notification to the Commission under the PS Act.

However, pursuant to s.27A of the PS Act the Commission is required to monitor prices, costs and profits relating to the supply of those services covered by the Treasurer's direction[7], including aircraft refuelling.

In exercising its monitoring functions, the Commission is, pursuant to s.17(3) of the PS Act, required to have particular regard to:

(a) the need to maintain investment and employment, including the influence of profitability on investment and employment;

(b) the need to discourage a person who is in a position substantially to influence a market for goods or services from taking advantage of that power in setting prices; and

(c) the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.

The Treasurer, in announcing the monitoring direction, emphasised the matters covered by (b) above, in particular:

> *Price monitoring will allow the Commission to collect data where the airport operator may have scope to exercise market power but where coverage of the services under the more formal price cap arrangements is not considered warranted. Any abuses of market power detected through the prices*

[7] Direction number 14, 22 May 1998 and Direction number 16, 9 July 1998.

*monitoring arrangements will be the trigger for consideration of stricter forms of prices oversight.*[8]

The term "abuse of market power" as used in the Treasurer's Press Release relates to the PS Act. The direction and Press Release were issued pursuant to the PS Act and the ACCC has interpreted the term accordingly. In particular, the ACCC has interpreted the term in the context of section 17 (3)(b) of the PS Act:

*The need to discourage a person who is in a position substantially to influence a market for goods or services from taking advantage of that power in setting prices*

For the purposes of this report "market power" refers to circumstances in which a person is in a position to substantially influence a market for goods and services. An "abuse of market power" occurs where the person takes advantage of that power in setting prices.

The Commission's monitoring role requires it to follow actively prices, costs and profits relating to the relevant services. To that end, the Commission has formal power to require the provision of relevant information and can disclose that information where it would not damage the competitive position of the provider, or if so, is necessary in the public interest, in performing its monitoring function.

As mentioned above the Treasurer has directed that the Commission report to him on its monitoring activities following the end of each financial year. This report forms part of the Commission's monitoring activities for the end of the 1997/98 financial year.

[8] ibid.

## 3 FUEL THROUGHPUT LEVIES

The facilities used to provide airport refuelling services vary from airport to airport. However, the provision of aircraft refuelling services depends typically on the provision of certain facilities by the airport operator and other facilities by the oil companies. At small airports where fuel is trucked to aircraft, the airport operator provides facilities for access to the aircraft and it may also provide land for storage of fuel and equipment. At larger airports, and each of the Phase I airports, the airport operator provides land upon which storage and reticulation equipment can be built by the oil companies. Commonly, the oil companies build storage and reticulation systems jointly.

The Commission discussion paper centred on refuelling services at Brisbane and Perth airports because they have introduced, or plan to introduce, a fuel throughput levy. Nonetheless, many of the general characteristics of refuelling facilities will apply at other airports. Mobil Oil Australia Ltd (Mobil) described the refuelling facilities at both Perth and Brisbane airports in its submission:

> *The refuelling facilities at both these airports are known as joint user hydrant installations ("JUHI"). The JUHI consists of a number of different assets being:*
> *(a) fuel storage facility;*
> *(b) pipelines joining the fuel storage facility with hydrant refuelling sites ; and*
> *(c) hydrant refuelling sites at each terminal.*
>
> *The Brisbane JUHI and Perth International JUHI are owned by joint ventures comprising Mobil, Shell, BP and Caltex/Ampol (Brisbane) and Mobil, Shell and BP (Perth International).*

Caltex Australia Petroleum Pty Ltd (Caltex) described the operation of the fuel transfer service at Brisbane Airport as follows:

> *Each of these oil companies [Caltex, Ampol, Shell, BP, Mobil] supplies aircraft operators with aviation fuel. Each oil company uses its own aviation fuel to supply its own customers. Each oil company puts its own aviation fuel into the JUHI according to demand. Product is then drawn from the JUHI and transferred via pipelines to trucks, which pump the aviation fuel into the relevant customer's aircraft.*

Airports have historically charged, and continue to charge, for the use of land to build refuelling facilities by way of rent payable under leases and licence fees. Shell explained the charging regime for the JUHI at Brisbane airport in the following way:

> *The existing cost regime includes annual licence fees payable pursuant to the licences and rents payable pursuant to the leases under which the oil companies occupy the two refuelling depots.*

Prior to privatisation, the Federal Airports Corporation (FAC) introduced provisions into leases with oil companies to allow the charging of a fuel throughput levy in addition to lease and licence charges. A fuel throughput levy is a charge, per volume, on all fuel uplifted at an airport. The FAC did not activate the levy provisions although legally entitled to do so. As successors in title to the FAC, Brisbane and Perth airports have acquired the right to impose fuel throughput levies. BP discussed the negotiation of leases at Perth airport in the following terms:

> *As a result of the privatisation of Perth Airport in 1997, Westralia Airports Corporation Pty Ltd (WAC) has assumed the rights and obligations of the FAC under the lease. ...*
> *In 1995 a standard lease was generally agreed between the oil companies and FAC with the exception of the FAC's attempt to include a non-negotiable throughput levy clause. Due to disagreement over this clause no new leases were signed by the oil companies at FAC airports during this period and hence were operating some facilities wi thout signed leases. ...*
> *On March 11 1997 advice was received from the FAC that unless leases containing throughput levy provisions were signed by 20 March 1997, then the privatisation of Perth Airport would proceed without the oil companies having secure tenure with respect to their assets on the international terminal. ...*
> *The lease was therefore signed on 19 March 1997, however, a covering letter by BP was given to the FAC on 19 March 1997 reiterating the objections to the inclusion of throughput levy provisions in the lease, and reserving our [BP] rights with respect to the imposition of such a levy.*

Mobil described the proposals at Brisbane and Perth Airports:

> *Brisbane Airport Corporation Limited (BAC) purported to introduce a throughput levy of 0.4 cpl at Brisbane Airport as from 14 July 1998.*
> *Westralia Airports Corporation Pty Ltd (WAC) has also given notice that it proposes to introduce a levy of 0.5 cpl on refuelling operations at Perth International terminal, taking effect from 1 June 1999.*

Concerns have been expressed by airlines and oil companies in relation to these charges, in particular that fuel throughput levies represent a significant increase in the charges for aircraft refuelling. At Brisbane Airport, the concerns of the JUHI managers led to expert determination of the level of the fuel throughput levy under the provisions of the contract. Shell stated:

> *Following the BAC letter dated 15 July 1997 informing Shell of its intention to impose a throughput levy, Shell gave notice to the BAC by letter dated 25 July 1997 that it did not accept the proposed throughput levy ...*
> *By letter dated 17 November 1997 the BAC, through its solicitors Mallesons Stephen Jaques, gave notice to Shell that it required the matter to be determined by an "expert" in accordance with the licence provisions.*

The result of this expert determination was to confirm that BAC had a legal right to charge the levy and the level of 0.4 cents per litre was reasonable in terms of BAC's contractual rights. However, submissions raised a number of questions concerning the adequacy of the determination process. Qantas Airways Limited (Qantas) expressed the essence of these concerns in its submission:

> *The expert was Mr Keane QC. In undertaking the determination, Mr Keane defined his powers and role by reference to clause 12. Mr Keane did not determine whether the fee sought to be imposed by BAC was reasonable on an objective commercial, financial and economic analysis.*

The Commission considers it beyond the scope of this report to analyse the process of determination under the JUHI contract.

Concerns have also been raised by oil companies about the acceptability to them of the introduction of a fuel throughput levy at Perth's International Terminal. In its submission, BP suggested:

> *Accordingly it is unlikely resolution can be agreed to the satisfaction of both parties ... to resolve the issue at Perth Airport, it is likely an expert will be needed to be appointed to decide the outcome.*

In addition to concerns raised regarding BAC's and WAC's introduction of fuel throughput levies, Shell, Mobil and BP expressed the view that the introduction of fuel throughput levies at two airports is likely to lead to them being introduced at other airports.

# 4 FUEL THROUGHPUT LEVIES – DISCUSSION PAPER

The Commission became aware in late 1997 that certain privatised airport operators proposed to introduce, or were in the process of introducing, fuel throughput levies. BAC had advised of a fuel throughput levy for aircraft refuelling at Brisbane Airport and WAC had advised the oil companies that it was proposing to introduce a levy at Perth Airport's International Terminal.

In light of the number of complaints from airline operators, oil companies and from the Board of Airline Representatives of Australia (BARA), the Commission wrote to BAC asking for confirmation of the proposed fee as well as its level and coverage.

BAC advised that it would introduce a fuel throughput levy of 0.4 cents per litre on all fuels supplied, distributed or transferred through the combined main/short pipeline at Brisbane Airport from 15 July 1998. The Commission requested that BAC provide reasons for these charges. BAC subsequently advised the Commission that it was legally entitled to increase charges in this manner under the provisions of contracts between it and the oil companies.

BAC also identified a commercial need to recover additional costs associated with the privatisation of the airport, such as funding an environmental officer and decreasing revenues. BAC advised that the fee was subject to an expert determination process conducted by a Queen's Counsel and that the result of this expert determination was to confirm that BAC had a legal right to charge the levy and that the level of 0.4 cents per litre was reasonable in terms of BAC's contractual rights.

On June 22, 1998, the Chairman of the Commission issued a notice on BAC pursuant to section 32 of the PS Act. This notice requested that BAC provide information regarding the anticipated revenue and costs of providing refuelling services at Brisbane Airport in the years 1997/98 and 1998/99.

Further to the introduction of a fuel throughput levy at Brisbane Airport, the Commission understood that WAC had issued a "Throughput Fee Notice" to BP that it intended to introduce a fuel throughput levy at Perth Airport International Terminal from June 1 1999.

The Commission received complaints from airport users that such a charge would significantly increase the costs of operating international aviation services at Perth Airport.

The Commission responded to the proposed introduction of a fuel throughput levy at Perth International Terminal in a similar manner as it responded to the proposed levy at Brisbane Airport. On June 26, 1998, the Chairman of the Commission issued a notice on WAC pursuant to section 32 of the PS Act, in the same terms as that issued on BAC. This notice requested that WAC provide information regarding the anticipated revenue and costs of providing refuelling services at Perth Airport in the years 1997/98 and 1998/99. The information provided by BAC and WAC is presented in appendix C.

Prior to the release of this report, the Commission assembled the information collected from the respective airports and produced a discussion paper as part of its formal reporting role. The discussion paper was intended to elicit submissions from interested parties for use as input to a final report. For this reason interested parties were directed to make submissions on four questions. In turn these questions were intended to elicit responses that would help the Commission understand the issue of fuel throughput levies in the context of section 17(3) of the PS Act and the Treasurer's direction.

The first question respondents were directed to was intended to generate information to assist the Commission understand the impact of fuel throughput levies on profits and investment at airports. The next two questions were intended to generate responses that would shed greater light on the questions regarding the implementation of fuel throughput levies and market power. The final question was intended to encourage participants' suggestions as to the form of any stricter prices oversight they might advocate.

Section 5.5 of this report discusses the issue of employment and investment in line with section 17(3)(a) of the PS Act. No questions were directed at section 17(3)(c) of the PS Act as it was thought not to be relevant to this issue.

# 5 RESPONSES TO THE QUESTIONS IN THE DISCUSSION PAPER

The Commission received a total of 14 submissions in response to its discussion paper from a range of groups including airport operators, airlines, aviation fuel suppliers, the International Air Transport Association (IATA) and BARA. As stated in the discussion paper, the comments and feedback from interested parties have provided input to the formulation of the views contained in this report. Appendix A contains a list of submissions.

As well as information provided in submissions, this report draws on information provided by BAC and WAC concerning the costs and revenue associated with aircraft refuelling at Brisbane and Perth airports.

The following discussion sets out the views of airport operators, aviation fuel suppliers, airlines and other interested parties on each of the four issues raised in the discussion paper. It also provides a discussion of the employment and investment issues related to section 17 (3)(a) of the PS Act.

## 5.1 The extent of any increase in the price of refuelling services and airport profits due to increases in refuelling charges;

*Airport operators' views*

Although a number of airport operators made submissions to the discussion paper, only one of those submissions addressed this issue directly. BAC stated:

> *... it is misleading to suggest that fuel throughput levies represent significant increases in charges. A pro-rating of charges over the number of passenger movements at Brisbane Airport suggest that the impost on each passenger (assuming that the full impact of the levy is passed on only to passengers and not freight and other operations) is approximately 25 cents per passenger ...*

BAC also commented about the increase in airport profits due to increases in refuelling charges:

> *The Commission cannot reasonably expect to receive informed submissions on the increase in airport profits likely to arise from the increase in refuelling charges. Persons making submissions on this point would be completely uninformed regarding airport profits and any submission would therefore be useless. Furthermore, the undertaking of this exercise in relation to a particular charge does not assist an understanding of pricing at privatised airports.*

*Oil companies' views*

Both the managers of the Brisbane Airport JUHI and the Perth International Terminal JUHI made submissions addressing this question. Shell submitted, on behalf of the Brisbane JUHI:

> *The imposition of a throughput levy of 0.4 cpl will realise annual income to the BAC of approximately $2.52 million based on 1997 calendar year throughput. While the passing on of such levies from the Oil Companies to the airlines will depend on their individual contractual arrangements, the threefold increase in operating costs resulting from this levy makes it almost inevitable that the Oil Companies would endeavour to do so where this is contractually possible.*

BP submitted a similar statement regarding the impact of the proposed fuel throughput levy at Perth International terminal:

> *The imposition of a throughput levy of 0.5 cpl will realise annual income to the WAC of approximately $0.875 million based on 1997 calendar year throughput. While the passing on of such levies from the Oil Companies to the airlines will depend on their individual contractual arrangements, the twofold increase in operating costs resulting from this levy makes it almost inevitable that the Oil Companies would endeavour to do so where this is contractually possible or when contracts are renewed.*

Caltex and Mobil made similar observations about the impact of the fuel throughput levy being to triple the cost of using the facilities at Brisbane and double the cost at Perth.

*Airlines' views*

Both Qantas and Ansett Australia (Ansett) submitted calculations of the increase in the price of refuelling services due to the imposition of fuel throughput levies. Ansett submitted:

> *In determining the financial impact to Ansett, including Ansett International, we have assumed the worst case scenario, ie. that our fuel suppliers will pass on 100 % of the cost to us and that our refuelling volumes will remain unchanged in the short term (12 months).*

| *Location* | *Fuel volume uplift ('000s litres)* | *Proposed fuel throughput fee* | *Total additional cost* |
|---|---|---|---|
| *Brisbane* | *135 000* | *0.004* | *540 000* |
| *Perth* | *1 200* | *0.005* | *6 000* |

> *As indicated above, the total additional cost to Ansett from the proposed introduction of a fuel throughput fee amounts to $546 000 p.a.*

Qantas forecast its consumption of aviation fuel for the financial year ending 30 June 1999 when it assessed the increase in the price of refuelling services due to the imposition of fuel throughput levies:

> *Qantas' forecast consumption of aviation fuel at Brisbane Airport for the financial year ending 30 June 1999 is 196.7 million litres. Accordingly the fuel throughput levy constitutes an additional cost to Qantas of $786 900.*
> *... based on forecast consumption for the financial year ending 30 June 1999, the additional cost to Qantas on its international services [through Perth] is estimated to be $310 700.*[9]

*Industry groups' views*

Submissions from the Board of Airline Representatives of Australia (BARA) and the International Air Transport Association (IATA) expressed similar views to those of the airlines. BARA made the following general statement regarding the impact of increases in prices for refuelling services:

> *The levies will result in substantially increased refuelling charges each year to airlines operating to Brisbane and Perth airports ...*

IATA submitted data on the financial impact of increases in prices for refuelling services. IATA's estimate of the impact of the refuelling levies was the same as that submitted by the managers of the respective JUHI facilities presented above.

> *Aviation fuel is a critical factor in the economy of flight operations, accounting for a large proportion of our costs. It is therefore essential that refuelling costs are both transparent and fair. Our industry continues to face strong pressure to reduce the air tariffs, and simply cannot absorb unjustified increases in overall fuel costs. A throughput fee of 0.04 AUC/Litre at Brisbane and 0.05 AUC/Litre at Perth, - based on the 1997 volume fuel uplift -, would increase the costs by $2 525 600 at Brisbane and $875 000 at Perth.*

*Discussion*

Submissions detailed the impact on Brisbane and Perth airports' revenue from a fuel throughput levy. Holding all other factors constant, to the extent that the introduction of a fuel throughput levy increases revenue, it contributes to the improved financial performance of the company that levies it.

As noted in a submission by BAC, interested parties would not have the information to quantify the impact of the proposed fuel throughput levy on the profitability, or otherwise, of Brisbane Airport in their submissions. As a consequence the information in

[9] This calculation estimates the impact that Qantas would sustain if the fuel throughput levy at Perth had been introduced for the full financial year 1998–99. To this extent it is a large overstatement of the impact in that period.

submissions was not sufficiently detailed to allow quantification of the impact of the levy on profitability.

Aircraft refuelling charges are levied by airport operators under lease and licence arrangements with oil companies. The current arrangements were negotiated and put in place by the Federal Airports Corporation (FAC) before the airports were privatised. The leases include provisions for fuel throughput levies, but these were not activated by the FAC.

Since then BAC introduced a levy of 0.4 cents per litre (in July 1998), while WAC has announced that it will introduce a levy of 0.5 cents at the International Terminal to commence in June 1999. Estimates by the airport operators indicate that revenue generated by the fuel throughput levy each year at Brisbane Airport will be about $2.0 million and at Perth International Terminal more than $0.7 million. This additional revenue will flow directly to each airport's bottom line in the absence of additional costs associated with provision of the service.

A summary of revenue raised by the site leases before and after introduction of the fuel throughput levies at Brisbane and Perth Airports is provided in table 1.

**Table 1: Revenue from aircraft refuelling site leases at Brisbane and Perth Airports**

| | Revenue 1997/98 (before introduction of levies) $000's [a] | Revenue, first full year of operation of the levies $000's [c] | Percent increase (approx.) |
|---|---|---|---|
| BAC | 660 | 2,500 – 3,000 | 300% |
| WAC | 310 | 1000[b] | 200% |

a Source: Information provided by BAC and WAC in response to notices issued pursuant to section 32 of the PS Act (see appendix C for details) and oil companies in submissions.
b The levy only applies at international terminals.
c Estimates, 1998-99 for BAC, 1999-2000 for WAC.

Submissions from the JUHI managers suggested that the estimates by the airport operators of the revenue impact of the fuel throughput levies were conservative. Shell submitted:

> *The BAC's estimates of the financial impacts of the fuel throughput fee [contained in correspondence between BAC and the Commission dated July 28, 1998] overlooks two significant points.*
>
> ? *The BAC's pessimistic growth estimates are questionable. To draw a parallel to the current situation, the Australian recession of the early 1990's saw negative growth in the demand for jet fuel between 1991 and 1992, however, the average annual growth of jet fuel throughput at Brisbane Airport has been in the order of 8% in the ten years since 1988. In the likely event that such growth continues, the Oil Companies estimate the*

*BAC's annual income from the fuel throughput levy will exceed $5M by 2006 – with no additional provision of service.*

- *It should be noted that the BAC is intending to increase the throughput levy in line with movements in the Consumer Price Index, again with no additional provision of service.*

BP attached detailed calculations to its submission and made the following point as the manager of the Perth International Terminal JUHI:

> *The throughput levy clause allows for review every 6 years with CPI increases annually. Based on CPI and volume growth alone, within 5 years the WAC could expect to see the income from International Aircraft fuel sales increase to more than $1.3M per annum by 2003/04 financial year, excluding rent.*

The comments from BAC and WAC raise two separate points. First, CPI increases in fuel throughput levies maintain the real value of the levy to the airport operator over time. Second, any positive growth in traffic volume at the airports is likely to be reflected in higher volumes of jet fuel throughput. As such, by maintaining the real value of the levy per litre of fuel, they will capture any growth in fuel volume in terms of a real increase in revenue.

Conclusion:

The introduction of the fuel throughput levy at Brisbane Airport will raise about $2.0 - $2.5 million per annum. This represents an increase in revenue to BAC from refuelling services in the order of 300% between 1997-98 and 1998-99. At Perth Airport's international terminal introduction of the proposed fuel throughput levy will generate more than $700 000 annually, an increase in revenue to WAC from refuelling services of some 200% in 1999-2000 compared to 1997-98. Over time, real revenue accruing to the airports from the fuel throughput levy might increase with traffic growth.

The Commission sought information on the costs of providing these services as part of its information requests in the section 32 notices sent to BAC and WAC under the PS Act. Each airport advised that it could not provide the information at that time. However, BAC noted in its submission that there had been additional costs imposed on it by the Government, after the airport sales process. This issue is discussed in greater detail in section 5.2.

As part of the regulatory accounting requirements for privatised airports, BAC and WAC provided cost allocations for aeronautical related services at their respective airports for the period ended 30 June 1998. The information provided indicates that the costs to the airport operators of providing refuelling services are significantly lower than the revenue raised from refuelling charges (this is discussed below in relation to the next question from the discussion paper).

It is apparent that the introduction of fuel throughput levies will increase significantly the price of refuelling services at airports where those levies are introduced. The extent of

the increase in the price of refuelling services is less clear. Looked at overall, submissions were inconclusive regarding the price increase that will result in the final (airfare) market. Nonetheless there appeared to be broad consensus regarding the substantial adverse cost impact on the airlines.

Conclusion:

The introduction of fuel throughput levies will increase significantly the price of refuelling services at airports where those levies are introduced.

As noted in the discussion paper, the economic impact of a fuel throughput levy is similar to the economic impact of a tax on fuel. That is, the levy will be shared between the producers and consumers in that market according to whose demand is least responsive to price. In markets where consumers' demand is relatively insensitive to price, a tax will be borne mostly by consumers.

In the case of a fuel throughput levy, the producers of land for refuelling services are the respective airports. The consumers are the oil companies. In the presence of significant barriers to exit, the fuel companies will bear most of the levy.[10]

Unless the oil companies are able to absorb the full impact of the levy, some or all of it will be passed on to their customers (airlines) in the market for aviation fuel. In turn, it is likely that aircraft operators will seek to pass on some or the entire levy that they incur in the form of higher ticket prices. A logical outcome of the introduction of a fuel throughput levy at an airport is higher charges to passengers on at least some airline services to that destination.

Conclusion:

The introduction of a fuel throughput levy at Brisbane and Perth airports is likely to result in some or all of that levy being passed on to the airlines refuelling at those ports.

[10] The large capital investments made by the oil companies at the respective airports, and the immobile nature of that capital, mean that the oil companies' will be reluctant to exit the refuelling business at an airport, at least in the short run.

**5.2 Whether the introduction of fuel throughput levies can be justified through:**

**(a) increases in costs; and/or**

**(b) any offsetting reductions in other charges;**

*Airport operators' views*

BAC questioned in a submission the idea that increases in costs and offsetting reductions in other charges were necessary to justify the introduction of fuel throughput levies. It stated:

> *BACL's contractual entitlement to impose the levy is sufficient justification for imposing it if it has a need for revenue to generate a reasonable return on its investment; ...*

BAC also linked the CPI-X regime's requirement for real decreases in aeronautical charges to the need for increasing revenue in other parts of the airport business—for example by imposing a fuel throughput levy. BAC stated:

> *The proposed fuel throughput levy is unrelated to any falling revenues associated with the "Asian crisis". This is clearly evidenced by the fact that BACL had put in train the fuel throughput levy in July 1997, which was well before the onset of that crisis.*
> *The need for such return is related more to the CPI-X obligation and additional costs associated with running a privatised airport rather than falling revenues associated with the "Asian Crisis".*

Later in that submission, BAC added further comment on the justification for fuel throughput levies:

> *Submissions on this item will serve no real purpose. Assuming that many submissions support the proposition that the introduction of a fuel throughput levy cannot be justified because of increase in profits or offsetting reductions in charges, this does not establish whether or not the fuel throughput levy can be justified on other grounds. For example: existing contractual grounds, or return on investment.*

WAC made similar comments to BAC, arguing that the central issue in the discussion of fuel throughput levies is the contractual right of the airport operator. WAC did not attempt to justify the imposition of the fuel throughput levy in terms of cost.

> *Projected revenue from this fee was factored into the price paid to the Government for Perth International Airport. If the Government did not want WAC, or other bidding groups, to impose such a fee, it should have made it perfectly clear prior to January 1997 that either:*

*(a) revenue that would be collected by airports from such fees would be included under the price cap; or*
*(b) not accept Airstralia Development Group's (ADG) bid.*
*... it would appear that the airport operators are being accused of implementing new revenue initiatives to replace revenue lost through the price cap regime, when in fact they inherited the right to charge a fuel throughput fee from the Federal Airports Corporation, a previous Government owned business.*

As well as submitting that the existing contractual arrangements are adequate justification for the imposition of a fuel throughput levy, Northern Territory Airports Limited (NTA) criticised the Commission's approach of linking charges to costs in a single period. It submitted:

*ACCC appears to adopt the view that revenue in one year must relate to costs incurred in that year. ... infrastructure investments involve large outlays of funds for revenue streams over a long period. Unlike variable cost industries, infrastructure annual revenues do not necessarily relate to costs incurred in that year. The costs associated with fuel throughput levies are generally sunk costs tied to long term leases. These costs and associated revenues have recently been valued and capitalised during airport privatisation. In evaluating costs associated with leases to fuel suppliers, ACCC will need to take into account the price paid for long term airport leases.*

*Oil companies' views*

The four oil companies that made submissions to the discussion paper each asserted that there was no clear justification for increased charges based on costs. Caltex stated:

*What is readily apparent is that BAC cannot point to any additional costs factors associated with the provision of services under the lease and licences which would justify an increase in the amounts paid to BAC by the oil companies.*

BP argued that there is no commercial justification for the imposition of a fuel through put levy at Perth International terminal.

*There is no commercial justification for the imposition of a fuel throughput levy at Perth Airport. The refuelling facilities have been provided by the Oil Companies, not the WAC or its predecessors. The Oil Companies have an original cost investment of 4 million, ($5.5 million replacement cost) in the International JUHI and have made that investment on the economics of a known cost regime. ...*
*Existing licence fees and rents have historically, and continue to be, charged on a fixed cost basis, independent of throughput. It is reviewable on a market valuation basis every two years.*

*The recovery of the throughput levy would amount to a windfall gain for the WAC given that it is not proposing to provide any additional services or facilities to the Oil Companies to support the imposition of the throughput levy.*

Shell made similar comments regarding the proposed fuel throughput levy at Brisbane in its submission as manager of the Brisbane JUHI. Mobil also argued that there is no justification for fuel throughput levies in terms of cost.

*There is no commercial justification for the imposition of a fuel throughput levy as a means of recovering the direct costs incurred by an airport operator in supplying refuelling facilities. As stated above, neither BAC nor WAC has any investment in JUHI facilities; these are owned and operated solely at the risk of each JUHI participant. ...*
*The services provided by BAC and WAC in relation to refuelling facilities at Brisbane and Perth airports is simply access to land for the purposes of installing the JUHI facilities. For this service they are paid commercial licence fees or rentals, subject to market review every 2 years.*

*Airlines' views*

Qantas supported the view that there is no cost based justification for the imposition of fuel throughput levies. It submitted:

*... neither BAC nor WAC (nor their predecessor, the FAC) provided any of the assets required for the JUHI facilities. All that is provided by each airport operator is a licence to use airport land for the purposes of constructing and maintaining the facilities in exchange for the payment of rent at commercial rates. All capital costs of construction and all operating costs of maintenance are borne by the JUHI members.*

Ansett argued in its submission that airport charges should reflect the underlying cost of providing the facility or service. It claimed:

*It is important to major airport customers that user pays principles be properly reflected in the airport's aeronautical and non-aeronautical revenue streams. Cost allocation methodology and other assumptions should be made transparent and agreed with major customers to ensure that all airport charges properly reflect the underlying cost of providing a service or facility.*

British Airways noted that the IATA policy with respect to fuel throughput levies is that they are acceptable providing they are cost justified. It submitted:

*"British Airways supports the international (IATA) policy that such fuel fees are acceptable, provided they are cost-justified, and are used to fund the required level of fuel facilities at airports"*

*Industry groups' views*

IATA indicated its disapproval of airport pricing practices where fees are unrelated to the costs of providing a service:

> *IATA is strongly opposed to fees or taxes on international civil aviation which are unrelated to the actual cost of providing a service. In the present context, the pricing policy for aviation fuel purchased by the airlines should not be used to generate revenues to meet goals unrelated to aviation. Indeed, throughput charges and taxes are contrary to the policies of the International Civil Aviation Organisation (ICAO) and reflected in bilateral Air Transport Agreements.*

BARA commented about the lack of a cost based justification for fuel throughput levies at any stage in the history of the issue. BARA asserted:

> *Neither BAC nor WAC will provide any additional services pursuant to the introduction of the levies. Similarly, neither BAC nor WAC has provided any evidence of increased costs related to aircraft refuelling to justify the introduction of the levies. In fact, BARA understands that there has never, at any time, been any demonstration by, firstly, the FAC and then privatised airport operators, of any costs incurred to be offset by the implementation of the levy.*

*Discussion*

Submissions on this point raised a number of separate but related issues. First, submissions raised the issue of contractual validity and thereby the question of whether contractual validity amounts to justification. Secondly, airport operators questioned whether decreasing revenues in other parts of the business are justification for fuel throughput levies. Thirdly, submissions raised the issue of costs associated with refuelling services and lastly, there is the issue of additional costs imposed on the privatised airports since the privatisation process.

The Commission has not examined the question of the validity of the contractual arrangements between the private airport operators and the refuelling service providers at those airports. Nor has the Commission investigated the process of determination conducted under the provisions of the contract. Such questions are a matter for the relevant parties and are beyond the scope of this report.

It is the Commission's view that the issues of validity and justification in terms of costs or offsetting reductions in charges are not related. The Commission, in its discussion paper, raised the issue of justification in terms of increased costs or offsetting reductions in other charges. The reason for doing this relates to the criteria in section 17(3) of the PS Act. Section 17(3)(b) requires the Commission to have particular regard to:

*the need to discourage a person who is in a position substantially to influence a market for goods or services from taking advantage of that power in setting prices;*

The question discussed here forms part of the Commission's consideration of section 17(3)(b). The absence of increased costs or offsetting reductions in charges is an important step in assessing whether the airport operator has taken advantage of market power that it might have in setting prices.

Conclusion:

The question of the validity of contractual arrangements between the airport operators and leaseholders is a matter for the relevant parties not the Commission. The validity of the contractual arrangements is separate from the issue of the relationship of fuel throughput levies to costs or reductions in charges elsewhere, and as such is not directly relevant to the Commission's monitoring role under section 27A of the *Prices Surveillance Act* or the section 17 criteria of the *Prices Surveillance Act* which guide the Commission in conducting its monitoring functions.

Neither BAC nor WAC attempted in submissions to relate the imposition of fuel throughput levies to any increase in costs of providing the refuelling services. But both airport operators did relate the imposition of a fuel throughput levy to decreasing revenues and returns on their investments into the airports. The comparison by the Commission of the impact of a fuel throughput levy and the CPI-X price cap in a 12 month period at Brisbane and Perth airports was questioned in submissions. Airport operators argued that the relevant comparison is over the full five year period of the price cap. This issue is discussed in Appendix D.

In addition airport operators commented on the calculation of the "X" values for the purposes of the price cap. Submissions from Melbourne Airport and BAC discussed the relationship between the current X values and growth in traffic volume. They suggested that since anticipated volume growth has not been realised those X values should be reviewed. Melbourne Airport submitted:

> *The second concern in respect to the paper is the statement "The value of X reflects government policy that privatised airports reduce aeronautical charges over time in real terms, reflecting productivity improvements that the Government considered can be made in the provision of aeronautical services at each airport". Although this statement is generally correct, it is our opinion an oversimplification of the X factor regime, and fails to articulate the whole range of factors that were included in determining the X for each airport. Clearly productivity gains were expected, but a significant part of the unit improvement in the productivity flows from increased traffic and not entirely from inefficiencies that may have resulted from Government ownership. Other factors also had an impact on the determination of the X factor including the level of capital expenditure required to accommodate future traffic growth.*

BAC also commented on the importance of growth in the calculation of the value of X, stating:

> *... the Minister for Transport and Regional Development, in announcing the "X" factors for the various airports, stated in his media release that" the 'X' factors reflect a significant productivity improvement and growth in that the government is confident that the new airport operators can achieve in the first 5 years of their lease". The discussion paper fails to mention growth. Under FAC's ownership, Brisbane Airport's efficiency using virtually any measure was better, and in some cases significantly better than other airports. One could assume therefore that growth was a more important factor than productivity improvements in setting the level of "X". At Brisbane the anticipated early growth has not eventuated and in the view of BACL consideration needs to be given to a formal review of the level of the price cap.*

The values of X were known in advance of the sale of airport leases. Bidders were aware of both the upside and downside risks of incorrectly forecasting traffic volumes when developing offers. The reason for the fuel throughput levy - unrealised traffic forecasts or otherwise - does not affect the assessment of what constitutes taking advantage of market power unless there is a cost based argument or compensating reductions in charges elsewhere in the business.

In terms of the relationship between fuel throughput levies and the costs of providing aircraft refuelling services, data supplied by BAC and WAC as part of the regulatory reporting requirements indicates that revenues substantially exceeded costs prior to the introduction of a levy.[11] The Commission has not been made aware of any cost increases in providing refuelling services since then, or any cost increases anticipated in the future.

In correspondence to the Commission, BAC also identified a number of additional costs imposed by governments since the privatisation of Brisbane Airport. For example, the annual costs of the Commonwealth appointed Airport Building Controller and the annual costs of the Commonwealth appointed Airport Environment Officers. In general companies have a legitimate interest in recovering costs associated with external factors. In the case of airports the relevant issue is the costs imposed post sale and which the operators were not informed of during the sale process. Other costs could have been factored into the bids for the airport leases.

Importantly, accepting the need to recover costs imposed since privatisation is not the same conclusion as permitting a firm to underwrite a target rate of return on its investment by increasing prices in parts of the business where it has substantial market

[11] These costs exclude any apportionment of interest expense or amortisation of intangible assets. At both airports these expenses represent a significant proportion of the airport's total costs. The ACCC has not attempted to allocate these costs because any allocation of them involves a degree of subjectivity and because of the circularity of determining the cost of a revenue stream based on what was paid for access to that revenue stream.

power. As discussed earlier, the owner of an airport has a monopoly in the provision of land for refuelling services at that airport; and the Commission is required to assess whether the operator has been "taking advantage of that power in setting prices".[12]

Conclusion:

The Government has imposed additional costs on Phase I airport operators since the privatisation process was completed. Airport operators have a legitimate concern to recover these costs and fuel throughput levies may be one way of doing so. However, these additional costs are likely to be substantially lower than the revenues raised from the fuel throughput levies introduced by BAC and WAC and do not justify the magnitude of the levies introduced and proposed.

### 5.3 Whether the imposition of a fuel throughput levy is an "abuse of market power" of the type referred to in the Treasurer's statement at the time of the monitoring direction; and

A number of submissions to the discussion paper discussed the idea of an "abuse of market power" and taking advantage of that power in relation to the TPA. For example, Qantas submitted:

> *… in imposing the fuel throughput levy, there can be no doubt that BAC and WAC are taking advantage of that power. The expression 'take advantage' was interpreted and defined by the High Court of Australia in Queensland Wire v BHP (1989).*

Caltex offered the following discussion:

> *It is not a sufficient answer for BAC to say that all it is doing is exercising a contractual right, ie. The right bestowed under Clause 12. See the comments of Dawson J. in Queensland Wire Industries Pty Ltd v Broken Hill Pty Co. Ltd (1989) 167 CLR 177 at 202 where His Honour expressed the view that the fact that action is taken pursuant to the terms of a contract has no necessary bearing upon whether it is the exercise of market power in contravention of s. 46 (TPA). … It is submitted that Dawson J's view is the correct view.*

As noted previously in this report, "market power" is used in a different sense in this report. It refers to where a person is in a position substantially to influence a market for goods and services. Thus an "abuse of market power" occurs where the person takes advantage of that power in setting prices.

*Airport operators' views*

The submissions from NTA, Melbourne Airport and WAC did not address directly the question of whether the imposition of a fuel throughput levy is an "abuse of market

[12] *Prices Surveillance Act 1983,* section 17(3)(b).

power" of the type referred to in the Treasurer's statement at the time of the monitoring direction. The submissions from BAC addressed this issue at length.

BAC's submission raised firstly the issue of the negotiation of the original contract:

> *... the Federal Airports Corporation negotiated the original contract with the oil companies. Presumably it did not abuse its market power in doing so. If it did, then this was certainly a material matter not disclosed to airport bidders in the privatisation process.*

BAC also addressed the issue of 'abuse of market power' directly in submissions. It stated in its first submission:

> *Because the increase arises from an existing contractual arrangement, it is not correct to suggest that the exercising of these contractual rights amounts to an "abuse of market power". If market power was abused, then this could only have occurred at the time the contract was negotiated by the Federal Airports Corporation.*
> *BACL strongly refutes any suggestion that it has abused its market power because it "activated" a fee covered by an existing contractual arrangement and determined as reasonable by an independent expert*

BAC added in a later submission:

> *We again state that if there was any abuse of market power it must have been by FAC at the time the contract was entered into. BACL simply proposed a reasonable market rate following research at other airports around the world and the reasonableness of this rate was supported by a QC appointed by the parties.*

*Oil companies' views*

Each of the four oil companies that made submissions argued that the imposition of a fuel throughput levy is an "abuse of market power" of the type referred to in the Treasurer's statement at the time of the monitoring direction. Shell said of the proposed fuel throughput levy at Brisbane:

> *The Oil Companies believe that the imposition of the throughput levy amounts to an abuse of market power of the type referred to in the Treasurer's statement and the associated profits realised by the BAC will be at the expense of the travelling public and economic efficiency.*

BP made the same point in regard to the proposed levy at WAC in its submission on behalf of the participants in the Perth international terminal JUHI. Mobil and Caltex also made strong arguments that the imposition of fuel throughput levies amounts to taking advantage of market power. Mobil stated:

*Mobil believes that fuel throughput levies cannot be justified by the costs, or additional cost, of providing access to refuelling services. In imposing such unjustifiable throughput levies, an airport operator is taking advantage of its power in relation to the supply of aeronautical related services at that airport, so as to amount to an "abuse of market power" of the type referred to in the Treasurer's statement issued on 22 May 1998.*

Caltex discussed what constitutes market power in arriving at the conclusion that BAC is misusing its market power. Caltex argued:

*It is Caltex's submission that the throughput Clause 12 in each of the agreements which BAC is seeking to enforce is a term which was imposed upon the oil companies as a result of FAC's market power, which was inherited by BAC as successor to the lease and licence agreements.*
*In any analysis of misuse of market power, it is important to identify the relevant market. In any particular case, it may be relevant to consider more than one market, or perhaps submarkets. There is a separate market for the supply of airport and airport related services in the Brisbane area. This is because there is only one airport in the Brisbane area which can cater for the type of traffic provided by major international airlines. Access to Brisbane Airport itself is essential to a company such as Caltex to be able to provide airline fuel services to major airlines.*

*Airlines' views*

Both Ansett and Qantas expressed views in their submissions that the introduction of fuel throughput levies was a misuse of market power. Ansett stated:

*In a monopoly market, it is not appropriate to increase existing charges or levy airport users for no additional service or facility, as competitive forces do not moderate aggressive pricing practices.*

Qantas was more explicit in its view on this point, arguing:

*Qantas has no doubt that the introduction of a fuel throughput levy at Brisbane and Perth airports is an abuse of the natural monopoly power at those airports. In the absence of any competitive constraints, the airport lessee companies have sought to increase prices without any increase in supply costs or offsetting reductions in other charges. The airport lessee companies are clearly taking advantage of their market power within the meaning of section 17(3) of the Prices Surveillance Act 1983.*

*Discussion*

A number of issues need to be considered when assessing whether the airport operator has market power in the provision of aircraft refuelling services:

- the relevant market;
- substitution possibilities – land sites; and
- substitution possibilities – refuelling at other airports.

In relation to the relevant market, section 17(3)(b) defines market power in relation to a market for goods and services. In this case the Commission considered the market for aircraft refuelling services. Airport operators contribute one component of refuelling services – the land for provision of on-airport refuelling infrastructure and activities. It is the ownership of land that creates the potential for airport operator market power in the provision of aircraft refuelling services.

The extent of the airport operator's market power in the provision of aircraft refuelling services is determined by substitution possibilities, in relation to land sites, but also refuelling at other airports.

In certain situations, there might be substitutes for the land at the airport. For example, at small general aviation airports it is conceivable that neighbouring properties could be competitors. Aircraft could taxi beyond the airport, refuel using facilities installed on neighbouring land, and return to use the airport for other necessary civil aviation services. However, the extent of market power that large airports have where land is required to install JUHI facilities seems clear. There are no alternative providers.

The second issue related to airport operator market power in the market for aircraft refuelling services is whether refuelling services at a given airport are a captive market. There may be operational changes that airlines can make to avoid refuelling at a particular airport. For example, can flights that use Brisbane airport refuel at other airports? Can an airline deploy its fleet in such a manner as to avoid refuelling at an airport that imposes a throughput levy?

Submissions from airport operators asserted that possible operational changes are evidence that the service of aviation refuelling is not a captive market at a particular airport. NTA submitted:

> *ACCC assumes that the cost of fuel throughput levies will be borne by consumers through higher airfares. The competitiveness of the Australian domestic airline market is a matter for consideration by the ACCC and the Commonwealth. However, in a competitive market, it is likely that throughput levies would be borne by (a) fuel suppliers who have enjoyed benefits of on-airport sales and (b) airlines who compete and are in a position to and seek efficiencies through fleet planning, fleet deployment, route planning and operational procedures.*

By contrast, submissions from airlines indicated that they consider possible operational changes and fleet rationalisation are likely to be more costly than the payment of the levy introduced by BAC or proposed by WAC.

The submissions indicate that there are some substitution possibilities. However, such alternatives involve costs to the airlines. Qantas submitted that the increase in costs per litre from refuelling at airports other than Perth and Brisbane is one or two cents. It follows that substitution possibilities are not relevant for refuelling charges of less that one or two cents per litre. It should also be noted that because of the costs of using alternatives to refuelling at an airport, if any substitution did take place the outcome would be economically inefficient.

Conclusion:

There is a strong case that large airports have market power in the market for refuelling services.

This conclusion is consistent with the Government's regulatory regime, which recognises explicitly that airports have substantial market power in many areas. The issuance of monitoring instruments by the Treasurer recognises that refuelling services may be one such area.[13]

When considered together with the monopoly nature of the market for land for refuelling facilities, the lack of alternatives to refuelling at some airports reinforces the airports' market power. When considered in light of the lack of any cost related justification for the levies, or offsetting reduction in charges, there is a strong case that the imposition of a fuel throughput levy is taking advantage of market power.

BAC argued that, if market power had been exercised in this market it was by the FAC. The Commission accepts that the imposition of fuel throughput clauses in FAC contracts might have arisen by virtue of the FAC's market power. However, the FAC did not impose any levies, it reserved the right to do so. This is an event of a different nature than the activation of the clauses that had been included previously.

If the reasoning of BAC's submissions is accepted and the FAC took advantage of its market power by insisting on the inclusion of fuel throughput clauses, the privatised airports are continuing to take advantage of the same market power by activating those clauses.

[13] Treasurer's Office, Press release number 55, 25 May 1998.

Conclusion:

There is a strong case that by introducing fuel throughput levies airport operators have taken advantage of market power that they have in the provision of aircraft refuelling services.

### 5.4 Whether such charges should trigger consideration of stricter forms of prices oversight, consistent with the Treasurer's statement, and forms that may take.

*Airport operators' views*

Neither NTA, nor WAC addressed this issue in their submissions. Melbourne Airport seemed to suggest that the Commission had already formed the view that a 'single till' approach to pricing was to be recommended. It submitted:

> *... [Melbourne Airport] finds the analysis as presented in the paper is misleading given that the pricing regime clearly delineates between "aeronautical charges" and "aeronautical related charges". The main argument of the paper appears to propose a single till approach to charging and this is not our understanding of current government policy or the current pricing regime.*

BAC addressed the question directly, arguing:

> *It is far too early for the Government or the ACCC to be considering whether stricter forms of prices oversight are required, and the forms that should be adopted for privatised airports. The need for stricter oversight, if it arises at all, will arise from a review of the overall profitability and rate of return on aeronautical and aeronautical related services rather than from an individual service charge. No one, including the ACCC, has sufficient information at this stage to make a meaningful submission on this point. To the extent that any submissions are received, they will be substantially uninformed. ...*
> *BACL submits, for the reasons explained above [in its submission], that there has not been any abuse of market power on its part in relation to fuel throughput levies. Nor has there been any such abuse by BACL in relation to other charges. Consequently, BACL submits that no consideration needs to be given at this stage to any form of stricter price oversight.*

*Oil companies' views*

Neither of the managers of the Brisbane or Perth JUHIs made submissions directly related to the matter of stricter forms of oversight. Those submissions questioned whether the intentions of the present framework were being met. Each of Shell and BP submitted:

*It is the understanding of the Oil Companies that the CPI-X price cap for aeronautical services was intended to pass onto consumers the efficiencies gained from privatisation. Excluding the throughput levy from the regime appears to be at odds with this intention, particularly in view of the levy being indexed to CPI. At best, excluding the throughput levy from the 'basket' of price capped fees undermines the proposition; at worst there is a very real possibility that price reductions from improved efficiency will be more than offset by increased charges in the form of the throughput levy.*

Caltex and Mobil both requested stricter forms of prices oversight, Caltex making the following point:

*Caltex submits that the ACCC take steps to ensure that BAC and Westralia Airports Corporation are prevented from imposing and enforcing any fuel throughput levies at Brisbane and Perth Airports.*

Mobil presented this argument for stricter prices oversight in its submission:

*The potential for the throughput levies imposed by BAC and proposed by WAC to be seen by operators of other airports as a precedent justifying the imposition of similar fees at those airports cannot be underestimated.*
*Mobil understands that the CPI-X price cap for aeronautical services was adopted so as to pass onto consumers the efficiencies released by the privatisation program. Excluding a fuel throughput levy, particularly where such a levy is not imposed in return for the provision of additional services or as a result of higher costs in providing those services, would appear to be counter-productive and at odds with this intention.*
*Mobil therefore submits that it is important for the ability of airport operators to increase charges such as the provision of refuelling services to be subject to stricter oversight than is presently the case.*

*Airlines' views*

Each of British Airways, Ansett and Qantas requested that stricter forms of prices oversight be considered. Ansett submitted:

*In light of the above, we consider it appropriate that a stricter form of pricing oversight be triggered at least for an interim period until such time as the issues as outlined above [in its submission] can be adequately resolved between the airports and their major customers.*

British Airways made two suggestions for stricter oversight:

*We would request that the ACCC instructs Brisbane Airport Corporation to suspend the introduction of the fee until consultations have been held with representatives of the IATA airline industry, and furthermore would suggest*

*consideration is given to bringing these fees under some form of regulatory control as fuel is an essential part of the airport's operational infrastructure.*

Qantas submitted a list of requests that amounted to consideration of stricter prices oversight:

*Qantas strongly recommends that the ACCC take all appropriate action to ensure that fuel throughput levies are not imposed. Such mechanisms include:*

1. *seeking the necessary Ministerial approval under section 18 of the Prices Surveillance Act to hold an inquiry into the proposed imposition of the fuel throughput levies;*
2. *recommending that refuelling services be included in Prices Surveillance Declaration No. 83 so that the price cap applies to such services; and*
3. *arbitrating the dispute between the oil companies and the airport lessee companies under the access regime now in place under section 192 of the Airports Act 1996.*

*Industry groups' views*

Both BARA and IATA requested consideration of stricter forms of prices oversight. BARA made the following request:

*... BARA requests the ACCC to disallow the implementation of fuel throughput levies by BAC and WAC. BARA understands that the ACCC could pursue this outcome via either an inquiry under the Prices Surveillance Act or action under the access undertaking regime.*

IATA also considered that an inquiry should be held into the price of these services:

*Following up on previous communications on this important issue, I once again request that implementation of the proposed throughput fee be delayed until such time as a thorough price inquiry has been carried out.*

*Discussion*

Arguments submitted by BAC and WAC raised concerns about the ACCC's involvement in the issue of fuel throughput levies. But the regulatory framework is clear in this regard. It requires explicitly that the ACCC monitor aircraft refuelling at privatised airports.

The Treasurer's direction number 14 pursuant to section 27A of the PS Act included 'aircraft refuelling' in aeronautical related services.[14] It also expressed the purpose of the prices oversight regime more generally. The Treasurer's press release stated:

[14] Direction Number 14, Commonwealth of Australia, 22 May 1998.

> *The prices oversight regime is designed to strike a balance between protecting airport users from monopoly pricing and creating the conditions for commercially-driven decisions on the part of airport operators.*[15]

The Treasurer's press release made the following point about the Commission's role:

> *Any abuses of market power detected through the prices monitoring arrangements will be the trigger for consideration of stricter forms of prices oversight.*[16]

In short, the Treasurer has asked the Commission to consider stricter forms of prices oversight where the Commission thinks it is required to enhance the efficacy of the existing framework.

In this report the Commission has argued that there is strong evidence that operators, through the introduction of fuel throughput levies, are taking advantage of market power. Secondly, the report argues that the imposition of fuel throughput levies has a significant impact on the cost of refuelling services. Lastly it is noted that the introduction of fuel throughput levies at two airports could have a significant precedent effect at other airports.

In combination, these factors could erode some or all of the intended benefits of the price cap and as such potentially compromise the effectiveness of it. It follows from this that the Commission should consider whether to recommend stricter forms of prices oversight for refuelling services.

| Recommendation |
| --- |
| The Commission recommends that stricter forms of prices oversight should be considered in relation to aircraft refuelling services. |

Including refuelling services in a price cap is not the only stricter prices oversight option to address concerns raised about the introduction of fuel throughput levies. A number of submissions also raised other options including declaration and arbitration under Part IIIA and the Commission seeking authority to conduct an inquiry into the fuel throughput levy issues.

The Commission discusses these options in detail in section 6 below. Prior to that discussion, the Commission completes its assessment against the criteria in section 17 of the PS Act by considering the implications of fuel throughput levies for investment and employment.

[15] Treasurer's Office, Press release number 55, 25 May 1998.
[16] ibid.

## 5.5 Fuel Throughput Levies and Employment and Investment

The discussion in this report relates to section 17 of the PS Act, primarily to section 17(3)(b) and the issue of airports' market power in the provision of land for refuelling services. Section 17 of the PS Act also requires the Commission to have particular regard to other issues in exercising its powers and performing its functions under the Act, namely:

> 17(3)(a) the need to maintain investment and employment, including the influence of profitability on investment and employment;
>
> 17(3)(c) the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.

As noted in section 4 above, the Commission does not consider that section 17(3)(c) raises any issues of direct relevance to fuel throughput levies. For that reason it has not been addressed.

BAC expressed concern that fuel throughput levies should also be considered in light of the issues in section 17 (3)(a). BAC submitted:

> *BACL notes that in exercising its functions the ACCC must have particular regard to the need to maintain investment and employment, including the influence of profitability on investment and employment.*

In April this year the Commission released a paper *"Draft Statement of Regulatory Approach to Price Notifications"* which outlined the Commission's current approach to interpreting the section 17 criteria. The Commission's approach to monitoring fuel throughput levies is guided by the draft statement.

In interpreting section 17(3)(a) of the PS Act, the Commission has focused on broad notions of investment and employment, considering economy-wide as well as local impacts. The draft statement emphasised the benefits of efficient provision of services and 'competitive' prices across the economy. On this basis, the impact of pricing on employment needs also to be assessed in downstream markets, not only for the regulated service provider. The draft statement expressed this in the following terms:

> *... an important consideration is that in an open and competitive market economy efficient provision of services underpins investment and employment opportunity. Investment and employment in the national economy will be promoted when firms produce goods or services efficiently and charge prices that are at competitive levels.*
>
> *Monopoly suppliers do not necessarily produce goods or services at efficient cost levels or at competitive prices. If higher than efficient prices are passed*

*on to the competitive part of the economy, there is a resultant loss in allocative efficiency and potentially therefore in investment and employment opportunity.*

*Encouraging efficient pricing outcomes in line with more competitive conditions implies that price increases should not be in line with unit costs on top of a cost base that is too high due to inefficiency or excessive margins.*

Conclusion

When interpreting section 17(3)(a) of the Prices Surveillance Act, it is appropriate to focus on broad notions of investment and employment, considering economy-wide impacts plus those in a particular industry. In this way the Commission would consider the impact on users of the airport as well as the impact on the airport operators.

The draft guidelines state that the Commission will direct its attention to two factors in considering the section 17 criteria:

- *the efficiency of the cost base that the declared company is working from to earn a return; and*
- *the reasonableness of the rate of return.*

The issue of the relationship between the fuel throughput levies introduced or proposed and costs is discussed in section 5 of this report. The Commission has no reason to question the efficiency of airport operator provision of aircraft refuelling services at Brisbane or Perth Airports.

In relation to rates of return, the Commission notes that there are two possible approaches to considering the reasonableness of returns. One is to consider only returns on the service in question based on an identified cost base. This is the approach adopted in this report and underlies the discussion in section 5.3.

A second approach would be to consider overall returns on the airport, and to consider the fuel throughput levy in terms of its impact on those returns. This effectively amounts to a 'single till' approach.

Submissions from Melbourne Airport and BAC commented on a single till approach. Melbourne Airport's submission pointed to three categories of charges, price capped, monitored and other services and argued:

*Melbourne Airport believes that the Government's intention was for each of these categories to be treated separately and that within the price monitored activities each item would be looked at on a case by case basis.*

Its submission proceeded:

*We are working to build a partnership with those that use or conduct business at the airport while expanding the airport's revenue base. If any expansion of*

*revenue is then to be swept up into reduced aeronautical charges in the future the incentive to build new business becomes greatly reduced.*

BAC made a similar point:

*We support Melbourne Airport's views in relation to a single till arrangement. It was, quite rightly, never the intention of the airport pricing regime to create a single till arrangement. To do so would provide no incentive for airports to undertaking any commercial activities since there would be little point in taking risks if the overall return to BACL was capped.*

Consistent with the framework for economic regulation of airports set in place by the Government the Commission has not adopted a single till approach.

However, the Commission recognises that the Government has imposed additional costs on the Phase I Airport operators since completion of the sales process. Airport operators have a legitimate interest in seeking to recover those costs.

# 6 OPTIONS FOR STRICTER PRICE CONTROL

In the light of the Commission's conclusion that airport operators are taking advantage of market power by introducing fuel throughput levies, it is appropriate to consider alternate solutions to the issue. Three main alternative recommendations were suggested in submissions. They are:

1. seek authority to conduct an inquiry into fuel throughput levies;

2. encourage use of the access provisions in section 192 and Part IIIA, with no recommendation to the Treasurer for stricter forms of prices oversight at this stage; and

3. recommend prices surveillance of refuelling services.

Each of these alternate options for stricter prices control is discussed in the sections following.

## 6.1 Seek authority to conduct a public inquiry

A number of submissions raised the issue of whether the introduction of fuel throughput levies was a suitable reason to hold a public inquiry. The submission from Qantas is the clearest example of this argument. Qantas argued strongly that the imposition of fuel throughput levies is an appropriate basis on which to conduct a public inquiry. Qantas stated:

> *… we strongly recommend that the ACCC seek the approval of the Minister under section 18 of the Prices Surveillance Act to hold an inquiry under section 17 into the proposed imposition of fuel throughput levies by the privatised airports.*

The Commission cannot instigate a public inquiry, but it can recommend that the Treasurer direct the Commission to undertake a public inquiry. Although the conduct of a public inquiry would freeze prices and prevent the introduction of new fuel throughput levies or increases in existing levies for the inquiry's duration, it would lead to a significant delay in the resolution of the concerns raised by the airline industry and the oil companies. Furthermore, it is not necessary in order to consider the justification for the levies proposed. That is addressed in this report, and the process of issuing a discussion paper and calling for submissions is sufficiently similar to the inquiry process to raise doubts about the value that would be added by calling for another round of participants' responses.

The strongest case for an inquiry would be the existence of a number of other issues closely related to the questions of market power and fuel throughput levies. The Commission does not consider that to be the case at this time.

The Commission does not consider it appropriate at this stage to recommend to the Treasurer that a public inquiry into fuel throughput levies be conducted.

## 6.2 Encourage the use of the access regime to address industry concerns

A second possible response involves asking whether the existing framework is capable of addressing concerns raised about the introduction of fuel throughput levies.

One way the existing framework might be able to deal with these concerns would be through the access provisions under Part IIIA of the TPA. While not subject to the price cap, aircraft refuelling services at larger airports are likely to be subject to declaration under section 192 of the *Airports Act 1996* for purposes of Part IIIA of the *Trade Practices Act 1974* (TPA). Potentially this provides service users with a mechanism for addressing concerns about introduction of fuel throughput levies.

Part IIIA is a new part of the TPA. It establishes a legal regime to facilitate access to the services of certain services of national significance. The rationale underlying Part IIIA is explained in the Second Reading Speech accompanying *the Competition Policy Reform Bill 1995*:

> *"The notion underlying the regime is that access to certain facilities with natural monopoly characteristics, such as electricity grids or gas pipelines, is needed to encourage competition in related markets, such as electricity generation or gas production"*[17]

Part IIIA recognises that owners of such "bottleneck" facilities may be in a position to inhibit or distort competition in downstream markets. At the same time Part IIIA recognises that it may not be possible or even desirable for competition to eliminate the market power that makes such conduct possible. Typically, such market power exists for the reason that economies of scale and scope make it more efficient for the service to be provided by one supplier.

The approach adopted by the legislative regime is based on commercial negotiation of access terms and conditions between the parties in the first instance, supported by arbitration of disputes by the Commission if the negotiations fail.

In the case of refuelling services the access arrangements allow interested parties to seek a determination from the ACCC (under section 192 of the Airports Act) on whether refuelling services are an airport service and thus declared. If refuelling services are declared, an oil company could notify an access dispute and seek ACCC arbitration of the terms and conditions of access. This would necessarily include the fees charged by the airport operator.

There are arguments both for and against encouraging reliance on the access arrangements.

[17] Page 7 of the Second Reading Speech accompanying the *Competition Policy Reform Bill 1995*.

*Arguments for relying on access provisions as the preferred means of addressing market power in refuelling services.*

These arguments flow from the assumption that minimal change to the framework is desirable unless there is an obvious shortcoming. Some arguments include:

? the present framework is still in its infancy and should be given the chance to address industry pricing concerns where they arise; and

? the access provisions in the Airports Act and Part IIIA are oriented to negotiation and arbitration between the parties.

*Arguments against relying on access provisions as the preferred means of addressing market power in refuelling services.*

Arguments against relying on access provisions relate predominantly to uncertainty about whether the access framework can address airport user concerns in this instance:

? while anyone can potentially approach the Commission to seek a determination that refuelling services are an airport service for the purposes of the Airports Act it seems likely that only the oil companies can notify a dispute under Part IIIA. To date the oil companies have been reluctant to notify. Continued reluctance from the oil companies would prevent the framework from addressing concerns raised by the airlines;

? the access framework is essentially about competition in markets downstream from the airport market. As the PS Act is legislation designed to address issues of market power, it might be better suited to addressing the concerns raised by oil companies and airlines; and

? there is uncertainty for the affected parties associated with the outcome of arbitration. The outcome of arbitration is also subject to appeal to the Australian Competition Tribunal.

## 6.3 The inclusion of refuelling services within a price cap

The third and arguably the strongest response to requests for stricter prices oversight is to recommend that aircraft refuelling services are included within a price cap. Arguments both for and against this are discussed below.

*Arguments for inclusion of aircraft refuelling services in a price cap*

There are a number of arguments for such a recommendation, including:

- the price cap has proved effective to date. Private airport operators have complied and it is relatively straightforward to administer both for the Government and airport operators.

- inclusion of refuelling services within a price cap may also have advantages in terms of certainty of revenue for airport operators. By contrast there is likely to be some uncertainty about the outcome of an arbitration process should an access dispute be notified to the Commission;

- inclusion of refuelling services under a price cap would not involve a new regulatory element. It would require only the reissue of existing instruments familiar to all the industry players; and

- the PSA considered the issue of coverage of the price cap in its 1993 inquiry into FAC charges. Significantly, in the inquiry and in subsequent advice to the Government on the regulatory framework to apply to privatised airports, the PSA recommended that—on the basis of a functional definition of aeronautical services—aircraft refuelling services be included in the price cap. The PSA concluded:

  > *Services and facilities which are functionally aeronautical are those which broadly relate to aircraft movement, the embarkation and disembarkation of passengers and the loading and unloading of freight. This includes services / facilities such as aircraft refuelling, passenger terminals, freight services, baggage handling and aircraft maintenance. … This functionally-based definition of aeronautical service charges is appropriate for the purposes of prices surveillance as those FAC services included within its scope confer market power on the FAC.*

  The present complaints from oil companies and airlines and the conclusions arrived at by the Commission in section 5.3 of this report support the conclusions and recommendations reached by the PSA in its inquiry.

*Arguments against including refuelling services in a price cap*

There are a number of countervailing arguments to any suggestion that refuelling services should be included within a price cap:

- the Government intended to exclude aircraft refuelling from the price cap when it developed the regulatory framework and confirmed this policy in May this year when the Treasurer replaced the original declaration with a new one that excludes aircraft refuelling;

? the purchasers of airport leases have stated publicly that they were advised during the bidding process that aircraft refuelling services would not be included within the price cap. Operators can argue that they factored additional revenue from fuel throughput levies into their bid prices; and

? it is not clear that the concerns raised by the oil companies and the airlines can't be addressed by other measures, such as through the access provisions.

## 6.4 The Commission's preferred approach

The Commission concludes that it is appropriate to recommend the inclusion of refuelling services provided by airport operators within a price cap.

Private airport operators taking advantage of market power by introducing fuel throughput levies has the potential to significantly increase the cost of those services at Australia's major airports. As discussed in sections 5.2 and 5.3, no cost based justification, or other adequate justification has been advanced for the proposed increases in refuelling fees by airport operators.

In making its recommendation the Commission considers that fuel throughput levies have the potential to compromise the Government's stated objectives in establishing the prices oversight arrangements applying to leased airports. The Pricing Policy Paper states:

> *Pricing oversight arrangements at airports post-leasing have been designed to achieve an appropriate balance between public interest and private commercial objectives.*
>
> *Pricing oversight arrangements are intended to promote operation of the airports in as an efficient and commercial a manner as possible. Pricing is fundamental to the efficient use of airport infrastructure. It is in the interests of airport users in particular, and the national economy in general, that commercially-driven decision be made about maintaining existing airport infrastructure, and building new infrastructure.*
>
> *The arrangements should also aim to protect airport users from any potential abuse of market power by airport operators.*[18]

The real price reductions that the price caps deliver will, at least in part, be offset by introduction of fuel throughput levies (see for example, appendix C and D). As explained in sections 5.2 and 5.3 the Commission considers that there is a strong case that airport operators have market power in provision of aircraft refuelling services and that there is a strong case that introduction of fuel throughput levies is only possible because of the market power that they have.

[18] Page 2 of the Pricing Policy Paper, Department of Transport and Regional Development, November 1996.

Recommendation:

The Commission recommends that refuelling services are included within a CPI-X price cap.

In making this recommendation the Commission also considered the effectiveness of the existing regulatory regime in meeting the Government's objective of protecting airport users. While not subject to the price cap, aircraft refuelling services at larger airports are likely to be subject to declaration under section 192 of the *Airports Act 1996* for purposes of Part IIIA of the TPA. Potentially this provides service users with a mechanism for addressing concerns about introduction of fuel throughput levies. Declaration provides for commercial negotiation of access terms and conditions between the parties in the first instance, supported by the option of arbitration of disputes by the Commission if the negotiations fail.

Some of the main factors relevant to arriving at this recommendation are as follows:

1 The existing price cap has proved effective to date. By contrast there are some potential limitations with the access arrangements. In particular:
- the Commission has not made a determination regarding whether refuelling services are an airport service for the purposes of section 192 of the Airports Act. It has not been requested to do so. This means that it is not certain at this stage that refuelling services are declared. However, the Commission's view in its draft guide to declaration of airport services is that refuelling services are likely to be subject to the access provisions in Part IIIA;
- it seems likely that only the oil companies can notify a dispute under Part IIIA. To date the oil companies have been reluctant to notify. Continued reluctance from the oil companies would prevent the framework from addressing concerns raised by the airlines; and
- the access process requires a party seeking access to first notify a dispute. The Commission can then arbitrate the dispute and the arbitration can be appealed to the Australian Competition Tribunal. This process raises issues of expense and timing for the parties involved.

2 The legislative base for a price cap, the *Prices Surveillance Act 1983*, was designed specifically to address issues of monopoly pricing. By contrast the access arrangement under Part IIIA of the *Trade Practices Act 1974* focus on promoting competition in markets upstream or downstream of the airport. As such the Commission considers that a price cap is better targeted to addressing the issue of airport operators taking advantage of the market power they may have in the provision of aircraft refuelling services.

3 Inclusion of aircraft refuelling services in a price cap is consistent with the existing regime and would not involve a new regulatory element. It could mean that the access arrangements and a price cap would operate concurrently in

relation to aircraft refuelling services. However, this is already the case for services currently covered by the existing price cap.

## 6.5 Implementation

The Commission's recommendation that the Treasurer declare aircraft refuelling services so that they can be covered by a price cap raises a number of issues in terms of the details of practical implementation. This section of the paper outlines some of the main implementation issues and some of the options available.

To include aircraft refuelling services in a price cap, it is necessary for the Treasurer to either amend the relevant declarations under the Prices Surveillance Act[19] to specifically include aircraft refuelling services or to issue an additional declaration.

Direction 13 sets out how the Commission is to administer the declarations covering aeronautical services at leased airports. It includes details on the price cap formula, starting point prices for the CPI-X price cap and the X values. Direction 15 sets out how the Commission is to administer prices surveillance at Sydney Airport. In incorporating aircraft refuelling services into the cap some changes to the directions may be required.

Coverage of refuelling charges through a price cap raises a number of implementation issues:

- whether to apply a separate cap to refuelling services or include them in the existing price cap;
- starting point prices for aircraft refuelling services;
- the X value to apply to aircraft refuelling services;
- the start and finish date for inclusion of aircraft refuelling services in a price cap; and
- which airports the changes should apply to.

A discussion of these issues follows. Resolution of these issues would require the views of affected parties to be taken into account. For this reason this report does not make recommendations in relation to implementation. Importantly, though, there do not appear to be significant issues, which would prevent effective implementation of the Commission's recommendation to include aircraft refuelling services in a price cap.

*A separate cap for aircraft refuelling services?*

Aircraft refuelling charges could be included in the existing price cap on aeronautical services. This would allow aircraft operators to rebalance charges between aircraft refuelling charges and other charges in the price cap. For example, it would allow airport operators to introduce or increase fuel throughput levies with compensating

[19] The relevant declarations are Declaration 83 [which covers Phase I airports], Declaration 84 [which covers Phase II airports] and Declaration 85 [which relates to Sydney Airport]).

reductions in charges for landing aircraft or other services already covered by the price cap.

An alternative option is to apply a separate cap to aircraft refuelling services. This could be achieved by introducing a new declaration relating only to aircraft refuelling services.

The approach of using a separate cap has the effect of quarantining aircraft refuelling charges from other charges in the cap. It allows airport operators to rebalance refuelling charges within the separate cap, for example, by introducing or increasing fuel throughput levies but with compensating reductions in existing aircraft refuelling lease or licence charges. But it does not allow rebalancing of charges with other services.

The advantage of using a separate price cap is that it allows the Treasurer to apply different X values to aircraft refuelling services from the X values that apply to other capped services and therefore allows for a separate assessment of the appropriate level of refuelling charges. This issue is covered in the discussion below about X values.

*Starting point prices for a price cap on refuelling services*

Starting point prices for the existing price cap are specified in Direction 13 as the Federal Airports Corporation prices introduced on 1 January 1997. This applies to both Phase I and Phase II airports.

One option for aircraft refuelling services is to use the same starting point prices as the services already declared (that is, prices in place at 1 January 1997). Another option is to specify starting point prices for aircraft refuelling services that were thought to be more appropriate. For example, starting point prices could be set at the prices in place at a more recent date.

One factor for consideration is that BAC has already introduced, and WAC has already proposed, a fuel throughput levy. As discussed in this report the Commission considers that there is a strong case that BAC and WAC have taken advantage of market power in introducing the levies. On this basis the starting point prices should not include existing or proposed refuelling levies introduced post privatisation except to the extent that they are cost justified.

A useful approach in assessing appropriate starting point prices may be to consider the leases in place at the time the airport leases were granted and relevant changes since then. Relevant issues could include:

- changes in the costs to airport operators associated with providing refuelling services; and
- additional costs imposed on airport operators since the sale process was completed.

In section 5.2 of this report the Commission noted that Governments have imposed additional costs on Phase I airport operators since the privatisation process was completed. Airport operators have a legitimate concern to recover these costs. The additional costs could be a consideration in setting the starting point prices to apply to price capped aircraft refuelling services.

The Commission does not recommend specific starting point prices for a price cap on aircraft refuelling services. This is an issue, which needs further consideration. However, as discussed in this report the Commission considers that there is a strong case that BAC and WAC have taken advantage of market power in introducing the levies. On this basis the starting point prices should not include existing or proposed refuelling levies introduced post privatisation except to the extent that they are cost justified.

*X values*

Direction 13 specifies the X values that apply at each of the airports. This raises the question of the X values to apply to aircraft refuelling services if declared for prices surveillance. In turn this question relates to whether aircraft refuelling services are separately capped.

One approach would be to use the same X values for refuelling services as applies to the other capped services at each of the airports. Indeed if aircraft refuelling services are included in the price cap in the same way as other services then the same X values would need to apply.

An argument against this approach is that aircraft refuelling charges are different from the charges that apply to other services in the cap in two ways. Firstly, the productivity gains and cost savings that can be expected of the airport operators in the provision of refuelling services is likely to differ from other price capped services.

Secondly, and related to this, the aircraft refuelling charges that currently apply are based on lease agreements and licences between the oil companies and the airport operator. With the exception of the fuel throughput levy component introduced by BAC and proposed by WAC, these arrangements are not volume based. By contrast the charges currently covered by the cap are volume based; in the case of landing charges, for example, tonnage is the relevant variable. Landing charges and other charges included in the cap allow airport operators to gain the revenue benefits of growth in traffic volume over time. Airport operators do not currently get this benefit from existing aircraft refuelling leases (except, and as mentioned above, in relation to any fuel throughput component of the lease).

As an alternative the Treasurer could apply a separate cap to refuelling services (as discussed above) and specify different X values for the aircraft refuelling services from the X value applying to other price capped services.

Having different X values from other price capped services allows the X value to be set on the basis of an assessment of relevant issues. Those issues include:

? Existing site lease arrangements. These leases typically include a CPI escalator. An assessment of X values to apply to refuelling services could take into account the escalators already built into the leases.

? The costs to the airport operator of providing refuelling services and likely changes in those costs over time.

In summary, there are two main options for setting X values for aircraft refuelling services. The first is to use the same X values that apply to other services in the price cap. The second is to apply a different X value than that applying to other capped services. The X value could then be set to allow for relevant factors such as the CPI escalators in existing lease arrangements. The Commission considers that there are no significant impediments to implementing either of these approaches. However, the Commission notes that the second option of specifying different X values from other capped services would require implementation of separate price caps on refuelling services.

*Starting and finishing dates*

Declarations 83, 84 and 85 specify a starting date of 1 July 1998. If the same starting date applied to aircraft refuelling services the declarations would in effect be retrospective. For this reason the Commission considers that it may be more appropriate for the declarations to specify a new starting date for aircraft refuelling services, for example, on or before 1 July 1999.

The declarations also include a finishing date. The declaration covering Phase I airports (Declaration 83) ceases on 1 July 2002. The declaration covering Phase II airports (Declaration 84) ceases on 1 July 2003. The different dates reflects the fact that Phase II airports were leased a year later. In Sydney Airport's case the declaration (Declaration 85) also ceases on 1 July 2003. It would seem appropriate that a declaration applying to aircraft refuelling services cease on the same date as other services at an airport.

The Commission considers that it would be appropriate for the declarations to specify a new, prospective, starting date for aircraft refuelling services included in the declarations. It also considers that the finish dates should be the same as for the other services included in the declarations to coincide with completion of the proposed five year review of the airport regulatory framework.

*At which airports should refuelling services be declared?*

The current declarations specify both which airport services are declared and which airports the declaration applies to.

Two possible approaches in considering the question of which airports aircraft refuelling services should be declared are as follows:

1. Declare aircraft refuelling services on an 'as needed' basis. This would involve declaring aircraft refuelling services only at those airports that have introduced or propose to introduce fuel throughput levies or significant increases in other aircraft refuelling charges.

2. Declare aircraft refuelling services at all of the airports covered by declarations 83, 84 and 85.

The fact that to date only BAC and WAC have announced the introduction of fuel throughput levies lends support to the first option. This approach would also be consistent with the Commission's approach to its review of prices oversight arrangements to be conducted in the fifth year of operation of the price cap. In conducting the review the Commission can make different recommendations for different airports – taking into account the different circumstances faced by each airport and the track records of the airport operators. In this way the track record of one operator need not affect other operators.

On the other hand the Commission has noted in this report that there is a strong case that other airports have market power in the provision of aircraft refuelling services. In addition introduction of fuel throughput levies at Brisbane and Perth airports could have a significant precedent effect at other airports. These factors lend support to option two.

The Commission has not made a recommendation on which airports aircraft refuelling services should be declared at. It notes, though, that a sound basis for this decision and other decisions in implementation of price cap arrangements for aircraft refuelling services is that any amended declaration should not penalise operators who don't seek to take advantage of market power that they may have in the provision of refuelling services.

## APPENDIX A: List of submissions

The Commission received 14 submissions from interested parties concerning the Commission's discussion paper "Fuel Throughput Levies", representing domestic and international airlines, airport operators, oil companies and industry representative groups. Submission were made by the following organisations:

- Ansett Australia
- Air BP
- Board of Airline Representatives of Australia Inc.
- British Airways
- Brisbane Airport Corporation
- Caltex Australia Petroleum Pty Ltd
- International Air Transport Association
- Kendell Airlines (Aust) Pty Ltd
- Melbourne Airport
- Mobil Oil Australia
- Northern Territory Airports Limited
- Qantas Airways Limited
- The Shell Company of Australia Limited
- Westralia Airports Corporation

Submissions have been retained on a public register. Unless a submission has been marked confidential it can be made available to any person or organisation on request. Parties seeking access to submissions should contact:

Mr. Douglas Shirrefs
Assistant Director, Aviation
Australian Competition and Consumer Commission
GPO Box 520 J
Melbourne, Victoria 3001
E-mail douglas.shirrefs@accc.gov.au

**APPENDIX B: Commonwealth of Australia, *Prices Surveillance Act 1983,* Direction NO 14**

# COMMONWEALTH OF AUSTRALIA

*Prices Surveillance Act 1983*

## DIRECTION NO 14

I, Peter Costello, Treasurer, pursuant to section 27A of the *Prices Surveillance Act 1983*, hereby direct:

(1) the Commission to undertake formal monitoring of aeronautical related services at the following airports:

- (a) Adelaide;
- (b) Alice Springs;
- (c) Brisbane;
- (d) Canberra;
- (e) Coolangatta;
- (f) Darwin;
- (g) Hobart;
- (h) Launceston;
- (i) Melbourne;
- (j) Perth; and
- (k) Townsville.

(2) In this direction, **'aeronautical related services'** means the provision, by an airport operator company, of any of the following:

- (a) aircraft refuelling;
- (b) aircraft maintenance sites and buildings;
- (c) freight equipment storage sites;
- (d) freight facility sites and buildings;
- (e) ground support equipment sites;
- (f) check-in counters and related facilities; or
- (g) car parks (including public and staff parking but not valet parking).

(3) The Commission is to report to me on its monitoring activities in paragraph (1) following the end of each financial year

PETER COSTELLO
22 May 1998

## APPENDIX C: The impact of fuel throughput levies at Brisbane and Perth airports

BAC and WAC provided the following information to the Commission in response to notices issued pursuant to section 32 of the PS Act. Both BAC and WAC have consented to the release of this information.

The fuel throughput levy at Brisbane airport is charged at the rate of 0.4 cents per litre. It will have the following estimated impacts:

(i) Estimated revenue accruing to BAC from the fuel throughput levy for the financial year 1998/99 is marginally less than $2 million.

(ii) Estimated revenue accruing to BAC in relation to aircraft refuelling at Brisbane Airport — not including the levy — for the financial year 1998/99 is more than $500 000. This is about $100 000 less than estimated revenue in relation to aircraft refuelling for 1997/98, which is more than $600 000.

(iii) BAC was unable, at the time of this notice, to make available estimates of costs in relation to the provision of aircraft refuelling for the financial years 1997/98 and 1998/99. BAC advised that an estimate of such costs might be available as part of the broader financial reporting requirements under Part 7 of the Airports Act and sections 21 and 27A of the PS Act. BAC also advised its expectation that there will be no material increase in costs between the two years.

The information provided by BAC in response to the notice from the Commission indicates that the introduction of the fuel throughput levy increases revenue from refuelling services at Brisbane Airport in the year 1998/99 by almost $2 million.

WAC supplied the following information regarding the financial impact of the fuel throughput levy.

WAC proposes to introduce a fuel throughput levy from June 1, 1999. The levy proposed by WAC will only apply to refuelling services at the international terminal. It is proposed that the fuel throughput levy at Perth Airport's international terminal be charged at the rate of 0.5 cents per litre.

(i) Estimated revenue accruing to WAC from its proposed fuel throughput levy for the financial year 1998/99 is about $60 000. This amount is due to the proposed levy operating for one month's trading in financial year 1998/99.

(ii) Estimated revenue accruing to WAC in relation to aircraft refuelling at Perth Airport international terminal — not including the levy — for the financial year 1998/99 is almost $142 000. This is about $2 000 more than estimated revenue accruing from the same services in 1997/98. Total revenue from refuelling services in 1997/98 was around $310,000.

(iii) WAC was unable, at the time of this notice, to make available estimates of costs in relation to the provision of aircraft refuelling for the financial years 1997/98 and 1998/99. WAC advised that an estimate of such costs might be available as part of the broader financial reporting requirements under Part 7 of the Airports Act and sections 21 and 27A of the PS Act.

The information provided by WAC in response to the notice from the Commission indicates that the introduction of the fuel throughput levy has the affect of increasing revenue from refuelling services at Perth Airport in the year 1998/99.

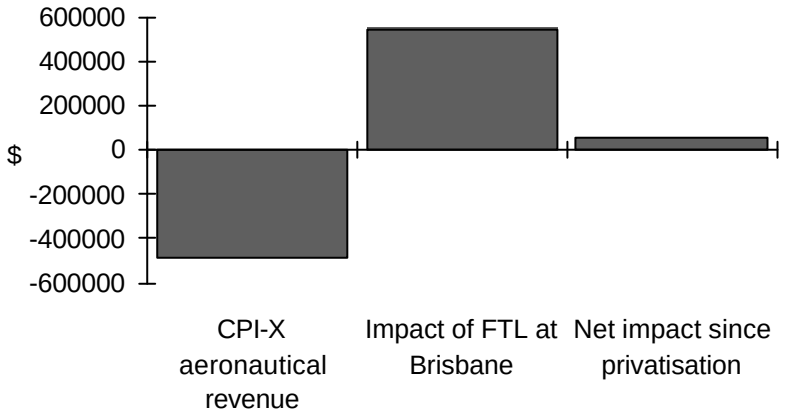
## APPENDIX D: Comparing the impact of a fuel throughput levy and the CPI-X price cap

Attachments A and B in the Commission discussion paper on fuel throughput levies provided numerical examples of the impact of a fuel throughput levy at Brisbane and Perth airports by comparison with the impact of the CPI-X price cap at those airports for a single year.

Submissions varied regarding the utility of that comparison. Ansett argued that it is appropriate to compare the total impact of changes in aeronautical and non-aeronautical charges at each airport. Ansett submitted:

> *Whilst application of CPI-X at major airports has resulted in reductions in aeronautical charges to airlines generally, as a major customer of both aeronautical and non-aeronautical services and facilities, to both Brisbane Airport Corporation and Westralia Airports Corporation, the privatisation of Brisbane Airport in particular, has resulted in significant increases to Ansett's total operating costs.*

Ansett also provided the following data. The data demonstrates that, had the fuel throughput levy at Brisbane airport been introduced from July 1 1997, it would have more than offset the reduction in aeronautical charges accruing to Ansett under the price cap in that period. As the figure below indicates, the overall increase in cost for Ansett would have been about $50 000 for that period at Brisbane Airport.




*Source*: Data supplied by Ansett Australia.

A number of other submissions argued that such a comparison was not useful. Melbourne Airport submitted that such a comparison was irrelevant and misleading. It argued:

> *The analysis is a direct comparison of the revenue raising capacity of a fuel throughput levy and a calculation of the real savings in "aeronautical charges" that flow to airlines. Melbourne Airport's position is that "aeronautical charges"*

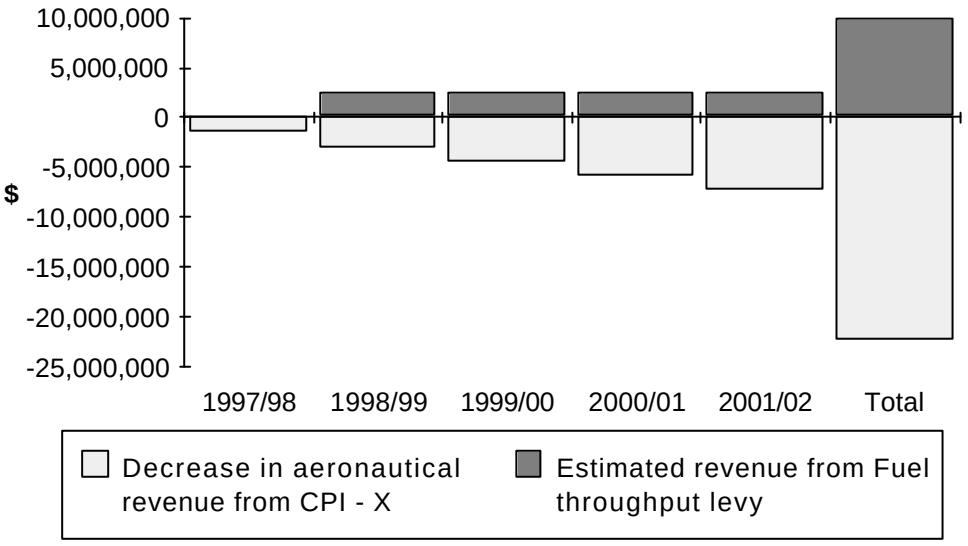
*and fuel throughput charges are complete separate issues in terms of regulatory regimes, and that the analysis presented is [was] misleading and not directly relevant to the discussion.*

BAC also argued that such a comparison was incorrect and irrelevant. But BAC made a different point than Melbourne Airport, stating that the appropriate comparison was over the full term of the price cap:

*... BACL submits that the price cap is designed to bring about a 4.5% cumulative annual real reduction in respect of aeronautical services provided at airports. ... Five year estimates and not just one year's figures should be used. The information is not relevant and the result is anyway not unintended under current policy.*

Using data provided by BAC and WAC the following comparisons of the impact of the price cap and the proposed fuel throughput levies over the five years of the price cap regime can be calculated.

**Figure 1 Brisbane Airport: The revenue impacts of the price cap and the fuel throughput levy.**



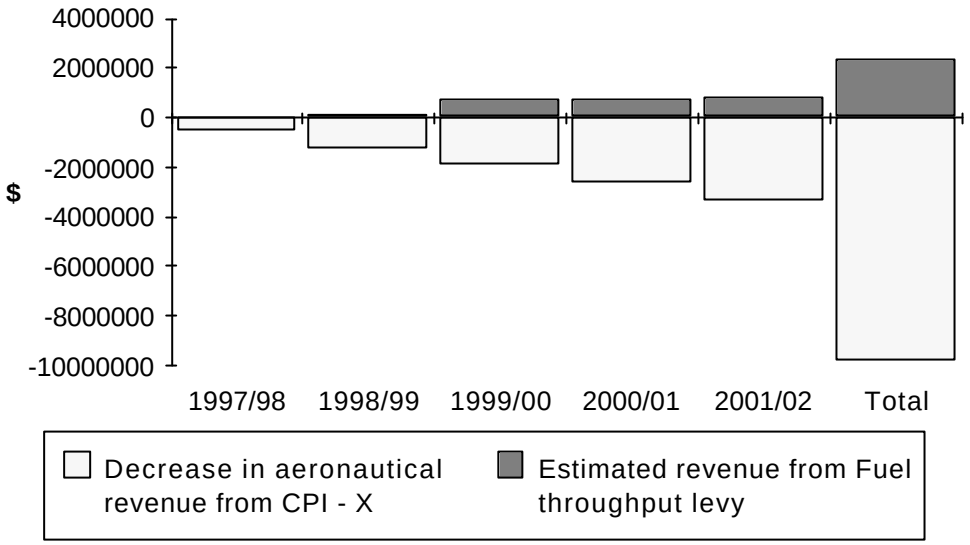

*Source*: Data supplied by BAC.

The chart in Figure 1 shows that the imposition of the fuel throughput levy at Brisbane Airport generates total revenue over the first five years of privatisation of marginally less than $10 million in four almost constant annual flows. Over the same period, the impact of the price cap reduces aeronautical revenue by more than $22 million.

The chart in Figure 2 below, shows that a fuel throughput levy at Perth Airport International Terminal does not have the same impact on revenue for WAC as the levy proposed at Brisbane. Over the course of the first five years of the regulatory regime, the proposed fuel throughput levy at Perth Airport will generate revenue of about $2.3

million. Over the same time, the price cap on aeronautical revenue will bring about a real decrease in revenue to WAC of marginally less than $10 million.

**Figure 2 Perth Airport: The revenue impacts of the price cap and the fuel throughput levy at the international terminal.**




*Source*: Data supplied by WAC.

It should be noted that the above figures are based on data supplied by the airport operators. Submissions from the managers of the Brisbane and Perth International JUHIs suggested that the data supplied by the airport operators was conservative in as much as it did not take into account an appropriate amount of growth in fuel volumes and increases in levies in line with the CPI.

The CPI increases are not a significant issue as the only impact they have on the levy is to maintain its real value per litre. A comparison of real increases in revenue from fuel throughput levies and nominal increases in total revenue would be misleading.

To the extent, that airport operators have been conservative in estimates of fuel volume growth, it is likely that the figures above understate the impact of the fuel throughput levies. That notwithstanding, any conservatism in regard to volume growth is also likely to be reflected in total airport revenue over the period of the cap as much of aeronautical revenue is volume based.