Adelaide Airport submission to the Productivity Commission inquiry into the Economic Regulation of Airports

3 September 2018

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Executive summary

Adelaide Airport Ltd (AAL) is pleased to make a submission to the Productivity Commission's inquiry into the Economic Regulation of Airports.

Adelaide Airport is the fifth largest domestic and sixth largest international airport in Australia. As the aviation gateway to South Australia, Adelaide Airport processes more than 8 million passengers per annum, including 1 million international passengers.

This submission is to be read in conjunction with the submission from the Australian Airports Association (AAA) and AAL endorses the positions outlined in the AAA submission.

Market power and commercial negotiations with airlines

The Qantas and Virgin Groups are AAL's largest direct customers and are highly valued by AAL for the service that they offer our mutual end-customers. Commercially, Qantas and Virgin are materially more important to AAL than Adelaide Airport is to either airline group. The Qantas Group carries 52% of AAL's passengers, whereas passengers to/from Adelaide Airport represents 4% of Qantas Group passengers. The Virgin Group carries 32% of AAL's passengers, whereas passengers to/from Adelaide Airport represents 6% of Virgin Group passengers.

As a result, AAL is of the view that both the Qantas and Virgin groups hold significantly more market power than AAL in commercial negotiations. In addition, the airlines are able to bring a higher level of resourcing and sophistication to the table, as well as strong political, public relations and brand influence, and extensive information gained from negotiations with all Australian airports. Nevertheless, negotiations are generally constructive and held in a spirit of good faith, albeit challenging – which they should be to some extent as there are significant resources and service outcomes at stake.

Similarly, AAL has no market power for international services. Rather, Adelaide is a price taker in negotiations with international airlines. In a globally competitive market, AAL is regularly reminded by individual airlines and representative groups that if airport charges and service quality expectations aren't met then the airlines will choose other destinations.

While the international airlines have the market power in price and service negotiations, no individual international airline has sufficient market power to be able to veto investment decisions. As a consequence, AAL has been able to engage constructively with the international airlines and the Board of Airline Representatives Australia (BARA) on investment plans, service quality and long-term commercial agreements that balance the needs of the aviation community.

AAL has a long term, proven track record of working commercially and transparently with the airlines. AAL also, in the most part, enjoys its interaction and collaboration with its airline customers. Most recently, AAL has undertaken extensive consultation with the airlines regarding a recently announced terminal expansion. During the consultation and negotiation AAL has sought to balance the conflicting objectives of the various airlines and passengers, resulting in significant design changes to the project and strong support from airlines.

Market power: efficiency and service quality

AAL has a small, integrated team that has remained focused on cost efficiency, which is regularly reviewed with the airlines. Over the period since the integrated terminal was opened, AAL has improved real costs per passenger by 1-2% pa.

AAL is proud of its commitment to service quality, which has included significant investment in a range of infrastructure and many customer service centric initiatives. This commitment is reflected in strong service quality ratings and a high net promoter score.

Monitoring and other regulatory frameworks

On balance, AAL does not believe that significant changes to the current 'light-handed' regulatory approach are warranted.

That is not to say that AAL believes that the conduct of airports and airlines under the current regime is always smooth. AAL has found a number of commercial negotiations to be long and protracted, particularly in relation to any infrastructure that is not directly and immediately of benefit to a particular airline. For example, AAL's landing fee negotiations for the year commencing 1 July 2012 were not finalised with Qantas until approximately three years into that agreement period. Agreement for the period commencing 1 July 2017 has recently been concluded for all airlines other than with the Qantas Group.

If cost-free regulatory change could be implemented, AAL would prefer stronger remedies against the exercise of market power by the airlines. However, AAL strongly believes that the direct and indirect costs of regulatory intervention to curb airline market power, or to force the separation/divestment/demerger of individual airlines within groups into separate airlines, would outweigh the benefits.

Instead, AAL considers that the regime that applies to the second-tier airports provides the appropriate information to airlines, other users and the government.

Economic regulation of airports

AAL submits that neither monitoring nor any other form of economic regulation of aeronautical services is appropriate unless an airport has significant market power relative to their airline users. Given the range of actions available to, and used by, the airlines, it is unclear to AAL whether monitoring is necessary for even the largest Australian airports. These include:

- Reallocating aircraft capacity to other routes in Australia or overseas;
- Not paying charges relating to investments that do not directly benefit the airline; and
- Political lobbying, including through the use of media campaigns.

It is AAL's experience that these commercial remedies are more than sufficient for the airlines to achieve satisfactory outcomes. In addition to these commercial remedies, the airlines have remedies through Parts IIIA and VIIA of the Competition and Consumer Act 2010. AAL would be concerned with any regulatory framework that re-introduced an incentive to approach a regulator rather than conduct genuine commercial negotiations.

There are profound differences between the operational and commercial arrangements at the airports. For example, Adelaide Airport's costs per passenger are influenced by its curfew, single high-quality terminal for all users and low international passenger share, while AAL's 15-year terminal agreement can result in substantial price adjustments and apparently significant changes in return. Consequently it is likely that any monitoring designed to identify prima facie evidence of abuse of market power would need to be bespoke to each individual airport. The cost of a bespoke approach to both the airports and the ACCC is likely to make it appropriate only if it is clear that the airport has significant relative market power and the other actions available to the airlines are inadequate.

Similarly, any benchmarks used to identify abuses of market power in aeronautical services would need to reflect the individual circumstances of each airport or allow a very broad range. In addition to the impacts of the profound differences between airports, particular care would need to be taken to avoid over-diagnosing the abuse of market power as a result of results exceeding forecasts. Over the past decade AAL has noted annual international traffic growth of between -8.3% and 26.5%, which would make any ex-post assessment of returns or investment timing problematic, if not impossible.

Landside access

It is not in an airport's interest to physically restrict access to the airport in such a way that passenger volumes are impacted. Lower traffic volumes would directly impact aeronautical and retail revenues, and indirectly impact property and car parking revenues.

AAL does not have market power in landside access, and has not attempted to either create or use market power in landside access. In particular:

- Only 27% of AAL passengers use the paid car parking, with competition being provided by off-airport car parking, private buses, public buses, taxis, ride-share, chauffeurs, car share, rental cars and drop-off/pick-up.
- From 2012 to 2018, AAL has invested approximately $15million in capital projects to service taxi, bus and chauffeur vehicles to provide facilities that are broadly equivalent in convenience to the paid car parking.
- AAL's Master Plan has retained land next to the terminal for a future light rail corridor.
- AAL employs 35 Landside Customer Service Officers (CSO). One unique feature of the CSO program at Adelaide is the provision of services for disabled and less mobile passengers in the pick-up/drop-off areas.

Car parking prices for the car parks are set to be competitive with alternative access modes, with car parking volumes sensitive to car parking prices. The headline charges for one day parking of $31 (in the Long Term Car Park) and $40 (in the Terminal Car Park) are closely linked to taxi charges (and the offerings of other competitors), being a small premium to a typical taxi cost to the CBD of $28. Long term car parking prices also reflect the prices of off-airport car parking providers.

In addition to the need to compete on price, AAL also needs to provide a strong car parking service to customers. As a result of service quality initiatives implemented, AAL enjoys a Net Promoter Score of +77 in its car parking business. This score is very good and benchmarks above most other service industries.

Future regulation of landside access

On-airport car parking is operating in a competitive market. Monitoring of on-airport car parking is unnecessary, and in any event will become increasingly difficult and problematic as airports (including AAL) grow the 'yield-management' approach to pricing.

It is not in an airport's interest to physically restrict access. In any event, the Master Plan and Major Development Plan approval processes provide the government with the regulatory tools necessary to ensure that sufficient landside access capacity is provided to meet growing demand.

Self-reporting of landside access charges to commercial landside operators should provide the customers, government and regulator with sufficient information to identify any potential use of market power.

Airport and airline market power

Identifying market power

In Australia (as in most parts of the world), access by airlines and passengers to the airport is outside the control of the airports. Instead, the right of airlines and passengers to access the airports are governed by international agreements between governments, government legislation and regulations, and government agencies relating to security and safety.

Any market power airports have relates only to negotiations on price and service quality with the airlines. As such, AAL would contend that airport market power is not absolute and separable from considerations of the airlines' countervailing power. Rather, airport and airline market power should be considered relative to each other.

AAL proposes that some measures that could assist in identifying an airport's relative market power include:

- A comparison between the market concentration of airlines at an airport to the concentration of airports served by each airline; and
- The percentage of travellers to/from an airport catchment that are served directly via the airport (rather than by competing airports or alternative travel modes).

While other contractual and/or regulatory arrangements may further limit the market power of any particular airport, AAL contends that prima facie an airport can't have market power if it faces high airline concentration or high competition from other airports or travel modes.

Domestic services

Both the Qantas and Virgin groups have significantly more market power than AAL in commercial negotiations. Quite simply, while Adelaide Airport is of more importance to the major domestic airlines than it is to the international airlines, the major domestic airlines are essential to AAL:

- The Qantas Group represents 52% of AAL's passengers, whereas passengers to/from Adelaide Airport represents only 4% of Qantas Group passengers.
- The Virgin Group represents 32% of AAL's passengers, whereas passengers to/from Adelaide Airport represents only 6% of Virgin Group passengers.

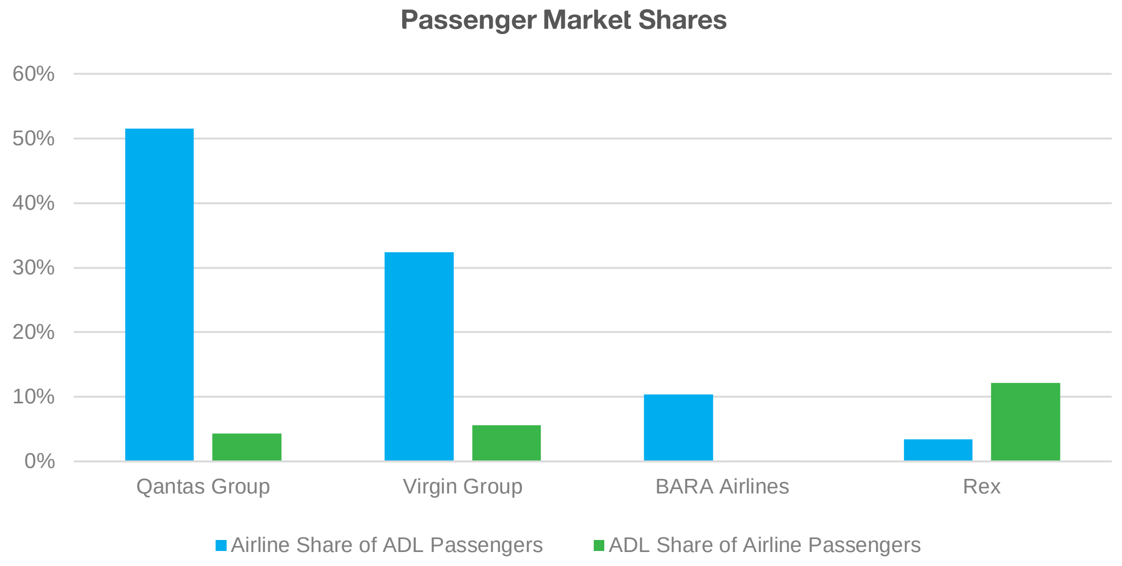
A significant reduction in services from either the Qantas or Virgin groups could have a material impact on the financial performance of AAL, while allowing the airline(s) to redeploy the aircraft on other routes in their network.

In addition, each airline has large teams of experienced executives who negotiate infrastructure agreements with airport operators across Australia and globally. The airlines therefore have significant knowledge across all Australian airports (and many overseas airports) that isn't available to the individual airports. Furthermore, the major airlines also have a strong political, public relations and brand presence that they are capable of quickly mobilising against a counterparty. As it is important for an airport to have the confidence of the community that it serves, this acts as a significant threat.

An airport company of the size of AAL can match neither the resourcing of the major airlines nor achieve the same level of political, public relations and information dissemination reach and influence.

AAL's historic and current commercial agreements with the Qantas Group airlines and Virgin Australia require these airlines' agreement to any price change and, in combination with their high market shares, give these airlines effective veto power on many airport investments or changes to services.

Rex passengers represent only a small proportion of total passengers at Adelaide Airport. However, Rex is disproportionately important to AAL both as a source of international and domestic transfer passengers, and due to their importance to regional South Australia.



The domestic airlines not only have significant market power in their negotiations with airlines, but also in their provision of services to passengers. In a domestic market where two airline groups have a market share of well over 90%, the airlines have an ability and incentive to constrain capacity, segment the market (e.g. by reducing the service quality to economy-class passengers while increasing the service quality to business-class passengers) and prevent the entry of new competitors.

The airports' incentives are more closely aligned to the passengers, with the airport benefiting most from increased passenger volumes, good service quality for all passengers to encourage retail and car parking expenditure, and open access to new airlines.

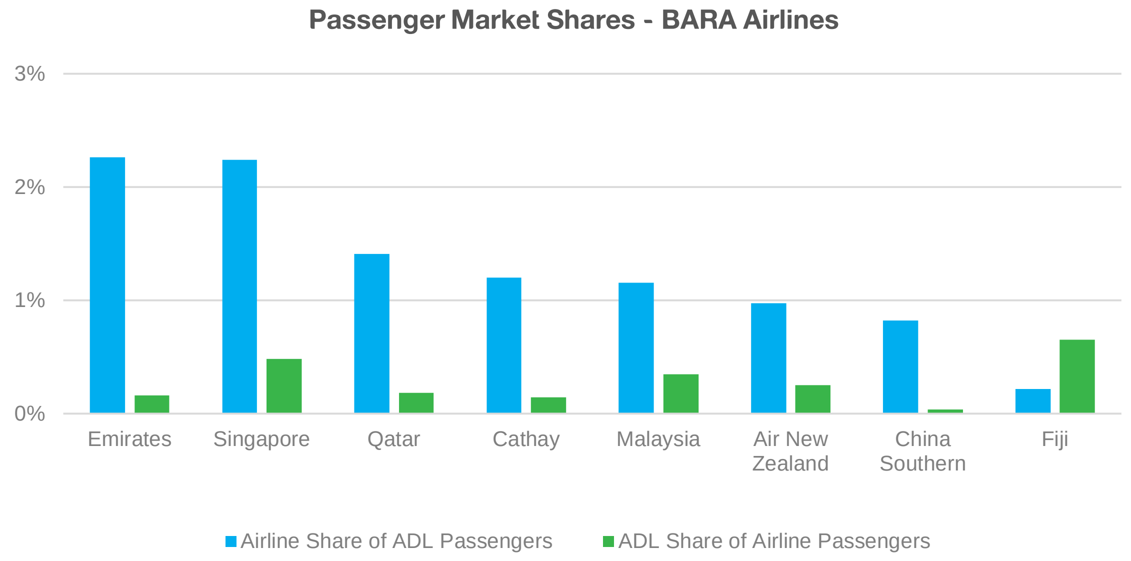
International services

AAL has no market power for international services. Rather, Adelaide is a price taker in negotiations with international airlines that can choose between multiple Australian and overseas destinations.

AAL actively pursues airlines to increase its route network and is regularly reminded by individual airlines and representative groups that if airport charges and service quality expectations aren't met then the airlines will choose other destinations. The current relative unimportance of Adelaide to international airlines is demonstrated by the statistics:

- 37% of international travellers to/from Adelaide are not served by international airlines, but must travel to another Australian city first (and of the 63% that fly internationally from Adelaide, around 70% cannot fly directly to their destination but must transfer via an overseas airport). Even on international routes directly served from Adelaide, only 76% of passengers fly directly from Adelaide to their destination.
- Nine international airlines serve Adelaide Airport, eight[1] of which are members of BARA which assists them in their negotiations with AAL. These airlines collectively represent 10% of Adelaide Airport's passengers, whereas Adelaide Airport represents 0.2% of their total global passenger volumes. With the exception of Fiji Airways, each airline is substantially more important to AAL than Adelaide Airport is to the airline.

[1] Excludes Jetstar International, which negotiates as part of the Qantas Group.



AAL's effectiveness in pursuing new airlines was recognised by the airport being named best airport in the 4-20 million passenger category at the Routes Asia Marketing Awards in both 2017 and 2018. AAL has also been short listed for the 2018 World Routes Marketing Awards.

Adelaide Airport's experience with airline market power

AAL's experience is that the airlines' approach to negotiations reflects both the importance of Adelaide Airport to that airline and the importance of the airline to AAL.

The international airlines are very forthright in their negotiations. While the airlines have the market power in price and service negotiations, no individual international airline has sufficient market power to be able to veto investment decisions. As a consequence, AAL has been able to engage constructively with the airlines and BARA on investment plans, service quality and long-term commercial agreements that balance the needs of the aviation community. As recently demonstrated with AAL's terminal expansion project, AAL currently estimates that this project can be undertaken by AAL without a material real increase in AAL's all-in aviation charges applicable to international airlines.

While AAL believes that the Virgin Group has stronger market power than AAL, it has experienced a very constructive approach from the Virgin Group. For example, the Virgin Group supported the investment in additional apron capacity at the southern end of the terminal in the 2012-17 agreement because the capacity was required for the aviation community, even though the Qantas Group would be the direct user.

AAL highly values the Qantas Group and its relationship – the Group is AAL's largest customer. As a statement of fact: AAL has found negotiations with Qantas more challenging, resource intensive and time consuming, particularly in relation to any infrastructure that is not directly and immediately of benefit to the Qantas Group. For example, negotiations with the Qantas Group over the proposed investment in additional apron capacity at the northern end of the terminal have been protracted, with discussion over the scope, timing, cost and triggers taking place with the consideration of multiple options over a number of years. The additional capacity, while required for the aviation community, will be most directly used by the Virgin Group and Regional Express and will not be directly used by the Qantas Group.

In addition, the Qantas Group adopts a negotiating position that proposes an allowed return on invested capital (ROIC) for AAL that is both materially lower than the ROIC proposed by other airlines and materially lower than the 10% ROIC that Qantas uses for its own business[2].

[2] Qantas Airways Limited FY18 Results presentation, pages 14 and 16.

Nevertheless, while negotiations with Qantas have been challenging and protracted, AAL has historically been able to ultimately negotiate agreements that balance the needs of all airlines and AAL. In relation to the apron expansion, AAL is continuing to negotiate an outcome with the Qantas Group that will not just meet the capacity required for the airline community, but will do so without unreasonably reducing the service quality to other airlines (e.g. through increased busing or towing costs) and without incurring unnecessary staging costs. Despite the time taken, AAL is confident that the Qantas Group will ultimately arrive at a constructive outcome. AAL also notes that, in general, the detailed information requests from the Qantas Group are reasonable and that AAL now invests more time earlier into preparing the type of information that the Qantas Group would likely require. This helps to avoid the potential delays that the ongoing sequential requests for additional information could otherwise result in.

Adelaide Airport's track record

AAL has a long term, proven track record of working commercially with the airlines.

AAL's submissions to the 2011 Productivity Commission review noted AAL's:

- Waiving of a previously agreed charge increase immediately following the Global Financial Crisis;
- Range of discounts on servicing new routes;
- Decision to give each airline the choice between passenger or tonnage-based charges; and
- Agreement in 2011 to a (terminal) Passenger Facilitation Charge (PFC) reset that was 2% below the level calculated according to the prescriptive approach set out in the long-term agreement.

Since 2012:

- The range of airline support packages has been expanded to support new routes, significant new competition on existing routes and strong growth from existing airlines. This includes a rebate of any landing charge for growth above 15% for any individual airline group, and a 50% rebate for growth between 6% and 15%;
- AAL renegotiated the landing charges in 2012 and 2017;
- AAL renegotiated the terminal PFC for a further five years in 2016 (the third PFC contract period);
- Decision to give each airline the choice between passenger or tonnage-based charges; and
- AAL has committed to a $165 million upgrade of terminal facilities, which is the single biggest capital investment by AAL since the original terminal build in 2005.

From 2015 to 2018, AAL undertook extensive consultation with the airlines regarding the expansion of the domestic and international terminal. During the consultation and negotiation process, AAL has sought to balance the conflicting objectives of the various airlines and passengers. As a result the terminal expansion has been significantly redesigned. In their written support for the project, the domestic and international airlines noted both the "open and transparent way in which the AAL team worked" and "the genuine effort by Adelaide Airport to find a cost-effective solution for increasing the capacity and service quality outcomes".

Efficiency

AAL has a small integrated team that has remained focused on cost efficiency. While benchmarks are problematic, Figure 5-4 in the InterVistas Benchmarking Report has a cost per passenger that is in the middle of comparator airports, despite a relatively concentrated passenger peak. Since the integrated terminal was opened (in 2005), AAL has improved real costs per passenger by 1-2% pa.

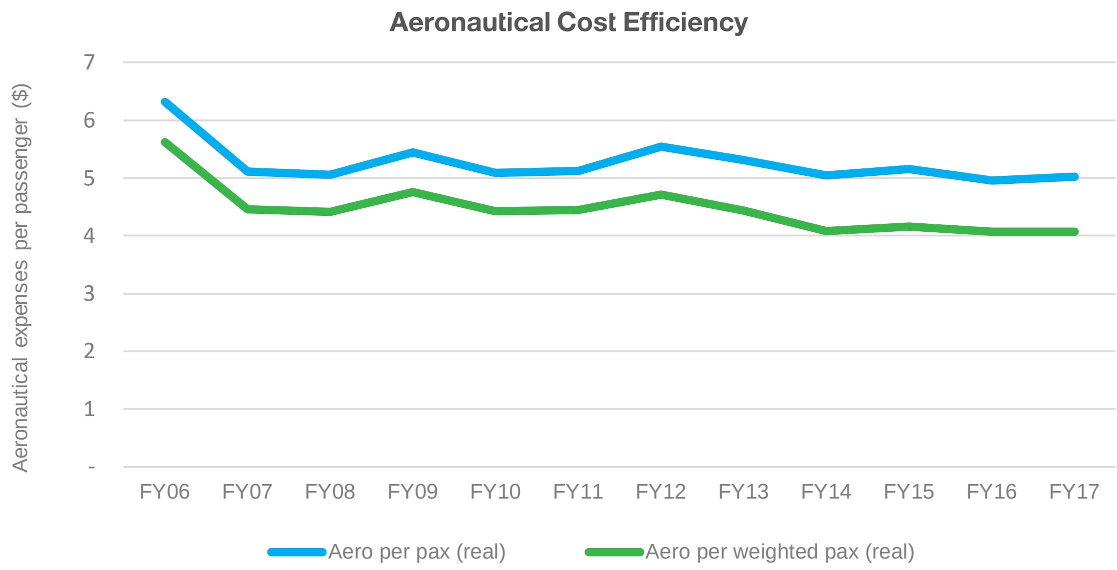
If the period from FY06 to FY17 is broken into three equal sub-periods, average real expenses per passenger declined from $5.48 to $5.27 to $5.05, an overall decline of ~1% pa.

This improvement is despite the stronger growth of international passengers, which are significantly more expensive to process[3]. Indicatively, on a weighted-passenger basis, the efficiency improvement has been ~2% pa[4].

[3] International passengers typically have a more concentrated peak, require additional services (e.g. higher security) and dedicated facilities (e.g. separate facilities for arriving and departing international passengers).

[4] Assumes each international passenger has a cost-to-serve of three domestic passengers.

This result has been a complex combination of ongoing efficiency initiatives, passenger growth, increases in airline and passenger expectations, investments and other factors.



Service quality

AAL is proud of its commitment to service quality. This has included significant investment in a range of infrastructure, as well as many ‘customer service’ initiatives including:

- Following AAL’s move to tier 2 airport reporting in 2012, AAL appointed an Executive General Manager Customer Service in addition to appointing additional management positions that are focused on service quality - being an ‘Ambassador Coordinator’, a ‘Customer Experience Manager’, and a ‘Customer Service Coordinator’;
- Creating an International Ambassador Program in late 2016 to support China Southern Airways’ flights between Adelaide and Guangzhou. The program consists of 14 bilingual English-Mandarin ambassadors that specifically cater to the cultural and language needs of Chinese visitors and complements AAL’s long standing Ambassador program.
- Customer Service Awards available to AAL staff and Customer Service Excellence awards offered by AAL to staff members of AAL’s partners (such as cleaners and security staff);
- International Customer Service Standard (ICSS: 2015-2020) certification from the Customer Service Institute of Australia, Australia’s peak independent customer service body;
- Development of a customer service charter and set of customer service standards in consultation with key airport stakeholders;
- Quarterly reporting of service quality measures and customer feedback metrics on the AAL website; and
- Many service quality initiatives in landside access and car parking, as described later.

AAL uses the ACI ASQ results to identify service quality priorities. For example, in response to the survey results on bathrooms, Adelaide Airport invested $4 million to upgrade all public bathrooms in 2016-18. Customer feedback has been very positive since this project was completed in early 2018.

‘Pre-funding’

AAL takes a pragmatic approach to the funding of investment, which includes a variety of mechanisms that depend on the circumstances. In particular:

- Most capital expenditure, including all maintenance and minor expenditure, is included in the commercial agreements as part of a ‘capex envelope’. Based on forecast capex, an estimate of the appropriate return on capital and depreciation is calculated for each year of the agreement, in line with the capex cashflows (rather than the project completion dates).

- Some medium-large capital expenditure is paid for by the airlines only once the project is completed. This relates to projects that have a long enough duration for the timing differential to be significant to the airlines, but which are small enough that the impact on AAL cashflows can be managed (e.g. within debt covenants). Returns on capital accrue during the project and are capitalised into the final project cost, resulting in the total charges being higher (but with an equivalent NPV).
- Some large projects may in the future (although none are envisaged in the short term) have sufficient impact on AAL's cashflows and balance sheet that they may need to be paid for by airlines, at least in part, as the capex is spent. While some airlines describe this as 'pre-funding', from AAL's perspective returns are only received after the capex is spent and it is no different to the capex envelope.

'Pre-funding' can be the most economically efficient method of funding for the overall aviation community. In Australia the expectation is that airport aeronautical revenues broadly reflect airport costs, and the efficient mix of debt and equity is based on the revenues and costs. In that sense, 'pre-funding' is a logical component of cost-reflective pricing. In competitive industries with lumpy investments, the counterpart to 'pre-financing' is scarcity rents that would be initially much higher than the steady increase in prices arising under 'pre-financing'.

In the absence of revenues arising during the course of a significant capex project, AAL may be unable to finance any of the project through debt, resulting in a higher cost of capital for the project. This would result in higher total costs to passengers (and to the overall airline community) over the life of the investment.

Whether 'pre-funding' is appropriate or even necessary depends on a range of circumstances including the size of the capex, the time period between the start and end of the investment, and the financial circumstances of the airport at the time (which will depend in part on the overall position of the airport in the investment cycle).

Monitoring and other regulatory frameworks

Is monitoring necessary?

AAL submits that neither monitoring nor any other form of economic regulation of aeronautical services is appropriate unless an airport has significant market power relative to their airline users. AAL's experience with airline negotiations is consistent with very few, if any, airports in Australia having market power relative to the airline users. Neither AAL nor any of the airports smaller than Adelaide would have market power relative to the airlines.

While AAL has not specifically assessed the relative market power of the largest four airports, it would be surprised if Brisbane Airport has relative market power given the close proximity of Gold Coast (~100km South), Sunshine Coast (~100km north) and Wellcamp (~140km west) airport. Similarly, while Perth Airport is ~50% larger than Adelaide Airport and is therefore likely to have more relative market power than AAL, it is unlikely to have significant market power relative to the airlines.

Even if an airport has relative market power, monitoring is likely to be unnecessary and slower than other avenues available to airlines. The actions that have been taken by airlines during commercial negotiations include:

- Reallocating aircraft capacity to other routes in Australia or overseas;
- Not paying charges relating to investments that do not directly benefit the airline;
- Seeking (or threatening to seek) the Declaration of airport services; and
- Political lobbying, including through the use of media campaigns.

Given these actions available to, and used by, the airlines, it is unclear to AAL whether monitoring is necessary for even the largest Australian airports. If monitoring is continued, AAL believes that Brisbane Airport, and potentially Perth Airport, should be removed from the monitoring regime.

Could monitoring be effective?

In principle, AAL considers that monitoring of airport behaviour may be able to identify abuse of market power by airports (or airlines). At the very least, a focused monitoring framework could identify prima facie evidence of market abuse that warranted discussion with the airport (and possibly subsequent investigation).

However, there are significant differences between the operational and commercial arrangements at the airports. For example, each of the airports have different:

- International and domestic terminal arrangements, both physically (e.g. integrated or distinct) and commercially (e.g. ownership);
- Investment cycles; and
- Commercial structures in their aeronautical agreements. For example:
  - AAL's 15-year terminal agreement can result in substantial price adjustments and apparently significant changes in return[5];
  - Brisbane has 10-year pricing agreements that were negotiated to build the new runway;
  - Perth Airport has a bilateral agreement with Virgin Australia that was negotiated to build Virgin Australia's domestic facilities at the international terminal; and
  - Sydney Airport has agreements of up to 17 years with each of the airlines for the use of T2 (the former Ansett terminal), as well as a 10-year agreement with Qantas for the use of T3 (the former Qantas terminal); and
- Operational circumstances and regulations:
  - Adelaide and Sydney airports are both subject to a curfew that concentrates the peak and impacts on operational efficiency and investment decisions;
  - Brisbane and Perth airports are to different degrees subject to the mining investment cycle;

[5] The terminal agreement runs for three successive 5-year periods, with a further impact on the subsequent 5-year period. One unusual element of the agreement is that the airlines take the volume risk in relation to some elements of the charge, with traffic outperformance or underperformance in each period resulting in a rebate/catch-up in subsequent period. Hence, prices and returns may appear unreasonably high/low in a 5-year period that includes an adjustment that relates to unexpectedly low/high traffic in the previous 5-year period.

- o Perth Airport is located 4-5 hours flight-time west of the east coast airports, resulting in distinct traffic patterns that impact on operations and investment; and
- o Sydney Airport is also subject to other operational regulations (e.g. the NSW regional requirements included in this inquiry's terms of reference).

Given the profound differences between the airports, it is likely that any monitoring designed to identify prima facie evidence of abuse of market would need to be bespoke to each individual airport. The cost of a bespoke approach to both the airports and the ACCC is likely to make it appropriate only if it is clear that the airport has significant relative market power and the other actions available to the airlines are inadequate.

Is the current monitoring effective?

AAL considers that the regime that applies to the second-tier airports provides the appropriate information to airlines, other users and the government. This information is of direct relevance to airport users and of general interest to the community, and includes:

- Aeronautical charges;
- Car parking charges;
- Service quality outcomes; and
- Complaint-handling processes and outcomes[6].

AAL finds that there is a relatively low cost of compliance with the regime as it involves producing and publishing information that AAL would use for the running of the business and would otherwise be publishing. The compliance costs could be onerous if information that was not used by the management were required to be created and disclosed.

AAL's previous experience with the monitoring regime administered by the ACCC was that it could not effectively assess airport behaviour because the standardised financial monitoring approach does not take into account any of the specific circumstances of each airport. In addition, when AAL reported in accordance with the ACCC monitoring regime, AAL considered that the ACCC service quality monitoring was costly and did not provide an accurate representation of Adelaide Airport's service quality. Instead, the ACI ASQ is a significantly more relevant measure of service quality.

Should benchmarks be provided to guide negotiations?

For the reasons noted above, any benchmarks used to identify abuses of market power in aeronautical services would need to reflect the individual circumstances of each airport or allow a very broad range. In addition to the impacts of the differences noted earlier, particular care would need to be taken to avoid over-diagnosing the abuse of market power as a result of results exceeding forecasts.

Since privatisation, Adelaide Airport has observed large changes in all aspects of its business.

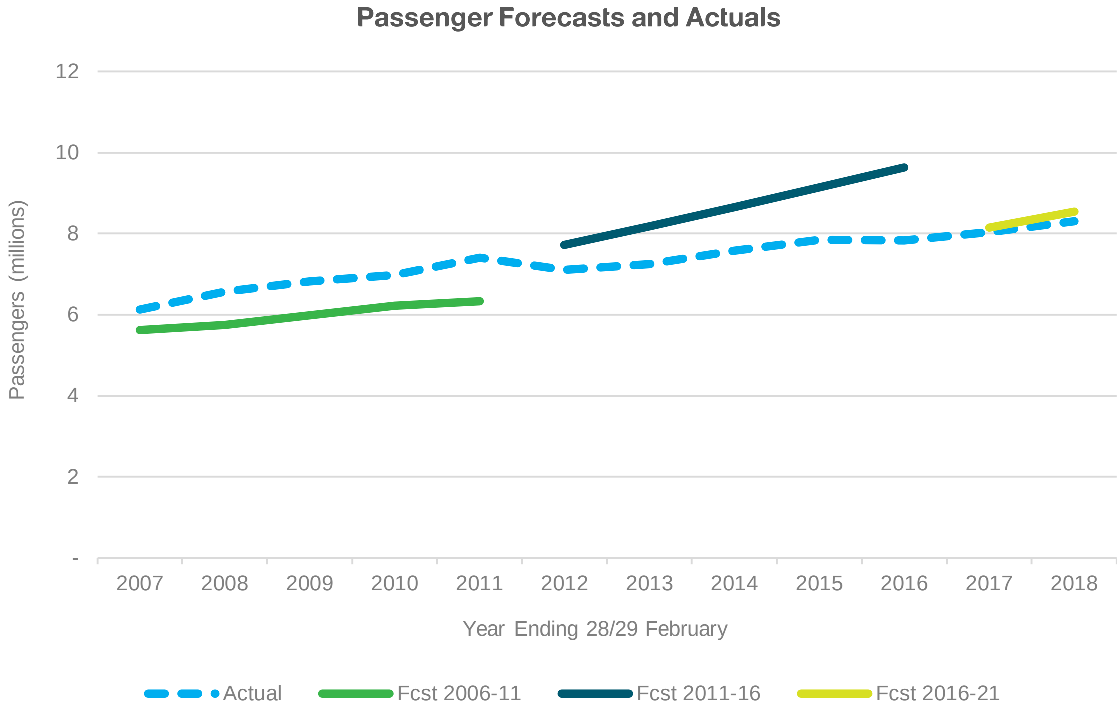
Financial benchmarks

While the airport has grown at 3.1% pa from 6.5 million annual passengers to over 8 million passengers since the integrated terminal opened in 2006, passenger growth rates have varied between -4.0% and 8.1%. The volatility has been even more marked in international volumes, where annual growth varied between -8.3% and 26.5%. As a result there have been both periods where financial returns have been lower than expected and periods with higher than expected returns. This is most clearly shown in the terminal agreement where there was a $23.9 million over-recovery in the 2006-11 period and a $26.7 million under-recovery in the 2011-16 period[7].

These under and over-recoveries were caused by significant variances between actual and forecast traffic volumes, as shown in the chart below.

[6] Following discussions with the Department of Infrastructure, Regional Development and Cities (DIRDC) in April 2018, AAL has increased its reporting of complaint-handling outcomes which DIRDC has now confirmed is meeting its reporting expectations.

[7] Years in the integrated terminal agreement run from 1 March to 28/29 February.



The 2016-21 period is currently forecast to be a more modest under-performance but could change if traffic growth accelerates.

Equally, the debt and equity funding costs have changed, at times relatively quickly (e.g. at the height of the Global Financial Crisis), as have operating costs in response to changing passenger and airline expectations and regulatory requirements.

AAL's overall aeronautical returns[8] under the current regulatory regime (FY03 to FY17) demonstrate both a lack of an overall excessive return and the difficulties in assessing airport behaviour based on aeronautical returns. Over the 15 years from 2002-3 to 2016-17, AAL's average aeronautical return was 6.9%. This return reflects the commercial agreements negotiated with the airlines as well as the variance over time between expected and actual traffic volumes, expenses and investment.

However, the observed pre-tax aeronautical returns in any year (5-year period) have varied between -1% and 12% (2.2% and 9.8%). This wide variation also reflects the smoothing of prices (and back-ending of returns) over the term of the 15-year terminal agreement as well as the mismatch in timing between investment and charges. A wide variation in returns is also observed in airlines. For example, over the past decade Qantas' ROIC has been as high as 22.7% in 2015/16 (and an average of 20.5% over most recent past 4-year period), while being negative in earlier years[9].

Operational efficiency benchmarks

While (as described earlier) AAL is comparable to its peers in the InterVistas Benchmarking Report and has improved its real operating cost per passenger over the period since the opening of the integrated terminal in 2006, AAL considers that efficiency benchmarking in airports is very problematic.

The apparent efficiency of different airports is sensitive to many external factors such as the passenger mix, the peakiness of the schedule, climate, the investment cycle, the scope of the services provided, government regulations, labour costs and terminal configurations. Even the relative efficiency of one

[8] Calculated using the line-in-the-sand asset values, which do not reflect the nature of the commercial agreements (as discussed elsewhere).
[9] Qantas Airways Limited FY18 Results presentation, page 16.

airport over time is affected by many external factors, as can be observed in the significant annual variation in AAL's aeronautical expenses per passenger.

Service quality benchmarks

AAL considers the global ASQ survey to be the most useful service quality benchmark and uses the survey to provide insights on its own performance and changing passenger expectations. Nevertheless, ratings can be affected by a range of circumstances beyond the control of the airport and care needs to be applied to avoid over-interpreting the results.

Rather than benchmark itself against the broader population of all airports, AAL has selected an aspirational group of airports in Europe, North America and Asia against which it measures its own performance. These airports are selected to be similar in size and demographic to Adelaide Airport, while also having strong service quality aspirations and relatively new terminals. In addition, AAL benchmarks itself against other Australian airports.

AAL does not aim to be best-in-class if this can only be achieved through high airport charges. Rather, AAL uses the ASQ benchmark information to identify areas of relative weakness on which to focus (across the 55 services measured in the ASQ).

Changes to current regulatory approach

On balance, AAL does not believe that significant changes to the current 'light-handed' regulatory approach are warranted.

That is not to say that AAL believes that the conduct of airports and airlines under the current regime is always smooth. As noted earlier, Qantas is a challenging negotiation counterparty, particularly in relation to any infrastructure that is not directly and immediately of benefit to the Qantas Group. Equally, AAL's consultation during the terminal expansion project was an improvement on previous processes – AAL has learnt lessons from that consultation that it will apply in the future and continue to improve from.

If cost-free regulatory change were to occur, AAL would prefer stronger remedies against the exercise of market power by airlines. In practice, AAL strongly believes that the direct and indirect costs of regulatory intervention materially outweigh the benefits.

Consequently AAL would advocate for the fine-tuning of the existing regime, including removing Brisbane Airport and potentially Perth Airport from the ACCC Monitoring Regime and potentially refining the information collected by the ACCC (on which the first-tier airports and airlines would be better informed).

Remedies in the existing framework

As described earlier, the airlines have significant market power individually and collectively. Before pursuing a regulatory remedy, airlines can and do use their commercial leverage during negotiations. These include:

- Reallocating aircraft capacity to other routes in Australia or overseas. These airline decisions have a significant impact on both the aeronautical and commercial revenues of Adelaide Airport;
- Not paying charges relating to investments that do not directly benefit the airline. In the ordinary course, AAL cannot invest until it has the agreement of the Qantas and Virgin groups as well as BARA (as the advisor to the international airlines) and Rex; and
- Political lobbying, including through the use of media campaigns, to influence government decisions in relation to regulations and/or investment approvals (or to simply put pressure on airport management).

It is AAL's experience that these commercial remedies are more than sufficient for the airlines to achieve satisfactory outcomes. While AAL cannot say whether these commercial remedies would be sufficient at the largest airports, media reporting in relation to other airports indicates the airlines have been using their commercial leverage to influence the design and timing of investments and actively using the media and their political influence.

In addition to these commercial remedies, the airlines have remedies through Parts IIIA and VIIA of the Competition and Consumer Act 2010.

Alternative regulatory frameworks

There are many other regulatory frameworks that have been applied to or proposed for airports or other infrastructure industries in Australia and overseas. AAL is not qualified to comment in detail on any of these frameworks.

However, AAL notes that the current regime is an evolution of the approach recommended by the Productivity Commission in 2002. Finding 8.2 of its report observed difficulties under the previous regime in which the ACCC made decisions on airport investments and pricing arising from:

- “the incentives for some participants to approach the regulator rather than achieve commercially-negotiated solutions;
- the high costs of complying with the regime; and
- the regulatory risk due to the uncertainty and delays introduced by the need to have every investment-related price increase vetted by the regulator”.

A particular case study the Commission considered at the time was the new terminal development at Adelaide Airport, which was finally developed in 2005 (under a 15-year commercial agreement agreed under the ‘light-handed’ regulatory framework).

AAL would be concerned with any regulatory framework that re-introduced the incentive for an airline or airport to approach a regulator rather than conduct genuine commercial negotiations. For example, if access to regulatory intervention were easy for each individual airline, then there is an incentive for any airline whose competitive position is weakened by any particular investment to threaten or pursue regulatory intervention (which, at the very least, would delay investment). AAL regards an arbitration model as re-introducing a degree of adversarialism and process that would reduce the incentives to collaborate and arrive at bespoke win-win outcomes. AAL envisages that it would not impact significantly on prices or returns, but would reduce incentives to offer more tailored service levels and facilities and therefore reduce customer experience.

Behaviour-focused monitoring

An alternative to, or refinement of, the current ‘light-handed’ regime would be to focus more directly on the behaviours of the airports and airlines. Airports (and airlines) are very public institutions, and all of their behaviours are directly observable by the government/regulator or the airlines (and airports). In particular, if an airport or airline were to materially exercise market power, the most likely responses by the airlines/airport actions during and following commercial negotiations are observable:

- Any substantial reallocation of aircraft capacity by an airline from an airport to other routes in Australia or overseas would be directly observable, and could indicate an exercise of market power by an airport or airline[10].
- Any court action by an airport seeking to enforce an aeronautical charge may indicate the exercise of market power by either the airport or airline[11], or may represent a genuine and intractable difference in view.
- Similarly, an application for Declaration could indicate the exercise of market power by either the airport or an airline.
- Any media campaign is directly observable, and while it most likely represents an attempt to use public pressure as commercial leverage by an airline or airport, if there is any misuse of market power by an airport it is likely to be exposed by the media in the process (given the public nature of its service delivery and conduct).

[10] The reallocation of capacity could itself be an exercise of market power by the airline, or a response to the airport’s exercise of market power.

[11] The court action could represent the airport enforcing an exercise of market power, or seeking a remedy via the courts against the airline exercising market power.

Landside access

Evidence to identify the existence and use of market power

In the absence of landside access restrictions to off-airport competitors, airports have no market power in on-airport car parking. Off-airport providers of landside access (including off-airport car parking, taxis, rental cars, car share, ride share and buses) provide a direct alternative to on-airport car parking, and any on-airport car park price premium due to convenience reflects the value of the convenient location.

To the extent an airport has market power in landside access, it arises only if an airport can effectively restrict access to off-airport competitors, either through physical restrictions or excessive access prices. In practice, both the fear of government intervention and the links between an airport's reputation and discretionary passenger spending on car parking and retail eliminate or reduce any ability for an airport to create market power. In fact, ride share is experiencing explosive growth at Adelaide Airport, and taxi pick-ups continue to grow.

Hence, even if you assume an airport management team doesn't fear government intervention, the questions to be assessed in any inquiry into airport market power and behaviour in landside access could be summarised as:

1. Does the airport have market power (and has it used any) in physically restricting landside access in order to earn excessive returns on on-airport car parking facilities?
2. Does the airport have market power (and has it used any) in setting landside access charges in order to earn excessive returns on landside access or car parking facilities?

Does the airport have market power (and has it used any) in physically restricting landside access in order to earn excessive returns on on-airport car parking facilities?

It is rarely in an airport's interest to physically restrict access to the airport in such a way that passenger volumes are impacted. Lower traffic volumes would directly impact aeronautical and retail revenues, and indirectly impact property and car parking revenues. Unless an airport's car parking revenues are a very high proportion of their total revenues, then it is very unlikely that an airport has significant market power to physically restrict access.

Evidence that could be used to assess whether an airport has, or has used, market power in physically restricting landside access in order to earn excessive returns includes:

- What is the market share of paid on-airport car parking?
- Can the airport physically relocate the landside access infrastructure to sites that are materially less convenient than the on-airport car parks and still facilitate the expected growth in passenger volumes? Has the airport done so?
- Can the airport physically relocate the landside access infrastructure for the major off-airport competitors to sites that are materially less convenient that the on-airport car parks? Has the airport done so?
- Does the physical layout of the airport allow the airport to prevent significant numbers of passengers from using free on or off-airport car parks and walking to the terminal? Has the airport prevented passengers from doing so? If not, the airport will not have any market power in discount/long term car parking (and, depending on the location, won't have market power in terminal car parking).

Does the airport have market power (and has it used any) in setting landside access charges in order to earn excessive returns on landside access or car parking facilities?

As with physical restrictions, unless an airport receives a very high share of its revenue from car parking and landside access, it is not in an airport's interest to set landside access charges in such a way that passenger volumes are impacted. In addition, landside facilities that form part of the aeronautical asset base or are provided to commercial tenants generally can't have commercial access charges applied to them. Consequently, it is generally not possible to apply landside charges to rail, public bus or short-stay pick-up and drop-off. Hence an airport's market power, if any, is likely to be restricted to the setting of charges for commercial landside providers.

Evidence that could be used to assess whether an airport has, or has used, market power in setting landside access charges for commercial landside providers includes:

- What is the market share of paid car parking and commercial landside access relative to free options (including rail, public bus, drop-off and pick-up)?
- Are there free 'work-arounds' available to passengers if commercial landside charges are too high? For example, can passengers pre-book a taxi or ride-share for pick up in the car park of an on-airport fast-food restaurant or service station?
- Are the returns the airport is earning per m^2 on landside access facilities unreasonably high given the land values surrounding the airport and the value associated with convenience to the terminal?
- Are car parking prices high relative to car parks operated for commercial profits (excluding car parks operated by non-profit organisations or as loss-leaders such as in shopping centres) in equivalent CBD locations?

Does Adelaide Airport have market power in landside access?

AAL does not have market power in landside access, and has not attempted to either create or use market power in landside access. In particular:

- Only 27% of AAL passengers use the paid car parking, with competition being provided by off-airport car parking, private buses, public buses, taxis, ride-share, chauffeurs, car share, rental cars and drop-off/pick-up.
- From 2012 to 2018, AAL has invested approximately $15 million in capital projects to service taxi, bus and chauffeur vehicles with a further $1.5 million forecast for FY19 to provide facilities for buses and taxis that are broadly equivalent in convenience to the paid car parking. This includes ongoing investment to taxi concierge services, provision of taxi and ridesharing lay off areas and associated facilities, $750,000 to develop a new sheltered ride share pick up area, $5 million currently invested in constructing a new taxi drop off facility next to the terminal, and $1.5 million to commence improvements to chauffeur and bus shelter areas and traffic flows. The associated landside access charges do not currently include any return on land.
- Free, close on-street parking is available to passengers.
- The AAL Master Plan has retained land next to the terminal for the provision of a State Government funded light rail corridor to the airport. AAL would construct and maintain an appropriate sheltered tram stop for passengers.
- AAL's landside access charges currently only apply to taxis and ridesharing vehicles (and neither public buses nor shuttle buses used by off-airport competitors). The taxi charges meet the operating and depreciation costs of the taxi facilities and provide a modest return on capital, but do not currently include any return on land.
- AAL employs 35 Landside Customer Service Officers (CSO). One unique feature of the CSO program at Adelaide is the provision of services for disabled and less mobile passengers in the pick-up/drop-off areas, including physical assistance with bags and the provision of wheelchairs. These employees are able to assist people from their vehicle all the way to the check-in desks. In addition, AAL subsidises the information booth in the terminal which, among other services, assists passengers in booking transport from the airport.
- The facilities for public and private buses (including shuttle buses used by off-airport competitors), taxis and paid car parking are broadly equivalent in convenience to the terminal, as shown in the table below. A map of the facilities is included in the appendix.

Landside access facility	Metres to terminal
Disabled pick-up/drop-off	4
Taxi drop-off	38
Chauffeur pick-up/drop-off	48
Taxi pick-up	70
Public pick-up/drop-off	84
Terminal car park	98
Private bus (including off-airport competitors)	134
Public bus	189
Staff car park 1	226
Staff car park 2	365
Long term car park	533

Car parking

Car parking prices for the car parks are set to be competitive with alternative access modes. AAL is progressively managing prices more dynamically using the online booking system, with discounts changing depending on the day of the week and for school holidays. AAL has observed that car parking volumes do respond to the car parking prices.

The headline charges for one day parking of $31 (in the Long Term Car Park) and $40 (in the Terminal Car Park) are closely linked to taxi charges, being a small premium to a typical taxi cost to the CBD of $28 and a larger premium to the cost of an Uber. In addition, the prices reflect competition from cheaper options such as public and private buses, as well as the offerings of off-airport car parking competitors (including the CBD car parks). AAL believes that a higher price would result in a significant mode share to taxis, ride share and off-airport competitors.

Long term car parking prices also reflect the prices of off-airport car parking providers. While AAL's prices and those of its competitors are dynamic, the AAL price is typically a small premium above the off-airport competitors, reflecting the convenience of parking closer to the terminal.

In addition to the need to compete on price, AAL also needs to provide a strong car parking service to customers. AAL has invested significantly in technology to integrate all facets of its car park management system into AAL's centrally managed Customer Relationship Management system (CRM). The CRM can track the entire customer experience from booking online until the customer exits the car park and effectively harnesses AAL's CRM to proactively solve customer problems (including automated refunds), often before they are aware there is a problem. As a result of this initiative, AAL now enjoys a Net Promoter Score of +77 in its car parking business. This score is very good and benchmarks above most other service industries.

Future regulation of landside access

In the absence of any action taken by the airport to restrict competing access, on-airport car parking is operating in a competitive market. Monitoring of on-airport car parking is unnecessary, and in any event will become increasingly difficult and problematic as airports (including AAL) grow the 'yield-management' approach to pricing.

As noted, it is not in an airport's interest to physically restrict access. In any event, the Master Plan and Major Development Plan approval processes provide the government with the regulatory tools necessary to ensure that sufficient landside access capacity is provided to meet growing demand (whether as a result of aviation expansion or commercial property development).

Self-reporting of landside access charges to commercial landside operators should provide the customers, government and regulator with sufficient information to identify any potential use of market power.

Landside access planning

AAL works closely with the South Australian Government and local councils to ensure infrastructure improvements required to support airport-related traffic growth on external road systems surrounding the airport are appropriately managed. For example, in 2017, AAL and the South Australian Department of Transport and Infrastructure worked together to provide an additional lane for vehicles exiting the airport on the Sir Richard Williams Avenue/Sir Donald Bradman Drive approach.

AAL continues to fund infrastructure upgrades required on airport for commercial developments. In parallel, AAL continues to work with the South Australian Government to advocate for a number of upgrades that would enhance the safety and efficiency of the South Australian Government transport network for access to and from the airport.

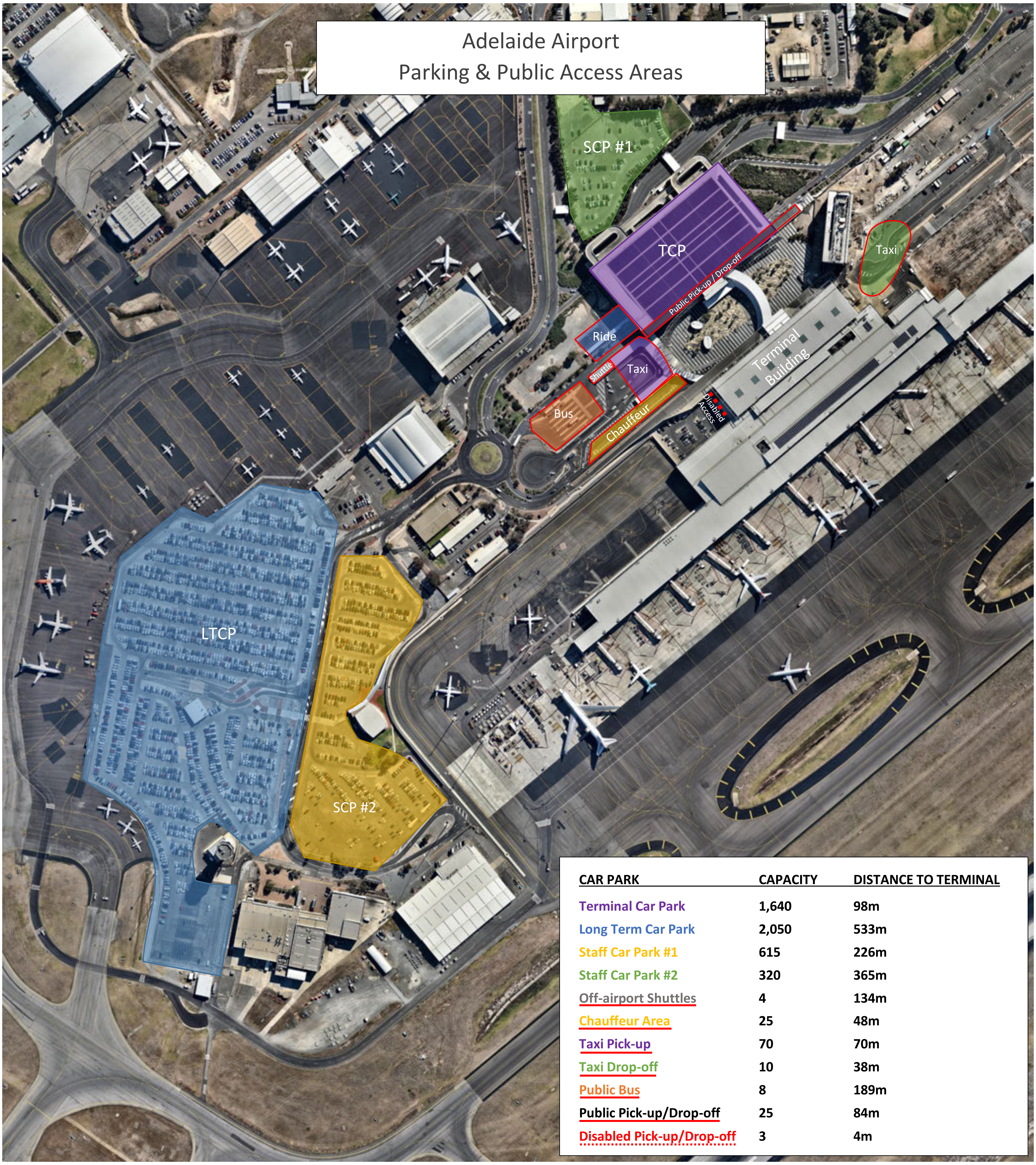
AAL worked closely with the previous South Australian Government to negotiate a set of infrastructure principles to guide investment in road infrastructure on airport or surrounding the airport. Following the state election in March 2018, AAL will continue to discuss the infrastructure principles with the new South Australian Government. In its Master Plan, AAL has provided land for a light rail corridor that would interconnect with the terminal and business precinct. AAL would construct and maintain a tram station to ensure that the passenger journey is seamless and easy.

Jet fuel

AAL notes BARA's position on jet fuel supply and broadly agrees with the principles as outlined in the BARA submission. AAL considers that the aviation industry would benefit from greater transparency in jet fuel supply.

Appendix A

Adelaide Airport
Parking & Public Access Areas



CAR PARK	CAPACITY	DISTANCE TO TERMINAL
Terminal Car Park	1,640	98m
Long Term Car Park	2,050	533m
Staff Car Park #1	615	226m
Staff Car Park #2	320	365m
Off-airport Shuttles	4	134m
Chauffeur Area	25	48m
Taxi Pick-up	70	70m
Taxi Drop-off	10	38m
Public Bus	8	189m
Public Pick-up/Drop-off	25	84m
Disabled Pick-up/Drop-off	3	4m