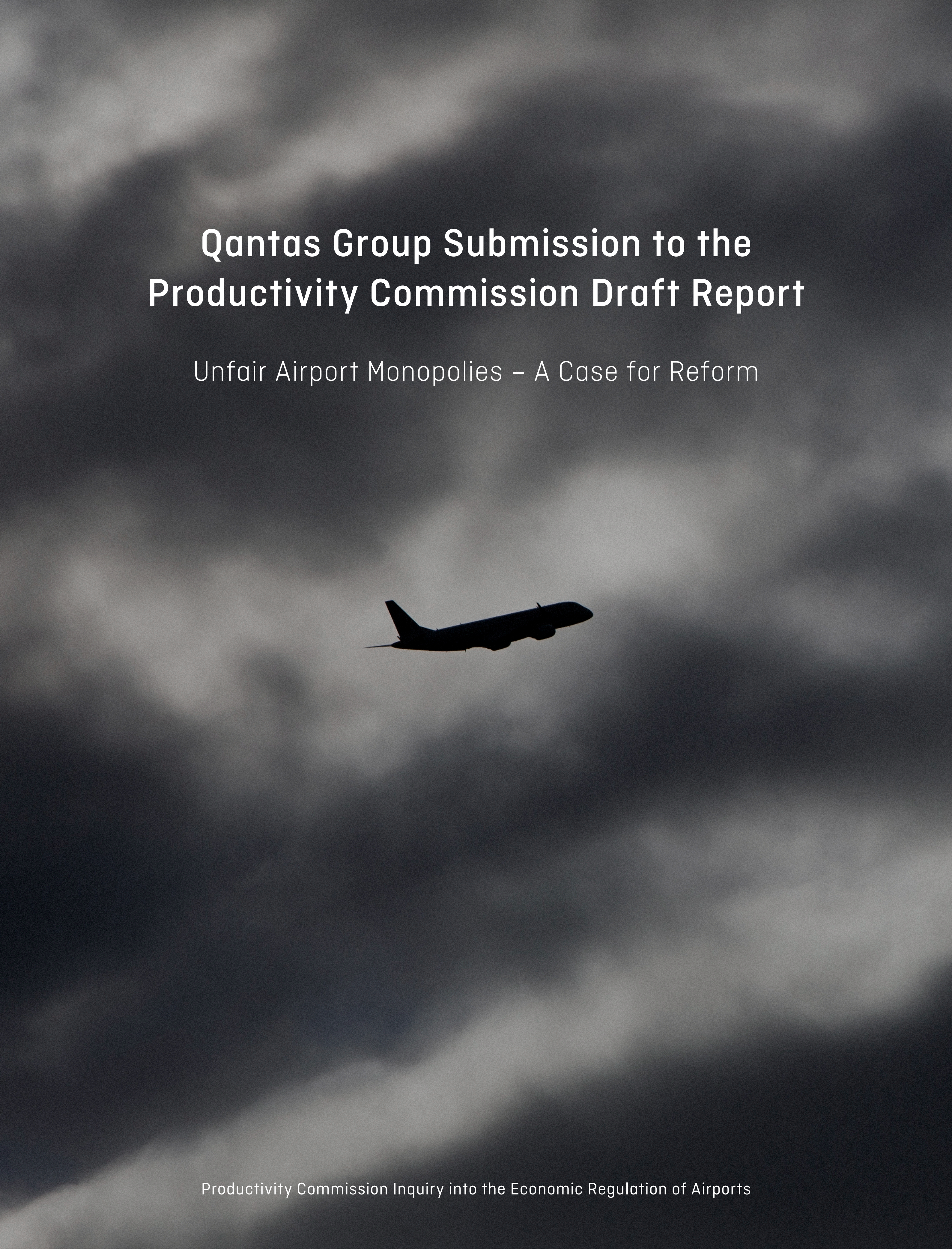
Qantas Group Submission to the Productivity Commission Draft Report

Unfair Airport Monopolies – A Case for Reform



Productivity Commission Inquiry into the Economic Regulation of Airports

QANTAS QANTASLINK QANTASFREIGHT Jetstar

This is a public, evidence-based submission to the Draft Report of the Productivity Commission Inquiry into Economic Regulation of Airports. It focuses on the Productivity Commission's draft findings and draft recommendations. It provides further information as requested by the Productivity Commission regarding airport reform directions, commercial negotiations, landside access, access arrangements at Sydney Airport and competition in markets for jet fuel.

Elements of this submission focus on the detrimental impact of market power of Australia's monopoly airports on air travellers, airport users and the community at large. Airport reform has never been more pressing.

This submission supports the investigations, findings and recommendations by Airlines for Australia and New Zealand (A4ANZ) and aligns with the submissions made by International Air Transport Association (IATA) and Board of Airline Representatives of Australia (BARA).

Contents

Executive Summary

THE PROBLEM

The Commission is wrong to permit the systematic abuse of market power by Australian monopoly airports to the detriment of the community. The Draft Report is flawed, contradictory and ignores critical evidence.

It is out of touch with day-to-day reality for travellers and airport users. And it is deeply unfair.

Australians are already paying too high a price for the Commission's inaction.

Entrenched bullying behaviour by monopoly airports	Canberra Airport held up a Qantas Boeing B737 plane until their demand for $18,000 was paid by the pilot.
Sky-high charges rising fast and holding back affordable travel	Airport charges are going up while airfares have declined 40% since 2003. Sydney Airport charges $34,345 in arriving and departing charges for just one Airbus A380-800 aircraft of passengers.
Super-normal profits by monopoly airports costing jobs and growth	Airports make 'super-normal' profits even higher than the banks, according to the independent Grattan Institute.[1]
Super-normal profits from monopoly airport car parking	Frontier Economics found that if Qantas were to withdraw a single, daily return flight between Melbourne and Perth, it would lose up to 10 times more than Perth Airport. Qantas would lose up to 8 times more than Newcastle Airport for withdrawing a single, daily return flight to Brisbane.
Countervailing market power is a myth	Frontier Economics found that if Qantas were to withdraw a single, daily return flight between Melbourne and Perth, it would lose up to 10 times more than Perth Airport.
Private airport monopolies are effectively unregulated	Even investors say, "*Sydney Airport has an unregulated revenue stream in a monopoly environment.*"[2]
Expert evidence on monopoly airports ignored	Critical evidence provided by National Competition Council, the ACCC, Frontier Economics, Michael O'Bryan QC, Margaret Arblaster, Council of Australian Governments and Professor Peter Forsyth.
Little transparency, accountability or consultation by monopoly airports	Seven Australian airports charge fuel throughput levies without any extra service - delivers a windfall gain of over $20 million a year.
Hidden profits and costs in aviation security by monopoly airports	Some airports assert their right to extract a return on security assets and charge administration and other fees in their Conditions of Use.

THE SOLUTION

Deliver fair and transparent airport charges to benefit the community.

Qantas Group supports an effective light-handed regulatory framework to incentivise commercial discipline and improve community welfare. The framework should:

- Preserve and accelerate commercial negotiation processes
- Give access to arbitration for either party as last resort via ACCC or independent expert
- Establish a regulatory benchmark on the cost of capital incurred by airports
- Legislate aeronautical pricing principles and airport leasing principles to apply during negotiations and under contracts
- Review dual till approach
- Transfer responsibility of any future reviews of airport market power from the Commission to ACCC
- Retain security charging in line with Australian Government policy
- Encourage genuine collaboration on master plans
- Streamline airport design and improve customer experiences
- Ban Fuel Throughput Levies at all airports
- Deliver best practice conduct of negotiations

A modest change to existing legislation will encourage competitive behaviour and better service for the 160 million air travellers that travel through Australian airports every year.

THE BENEFITS

Even applying extremely conservative assumptions, there are significant benefits associated with implementing the necessary and minimal reform:

- At least $445 million in net savings and efficiency benefits, with a benefit to cost ratio of 14:1[3]
- Increased opportunities to travel because of higher frequencies or new routes implemented by airlines, such as Perth-London in response to more competitive airport charges
- Increased competition between airlines as more competitive charges allow competing airlines to expand their offer (or enter new markets)

Additional investment by airlines in:

- improving the consumer experience, including building fleet capacity
- preserving essential regional air services
- collaborating with airports to progress innovations in customer experiences
- quality of service offered to passengers

Australians deserve fair and effective, light-handed regulation that ends the systematic abuse of market power by monopoly airports and makes travel more affordable for everyone.

Overview

> "Imagine owning a shopping centre that your customers are forced to stay in for several hours. Better yet, everyone who visits is relatively rich, and many are in a giddy holiday mood. Now imagine that the number of these special shopping centres is strictly regulated, giving you a monopoly. On top of this you get paid a fee per visitor. No wonder buying airports has become something of an investment fad."[4]
>
> **The Economist, 2015**

The Productivity Commission's Draft Report is a significant regressive step for the productivity of the Australian economy and the broader community. Unless the Final Report changes course, these findings will stifle productivity, jobs, economic growth and affordable travel.

On behalf of our 55 million passengers, Qantas, Jetstar and QantasLink airlines are disappointed that the Commission's findings are out of touch with their everyday reality of overpriced airport services.

The Draft Report's key conclusion that there is nothing wrong with the super-normal profits, excessive charges and bullying behaviour of major Australian airports disregards independent evidence from multiple economic and competition experts.

Similar critiques of the Draft Report have been made by the Australian Competition and Consumer Commission (ACCC), industry bodies including Airlines for Australia & New Zealand (A4ANZ) and Board of Airline Representatives of Australia (BARA), independent experts and even politicians.[5]

DUE PROCESS ABSENT

The Commission has discounted important, independent evidence by the National Competition Council (NCC), the ACCC, Frontier Economics, Cambridge Economic Policy Associates (CEPA), Norton White, Michael O'Bryan QC, Margaret Arblaster, Professor Peter Forsyth, the Council of Australian Governments (COAG) and even the European Commission.

By not including and ignoring the multitude of independent, non-partisan expert evidence put to it, the Commission has produced unbalanced findings and recommendations detrimental to the community.

By disregarding the voices of everyday airport users and experts, the Commission appears as a cheerleader for monopoly airports.

Recent, enthusiastic congratulations to the Commission by the Australian Airports Association (AAA) should be cause for reflection:

> … the AAA welcomes the Commission's sixth rejection of calls for an industry specific arbitration for access to airports."[6]
>
> (Emphasis added)

The Draft Report reduces air travellers to simple economic units rather than understanding their experience and contribution to the broader Australian community through tourism and travel.

Every excess dollar a traveller is forced to spend in an airport car park, on an airport trolley, an airport coffee and through airport landing charges for airlines – i.e. higher airport rents – is a dollar not spent on supporting jobs in tourism and trade.

SYSTEMATIC AND INCREASING USE OF MARKET POWER

The Draft Report fails to recognise the systematic abuse of market power by Australia's monopoly airports despite the abundance of compelling evidence by the Australian competition regulator, airport users and credible experts.

This abuse of market power puts at risk the future economic viability of airlines, aviation and air travel – and in particular, the rise of affordable travel driven by low cost carriers.

It places undue cost on the entire Australian economy and ultimately means fewer Australians will be able to afford to fly.

The Draft Report's key conclusions regarding market power are incorrect, and Qantas Group urges the Commission to more seriously consider the evidence already before it as well as any new evidence ahead of the Final Report.

AIRLINE COUNTERVAILING POWER IS A MYTH

Qantas Group asked Frontier Economics to assess the likelihood of Qantas being able to wield countervailing market power in negotiations with airports. It found that countervailing power in Australia is a "*largely irrelevant and immaterial consideration in airport charge setting.*"

The Commission's opinion is predicated on the serious misconception that an airline can credibly threaten to bypass an airport. This is simply not true.

At face value, the Commission's suggestion that "*Airlines can refuse to pay charges at the level determined by an airport when an agreement expires*"[7] is extraordinary, as is the implication that payment delaying tactics to restrain charges are a normal and adequate bargaining tool.

These extreme measures are indicative of a broken system that offers airlines few options to moderate airport charges to reasonable levels.

Frontier Economics considered the relative costs faced by Qantas Group and Perth Airport from the threat of withdrawal of a single, daily return flight between Melbourne and Perth and found that Qantas Group would have more to lose – up to 10 times more – than Perth Airport because of the critical importance of Perth to Qantas customers, broader network and operations.

Even at a smaller non-monitored airport, such as Newcastle Airport, where Qantas Group was forced to withdraw services due to pilot shortages, Frontier Economics found that due to customer demand, Virgin Airlines was able to respond almost immediately to backfill the lost capacity.

Even if it were credible that Qantas Group could withdraw services due to the threat of higher airport charges and they were replaced at the airport by another airline, the new airline would face the same exorbitant airport charges as the Qantas Group, leaving travellers worse-off in either case.

Long, protracted payment disputes leading to court action are evidence that the system is broken and reform is urgently needed.

Qantas Group caution the Commission against relying on shallow anecdotes and conjectures to determine whether airlines have countervailing power, such as unsubstantiated stories that airlines down-gauge aircraft as punitive measures against airports. This would show, as the Hon Anthony Albanese MP stated, a lack of aviation experience.

Airlines do not down-gauge or cancel services over commercial disputes, as we demonstrate in this submission.

With little power to do otherwise, Qantas Group simply respond to market forces, traveller demand and our competitors' behaviour.

SOARING CAR PARKING AND AIRPORT CHARGES

As privately-owned monopolies with significant economies of scale, Australian airports have the economic advantage of falling costs per passenger as output increases.

Despite significant and continual increases in passengers and freight from airlines, monopoly airport charges continue to rise well ahead of inflation. Excluding airport charges and fuel, Qantas Group costs have fallen by 4% in real terms since FY15. At the same time charges paid to airports have grown 6.5% above inflation.

While Australian monopoly airport revenue has soared 25% over the past decade, airfares continue to be lower as a result of airlines focusing on reducing all aspects of its cost base and continuously striving to develop ways to operate more efficiently for its customers.

False claims by the AAA of a steady increase in 'real domestic airfares' over the last seven years have skewed the Commission's analysis and findings. In truth, the 'Real Restricted Economy' airfares the AAA uses to base its entire argument make up less than 2% of airfare inventory sold. This is extraordinarily misleading and irresponsible behaviour by the AAA.

Airlines negotiate successfully with other more competitive suppliers to reduce costs and ultimately deliver better airfares and travel experiences. But charges by Australian monopoly airports have remained largely non-negotiable.

AIRPORTS' SUPER-NORMAL PROFITS ARE A DISTURBING TREND

Sydney Airport is the most profitable airport in the world for its size. Melbourne, Brisbane, Perth and other Australian monopoly airports are not far behind.

The Grattan Institute found the four largest monopoly airports are more profitable than the 'big four' banks.[8]

Sydney Airport's car parking was the most profitable for the fifth year in a row, earning more than 70¢ in every dollar of revenue.[9]

It costs $34,345 in arriving and departing charges at Sydney Airport for just one Airbus A380-800 aircraft at full capacity.[10]

Whether it is parking planes or parking cars, Australian monopoly airports are gouging airport users and air travellers.

Excessive super-normal profits are costing the economy, community and airport users billions of dollars in lost productivity while lining the pockets of a few of Australia's private investors.

AIRPORT INVESTMENT NOT AT RISK WITH REFORM

Neither the Commission nor the airports have provided any evidence whatsoever for their claim that airport infrastructure investment may be at risk if the regulatory framework is amended to improve commercial negotiations.

This spurious argument focuses on the aeronautical investments made by the monitored airports over the past 10 years, ignoring the detrimental impact that unfair airport pricing has on investment for downstream providers like Qantas Group.

Over the same decade, Qantas Group alone has invested over $11 billion in new aircraft, significantly more than the four monitored airports combined. This does not include any investments made by Qantas Group on crew and maintenance bases, passenger lounges, ground service infrastructure or aircraft seating and configuration overhauls.

Another flaw in the Commission's analysis is that it fails to acknowledge that like airports, airlines must also make significant investments and cover large sunk costs.

For example, Qantas Group aircraft orders are placed over 3-5 years in advance and lease agreements 6-12 years in advance, depending on the aircraft type.

Aircraft purchase agreements are up to 10 years in advance. Qantas Group is a long-term asset holder of aircraft with an operating life typically lasting 18-24 years.

Arguments put forward by the airports that changes to airport regulation will threaten the development of key airport infrastructure are a smokescreen and should be treated as such.[11]

Qantas Group provides evidence further below on the negligible differences in investment levels at single and dual-till airports.

CURRENT 'LIGHT-HANDED REGULATION' IS NO REGULATION

The current regulatory oversight of Australian monopoly airports is ineffective because it is simply not regulation. To call it 'light-handed regulation' is a misnomer. A more accurate term would be 'non regulation.'

Australian airports face no competition and no credible threat of regulatory intervention.

Price monitoring is not regulation, as the ACCC has consistently argued.[12] Monitoring alone is not enough to constrain the behaviour of airports with significant market power.[13]

The ACCC and the Commission both note the difficulty in assessing whether the airports returns are excessive, which begs the question: how can the regime be considered effective?

Declaring an airport under the National Access Regime (Part IIIA of the *Consumer and Competition Act 2010*) is too uncertain, expensive and time consuming to provide any protection, as Virgin Blue discovered when its battle to declare Sydney Airport for 5 years lasted 3 years at a cost of millions of dollars.

Recent changes to the regime further inhibit access to the dispute resolution process. Expert legal opinion provided to the Commission by Michael O'Bryan QC made it clear that even airports exercising market power and charging monopoly prices will not necessarily meet the threshold for declaration.[14]

Indeed, the Commission itself admitted in the Draft Report that the amendment of the National Access Regime has not yet been tested in court so any successful applications may result in further litigation.

The Draft Report noted that the NCC was considering whether declaration of services at the Port of Newcastle should be revoked. In fact, the NCC has recommended that the declaration of the Port of Newcastle be revoked.

The Commission's infrequent reviews are also not regulation. They lack any regulatory oversight and the Commission lacks any enforcement powers.

The predictability with which the Commission continues to dismiss airport users' concerns will ensure airports never again take an inquiry by the Commission seriously.

The current regime gives Australia's privately-owned monopoly airports *carte blanche* to increase airport charges and sting air travellers as much and as often as they want.

It makes a mockery of government policy. This is a gross inequity and brings great harm to the community.

PERTH AIRPORT IS PROOF THAT AIRPORTS WILL NEVER AGREE TO FAIR AND INDEPENDENT ARBITRATION

Qantas Group believes fair and independent arbitration should be open to all parties to quickly and efficiently resolve commercial disputes.

Qantas Group engaged in good faith with Perth Airport for over 18 months to renegotiate the agreements governing use of Terminals 1 and 3 and the airfield. During that time, Qantas Group continued to pay a fair and reasonable price.

Qantas Group sought a circuit breaker and proposed the matter be referred to independent, binding, expert determination on mutually agreed terms – Perth Airport rejected this offer and went straight to court.

Airlines and airport users cannot compel arbitration to effectively and efficiently resolve disputes, despite such mechanisms being in the Conditions of Use Perth Airport publishes on its website.

Legal proceedings will only apply retrospectively at the public expense and tie up judicial resources in matters which could be resolved more quickly and cost effectively using commercial arbitration.

Qantas Group stands ready to pay a fair and reasonable charge for the use of Perth Airport, which includes Perth Airport receiving a fair return on their investment.

But its current fees proposal will increase the cost to air travellers by 38% over the next seven years. Such an increase in airport charges are unfair and unreasonable.

Expert determination is a cost effective means of dispute resolution, however in Qantas Group's experience, airports neither offer nor agree to pursue independent arbitration.

REAL REFORM IS NEEDED

Reform is needed to deliver effective, light-handed regulation. Reform must encourage Australian monopoly airports to deliver competitive prices, greater efficiencies and leading innovations for air travellers and airport users.

Qantas Group strongly believes that access to transparent and independent arbitration as a last resort is needed to incentivise good performance and deter Australian monopoly airports from abusing their market power.

Australians should not have to pay for the super profits of a handful of unregulated private entities. The community deserves better.

Australians cannot wait until 2024 for another review that is likely to reiterate previous views.

Importantly, Qantas Group does not support further inquiry referrals by the Australian Government to the Commission. It is likely to be a waste of time and resources by all parties involved.

Qantas Group believes it is far more effective to transfer scrutiny of airport economics to the only body with a track record of protecting consumer interests and promoting competition – the ACCC.

Fair and reasonable pricing, coupled with transparency and a credible threat of intervention will make airports more efficient and more productive.

And more rewarding for all Australians.

> *'...there is no doubt that we can always do better in our inquiries.'*
>
> *Paul Lindwall, 2019*[15]

1. Airports' Market Power

This chapter considers the draft findings, recommendations and information requests contained in Chapters 4, 5 and 10.

Qantas Group strongly disagrees with Draft Finding 5.1. This finding is at odds with independent expert evidence, Qantas Group airlines' experiences of airport negotiating practices and pricing tactics, and the everyday reality of air travellers.

COMMISSION HAS IGNORED A RANGE OF EXPERT EVIDENCE

Several leading and independent economists, and experts in competition law and aviation regulation have found that major Australian airports have systematically and increasingly exercised their market power to the detriment of airport users and the community. Change to the current form of regulation and oversight of aeronautical services at these airports is both justified and urgently required.

Qantas Group draws the Commission's attention to A4ANZ's submission[16] which outlines the range of eminent and independent Australian experts that the Commission appears to have ignored in its Draft Report, including:

1. NCC, in its recent (Dec 2018) draft recommendation on the Port of Newcastle declaration under the revised Part IIIA of the CCA;
2. ACCC, in its submission to the Commission's Inquiry, supported by nearly two decades of airport monitoring reports, highlighting the ineffectiveness of the current regime;
3. Australian Competition Tribunal, in its statement of judgement on the Virgin Blue application for the Sydney Airport declaration in 2005;
4. Frontier Economics, in its submissions on market power and cost-benefit analyses, supported by global insights and decades of experience in regulatory economics;
5. Grattan Institute, in its 2017 publication Competition in Australia – Too little of a good thing?, which highlighted the "super profits" of the 4 major airports;
6. Professor Peter Forsyth, an expert in transport economics, in his submission to the Commission's Inquiry showing that total factor productivity at the four major airports has in fact decreased year on year;
7. Professor Stephen Littlechild, economist and regulatory expert, in his comments on the previous (2011) Commission Draft Report;
8. Michael O'Bryan QC, a member of the panel which oversaw the Harper Review of the CCA, in his memorandum explaining the impact of the changes to Part IIIA of the CCA;
9. Dr Michael Vertigan, economist, in his review of the Australian gas market, which outlined the benefits of a negotiate-arbitrate regime as protection against monopoly suppliers;
10. Professor Frederick Hilmer, in the National Competition Policy Review of 1993, which raised concerns about monopoly infrastructure, and the likelihood of these firms being able to charge prices above the efficient level;
11. Professor Ian Harper, in the National Competition Policy Review of 2014, which reiterated the importance of consumer and community protection against monopolies;
12. COAG Energy Council, in its gas market reform package of 2017, which adopted the negotiate-arbitrate framework to protect against monopoly pricing;
13. Australian Energy Market Commission, in its review of the economic regulation of gas pipelines in 2018, which found that the negotiate-arbitrate regime was necessary for an appropriate constraint on market power;
14. Margaret Arblaster, economist and widely-published airport regulatory expert, in her assessment of the current regulatory model and best practice approach; and
15. The European Commission, with its methodological approach to reviewing EU airport charges, as well as its preliminary findings.

In Europe, where market power is arguably more challenging to demonstrate, economic experts also stress the importance of *ex ante* regulation. CEG, in its 2018 advice to IATA and Airlines for Europe on effective regulation of airports with market power, states that where an airport has significant market power, *ex ante* regulation of that airport's charges is needed to prevent market power being exploited.[17]

Ex ante regulation enables a regulator to determine or issue guidance on the level of charges for the forthcoming period that are sufficient for an airport to recover its overall prudent and efficient costs, including its cost of capital and taking into account the profit contribution from non-aeronautical services (single till).

Ex post competition law such as the Australian National Access Regime instead creates uncertainty for airport owners and users as to what charge levels are reasonable and potentially require courts to make difficult judgments in relation to factors such as allowable costs, the depreciation approach and the cost of capital. The onus is also on airlines and airport users, many of which are small businesses, to bring these lengthy and costly cases.[18]

The Civil Aviation Authority (CAA) in the UK also rejected that competition law alone can effectively remedy airport Significant Market Power (SMP):

> "Ex post competition law, whether under the Competition Act 1998 or the Enterprise Act 2002, is not well adapted to pre-empting conduct which amounts to abuse of SMP in the form of excessive pricing or reduced service. There are also considerable challenges for the users of air transport services, particularly passengers, who are affected by this kind of abuse in bringing challenges or seeking damages based on competition law. This limits the likely deterrent effect of competition law… When the market is impaired by the existence of SMP which brings with it the risk of abuse by the holder of that SMP, there is a need to open markets and construct remedies that are detailed, timely and able to be flexed over time. The CAA has concluded that in relation to HAL [Heathrow Airport Holdings Limited], competition law will not readily present such incentives or offer effective and/or timely remedies. In such circumstances, it is appropriate and proportionate to look at regulatory controls."[19]
>
> (Emphasis added)

As noted by the CAA, in an efficient and competitive economy the role of smart regulation is to discourage poor behaviour and promote competition and economic discipline, not merely penalise abuse after the fact.

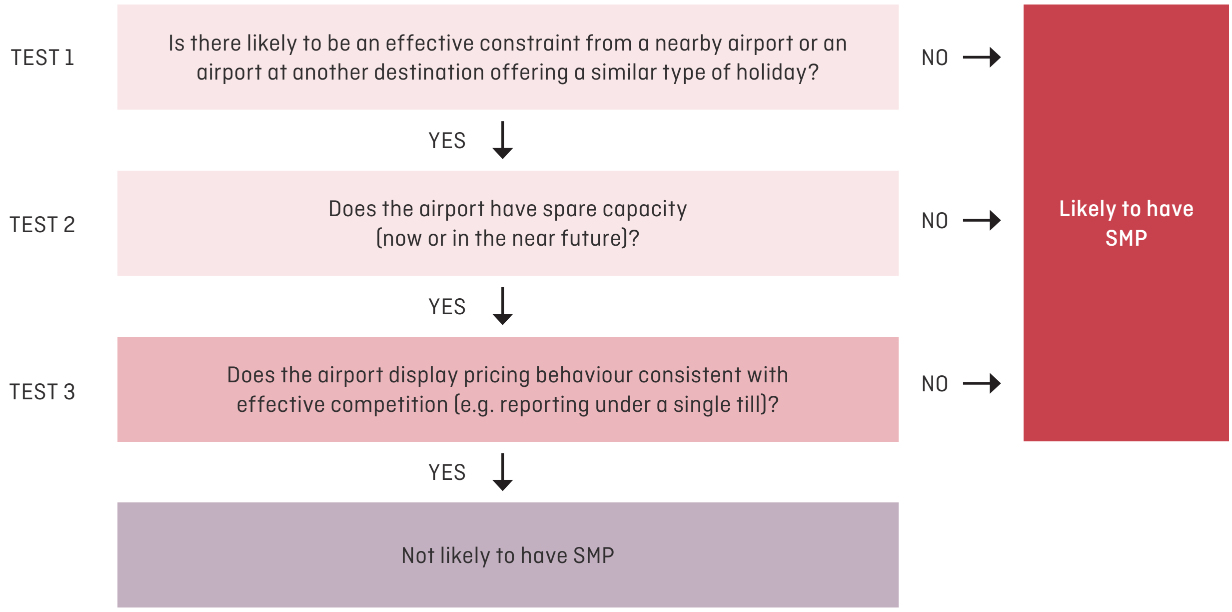
THERE ARE BETTER FRAMEWORKS FOR ASSESSING AIRPORT MARKET POWER

A4ANZ's submissions to the Commission provide a more rigorous assessment of existing models for assessing airports market power and their relative merits.[20]

Qantas Group include another for the Commission's consideration. Respected economists, CEG have developed a simplified framework for regulators assessing whether European airports have SMP which has relevance to Australia (Box 1).[21] The impetus for CEG's analysis was the European Commission's Ex Post Evaluation report which identified not all national regulators are appropriately resourced and incentivised to regulate their local airports.[22] CEG has recommended that airports with SMP should be subject to ex ante price caps determined on a single till basis and by reference to estimated efficient costs.

BOX 1: CEG'S RECOMMENDED GENERAL FRAMEWORK FOR AIRPORT MARKET POWER

- National regulators would be required to apply three Significant Market Power (SMP) screening tests to all airports with over 5 million passengers per annum;
- The three screening tests are:



- Regulators would retain the option to conduct full market power assessments if there are unusual circumstances warranting more in-depth investigation;
- Where an airport is found likely to have SMP then the airport would need to be regulated within a specified time period (e.g. 12 months) unless a full market power assessment was conducted within that period showing that the airport does not have SMP;
- European Commission should have a role to review draft full market power assessments by national regulators to ensure that the analysis is reasonable and based on sound evidence (the Commission performs a similar role under the telecommunications framework); and
- Airports with SMP should be subject to ex ante price caps determined on a single till basis and by reference to estimated efficient costs.

Source: CEG, *Effective regulation of airport market power*, 2018

DECLINING ROAAs ARE STILL WELL ABOVE REGULATORY EXPECTATIONS

The Commission assumes that a fall in the four monitored airport's return on aeronautical assets (ROAA) is evidence that they have not been exercising their market power, with Sydney Airport's increasing returns explained as due to scarcity rents.[23]

Qantas Group submits that the current level of returns are still well above what an Australian regulator might set or recommend.[24] The Commission does not appear to recognise that even a few basis points above a 'regulated' weighted average cost of capital (WACC) can lead to significant excessive profits for the airports.

CEPA were asked by Qantas Group to estimate the degree of over-charging by the four monitored airports. CEPA estimates that for every 1% that the four monitored airports' rates of return are above their actual cost of capital equates to $80 million per annum in additional charges.[25]

In the case of Perth Airport, it is important to note that despite Perth Airport's passenger volumes being significantly lower than forecast, its returns have still been well above its cost of capital. This does not support the Commission's argument that the airports have not been exercising market power.

Perth Airport contractually set the majority of its pricing with airlines in 2011 with pricing locked in for seven years. Therefore, Perth Airport did not have the ability to adjust its prices when actual volumes were materially below its forecasts. If passenger volumes had not fallen at Perth Airport, then its ROAA would almost certainly have remained high ('super-normal') or continued the upward trend observed from 2012 to 2014. Perth Airport has now reset its prices such that it can earn super-normal profits over the next pricing period.

The impact of investment on the ROAA could also be considered more thoroughly by the Commission. The Commission notes that the lumpiness of airport investments means that returns in a single year may be affected by the airports' capital expenditure, observing that investment has been a key reason for declining ROAAs at Perth and Melbourne airports. The historical high ROAAs achieved by these airports, however, indicates that as the current phase of investment ends, returns may be expected to increase again.

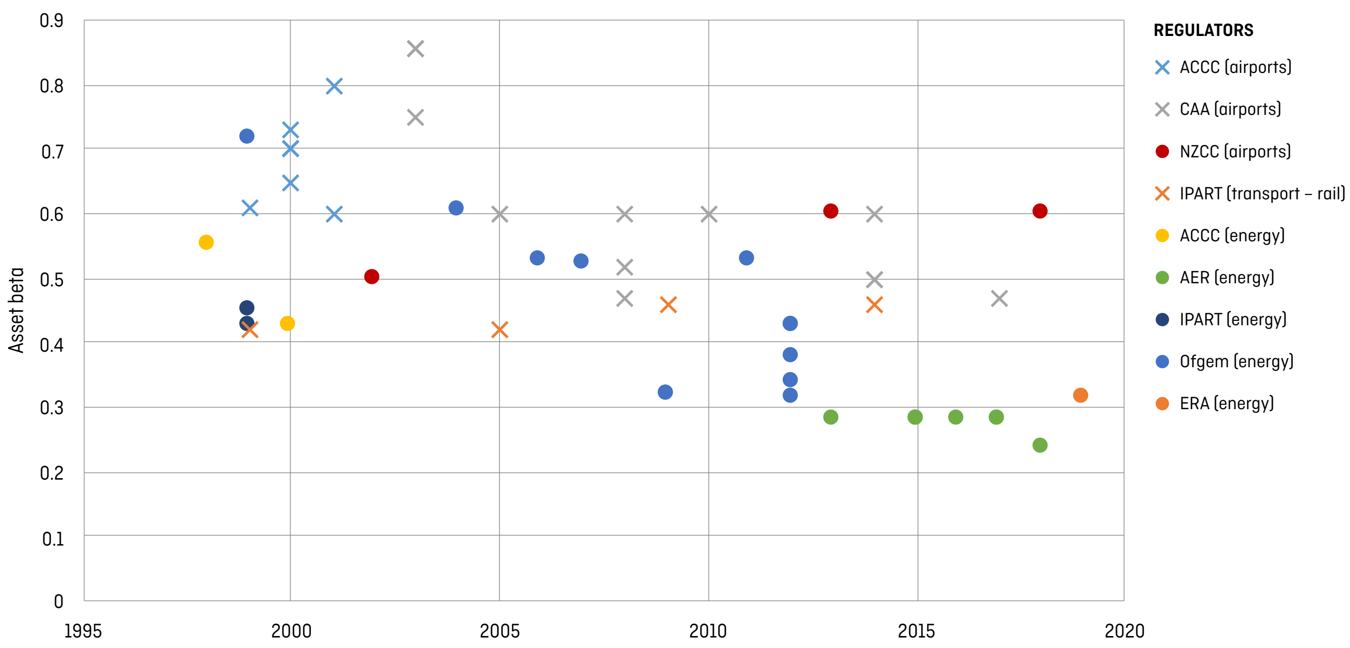
Indeed, the airports are pricing based on immediately earning a return on the full value of the new assets before they are fully utilised. This suggests that a reduction in ROAA due to investment does not provide strong evidence that the airports have not exercised market power.

COMPARISON OF CHANGES IN ROAA TO CHANGES IN THE RISK-FREE RATE ARE NOT APPROPRIATE

While the Commission cites regulatory decisions in other sectors and compares this to changes in the risk-free rate over time, Qantas Group is concerned that the Commission has not considered how and at what level a regulator might set the WACC for an airport today.

The Commission assumes that regulated WACCs in Australia have fallen in line with the risk free rate. However, this ignores evidence that WACCs have also been falling due to regulators taking a progressively stronger view that regulated companies' risks are towards the bottom end of the empirical evidence. This is shown in Figure 1 below:

Figure 1: Regulatory precedent – airport and energy sector asset beta determinations over time[26]



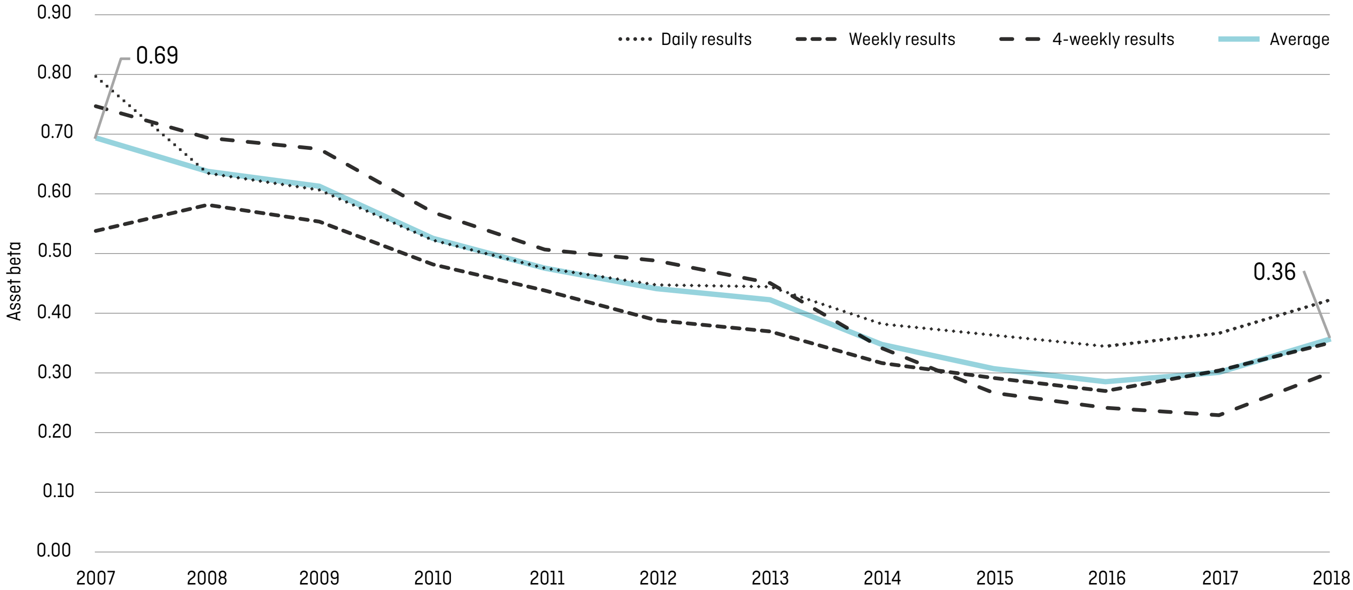
Source: ACCC, Civil Aviation Authority of the UK (CAA), New Zealand Commerce Commission (NZCC), Independent Pricing and Regulatory Tribunal of New South Wales (IPART), Australian Energy Regulator (AER), UK energy regulatory (Ofgem), Economic Regulatory Authority Western Australia (ERA). Prepared by CEPA.

As part of the privatisation process, in 1999 to 2001, the ACCC estimated asset betas for the major airports, using a small set of international comparisons. Sydney Airport's asset beta was set at 0.6 while Melbourne Airport was 0.7. The Commission appears to rely on the 1999 to 2001 ACCC airport decisions as a reference point while noting that the regulatory or systematic risks have not changed since then. The ACCC's decisions were based on a sample of four airports (BAA, Copenhagen, Auckland, and Vienna) with an adjustment for relative passenger volume risk to place the other airports in a range with reference to ACCC's Adelaide Airport decision. HoustonKemp's report for the AAA submission to the Commission relied on these hypothetical asset betas.[27]

This approach is no longer appropriate. An Australian airport regulator would reflect current market evidence and current methodologies in determining an appropriate target rate of return for airports today. Unlike the evidence before the ACCC in the early 2000s, there is now far more robust data of airports' asset beta, including Sydney Airport (see Figure 2), and a number of international airports.

For example, the CAA and Competition Commission in the UK has relied heavily on empirical observations of BAA's beta even after it was delisted in 2006, in preference to other methodologies.[28] In addition, there is now more evidence of regulatory decisions on airport asset betas from the UK, New Zealand, and other jurisdictions.

Figure 2: Sydney Airport's betas and gearing[29]



Source: Bloomberg

This evidence demonstrates that regulatory authorities have been satisfied that airport asset betas should be set lower than what they were in the late 1990s and early 2000s. Qantas Group submits that if the ACCC were to set the asset beta again today, it would be set at far lower levels. This illustrates that just because ROAAs are declining at some major airports, the Commission should not assume that airports are not overcharging airlines and air travellers. Therefore, the claims of the Commission and monopoly airports that falling ROAA points to restraints of market power are also misguided.

Qantas Group submits that the Commission has a responsibility to tell the community what financial metrics it would find sufficient to indicate that an airport is exercising market power.

INVESTMENT BY AIRPORTS DOES NOT MEAN THAT THEY HAVE NOT EXERCISED MARKET POWER

The Commission notes that the airports have continued to invest and grow their asset bases and has used to this as evidence that the airports are not exercising their market power by running down their assets while continuing to charge high usage fees.

Qantas Group does not oppose infrastructure investments which are fit-for-purpose, efficient and necessary to meet increasing passenger demand or relieve airport capacity constraints. What Qantas Group opposes is monopoly airports exploiting the flaws in the current regulatory framework and exercising their market power in order to extract excessive returns.

Australian monopoly airports' willingness to invest should be considered against the ability of the airports to exercise market power to ensure that they maximise returns on their asset base. Qantas Group contend that airports are acting like pseudo-regulated companies with a 'guaranteed' regulated asset base (RAB). By growing their asset bases they are able to grow their overall revenues and if they are able to earn a return above their cost of capital, for which Qantas Group, A4ANZ and a number of independent experts have provided strong evidence, then they are able to increase profits for their investors.

There is extensive research and commentary on infrastructure providers' tendency to grow their asset base (for example, the often cited Averch-Johnson effect).[30] Even when a company's returns are in line with its cost of capital there still appears to be an incentive for companies to grow their asset bases.

CEPA analysis commissioned by the Australian Energy Market Commission (AEMC)[31] last year cites a range of equity and investor research that highlight the positive revenue growth opportunities from companies' ability to increase their asset bases. While this commentary is in relation to regulated energy networks, the same sentiment applies to any infrastructure company which is in a strong (monopoly) position to earn a return on these assets at or above their cost of capital.

AIRPORTS ARE NOT TRANSPARENT OR TRUSTWORTHY IN THEIR PRICING MODELS

Norton White's analysis for Qantas Group, which was provided to the Commission, showed that under the guise of aviation security, many monopoly airports are extorting air travellers and airlines to line their pockets.

Northern Territory Airports have expanded their security charges from recovering direct, government mandated costs, such as costs of providing passenger and baggage screening services, to indirect costs such as administration fees, return on capital investment and overheads.[32] This is explicitly outlined in their 1 July 2018 Conditions of Use, where they claim an entitlement to charge for a "reasonable return on capital investment".[33]

The analysis also demonstrates that the security 'pass-through charge' model acts as a disincentive for monopoly Australia airports to be more efficient – indeed it rewards operational inefficiencies. The model handicaps productivity gains at the four monitored airports and requires immediate change.

This security money-grab by airports is in violation of bipartisan government policy that airports must deliver only mandated aviation security and pass-through costs to customers on a not-for-profit basis. Airport profiteering from security is also not aligned to expectations by the community that security charges fund only those services that protect and safeguard aviation.[34] A more detailed consideration of the Commission's (absence of) findings regarding discrepancies in security charges is on page 24.

Qantas Group also submits that the existence of Fuel Throughput Levy (FTL) at several airports highlights a significant flaw in Commission's focus on prices charged by airports for various services to multiple users rather than the total revenue earnt by airports.

Without sufficient transparency and a credible threat of regulatory intervention, there is a high probability that these airports would simply move the revenue pool generated by FTLs elsewhere through excessive charging of either airlines, fuel companies or other airport users.

COMMISSION'S APPROACH IS OUT OF STEP WITH REGULATORS OF MONOPOLIES

Successive governments and regulators such as the ACCC and AEMC have taken a very different approach to other regulated monopolies than the Commission has with airports.

Industry-specific access regulations, which are in addition to the general national framework for access to infrastructure industries, have been created for industries such as telecommunications and natural gas pipelines. In the telecommunications industry, the ACCC can determine whether eligible services are 'declared services' for the purposes of Part XIC of the *Competition and Consumer Act 2010*. The ACCC can declare the service if it is satisfied it will promote the long-term interests of end-users and a public inquiry about the proposal must be conducted by the ACCC.

Qantas Group submitted a highly relevant but little-known example from broadcasting in its original submission to the Commission. The National Transmission Network Sale Act 1998 (NTN Act) established an access regime which operates, in essence, as a deemed declaration of certain 'nominated services' provided by means of the National Transmissions Network (NTN) for the protection of identified 'nominated customers.' The NTN Act allows engagement of the arbitration-based telecommunications access regime in the event of a dispute about nominated services without the need to go through any complicated declaration process.

The NTN Act successfully dealt with the situation where a few customers needed services from a large supplier by piggybacking on the then new arbitration-based telecommunications access regime. The NTN access regime still applies today and there continues to be no known access disputes to have arisen. There has been no opening of a floodgate to arbitration. Rather the service provider and the national broadcasters have negotiated commercially and successfully entered multiple long-term service contracts and renewals and there has been capital spent on the NTN, but all with the conditioning safety net of ACCC arbitration based on defined principles having been available if negotiation failed.

A tailored mechanism for airport services would not be unprecedented or unique. Therefore, endorsement of a light-handed regulatory framework which includes deemed declaration would support public policy practice.

Indeed, the Draft Report itself opens the door to an industry-specific regime for jet fuel, despite the Commission admitting that scant information exists to form definitive views about the exercise of market power. Jet fuel *prima facie* has more competition than airport services. It is bewildering that the supply of aviation fuel is considered potentially worthy of industry specific regime by the Commission while airport services, where a multitude of evidence points to market power abuses, is dismissed so easily.[35]

All that airlines and airport users are seeking is the full implementation of the Australian Government's response to the Commission's 2006 report, which promised to ensure effective commercial negotiations including the commercial resolution of disputes through independent and binding arbitration.[36]

Access to independent and binding arbitration is standard practice in the effective resolution of commercial disputes.

Access to independent and binding arbitration by either party in disputes and breakdowns between airports and airport users incentivises commercial resolution.

To ensure commercial resolution in a timely and cost effective manner, arbitration methods as recommended by A4ANZ can include fixed timeframes and binding resolutions in their guiding principles.[37]

Airlines and airport users do not seek heavy-handed regulation but rather effective and efficient light-handed reform that benefits the aviation sector and the community at large.

COMMISSION'S FINDING IS INCONSISTENT WITH THOSE OF THE CONSUMER WATCHDOG

As Australia's competition regulator, the ACCC has found ongoing evidence of abuse of market power by Australian monopoly airports by excessive charging, revenue gouging and poor quality service over consecutive years.

The ACCC's latest airport monitoring report included the following key findings:[38]

- Four monitored airports made a combined $820.1 million in operating profit from aeronautical activities, an increase of 6.2 per cent. Aeronautical profit margin increases ranged from 38.6 per cent at Melbourne Airport to 49.3 per cent at Brisbane Airport.
- No airport rated as 'excellent' for overall quality of service.
- Aeronautical revenue per passenger for Brisbane Airport leapt by 15.4 per cent to $14.82, while for Sydney Airport jumped by 3.1 per cent to $19.26.
- Profit margins for car parking remained exorbitant across all airports. Profit margins for car parking ranged from 52.7 per cent for Perth Airport to 69.9 per cent for Sydney Airport. Four monitored airports made a combined operating profit of $278.5 million from car parking.

ACCC monitoring of Sydney Airport, Melbourne Airport, Brisbane Airport and Perth Airport, however, only measures abuse of market power after the fact. Such monitoring is not an effective regulatory intervention to *prevent* abuses of market power. Reporting abuses of market power after the fact is to the detriment of airlines, airport users and the community at large.

In the ACCC's original submission, the regulator acknowledged that while mandatory information disclosure by airports can be used to reduce information asymmetry to an extent,

> "Data collected by the ACCC under the current monitoring regime is insufficient to enable the ACCC to make any conclusive judgement about whether the price levels observed for the monitored airports are reasonable or reflect monopoly profits.[39]

The ACCC also identified the inherent limitations of using accounting data to analyse economic behaviour:

> "The limitation of the monitoring regime is primarily because it is based on accounting data. For example, to measure profitability, the ACCC is limited to using 'operating profit margin' and 'return on assets'. These are accounting measures which are not well suited to analysing monopoly profits."[40]

Qantas Group also submits that the Commission has not justified its statement that,

> "As noted in chapter 3, Perth Airport likely has less market power than Melbourne and Sydney airports, and analysis of its performance suggests that it has not systematically exercised any market power that it does have".[41]

In fact, the closest the Commission gets is a statement that,

> "[Perth] is less of a business and tourism hub compared to the other monitored airports (and following the end of the mining investment boom)."[42]

It is not clear that "it is less of a business and tourism hub" is evidence that it "likely has less market power than Melbourne and Sydney airports". Having lower demand does not mean that it has more elastic demand.

The ACCC has called for effective regulatory reform in order to ensure a credible threat against misuse of market power exists.[43] The ACCC exists to promote competition and fair trade in markets to benefit consumers, businesses, and the community.

For the Commission to dismiss recommendations from Australia's competition regulator and national consumer law champion is surprising. For the Commission to do so without presenting credible alternative evidence may be negligent.

LOWER AIRPORT CHARGES WOULD BENEFIT THE COMMUNITY

The Commission's view that there will be no net change to community welfare if airport charges are lower is incorrect.

> "The Commission's assessment is that the market for domestic air travel is highly concentrated and that airlines would have little incentive to pass through cost savings to consumers."[44]

This effort to dismiss concerns about monopoly prices as a fight for revenue share is misguided and wrong.

With 61 international airlines flying into and within Australia[45] and a highly competitive domestic market, the fierce nature of airline competition would not give Qantas Group airlines the luxury of simply holding on to savings. The historical trend of airfares in Australia is downward as airlines have become more efficient and more competitive as they pass through cost savings to consumers.

Evidence from the Bureau of Infrastructure, Transport and Regional Economics below shows that in real terms, 'Best Discount Economy airfares are 40% lower today than in 2003 (Figure 3 below).

No other sector of the economy is as capital and labour intensive or as highly regulated as civil aviation has delivered this level of efficiency, consumer benefit and economic gains.

Qantas Groups' airlines have a laser-like focus on costs on all aspects of its cost base – the outlier continues to be rising airport charges.

The AAA submission referencing 'Real Restricted Economy' Airfares demonstrates its basic lack of understanding of airline economics.

The facts are that:

- 80% of domestic sectors sold in economy class are discounted fares or from the Red eDeal family; and
- 66% of Jetstar Group fares are sold for less than $100.

The higher fares quoted by AAA in their briefings and referenced in other submissions are at the top of the tariff, these are usually found at peak demand times or very close to departure where there is last seat availability pricing. These peak price points make up less than 2% of all inventory sold.

The Commission needs to reconsider its endorsement of false claims by the airports about the nature of savings to consumers.

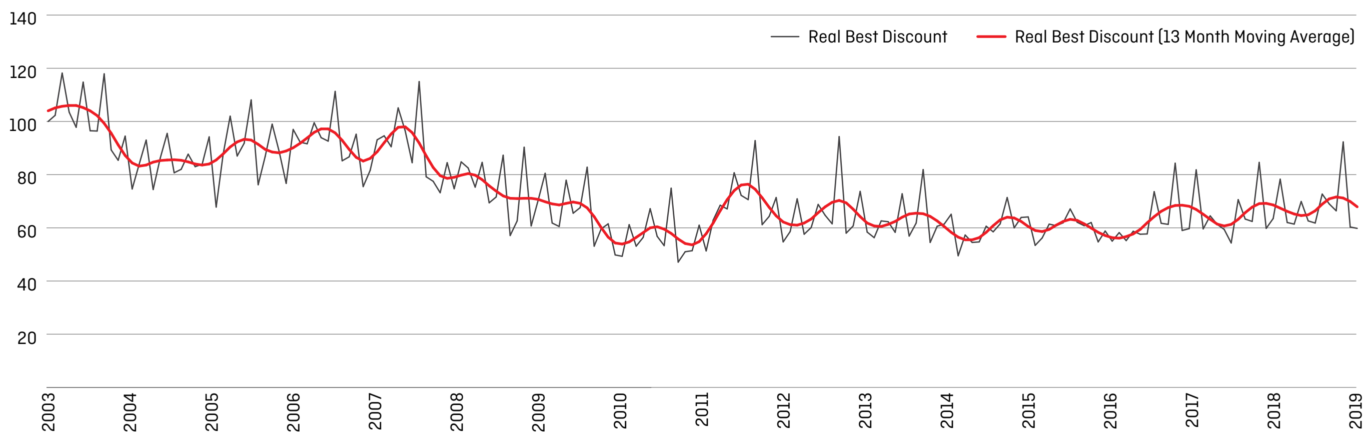
Regardless of whether financial savings from airport charges were passed on to consumers or not, the Commission should still be concerned about the extraction of monopoly rents by upstream providers like airports.

In order to operate competitively and safely, airlines make expensive, sunk investments in aircraft, crew bases, jet bases, and accreditation including air operator certificates and training. Not only do increasing monopoly rents limit that investment but they also discourage innovation and stifle operational efficiency as any savings are simply extracted by airports.

As the ACCC Chairman, Rod Sims said,

'Monopolies can be harmful in that they can limit investment and innovation in upstream or downstream industries'.[46]

Figure 3: BITRE Domestic Discount Airfares July 2003 – February 2019 CPI Adjusted



Australian Bureau of Statistics. (2003-2019). Australian Domestic Air Fare Indexes. Retrieved from https://bitre.gov.au/statistics/aviation/air_fares.aspx.

SKY-HIGH AIRPORT CHARGES ARE BECOMING UNSUSTAINABLE

Qantas Group notes that although airlines have consistently lowered airfares, continually absorbing price rises by Australia's privately-owned monopoly airports to keep airfares affordable is becoming unsustainable.[47]

Since May 2002, the ACCC has ensured airlines publish only all-inclusive fares which means all taxes, levies and charges must be included in the advertised price of their airfares.[48] Airline pricing systems are dynamic and adjust prices and inventories quickly if any type of increase is misaligned with the market. This means that all increases in input costs to airfares are directly exposed to the competitive market.

For example, increasing airport charges from $20 to $30 on a $199 airfare shifts $10 to the airport and leaves an airline $169 instead of $179 with no change in demand. In reality, the all-inclusive fare adjusts over time to settle at a new market equilibrium in line with capacity, demand and economic conditions, which has been trending downward over the past 15 years.

Qantas Group has temporarily maintained a number of loss-making routes for network, customer or other reasons. This can mean that in the short term, as airlines compete on a route, customers benefit (low fares) and airports benefit (high volumes due to high capacity and low fares due to intense competition). In the medium to long term, loss making routes can lead to structural change of some sort such as reduction of capacity by airline operators to stabilise yield.

Increasing monopoly airport fees and charges places pressure on the price of airfares across a highly competitive market that cannot continue to absorb rising costs, particularly for low cost carriers that have played a major role in the extraordinary expansion of aviation over the past decade.[49]

Over the last 12 months, almost two thirds of Jetstar's domestic and international airfares sold for less than $100. Large and inexplicable differences in airport passenger charges dramatically and directly influence an airline's ability to maintain frequency and capacity, while offering low airfares and stimulating travel. Additional cost inputs including fuel, pilots, cabin and ground crew, maintenance and navigation charges demonstrates the significant impact airport charges have on the commercial viability of airline service.[50]

A Jetstar example demonstrates that the opposite is also true – that lower airport charges can directly lead to more services and lower fares for travellers (Box 2).

Profits at Australian Airports Keep Fares High

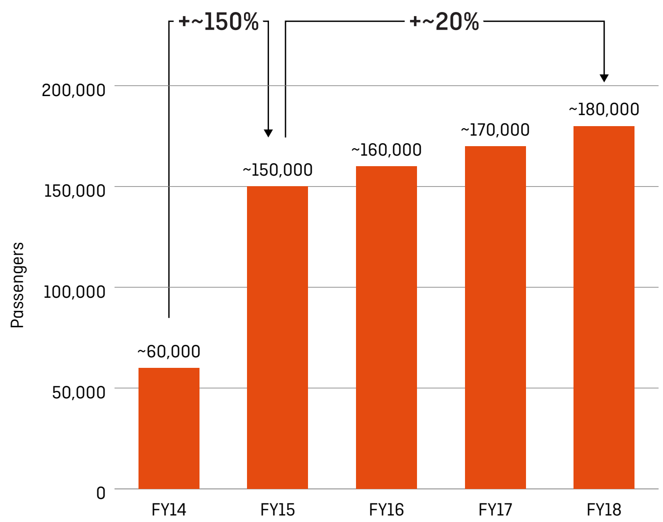
SBS[51]

BOX 2: CASE STUDY AYERS ROCK AIRPORT (AYQ)

- During Jetstar's negotiation with Ayers Rock airport in FY15, a new, more competitive pricing structure was negotiated.
- This structure, which came into effect in FY15, contributed to a ~150% increase in Jetstar passenger numbers through the airport.
- It also facilitated a further ~20% increase in Jetstar passengers over the same period.

Competitive airport charges underpin LCC macroeconomic principles and facilitate and foster passenger growth at airports.

Jetstar



AIRLINE COUNTERVAILING POWER IS A MYTH PERPETUATED BY AIRPORTS

Airlines' countervailing power is a fiction. Qantas Group counsels the Commission against accepting this fiction as fact.

The Draft Report claims:

> "...airlines can credibly threaten to withdraw their services where total cost to the airline of withdrawing the service, including the cost to its overall network is less than the cost to the airport operator".[52]

Qantas Group respectfully suggests this claim is insufficient and lacks both intellectual rigour and verifiable evidence. Airports that are exercising market power would not be expected to price to a point where airlines leave the airport. The airports exercise market power by pricing up to, but not above, the point at which airlines reach a 'tipping point' of credibly leaving the airport. That is, the airports will still have regard to demand when determining how to maximise their profits.

Qantas Group's original submission explained that reducing or withdrawing services in response to airport behaviour is not feasible because of loss of network connectivity, loss of business, claims by passengers with bookings, loss of revenue, redundancy of aircraft assets, redundancy of airport investments such as hangar and lounges, and competition from other entrants.[53]

Airlines cannot switch to a different airport to mitigate airport market power due to route and air traveller preferences, critical market share, asset relocation, major costs and loss of economies of scale. Qantas does not have viable alternate airport substitutes in Australia particularly for premium customer segments.

Shifts in capacity are done in line with passenger demand and overall market profitability, of which airport charges are a part but not the only factor. They are not negotiation tactics.

In the four years prior to September 2018, Jetstar changed at most, about 2 per cent of its capacity in association with new routes and exits in any given year, even in the face of increasing airport charges and monopolistic airport behaviour.

Qantas Group does not believe that the Commission has provided evidence to substantiate its view of countervailing power. Countervailing power would be expected to differ across airports and therefore must be assessed on a case-by-case basis. The conditions that might give rise to countervailing power such as an airline's market share and complementary investments at the airport, are airport specific. Anecdotes of countervailing power, which is all that the Commission appears to rely upon, cannot be extrapolated to a general finding of airline countervailing power.

Regarding the use of market shares as an indicator or threshold at which countervailing power might be relevant, there is no commonly understood threshold. This is because it is the relative position of the buyer and the seller that matters. A monopoly seller position means the buyer's relative position would have to be extremely strong.

The Commission itself indicated in its 2006 inquiry report that countervailing power was relevant only in relation to Canberra where Qantas had a 75% market share. Qantas does not have a market share (by capacity) that comes close to exceeding this threshold at any of the tier 1 or tier 2 airports. In fact, Qantas Group's market share at Canberra is now 58%. So, there is little general basis for a finding of countervailing buyer power based on market share alone.

The burden of proof for airlines exercising countervailing power rests with the Commission.

Qantas Group strongly objects to any claim that suggests airlines flex countervailing power or in any way penalise airports by deliberately down-gauging aircraft types at certain airports. This is incorrect and misleading.

Airlines strive for maximum aircraft utilisation and will make decisions regarding aircraft type based on passenger demand for the route.

This is nowhere more evident than at Perth. While Perth Airport and Qantas Group are currently in a legal dispute, Qantas will add 14% more capacity into domestic, intra-WA markets during the upcoming Northern Summer 2019 scheduling period. In addition, Qantas will also add an approximate 100 extra flights on east-west routes from Perth over the same period. So much for the argument that airlines withdraw or reduce services for leverage during disputes.

To further examine the feasibility of countervailing power, Qantas Group commissioned Frontier Economics to review its network and financial data on a sample of routes. Due to commercial confidentiality, Qantas Group is providing a limited analysis publicly at Appendix 1 with a full version provided confidentially to the Commission.

Frontier Economics found that countervailing power is largely an irrelevant and immaterial consideration because there are very few circumstances in Australia where the necessary conditions for countervailing power would hold because airlines cannot bypass an airport.

For countervailing power to offset an airport's market power, airlines would need to be able to credibly threaten to bypass an airport. Bypass typically takes the form of vertically integrating into the upstream market or sponsoring new entry.[54]

As airlines cannot bypass airports, supposed remaining threats in the face of high airport changes are very limited, and generally not credible because threats to reduce service tend to be very costly for airlines and so Australian airports ignore them in pricing considerations.

At face value, the Productivity Commission's suggestion that "*Airlines can refuse to pay charges at the level determined by an airport when an agreement expires*"[55] is extraordinary, as is the implication that Qantas' use of payment delaying tactics to restrain charges are a normal and adequate bargaining tool.

These extreme measures are indicative of a broken system that offers airlines few options to moderate airport charges to reasonable levels.

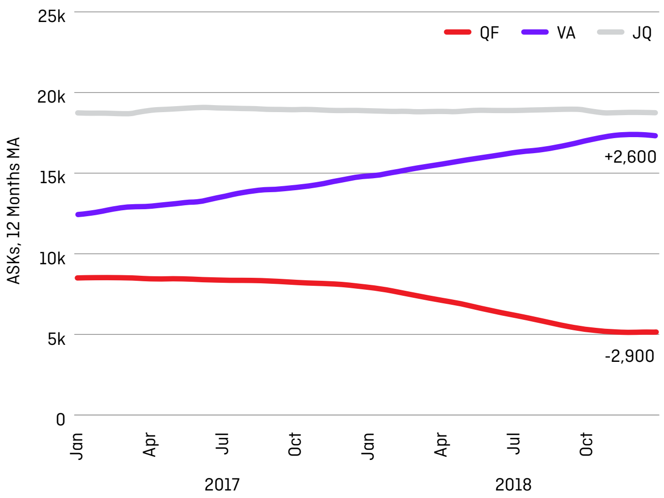
Monopoly airports can readily backfill any landing slots made available from a service withdrawal by offering capacity to other airlines. If backfilling occurs, the airport will lose little to no revenue. Backfilling is even more likely where airports are capacity constrained.

At the top 15 domestic airports by capacity which account for greater than 90% of total domestic capacity, Virgin and other airlines have on average a 40% market share.[56]

With two or more airlines operating out of all these airports, and ready demand available from passengers should one airline withdraw, an existing airline is able to expand its services to fill available slots.

When Qantas withdrew services from Newcastle due to pilot shortages in 2018, Frontier Economics found that Virgin was able to respond almost immediately to backfill the lost capacity. This is seen in Figure 4 below:

Figure 4: Changes in available capacity on the Brisbane-Newcastle route



Source: Frontier Economics analysis of Qantas Group data

Even if it were credible that Qantas Group could withdraw services and it were replaced at the airport by another airline, the new airline would be facing the same exorbitant airport charges as Qantas Group would have faced, leaving travellers worse-off in either case.

Frontier Economics demonstrate that even if airports could not readily backfill slots, airlines will lose far more from service withdrawals than an airport. For Perth Airport and Newcastle Airport, Frontier Economics estimates Qantas would incur net losses per flight of between 2 and 10 times those of airports if it was to reduce services.

The reasons for this are as follows:

- Airlines have very few outside options — Qantas could re-use its planes elsewhere, and passengers may continue to use other Qantas services to that destination. However, with interconnected and optimised networks it is difficult to profitably utilise assets elsewhere or take more passengers on other flights without affecting network service.
- Airlines have significant costs that are fixed in the short-medium term and could not be reduced should services be temporarily withdrawn.

These figures underestimate the true costs that would be incurred by Qantas Group. Qantas would also incur significant additional losses should it withdraw even minimal services on any route from these airports given their significance to either our customers and our broader network and operations. Such actions would cause reputational damage to Qantas which ultimately add to the cost of disputes.

Furthermore, Qantas Group notes that the Commission itself acknowledges that the presence of countervailing power does not mean that "regulation is less warranted."[57]

> Countervailing power is not helpful from the consumer's perspective, as passengers still pay a high price that reflects the exercise of market power (Forsyth, sub. 15).[58]

THE AIRPORTS ACT IS NO RESTRAINT ON MONOPOLY AIRPORT PRICES

The Commission accepts at face value the false assertion by Australian airports that the *Airports Act 1996* restrains the exercise of power and has used it to bolster claims of airline countervailing power. The Commission claims:

> 'Even without an agreement in place, airlines are able to access airport services and can refuse to pay charges at the level determined by the airport.' (AAA, sub. 50).[59]
>
> 'The federally leased airports are required to fulfil their lease terms, which only allow airports to deny access to airlines under limited circumstances (Melbourne Airport, sub. 33; AAA, sub. 50).'[60]

These assumptions are either naïve or the Commission has been misled.

In reality, airports easily sidestep this restriction by refusing or frustrating access to other infrastructure that is nevertheless necessary to an airline's day-to-day operation or to its product offering. Preventing access to airline lounges, passenger waiting areas, staff offices, cargo terminals and baggage facilities can all achieve the same outcome – pressure airlines into exorbitant prices by denying or frustrating access to airports.

Before the Commission dismisses such scenarios as unrealistic, Qantas Group was last year served with Notices to Quit premises during negotiations with a major Australian airport operator. These premises included Qantas Group freight facilities, engineering facilities, Qantas Lounge, staff offices and even a waiting room used by unaccompanied minors waiting to board on Qantas flights. Qantas Group was advised that a failure to vacate would result in rent being charged at double the market rate.

Not only does this show airports' utter disregard for the principles behind the *Airports Act*, it also demonstrates the take-it-or leave-it behaviour Qantas Group regularly experience at airports.

Implicit in the Commission's acceptance of airports' rhetoric is that it regards operators' obligations under the *Airports Act* to pose as some sort of threat against the exercise of market power. During two decades of dealing with privatised Australian airports, Qantas Group is not aware of a single instance of airports considering the *Airports Act* to be a restraint on their market power.

In fact, airports such as Canberra Airport are not afraid to flout their *Airports Act 1996* obligations through actions such as blocking an aircraft from departing unless its pilot handed over a credit card immediately to pay additional airport charges before departing.[61]

The provisions under the *Airports Act 1996* also do not obligate airports to give access to non-aeronautical users such as newsagents, cafés, car rental companies or rideshare companies.

AIRPORTS CONSISTENTLY BEHAVE POORLY WITH AIRPORT USERS

In Qantas Group's experience, take-it-or-leave-it behaviour is commonplace during negotiations with Australian monopoly airports large and small. Table 1 below provides some examples of such poor behaviour.

Qantas Group respectfully seeks a clarification of how the Commission proposes to analyse anecdotes and examples presented to it. On the one hand, the Draft Report states,

> "An infrastructure operator who is exercising its market power during negotiations could, for example...deny access to the service (or threaten to)..."[62]

Yet in response to the examples Qantas Group gave in its original submission, including those relating to Canberra and Townsville airport management, the Commission said the following:

> "Such behaviour is not unique to contract negotiation in aviation and occurs in other commercial negotiations and industries."[63]

On face value, the Commission appears to have lowered the bar for what constitutes acceptable behaviour from airports, dismissing extreme measures such as those above as simply "argy bargy".

Table 1: Monopoly airport behaviour at work

Airport	Example
Townsville Airport	Townsville Airport, which is owned and operated by Queensland Airports Limited (QAL) proposed an upgrade to their terminal at a cost of $50 million. The upgrades would require Qantas to relocate its existing lounge at the end of its tenancy agreement. At that time, QAL had already served Qantas a notice to vacate the lounge. Qantas' position was that upgrades to the existing infrastructure could be completed at a significantly lower cost which would also see the lounge remain in its existing position. In March 2018, QAL placed chairs in the thoroughfare blocking the walkway and entrance to the Qantas Lounge without consultation or notification to passengers due to a dispute over capital investment plans. Qantas and QAL remain in discussions relating to current base pricing, however no further talks have been held on the terminal upgrade. Qantas is aware QAL has recently been provided with a loan by the NAIF for $50 million to cover the cost of QAL's proposed Terminal upgrade.
Canberra Airport	In March 2017, Qantas Group was forced to pay a non-standard $18,000 diversion fee (more than 20 times that at Sydney Airport) following an unexpected landing due to bad weather. Canberra Airport parked a ground vehicle behind the aircraft and refused to allow the aircraft to leave until payment was made by credit card.
Perth Airport	Prior to the launch of Qantas' direct non-stop Perth-London service, there was significant misalignment on the expected costs and timelines to retrofit Terminal 3 ($45 million quoted by Perth Airport vs. $25 million by Qantas Group) which threatened the viability of the landmark non-stop Qantas Perth-London flight. Only after pressure from the Western Australian Government was the retrofit completed with the infrastructure project completed by Qantas Group on time and within its considerably low budget. Perth Airport reached an agreement with Qantas Group after the Federal and State Governments intervened.
Perth Airport	In April 2018, Perth Airport blocked Qantas' proposed Auckland-Perth-Johannesburg service operating from Terminal 3 without reasonable justification, which would have seen an additional 4,000 international seats per week into Western Australia. This international service has never proceeded.

AIRPORTS RARELY GIVE ACCURATE AND RELIABLE INFORMATION TO USERS

The Draft Report recognises the importance of information transparency by airport operators.

> "Essential to a light-handed regulatory regime is transparency as to how an airport operator is performing and a credible threat of further regulatory intervention."[64]

Airport users agree. In order to make economically efficient and timely decisions, airlines and airport users require specific information including the investment scope, rationale, expected improvements to service outcomes and the estimated capital costs.[65]

Reasonable transparency and meaningful consultation by Australia's monopoly airports is the exception, not the norm. Airlines are not able to compel transparency or engage in meaningful consultation which sets the scene for deceptive behaviour by airports and long, expensive negotiations.[66]

The Commission also highlights the importance of consultation with airport users and repeatedly portrays Perth Airport as exhibiting model behaviour.

> "... negotiating agreements is information intensive and some airports have taken steps to improve the flow of timely and relevant information to airlines. Examples include a publicly accessible website hosted by Perth Airport that has information on its indicative 10 year capital expenditure plan, 10 year forecasts for passenger numbers and operational costs, and proposed pricing models, among other things."[67]
>
> (Emphasis added)

This endorsement is reiterated later in the Draft Report.

> "Information sharing by Perth Airport is one example of greater transparency."[68]

The reality for airport users at Perth Airport is quite different, as Box 3 shows.

BOX 3: LACK OF INFORMATION SHARING AT PERTH AIRPORT

Operating expenditure

- Perth Airport's public website and its subsequent bilateral consultation with Qantas Group did not provide a historical breakdown of aeronautical operating expenses.
- Perth Airport used 2016-17 as the base financial year to forecast the operating expenses included in its aeronautical charges, although an operator's historical trends are a better indicator of whether that starting point is efficient.
- Qantas Group queried Perth Airport on why its Average Staff Equivalent headcount for aeronautical services had increased by 86% from FY11 to FY17 while passenger volumes increased by 25% from 11.4 to 14.3 million.(69) Perth Airport explained this was driven by increases in passengers and the construction of T1 Domestic and T2 terminals.
- However, Perth Airport's public website showed T1 Domestic and T2 comprise 10% of the airport's salary and wages, and passenger growth during that period was 25% (based on ACCC Monitoring Reports). Therefore, approximately 50% of the increase was unaccounted for – and remains factored into the publicly disclosed charge.

Capital expenditure

- Although a Capital Expenditure report with descriptions of proposed projects was made available on the website,
  - there was almost no capacity and demand assessment shared despite many of the projects described as driven by demand;
  - benefits of the projects to airlines are not well articulated (if at all);
  - no detailed costings or cost plans were shared either publicly or bilaterally– only the total project cost for each project was provided; and
  - information on whether alternate options were investigated was not included.
- Perth Airport proposed a Significant Terminal Expansion Project (STEP) for ~$600 million in additional gates and improved service levels. The information failed to:
  - include a breakdown of estimated costs;
  - describe benefits for airlines or airport users;
  - propose or provide assessment of any alternate options considered; or
  - include capacity and demand assessment for each processing point.

Source: Perth Airport website and Qantas analysis, 2019

These omissions and refusals to give reasonable and necessary information have made it impossible for airlines to complete their own cost/benefit assessments and determine if airport proposals were the most cost-effective solution for travellers.

In addition, the Commission drew attention to the inefficient and high operating costs at Perth Airport yet dismissed this on the basis that passenger numbers were lower than forecast and a large portion of these costs were fixed costs.[70]

However, as Box 3 illustrates, unjustified increases in full time staff numbers, which are wholly within the control of Perth Airport, have contributed to these high operating costs and demonstrate inefficient management of resources and poor productivity.

The Commission also appear to accept that costs at the end of Perth Airport's agreement period were in line with forecasts. Even if this were true, Box 3 is an example of why those costs should have been lower.

COMMISSION'S LOGIC ON AIRPORT PRICE COMPARISONS IS INCONSISTENT

The Commission states that there are difficulties comparing the monitored information and therefore their findings must be treated with caution. But it then appears to rely on the monitored information to form a view on the success of the monitoring regime.

While the Commission is proposing 'improvements' to the monitoring regime, the fact that the regime does not appear sufficient to determine the exercise of market power should be a concern for the Commission.

In addition, the Commission makes it clear that comparisons to international data are to be treated cautiously.

> "Comparisons of an airport's financial performance using these measures are flawed for a number of reasons. International comparisons of whole of airport company operating profit margins can be heavily influenced by the types of non-aeronautical activities that are reported in annual financial reports."[71]

Nevertheless, it goes on to say that,

> "Overall, Australian airports are relatively efficient businesses with about average revenue generation capability."[72]

The logic of saying that the evidence is flawed then relying on that same flawed evidence to suggest there is no problem with airports exercising market power is untenable. If implemented, the consequences of this flawed logic are concerning for the community.

DISPUTE RESOLUTION MECHANISMS ARE REGULARLY IGNORED BY AIRPORTS

Perth Airport's poor behaviour is also evidence that airports reject dispute resolution opportunities. The airport's own *Conditions of Use for Aeronautical Services and Facilities*, dated 1 July 2018, state that prior to beginning legal proceedings, a party must first refer the matter to an expert for a determination.[73]

Perth Airport commenced legal proceedings against Qantas Group prior to activating these provisions under its own Conditions of Use as they refused, despite numerous requests by Qantas Group to have the matter determined by a mutually-appointed, independent expert. This is despite claims by the AAA that this is a dispute resolution mechanism contained in and easily accessed through agreements.[74]

Qantas Group notes that this dispute resolution mechanism is recommended in the aeronautical pricing principles however Perth Airport shows how easily monopoly airports discard those principles. Perth Airport's proposed methodology for determining a fair and reasonable price in Court also appears to be inconsistent with aeronautical pricing principles and the building block methodology.[75]

In light of the above, Qantas Group respectfully asks the Commission to cease endorsing Perth Airport both explicitly and implicitly.

COMMISSION'S ACCEPTANCE THAT AIRPORT CARE FOR SERVICE QUALITY IS UNFOUNDED

The Draft Report contains multiple, favourable references to airports' claims that their agreements with airlines have become more mature with airports taking responsibility for quality and service levels. Pages 12, 13, 18, 19, 24, 108, 114, 115, 116, 133, 136, 150, 153, 171, 275, 303 and 304 are relevant examples.

The following extract from the Draft Report typifies the overall tone of these references:

> 'Key performance indicators (KPIs) and service failure rebates have become more prevalent features of SLAs since 2011. All monitored airports have developed or are negotiating KPIs of service quality (Sydney Airport, sub. 53; Melbourne Airport, sub. 33; Brisbane Airport, sub. 38; Perth Airport, sub. 51). Recently negotiated agreements include improved performance indicators for, among other things, on-time performance, queue time or baggage handling, and financial consequences where those outcomes are not met (Melbourne Airport, sub. 33). Some airports also include KPI results in consultation processes and capital development plans in order to align their future investments with identified service quality issues (AAIG, sub. 20; Sydney Airport, sub. 53). At Sydney Airport, KPI results are discussed with airlines through the quarterly Industry Consultative Forum (Sydney Airport, sub. 53).'[76]

This optimism is premature. Service Level Agreements (SLAs) with airports are largely ineffective, irrelevant and unhelpful for air travellers.

A large number of SLA claims are rejected by monopoly airports. In FY17, Sydney Airport informed its Industry Consultative Forum that it had rejected over 70% of all claims, while in FY18 Sydney Airport rejected 43% of all claims. Relevant documents from the Industry Consultative Forum are at Appendix 2.[77] Qantas Group contends that the rebate criteria are too narrow and determined largely unilaterally by the airport.

SLAs are also not monitored or regularly reported by monopoly Australian airports. One particular monitored airport provides an annual and ongoing rebate to cover all, unspecified failures in its international operations in lieu of compensation or rectification of any individual event of service failure.

Another monitored airport would only agree to adding rebates for failure in their SLA if airlines agreed to pre-fund the rebates through higher aeronautical charges. This would make rebates akin to an insurance premium rather than a performance incentive.

In the case of another monitored airport, the rebates and penalties are too low to cover the actual cost of service failure to airlines. Brisbane Airport's SLA states that the airport must rebate the fees charged for a flight if it is delayed by more than 15 minutes. The value of the rebate is not sufficient to address the risk to the airline of the delay which could include accommodating passengers, rescheduling aircraft and refunding tickets.

As the cost to the airline of delays is generally far higher than the fees payable by Brisbane, the airline will naturally expend all possible resources to compensate for the airport's failures and ensure that flights are not delayed. In this instance, the SLA does little to encourage performance improvement at Brisbane Airport.

> Airport Parking Monopoly Pricing: Why improve customer service when you don't have to?
>
> **Choice[78]**

Australian privately-owned monopoly airports are also disinterested in responding to feedback from air travellers. Unlike with airlines, there is currently no mechanism for passengers to report grievances, seek recompense, switch airports or substitute for air travel.[79]

Complacency driven by monopoly power has meant that Australian airports are increasingly operated to maximise airport operator revenue rather than deliver efficient or excellent customer experiences.

AIRPORT THREATS OF STOPPING INVESTMENT ARE OVER-INFLATED

The Commission has made multiple references to the four monitored airports investing around $7 billion in aeronautical infrastructure over the past 10 years and noted that airports require large, long-term sunk investments. These references are used to bolster the case for the current, ineffective regulatory regime.

Qantas Group submits that airlines also require large investments. Over that same decade, Qantas Group has invested over $11 billion in new aircraft, more than the four monitored airports combined. This does not include additional investments made by Qantas Group in regard to crew and maintenance bases, passenger lounges, ground service infrastructure or aircraft seating and configuration overhauls.

The flaw in the Commission's analysis of infrastructure investment is that it fails to consider the harmful impacts of monopolistic airport pricing on investment and innovation for downstream providers like airlines and those further along the supply chain, such as the over 13,000 small business and regional suppliers to Qantas Group. It does not acknowledge that like airports, airlines too must make significant investments and cover large sunk costs.

Arguments put forward by the airports that changes to airport regulation will threaten the development of key airport infrastructure are a smokescreen and should be treated as such.[80]

Qantas Group does not oppose infrastructure investments which are fit-for-purpose, efficient and necessary to meet increasing passenger demand or relieve airport capacity constraints. What Qantas Group does not support is airports exploiting the flaws in the current regulatory framework to gold plate airport infrastructure.

As airports have been quick to stand by their obligations under the *Airports Act 1996*, Qantas Group notes the Act also requires each airport operator to develop and implement a master plan which establishes the "*strategic direction for efficient and economic development at the airport over the planning period of the plan.*"[81]

COMMISSION SHOULD BE CONCERNED ABOUT CONCENTRATED AIRPORT OWNERSHIP

Qantas Group agrees with the Commission that the monitored airports face no or little competitive constraints from nearby airports and that, in the Australian context, the competitive constraint that airlines, particularly LCCs provide to the major airports is small.[82]

Nevertheless, the growing concentration of ownership of Australian capital city and major airports into a few, private hands should be of greater interest to the Commission and to the ACCC. The Airports Act 1996 imposes a 15% restriction on the cross-ownership of certain pairs of Australia's four monitored airports, which indicates a degree of concern about the consequences of ownership consolidation, such as significant information asymmetry or unfair negotiating leverage.

Qantas Group notes that several institutional investors today own a 15% or higher stake in at least 2 capital city airports, as Table 2 below demonstrates.

Table 2: Analysis of ownership consolidation (as at 20 July 2018)[83]

Shareholder	Airport Ownership Stake	Related Parent Companies
Industry Funds Management	77.4% – Darwin	Airport Development Group
	25.2% – Melbourne	Australian Pacific Airports Corporation
Future Fund	30% – Perth	Perth Airport Development Group
	20.3% – Melbourne	Australian Pacific Airports Corporation
UniSuper Ltd	49% – Adelaide	Adelaide Airport Ltd
	16.0% – Sydney	Sydney Airports
Colonial First State	17% – Brisbane	Brisbane Airport Corporation
	15.3% – Adelaide	Adelaide Airport Ltd
Statewide Super	19.5% – Adelaide	Adelaide Airport Ltd
	17.3% – Perth	Perth Airport Development Group

In fact, Industry Funds Management has major ownership stakes in another two capital city airports Brisbane (13.8%) and Adelaide (12.8%) as well as owning over two-thirds of Alice Springs and Tennant Creek airports', and more than one-quarter of Launceston Airport.[84]

In the absence of meaningful regulatory reform, the trend towards increased consolidation of airport ownership will continue to erode the already limited leverage airlines hold in commercial negotiations, exacerbate uncompetitive dealings and negatively impact the economy to the detriment of the community.

EVIDENCE OF MONOPOLY AIRPORT MARKET POWER IN AVIATION SECURITY OVERLOOKED

Qantas Group is disappointed that the Commission chose to ignore the cost-effective delivery of security services and the calculation and recovery of airport security charges.

Although aviation security is a major issue affecting the economic regulation of monopoly airports, the Commission has excluded any meaningful analysis in the Draft Report and failed to make any Draft Recommendations in relation to security services or charges. Security costs make up a significant proportion of overall airport operating costs.

Qantas Group requests that in its Final Report, the Commission carefully review the issues around security service delivery, calculation and recovery of security costs and necessary recommendations.

Indeed, even the AAA implicitly acknowledge airlines' authority to comment on the cost-effectiveness of provision of security when it says, "the mandated security cost risk typically rests with airlines."[85]

Currently security services and charges by monopoly airports promote economically inefficient operations, add unnecessary compliance costs and foster the potential to abuse market power by airport operators.

The fact that aviation security generates externalities is not a legitimate reason to decline to evaluate the means by which the security services are provided, how the costs are calculated and recovered and how the costs impact airlines and airport users.

The Commission has also failed to consider the relevance of diminishing returns and the fact that excessive monopoly airport security measures generate negligible increases in security and social benefits and ultimately lead to negative externalities in the form of detrimental impacts on passenger experience and the airline industry's ability to contain operational costs.

It is also concerning that the Commission has found that there is no systematic exercise of market power in negotiations when airlines are presented with terms and conditions on aviation security on an as-is basis that have now become market standard for Australian monopoly airports and where airlines have no countervailing power available to address the appropriate boundaries of recoverable security costs. This take-it-or-leave-it approach by monopoly airports is even more marked in the case of security charges – which are presented as a pass-through, non-negotiable amount – than for passenger or terminal charges.

In its Final Report, we implore the Commission to consider the following issues:

- Monopoly airports procure the security services but ultimately do not have to pay for them and therefore have little if any incentive to obtain value for money or maintain efficiency,
- Monopoly airports openly acknowledge in their terms and conditions that they are entitled to make a profit on security,
- Monopoly airports openly acknowledge in their terms and conditions that they have broad leeway to introduce new charges at any time under the umbrella of government mandated security charges,
- Monopoly airports have expanded the types and scope of security costs beyond what was originally contemplated by government,
- Monopoly airports have an incentive to over-service e.g. keep more security lanes open in off peak times, in order to maximise customer dwell time in retail areas. The full cost for staffing low utilised lanes is then passed through to airlines.

AIRPORTS BEYOND THE 'BIG FOUR' ALSO EXERCISE MONOPOLY POWER

While many non-monitored Australian monopoly airports may have less market power, in Qantas Group's experience, they are not afraid to flex that power.[86]

Claims by the Commission that Canberra Airport does not exert its market power because of the presence of modal substitution are misguided and incorrect. The Draft Report acknowledges the fact that air travellers at Canberra Airport are predominantly business passengers but fails to follow this point through its logical conclusion that business travellers are unlikely to substitute air travel with bus travel or driving seven hours return to Sydney. This is evident from Jetstar's codeshare arrangement with Murrays Coaches where only an average of 2.3 seats were sold a month on its Canberra-Sydney route.[87]

Qantas Group's ongoing challenges with airports' misdirected capital expenditure plans also demonstrate how airports other than the four monitored airports continue to flex their market power. Commercial confidentiality prevents Qantas Group from providing a number of examples of second-tier airports on the record in sufficient detail. We present one of these examples on an anonymised basis below.

An airport serving a major tourism destination put forward a terminal expansion plan worth over $270 million ($212 million or 76% claimed as aeronautical).

Qantas Group considered the cost unjustified against market demand (with both parties misaligned on forecasts), and indicated, in principle, support of a more modest fit-for-purpose development. Negotiations and many of the necessary upgrades effectively stalled over the next 18 months whilst the airline invested significant amounts of time and resource to attempt to support the airport reach a mutually beneficial outcome.

This airport presented an updated capital expenditure cost of $435 million ($385 million or 88% now claimed labelled aeronautical). Challenges exist with the scale of actual spend, airports building ahead of demand and the ability for negotiation of fair and reasonable returns with no regulatory oversight.

Qantas Group objects to the Commission's Draft Recommendation to discontinue voluntary self-reporting of second-tier airports. We agree with the ACCC submission to the Commission that second tier airports are likely to have a considerable degree of market power.[88] Although this reporting does not act as a credible threat, publicly-available information is important for future market power assessments.

Qantas Group notes that if the substance of Draft Recommendations 10.3-10.7 were adopted by the Australian Government, it would create a scenario where there is some additional scrutiny of the largest four airports and the 80-odd smallest airports, and no scrutiny whatsoever of the 17 (federally leased) airports in the middle. This peculiar outcome should prompt the Commission to reconsider its views.

AIRLINES BEAR VOLUME RISK, NOT AIRPORTS

The Commission is seeking additional information on the ways in which airports and airport users share risks through negotiated agreements.

While the charges set by airports should reflect a reasonable sharing of risks and returns, the reality is that they do not.

According to the Draft Report,

> "…one example of this risk is the infrastructure upgrades undertaken by the monitored airports, such as to widen taxi and runways and adjust aprons, gates and aerobridges, in order to accommodate A380 aircraft".[89]

The assumptions underlying this claim are incorrect. Airports have not incurred any financial risk for A380-related infrastructure; it is airlines and their travellers who have paid for this and continue to. The charges to travellers also include over-inflated claims by airports of their cost of capital. Importantly, the Commission fails to consider the significant investment made by Qantas Group and other airlines in purchasing A380 or any other aircraft. The Commission's assumption that airline infrastructure is more mobile and therefore less risky is entirely without basis, as we have demonstrated in an earlier section.

The Draft Report notes,

> "Airports argued that they face greater volume risk when agreements include per passenger charges compared with aircraft weight based charges (Brisbane Airport, sub. 38)".[90]

Qantas Group has taken proactive measures to assume passenger volume risk at several airports.

During recent negotiations for a new Aeronautical Services Agreement with at least three monitored and non-monitored airports, Qantas Group offered to assume passenger risk in the event that changes to market conditions would mean actual passengers were below the airports' forecasts, in effect, a fixed-volume, 'take-or-pay' agreement.

The offer was rejected by all of these airports without adequate explanation. Qantas Group believes this offer was rejected because airports are aware that airlines are the true bearer of passenger risk.

Airports' pricing models rely on inflating the cost of capital (WACC) to artificially boost aeronautical charges. Agreements that take passenger risk away from airports would necessarily require airports to lower risk premiums, a key input in pricing models, and in turn lower the price they charge per passenger. To date, airports are unwilling to accept pricing models that would deliver volume certainty but lower unit revenues.

SINGLE AND HYBRID TILLS ARE BETTER APPROACHES TO MANAGE RISK

Qantas Group submits a more appropriate way to manage volume and economic risks to airports and airlines would be through a single or hybrid till approach to charging.

Single till acknowledges the symbiotic and essential relationship between airports and airline users. In contrast, a dual till entrenches a disproportionate share of risk between airlines and airports – airports benefit both directly and indirectly from passenger demand from airlines while airlines bear all downside volume risk.

In an economic downturn, airlines must respond to maintain passenger throughput through discounted fares. However, airports are insulated from the passenger volume risk by pricing tactics adopted by airlines and do not offer reciprocal discounts to per passenger charges.

In Qantas Group's initial submission, figure 5 below was produced which highlights the volatility in airline margins against a backdrop of Australian monopoly super-profits and how airports are protected from passenger risk even during economic shocks such as the Global Financial Crisis.

A dual till approach to charging is possible only because airports do not operate in a competitive environment. As IATA notes,

> "Return on investments for airports should naturally include aeronautical and non-aeronautical revenue as the distinction is unimportant for the economic regulation of airports."[91]
>
> (Emphasis added)

In their advice to Qantas Group, CEPA identified that a hybrid till model would also be a practical approach for regulators to lower aeronautical charges as non-aeronautical revenue could be used to partially cross-subsidise charges, reducing any inequitable outcome that results from non-aeronautical revenue being excluded.[92]

Qantas Group is disappointed that the Draft Report recommends the continuation of dual-till monitoring without providing any evidence of benefit whatsoever and in the face of international and local expert evidence to the contrary.

Airports earn substantial profits on their retail and other non-aeronautical activities. As CEG found in its 2018 airport market power study for IATA, regulation on a single till basis with an airport's overall revenues set to just recover the airport's overall costs can enable lower aeronautical charges and increase overall benefits to consumers.

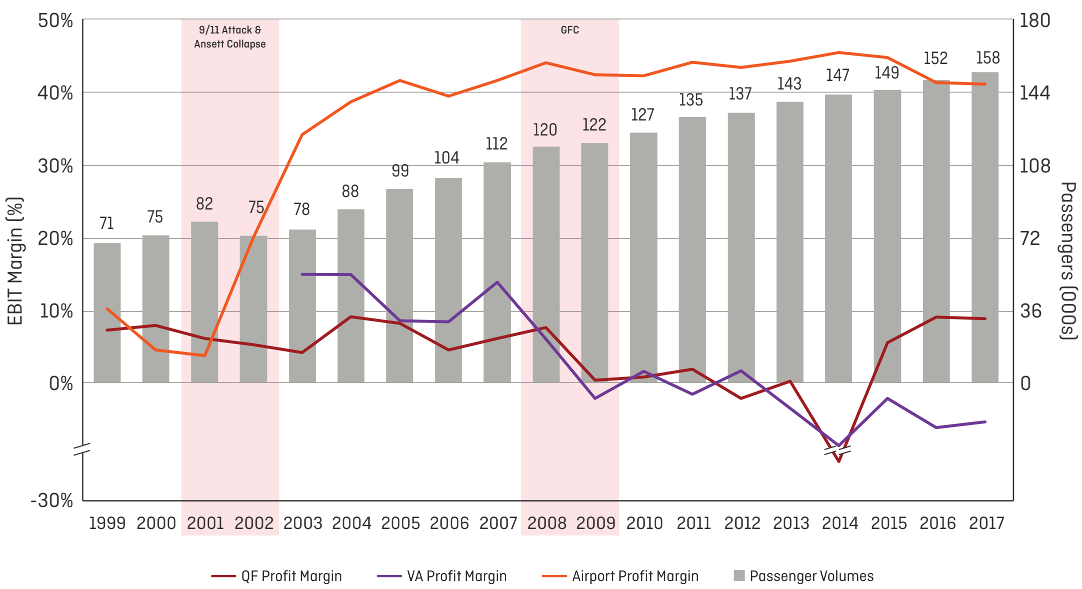
There are also many examples from other industries in which prices on one-side of a platform are kept low with costs being recovered largely or solely from other activities such as broadcast TV, social media platforms and newspapers supplied for free to individuals with costs recovered from advertising.

The UK Competition Commission considered arguments for and against a single till for the London airports and concluded in favour of a single till. Key elements of the Commission's reasoning were:

- no evidence that the single till had led to any general underinvestment in aeronautical assets at the London airports in the past, nor any expectation that it would do so over the next five years;
- dual till was not expected to lead to significantly better aeronautical investment in the future and in some respects was likely to be worse;
- dual till would only marginally improve the efficient use of capacity;
- conceptually perverse to separate commercial and aeronautical facilities as commercial revenues would not be generated without the aeronautical facilities;
- reasonable for the benefits of commercial activities to be shared with airlines and airline users as the development of commercial revenues requires airlines to attract passengers to the airport; and
- shift to a dual till would lead to higher airfares with little or no offsetting benefits.[93]

Figure 5: Volatility in airline margins

Volatility in the airlines industry has hit airline margins significantly, while airports margins have remained high given increasing passengers.



Source: ABS, ACCC Airport Monitoring Report, BITRE, Annual Reports

CEG reviewed wider European evidence suggesting that a single till approach can ensure sufficient revenues to support efficient investment levels.[94] Single till can also be applied with adjustments to support airports making commercial investments where they will bear the risks by excluding the revenues and costs of those investments from the calculation of the price cap.

Figure 6 (recreated from CEG's paper) shows the capacity utilisation index (CUI) for European airports operating under both regimes. The higher the value of the index, the higher capacity utilisation and capacity constraints.

Figure 6 shows that there is no link between the regulatory regime and capacity constraints. Indeed, airports such as Barcelona, Madrid and Dublin airports significantly increased their capacity from 2005 to 2015 while operating under a single till system.

TRANSPARENCY AND CONSISTENCY OF REGIONAL AIRPORTS' ASSET MANAGEMENT NEEDED

Qantas Group does not disagree with Draft Recommendation 10.7 and would encourage the Commission to go further in its recommendation in its Final Report.

Qantas Group contends that the Australian Government should review the Western Australian Strategic Airport Asset and Financial Management Framework now, in consultation with State, Territory and Local Governments.

It is in the interests of rate payers and air travellers for local governments to have sound asset management practices and greater transparency when determining airport charges at regional airports. It is disappointing that this is not already the case.

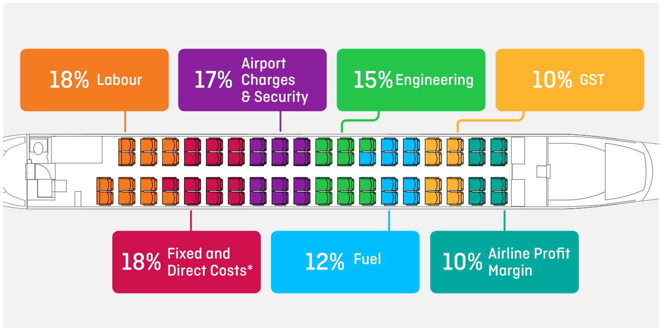
Significant community harm has been done to regional communities and regional jobs from unreasonable, irrational, high charges at regional airports leading to higher airfares and stifling demand for travel.

Pending the findings of that review, an Asset and Financial Management Framework should be adopted by State and Territory governments in other jurisdictions and tied to federal funding for local governments under the *Local Government (Financial Assistance) Act 1995*. This could be done through amending the National Principles formulated under subsection 6(1) of the Act. The Australian Government has transferred over $52 billion under the Financial Assistance Grant program to local government in the last 45 years. Greater accountability for this funding is reasonable.

The need for regional airports to exercise greater financial discipline and accountability is important given the direct impact increases in airport charges can have to the sustainability of many regional routes, particularly on regional services which provide marginal returns or do not return their cost of capital.

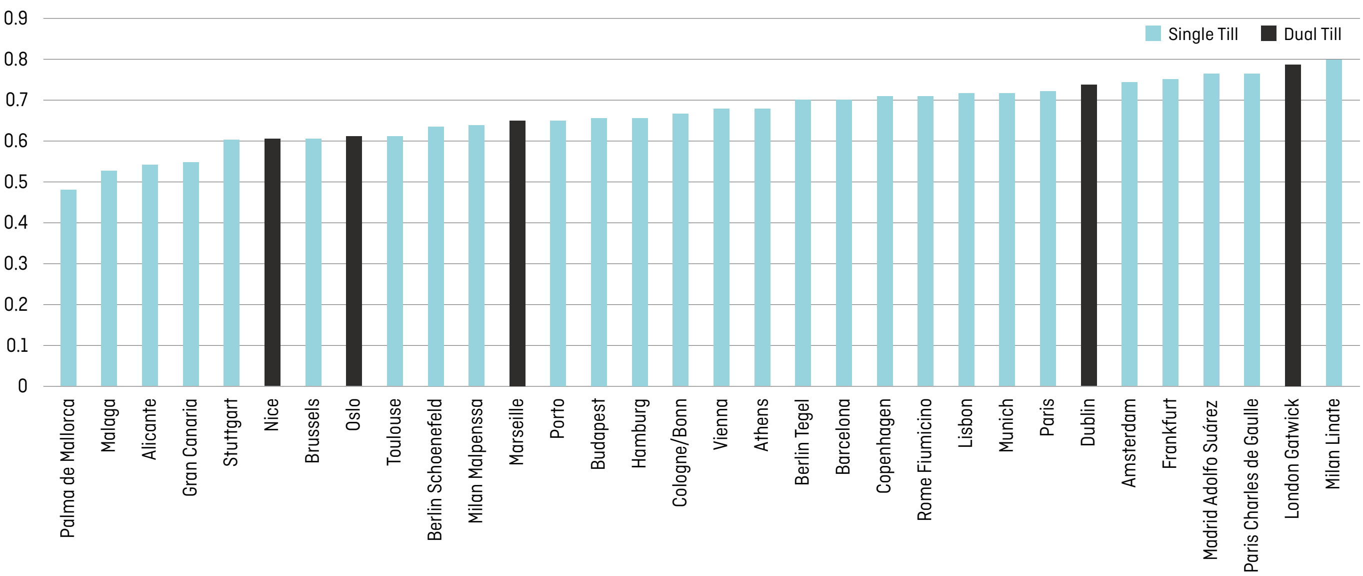
As seen in Figure 7, airport and security charges are the third-largest cost that goes towards a Qantas regional airfare.

Figure 7: The economics of a regional fare



Based on FY16-FY18 performance of a Dash 8 aircraft on intra-QLD routes. Includes depreciation, leases, property, ground handling, marketing, advertising, IT costs, customer reservation system fees, credit card charges and commissions and other expenses.

Figure 6: Airport capacity constraints in relation to till approach



Source: Table X with till approaches. SEO, 2017, The impact of airport capacity constraints on air fares SEO Capacity utilisation index. The index estimates capacity utilisation relative to the 5% busiest peak hour and is defined as the average number of movements per hour divided by the 5% peak hour capacity.

Lack of transparency in airport asset management and the arbitrary setting of airport charges by regional airports has meant large variations in charges with little to no explanation why. For example, when comparing Qantas Group operations at regional airports with fewer than 500,000 passengers, the average cost per passenger (excluding security) is $16 for airports in the southern regions of Australia and $25 for airports in the northern regions – over 50% higher.

The Commission's recommendation is a step forward in the right direction towards improving the asset management practices and level of transparency of regional airports.

Qantas Group notes with some bewilderment that the net result of Draft Recommendations 10.3, 10.4, 10.5, 10.6 and 10.7 is some additional scrutiny of the largest four airports and the approximately 80 smallest airports but no scrutiny at all of the 17 (federally leased) airports in the middle, including the national capital airport.

PRICE MONITORING IS NOT REGULATION

"If competition is not possible, then privatisation and regulation is a compromise solution."

Dr Stephen King[95]

Qantas Group agrees with the ACCC that the current price monitoring regime does not offer a credible threat if an airport operator is found to be exercising its market power to the detriment the community.[96] As the ACCC has stated over several years,

> "Monitoring alone is not enough to constrain the behaviour of companies with significant market power, such as airports."[97]
>
> "...the mantra that light-handed regulation means price monitoring is ill-conceived in economic theory and not working in practice."[98]
>
> "...it [price monitoring] does not amount to any form of regulation. Without competition, simply monitoring prices will not provide any discipline on pricing."[99]
>
> "Price monitoring does not amount to regulation."[100]

The same assessment applies for quality of service monitoring. Enhanced transparency of service quality monitoring is of limited value unless there is a credible threat linked to it. Further, as the ACCC has acknowledged, there are limitations to service quality monitoring:

> "Price and quality of service monitoring provide indicative information but do not permit an assessment of whether airports are economically efficient or whether they have used their market power."[101]

NATIONAL ACCESS REGIME NOT SEEN AS A CREDIBLE THREAT

Airports do not consider the National Access Regime a credible threat of regulatory intervention. Prior to the 2017 legislative changes to the "declaration criteria", accessing arbitration under the Regime was already lengthy, expensive and uncertain. Virgin Blue's ultimately successful application for declaration of certain Sydney Airport services took nearly 5 years to finalise, including appeals. This did not include time for any actual arbitration by the ACCC.

Today, obtaining a declaration under the amended National Access Regime is even more difficult, costly and uncertain.

The Commission has not given due regard to the significant time and uncertainty associated with an application for declaration, as Table 3 demonstrates. Qantas Group estimates the costs of pursuing declaration to be several million dollars and could take up to 5 years, allowing for appeals.

Table 3: Declaration Process Stages and Timing

Stage	Description	Decision maker	Timing
1	Prepare application to National Competition Council (NCC) for declaration of an infrastructure service.	Applicant	3 months +
2	Application made to NCC for declaration of an infrastructure service. NCC assesses the application against the declaration criteria in s.44CA and recommends to Minister to declare or not to declare the infrastructure service. Submissions sought from interested third parties. NCC produces a draft recommendation and allows the applicant and interested parties an opportunity to make further comments before making a final recommendation.	NCC	180 days + (plus possible extensions)
3	Minister decides to declare or not to declare the infrastructure service and must publish his or her decision. Minister may also invite submissions and consider any other relevant matters. Where no decision is published within the relevant time period, Minister is taken to have adopted the recommendation of the NCC.	Cth Minister (Federal Treasurer)	60 days after receiving NCC recommendation
4	Depending on the Minister's decision, original applicant or the service provider may request a review by the Australian Competition Tribunal within 21 days. Tribunal reconsiders matter based on information taken into account by the Minister. Tribunal can request further information it considers reasonable and appropriate to make a decision (see ss.44K, 44ZZOAA and 44ZZOAAA). Tribunal may affirm or set aside the original decision.	Tribunal	180 days (plus possible extensions)
5	Judicial review of declaration matters (legal reasoning and/or procedure) is possible at any stage during declaration process.	Full Federal Court /High Court	No statutory timeframe e.g. 8 – 12 months

The Commission acknowledges the uncertainty twice in its Draft Report:

> The revised declaration criteria are as yet untested in Court — any opinion on the likely outcome of an application for declaration is just that, an opinion.[102]
>
> (Emphasis added)

The Draft Report strengthens these concerns in Chapter 8, where it flags its potential support for an industry-specific regime for access to jet fuel:

> "A number of factors may have discouraged interested parties seeking access through the National Access Regime:
>
> – in 2011, the National Access Regime was tested on the Sydney JUHI and the Caltex pipeline but it did not lead to declaration of infrastructure services
>
> – an amendment to criterion (a) in 2017 has not yet been tested in court so any successful applications may result in a merits review and further litigation (noting the NCC is considering whether declaration of services at the Port of Newcastle should be revoked (discussed above))."[103]
>
> (Emphasis added)

Despite its own concerns regarding the effectiveness of the National Access Regime, the Commission concludes, perplexingly:

> The proponents have also failed to demonstrate why a negotiate/arbitrate framework specific to airports is needed when the National Access Regime enables airport users to seek declaration of airport services and subsequently to seek access to arbitration by the ACCC if negotiations fail.[104]
>
> (Emphasis added)

AERONAUTICAL PRICING PRINCIPLES ARE LARGELY UNENFORCEABLE

The Draft Report places undue importance on the non-binding, voluntary aeronautical pricing principles. In its Glossary, the Commission states that it has:

> "… drawn on these principles to assess the reasonableness of current aeronautical charges and the commercial negotiation process between airports and airlines."[105]

To be clear, aeronautical pricing principles are not regulation. Today they exist in two places – a 2007 government media release and a 2009 Draft Guideline developed for the National Aviation Policy Statement.[106]

Aeronautical pricing principles are not compulsory, legislated or enforceable. They are not even endorsed government policy This is further evidenced by Perth Airport seeking to apply an inconsistent pricing methodology in its legal case with Qantas.[107]

Aeronautical pricing principles are not binding on the four monitored airports. They do not apply at all to the other airports. Indeed, they are not even included in Figure 1.3 of the Commission's Draft Report which summarises the current airport regulatory framework.[108]

Qantas Group submits that as the Commission wishes to continue making an example of these principles, it should consider recommending that the Government legislate them.

Legislating aeronautical pricing principles will make them binding on all Australian monopoly airports and airlines, and improve overall commercial discipline and community welfare.

EVEN AIRPORTS ADMIT 'ROOM FOR IMPROVEMENT'

Qantas Group notes that even airports have admitted deficiencies in current negotiation frameworks. In their original submission, both the AAA and Sydney Airport agreed that there was room for improvement in the negotiation process between airports and airlines stating:

> "Taking submissions from airports, airlines and their representatives together, and putting aside obvious points of self-interest, it is reasonable to conclude that there is scope to improve the negotiating and contracting processes that underpin the provision of aeronautical services."[109]
>
> "Sydney Airport appreciates, however, that the negotiation processes and behaviours of both airports and airlines could be improved without the impost of commercially distorting regulation."[110]

In its submission to the Draft Report, the AAA admits there is "still room for improvement" and flags its intent to explore this further with international airlines through BARA. While the sentiment is commendable, it is difficult to take it seriously when the AAA continues to make egregious claims against Qantas Group, including in its submissions to the Commission. Indeed, the AAA's generosity does not appear to extend to the domestic airlines which transport a significant majority of travellers.[111]

LACK OF EFFECTIVE REGULATORY REFORM IS HOLDING BACK JOBS AND GROWTH

"Privatisation without competition risks turning a public monopoly into a private monopoly. The owners may change but the public will get ripped off just the same. What is the second option? If competition is not possible then the privatised business needs to be regulated so that it cannot exploit its market power."

Dr Stephen King[112]

In its supplementary submission to the Inquiry, A4ANZ presented analysis by Frontier Economics of the benefits of reform to deliver effective and truly light-handed regulation. Frontier estimated the impact of a range of behavioural changes including administrative and compliance cost reductions and more affordable travel for more Australians.

Even applying extremely conservative assumptions, there remains significant benefits associated with the necessary and minimal reforms advocated by A4ANZ including:[113]

- $445 million in net benefits with a benefit to cost ratio of 14:1,
- improved timeliness of negotiations valued at $34 million,
- full benefit of travel time saving valued at $410 million, and
- full benefit of deadweight loss valued at $36 million.

A4ANZ highlighted the additional impacts from airlines reinvesting savings in airport charges in improving the air traveller experience with reduced airfares, increased capacity on routes, renewed fleet capacity, preserved regional air services, collaborations with airports to progress innovations in customer experiences, improved domestic and international service levels.

AIR TRAVELLERS CANNOT WAIT UNTIL 2024 FOR FAIR AND COMPETITIVE AIRPORTS

Qantas Group disagrees with Draft Recommendation 10.2. Air travellers cannot afford to wait until 2024 for economic reform that is urgent and necessary today.

Qantas Group contends that there is no longer a justifiable role for the Commission to be involved in matters of airport regulation. Qantas Group agrees with the ACCC that,

> "...the credibility of threat from a Productivity Commission inquiry has diminished each time an inquiry recommended no action."[114]

These reviews should be abandoned and handed to a body with the credibility and expertise to investigate these matters.

Under the Commission's watch, Australian airports increased their revenue per passenger by 25% in real terms over the last decade, while airlines continued to lower airfares.[115] Car parking charges, access fees and the cost of everyday items have soared at the nation's airports during that time while service quality levels have decreased.

The Commission's inquiries are not regulation nor are they a substitute for it. The increasing number of protracted disputes, multiple examples of poor bargaining behaviour by monopoly airports and rising airport revenue proves that there is an inherent problem with the current regulatory regime which continues to be endorsed by the Commission.

Draft Recommendation 10.2 also requests the Australian Government stipulate in the terms of reference of the next inquiry that "*on request, the monitored airports should make their agreements with airport users available to the Productivity Commission*".[116]

Qantas Group again submits that the Commission already has powers to request a range of documents from airports under Section 48 of the *Productivity Commission Act 1998*. Qantas Group requests clarification from the Commission on whether airports have attempted to obstruct or frustrate this inquiry in any way.

Qantas Group agrees with leading industry experts that because of clear evidence of unjustifiable price increases and other systematic misuse of market power across the monitored airports, airport regulatory reform is urgently today, not in another 5 years.

2. Car Parking and Landside Access

The Commission's conclusions that there is little evidence of Sydney, Melbourne, Brisbane and Perth airports exercising their market power in car parking is deeply concerning. Qantas Group submits that the Commission has the ability to compel further information from airports and car park operators to determine whether and how airports are exercising their monopoly power.

The Commission risks sending a signal to landside operators that it is acceptable for airports to charge exorbitant prices and generate extreme profits from car parking and transport access to the detriment of airport users, air travellers and the community at large.

Submissions made by Essential Services Commission (ESC) and Andrew's Airport Parking Group (AAPG) clearly demonstrate consistent bullying by the monopoly Australian airports and the untethered ability to unilaterally increase fees without explanation.

ESC alerted the Commission to two separate occasions when Melbourne Airport asked ESC to increase the airport rank fee that taxis may charge passengers and then later advised it would increase the access fee regardless of ESC's decision.[117] In effect, this meant that if the airport rank fee was not increased, taxis would need to absorb the additional costs.[118]

The AAA wrongly claims that,

> "no evidence has been presented that airports have used their control of ground access to advance their own car parking businesses."[119]

AAPG's submission highlighted serious issues in its dealings with airports, which directly or indirectly disadvantage its business with respect to airport-owned car parks:[120]

- since AAPG began paying access fees at Melbourne Airport in September 2004, fees have continued to increase without any formal notification or clarification of methodology; and
- despite significant increases in access fees at Brisbane and Melbourne Airport, infrastructure and services specific to off-airport parking remain largely unchanged at both airports and discussions with both airports have become cursory.

Qantas Group is also aware that at-distance car park businesses and other landside transport businesses, such as car rental companies and hire car operators have been subject to punitive measures and even intimidation for raising concerns about airport behaviour. It is likely that many smaller businesses and sole operators are simply too afraid to come forward for fear of retribution or commercial disadvantage.

Despite the AAA's spurious claims to the contrary, over the years, ACCC Monitoring Reports indicate the exercise of airport market power and their ability to systematically extract monopoly profits. In 2017-18, the ACCC found profit margins for airport car parking ranged from 52.7% for Perth Airport to 69.9% for Sydney Airport.[121] Over the past 10 years, Sydney, Melbourne, Brisbane and Perth airports have made a combined operating profit of $2.5 billion from car parking charges alone.[122]

In spite of having the lowest profit margins for the largest four airports, Perth Airport is by no means missing out. Between 2010-11 and 2016-17, Perth Airport's short-term one-hour parking charges increased by 93%, while long-term seven-day parking charge increased by 53%.[123]

Further, the Commission stated that:

> "...on average across the monitored airports, short-term users accounted for approximately 78 per cent of at-terminal car park users in 2016-17"

and that

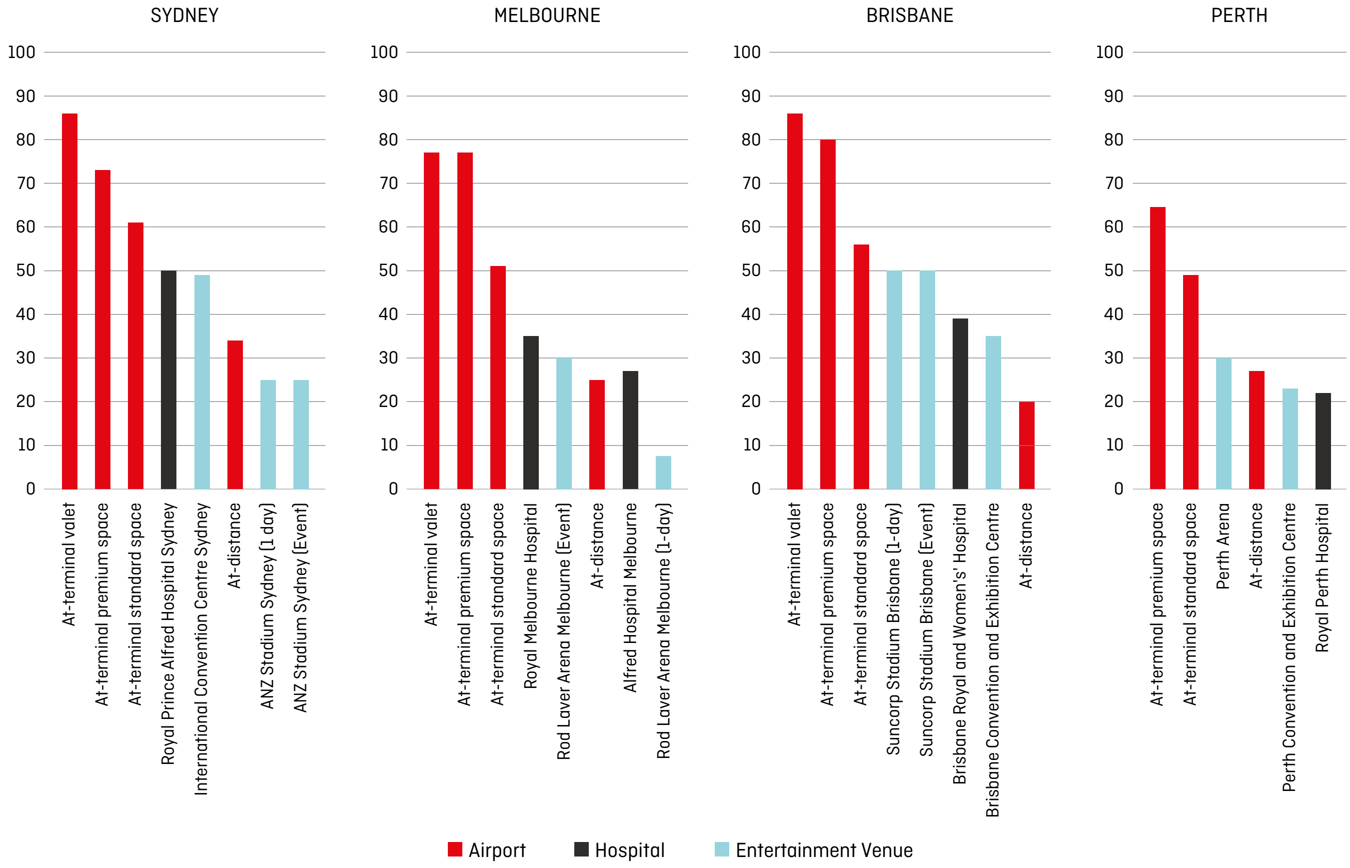
> "at-distance and off-airport car parks are poor substitutes for terminal-adjacent car parks for most short-term users."

This lack of substitution highlights the fact that there is little to no constraint to airport operators profiteering from car park pricing for short-term users.

The Commission suggests that the value people place on convenience is not limited to airports. Qantas Group does not dispute that people are willing to pay a premium for more convenient parking locations. What is of concern is the *excessive* premium extracted from this service – which the Commission's own data reflects. For example, at Perth Arena it costs $25 to park a car for 1 day (Figure 6.2 of Draft Report) compared to Perth Airport which is around $49 for 24 hours an at-terminal standard space (Figure 6.1 of the Draft Report) – a 96% difference.

Figure 8 shows that when the Draft Report's car parking data is reorganised from highest to lowest cost in each city, the disparity of charges becomes clear. Australia's monopoly airports, without exception, charge the highest rates by far of any comparable location.

Figure 8: Airport vs hospital and entertainment venue car parking charges



Source: Productivity Commission Draft Report, p. 187 and 189.

Indeed, even the Commission admits that drivers may be hit by a "nasty surprise" in comparing car parking options.[124]

While the Commission has selected hospital and entertainment venues in order to compare prices charged by airports, the same comparison cannot be made for other transport access. Taxis and rideshare services such as Uber are charged access fees at the monitored airports but no such fees are imposed at hospital or entertainment venues. Sydney Airport's access charges for taxis and Uber rideshare services can be seen in Figure 9 below:

Figure 9: Taxi and rideshare access fees at Sydney Airport and a non-airport location

Prices and Charges	SYD Airport	Non-airport Location
Taxi access charge[125]	$4.60	$0
Uber access charge[126]	Domestic: UberX – $4.20 UberBlack – $8.40 International: UberX – $4.20 UberBlack – $11.00	$0

In light of the evidence both tabled to and used by the Commission, it is unclear how the Draft Report arrived at its conclusions that current airport behaviour regarding car parking and landside access is satisfactory.

It is ludicrous for the AAA to claim that Qantas Group has not identified ways to reduce exorbitant airport charges for land transport access to airports.[127] Qantas Group submit that it is in the hands of AAA members to stop charging excessive fees to airport users.

Qantas Group has consistently argued that without effective, light-handed regulation with access to arbitration as a last resort, airports have little incentive to behave and price more competitively.

3. Sydney Airport Access Arrangements

Qantas Group's regional network operates over 2,300 flights each week to 48 regional destinations on 73 routes across Australia. In NSW, Qantas Group flies to 10 regional destinations and operates around 527 services a week. In the year ending February 2019, Qantas Group flew over 2 million passengers on its regional NSW network.

REGIONAL RING-FENCING

Qantas Group does not disagree with Draft Recommendations 7.1 and 7.2. However, Qantas Group would caution against any radical changes to a scheme that is delivering the desired outcome for regional NSW. Qantas Group continues to support the preservation of the current slot allocation principles at Sydney Airport including the regional ring fencing regime. Qantas Group is open to evaluating an alternate scheme should more details become available.

AIRCRAFT MOVEMENTS

In relation to the Commission's commentary on aircraft movement regulations at Sydney Airport and its Information Request 7.1, Qantas Group acknowledges there is widespread community acceptance of the 80 movements an hour cap at Sydney Airport. As well as being a regulatory compliance obligation, the hourly cap is seen as an important component of Sydney Airport's social licence to operate by the community and governments.

Qantas Group recognises there is merit in a reconsideration of the precise manner in which the 80 movements an hour cap is measured. The current system of counting movements in 15-minute intervals inadvertently impacts the punctuality of airlines, increases holding times and affects fuel consumption and carbon emissions.

During peak periods, several flights can be delayed as a result of the measurement methodology, which adds to pressure on aircraft to arrive back in Sydney prior to the evening curfew. This can also cause a higher than usual number of arrivals prior to the commencement of curfew at 11pm. Qantas Group believes that adding some flexibility to the 80 movements an hour in 15-minute intervals would ensure the cap and the principles underpinning it are preserved while continuing to benefit the community at large.

The curfew came into force in 1989 to limit the noise to the neighbouring community and Qantas Group does not oppose the underlying principles of the curfew, albeit minor amendments to deal with overnight freight movements and practical measures to deal with extraordinary weather and infrastructure events.

As technology has advanced in the past 30 years, freight aircraft have become markedly quieter. Qantas Group contends there is scope to review certain aspects of the curfew to deliver additional flexibility while meeting the original policy objectives and lowering the noise impact. These include:

- Amendment to Section 13 of the *Sydney Airport Curfew Act 1995*, which refers to "BAE-146 and DC9 Aircraft used for freight" to allow additional aircraft types to be utilised for overnight freight operations, specifically the Boeing 737 or Airbus A320 type, aircraft which are built or modified to Chapter 4 compliance. When compared to the BAE-146, these modern aircraft deliver a significant community benefit in terms of noise reduction on flight paths to the south of the airport.
- Amend the Curfew Dispensation Guidelines at Sydney Airport to include weather, aircraft serviceability, security, safety, airport infrastructure constraints and force majeure to better serve air travellers and the community at large.

EFFECTIVENESS OF WORLDWIDE SLOT GUIDELINES

Qantas Group disagrees with Draft Recommendation 7.3 and submits that the Commission has failed to grasp the real drivers of aviation capacity constraints, namely, inefficiencies in existing infrastructure and lack of investment in necessary, fit-for-purpose aviation infrastructure.

The air transport industry is a complex network of routes relying on global connectivity and consistency in common rules and procedures. Slot allocation principles are based on consistency and certainty regardless of country, scale of congestion or airline serving the market. The process works to serve all airlines fairly, non-discriminately and transparently to ensure equal access and competition.

Slot coordination is a process by which all constrained airport infrastructure is allocated for use by all airlines, and includes all terminal facilities, gates, aprons, runways and other associated airport infrastructure. This complex process ensures all infrastructure can accommodate planned flights.

The strategic review into the Worldwide Slot Guidelines (WSG) is a tripartite process, being conducted by Airports Council International (ACI), International Air Transport Association (IATA) and the Worldwide Airport Coordinators Group (WWACG).

While Qantas Group recognises the WSG are not perfect, they are a fair, transparent and efficient way to allocate available capacity at the busiest airports.

The current slot process at Sydney Airport is highly dynamic and mobile. Airlines swap slots one for one, both during coordination and during the season, providing much needed flexibility to respond to demand changes, optimise schedules for operational reasons and build efficiency in connectivity.

Key issues including the new entrant rule and the timing and transparency of allocation of slots, are currently under consideration in the strategic review. Some of the recommendations on the 'Availability of Airport Capacity', 'Demand and Capacity Analysis' and 'The Role of the Coordinator' from this strategic review have already been implemented in the current edition of the WSG – without the need for government or regulatory intervention.

The global aviation industry recognises the strategic review is a good opportunity for ongoing improvements under a global umbrella. Qantas Group believes there is no value in the government commissioning a public review of the WSG following the completion of the strategic review. To add unnecessary complexity and parochialism in isolation of a recognised and accepted global standard that over 200 airports follow will harm rather than benefit air travellers.

AIRPORT SLOT AUCTIONS

Qantas Group is troubled by the Commission's reference to slot auctions in its Draft Report.[128] Any proposal to auction capacity contradicts the government's equity-based objective to allocate capacity to enhance domestic and regional connectivity and provide new opportunities for new entrants to new and existing markets.

An auction basically determines the willingness of carriers to pay for slots and does not consider small incumbents and new entrants. Qantas Group has seen no evidence that auctions deliver a better distribution of new slots that meets the needs of air travellers or community needs. In contrast, there is proven evidence[129] that the existing WSG allocation process fairly balances all considerations, enables competition and produces an optimised outcome of a congested airport's facilities.

It is difficult to envisage how an auction could be conducted to allocate available scarce capacity and maintain the same principles of fairness, non-discrimination, transparency and certainty that are recognised by ICAO, global governments and all aviation stakeholders.

The WSG is regularly updated and is currently undergoing a tripartite strategic review to ensure it reflects the needs of the aviation industry.

It provides a proven and practical global solution that allocate slots efficiently and effectively.

4. Competition and Supply in Jet Fuel

This chapter considers Draft Finding 8.1 and Draft Recommendations 8.1 and 8.2 and where possible, provides additional information to support the Commission's requests.

FUEL THROUGHPUT LEVIES INDICATE ABUSE OF AIRPORT MARKET POWER

The systematic abuse of market power by Australian monopoly airports is evident in the application of a Fuel Throughput Levy (FTL).

A FTL is not commensurate to the provision of any additional product or service and therefore the revenue from the FTL represents a windfall gain by monopoly airports. In addition, revenue derived from the FTL is not offset against the allowable revenue calculated as part of the other aeronautical charges paid by airlines. This has a direct impact on airline fuel prices as the fuel providers pass through the cost directly to airlines as a higher fuel price. Airlines have no ability to negotiate this fee.

The Sydney joint user hydrant installation (JUHI) facility pays Sydney Airport for use of land through leasing fees and access to the hydrant through licence fees. These fees cover the entirety of Sydney Airport's potential cost of hosting the JUHI facility.

At Sydney Airport, the FTL delivers a windfall gain of approximately $17 million a year from total fuel sales at the airport. No additional service is provided by Sydney Airport to oil companies or airlines as a result of this fee, and the airport continues to arbitrarily increase the fee, as seen below:

- In October 2012, Sydney Airport first introduced a FTL at 0.4 Australian cents per litre (AcpL)
- In October 2014, Sydney Airport increased the FTL to 0.5 AcpL.

No justification was provided to Qantas Group to explain the previous increase and it has set a disturbing precedent for the airport's ability to impose future increases.

Another example is Darwin International Airport who introduced a FTL and infrastructure fee in 2017. These fees were introduced ostensibly as a result of opening up the Darwin jet fuel market to competition due to a renegotiation of the lease between the airport and the JUHI. We understand that the infrastructure fee at Darwin International Airport essentially re-values assets that have already been largely depreciated.

Due to the relatively small throughput of jet fuel at Darwin International Airport, it is unlikely more competition will materialise and consequently Qantas Group has already seen an increase in jet fuel prices. Darwin International Airport therefore enjoys a windfall gain of $0.6 million per annum, with no additional service provided while airlines pay more for jet fuel.

Other airports charging a FTL include Alice Springs, Broome, Archerfield, Tennant Creek and Canberra and we understand that there are other airports where the charging of a FTL has been flagged.

With respect to Canberra Airport, the fee consists of an infrastructure charge and a FTL with no transparency on the split between the two charges.

It is clear FTLs are a blatant demonstration of the abuse of airport monopoly power and should cease immediately.

The issue of efficacy of a FTL has been considered in the Australian context by regulatory authorities since airport privatisation in 1998. Even at that point in time, the ACCC found that FTLs would significantly increase the price of refuelling services and the levy was not justified in terms of increases in costs or through offsetting reductions in other charges. This pointed to airport operators exercising market power in the provision of refuelling. Qantas Group maintains that some 20 years later, the efficacy of FTLs has not changed. The only issue that has changed is the number of airports charging this levy increasing from two in 1998, to seven today. It is an additional charge unrelated to infrastructure improvements or lease benefits. It is blatant profiteering.

In light of the above and the unique opportunity the Australian Government has in establishing best practice in jet fuel infrastructure at Western Sydney Airport, Qantas Group requests the Commission ensures that the Western Sydney Airport Corporation does not impose a FTL.

Further, Qantas Group also submits that the existence of a FTL highlights a significant flaw in the Commission's focus on prices charged by airports for various services to multiple users rather than the total revenue earnt by airports. Without sufficient transparency and a credible threat of regulatory intervention, there is a high probability that airports such as Sydney Airport will simply move that revenue pool elsewhere through excessive charging of either airlines, fuel companies or other airport users.

OPEN ACCESS JUHI AT WESTERN SYDNEY AIRPORT NECESSARY BUT NOT SUFFICIENT

Qantas Group does not disagree with Draft Recommendation 8.1.

Qantas Group submit that resolving on-airport access arrangements is only part of the necessary policy framework needed to deliver reliable aviation fuel supply. Airlines operating at Western Sydney Airport will require fit-for-purpose infrastructure on and off-airport and reasonable access to both.

Justification and transparency of open access pricing is required. Airport users need transparency of the pricing mechanism in the open access environment which funds adequate but not excessive investment in infrastructure with a reasonable return, and fees for actual services provided (without FTL). While Melbourne Airport has open access, the charge for the use of the JUHI is opaque to airlines.

JET FUEL SUPPLY COORDINATION AND INFRASTRUCTURE URGENTLY NEEDED

Qantas Group supports Draft Finding 8.2. An ongoing coordination forum for infrastructure planning and price setting is necessary to improve the consultative process between airports, oil companies, airlines and the government and increase airport transparency.

The Jet Fuel Roundtable, which was established by the Victorian State Government in response to the critical supply issues at Melbourne Airport, is an example of where such forums have led to positive outcomes. This roundtable has been a useful information sharing forum, exposing the State Government to the issues associated with the supply of jet fuel at the major ports.

The critical problem with jet fuel is the lack of infrastructure investment. For example, at Sydney Airport, infrastructure investment is stalled as the airport has not given long-term lease tenure to the on-airport storage operator. Therefore, Qantas Group supports any forum which can be used to discuss the lack of timely infrastructure investment, with the aim that these discussions would lead to more funding.

While Qantas Group welcomes this recommendation, it does not go far enough as jet fuel supply issues are not isolated to only the four monitored airports. Therefore, this recommendation should be extended to other airports including Adelaide Airport, Canberra Airport and Northern Territory Airports.

To ensure security and quality of supply, Qantas Group also advocates the inclusion of fuel demand and supply infrastructure considerations in all federally-leased airport master plans. There is currently no effective process whereby infrastructure owners, airports and airlines engage with respect to future on-airport fuel facility infrastructure requirements. Airlines are directly affected and impacted by jet fuel investment decisions by Australia's monopoly airports and therefore need a greater involvement in the process.

Endnotes

1 The Grattan Institute, 'Competition in Australia – Too little of a good thing?', December 2017, p.39.

2 UBS, Global Airports – Trends and prospects for traffic growth, retail and regulation, July 2018.

3 Frontier Economics, quoted in A4ANZ submission - Appendix D - Conservative estimate of net benefits of the reforms, p.3.

4 The Economist, Flying High, June 2015, https://www.economist.com/finance-and-economics/2015/06/04/flying-high

5 Anthony Albanese, Twitter, 5 February 2019.

6 AAA Submission to Draft Report, p.9.

7 Productivity Commission Draft Report, p.119.

8 The Grattan Institute, 'Competition in Australia - Too little of a good thing?', December 2017, p.39.

9 Herald Sun, 'Throttle back parking profits,' 23 February 2019, https://readnow.isentia.com/Temp/96824-53268856/1082594806.pdf

10 Sydney Airport, Summary Table of Charges from 1 January 2019, https://assets.ctfassets.net/v228i5y5k0x4/lcHpFD7La0gYg6KwU0ukY/9ba50ce25109312feaff28a7a315152e/Table_of_Charges_COU_Version_2.38_-_1_January_2019.pdf (accessed 22 March 2019).

11 A4E, Don't believe the airport myth on investments and capacity, 8 March 2019, https://a4e.eu/dont-believe-the-airport-myths-on-investments-and-capacity/ (accessed 14 March 2019).

12 ACCC, 'Airport profits mostly up, but service also improves,' Media Release, 25 February 2019.

13 ACCC, 'Airport profits mostly up, but service also improves,' Media Release, 25 February 2019.

14 A4ANZ submission, Appendix B, p.2.

15 Paul Lindwall response to The Mandarin, 'How The Productivity Commission Undermines Scientific Literacy In Policy,' 2019, https://www.themandarin.com.au/103892-how-the-productivity-commission-undermines-scientific-literacy-in-policy/ (accessed 13 March 2019).

16 A4ANZ submission to Draft Report, p.8-9.

17 CEG, Effective regulation of airport market power: A report for Airlines for Europe and IATA, October 2018, p.4.

18 CEG, Effective regulation of airport market power: A report for Airlines for Europe and IATA, October 2018, p.4.

19 CAA, Market power determination in relation to Heathrow Airport – statement of reasons, p.8-9.

20 A4ANZ submission to Draft Report, p.27.

21 CEG, Effective regulation of airport market power: A report for Airlines for Europe and IATA, October 2018, p.3.

22 CEG, Effective regulation of airport market power: A report for Airlines for Europe and IATA, October 2018, p.44.

23 Productivity Commission Draft Report, p.166.

24 CEPA, Economic analysis to support Qantas' submission to the Productivity Commission, 6 September 2018, p.4.

25 This is a based on the four airports' combined non-current assets being approximately $8 billion, as per the ACCC's 2016/17 monitoring report.

26 The NZCC's 2002 decision was based on a range of 0.4 to 0.6 and it chose the mid-point. AER took over the regulation of energy from IPART and ACCC in the mid-2000s.

27 AAA submission 2018, Attachment 1.

28 The Competition Commission's 2007 report on the price controls at Heathrow and Gatwick airport noted the following: "[Our] methodology gives considerable weight to empirical observations of BAA's historical share price movements. We believe that this approach to the estimation of beta provides by far the most robust insights into investors' perceptions of the riskiness of BAA's shares when it was a listed company and, through this, the riskiness of individual airports."

29 Figures 1 and 2 were prepared by CEPA at Qantas Group request after analysing Bloomberg data using NZCC asset beta spreadsheet, March 2019.

30 Averch, H and Johnson, L, 'Behavior of the Firm Under Regulatory Constraint' (1962) American Economic Review, Volume 52 (5) p.1052–1069.

31 CEPA, 'Expenditure incentives faced by network service providers - Australian energy market commission - Final Report', 25 May 2018, p.62-64.

32 Qantas Group submission, Appendix 3 – Norton White Lawyers: Memorandum of Advice on Aviation Security, p.4.

33 Northern Territory Airports, Conditions of Use (1 July 2018), p.17 https://www.alicespringsairport.com.au/node/854/attachment (accessed 12 March 2019).

34 Qantas Group submission, p.49.

35 Vertigan, M, 'Examination of the Current Test for the Regulation of Gas Pipelines', 14 December 2016, http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Examination%20of%20the%20current%20test%20for%20the%20regulation%20of%20gas%20pipelines%20-%20Final%20Report.pdf

36 Australian Treasury, 'Review of Price Regulation of Airport Services,' Media Release, 30 April 2007.

37 A4ANZ submission, p.47.

38 ACCC, Airport Monitoring Report 2017-18, 25 February 2019.

39 ACCC, submission, p.31.

40 ACCC, submission, p.31.

41 Productivity Commission Draft Report, p.174.

42 Productivity Commission Draft Report, p.105.

43 ACCC submission, p.3.

44 Productivity Commission Draft Report, p.322.

45 BITRE, International Airline Activity, https://bitre.gov.au/statistics/aviation/international.aspx (accessed 23 March 2019)

46 Speech by ACCC Chairman Rod Sims, 'How did the light handed regulation of monopolies become no regulation', 29 October 2015.

47 Qantas Group submission, p.14.

48 ACCC, 'All-inclusive price advertising: Airfares,' Media Release, 13 May 2002.

49 Sydney Morning Herald, 'Travellers paying more to fly because of airport fees: ACCC', 25 April 2018.

50 Qantas Group submission, p.16.

51 SBS, Profits at Australian Airports Keep Fares High, 26 April 2018.

52 Productivity Commission Draft Report, p.120.

53 Qantas Group submission, p.8.

54 ACCC Merger Guidelines, November 2017 as amended, p.44.

55 Productivity Commission Draft Report, p.119.

56 There is no well understood threshold at which Countervailing Power becomes relevant. What is important is the asymmetry in the market shares of the negotiating parties. In most instances' airports are likely to have a 100% market share which almost always exceeds the Qantas groups share of capacity. By contrast the top 15 domestic airports (by capacity) account for >90% of domestic capacity and Qantas Groups' (Qantas and Jetstar) shares averages 60% at these airports.

57 Productivity Commission Draft Report, p.101.

58 Productivity Commission Draft Report, p.101.

59 Productivity Commission Draft Report, p.101.

60 Productivity Commission Draft Report, p.112.

61 Canberra Times, 'Qantas hits back at aggressive Canberra Airport tactics', 13 May 2018.

62 Productivity Commission Draft Report, p.12.

63 Productivity Commission Draft Report , p.120.

64 Productivity Commission Draft Report, p.61.

65 Frontier Economics, quoted in A4ANZ submission, Appendix A - The market power of Australian airports, September 2018, p.104.

66 Qantas Group submission, p.6.

67 Productivity Commission Draft Report, p.13.

68 Productivity Commission Draft Report, p.290.

69 ACCC, Airport Monitoring Report 2016-2017 Supplementary Spreadsheet B Indicators and Statistics Used, 26 April 2018.

70 Productivity Commission Draft Report, p.144.

71 Productivity Commission Draft Report, p.168.

72 Productivity Commission Draft Report, p.170.

73 Perth Airport, Conditions of Use for Aeronautical Services and Facilities, 1 July 2018, https://www.perthairport.com.au/-/media/Files/CORPORATE/Work-with-us/Airport-charges/Conditions-of-Use-for-Aeronautical-Services-and-Facilities-Perth-Airport-Final.pdf?la=en (accessed 13 March 2019).

74 AAA Submission, p.84

75 Perth Airport, Statement of Claim, Supreme Court of Western Australia, No. CIV3147/2018.

76 Productivity Commission Draft Report, p.116.

77 Sydney Airport Industry Consultative Forum, 6 June 2017, slide 12; Sydney Airport Industry Consultative Forum, 21 June 2018, slide 60.

78 Choice, Airport Parking Monopoly Pricing: Why improve customer service when you don't have to? 5 April 2016 https://www.choice.com.au/travel/on-holidays/airlines/articles/airport-parking-monopoly-pricing

79 Commonwealth Ombudsman, Complaint Handling in Australian Airports – Own Motion Investigation, May 2007, p.16.

80 A4E, Don't believe the airport myth on investments and capacity, '8 March 2019, https://a4e.eu/dont-believe-the-airport-myths-on-investments-and-capacity/ (accessed 12 March 2019).

81 Airports Act 1996 (Cth) s70.

82 Productivity Commission Draft Report, p.81-92.

83 Qantas Group submission, p.44.

84 Airport Development Group, Annual Report 2016-17, p.2 file:///D:/Users/204312/Downloads/adg_annual_report_2017_digital%20(2).pdf; Brisbane Airport Corporation Annual Report 2017, p. 5 https://bne.com.au/sites/ default/files/2017-10/BAC-Annual-Report-2017.pdf; Adelaide Airport, Management and Governance https://www. adelaideairport.com.au/corporate/about-us/managementgovernance/

85 AAA Submission to Draft Report, p.7.

86 ABC, 'Qantas boss Alan Joyce likens Canberra Airport to Somali pirates; airport responds with bewilderment', 25 May 2018.

87 Qantas Group submission, p.17.

88 ACCC submission, p.18.

89 Productivity Commission Draft Report, p.127.

90 Productivity Commission Draft Report, p.128.

91 IATA, Single Till, https://www.iata.org/policy/Documents/single-till.pdf (accessed 14 March 2019).

92 Qantas Group submission, p.18.

93 CAA, Market power determination in relation to Heathrow Airport – statement of reasons, p.8-9

94 CEG, Effective regulation of airport market power: A report for Airlines for Europe and IATA, October 2018, p.42-43.

95 The Conversation, 'A Privatised Monopoly Is Still A Monopoly, And Consumers Pay The Price', 24 June 2014.

96 ACCC submission, p.36.

97 ACCC, 'Airport profits mostly up, but service also improves,' Media Release, 25 February 2019.

98 Speech by ACCC Chairman Rod Sims, 'How did the light handed regulation of monopolies become no regulation', 29 October 2015.

99 Speech by ACCC Chairman Rod Sims, Ports: What measure of regulation, 20 October 2016.

100 ACCC, 'Privatisation needs smarter regulation,' Media Release, 4 August 2016.

101 ACCC submission, p.32.

102 Productivity Commission Draft Report, p.284.

103 Productivity Commission Draft Report, p.265.

104 Productivity Commission Draft Report, p.316.

105 Productivity Commission Draft Report, p.13.

106 Peter Costello, 'Productivity Commission Report – Review of Price Regulation of Airport Services', Press Release, 30 April 2007; Department of Infrastructure, Transport, Regional Development and Local Government, Aeronautical Pricing Show Cause Guideline, January 2009, https://infrastructure.gov.au/aviation/airport/files/Aeronautical_Pricing_Show_Cause_Guideline_22_December.doc

107 Perth Airport, Statement of Claim, Supreme Court of Western Australia, No. CIV3147/2018.

108 Productivity Commission Draft Report, p.5.

109 AAA submission, p.9.

110 Sydney Airport submission, p.5.

111 AAA Submission to Draft Report, p.10.

112 The Conversation, 'A Privatised Monopoly Is Still A Monopoly, And Consumers Pay The Price' 24 June 2014.

113 A4ANZ submission, Appendix D, p.3.

114 ACCC submission, p.31.

115 BITRE, Domestic Air Fares Indexes, 14 March 2019, https://bitre.gov.au/statistics/aviation/air_fares.aspx#index (accessed 20 March 2019).

116 Productivity Commission Draft Report, p.38.

117 Essential Services Commission submission, p.1.

118 Essential Services Commission submission, p.1.

119 AAA Submission to Draft Report, p.11.

120 Andrew's Airport Parking Group submission, p.3.

121 ACCC, Airport Monitoring Report 2017-18, 25 February 2019.

122 ACCC, Airport Monitoring Report, reports sourced from 2008 – 2018.

123 ACCC, Airport Monitoring Report 2010-2011, 29 March 2012, p.15; ACCC, Airport Monitoring Report 2016-2017, 26 April 2018, p.40-41.

124 Productivity Commission Draft Report, p.194.

125 Sydney Airport, By Taxi and Rideshare, https://www.sydneyairport.com.au/info-sheet/by-taxi-and-rideshare-international (accessed 15 March 2019); Melbourne Airport, Taxis, Rideshares and Chauffeurs, https://www.melbourneairport.com.au/Passengers/To-from-the-airport/Taxis-chauffeur (accessed 15 March 2019); Hospital/Stadium example needed

126 Uber, https://www.uber.com/en-AU/airports/syd/ (accessed 15 March 2019); https://www.uber.com/en-AU/blog/melbourne/melbourne-airport-uberx-pickups-have-landed/ (accessed 15 March 2019)

127 AAA Submission to Draft Report, p.2.

128 Productivity Commission Draft Report, p.238.

129 NERA Consulting, 'Study to Assess the Effects of Different Slot Allocation Schemes', January 2004, p.214.

5. Appendices

Appendix 1

Frontier Economics – Countervailing Buyer Power: A Report for Qantas

22 MARCH 2019

COUNTERVAILING BUYER POWER

A REPORT FOR QANTAS

CONTENTS

Tables

Figures

Boxes

OVERVIEW

Qantas[1] has asked Frontier Economics for its assessment of the likelihood of Qantas being able to wield countervailing power to inform its submission to the Productivity Commission's 2018 draft report on the economic regulation of airports.[2] This report presents the outcomes of our analysis.

Countervailing power is a term used to describe the ability of buyers in downstream markets to counteract the ability of an upstream supplier to exercise its market power.

The Productivity Commission has suggested that airlines can, and do, exert countervailing power on airport operators when they control a significant proportion of the market. The Productivity Commission cites evidence that airlines operate in concentrated markets as a factor explaining why airports may hold market power, but not be able to exercise it.[3]

We disagree. Countervailing power is largely an irrelevant and immaterial consideration in airport charge setting. This is because there are very few circumstances in Australia where the necessary conditions for countervailing power would hold.

Bypass options create countervailing buyer power

Competition authorities frequently consider whether market power that might be created by a merger can be offset by countervailing power of buyers. These authorities suggest that it is more than the ability to switch suppliers which is critical to countervailing buyer power; it is something which reflects additional leverage over suppliers. This might reflect size or commercial significance of customers; however, authorities recognise that where inputs are essential, only bypass can provide leverage. For example, the ACCC's merger guidelines emphasise that:

> *"… the size and commercial significance of customers … is not sufficient to constitute countervailing power. ...if the supplier's product is an essential input for the buyer, the only way the buyer can defeat any attempted increase in market power is if it can credibly threaten to bypass the supplier."*[4]

To apply this to present circumstances, the Productivity Commission appears to accept that at least for the tier 1 monitored airports, each airport's services are an essential input for airlines.[5] Competition authorities including the ACCC would then suggest that for countervailing power to offset an airport's

[1] In this report we refer to either Qantas or Qantas Group (Qantas plus Jetstar).

[2] Productivity Commission (2019), "Economic Regulation of Airports, Draft Report", p. 9. (**Draft report**)

[3] Draft report, p. 9.

[4] ACCC Merger Guidelines, November 2017 as amended, p44. Similar wording arises in the European Commission's horizontal merger guidelines (section V) and the US horizontal merger guidelines (Section 8).

[5] Draft report, p. 104.

market power, airlines would need to be able to credibly threaten to bypass an airport. Bypass typically takes the form of vertically integrating into the upstream market or sponsoring new entry.[6]

Airlines cannot bypass an airport

Airlines cannot credibly threaten to bypass an airport. Even were it to be commercially feasible, such options are limited by ownership restrictions in s44 of the *Airport Act 1996 (Cth).* Indeed, as noted by the Productivity Commission in its draft report, the only options actually available to airlines in negotiations with airports include reducing or ceasing services to an airport, or refusing to pay on time.[7] These are not bypass options. Rather they involve airlines no longer providing their customers with services, or engaging in actions that will only result in delay as charges ultimately have to be paid.

Airlines cannot credibly threaten airports

If airlines cannot bypass airports, they have little ability to negotiate effectively with airports. Their remaining threats in the face of high airport charges are very limited, and generally not credible. Standard economics on the credibility of threats states that, to be credible, an airport must believe:

- the airline would carry through with the action threatened; that is, carrying through would be rational (or credible on commercial grounds), for the airline, given its choice between the action and the option of accepting the high charges.
- that if the threat is carried through the airport's losses will be of similar or greater magnitude to the airline's losses. If the airport's losses are small then it will not be swayed by threats which, if enacted, would impose much greater costs on airlines.

As we will show, threats to reduce service tend to be very costly for airlines and are therefore usually not credible – meaning that airports ignore them in pricing considerations.

Delaying payment does not indicate countervailing power

The Productivity Commission highlights circumstances where airlines have refused to pay increases in airport charges, or have indicated that they intended to reduce services to an airport, as evidence of countervailing power (including Box 4.1). Indeed, the Commission cites Perth Airport's legal action against Qantas – presumably, to enforce Perth Airport's rights to collect charges from Qantas at whatever level the Airport has determined – as evidence of Qantas's countervailing power.

At face value, the Productivity Commission's suggestion that "Airlines can refuse to pay charges at the level determined by an airport when an agreement expires"[8] is extraordinary, as is the implication that Qantas's use of payment delaying tactics to restrain charges are a normal and adequate bargaining tool. In our opinion, these extreme measures are indicative of a broken system that offers airlines few options to moderate airport charges to reasonable levels.

Moreover, the Commission's (repeated) claim that airports have strong incentives to reach agreement because of cash flow concerns is not supported by evidence that, in fact, airports have settled due to pressure from airport investors. Indeed, if the airport is within its rights to charge the airlines[9], then

[6] ACCC Merger Guidelines, November 2017 as amended, p44.

[7] Draft report, p. 9.

[8] Draft report, Box 4.1.

[9] Technically, the airports are constrained by the Aeronautical Pricing Principles in Part 7 of the *Airports Regulations 1997*. However, these are not enforceable and are used for monitoring purposes.

airports enforcing their rights to charge by taking airlines to court for under-payment of charges will cost very little, and there is no reasonable expectation that investors would not finance such temporary costs even if they arose. Reference to instances of payment disputes falls far short of evidence that Qantas has exercised buyer power sufficient to constrain an airport's charging.

Countervailing power cannot be established solely with anecdotes

Countervailing power differs across airports and therefore must be assessed on a case-by-case basis. The conditions that might give rise to countervailing power – for example, an airline's market share and complementary investments at the airport – are airport specific. Anecdotes of countervailing power cannot be extrapolated to a general finding of airline countervailing power.

With respect to the use of market shares as an indicator or threshold as which countervailing power might be relevant, there is no commonly understood threshold. This is because it is the relative position of the buyer and the seller that matters. A monopoly seller position means the buyer's relative position would have to be extremely strong. The Commission itself indicated in its 2006 inquiry report that countervailing power was relevant only in relation to Canberra where Qantas had a 75% market share. Qantas does not have a market share (by capacity) that comes close to exceeding this threshold at any of the tier 1 or tier 2 airports. In fact, Qantas Group's market share at Canberra is now 58%. So, there is little general basis for a finding of countervailing buyer power based on market share alone.

Moreover, competition regulators including the ACCC consider that for countervailing power to offset any market power, it is not sufficient for only one buyer to bypass the supplier. Rather, a significant proportion of customers would need to be shielded from the effects of market power. For airports, this would imply that for countervailing power to be relevant to any market power considerations, most airlines as well as other customers such as passengers, car hire companies and other businesses on the landside would all need some countervailing power.

Airports can readily backfill flights under typical conditions

A basic problem with the conception that airlines can exert countervailing power by imposing costs on airports is that airports have better outside options than airlines. Most tier 1 and 2 Australian airports could readily backfill any landing slots made available by an airline service withdrawal by offering the capacity to other airlines. If backfilling occurs, the airport will lose little to no revenue. At the top 15 domestic airports (by capacity) which account for greater than 90% of total domestic capacity, Virgin and other airlines have a 40% average market share.

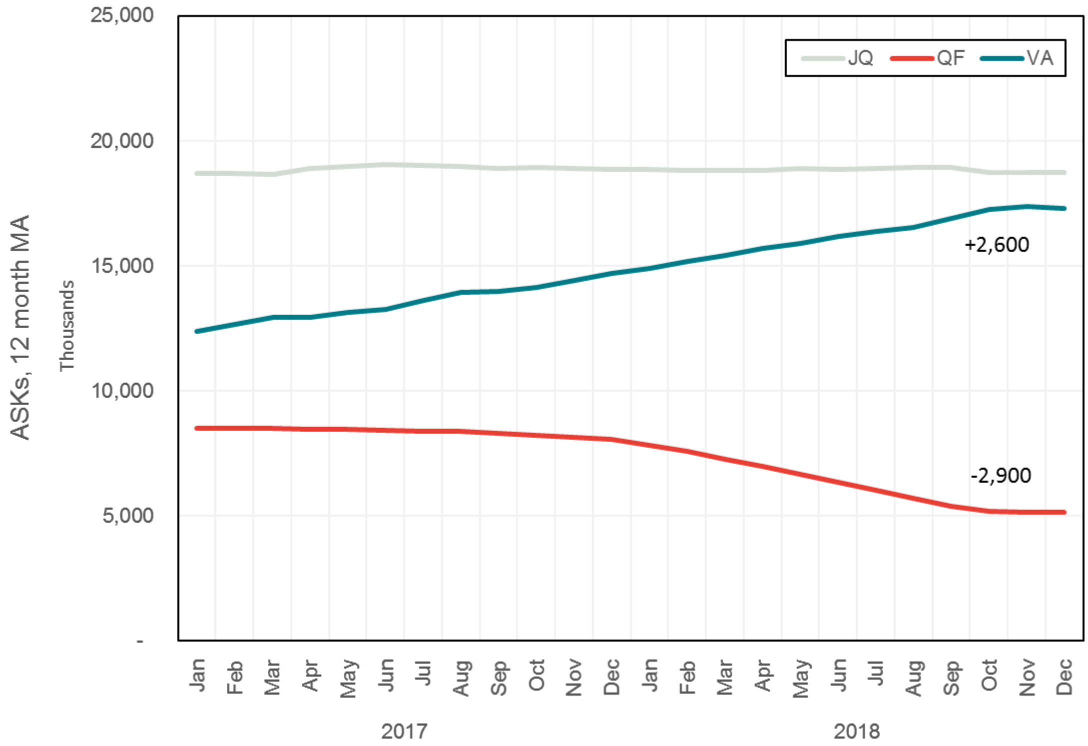
There is no well understood threshold at which Countervailing Power becomes relevant. What is important is the asymmetry in the market shares of the negotiating parties. In most instances' airports are likely to have a 100% market share which almost always exceeds the Qantas Group's share of capacity. By contrast the top 15 domestic airports (by capacity) account for >90% of domestic capacity and Qantas Group's shares averages 60% at these airports.

With two or more airlines operating out of all these Airports, and ready demand available from passengers (should one airline withdraw), it should be relatively easy for an existing airline to expand its existing services to fill any slots made available. Backfilling is even more likely where airports are capacity constrained, such as Sydney and, to a degree, Melbourne.

Experiences at a smaller airport such as Newcastle Airport (NTL) highlight how quickly this can occur under typical conditions. Qantas faced pilot shortages between January and October 2018. This resulted in Qantas being forced to remove approximately 800 services over this period — equivalent to 1-2 daily return flights. The Qantas Group faces competition from Virgin on most routes to/from Newcastle broadly in line with the airlines' average capacity market shares across Australia.[10]

When Qantas withdrew these services, Virgin was able to respond almost immediately to backfill the lost capacity. This change in capacity (available seat kilometres) can be seen in **Figure 1** below, which shows the rolling average over the 2017 and 2018 calendar years.

Figure 1: Changes in available capacity on the Brisbane- Newcastle route



Source: Frontier Economics analysis of Qantas Group data

Airports benefit from passengers' ability to switch between airlines. In contrast, airlines have little ability to switch the airports to which they fly.

Airlines have more to lose

Even if airports could not readily backfill slots, airlines generally will lose far more from service withdrawals. The reason is that airlines have more to lose from flights not operating than does an airport. This same finding also applies to other "examples" cited by the Productivity Commission, such as reducing the number of seats or redistributing its fleet to "punish" an airport – such tactics invariably cost the airline more than the airport and so are not credible threats.

To illustrate why this is commonly the case, we develop two hypothetical case studies of Qantas service reduction scenarios at Perth and Newcastle Airports. These illustrative examples demonstrate the

[10] Qantas had 6% of available capacity (by total available seats), Jetstar had 58% and Virgin has 28%.

underlying economics which generally mean that Qantas would incur significantly higher losses from any service reductions than the tier 1 and tier 2 airports in question.

Our estimates suggest that even if an airport could not immediately backfill a withdrawn service[11], Qantas is likely to incur net losses per flight (in the form of contributions to profit margins) of between **2 and 10 times**[12] those of these airports if it was to reduce services. The reasons for this are as follows:

- Airlines have very few outside options — Qantas could re-use its planes elsewhere, and passengers may continue to use other Qantas services to that destination. However, with interconnected and optimised networks it is difficult to profitably utilise assets elsewhere or take more passengers on other flights without affecting network service.
- Airlines have significant costs that are fixed in the short-medium term and could not be reduced should services be temporarily withdrawn.

These figures underestimate the true costs that would be incurred by Qantas. Qantas would also incur significant additional losses should it withdraw even minimal services on any route from these airports given their significance to either Qantas' customers and its broader network and operations. Such actions cause reputational damage to Qantas which ultimately add to the cost of disputes.

[11] If immediate backfilling occurs, there is no loss to the airport.

[12] Qantas's net losses are anticipated to be between 2 and 10 times those of Perth Airport and between 2 and 8 times those of Newcastle airport

1 INTRODUCTION

1.1 Productivity Commission inquiry

The Productivity Commission (Commission) is currently undertaking its fourth review of the regulation of Australian airports previously operated by the Federal Airports Corporation. The purpose of this 2018 Inquiry is to determine the effectiveness and efficiency of the current arrangements and determine whether they remain appropriate.

1.2 Do airlines have any countervailing power?

Countervailing power is a term used to describe the ability of large buyers in concentrated downstream markets to obtain price discounts or otherwise counteract the ability of a supplier to exercise its market power in an upstream market.

The Productivity Commission's draft report suggested that airlines can, and do, exert countervailing power on airport operators:

> *The behaviour of some airlines during the negotiation process may indicate that they have strong countervailing power.*[13]

The Commission also says that:

> *An airline can threaten to withdraw some or all of its services at a particular airport if it is not satisfied with access conditions.*[14]

The Productivity Commission also cites that airlines operate in concentrated markets and use this as a factor explaining why airports may hold market power, but not be able to exercise it.[15]

A4ANZ and Qantas have already put forward arguments suggesting that airlines do not have anything other than *de minimus* countervailing power – including that airports simply don't believe that airlines would reduce or eliminate service at an airport if fees are not reduced / increased.

To date, the Commission has not offered analysis of the conditions under which countervailing power would be applicable, nor systematic evidence of airlines exercising sufficient countervailing power to offset an airport's market power (particularly at tier 1 or tier 2 airports, where more than 90% of air movements take place). The Commission's draft report has focussed solely on anecdotes of disputes

[13] Draft report, p. 130.

[14] Draft report, p. 9.

[15] Draft report, p. 9.

at Perth and other airports and appears to have extrapolated from this that airlines have countervailing power. However, these disputes are seen very differently by airports and airlines.

Qantas has asked Frontier Economics to assess the likelihood of its being able to exercise countervailing power against larger tier 1 and smaller tier 2 and below airports. Our analysis is informed by our experience in advising firms and competition regulators on competition matters in which countervailing buyer power is pertinent. This report presents the outcomes of our analysis.

It is set out as follows:

- In section two, we develop a framework for considering countervailing power in airline/airport negotiations.
- In section three, we discuss why airports will generally have more outside options that airlines, which are critical to bargaining outcomes.
- In section four, we analyse the likely losses experienced by Qantas from a hypothetical service withdrawal at a tier 1 and a tier 2 airport and compare these with losses likely experienced by airports.

2 BARGAINING BETWEEN AIRPORTS AND AIRLINES

A framework for considering countervailing power

It is seemingly not contentious that many or most airports in Australia have structural market features indicative of strong market power. However, it is also possible that in markets with strong buyers, the effect of market power can be lessened.

Countervailing power is a term used to describe the ability of buyers to obtain price discounts from suppliers, or in some other way counteract the ability of a supplier to exercise its market power. Buyers need more than size to constrain the exercise of market power. The standard economics of bargaining suggests that the outside options of the parties to the bargain are critical; buyers could have some countervailing power against a seller if a buyer can *credibly threaten harm* to a supplier by using its outside options if it attempts to exercise its market power.

2.1 Bypass options are critical with essential inputs

In the context of reviewing merger proposals, competition authorities will consider whether any increase in market power caused by the merger will be offset against (or countervailed) by the power of existing buyers in the market. These authorities suggest that it is more than the ability to switch suppliers which is critical to countervailing buyer power; it is something which reflects additional leverage over suppliers. This might reflect size or commercial significance of customers; however, authorities recognise that where inputs are essential, only bypass can provide leverage. Bypass typically takes the form of vertically integrating into the upstream market or sponsoring new entry.[16]

For example, the ACCC's merger guidelines state that

> *Countervailing power exists when buyers have special characteristics that enable them to credibly threaten to bypass the merged firm, such as by vertically integrating into the upstream market, establishing importing operations or sponsoring new entry…*

The ACCC warns that while size and commercial significance to suppliers are *necessary* conditions for countervailing buyer power, they are not *sufficient* conditions:

[16] ACCC Merger Guidelines, November 2017 as amended, p44. It can also include importing directly, which is not feasible here.

> *Countervailing power, however, exists when the specific characteristics of a buyer — such as its size, its commercial significance to suppliers or the manner in which it purchases from suppliers — provide the buyer with additional negotiating leverage…*
>
> *Importantly, the size and commercial significance of customers (sometimes referred to as 'buyer power') is not sufficient to constitute countervailing power….For example, if the supplier's product is an essential input for the buyer, the only way the buyer can defeat any attempted increase in market power is if it can credibly threaten to bypass the supplier.*[17]

Of the three relevant factors which the ACCC says it will consider when assessing countervailing buyer power, two relate to bypass options ("whether the threat to bypass is credible on commercial grounds", "whether the buyer is likely to bypass the supplier") and one relates to how widespread is the countervailing power among buyers ("the proportion of the downstream market able to wield a competitive threat").

Moreover, the ACCC's approach is not novel.

The European Commission's guidance on exclusionary conduct by dominant undertakings refers to how it will treat countervailing market power in the assessment of dominance (equivalent to substantial market power):

> *Competitive constraints may be exerted not only by actual or potential competitors but also by customers. Even an undertaking with a high market share may not be able to act to an appreciable extent independently of customers with sufficient bargaining strength. Such countervailing buying power may result from the customers' size or their commercial significance for the dominant undertaking, and their ability to switch quickly to competing suppliers, to promote new entry or to vertically integrate, and to credibly threaten to do so. If countervailing power is of a sufficient magnitude, it may deter or defeat an attempt by the undertaking to profitably increase prices. Buyer power may not, however, be considered a sufficiently effective constraint if it only ensures that a particular or limited segment of customers is shielded from the market power of the dominant undertaking.*[18]

Similarly, the European Commission's guidance on horizontal mergers notes that:

> *65. The Commission considers, when relevant, to what extent customers will be in a position to counter the increase in market power that a merger would otherwise be likely*

[17] ACCC Merger Guidelines, November 2017 as amended, p44. Similar wording arises in the European Commission's horizontal merger guidelines (section V) and the US horizontal merger guidelines (Section 8).

[18] European Commission, Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, February 2009, at 18.

to create. One source of countervailing buyer power would be if a customer could credibly threaten to resort, within a reasonable timeframe, to alternative sources of supply should the supplier decide to increase prices or to otherwise deteriorate quality or the conditions of delivery. This would be the case if the buyer could immediately switch to other suppliers, credibly threaten to vertically integrate into the upstream market or to sponsor upstream expansion or entry.

In past cases, the European Commission has further emphasised that it is not concentration per se that is important to countervailing power, but the relative concentration between supplier and purchaser:

The concentration on the customer side, such as it may be, must in any event be compared to the concentration existing on the supply side.[19]

Finally, the US DOJ and FTC guidelines on horizontal mergers state:

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry…[20]

This evidence suggests that most or all major competition authorities focus on bypass options when considering the relevance of buyer power, and that if were airports supplying an essential input to airlines, airlines would need to be able to credibly threaten to bypass an airport to exercise countervailing power.

In Australia, airlines cannot credibly threaten to bypass an airport and the Productivity Commission appears to accept that at least for the tier 1 monitored airports, each airport's services are an essential input for airlines.[21] Indeed, as noted by the Productivity Commission in its draft report, the options available to airlines are to "delay negotiations or credibly threaten to withdraw some or all of their services…".[22] These are not bypass options. Rather they involve airlines no longer providing their customers with services, or, in the case of refusing to pay charges, engaging in actions that will only result in delay. As we shall discuss, the major issue with the Commission's approach is that it assumes these threats are credible.

[19] European Commission, Case No COMP/JV.55 Hutchison/RCPM/ECT, available at: http://ec.europa.eu/competition/mergers/cases/decisions/jv55_en.pdf

[20] US Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, p. 27.

[21] Draft report, p. 104.

[22] Draft report, p. 120.

Box 1: Gatwick Airport

The importance of having a realistic, alternative bypass option is reflected in the UK economic airport regulator's — the Civil Aviation Authority (CAA) — approach to considering countervailing power. It considered that to have a degree of countervailing power "an airline would typically need to:

- Represent a significant proportion of a particular airport operator's business.
- Have at least one substitute airport to which it could credibly threaten to switch in response to that particular airport operator's behaviour.
- Have the ability to switch sufficient volumes to discipline the proposed price increase." [23]

The CAA found that there appeared to be limited scope for airlines to exercise buyer power in negotiating with Gatwick Airport (GAL). In its market power determination — statement of reasons it noted that:

"With respect to countervailing buyer power, some airlines have a sufficient share of GAL's business to suggest that they might have buyer power. However, the evidence suggests that these airlines have limited ability to credibly threaten to switch sufficient capacity away from Gatwick that would give them buyer power in their negotiation of terms with GAL." [24]

In other words, the CAA found countervailing power was not even relevant even where there were other substitute airports to which airlines could credibly threaten to switch in response to that particular airport operator's behaviour. [25]

Source: CAA, (2014) "Market power determination in relation to Gatwick Airport – statement of reasons, CAP 1134", Appendix E: Evidence and analysis on competitive constraint: Airlines

2.2 What makes a threat credible?

If airlines cannot bypass airports, their remaining threats to use outside options in the face of high airport changes are very limited. The Productivity Commission suggests, however, that airlines' threats to reduce the number of flights into or out of airports, or in some other way harm airports by changing their fleet mix, are *credible*.[26]

The standard economics of bargaining suggests that buyers have countervailing power against a seller if it can credibly threaten harm to a supplier if it attempts to exercise its market power. Threatening harm to an airport is easy, but such threats are not usually credible because *they also involve some harm to the airline itself*. It is therefore critical to understand the circumstances under which an airline could credibly threaten harm to an airport.

[24] CAA, (2014) "Market power determination in relation to Gatwick Airport – statement of reasons, CAP 1134, p40

[25] The CAA points to a number of critical factors driving their view including increasing capacity constraints and the likelihood of backfill limiting the ability of airlines to credibly threaten to switch to another airport.

[26] Draft report, p. 121.

Suppose that an airline is faced with a proposal of higher charges by an airport. The airline, in response, threatens to reduce services at that airport. A game-theoretic analysis of threats suggest that an airline's threat of harm will only be credible if, when it comes to acting on the threat, the airport believes either:

- the airline would carry through with the action threatened— that is, carrying out the threat would be rational (or credible on commercial grounds[27]) for the airline, given its choice between the action and the option of accepting the higher charges. For this to be possible, the airline would need to be able to take up other outside options, such as re-purposing an airplane to another route.[28]
- that the loss of profit to the airport if the threat is carried out will be of similar or greater magnitude to the airline: if the airport's losses are only small, then it will not be swayed by threats which, if enacted, would impose much greater costs on airlines.[29]

The rationale behind this is intuitive and consistent with the comments of the Productivity Commission in the past and other notable commentators. For example, the ACCC submission to the Productivity Commission 2002 Airports Inquiry suggests:

> *"The existence of a single significant buyer does not automatically create countervailing power … To determine if countervailing power is relevant, the analyst needs to consider the bargaining position of buyers and sellers. In particular, it is important to consider which parties will lose most from any failure to reach an agreement to trade the relevant product. For countervailing power to exist in a market that otherwise is deficient in competition, any losses from a break-down in bargaining need to be predominantly borne by the seller."*[30]

Similarly, the Productivity Commission in its 2002 Airports Inquiry report noted that:

> *"Exercising countervailing power essentially involves game playing between the protagonists and requires the ability to undertake or threaten behaviour that in the short term is not profit-maximising (that is, profits are forgone by not engaging in potentially profitable trades) in the expectation that this will deliver a more profitable, long term outcome (a better price or service)."*[31]

[27] For example, because of a commitment to undertake an action prior to the negotiation process.

[28] An airline's choice regarding the plane will be to consider which form of action minimises its loss: maintaining the route but accepting the higher charges, or redeploying the plane onto another route (if the airline is profit maximising this must result in lower profits).

[29] These costs could arise from any withdrawal of services or from any delay is reaching agreement.

[30] Attachment C to the ACCC submission (submission 36) to the Productivity Commission 2002 Airports Inquiry, p. 13.

[31] Productivity Commission Inquiry Report (2002) Price regulation of airport services, Report No. 19, 23 January 2002, p192

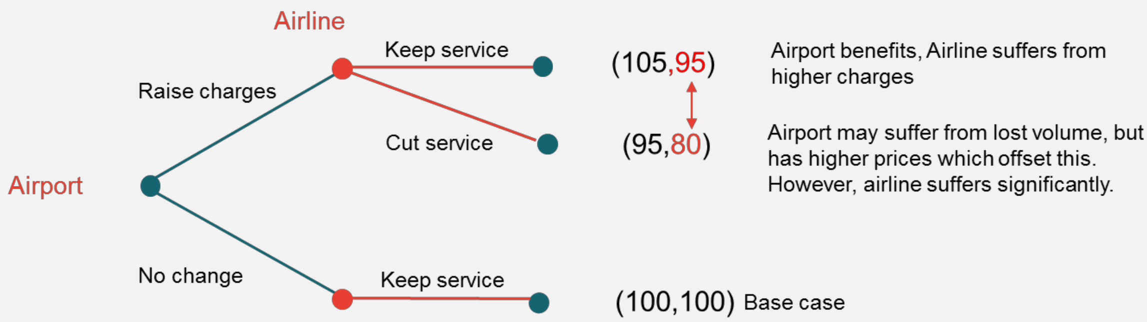
Box 2: A game theoretic example of a non-credible threat

The credibility of airline threats can be examined in the context of a sequential game. We consider a two-stage game in which:

- an airport is first given the choice to either raise its charges or leave them at the competitive level.
- an airline then has the choice in response to an airport's decisions to either cut or keep its services at existing levels.

Such a game is solved by the airport 'solving backward', and making its initial choice based on the expected choices of the airline. These choices along with the associated payoffs to each party (airport, airline) are represented in the decision tree below.

With these payoffs, the airline is always better off keeping services at existing levels — as its payoff will drop from 95 to 80 should it choose to cut services. Assuming no significant information asymmetries, the airport will recognise that, regardless of its action, the threat of the airline cutting services is not credible and hence its best choice would be to raise charges.



The following things would need to change for an airline to issue a credible threat.

- The airline's payoff from cutting services would need to be greater than the payoff from keeping services (i.e. >95). Then the airport's dominant strategy would no longer be to raise charges.
- The airport would need to face a bigger fall in payoffs relative to the airline should it cut services in response to the charge hike (i.e. if the airport's payoff was also 80). This would enable the airline to punish the airport[32].

Source: Frontier Economics

2.3 Factors affecting the presence of countervailing power

As we have indicated, bargaining theory suggests that the bargaining power of an airline with respect to an airport will depend largely on the outside options available to airports and airlines.

The **costs to an airport,** of an airline withdrawing or reducing its services to that airport, will depend on whether the airport has an alternative other than selling their services to the airline in question. In other

[32] For this to be credible the airline would need to be in a stronger financial position such that it is best able to sustain short-term losses. This might be more likely where the airport is credit constrained or faces cash-flow problems such that it would cease to become an ongoing concern should demand reduce for any extended period of time. Alternatively there would need to be significant wider strategic objectives or benefits for the airline.

words, costs for an airport will be lower where it can more readily fill the service vacated by an airline with the services of another airline ("backfill slots"). This will be easier where:

- other airlines already operate services from the airport;
- there are low barriers to other airlines commencing or expanding their operations to service demand for air services to and from the airport; or
- the airport is capacity-constrained such that there is high demand for slots.

The **cost to an airline** of enacting a threat to withdraw or reduce its services to an airport will be higher, such that the prospect for countervailing power will be limited, where:

- an airline has limited outside options — for example, the airline has limited ability to access landing slots and switch its services to other airports that meet the needs of existing passengers (i.e. no other competing airport or passengers serviced by the airport unlikely to be prepared to switch destinations[33]).
- the next best alternative option for utilising its assets (planes and staff) are significantly less profitable;
- the airport/route is significant to the airline's customers, operations or network configurations; or
- the airline has low customer loyalty (and will more readily switch to competitors' services).

As we will show in Chapter 3 and 4, threats to reduce service tend to be much costlier for airlines and are, therefore, usually not credible – meaning that the airport ignores them in pricing considerations.

2.4 Inadequacies in the Productivity Commission's approach

Before we consider our own analysis of countervailing power, it is necessary to highlight the inadequacies of the Productivity Commission's approach to countervailing power. The primary deficiencies are that:

- it ignores the general principle that it is bypass options which give buyers a credible threat against sellers (as discussion in section 2.3)
- it relies on limited, anecdotal examples which are not generalisable and falsely assumes that airports obligation to continue to supply services to airlines give airlines a strong negotiating position
- it assumes that countervailing power can be exercised by all airport users.

2.4.1 The anecdotal evidence presented is unconvincing

In suggesting that Qantas has countervailing power, the Productivity Commission identifies circumstances where Qantas has been in dispute with airports and has refused to pay charges at the levels demanded by the airports.

If airlines have effective countervailing power, there should be some evidence that airports responded to threats by changing their prices. Evidence that airports have taken airlines to court for non-payment of charges cannot an example of countervailing power – because it has manifestly not resulted in any change in the airport's pricing behaviour.

Moreover, the claims cited in Box 4.1 of the Commission's report relating to Alice Springs and Darwin airports (collectively the Northern Territory Airports (NTA) Group) make little sense. While first

[33] This would be the case where an airport services passengers that are mainly travelling for business or to visit friends and relatives as opposed to for leisure.

suggesting there is “no viable commercial response” and that airlines “can continue to refuse to pay higher charges indefinitely”, it is then stated that NTA is “…seriously contemplating legal action as its only avenue of redress”. The only reason NTA would contemplate court action is because it believes it has a legal right to force Qantas to pay the charges it sets – so Qantas’s tactic is merely one of delay.

In fact, the response of airports where Qantas Group has refused to pay suggests airports do not consider threats to be credible. Instead, these examples demonstrate airport operators exercise market power through take-it-or-leave-it offers, which the airlines are—ultimately—compelled to accept as otherwise they will be denied access to critical on-airport infrastructure.

2.4.2 No consideration of whether anecdotes can be extrapolated to all airports

From a limited number of anecdotal examples, the Commission appears to have drawn a conclusion that Qantas Group, Regional Express and Virgin Australia Group all have countervailing power at most airports. However:

- For countervailing power to offset any market power, it is not sufficient if only one buyer is able to threaten to harm the supplier. Rather, a significant proportion of customers would need to be shielded from the effects of market power. Most airlines but also other customers such as passengers, car hire companies and other land side users would all need countervailing power. This is a point the Productivity Commission has acknowledged but seemingly not considered in any depth: “Landside operators do not have the same degree of countervailing power as airlines and are more likely to be at risk of receiving and accepting take-it-or-leave-it contracts.”[34]
- Countervailing power applies on a case-by-case basis. The conditions that might give rise to countervailing power are airport specific; for example, Qantas will generally be less able to switch or reduce services away from airports where it has incurred significant investment (e.g. in engineering facilities). Fundamentally, it is a flawed approach to use anecdotes of instances of countervailing power and extrapolate them a general finding of airline countervailing power reducing the market power of airports.

[CONFIDENTIAL BOX]

[34] Draft report, p. 118.

3 AN AIRPORT'S OPTIONS

Most airports can readily backfill any slots made available

Airports have much better outside options that airlines in the event of disputes about charges. A key alternative for the airport is its ability to backfill any landing slots made available by a service withdrawal by offering to capacity to other airlines. If backfilling occurs, the airport will lose little to no revenue.

From the evidence we have reviewed, we consider that the all tier 1 airports (and many other non-tier 1 airports) could readily backfill any slots made available from a service withdrawal:

- There is more than one airline servicing most Australian airports, which would facilitate switching in the event of a demand increase.
- Customers show a willingness to switch between airlines – hence the regular domestic price and capacity wars.
- The limited market evidence that is available suggests that airports can backfill in a timely way under the current conditions in the air services market.

We expand on these points in the sub-sections below.

3.1 More than one airline services most airports in Australia

As described in section 2.3, the key factor affecting the extent to which an airport can readily backfill slots is the existence of other airlines already operating on the routes withdrawn; or, more generally, providing services from the airport in question. Increasing service frequency on an existing route will impose limited incremental fixed costs on an airline. Similarly, the incremental costs of expanding the routes serviced from an existing airport are also less substantial, than operating from a new port. This is because fewer ground staff are required, terminal facility costs are already incurred and the costs for marketing the route are typically lower.

Airlines face competition on routes to/from all major and most minor Australian airports, making it relatively easy for an existing airline to expand its services to fill any slots made available. By way of example, at the top 15 domestic airports (by capacity) which account for more than 90% of total domestic capacity, Qantas Group's share averages 60%[35]. Virgin and the other airlines therefore collectively have around a 40% market share. This can be seen in **Figure 2** below.

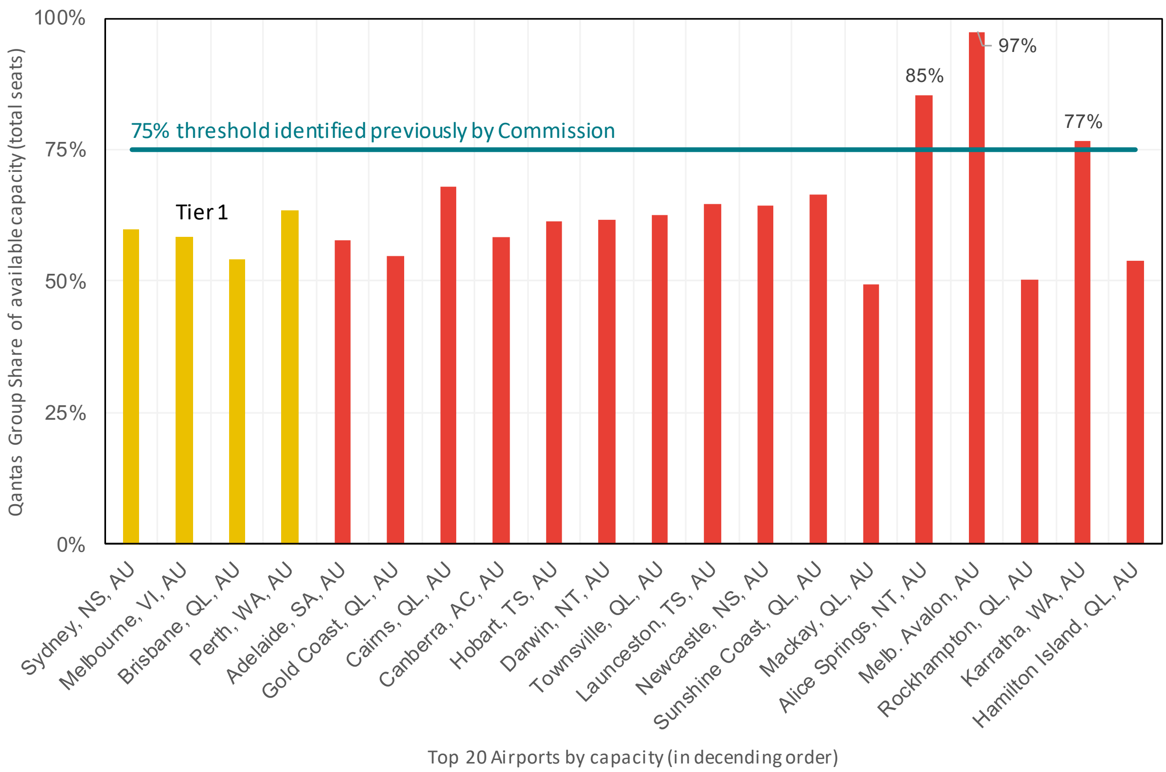
There is no commonly understood threshold at which countervailing power becomes relevant. What is important is the asymmetry in the market shares of the negotiating parties. In most instances, airports have a 100% market share, which almost always exceeds the Qantas Group's share of capacity. The Commission has previously suggested that countervailing power was relevant only in relation to Canberra where Qantas had a 75% market share[36]. The Qantas Group does not have a market share (by capacity) that comes close to exceeding this threshold at any of the tier 1 or tier 2 airports. In fact,

[35] Frontier analysis of Qantas Group data on airline capacity shares (total available seats) at each airport

[36] Productivity Commission (2006) "Review of price regulation of airport services".

the Qantas's market share at Canberra is now 58%[37]. In other words, at all of the tier 1 and tier 2 Australian airports, there two or more airlines operating from the airport.

Figure 2: Qantas Group's share of available capacity at the top 20 domestic airports



Source: Frontier analysis of Qantas Group data on airline capacity shares (total available seats) at each airport

Notes: Darwin and Alice Springs; Melbourne and Launceston; are jointly owned

Even of three airports at which Qantas Group's share exceeds 75%, joint ownership of Alice Springs and Darwin airports reduces Qantas's leverage. So, it is only at the 17th and 19th largest airports where Qantas meets the 75% criterion.

The importance of competition between airlines is as follows. Should one airline withdraw a service, the remaining airlines would have:

- **ready demand** available from passengers previously serviced by the airline that withdrew, and
- **ample warning** to optimise their services (which would take place if an airline issued a threat).

Alternative airlines will therefore find it relatively straightforward to expand existing services to fill any slots made available. This would only be undermined if customers were particularly loyal to the airline that withdrew service; while the Australian market shows some signs of loyalty, strong customer loyalty is not consistent with the widely-cited price and capacity "wars" between Qantas and Virgin.[38]

This analysis does not even take in account the real possibility of other airlines commencing operations at these airports.

[37] Frontier analysis of Qantas Group data on airline capacity shares (total available seats) at each airport

[38] See for example: https://www.smh.com.au/business/companies/qantas-plunge-highlights-the-secret-airline-fare-war-20160418-go8zry.html

Given the evidence and analysis, we do not agree with the Commission that Adelaide and Canberra airports are constrained from exercising market power by the significant countervailing power from Qantas Group and Virgin Australia Group.[39] Rather, these airports benefit from passengers' ability to switch between these two airlines; both operate numerous competing services from these airports. In contrast, these airlines have little ability to switch the airports to which they fly.

3.2 Backfilling can occur rapidly

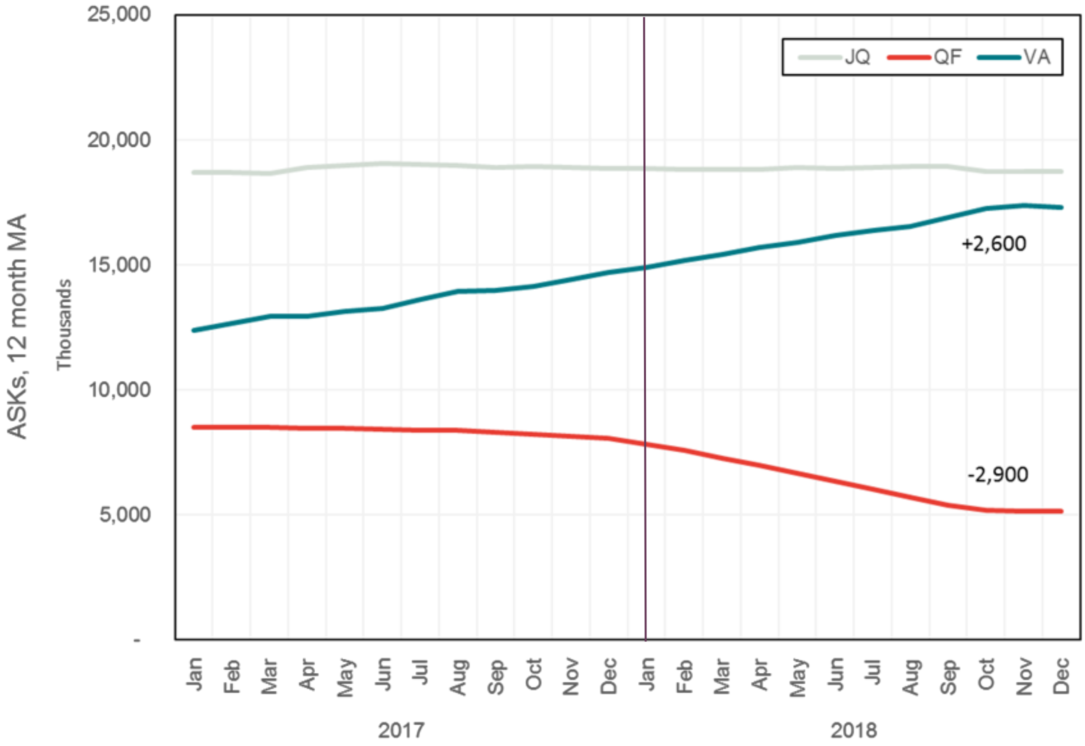
Experiences at Newcastle Airport (NTL) highlight how seamlessly backfilling can occur in response to service withdrawals. Qantas faced pilot shortages between January and October 2018. This resulted in Qantas removing approximately 800 services over this period — equating to 1-2 daily return flights. We are informed that the Qantas Group faces competition from Virgin on most routes to/from Newcastle broadly in line with the airlines' average capacity market shares across Australia.

When Qantas withdrew these services, Virgin was able to respond almost immediately to backfill the lost capacity. This change in capacity (available seat kilometres) can be seen in **Figure 3** below, which shows the rolling 12-month average over the 2017 and 2018 calendar years. While these data are based on information from Qantas, data from BITRE confirms that total capacity on the route is relatively unchanged through 2018 (BITRE data does not report capacity by airline).[40]

[39] Draft report, p. 295.

[40] BITRE, "ToproutesJuly2004Dec2018annual", available at: https://bitre.gov.au/publications/ongoing/domestic_airline_activity-time_series.aspx

Figure 3: Changes in available capacity on the Brisbane- Newcastle route



Source: Frontier Economics analysis of Qantas Group data

4 AIRLINES FACE HIGHER COSTS FROM WITHDRAWING SERVICES

In most circumstances, airline threats to airports lack credibility

Even if airports could not readily backfill slots, airlines generally will lose far more from service withdrawals. The reason is that airlines have more to lose from a flight not operating than does an airport.

We have indicated that assessment of countervailing power requires a case by case assessment of each airline's position at each airport. Undertaking such an assessment would be difficult. We have instead developed two hypothetical case studies of Qantas service reduction scenarios at Perth and Newcastle Airports to show the underlying economics that show Qantas would usually incur significantly higher losses from any service reductions than tier 1 and tier 2 airports.

Each case study assumes the case study airports are not able to fully and/or immediately backfill vacated services, as it would then be obvious that Qantas threats would be incredible. Estimates based on limited backfilling suggest Qantas would incur net losses per flight (in the form of contributions to profit) of between **2 and 10 times**[41] those of the airports. These figures almost certainly underestimate the true costs that would be experienced by Qantas. We cannot quantify losses on some services given their significance to either Qantas' customers and its broader network and operations. Furthermore, service reductions often cause significant reputational damage.[42]

The reasons that airline's loss of profits are generally much higher than airports is because:

- Airlines revenues per flight less their incremental costs are much higher than the airports' revenues and incremental costs (even though airports' margins are higher in *percentage* terms).
- Airlines have very few outside options — Qantas could re-use assets elsewhere, and passengers may continue to use other Qantas services to that destination. However, with interconnected and optimised networks, it is difficult to profitably utilise assets elsewhere or take more passengers on other flights without an effect on service.
- Airlines have significant costs that are fixed in the short term such that they could not be reduced should services be withdrawn with the intent of this being temporary.

[41] Qantas's net losses are anticipated to be between 2 and 10 times those of Perth Airport and between 2 and 8 times those of Newcastle airport.

[42] See for example: https://www.abc.net.au/news/2019-01-24/qantas-and-jetstar-axe-darwin-flights/10744002 in relation to the Northern Territory, where Qantas has reduced services due to declining demand.

4.1 Assessment methodology

4.1.1 Selection of airports

To illustrate the higher costs to airlines of acting on a threat, we developed a hypothetical case study for both a tier 1 and tier 2 airport.

Perth Airport (PER) was selected as the tier 1 case study as it is not currently capacity constrained. The Productivity Commission itself noted that an airline's threat to reduce services is less credible at a congested airport, such as Sydney Airport.[43] Furthermore, services from the airport are less likely to be part of a multi-leg route, which while exacerbating airline losses, would add considerable complexity to the analysis.

Newcastle Airports (NTL) was selected as the tier 2 case study given there had already been a service withdrawal take place at this airport (assessed in section 3.2) and the different airlines' capacity market shares at NTL are broadly in line with those of most tier 2 airports across Australia.

4.1.2 Threat scenario

As we have noted, airlines have few good strategic options for threatening an airport. We have chosen to focus our case studies on a service withdrawal or a reduction in service frequency at the airports being considered. The reason is that the other options available are not considered credible:

- Complete withdrawal is not considered viable at the case study airports being considered — as noted by the Productivity Commission complete withdrawal of services is only really an option at regional airports, where a single airline is the airport's main, or only, customer.[44]
- Not paying unreasonable bills is a one off, short-term delaying strategy that does not dissuade airports from higher charges. As described in **Error! Reference source not found.**in circumstances where Qantas has used such tactics, the response of the Airport has been to deny access to key facilities rather than attempt to negotiate.

For both case studies, we modelled the net loss of contributions to profit for Qantas and the airport from one fewer return flight. If this threat was followed through we considered this option was most likely to minimise Qantas's losses and maximise the airport's losses, and so be the most credible threat.

4.1.3 Cost considered

The costs incurred by Qantas and the airports from the removal of a daily return flight from the airport in question are summarised in **Figure 4** and described further in **Table 1**. To quantify the estimated losses, we used data from Qantas on its margins, costs and payment to the specific case study airports, and also relied on ACCC monitoring data to estimate the likely non-aeronautical margins at each airport.

[43] Draft report, p. 9.

[44] ibid.

Figure 4: Overview of calculations

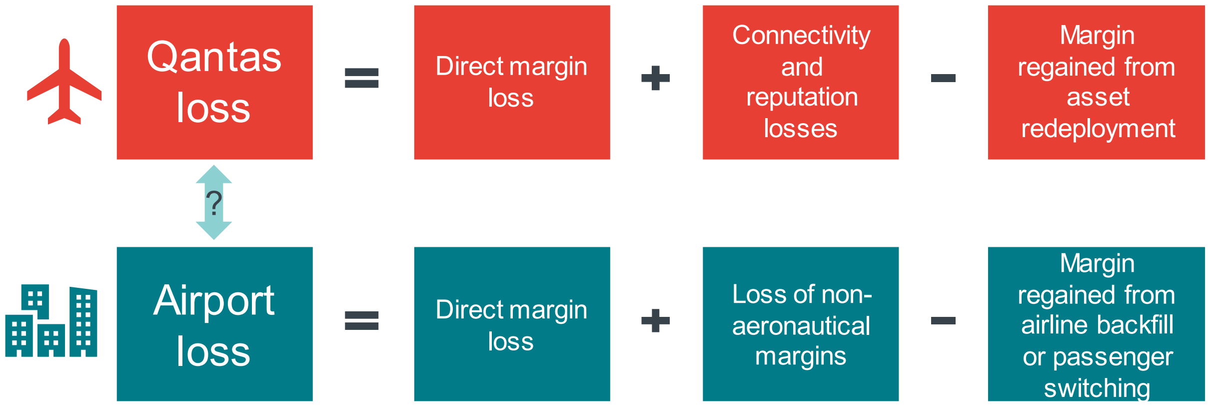


Table 1: Description of estimation method

QANTAS LOSS	AIRPORT LOSS
• The margin (or forgone profit) which Qantas earns on this service: = average revenue per return flight less avoidable cost (fuel costs, takeoff/landing charges, incremental catering and sales costs) *plus* • Any additional costs imposed on Qantas relating to changes in its network; for example, disruption on existing staffing or servicing arrangements (*not quantified*) *less* • The extent to which Qantas could recapture any lost margin either through: ○ customers switching to other Qantas flights, or ○ making other uses of its assets (plane and staff).	• The margin which the Airport earns on this service = landing/take off charges and per passenger charges per return flight less avoidable incremental costs[45] *plus* • The margin which the Airport earns on non-aeronautical spending by those passengers[46] *less* • The extent to which the airport recaptures any lost margin either through: ○ backfilling the slot freed by the Qantas service reduction, (enabling full recovery of landing and other non-aeronautical margins) ○ passengers continuing to travel but switching to other flights (enabling recovery of passenger-based aero margins and non-aero margins on these passengers)

Source: Frontier Economics

[45] We have used PER EBITDA % margin (as reported in the ACCC 2016/17 monitoring report) to estimate incremental costs

[46] We have estimated the non-aero profit per passenger as the EBITDA% x non-aero profit / passengers. We have used ACCC monitoring data for PER airport to estimate the EBITDA% and non aero profits.

4.1.4 Scenarios considered

We estimated the cost incurred by both Qantas and the airport in question under three scenarios which differed based on the assumptions made in respect to the proportion of any lost margin Qantas and the airport could recapture. We allow for a broad range of inputs to as the data required to estimate foregone returns is route-specific and, in any event, not fully available to Qantas.

The base case scenario assumes that:

- That Qantas Group can recapture 50% of its lost margin via
  - re-purposing the aircraft to another route (recognising that margins must also be offset against any one-off setup costs of a route)
  - passengers switching to its remaining services on the route in question, or from higher returns on remaining flights.[47]
- That 25% of passengers on the cancelled service no longer fly; this assumes that the airport cannot immediately backfill a slot made available by Qantas with a similar service to which all passengers would switch.[48] This might occur if, for example, additional capacity added is insufficient to fill the gap from Qantas's withdrawn flights, or if all consumers are not willing to switch to a competitor airline. This means the airport will lose movement-based aeronautical charges as well as passenger based aeronautical and non-aeronautical revenue from these lost passengers. Or, put another way, the airport will recapture the non-aeronautical revenue and passenger based aeronautical revenue from the 75% of passengers that still fly on Qantas or a competitor airline.

Qantas' **best-case scenario** from a service withdrawal assumes that:

- Qantas Group recaptures 75% of the lost margin.
- That 50% of passengers on the cancelled service no longer fly. This means the airport will lose movement based aeronautical charges as well as passenger based aeronautical and non-aeronautical revenue from these lost passengers.

Qantas' **worst-case scenario** from a service withdrawal assumes that:

- Qantas Group can only recapture 25% of its lost margin, as capacity is immediately replaced by a competitor airline, and there are few other profitable opportunities on its network to which the plane could be re-deployed.
- The airport is immediately able backfill the slot made available by Qantas and consumers switch to that flight. This means that the airport would be fully able to recapture its lost margin.

All scenarios assume no reputational damage or follow on network implications from the service withdrawal.

As we will show, the magnitude of the results is affected by the different assumptions in the scenarios. However, in all cases, the result that airlines have significantly more to lose from a service withdrawal holds.

[47] [CONFIDENTIAL]

[48] It is not possible to determine this proportion in cases where Qantas has withdrawn capacity, as while Qantas can observe increases in capacity by competitors it does not know what proportion of the created capacity is used.

4.2 Perth Airport Case study

4.2.1 Qantas's losses from a withdrawal would be significant

We have considered the relative costs faced by Qantas and Perth Airport from any threat of service withdrawal. This first requires outlining a likely scenario for any such withdrawal.

As discussed in section 4.1.2 we assume that a full withdrawal from Perth Airport is not a credible threat, to consider the relativity of any losses experienced, we have examined what might happen if Qantas was to withdraw a daily return flight from Perth to Melbourne.

Qantas primarily uses A330s on these flights. We estimate that Qantas earns, as a contribution to fixed costs and profits, around [CONFIDENTIAL] per MEL-PER return flight[49]. This equates to the foregone profit on a *per return* flight basis.

As discussed in section 4.1 we have assumed some proportion of this lost margin will be recaptured by Qantas through customers switching to other Qantas PER-MEL flights, paying higher prices for remaining capacity, or making other uses of its assets (plane and staff). Depending on the scenario, we estimate Qantas would experience a *net loss per flight* of between [CONFIDENTIAL] **and** [CONFIDENTIAL] **per return flight**.

We think these estimates are likely to be conservative for a number of reasons.

First, while it may be possible to redeploy the aircraft to increase the frequency of services on an existing international route (for example SYD-SIN) or on the busy east coast routes (MEL, SYD, BNE), there are limitations to Qantas' ability to exercise these options. For example, it could be difficult to obtain landing and take-off slots for these new services, particularly at Sydney Airport. (This is of course different to a competitor airline taking Qantas's foregone PER-MEL slot, because Qantas's withdrawal makes the slot available).

Furthermore, if we assume that Qantas has optimised its network, it follows that Qantas will have limited opportunities to profitably redeploy the aircraft and crew in the short to medium term. This is particularly true for medium to long range aircraft such as the A330 which is used for most east-west flights. If the aircraft was deployed on a new route, it would also be necessary to account for one-off costs. These make temporary re-deployment of an aircraft on a new route unlikely. These start-up costs relate to hiring and training, additional equipment, and marketing. In addition, revenues take some time to ramp up, which reflects a long-range booking curve coupled with getting customers used to flying a new route. By way of example, when launching a new domestic route to Bendigo, Qantas incurred [CONFIDENTIAL] of one-off start-up costs. Similarly, launching a new international route to/from Cairns-Port Moresby involved [CONFIDENTIAL] of one-off costs, even though Qantas already flew daily to both ports.

Second, Qantas would also incur significant unaccounted for wider costs should it withdraw some services from Perth airport because of Perth's criticality for Qantas' customers, broader network and operations

- Most routes into or out of Perth are critical for Qantas' core corporate customers and maintaining a network that provides frequent services to all main Australian population centres is a core requirement to retain these customers. Enabling another airline to capture services into or out-of Perth also risks that they will capture more multi-stop passengers and therefore more traffic on connecting routes.

[49] Based on data provided by Qantas.

- Flights on east west routes are timed for connections. Reducing the frequency of flights can be difficult as the new flight pattern may not fit with the rest of the schedule and affect crew rotations, as crew need to ideally return to their home base.
- It is worth highlighting that Qantas would also face significant brand damage if they attempted to reduce services. Furthermore, it would also affect the customer perceived quality of their overall service as the frequency and connectivity of their services would be reduced.

4.2.2 Perth Airport's losses would be relatively small

The costs to Perth Airport arise from forgone aeronautical and non-aeronautical profit:

- Perth Airport's *lost aeronautical profits per flight* would equate to between $0 (in the case of full backfilling) and [CONFIDENTIAL] per return flight. [50.] These estimates are based on Qantas and ACCC data. We have estimated the Airport's margins per return flight to be just over [CONFIDENTIAL] from a combination of a fixed movement charges and passenger charges. In our analysis we have assumed some proportion of this lost margin will be recaptured through either backfilling by another airline, or, in the absence of backfilling, customers switching to other PER-MEL flights.
- Perth Airport *lost non-aeronautical profit per flight* on the withdrawn return service equals [CONFIDENTIAL] per return flight[51].

This results in Perth Airport's expected **net loss per return flight of between** [CONFIDENTIAL], with a midpoint estimate of [CONFIDENTIAL].

We consider Perth Airport's losses are likely to be towards the lower end of this range as other airlines would backfill any capacity made available with either international or domestic flights. Competitor airlines would be well placed to rapidly backfill any capacity made available as:

- Virgin and Tiger Airways already collectively have 40% of the market share (by ASK) on the PER-MEL route.
- Any withdrawal that arises from Qantas attempting to use countervailing power would give other airlines including but not limited to Virgin and Tiger ample time to do preparatory work, such as redesigning their networks, to take advantage of the capacity made available and capture any serviced demand.
- Other international carriers may be able to partially accommodate the demand for journeys that start or end in international destinations. The market share of other airlines on international routes from PER is 65% (by ASK). As noted by the Productivity Commission the market for international flights is highly competitive, reducing the potential for airlines to exert countervailing power.[52]

4.2.3 Qantas has more to lose

In summary, on a comparative (per return flight basis), Qantas has much more to lose than Perth Airport from a service withdrawal, even in the absence of backfilling – likely between **2 and 10 times** that of Perth Airport (see **Figure 5**). In addition, Qantas would face wider losses should it withdraw some services from Perth airport because Perth is significant to Qantas' customers, broader network and

[50] Assumed to be 0% in the worst case scenario (i.e. flights are fully backfilled), 31% in the base case scenario (based on the assumption that 25% of passengers no longer fly) and 63% in the best case scenario (based on the assumption that 50% of passenger no longer fly). The proportion of passengers that no longer fly has been converted into a percentage of lost aeronautical revenue by estimating the airports revised aeronautical revenue per return flight under the lower passenger scenario described.

[51] Based on data from Qantas adjusted to account for different lost passenger scenarios as described in the footnotes above. No lost passengers under the worst case scenario, 25% lost under the base case and 50% lost under Qantas's best case.

[52]Draft report, p.10.

operations. In our opinion, it is unlikely that Perth Airport would view any threat made by Qantas to withdraw a service such as PER-MEL as credible.

Figure 5: Qantas and Perth Airport losses per withdrawn return flight from PER-MEL

[CONFIDENTIAL]

Source: Frontier Economics analysis of Qantas Group and ACCC data

Full details of our calculations can be found in Appendix A of the confidential version of this report.

4.3 Newcastle Airport

We have completed the same analysis at Newcastle Airport — a tier 2 airport. This shows that even at a smaller airport, if faced with price rises, the losses incurred by Qantas from withdrawing services to/from Newcastle would be far higher than the losses incurred by Newcastle Airport.

It is difficult to conceive how Qantas could issue a credible threat and therefore wield countervailing power in this instance given:

- Past experiences suggest Newcastle Airport could quickly and easily backfill any slot made available this means Newcastle Airport can easily mitigate losses imposed on it by Qantas (see section 3.2).
- If for some reason the airport could not backfill this slot Qantas would still forgo significant contributions to profit (margin) when compared to the margins lost by Newcastle Airport— Qantas' net losses are anticipated to be between **2 and 8 times** those of the Airport (see **Figure 6**).
- In addition, the Qantas Group would face wider losses should it withdraw some services from Newcastle airport because
  - more than a third of passengers on BNE-NTL services are connecting to another Qantas flight, so some revenue would also likely be lost on these connections; and
  - Jetstar has maintenance operations at Newcastle.

Figure 6: Qantas and Newcastle Airport losses per withdrawn return flight from BNE-NTL

[CONFIDENTIAL]

Source: Frontier Economics analysis of Qantas Group and ACCC data

Full details of our calculations can be found in Appendix A of the confidential version of this report.

4.3.1 Qantas' losses from any withdrawal would be significant and persistent

We have considered the relative costs faced by Qantas Group and Newcastle Airport from any threat of service withdrawal. For the purposes of considering the relativity of any losses experienced, we have examined what might happen if Qantas Group was to withdraw a daily return flight from Brisbane to Newcastle.

We estimate that Qantas Group earns, as a contribution to fixed costs and profits, around [CONFIDENTIAL] per BNE-NTL return flight.[53] This is the foregone profit on a *per return* flight basis.

[53] Based on data provided by Qantas.

As discussed in section 4.1 we have assumed some proportion of this lost margin will be recaptured by Qantas through customers switching to other Qantas Group BNE-NTL flights, or making other uses of its assets (plane and staff).[54] Therefore, depending on the scenario, we estimate Qantas would experience a *net loss per flight* of between [CONFIDENTIAL] **per return flight**.

As for Perth, these estimates are likely to be conservative as they do not take account of the following wider costs for Qantas Group.

First, these estimates take no account of the additional lost margins that would be incurred on connecting flights. More than a third of passengers on Qantas Group BNE-NTL services are connecting to other Qantas Group flights (both international and domestic). Enabling another airline to capture services into or out-of Newcastle also risks that they will capture more multi-stop passengers and therefore more traffic on connecting routes. It seems reasonable to assume that Qantas would therefore forgo additional margin on these connecting flights associated with passengers that no longer take these connections.

Second, there will be significant limitations on Qantas's ability to redeploy its assets elsewhere. Furthermore, Jetstar's national aircraft maintenance base, is located at Newcastle Airport. This means Jetstar cycles its fleet through Newcastle creating greater challenges for redeployment.

Finally, Qantas Group's complementary investments at the airport (namely Jetstar's national aircraft maintenance base) provides the airport with the opportunity to "make life difficult" should Qantas threaten withdrawal.

4.3.2 Newcastle Airport's losses would be relatively small and time limited

The costs to Newcastle Airport arise from forgone aeronautical and non-aeronautical profit.

- Newcastle Airport's *lost aeronautical profits per flight* would equate to between $0 (in the case of full backfilling) and [CONFIDENTIAL] per return flight.[55] Based on Qantas airport charge and ACCC margin data, we estimate the Airport's margins per return flight to be close to [CONFIDENTIAL].
- Newcastle Airport *lost non-aeronautical profit per flight* on the withdrawn return service would equate to between $0 and [CONFIDENTIAL] per return flight[56].

This results in Newcastle Airport's expected **net loss per return flight of between $0 and** [CONFIDENTIAL]

4.3.3 Qantas has far more to lose

In summary, on a comparative (per return flight basis), Qantas has much more to lose than Newcastle Airport from a service withdrawal, even in the absence of backfilling – likely between **2 and 8 times** that of Newcastle Airport. It seems highly unlikely that Newcastle Airport would view any threat made by Qantas to withdraw a service such as BNE-NTL as credible.

[54] Assumed to be 25% in the worst case scenario, 58% in the base case scenario (based on market share on the route) and 75% in the best case scenario.

[55] Assumed to be 0% in the worst case scenario (i.e. flights are fully backfilled), 31% in the base case scenario (based on the assumption that 25% of passengers no longer fly) and 62% in the best case scenario (based on the assumption that 50% of passenger no longer fly). The proportion of passengers that no longer fly has been converted into a percentage of lost aeronautical revenue by estimating the airports revised aeronautical revenue per return flight under the lower passenger scenario described.

[56] Based on data from Newcastle Airport and Qantas, adjusted to account for different lost passenger scenarios as described in the footnotes above. No lost passengers under the worst case scenario, 25% lost under the base case and 50% lost under Qantas's best case.

4.4 Analysis is equally applicable to other kinds of threat

The Commission's draft report states:

> *Reducing services is an extreme way, but not the only way, for an airline to exercise countervailing power. As passenger numbers often form the basis of aeronautical charges, an airline can also exercise countervailing power by reducing the size of aircraft that it uses on a route. A major airline, such as Qantas, could redistribute its fleet over its network of routes to achieve a change in passenger numbers at a particular airport.*[57]

This analysis suffers from the same flaws as those relating to service withdrawal. For such threats to be credible, the airport must believe that the costs of such actions will be both material to it but also relatively immaterial to the airline. However, exactly the opposite is likely to be true – airports recover fixed charges from airlines (not solely per passenger charges) and in dollar terms airlines make far more per passenger than does an airport. No airport would therefore believe a threat from an airline that it would reduce passenger numbers if charges did not fall – even before considering the reputation damage to an airline and the likelihood that such actions simply help competitors which can fill the vacated capacity.

[57] Draft report, p. 101.

A DETAILS OF PERTH AND NEWCASTLE CASE STUDY CALCULATION

Perth Airport (confidential)

Newcastle airport (confidential)

frontier economics

BRISBANE | MELBOURNE | SINGAPORE | SYDNEY

Frontier Economics Pty Ltd
395 Collins Street Melbourne Victoria 3000

Tel: +61 (0)3 9620 4488
www.frontier-economics.com.au

ACN: 087 553 124 ABN: 13 087 553

Appendix 2

Sydney Airport Industry Consultative Forum – 2017 and 2018

Service Level Recovery Mechanism
Summary of claims to date

Sydney Airport

The majority of claims received to date relate to delays to aircraft getting on and off gate on time, with multiple causes identified

Sydney Airport has continued to investigate the background of these claims to consider how SLRM funds could be reinvested to support improved gate and bay allocation and management of the airfield operations

Valid claims	
6	• Baggage
4	• Bussing
2	• Aerobridge malfunction
1	• FOD
1	• Roof collapse
1	• FIDS
1	• GPU failure
1	• Radio interference
1	• Runway closure

Rejected claims	
31	• Bay availability/taxiway congestion
9	• Delays due to single runway operations
4	• Delays caused by third parties
2	• Baggage
2	• Safety car and hazmat vehicle

** Note: of the 51 claims not accepted, 21 did not meet the 20-minute threshold to be eligible*

Year 2 of the Service Level Recovery Mechanism

Sydney Airport

Year 2 of the SLRM regime started on 1 July 2017 and 39 claims have been received as at 15 May 2018

Agreed SLRM rebate thresholds for one year trial period	
Up to 20 minutes late	0%
20 minutes late	20% of PFC
Over 20 minutes late	2% additional rebate/minute capped at 100%

Example Rebate Calculation 1:

- 15 minute delay qualifying for a rebate
- No rebate payable (below significant delay threshold)

Example Rebate Calculation 2:

- 30 minute delay qualifying for a rebate
- Rebate equals 40% of $26.23 PFC = $10.49/pax rebate

Summary of claims received since 1 July 2017

Claims accepted

9	Power outage
2	IT system outage
8	Baggage
1	Gate lounges
2	Aerobridge malfunction

Claims not accepted

16	Bay availability / taxiway congestion
1	Aerobridge

Of the 17 claims not accepted, 14 did not meet the 20-minute threshold to be eligible