Submission to the Productivity Commission's inquiry into airport regulation

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Table of Contents

Executive Summary

Brisbane Airport Corporation Pty Limited (BAC) welcomes the opportunity to contribute to the Productivity Commission's (Commission's) inquiry into the economic regulation of airports (the 2018 Review).

This submission, which is BAC's formal response to the 2018 Review, describes BAC's commitment to the development of Brisbane Airport *"consistent with a Major International Airport having regard to … the actual and anticipated future growth in, and pattern of, traffic demand for the Airport Site"* and *"the quality standards reasonably expected of such an Airport in Australia"*, which is its obligation under its lease from the Commonwealth.[1]

Importantly, this submission also provides evidence to the Commission of BAC's compliance with the lease's requirement to have regard to 'Good Business Practice' in the development of Brisbane Airport. The investment by BAC in facilities and services at Brisbane Airport, which has facilitated growth in competition for airline seats, and delivered considerable public benefit by improving access to the Queensland economy, should assist the Commission in forming its views on the effectiveness of the light handed regulatory framework in place since 2002.

It is BAC's view that the current regulatory framework has provided the appropriate environment to support measured, prudent investment in Australia's airports and thereby facilitate sustainable growth.

BAC endorses the submission to the Commission's inquiry by the Australian Airports Association (AAA) and its position that the current regulatory environment has delivered significant benefits to the people of Australia. This outcome, which is in part the result of the Commission's previous reviews, is consistent with the Commission's obligations under section 8(1) of the *Productivity Commission Act 1998*:

(a) to improve the overall economic performance of the economy through higher productivity in the public and private sectors in order to achieve higher living standards for all members of the Australian community;

(b) to reduce regulation of industry (including regulation by the States, Territories and Local Government) where this is consistent with the social and economic goals of the Commonwealth Government; and

(c) to encourage the development and growth of Australian industries that are efficient in their use of resources, enterprising, innovative and internationally competitive.

Brisbane Airport

Brisbane Airport is Australia's third busiest airport by passenger numbers and is the primary gateway for the state of Queensland. At the time of writing, Brisbane Airport provides services to 31 airlines flying to 50 domestic and 31 international destinations. In 2017/18, 23.6 million passengers used Brisbane Airport.

[1] Commonwealth of Australia, *Airport Lease for Brisbane Airport*, Lease 702599136, July 1997

Recent work undertaken for BAC by PWC and Colmar Brunton reveals that, as at 2018, Brisbane Airport directly contributes $2.6 billion towards the Queensland economy and another $1.4 billion indirectly through its supply chain.[2]

Furthermore, Brisbane Airport enables or facilitates $11 billion in economic activity across the State through the movement of goods and people. Brisbane Airport directly provides Queenslanders with 23,826 jobs, and indirectly through its supply chain, another 11,000.[2] That is, one in every 70 Queensland jobs is supported by Brisbane Airport.

Investment at Brisbane Airport

To drive this economic contribution, BAC has made significant investments in both aeronautical and non-aeronautical facilities and services at Brisbane Airport in order to improve the overall passenger experience and facilitate the growth in passenger traffic, which has more than doubled since the Airport was privatised in 1997. Overall, BAC has invested some $3.5 billion at Brisbane Airport since privatisation, with $1.5 billion invested over the past five years.[3] Major investments completed by BAC since light-handed regulation have included:

- Expansion of the northern and southern aprons adding 17 apron bays at the Domestic Terminal Building (DTB), as well as expansion of the passenger processing facilities at the common user terminal at the DTB to provide additional queuing space and self-service equipment;
- Expansion of the International Terminal Building (ITB), including expanding the main terminal building by 60 metres, expanding the northern concourse by 200 metres and expanding the apron by 45,000 square metres and two new gates;
- Further expansion of the ITB, including an additional 11,000 square metres of terminal space, 55,000 square metres of aprons to the north, three new aircraft bays, two new walk-out gates and four new aerobridges;
- Construction of a 5km new major access road to the domestic terminal precinct;
- Development of three multi-level car parks (MLCPs) – two adjacent to the DTB and one adjacent to the ITB adding a total of around 7,500 additional parking spaces;
- Development of the Central Parking Area to provide facilities for ground transport operators, as well as 2,500 additional public long term car parking spaces;
- Redevelopment of the pick-up and drop off zones at the DTB, including an elevated covered walkway to the MLCPs; and
- Stage 1 of the new parallel runway (NPR), comprising the ground improvement works required to create a stable platform on which to build the runway.

These investments have allowed BAC to maintain the quality of service for passengers at Brisbane Airport, with quality of service ratings (as measured by the Australian Competition

[2] Queensland Economic Advocacy Services, *Brisbane's new runway: What's in it for you*, August 2018
[3] This is the total aeronautical and non-aeronautical investment at Brisbane Airport. Airport charges incurred by the airlines relate only to the aeronautical portion of the investment and do not necessarily recover the full cost of that investment.

and Consumer Commission (ACCC)) consistently 'good' for both aeronautical services and car parking services for the past decade. Furthermore, independent surveys undertaken by the Airport Council International (ACI) have ranked Brisbane Airport's overall quality of service as 'very good' for the last six years.

BAC will continue to invest in Brisbane Airport to improve the efficiency of service delivery and the overall passenger experience, and support economic development in Queensland. BAC is planning to invest approximately $2.0 billion over the next five years, with a significant proportion of this being investments in aeronautical services and facilities – around 22% of this will be spent on the NPR and a further 37% will be spent on other capacity growth related projects.

Aeronautical charges are not excessive

The investments made at Brisbane Airport have resulted in increased charges for the use of the runways, terminals and associated infrastructure. However, the average price increases have not been excessive in light of these investments and the considerable volume risk borne by BAC. This is evidenced by BAC's modest rate of return on assets over the past 10 years.

BAC has consulted on and negotiated airline agreements with its airline customers for the use of the runways, including the NPR, covering a term of more than 10 years. The negotiation processes have been firm and commercially robust but open and transparent, with the airlines heavily involved in agreeing the capital expenditure programs. Through these agreements, BAC has committed to the level of investment it will undertake and bears considerable passenger volume risk on those investments. BAC therefore has no incentive to over-invest.

These outcomes have been achieved under the current light-handed regulatory framework.

The light-handed price and quality of service monitoring regime was retained for Brisbane, Sydney, Melbourne and Perth airports on the recommendation of the Commission following its review of airport regulation in 2011 (the 2011 Review). It found that the framework had been effective on the basis that:

- There had been a marked increase in aeronautical investments;
- Aeronautical charges were not excessive;
- Service quality outcomes were 'satisfactory' to 'good'; and
- Charges, revenues, costs, profits and investments appeared reasonable compared to overseas airports.[4]

Outcomes since the 2011 Review

A key element of the Terms of Reference for the 2018 Review is to report on the appropriate economic regulation of airport services. The onus is on the proponents of substantially increased regulation to provide the evidence to the Commission to demonstrate that there have been changes or developments since the Commission's 2011 Review, which would lead to a

[4] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011

different conclusion and warrant changing the regulatory framework. As the Commission notes:

> *"Any party arguing for new or increased government intervention would need to demonstrate that there is a sound rationale for intervention and that their proposal would be better than alternatives, including the status quo".*[5]

BAC submits that there have been no developments at Brisbane Airport that warrant substantial changes to the regulatory framework, and that the current light-handed regulatory framework should continue for aeronautical services and facilities. In particular, as the Commission found in its 2011 Review:

- BAC has continued to make significant investments in aeronautical services and facilities at Brisbane Airport;
- Price increases for aeronautical services and facilities have been in line with those investments;
- Price increases have not been excessive, with modest rates of return achieved on investments; and
- The quality of services has been consistently high at Brisbane Airport.

Constraints on market power

Notwithstanding that BAC has a strong incentive to 'do the right thing' to maintain its reputation as a good corporate citizen, there are a number of other factors that would effectively constrain the use of any market power held by BAC, including:

- *Competition from other airports* – there are four airports within 200km of Brisbane that provide competing services. Brisbane Airport's relative share of the market in south east Queensland has fallen since the early 2000s and is trending downwards. Independent consultants found that Brisbane Airport faces competition for a significant proportion of its passenger and airline traffic, including competition for international routes[6];
- *Significant countervailing market power of airlines* – the top two airline groups at Brisbane Airport, which account for 79% of the seat capacity, have credible options in terms of other airports at which they could locate existing or new capacity. Where airlines are able to switch or allocate marginal capacity to other airports, such competition at the margin can be sufficient to constrain the airport's behaviour. BAC often provides incentives to airlines in order to attract new routes or additional capacity on existing routes, and support airlines in start-up phase. BAC also notes that the Board of Airline Representatives of Australia (BARA), which represents the majority of airlines that use Brisbane Airport, has authorisation from the ACCC to collectively bargain on behalf of its members for aviation services at Brisbane Airport.[7] This effectively increases its members' market power;

[5] Productivity Commission, *Economic Regulation of Airports*, Issues Paper, July 2018, page 4
[6] Oxera, *Competition between Australian airports: focus on Brisbane Airport*, Prepared for Brisbane Airport Corporation, August 2018. A copy of the Oxera report is provided in Appendix A.
[7] ACCC, *Application for revocation of A91200 and substitution authorisation A91466,* Determination, 25 March 2015

- *An inability to withhold service* – BAC has obligations under the *Airports Act 1996* to operate the site as an airport and prepare a master plan every five years (approved by the relevant minister), which outlines the way in which BAC proposes to develop the airport site to meet future demand from the aviation industry for airport services and facilities. Furthermore, BAC has an obligation under its airport lease[8] to use the airport site as an airport and to provide access to its aeronautical services and facilities, with an obligation to provide access, even if there is no agreement between the airline and the airport; and
- *The prospect of a return to heavy-handed regulation* – BAC is conscious that abuse of any market power held by it could lead the government to implement a policy of heavier-handed regulation, such as price cap regulation. The fact that BAC's pricing is transparent, based on a generally accepted approach (i.e. the building block methodology) and involves input from the airlines mitigates against abuse of market power. This is discussed further in Section 3.2.6.

Future regulatory framework for aeronautical services

While BAC believes that, on balance, the current regulatory framework has been effective, it also notes that there is scope for improvements in the price and quality of service monitoring undertaken by the ACCC. In particular, the information presented by the ACCC in its monitoring reports could expand more on the investment outcomes. We believe its discussion of the prices and profits at an airport should take into consideration the rate of return on assets and where the airports sits in terms of the investment lifecycle. In that way the ACCC will provide a useful analytical framework to establish whether prices or rates of return are excessive. As shown in this submission, consideration of the returns in the context of the investment at the airport and against benchmark rates of return over time demonstrates that the returns (and thus prices) at Brisbane Airport are not excessive.

Under the current light-handed regulatory framework BAC is confident that it can continue to achieve commercially negotiated outcomes with the airlines that provides for efficient investment at the airport, consistently good quality of service and aeronautical charges that reflect a commercial return on assets. BAC believes the framework is working well overall and there is no need for a regulated arbitration framework to be developed or imposed on the aviation industry.

There are already a number of potential remedies available under the *Competition and Consumer Act 2010* to address potential abuse of market power. Furthermore, aeronautical agreements generally include dispute resolution clauses that apply once an agreement is executed. BAC submits that the final offer arbitration (FOA) model that has been floated by various parties in recent months is likely to increase the risk of regulatory error, potentially stifle necessary aeronautical investment and may increase the cost of capital for the airports. Therefore, FOA is unlikely to produce a better outcome for the community than the current framework.

[8] Commonwealth of Australia, *Airport Lease for Brisbane Airport*, Lease 702599136, July 1997

Car parking and landside access

For car parking, BAC questions the need for continued price and quality of service monitoring. There have been a number of developments since the Commission's 2011 Review that suggest monitoring is no longer required for these services.

Houston Kemp, who was engaged to assess the level and use of market power by BAC, concluded that BAC does not have substantial market power in car parking services.[9] This was based on the following observations:

- The number of alternative transport mode options, at a range of price points, for getting to the airport;
- The number of competitors for off-airport car parking;
- Prices being in line with investment and the locational rent;
- No evidence of a drop in the quality of service; and
- BAC has a strong incentive to increase total visitors to the airport.

Furthermore, Houston Kemp found that there is no evidence that BAC has improperly exercised any market power it may hold in the provision of landside access services.[9] BAC does not have an incentive to restrict access and undertakes a range of activities to promote the use of public transport access to the terminals.

[9] Houston Kemp, *Car parking and ground access – market power assessment,* A report for Brisbane Airport, September 2018. A copy of the Houston Kemp report is provided in Appendix B.

1. Introduction

Brisbane Airport Corporation Pty Limited (BAC) welcomes the opportunity to contribute to the Productivity Commission's (the Commission's) inquiry into the economic regulation of airports (the 2018 Review). It provides an opportunity to demonstrate how successful the current regulatory regime has been in enabling BAC to deliver the services and facilities its customers are seeking, whilst earning returns acceptable to its investors.

This is BAC's formal response to the Commission's request for submissions to its inquiry into the 2018 Review. In preparing this response, BAC has been cognisant of the Government's objectives, as set out in the Terms of Reference for the 2018 Review:

> *"In undertaking the Inquiry, the Commission should report on the appropriate economic regulation of airport services, including the effectiveness of the price and quality of service monitoring, in achieving the following objectives:*
>
> - *promoting the economically efficient operation of, and timely investment in, airports and related industries;*
> - *minimising unnecessary compliance costs; and*
> - *facilitating commercially negotiated outcomes in airport operations."*[10]

The Commission's Issues Paper requests further information on a range of issues. In general, this submission focuses on the particular issues of most concern to BAC. BAC has also contributed to the submission by the Australian Airlines Association (AAA), and supports the positions set out in that submission.

This submission focuses on providing evidence to assist the Commission in forming its views. It is structured as follows:

- Chapter 2 provides background information on Brisbane Airport and its operating environment leading up to this review;
- Chapter 3 addresses the Commission's specific questions on market power in aeronautical services and facilities;
- Chapter 4 addresses the Commission's specific questions on the prices and quality of service monitoring for aeronautical services and facilities;
- Chapter 5 addresses the Commission's specific questions on car parking and landside access; and
- Chapter 6 addresses the Commission's specific questions on other related issues.

The supporting appendices include two expert reports that were commissioned by BAC on:

- Competition between airports (prepared by Oxera); and
- Market power in car parking and landside access (prepared by Houston Kemp).

[10] Productivity Commission, *Economic Regulation of Airports*, Issues Paper, July 2018, page iv

2. Background

This section provides relevant background to the 2018 Review including:

- Context for the review;
- The key evidence tests that the Commission is seeking to apply and on which it is seeking evidence; and
- An overview of BAC and its performance over the relevant period.

2.1. The 2018 Review

BAC notes that the 2018 Review is the fourth undertaken by the Commission since 2000. The previous review occurred in 2011 (2011 Review).

BAC notes that the Terms of Reference for the 2018 Review are similar to the previous review. As per the 2011 Review, the Commission is to *"report on the appropriate economic regulation of airport services, including the effectiveness of the price and quality of service monitoring"*.[11] The list of matters that the Commission should examine and take into consideration were also in the Terms of Reference for the 2011 Review.[12]

BAC notes that the Commission's key conclusions for the 2011 Review were as follows:

- Under the light handed regime for aeronautical services:
  - Aeronautical investment had increased significantly;
  - The potential for airports to abuse market power was reduced through the continued growth of low-cost carriers, overseas national airlines and competition from secondary airports;
  - Aeronautical charges do not point to the inappropriate exercise of market power;
  - The airports' aeronautical charges, revenues, costs, profits and investment look reasonable compared with (the mostly non-commercial) overseas airports; and
  - Service quality outcomes overall were 'satisfactory' to 'good';
- Negotiations between airports and airlines were becoming more sophisticated;
- The range and extent of modal options at each airport provides a competitive constraint on airports' car parking pricing; and
- The access charges and conditions faced by competitors to on-airport car parking are not so high as to impede competition.[13]

[11] Productivity Commission, *Economic Regulation of Airports*, Issues Paper, July 2018, page iv
[12] The key difference is that the Terms of Reference for the 2018 Review require the Commission to examine regional air services at Sydney Airport, which was explicitly excluded from the 2011 Review. BAC has refrained from responding to matters relating to this, as it does not impact Brisbane Airport directly.
[13] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011

The key question for the 2018 Review is therefore whether there is compelling evidence and a sound rationale for the Commission to draw different conclusions to those it reached in 2011. BAC therefore notes that:

- The Commission is seeking evidence on behaviours within the industry; and
- The Commission reiterates its long standing position on regulatory matters; that evidence of market power is not sufficient of itself to make the case for change in regulatory arrangements. It has to be shown that the new regulatory arrangements would provide demonstrably better outcomes for the users of airport services:

  > *"Any party arguing for new or increased government intervention would need to demonstrate that there is a sound rationale for intervention and that their proposal would be better than alternatives, including the status quo."*[14]

  This is particularly relevant given the profound failures the Australian Competition and Consumer (ACCC) attributes to economic regulation in the energy sector in Australia (see below). This increases the burden of proof on those proposing alternatives to current arrangements to demonstrate that they will deliver better outcomes for the users of airport services.

2.2. The key evidence tests that the Commission is applying

The Commission identifies five categories of evidence that might inform a conclusion that there is substantial market power in the provision of some airport services and that this market power might be being misused. These are:

- *Excessive fees and charges for aeronautical services* – An airport operator with market power might maximise the airport's profits through excessive charges and by providing fewer services, leaving the community as a whole worse off;
- *Inefficient investment decisions* – Airports could exercise their market power by making such decisions and passing the costs on to airport users. This could include both under-investment and over-investment;
- *Inefficient operations* – Airport operators could also exercise market power by operating inefficiently – by not using the best combination of inputs to produce services;
- *Low quality or limited services* – Airports could exercise their market power by providing services of a low quality or limiting the range of services provided; and
- *Commercial negotiations* – The manner in which airports conduct commercial negotiations could indicate an abuse of market power.

BAC makes the following observations in respect of these categories of evidence:

- *Excessive fees and charges for aeronautical services* – conventional economic theory suggests that monopolists typically constrain output below optimal levels and increase

[14] Productivity Commission, *Economic Regulation of Airports*, Issues Paper, July 2018, page 4

prices above such levels.[15] BAC observes that evidence of high levels of investment is inconsistent with a claim that airports are engaged in this sort of behaviour. The investment undertaken by BAC in expanding capacity at Brisbane Airport is outlined in Section 2.4 below. This form of monopoly behaviour also implies that the monopolist is largely indifferent to volumes being constrained, as this assists them to increase prices above optimal levels. The evidence clearly shows that BAC has considerable exposure to volume risk, unlike most other forms of infrastructure (see Section 3.2.2). Moreover, BAC's rate of return is at the low end of the range of the rate of return estimated for a benchmark efficient airport operator (see Section 3.2.1) and BAC is subject to considerable bypass risks (see Section 3.1). BAC is therefore clearly incentivised to increase volumes.

If the issue is excessive prices in isolation, then the returns need to be viewed in the context of the life cycle of the assets and in the context of the risks that are borne. This is discussed in Section 3.2.

- *Inefficient investment decisions* – in respect of under-investment, this might occur in the context of the above or if returns are too low. However, under-investment is not an issue of contention in regard to airports. In respect of over-investment, this could be the result of a lack of prudency in determining what investments should be made, their size and timing, or a lack of efficiency in delivering those investments. While this risk may exist for an unregulated, private monopolist, it is evident that:
  - Equity investors have a strong incentive to ensure that this is not the case;
  - This is particularly true where they are bearing considerable volume risk (overinvesting in capacity is a bad idea and doing it inefficiently is an even worse idea);
  - While domestic airlines have limited discretion in respect of whether or not they use an airport if they want to service a particular market, they have much greater countervailing market power in determining whether major capacity upgrades are prudent and efficient. No major investment occurs at Brisbane Airport without endorsement, and ultimately agreement, from airlines in the context of an aeronautical services agreement, e.g. the new parallel runway (NPR) at Brisbane Airport. This is discussed further in Section 3.2.6; and
  - Most major capital projects will be contracted out by airports through competitive tender processes and there is therefore no incentive to procure inefficiently (i.e. pass profits to unrelated third parties);

    It is worth noting that the risks of inefficient over-investment are well established under some forms of regulation, particularly rate of return style regulation (where revenues are set to enable cost recovery and largely divorced from output levels). More recently, the ACCC has attributed a similar problem to the economic regulation in Australia, despite it being introduced primarily to address the failings of rate of return regulation. It argues that the energy regulatory regime has *"led to significant increases in prices"*[16] and that

[15] ACCC, *Submission to the Productivity Commission's inquiry into the economic regulation of airport services*, March 2011
[16] ACCC, *Restoring electricity affordability and Australia's competitive advantage,* Retail Electricity Pricing Inquiry – Final Report, June 2018, page iv

"decisive action is needed to ensure that, despite declining demand, networks continue to efficiently deliver benefits to consumers."[17] The ACCC also suggests that inappropriate reliability standards were a further cause of unnecessary costs being imposed on the electricity consumers.[18] Thus, inefficient investment decisions have been made in other industries, despite heavier handed regulatory frameworks.

The situation is so serious in the ACCC's estimation that it calls for asset write-downs for government owned network businesses to ease the pressure on electricity prices.

The ACCC would appear to be of the view that the energy network regulatory regime that has been applied in Australia has fundamentally failed. It appears to lay the blame for this failure in the design of the regulation, rather any errors by regulators themselves. This serves to highlight that regulation will not necessarily reduce inefficient investment and operations, and may even exacerbate it.

- *Inefficient operations* – the issues are similar to those outlined above for inefficient capital expenditure.
- *Low quality or limited services* – airlines often argue that quality of service has been stagnant despite increasing charges.[19] However, this fails to acknowledge that the quality of service at Australian airports is generally good (and has been consistently so in recent years – see Section 3.2.5) and that investment is required to maintain the level of services in an environment of both increasing number of passengers and changing passenger expectations.
- *Commercial negotiations* – a firm with market power could theoretically make 'take it or leave it' offers. However, the increasingly sophisticated nature of, and the extent of the concessions and incentives provided to airlines through the services agreements is evidence that this is not the case (see Section 3.2.6). BAC applies a shadow building block model to ensure prices are cost reflective and provide transparency to its airline customers. This is further supported by the detailed information provided to them on the proposed investments at the airport (see Section 3.2.6). Furthermore, airports have an obligation to provide access through their leases with the Federal Government, which provides the airlines with significant countervailing power. This is discussed further in Section 3.1.3.

There is at least one other area of evidence of the potential use of market power not identified by the Commission but worth considering. An infrastructure owner with a largely fixed cost base, and substantial market power, might choose to avoid taking volume risk. This is because it would appear to be poorly placed to manage this risk on behalf of its customers and would be in a position to impose the risk on its customers. Airports however take considerable volume risk on behalf of airlines and there is little evidence of them successfully using market power to impose this risk on airlines. Airlines are able to control their capacity, i.e. aircraft, by size and frequency of operations, and have done so in the past (see Section 3.1.2).

[17] ACCC, *Restoring electricity affordability and Australia's competitive advantage,* Retail Electricity Pricing Inquiry – Final Report, June 2018, page ix
[18] ACCC, *Restoring electricity affordability and Australia's competitive advantage,* Retail Electricity Pricing Inquiry – Final Report, June 2018
[19] Productivity Commission, *Economic Regulation of Airports*, Issues Paper, July 2018

There is also limited evidence of the airports being able to introduce better price signals to better allocate the use of aeronautical capacity. The Commission highlights the virtues of using price signals to alleviate congestion at airports:

> *"…where there is congestion at an airport, higher prices ensure that the scarce available capacity at the airport is allocated to those airlines (and their customers) with the highest willingness to pay, reflecting the value to those customers. In the absence of higher prices, congestion is often alleviated through quantity restrictions for customers (such as rationing), queuing and other delays, or particular customers simply 'missing out' on consuming the services they desire."*[20]

The explanation for the level of volume risk borne by the airports and the limited introduction of pricing signals for congestion is the countervailing power of the airlines (see Section 3.1.2). Airlines operating at a congested airport have an incentive to avoid congestion pricing in order to protect their incumbency by seeking to frustrate or defer capacity upgrades which would otherwise support market growth and airline competition, maintaining competitive airline pricing.

2.3. Brisbane Airport

Brisbane Airport is Australia's third largest airport by passenger numbers and is the primary international and domestic gateway into the state of Queensland. It is located 15 kilometres from the Brisbane central business district (CBD) and occupies approximately 2,700 hectares, making it one of Australia's largest airports by area. Brisbane Airport has no curfew and therefore the benefit of 24 hour operations.

In 2017/18, Brisbane Airport serviced 23.6 million passengers, comprising 17.5 million domestic (74%) and 6.1 million international travellers (26%). This represents an increase of 2.6% over 2016/17 and was driven largely by the increase in international passengers of 6.0% (compared to domestic passenger growth of 1.5%). The annual number of passengers has more than doubled since privatisation in 1997, when there were 10.2 million passengers passing through Brisbane Airport.

Brisbane Airport provides aeronautical services to eight domestic airlines, flying passengers to or from 50 domestic locations. There are currently 26 international airlines flying direct to or from 31 international destinations.[21] The airline market is highly concentrated, with the top two airline groups at Brisbane Airport accounting for 79% of the seat capacity.

Brisbane Airport is operated and developed by BAC under a 99 year concession (50 year lease plus 49 year option at no additional cost). BAC owns and operates the International Terminal Building (ITB), runways, and general aviation facilities. It also owns the Domestic Terminal Building (DTB), approximately 80% of which is under long-term leases to Qantas Airways (Qantas) and Virgin Australia (Virgin) expiring in late 2018. BAC operates the common user domestic terminal, which occupies the space not leased by Qantas or Virgin. Other airport

[20] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011, page 67
[21] Correct as at the time of preparing the submission.

services, such as air traffic control, aviation rescue and firefighting, customs, quarantine, and immigration, are the responsibility of the Commonwealth Government.

BAC's vision for Brisbane Airport is to be world-best and the preferred choice for passengers, airlines, business and community. Its purpose is to grow shareholder value through the efficient and sustainable operation, management and development of the airport. BAC will do this through applying the following values in everything it does:

- Building collaborative partnerships;
- Being proactive and innovative;
- Acting with integrity and commitment; and
- Providing excellent service.

BAC's operations are diverse and comprise four main business segments:

- Aeronautical, which includes the provision of passenger terminal and runway facilities to airlines, general aviation facilities and mandated security;
- Property, which covers BAC's portfolio of building leases, ground leases and vacant unleased land, including retail development at the Skygate and Service Centre precincts;
- Retail, covering the retail tenancies in the domestic and international terminals; and
- Parking and Transport Services, which covers a range of parking products and landside access to the terminals and airport facilities.

BAC operates under a 'dual till' model, meaning that the aeronautical and non-aeronautical activities are managed as separate businesses. This reflects the different nature of the key issues that these businesses face and is reflected in BAC's annual reporting.[22]

This is consistent with the model under which the airports were privatised, as confirmed by the Government's directive to the ACCC regarding its oversight of prices at Sydney Airport.[23]

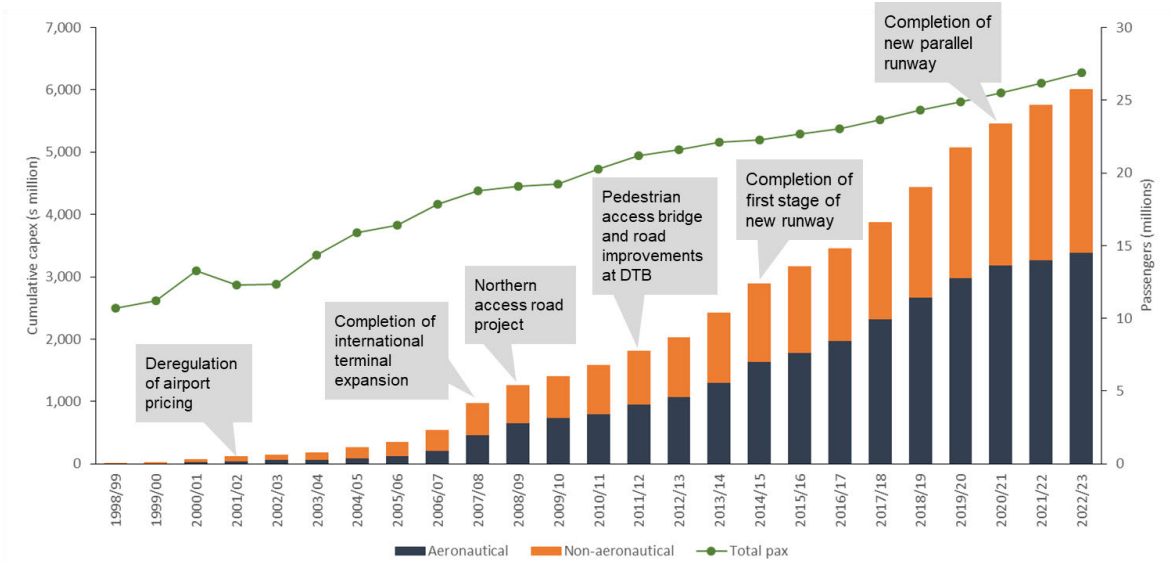
2.4. Investment in aeronautical services and facilities

In 2011, the Commission noted that, under the light handed regulatory regime, there had been a marked increase in aeronautical investment and that the monitored airports had not experienced the bottlenecks that have affected other infrastructure sectors.[24] This continues to be the case – since privatisation, BAC has invested more than $3.5 billion at Brisbane Airport.[25]

The cumulative investment in Brisbane Airport's aeronautical and non-aeronautical services and facilities continues to grow, as shown in the following chart.

[22] BAC's annual report breaks down the revenue into the following segments: Aeronautical, Landside Transport (including car parking), Property, Retail, Government Mandated Security and Interest.
[23] Minister for Financial Services and Regulation, *Prices oversight at Sydney Airport*, Media Release No. FSR/030, 20 April 2001
[24] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011, page XX
[25] This is the total aeronautical and non-aeronautical investment at Brisbane Airport. Airport charges incurred by the airlines relate only to the aeronautical investment and do not necessarily recover the full cost of that investment.

Figure 1. Cumulative capital expenditure, Brisbane Airport ($ nominal)



Source: ACCC monitoring reports (Various), ABS, BAC forecast

BAC invested more than $1.5 billion on services and facilities in the five years to the end of 2017/18, to meet growing demand (capacity) and enhance the experience of the travelling public. This level of investment in services and facilities at Brisbane Airport has been facilitated by the current light-handed regulatory framework and, in the case of aeronautical investments, has been agreed with the airlines through commercial negotiations primarily underpinned by growth in demand from aircraft and passenger movements.

Key projects completed since the 2011 Review include:

- Expansion of the southern apron at the DTB;
- Overlay upgrade of the main runway;
- Expansion of the Common User Terminal at the DTB;
- Retail developments within the terminals, including 24 new retail tenancies at the ITB and 16 new tenancies at the DTB;
- Completion of the second multi-level car park (MLCP) at the DTB, which increased car parking capacity by more than 3,000 bays;
- Completion of the Pedestrian Access Bridge and road developments at the DTB;
- Development of the Central Parking Area, comprising the Airpark (2,500 public long term parking), ground transport operator facilities and amenities, and staff car parking;
- Expansion of the ITB, including an additional 11,000 square metres of terminal space, 55,000 square metres of aprons to the north, three new aircraft bays, two new walk-out gates and four new aerobridges; and
- Common User self-service kiosks and automatic bag drop facilities at the ITB.

Major projects expected to be completed over the next five years include:

- NPR, including a 3.3km runway, 12km of taxiways and associated facilities;

- Development of a second MLCP at the ITB, which will increase capacity by 2,800 bays, and a third MLCP at the DTB, which will increase capacity by 4,000 bays;
- Expansion of the staff car parking capacity area at the Central Parking Area, which will increase capacity to 3,800 bays;
- Significant security upgrades to ensure compliance with security requirements advised by the Department of Home Affairs and Maritime Security;
- Stop bar installation to improve safety on the runways and taxiways;
- Common user self-service check in facilities at the southern end of the DTB;
- Expansion of the northern concourse and aprons to accommodate an additional four gates at the ITB;
- Upgrades to the baggage handling system and installation of self-service check-in kiosks and bag drop facilities at the ITB; and
- Northern apron expansion at the DTB, to deliver four new aircraft parking bays and associated taxiways.

More details of the investments in aeronautical services and facilities made by BAC and its processes used to ensure that investments are both prudent and efficient are provided in Section 3.2. Details of BAC's investment in car parking and landside access services and facilities are provided in Chapter 5.

2.5. Quality of services

Brisbane Airport has consistently ranked highly on the quality of aeronautical, car parking and landside access services provided at the airport. The most recent ACCC price monitoring report[26] indicates that Brisbane Airport has consistently been ranked as 'good' for overall quality, standard and availability of services (covering aeronautical services, car parking and landside access).

These findings are consistent with the findings of the Airport Council International (ACI) Airport Service Quality (ASQ) programme, which has consistently ranked Brisbane Airport as 'very good' in overall service quality for both its domestic and international airports for the past six years of the ASQ.

BAC uses a real-time feedback system (Dr Voxx[27]) to alert facilities management staff to any potential quality of service issues for the assets that it directly owns and operates, i.e. all assets on airport excluding the domestic terminal areas and airside infrastructure operated by Qantas and Virgin under long term leases. This allows BAC to respond proactively as issues arise, rather than reactively responding to quarterly survey results.

[26] Australian Competition and Consumer Commission, *Airport Monitoring Report 2016-17*, April 2018

[27] The Dr Voxx technology collects real-time feedback from guests via screen across the international and domestic terminals. The interactive touch screens capture customer feedback through a rating system so travellers can have their say and share their thoughts and BAC can respond in real time.

Further information on quality of service at Brisbane Airport is provided in Chapter 3 (for aeronautical services) and Chapter 5 (for car parking and landside access) in response to the Commission's specific information requests.

2.6. Commercial negotiations and agreements with airlines

BAC has a track record of successful commercial negotiations, which are delivering beneficial outcomes to the airlines, passengers and the airport. Furthermore, the nature of the negotiations and the resulting agreements have become more sophisticated over time. Key developments in the negotiations have included:

- Providing increasingly more detailed data to the airlines;
- Separation of agreements between the runway system and the terminals;
- Increasing timeframes, with the latest agreement for the runway having a term of 11 years and pricing resets for a number of key variables, e.g. passengers, operating and capital expenditure;[28]
- Greater proportion of charges being on a per passenger basis, which has shifted volume risk to BAC; and
- Increasing concessions provided to the airlines.

The nature of the negotiations and the outcomes achieved in negotiations with airline customers clearly demonstrates that there is fair and balanced market power between the parties.

The current standard Airport Services and Charges Agreement for the Runway System (2012 Runway ASCA) supports the development of the $1.3 billion NPR, which will alleviate runway capacity constraints and improve on-time performance to the benefit of passengers. The term of the agreement – 11 years – is the first of its kind for Brisbane Airport and the NPR will be a key driver of future economic growth in Queensland.[29]

Negotiations are currently underway with multiple airlines on the Aviation Services and Charges Agreement for the Terminals, Aprons and Related Infrastructure (Terminals ASCA). The current Terminals ASCA expires at the end of calendar year 2018, at the same time as the domestic terminal leases held by Qantas and Virgin expire. Thus, the 2019 Terminals ASCA will be the first terminals agreement with the whole of the DTB as a common user terminal, and the first with an extensive Service Level Agreement and Key Performance Indicator framework. This framework will apply to the ITB in the 2019 Terminals ASCA and we are working with the airlines to incorporate a similar framework for the DTB.

Further information on BAC's negotiations with its airline customers is provided in Section 3.2.6.

[28] BAC notes that the current agreement for the terminals is the shortest agreement to date. However, this is a bridging agreement to cover the period between the last airline agreement for the terminals, which expired on 30 June 2017, and the expiration of the Qantas and Virgin domestic terminal leases in December 2018.
[29] The signed agreements have a term of 11 years in contrast to the Runway ASCA published on BAC's website, which has a term of 25 years. This was the term initially proposed to airlines,

3. Aeronautical services and facilities

This chapter provides BAC's responses to the Productivity Commission's specific information requests regarding market power in aeronautical services and facilities. This chapter:

- Considers the extent of market power held by Brisbane Airport;
- Demonstrates that there are effective constraints on the use of any market power BAC does hold; and
- Demonstrates that BAC has not exercised that market power.

3.1. Market power in aeronautical services

The Commission is seeking information on the extent of market power held by airports and the constraints on the use of that market power. Specifically, the Commission had made the following information request:

INFORMATION REQUEST 1

The Commission welcomes suggestions on approaches for identifying which Australian airports have market power in aeronautical services and the extent of their market power.

The Commission is seeking evidence on the extent of market power held by Australian airports, constraints on the exercise of any market power, including whether countervailing power by airlines is sufficient to offset airports' market power. Participants are invited to provide examples of specific airports and airlines, or to discuss these matters in more general terms.

The Commission is seeking evidence on the effects of regulations and regulator behaviour on the conduct of airport operators and airport users, including in relation to an airport's ability and incentive to exercise any market power.

In 2011, the Commission found that the *"continued growth of low-cost carriers, overseas national airlines and competition from some secondary airports have reduced the potential for airports to exploit market power",* but that they retain sufficient market power to warrant continuation of the monitoring regime.[30]

BAC acknowledges that it continues to hold a degree of market power, but this does not mean that it has the ability to use this market power to raise and maintain prices above a competitive level. Rather, the evidence since the privatisation of Brisbane Airport indicates that BAC has not exploited its market power (see Section 3.2). Notwithstanding that BAC has a strong incentive to 'do the right thing' to maintain its reputation as a good corporate citizen, the factors that effectively constrain the use of market power by BAC include:

- Competition from other airports, both within south east Queensland and in other (domestic and international) destinations, particularly for the tourist passenger and in the freight market;
- Significant countervailing market power of airlines;
- Limited ability to withhold service; and

[30] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011, page XLVI

- The prospect of a return to heavy-handed regulation.

BAC commissioned Oxera to assess the extent of competition faced by Brisbane Airport from airports in south east Queensland and across Australia; and the level of countervailing market power held by airlines. Oxera concluded that *"Brisbane Airport faces competition for a significant proportion of its passengers and airline traffic"*.[31] The rationale for this conclusion is discussed in the following sections. A copy of Oxera's report is attached at Appendix A.

3.1.1 Competition from other airports

Oxera noted that airports compete with each other for passengers and for airline capacity. With respect to competition for passengers, Oxera identified three ways in which airports compete:

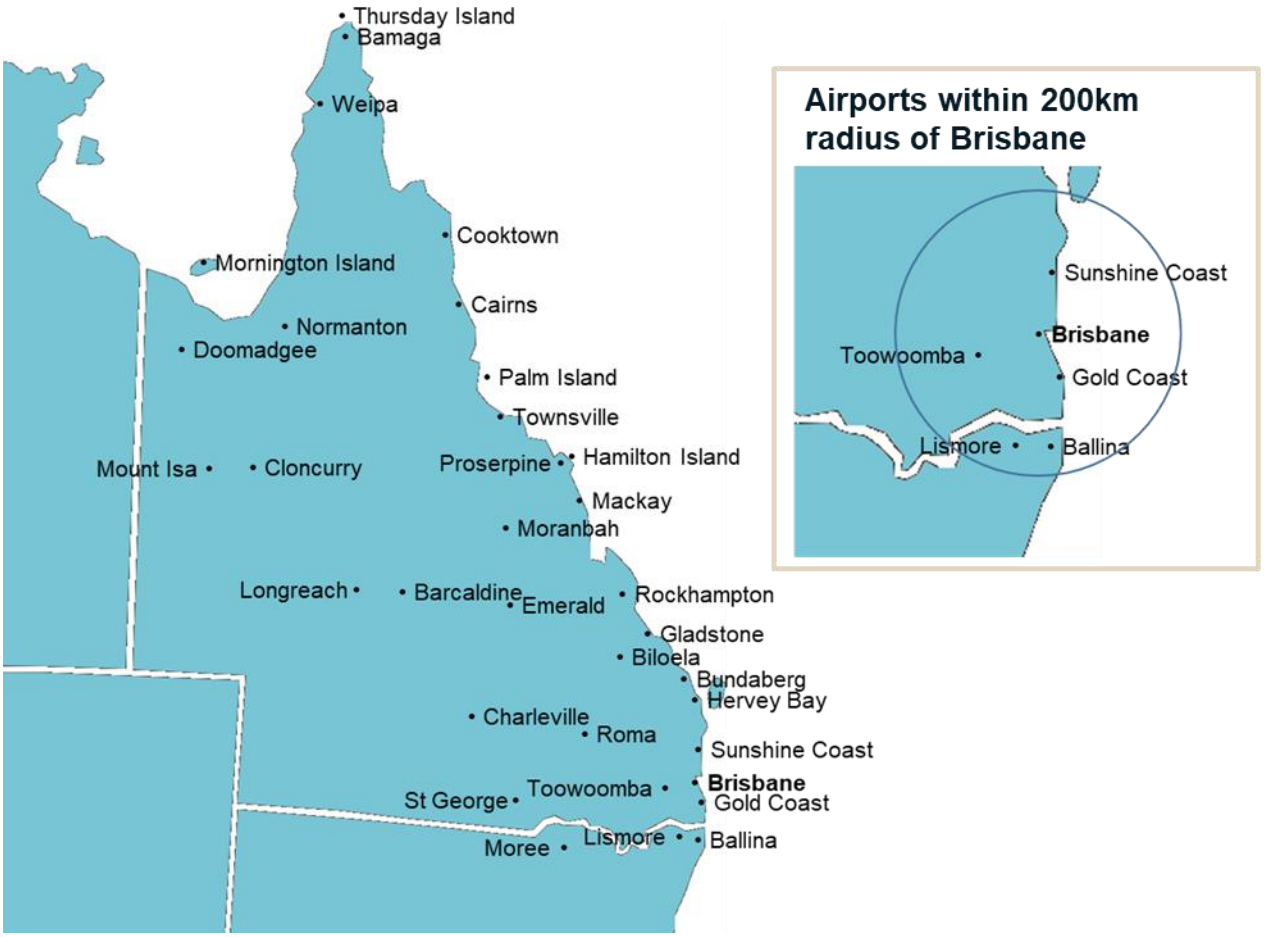
- Where two or more airports serve a particular catchment area, passengers may switch between these airports based on their respective price/service offerings[32];
- Competition for leisure passengers who do not have particular destinations in mind, but who are seeking 'beach holidays' or 'city breaks'; and
- Competition beyond the airports' local catchment areas for passengers transferring between flights.[33]

BAC competes with other airports to secure new airline capacity, and spends considerable effort working with the airlines, tourism bodies and government agencies to secure new routes for Brisbane Airport over other Australian and international airports.

Brisbane Airport operates in a highly competitive environment, with three international airports – Gold Coast, Sunshine Coast and Wellcamp (Toowoomba) – within a two hour drive of Brisbane, as shown in the following diagram.

[31] Oxera, *Competition between Australian airports: focus on Brisbane Airport*, Report prepared for Brisbane Airport Corporation, August 2018, page 46
[32] Note that not all the passengers through an airport need to have a choice between airports. If there are a sufficient number of passengers who can switch airports, this should constrain the airports' behaviour.
[33] Oxera, *Competition between Australian airports: focus on Brisbane Airport*, Report prepared for Brisbane Airport Corporation, August 2018

Figure 2. Regular Passenger Transport Airports in Queensland and northern New South Wales



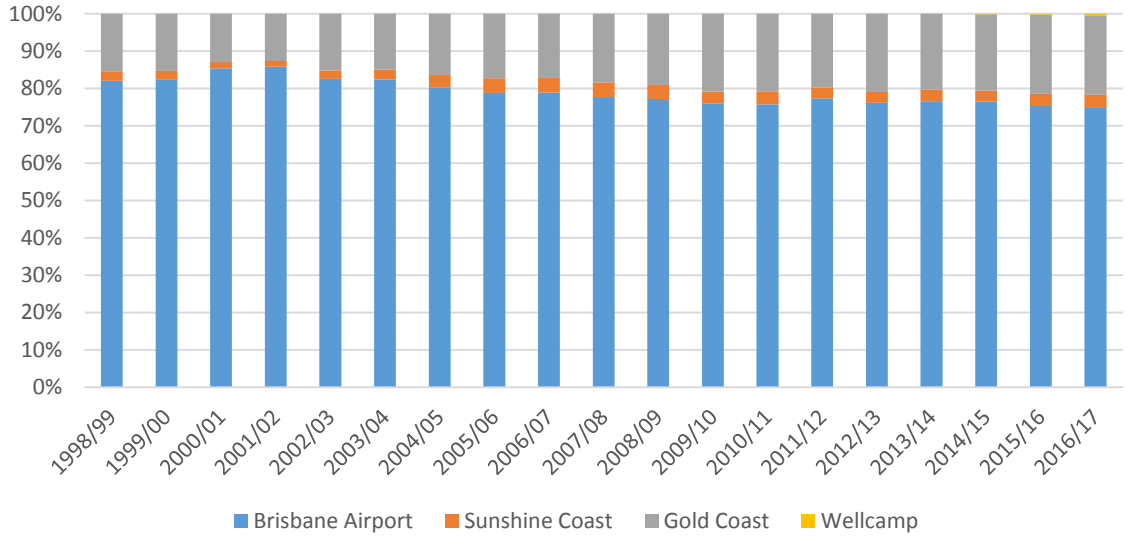
Source: Bureau of Infrastructure, Transport and Regional Economics

Each of these airports provides competing services to Brisbane Airport. Oxera's research found that there was at least one alternative service available within 200km for 69% of departures from Brisbane Airport in 2017, albeit generally at a lower frequency.[34] In contrast, the corresponding figures were 45% and 52% at Sydney and Melbourne Airports, respectively, suggesting that Brisbane Airport faces a greater level of competition from nearby airports.

As shown in the following graph, Brisbane Airport's share of the south east Queensland market is trending downwards. In 2016/17, Brisbane Airport accounted for 74.8% of passengers at south east Queensland airports, compared to 82% when the airport was privatised.

[34] Oxera, *Competition between Australian airports: focus on Brisbane Airport*, Report prepared for Brisbane Airport Corporation, August 2018

Figure 3. Passenger Shares, South East Queensland Airports, 1998/99 – 2016/17



Source: Bureau of Infrastructure, Transport and Regional Economics

The increase in Brisbane Airport's share of the south east Queensland market in 2000/01 and 2001/02 was attributable to a combination of factors. The collapse of Ansett in September 2001, the terrorist attacks in the United States of America also in September 2001 and the Bali bombings in October 2002 temporarily reduced the amount of discretionary leisure travel, which were the focus of the Gold Coast and Sunshine Coast airports. The subsequent reduction in Brisbane Airport's relative share of the south east Queensland market reflects the growth in the low cost carrier (LCC) market including Virgin Blue in 2000 (later rebranded as Virgin Australia), Jetstar in 2005, Tiger Airways in 2007, AirAsiaX in 2007 and Scoot in 2012.

Recent research commissioned by BAC and considered by Oxera shows that:

- Gold Coast Airport draws passengers from the Brisbane Airport catchment (and vice versa);
- Only 48% of passengers who used Brisbane Airport in the past 18 months lived in Brisbane, 20% lived in the Gold Coast / Northern NSW area, 17% lived along the eastern coastline and the balance lived further afield; and
- 42% of travellers from the Gold Coast and Northern NSW stated that they used their local airport (rather than Brisbane Airport) for international travel.[35]

There are a range of reasons for this, including route scheduling, pricing and personal preferences on aircraft and airports.

Oxera concluded that these findings indicate that Brisbane Airport faces strong competition from Gold Coast Airport in particular, and that airlines can switch between Brisbane Airport and Gold Coast Airport, but still tap into the same passenger demand pool.[35]

The competition from nearby airports provides an incentive for BAC to improve the quality of service it provides and to do so efficiently (contrary to the behaviour of a natural monopolist

[35] Oxera, *Competition between Australian airports: focus on Brisbane Airport*, Report prepared for Brisbane Airport Corporation, August 2018

exercising market power). As noted by the AAA, *"inefficient airport operations are likely to lead to higher airline costs which, like airport charges, will be relevant to the decision making of airlines to maintain or add capacity"*.[36]

Oxera noted that an airport that is capacity constrained may have reduced incentives to compete strongly with other airports and it would also reduce the bargaining power of airlines, as other airlines would quickly take up any available capacity.[37] BAC is currently capacity constrained only during the peak periods, but its capacity will double with the opening of the NPR in 2020. At the same time, the Oxera report highlights that Sunshine Coast and Gold Coast airports are both expanding their capacity, with current developments at Gold Coast Airport expected to double the airport's existing capacity by 2031. A new runway being constructed at Sunshine Coast Airport (and due for completion in 2020) will also increase the capacity of that airport to accommodate international flights, in particular to South-East Asia. This overall increase in capacity in south east Queensland will further increase the level of competition between Brisbane Airport and the other airports.

However, it is not only competition from nearby airports that constrain BAC's ability to exert its market power. Brisbane Airport has the services and facilities required to accommodate long haul services. This means that Brisbane Airport also competes in a wider geographic market and with airports further afield to attract certain types of passengers, namely those leisure passengers who are willing to switch between destinations, and transfer passengers.[37] Leisure passengers account for over 50% of Brisbane Airport's total passengers, while transfer passengers account for 8%.

BAC invests in joint marketing activities with tourism and investment bodies, such as Brisbane Marketing and Tourism & Events Queensland, to promote Queensland as a destination and secure new capacity from international airlines, over other airports in Australia. Recent examples of such collaborations include:

- BAC partnered with Brisbane Marketing, Tourism Australia, Tourism & Events Queensland, Brisbane Convention & Exhibition Centre and Trade & Investment Queensland to secure the Routes Asia 2018 Conference, which was held in Brisbane earlier this year; and
- BAC participated in a taskforce with the Queensland Government (Premier's, State Development and Tourism departments) and Brisbane Marketing to secure the base of operations for four Qantas 787 Dreamliner aircraft at Brisbane Airport. This deal, which was led by the Queensland Government, secured the 787 base over Melbourne Airport, and will allow for new direct routes, such as Chicago, to be serviced from Brisbane Airport. It provides benefits to Queensland as a whole through employment opportunities and to BAC through the new routes.

Oxera highlighted that airlines place airports in competition with one another when starting new routes and that this had resulted in Brisbane Airport undertaking a significant amount of due

[36] Australian Airports Association, *Submission to the Productivity Commission*, September 2018, Chapter 5
[37] Oxera, *Competition between Australian airports: focus on Brisbane Airport*, Report prepared for Brisbane Airport Corporation, August 2018

diligence and analysis to build up and support a business case, which would historically have been performed by the airlines.[38]

3.1.2 Airlines' countervailing power

The Commission has noted that an airport's market power can be constrained by the countervailing market power held by airlines, particularly where the market is concentrated as it is for domestic air travel in Australia.[39] This situation clearly holds at Brisbane Airport, with the largest airlines operating at Brisbane Airport – Qantas, Virgin, Jetstar and Tiger – accounting for 79% of seat capacity. Furthermore, the Board of Airline Representatives Australia (BARA), which represents the majority of airlines that use Brisbane Airport, has authorisation from the ACCC to collectively bargain on behalf of its members for aviation services at Brisbane Airport.[40] This effectively increases its members' market power.

Oxera found that the largest airlines have credible options in terms of other airports at which they could locate existing or new capacity. It concluded that the top two airline groups have significant operations across Sydney, Melbourne and Brisbane airports and therefore have a number of outside options in terms of where they operate their services.[38]

Oxera found evidence of routes being constantly churned in both the overall Australian market and at Brisbane specifically, demonstrating that airlines can and do relocate capacity:

- While the shares of Qantas and Virgin traffic remained broadly constant at Brisbane, Sydney and Melbourne airports between 2010 and 2017, the shares of the LCCs did not. For example:
  - Jetstar reduced its presence at Brisbane Airport between 2010 and 2017, but increased its presence at Melbourne and Sydney airports;
  - Tiger increased its capacity at Brisbane Airport and Melbourne, but decreased its capacity at Sydney Airport, over the same period; and
- Between 2011 and 2017, the average route opening rate[41] at Brisbane Airport was 12% and the average route closing rate was 9% - which was a greater churn rate than Sydney and Melbourne.

Oxera noted that airlines incur costs when switching aircraft to other routes, but that changing business models and technology changes, e.g. electronic ticketing and check-in, have reduced the ground operating costs over time, making it easier for airlines to switch capacity between airports.[38] Thus, threats to relocate have become more credible over time. This is especially so for threats to move to Gold Coast Airport, in light of the additional capacity to be developed at the airport over the next decade.

The Commission noted that an airline with countervailing power could threaten to withdraw from a route, with the potential loss of revenue acting to constrain an airport from raising its

[38] Oxera, *Competition between Australian airports: focus on Brisbane Airport*, Report prepared for Brisbane Airport Corporation, August 2018
[39] Productivity Commission, *Economic Regulation of Airports*, Issues Paper, July 2018, page 5
[40] ACCC, *Application for revocation of A91200 and substitution authorisation A91466,* Determination, March 2015
[41] Route opening (closing) rates are calculated as the number of routes that do (do not) operate in a year that did (did not) operate in the year before, divided by the total number of routes in operation in that year.

aeronautical charges. It is important to note that that an airline does not need to switch all of its services for there to be a potentially significant impact on the airport. The Oxera report highlighted that, if just one of the main airlines moved some of its capacity away from Brisbane Airport, this could have a significant effect on the airport's profitability.[42]

As shown by Oxera, it is the competition at the margin that needs to be considered. That is, whether airlines are able to switch or allocate marginal capacity to other airports, and whether any such competition at the margin is sufficient to constrain the airport's behaviour.

BAC notes that it cannot control the investment decisions of the airlines. In contrast, airlines can control their capacity and have done so in the past. For example, during the 'capacity war' in 2012-2014, Qantas made significant capacity adjustments in order to maintain its 65% share of the domestic market – referred to at that time by Qantas as its 'line in the sand'.[43] The decisions made by the airlines, including the subsequent withdrawals of Qantas' stance on the line in the sand market share, nearly led to a number of inefficient investment decisions at Brisbane Airport. For example, there were discussions around the need for a regional terminal (which was subsequently not required), which has delayed of capital expenditure at the terminals. These issues were resolved when Qantas withdrew its stance on the line in the sand market share and the demand from the fly-in fly-out (FIFO) market fell away.

More recently, Qantas reduced its domestic available seat kilometres (ASKs) by 2.4% in 2017/18, noting that it had continued its *"capacity management discipline"*.[44] Actions such as this can potentially lead to under-recovery of investments previously made by an airport on the indication of higher demand by airlines.

This highlights the need for BAC to have flexibility in airport capacity and investment decisions. This is best achieved through bilateral negotiations and agreements with the airlines. This level of flexibility cannot be achieved under heavy handed regulation.

Further evidence of the countervailing market power is in the concessions that BAC has to make to the airlines in order to secure their agreement on aeronautical charges. This is discussed further in Section 3.2.6.

3.1.3 Limited ability to withhold service

BAC notes that it has an obligation under its airport lease to use the airport site as an airport and to provide access to its aeronautical services and facilities.[45] The airport lease also requires BAC to notify the Department of Infrastructure, Regional Development and Cities if it intends to refuse access to an airline where it has failed to pay any amounts due to BAC.

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[42] Oxera, *Competition between Australian airports: focus on Brisbane Airport*, Report prepared for Brisbane Airport Corporation, August 2018

[43] Kitney, D., *Alan Joyce draws line in the sand*, The Australian, 17 February 2011

[44] Qantas Group, *Qantas Airways Limited FY18 Results*, 23 August 2018, page 9

[45] Clause 3.1(a) of the lease obliges BAC to provide for the use of the airport site as an airport; provide for access to the airport by interstate and international air transport; and provide for access to the airport by intrastate air transport. Clause 3.2 requires BAC to notify DIRDAC if it intends to refuse access to an airline where it has failed to pay any amounts due to BAC. Commonwealth of Australia, *Airport Lease for Brisbane Airport*, Lease 702599136, 1 July 1997.

While denial of access to the airport is a theoretical possibility in the event that airport charges are not paid, this needs to be balanced against the significant passenger disruption and reputational damage to BAC arising from such an extreme measure.

As detailed in the submission by AAA[46], BAC understands that it is obliged to provide access, even where there is no bilaterally negotiated agreement between the airline and the airport. It is likely that complex and costly litigation would be required to obtain payment where an airline has chosen not to pay an invoice for aeronautical charges issued by an airport.[46]

BAC refers the Commission to the AAA's submission for further information on the difficulties of airports enforcing price and contract terms.[46]

3.1.4 Prospect of re-regulation

The prospect of declaration and re-regulation can also act as a constraint on any exploitation of market power. The AAA notes that this threat remains as potent today as it did at the time of the 2011 Review.[46]

BAC is conscious that abuse of any market power could lead the government to return to a heavier handed regulation, such as price cap regulation. However, the fact that BAC's pricing is transparent, based on a generally accepted approach (i.e. the building block methodology) and involves input from the airlines mitigates against abuse of market power. This is discussed further in Section 3.2.6.

3.2. Use of market power by BAC

The Commission is seeking a range of information relating to the use of market power, specifically:

INFORMATION REQUEST 2

The Commission is seeking evidence on airports exercising market power, including:

- *excessive charges for aeronautical services*
- *inefficient investment decisions*
- *inefficient operations*
- *poor service quality*
- *their approach to consultation and negotiation with airport users regarding operational and investment matters, and whether airports' conduct facilitates reaching commercial outcomes.*

The Commission is also seeking evidence on:

- *airlines' approach to negotiations in respect to airports and potential competitors*
- *which parties are affected by airports' exercises of market power*
- *the merits of 'pre funding' airports' infrastructure investments*
- *the potential costs and benefits of changes to the regulatory regime.*

The Commission seeks co-operation from submitters in not asserting adverse market behaviour without supplying evidence.

[46] Australian Airports Association, *Submission to the Productivity Commission*, September 2018

BAC's submission focusses on the evidence relating to the exercise of market power, and demonstrates in the following sections that:

- BAC's fees and charges for aeronautical services are reasonable;
- Aeronautical investment at Brisbane Airport has been efficient;
- BAC's operations are efficient;
- BAC consistently provides good quality of service; and
- BAC has a track record of successful negotiations with its airline customers.

BAC notes that there is one further factor – the significant volume risk it bears under aeronautical agreements – that further demonstrates BAC has not exercised unreasonable market power nor has it been in a position to exercise any alleged market power.

BAC refers the Commission to the AAA submission for their views on the parties affected by the exercise of market power, the merits of pre-funding and the potential costs and benefits of changes to the regulatory regime. BAC supports the AAA submission on each of these matters.

3.2.1 BAC's fees and charges for aeronautical services are reasonable

Research undertaken by the AAA indicated that:

- Airport charges for international passengers at Australian airports:
  - Had grown modestly in real terms over the five years to 2017, with an average increase of 2.7% per annum after allowing for discounts off the published rack rates;
  - Had increased primarily due to changes in security costs and increased investment; and
  - Were broadly consistent with international comparator airports (based on rack rates);
- Airport charges for domestic passengers at Australian airports:
  - Had grown on average 2.3% per annum in real terms over the five years to 2017, after allowing for discounts on published rack rates; and
  - Were consistent with international comparator airports (based on rack rates).[47]

Notwithstanding the AAA's benchmarking findings, consideration of the level of the charges in themselves do not provide conclusive evidence either way that the charges are excessive. BAC agrees with the Commission that increases in charges in themselves do not mean that the charges are inefficient.[48] Rather, reasonableness of charges would be more appropriately assessed through the return on capital over the asset lifecycle, as this takes into consideration the underlying costs of the business. As noted by the AAA, the Pricing Principles also make it *"abundantly clear that the relevant metric for assessing the presence of excess returns is the return on tangible, non-current assets"*.[49]

[47] Australian Airports Association, *Submission to the Productivity Commission,* September 2018
[48] Productivity Commission, *Economic Regulation of Airports*, Issues Paper, July 2018, page 7
[49] Australian Airports Association, *Submission to the Productivity Commission,* September 2018, Chapter 3

Prices for aeronautical services at Brisbane Airport are determined through commercial negotiation with its airline customers, with indicative prices for those negotiations based on a building block methodology. This building block methodology is the same methodology used:

- Previously by the ACCC for assessing pricing for necessary new investments at airports; and
- Currently by the Australian Energy Regulator (AER) for determining allowable revenue for regulated energy networks.[50]

The building block methodology is a cost build up model, with the rate of return, aeronautical asset base, forecast capital expenditure and forecast operating expenditure being key inputs into the model. It is commonly used for regulating natural monopolies, where a market price cannot be observed.

BAC engages independent advisors (namely, Ernst & Young and Frontier Economics) to advise on the appropriate commercial rate of return for the aeronautical services and facilities provided by BAC. This independent analysis, which is conducted in line with regulatory best practice, and often relies on precedents from Australian regulators for individual parameters, is shared with BAC's airline customers. Thus, the rate of return is an important input into the overall price negotiations and has been agreed with the airline customers.

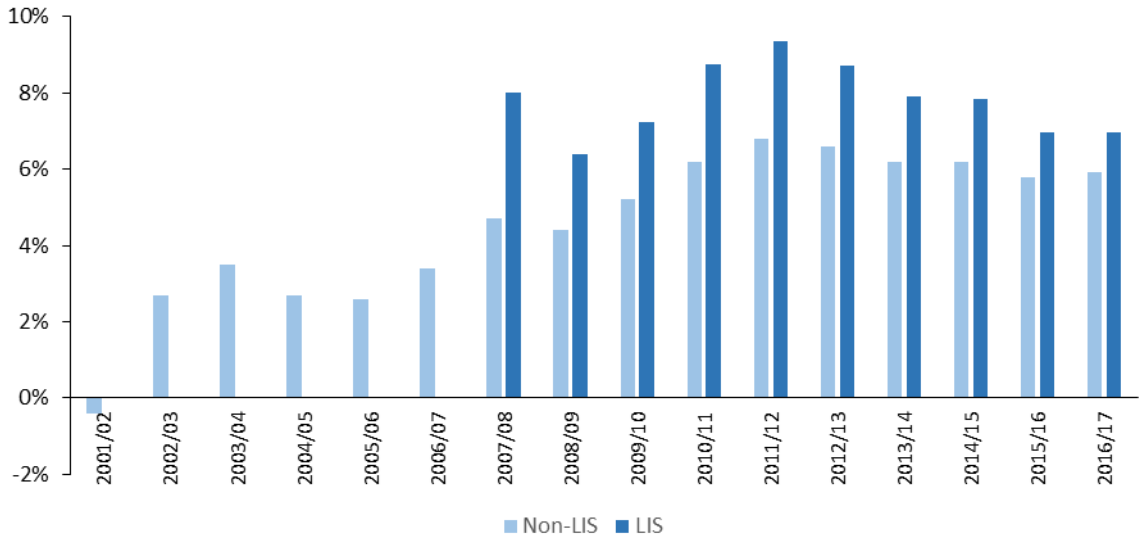
BAC notes that it has been open and transparent on the rate of return it uses for price modelling, and shares its independent reports on rate of return with the airline customers. In contrast, airlines generally present their 'house view' on what the rate of return should be, with limited supporting evidence provided for the quantum of the rate.

It should be noted that the building block model provides BAC's view of the indicative prices that form the starting point for the negotiations. Further information on BAC's negotiations with the airlines is provided in Section 3.2.6.

Given that the actual charges for aeronautical services and facilities are below the efficient prices determined through the building block model, it follows that the aeronautical charges at Brisbane Airport are not excessive. This is reflected in the actual rates of return on aeronautical services and facilities[51], as shown in the following chart.

[50] BAC notes that the criticisms noted about the regulatory framework applied by the Australian Energy Regulator relate primarily to factors other than the building block methodology.
[51] As reported in the ACCC's price monitoring reports. It is the rate of return on aeronautical tangible non-current assets using earnings before interest, tax and amortisation (EBITA).

Figure 4. Aeronautical rate of return, 2001/02 – 2016/17



Note: The aeronautical rate of return on aeronautical tangible non-current assets using earnings before interest, tax and amortisation (EBITA). The rate of return is presented on both a line-in-the sand (LIS) and Non-LIS basis to enable the historical rates of return to be presented. Over time the returns will converge as new assets enter the asset base and older assets are fully depreciated.
Source: ACCC airport monitoring reports (Various)

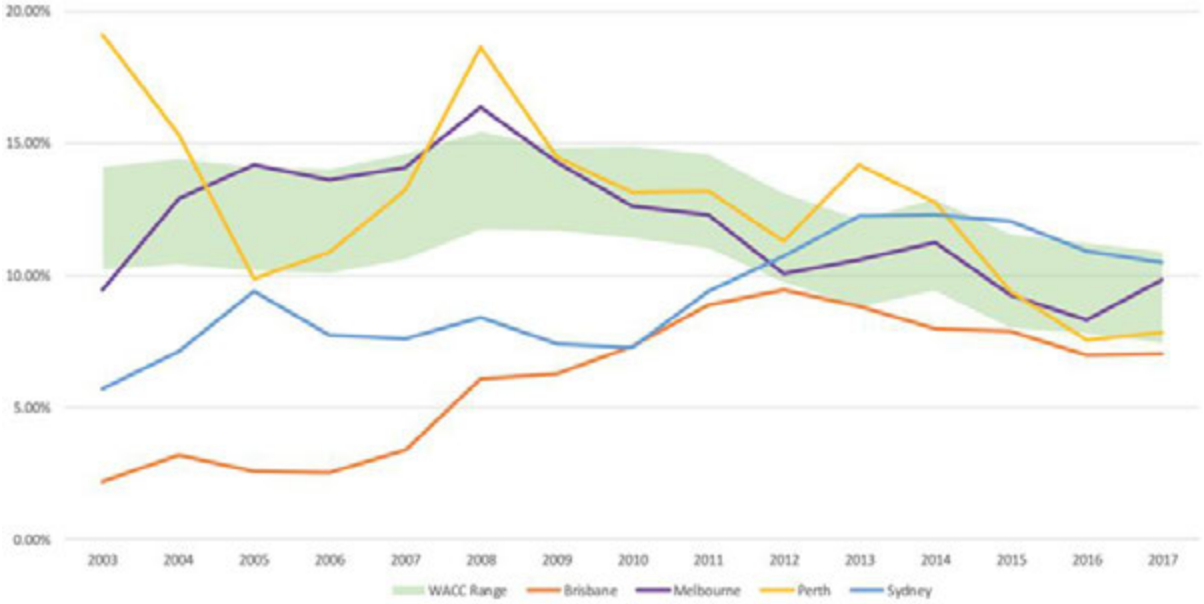
For 2016/17, the most recent year for which the ACCC released a monitoring report, BAC's rate of return for aeronautical services was just 7.0% on the 'line in the sand basis'. The average rate of return over the ten-year period from 2007/08 to 2016/17 was 7.8%, measured as the return on tangible, non-current assets.[52] By contrast, BAC notes that while Qantas has just announced a record full year profit, with a return on invested capital (ROIC) of 22% for 2017/18[53]; BAC's ROIC for the airport as a whole was 7.8% for the last financial year.

As shown in Figure 4, the rate of return was unsustainably low in the initial years following the privatisation of Brisbane Airport. The increases in the return on assets reflect both increases in prices to bring them into line with the Pricing Principles and aeronautical investments made by BAC. The fluctuations over time reflect the outturn demand (relative to forecast) and the profile of the capital investments at the airport. These fluctuations highlight the need to consider rates of return over time, rather than at a point in time when assessing whether market power has been exercised.

The AAA commissioned Houston Kemp to examine the extent to which the pricing of aeronautical services by the monitored airports reflected the exercise of market power. As part of its assessment, Houston Kemp compared the aeronautical return on assets of the airports against the rate of return for a benchmark efficient airport, which was estimated using regulatory principles. As reported by the AAA, Houston Kemp found the reported rates of return for Brisbane Airport over the period from 2003 to 2017 had been at or below the lower bound for the benchmark airport.[54] This is illustrated in the following chart.

[52] ACCC, *Airport Monitoring Report 2016-17*, April 2018
[53] Qantas Airways, *Qantas Group reports record full year profit*, Media Release, 23 August 2018
[54] Australian Airports Association, *Submission to the Productivity Commission,* September 2018

Figure 5. Return on aeronautical assets, monitored Australian Airports, 2002/03 – 2016/17



Source: AAA

Further information on Houston Kemp's assessment and findings are available through the AAA's submission.

3.2.2 BAC bears significant volume risk

Another important consideration is that BAC carries the majority of the volume risk, with the prices set on the basis of 'per passenger' charges for the terms of the two ASCAs.[55] This volume risk has two components:

- Demand uncertainty – which relates to forecasting accuracy or bias (i.e. charges are based on a certain base year volume and growth rate forecast and they are not 'best estimates'); and
- Demand volatility – the inherent volatility of demand for any year given an unbiased forecast (i.e. variations from forecast despite the forecast being unbiased).

These variations do occur in practice and can be significant. For example, the actual passenger volume in 2011/12 to 2016/17 was 11.5% below the forecasts for the 2012 – 2017 agreements. This led to some forecast capital expenditure being delayed.

Airports generally have limited capacity to manage demand (given it is derived from passengers' demand for travel) and thus manage exposure to volume risk. There are a range of mechanisms used in other infrastructure industries with similar cost structures to manage this risk, for example:

- Bulk ports and rail companies often use 'take or pay' arrangements, which compel the user to pay for the capacity irrespective of whether the capacity is used;

[55] There are two ASCAs for Brisbane Airport – one for the runway system and the other for the terminal, aprons and related infrastructure.

- Electricity generators often use long term power purchase agreements; and
- Electricity networks are regulated through a revenue cap, with annual 'unders and overs' adjustments to account for variances in revenue resulting from differences between forecast and actual demand.

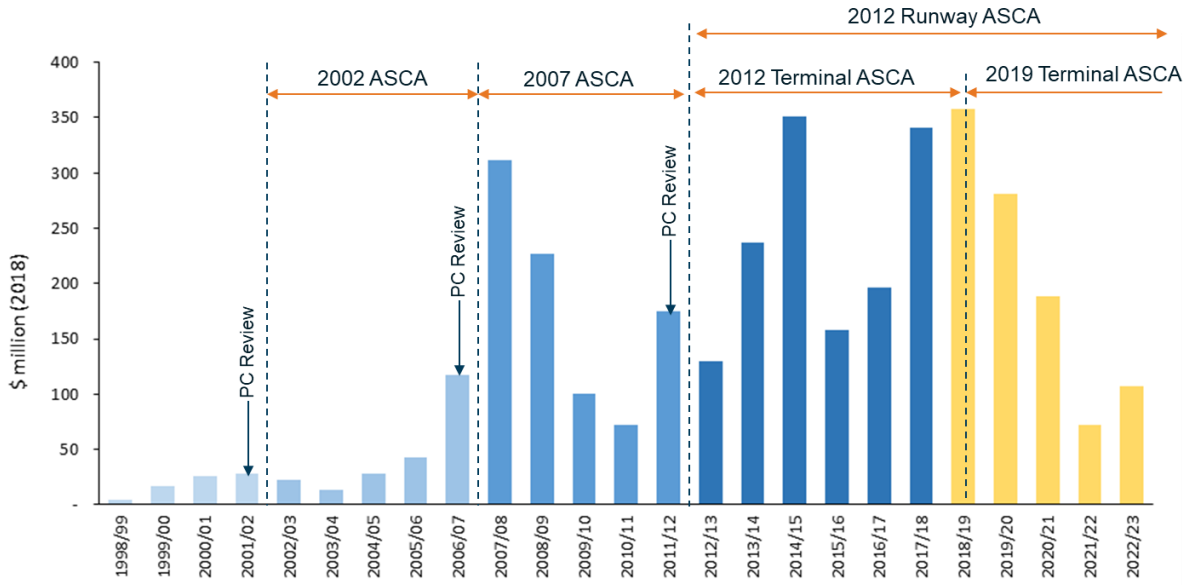
In the case of the Brisbane Airport ASCAs, there are no such adjustment mechanisms. BAC bears the cost if the actual passenger numbers are below the forecast (and vice versa if actual passenger numbers are greater than forecast).

The volume risk should be reflected in the required rate of the return for the airport. Therefore, the rate of return should be set with reference to an efficient operator in the airport sector, rather than relying on regulated rates of return, which reflect a different level of risk. This is consistent with the aeronautical Pricing Principles, which require that prices *"include a return on investment in tangible (non-current) aeronautical assets, commensurate with the regulatory and commercial risks involved*".[56]

3.2.3 Aeronautical investment has been efficient

The following chart shows the real investment in aeronautical services and facilities at Brisbane Airport since privatisation. It demonstrates BAC's ongoing commitment to efficient investment in both new capacity and refurbishment of existing capacity at Brisbane Airport.

Figure 6. Aeronautical Capital Expenditure, 1998/99 – 2022/23 (2018 dollars)



Source: ACCC, ABS (CPI), BAC forecasts

The major aeronautical projects planned for completion over the forecast period are set out in the following table.

[56] Australian Government 2007, *Productivity Commission Report – Review of Price Regulation of Airport Services*, Media Release No. 032, 30 April 2007

Table 1. Key aeronautical projects 2018/19 – 2022/23

Project	Expected Completion	Description
New parallel runway	2020	This project includes the construction of a new 3.3km runway, more than 12km of taxiways, navigational aids, airfield infrastructure and a underpass under the new taxiways for vehicular access to the general aviation precinct
Stop Bar Installation	2020	This project includes a series of unidirectional lights at right angles to the taxiway centreline and is designed to reduce runway incursions by enhancing visibility of holding points and increasing the defence against traffic controller error in aircraft or vehicle identification
ITB Northern Concourse Expansion Links (Bays 65-68)	2021	This project involves the construction of departure gates, fixed links and aerobridges to service four Code C (i.e. up to 737-900 aircraft) gates
ITB Northern Apron Expansion (Bays 65-68)	2021	This project includes the development of a new ITB apron to accommodate four Code C aircraft parking positions and a new adjacent ground services equipment storage area
Domestic Northern Apron Stage 5A	2022	This is the first of a series of three projects that together will deliver an expanded and reconfigured apron parking arrangement for up to 20 aircraft

There are a range of factors that work in combination to ensure that BAC's investments are both prudent and efficient:

- Extent of scrutiny by stakeholders, including airlines and government agencies;
- Demand risk borne by BAC;
- Obligations under the *Airports Act 1996* to develop master plans that provide for the efficient development of the airport; and
- Obligations under the airport lease to develop the airport to a nominated standard.

Before any capital expenditure is undertaken, BAC undertakes extensive consultation with the key stakeholders, including the airlines, to agree on the necessity, scope and scale of the investment and the proportion of the investment which should be classified as aeronautical and therefore included in the aeronautical asset base (and thus in prices). This occurs as part of the negotiations on the aeronautical agreements with the airlines, in addition to the consultation undertaken as part of the Master Plan (see below).

The capital investments made by BAC represent sunk costs—that is, the investment cannot be reversed. These investments are generally in long life assets, and have considerable lead times. The nature of these investments is such that BAC takes on demand risk, which means that it bears the risk of airlines changing their route selection. This adds further incentive for

BAC to negotiate prices that are acceptable to the airlines, so that airlines are less likely to withdraw services from Brisbane Airport based on airport charges.

BAC has obligations under the *Airports Act 1996* to operate the site as an airport (section 31) and carry out development which is (amongst other things) consistent with the master plan approved by the relevant minister (section 32).[57] In accordance with section 72 of the *Airports Act 1996*, one of the things the Master Plan is required to set out is the *"strategic direction for efficient and economic development at the airport over the planning period"*. The development of the Master Plan is subject to both public and government scrutiny, with extensive public consultation on the draft plan and subsequent approval by the relevant minister.

BAC notes that there are also investment requirements under its airport lease. Specifically, clause 12.1 of the airport lease requires BAC to develop the airport:

> *"… consistent with a Major International Airport having regard to:*
>
> *(a) the actual and anticipated future growth in, and pattern of, traffic demand for the Airport Site;*
>
> *(b) the quality standards reasonably expected of such an airport in Australia; and*
>
> (c) *Good Business Practice."*[58]

In this context, 'Good Business Practice' is defined as:

> *"… the good business practices expected of an airport operator having regard to the duties and obligations of the Lessee including, without limitation, providing appropriate facilities for the comfort, ease of access, expeditious movement and efficient use of the Airport Site by passengers and other users."*[59]

The Department of Infrastructure, Regional Development and Cities actively monitors BAC's compliance with these lease requirements and can require it to develop a plan to bring Brisbane Airport up to the required standard, if it believes BAC is not complying with the requirements of clause 12.1.

The level of scrutiny over the aeronautical services and facilities investments made by BAC ensures that sufficient capacity is maintained to service future demand (and not constrain output as a monopolist exercising market power might do). Furthermore, this scrutiny combined with the volume risk BAC bears, ensures that airport investments are efficient and not 'gold plated'.

3.2.4 BAC's operations are efficient

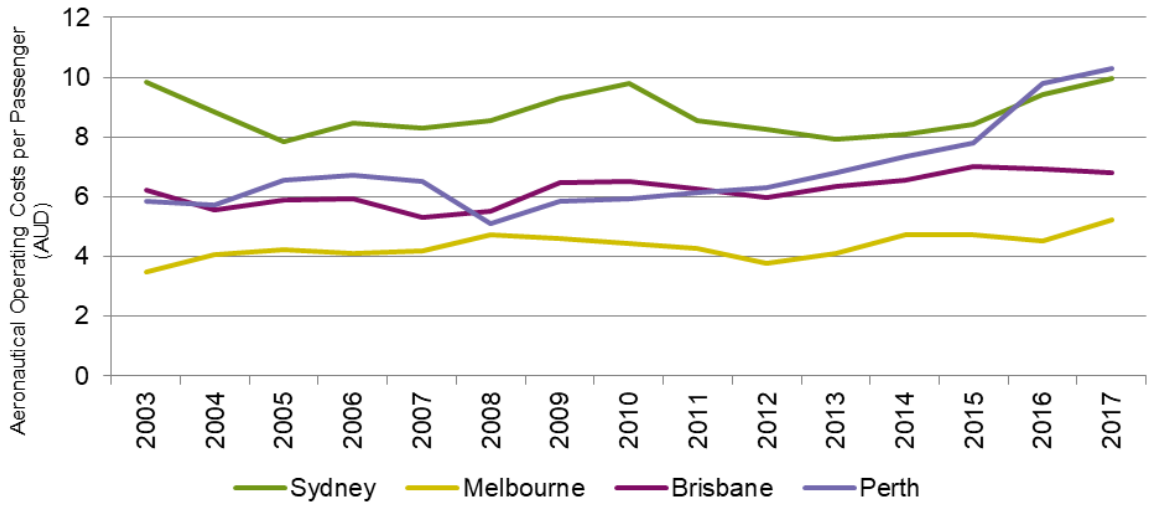
The factors noted above also work to ensure that the operation of the airport is efficient. This is supported by benchmarking undertaken by Intervistas for the AAA, which found that real operating cost per passengers for the major Australian airports:

[57] A master plan must be approved by the Minister for Infrastructure, Regional Development & Cities.
[58] Commonwealth of Australia, *Airport Lease for Brisbane Airport,* Lease 702599136, 1 July 1997, clause 12.1
[59] Commonwealth of Australia, *Airport Lease for Brisbane Airport,* Lease 702599136, 1 July 1997, clause 12.11

- Had experienced small but steady increases during the five years to 2017, with those increases attributed to increasing security costs, maintenance costs associated with aging assets and economy-wide increases in energy costs; and
- Were lower than the average of the international peers.[60]

The Intervistas report for the AAA also examined the aeronautical operating costs, as reported to the ACCC, since deregulation. As illustrated below, Intervistas found that real increases in operating costs per passenger ranged from 0.1% to 4% per annum.

Figure 7. Aeronautical Operating Cost per Passenger, 2002/03 – 2016/17 (2017 dollars)



Source: Intervistas (as reported in AAA submission)

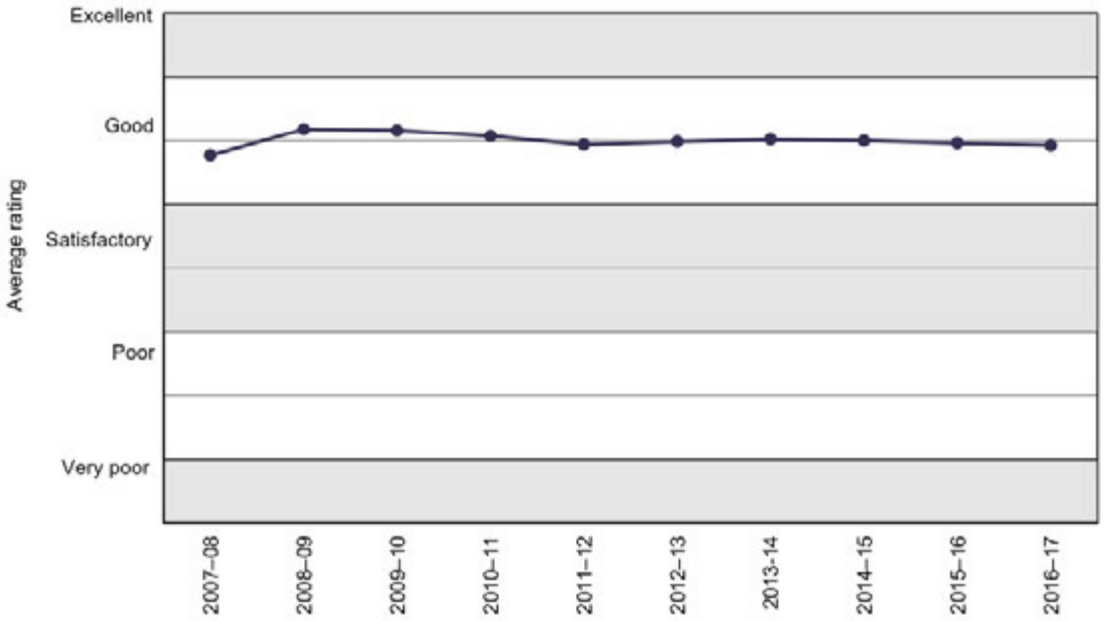
As shown above, the real growth in BAC's operating costs per passengers has been modest, and within the range of the other monitored airports.

3.2.5 BAC consistently provides good quality of service

The following three figures present the quality of service ratings relevant to aeronautical services and facilities, as reported by the ACCC in its monitoring report for 2016/17. The first figure shows Brisbane Airport's overall airport quality of service rating, which has consistently been 'good' for the past 10 years.

[60] Australian Airports Association, *Submission to the Productivity Commission*, September 2018

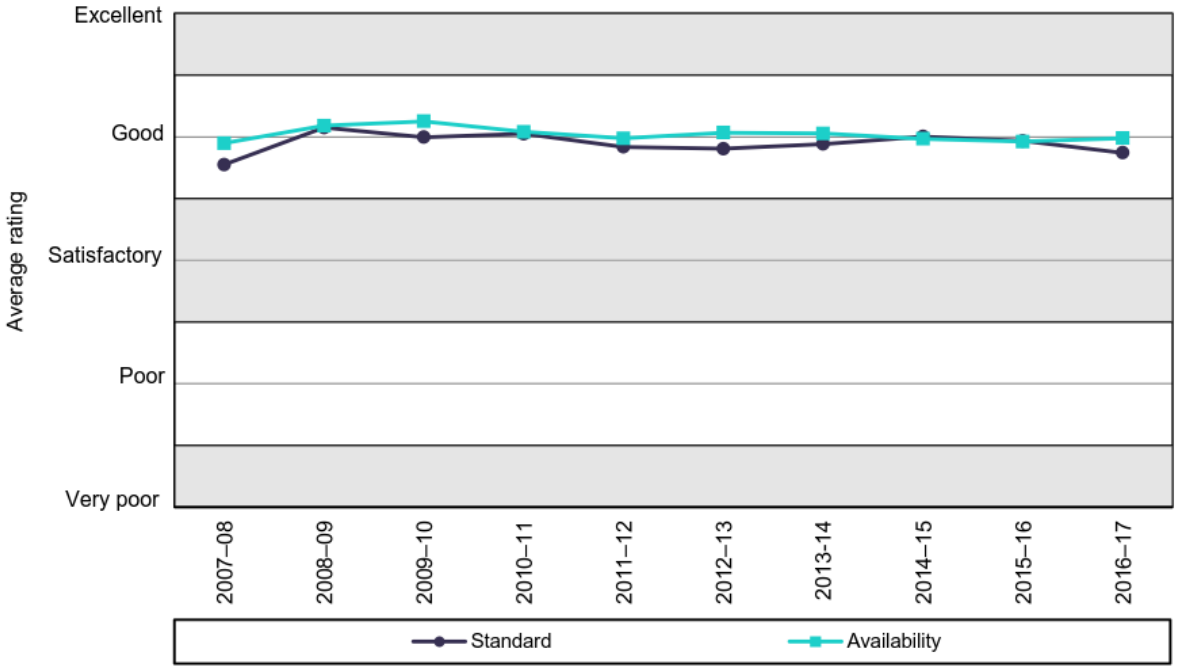
Figure 8. Overall airport quality of service rating, 2007/08 – 2016/17



Source: ACCC Price Monitoring Report 2016/17

Similarly, the standard and availability of airport services at Brisbane Airport have also been rated 'good' over the past ten years.

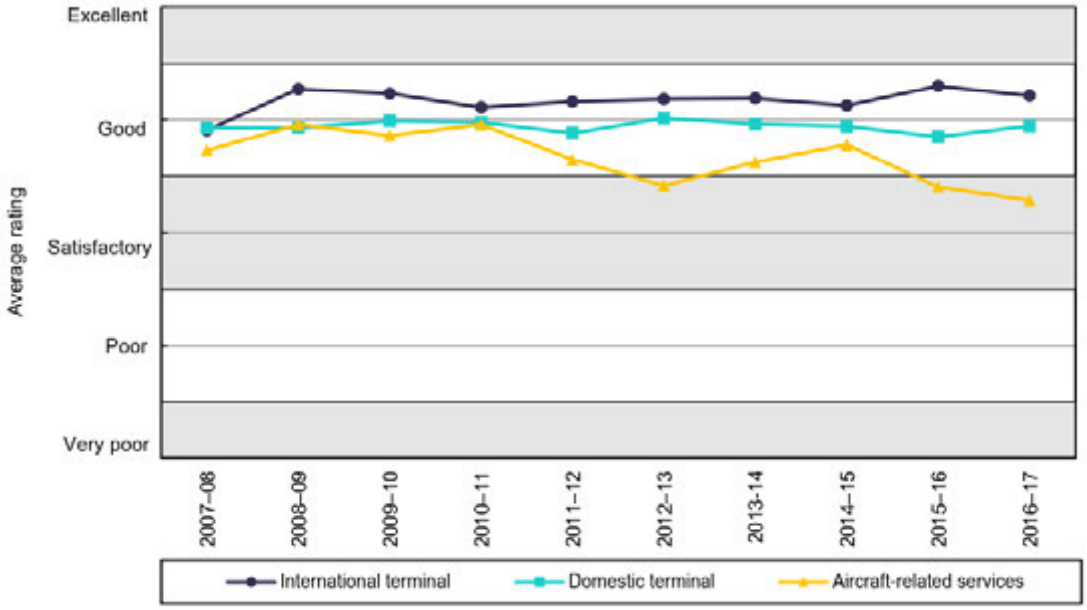
Figure 9. Ratings for standard and availability of total airport services, 2007/08 – 2016/17



Source: ACCC Price Monitoring Report 2016/17

The following figure shows the ratings for the international terminal, domestic terminal and aircraft related services at Brisbane Airport.

Figure 10. Quality of service ratings for aeronautical services, 2007/08 – 2016/17



Source: ACCC Price Monitoring Report 2016/17

Brisbane Airport achieved a consistent 'good' rating for the international and domestic terminals over the ten years. BAC notes that the ACCC results do not include the areas of the terminal that are leased to Qantas and Virgin. This is discussed further in Section 4.3.

BAC's rating for aircraft related services has been declining, although at the high range of 'satisfactory'. The ACCC quoted airline concern about air traffic demand in peak periods, including congestion, longer holding times and aircraft parking bay availability as key reasons for the survey outcomes for 2016/17.[61] This finding reflects the peakiness of demand and also that Brisbane Airport is currently operating at capacity during peak periods. BAC expects the quality of service rating for aircraft-related services to progressively return to 'good' following the completion of the NPR in 2020, the ITB northern apron expansion in 2021 and DTB northern apron expansion in 2022.

The findings for the aircraft-related services are based on the ACCC survey of the airlines only. BAC was this year able to obtain a copy of the survey questionnaire for the first time since monitoring commenced. The questionnaire is generally structured to obtain information about negative issues, establishing a negative bias as a result. A representative example of the questionnaire is as follows:

> *"Provide details of any issues or problems that the airline raised with the airport in relation to the availability of this service during the 2017-18 financial year, and the steps taken by the airport to address the areas of concerns. Is the availability of this service set by commercial negotiations between the airline and the airport operator? Also, provide details on how the airline and/or other parties can influence the availability of this service."*[62]

[61] ACCC, *Airport Monitoring Report 2016-17,* April 2018
[62] ACCC, *Survey of quality of services provided to airlines by Australian monitored airports in 2017*-18, 2018

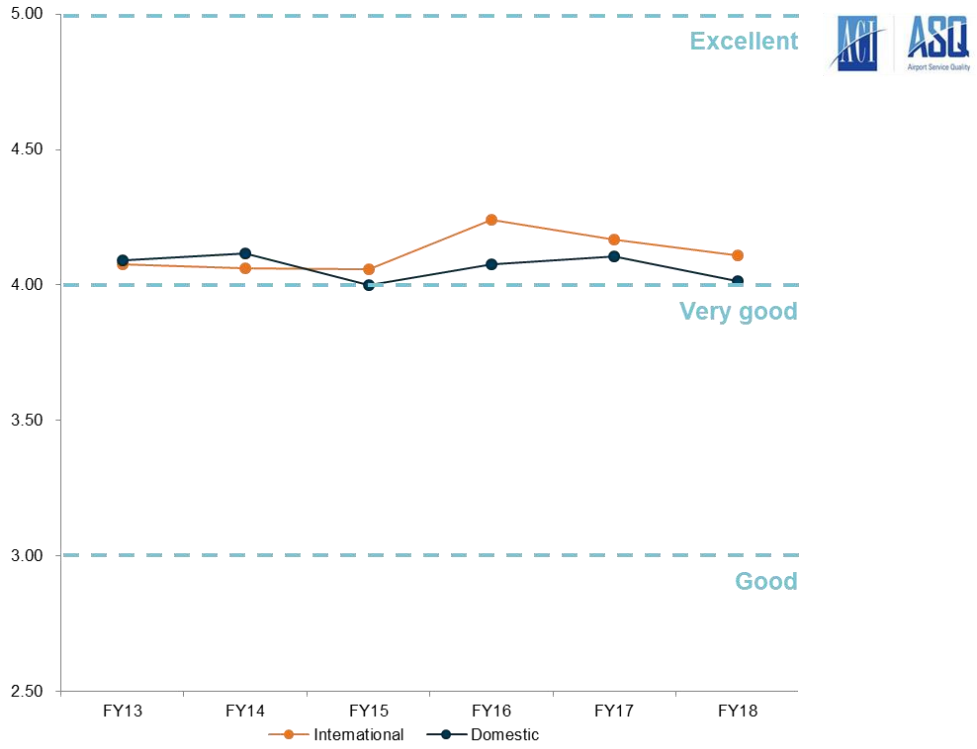
The ACCC noted in its most recent monitoring reports that airline ratings tend to be lower than passenger ratings and that:

> *"… customers of airport service such as airlines may be strategically motivated to rate the quality of services downwards at individual airports."*[63]

The negative connotation in the ACCC questionnaire may well explain its findings. A neutral prompter from the ACCC in its questionnaire would be more appropriate.

The overall findings by the ACCC are consistent with the findings of the Airport Council International (ACI) Airport Service Quality (ASQ) programme.[64] As shown in Figure 11 below, Brisbane Airport has consistently ranked 'very good' in overall service quality for both its domestic and international terminals for the past six years of the ASQ. Furthermore, the outcomes are consistent across the categories of service considered in the survey, as shown in Figure 12.

Figure 11. ACI ASQ results, Brisbane Airport, Overall, 2012/13 – 2017/18

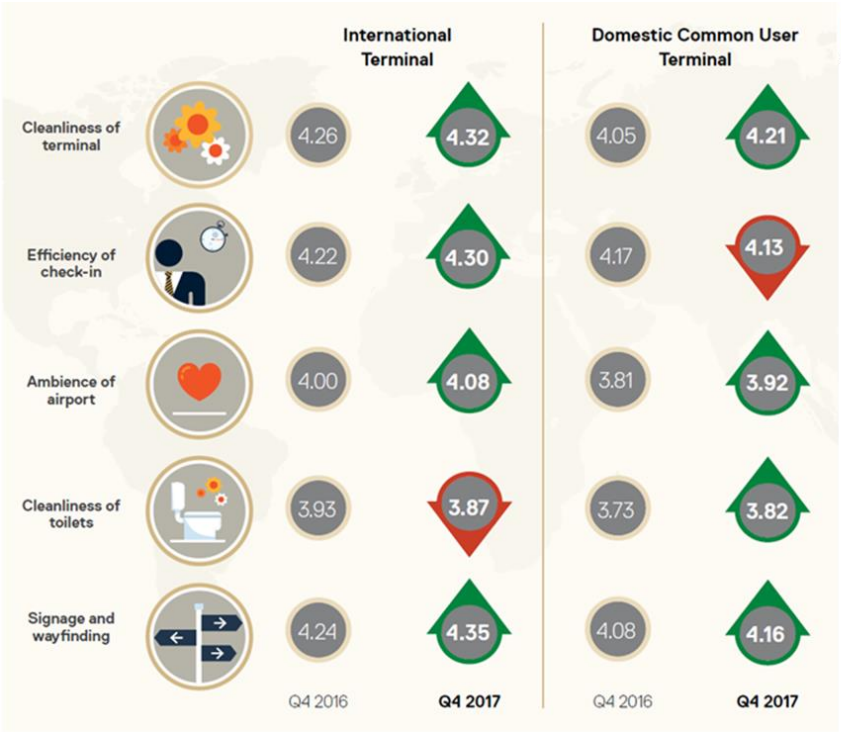


Source: ACI

[63] ACCC, *Airport Monitoring Report 2016-17,* April 2018, page 48

[64] The ACI ASQ is a worldwide survey, with over 350 participants, that measures passenger satisfaction for both arriving and departing passengers. The surveys used are consistent across the world and provide information on a range of performance indicators. See: https://aci.aero/customer-experience-asq/

Figure 12. ACI ASQ results, Brisbane Airport, by Category, Q4 2016 – Q4 2017



Source: ACI

The Commission previously noted that, under the light-handed monitoring regime, *"service quality outcomes overall are 'satisfactory' to 'good', although airlines have, on occasion rated two airports as 'poor'"*.[65] As shown above, the quality of service at Brisbane Airport has continually rated highly and there has been no deterioration in quality of service performance since the Commission's 2011 Review. BAC notes that Brisbane Airport was the highest rated airport for 13 years until 2016/17, when Perth Airport placed ahead of Brisbane Airport quality of service.

As noted above, BAC's airport lease also obligates it to develop the airport to the *"quality standards reasonably expected of [a Major International Airport]"*.[66] Failure to maintain an appropriate standard of quality at the airport may be considered a breach of BAC's obligations under the airport lease. This further acts to ensure that quality of service at Brisbane Airport is maintained over time.

3.2.6 BAC has a track record of successful negotiations

In 2011, the Commission noted that negotiations between airports and airlines were becoming more sophisticated and highlighted the inclusion of service level obligations, consultation on capital investment, price path and dispute resolution processes in the agreements.[67]

BAC agrees with the Commission's view that negotiations have become more sophisticated and the nature of the agreements with the airlines have changed significantly over time.

[65] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011, page XX
[66] Commonwealth of Australia, *Airport Lease for Brisbane Airport*, Lease 702599136, 1 July 1997, clause 12.1
[67] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011

However, there are elements of the process that, in the case of Brisbane Airport, have been consistent across each of the negotiation processes. These are:

- Detailed capital plans are developed and provided to the airlines;
- Independent advice from reputable specialist consultants on rate of return and aircraft movement and passenger growth, which is shared with the airlines;
- Indicative prices for negotiation based on a building block methodology, using commonly accepted regulatory principles;
- Airlines are provided with a copy of the building block model (not just the outputs), with full visibility over all the inputs in the model, including capital and demand forecasts; and
- Extensive consultation on all inputs and information is provided.

Key developments in the negotiations have included:

- Providing increasingly more detailed capital and operating expenditure data to the airlines, e.g. project by project justifications and incremental operating expenditure by project. BAC understands that some of the information requested is more detailed than that required by the AER for heavily regulated energy network businesses;
- Separation of agreements between the Runway ASCA and Terminals ASCA;
- Increasing timeframes, with the latest agreements for the runway having a term of 11 years and pricing resets for a number of key variables, e.g. passengers, operating and capital expenditure;
- Greater proportion of charges being on a per passenger basis (rather than maximum take-off weight of the aircraft), which has shifted volume risk to BAC; and
- Increasing timeframes for the overall negotiation process, from initial pricing proposal being provided to the airlines to reaching agreement.

The nature of the negotiations and the outcomes achieved demonstrate that BAC is not exerting market power. Rather, it highlights the real countervailing power held by BAC's airline customers – there is fair and balanced market power between the parties.

BAC's experience has been consistent with that reported by AAA in their submission, namely that agreement has been reached with the majority of airlines in a relatively smooth and timely manner. In BAC's experience, there are occasions where delays arise to reach agreement, or there is a delay in signing processes that go beyond the expiration of a contract term. There are very few that repeatedly and consistently refuse to reach agreement before the end of a contract term and hold out with short payments for extensive periods.

4. Price and quality of service monitoring of aeronautical services

This chapter provides BAC's responses to the Commission's specific information requests regarding the price and quality of service monitoring framework for aeronautical services. Specifically, it:

- Highlights the concerns BAC has with how the monitoring is implemented; and
- Suggests improvements to the monitoring regime for aeronautical services and facilities.

4.1. Identifying abuse through the monitoring framework

The Commission is seeking comment on the ability of the monitoring regime to detect abuses of market power and potential amendments to the data sets and analytical approaches, particularly:

INFORMATION REQUEST 3

The Commission welcomes comment on whether it is possible to identify abuse of market power through monitoring of airports' behaviour, whether the monitoring regime should continue, and any alternative approaches to identifying abuses of market power.

The Commission is seeking feedback on the matters it should take into account in its assessment of whether the price and quality of service monitoring regime is fit for the purpose of detecting and deterring abuses of market power.

And:

INFORMATION REQUEST 4

The Commission welcomes comment on whether the information that the ACCC collects is adequate to detect any abuse of market power by airports.

Inquiry participants who consider that the current information collected is not adequate to detect airports' abuse of market power are invited to suggest alternatives to augment or replace this information set. Suggested options should address the question of cost of information, who should pay and why.

The Commission invites comments on the use of analytical approaches, such as data envelopment analysis and stochastic frontier analysis, to interpret indicators of airport performance.

BAC supports the AAA's view that monitoring of the aeronautical services at Brisbane, Sydney, Melbourne and Perth airports should continue, and agrees that:

> *"… it is appropriate for there to be a degree of transparency provided to the community and policy makers regarding the annual financial performance of these important pieces of national infrastructure."*[68]

However, BAC has concerns with how the monitoring is currently implemented. The ACCC collects a wide range of information on airport financial and operational performance, but fails

[68] Australian Airports Association, *Submission to the Productivity Commission,* September 2018, Chapter 6

to use this in a meaningful or productive manner. The AAA's submission[69] points out a number of the flaws in the ACCC's approach:

- It uses an aggregate measure – average revenue per passenger – even though the ACCC itself acknowledges its shortcomings;
- In the 2016/17 report, the ACCC suggested that airlines had made $1.57 billion in additional payments to airports relative to what the charges would have been if they had only increased by inflation – with absolutely no rational basis for why inflation is the appropriate annual growth rate for the charges; and
- The ACCC compares the growth rates in aeronautical charges to the growth in airfares, which is akin to comparing apples to oranges given the different services provided by each and differences in cost drivers and technological changes.

It is important that the information presented by the ACCC in its monitoring reports are balanced and considered in the context of the airports' environments. The ACCC's reports generally do not do this. For example, for Brisbane Airport, the section in the 2016/17 prices monitoring report[70] that covers the return on assets:

- Notes that the return on assets for aeronautical services *"has not increased since 2011-12 when the rate was 9.3 per cent*", which has the effect of highlighting the high mark for the rate of return in the 10-year period presented;
- Does not mention that the rate of return has been on a decreasing trend and was at the low end of the range for the 10-year period;
- Does not mention the investments made during this period and fails to discuss the fluctuations in the rate of return (e.g. the low return on 2008/09 coincides with the completion of Moreton Drive and the ITB expansion); and
- Pointed out that the overall airport return was 9.4%, although this has no bearing on the objectives[71] of the monitoring regime and is arguably outside the scope of the ACCC's direction.

Furthermore, the ACCC presents the outcomes relative to the other airports (which, in the case of Brisbane Airport is a favourable result), but fails to make any comment on the reasonableness (or otherwise) of the rates of return on aeronautical services.

As noted in BAC's submission to the Commission for the 2011 Review, the current framework lacks an analytical framework to establish whether prices or rates of return for aeronautical services are excessive.[72] The observations made at that time, which still hold today, are:

> *"At a minimum, this would require an understanding of comparable returns in similar sized airports in other jurisdictions. In carrying out such a benchmarking exercise, the ACCC would however need to take careful account of factors that could influence the*

[69] Australian Airports Association, *Submission to the Productivity Commission,* September 2018
[70] ACCC, *Airport Monitoring Report 2016-17*, April 2018, section 3.2.6, page 61
[71] The objectives are set out in the Treasurer's direction to the Commission to undertake the review. See: Productivity Commission, *Economic Regulation of Airports,* Issues Paper, July 2018, page IV
[72] Brisbane Airport Corporation, *Submission to the Productivity Commission's Inquiry into Economic Regulation of Airport Services*, April 2011

rate of return earned such as risk profile, ownership structure, stage in investment cycle, regulatory regime, and level of competition faced.

… A well thought out and expressed rationale for how the ACCC determines whether rates of return are excessive would assist readers to interpret the ACCC's findings. This should be supported by ACCC research into comparator businesses and broader contextual information, which is a current gap in the ACCC's monitoring reports."[73]

In its most recent monitoring report, the ACCC has not stated that any of the airports have abused their market power in either aeronautical, car parking or landside access services. However, the media release associated with the 2016/17 monitoring report focuses on the dollar value of the profits and uses phrases such as *"significantly increased their profits"* and *"the airports are so profitable"* to create the impression that there is an issue with the level of the profits at the airports.[74] The profits at the airports should be considered in the context of the rate of return earned – a concept which is not mentioned in the media release or the key findings section of the monitoring report.

In summary, the ACCC collects the information that would allow it to provide a more considered view of the rate of return achieved on aeronautical services and facilities over time, but it does not do so. Instead the ACCC focuses its reporting and commentary on flawed measures. This was also identified by the AAA:

"Of course the reality is that the returns on aeronautical assets that the ACCC publishes, but never features in the media commentary of its Chairman, demonstrates that the monitored airports are fully compliant with the pricing principles and have been so since 2002."[75]

The development of an assessment framework, which focuses on rate of return, the trend in the return and consideration of this in the context of an airport's investment cycle, would be a significant improvement to the existing monitoring framework. Furthermore, this would be consistent with the requirements of the Pricing Principles, which require that prices should (amongst other things*) "include a return on intangible (non-current) aeronautical assets, commensurate with the regulatory and commercial risks involved"*.[76]

BAC also notes the AAA's findings on the quality of service monitoring undertaken by the ACCC, particularly the inclusion of airline survey responses in a non-transparent manner and that:

"… airline quality outcomes are better addressed through contractual arrangements agreed by airlines and airports on an airport by airport basis. The AAA understands that information collected and published by the ACCC in respect of airline quality outcomes is of very little utility to parties contracting for the provision of aeronautical

[73] Brisbane Airport Corporation, *Submission to the Productivity Commission's Inquiry into Economic Regulation of Airport Services*, April 2011, page 20
[74] ACCC, *Airport profits continue to grow*, Media Release 69/18, 26 April 2018
[75] Australian Airports Association, *Submission to the Productivity Commission,* September 2018, Chapter 6
[76] Australian Government, *Productivity Commission Report – Review of Price Regulation of Airport Services*, Media Release No. 032, 30 April 2007

services, for policy makers or members of the general public with an interest in the performance of the airports being monitored."[77]

BAC supports the AAA's view that airline quality of service outcomes are best addressed through the contractual arrangements and note that the terminal agreements currently being negotiated with airline customers include service level performance indicators.

4.2. Using benchmarks to identify abuse of market power

The Commission is seeking feedback on specific benchmarks to identify abuses of market power:

INFORMATION REQUEST 5

The Commission is seeking feedback on benchmarks to identify abuses of market power in aeronautical services, including financial benchmarks, operational efficiency benchmarks, service quality benchmarks and others.

In proposing benchmarks, the Commission would appreciate some consideration being given to risk.

BAC agrees with the AAA's observations on benchmarks, namely:

- Rate of return is the appropriate measure for assessing whether aeronautical charges are reasonable or excessive, and the use of this measure is consistent with the Pricing Principles;
- The aeronautical revenue per passenger measure used by the ACCC is flawed, as it is a simple average of total revenue across all passengers and does not take into account the increasing proportion of international passengers, who have higher charges due to the more extensive service and facilities required for international passengers;
- The aeronautical revenue per passenger measure is not suited to identifying potential abuses of market power, as changes in prices of themselves do not mean they are excessive;
- Margins are a poor indicator of profitability, as they will vary with the capital intensity of the business, and therefore are not appropriate for identifying potential abuse of market power;
- Operating cost per passenger is the best measure of operating efficiency as it removes the financing costs from the equation;
- Investment efficiency is the measure least amenable to benchmarking, and should not be measured at a point in time due to the investment lifecycle. Different airports will be at different points in their investment lifecycle, which means that comparisons at a point in time can be misleading; and
- Quality of service measures focusing on passenger outcomes are more relevant than airline quality outcomes, due to the small airline sample size and the potential for gaming. Furthermore, passengers are the ultimate end users of the services and facilities provided at the airport.

[77] Australian Airports Association, *Submission to the Productivity Commission,* September 2018, Chapter 4

BAC refers the Commission to the AAA's submission for further information on the benchmarking measures.

As noted above, BAC is of the view that the appropriate benchmark for assessing whether aeronautical charges are excessive is the return on assets, provided that the measured parameter is considered over time (rather than a point in time) and in the context of the investment lifecycle at the specific airport.

BAC does not agree the rate of return should be defined, as suggested by Virgin.[78] Houston Kemp, who were appointed by the AAA to assess market power in aeronautical services, notes that the Commission itself has acknowledged the issues in using a point estimate of rate of return for drawing conclusions about the exercise of market power.[79] BAC notes that the Commission explicitly recommended against setting building block parameters in the 2011 Review:

> *"Similarly, mandatory codes of conduct and mandatory guidelines to specify matters such as, the allocation of costs to aeronautical and non-aeronautical purposes and building block parameters, should not be introduced."*[80] (Recommendation 9.7)

Furthermore, it is also worth pointing out that dictating the rate of return to apply is contrary to the facilitation of negotiated outcomes.

4.3. Domestic terminal leases

The Commission notes that the exclusion of domestic terminal leases (DTLs) could distort the outcomes of parameters presented on a 'per passenger' basis. It is seeking further information on how this could be addressed:

INFORMATION REQUEST 6

The Commission is seeking feedback on the way domestic terminal leases are accounted for in the current price and quality of service monitoring regime and any alternative approaches. It also seeks feedback on the costs and benefits of domestic terminal leases.

The DTLs held by Qantas and Virgin at Brisbane Airport are due to expire on 30 December 2018 and 31 December 2018, respectively. At this point, control of the respective terminal areas will revert to BAC and the whole of the DTB will be operated as a common user terminal. This means that the whole of the DTB will be subject to prices and quality of service monitoring by the ACCC from 1 January 2019.

Working groups, comprising BAC and airlines, were established in 2016 and have been working through the practical implications of the upcoming changes. The Terminals ASCA is due to expire at the same time and BAC is currently in negotiations with the airlines for the new Terminals ASCA to commence from 1 January 2019.

From BAC's perspective, there will be a decrease in the commercial (non-aeronautical) related revenue and costs vis-à-vis the expiry of the DTLs and in turn, an increase in aeronautical

[78] Productivity Commission, *Economic Regulation of Airports*, Issues Paper, July 2018, page 8
[79] Houston Kemp, *Assessing market power in aeronautical services*, Report prepared for Australian Airports Association, August 2018
[80] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011, page 213

revenue and costs to cover the additional costs to maintain the additional aeronautical assets. This means that there will be a noticeable increase in the average aeronautical revenue per passenger and average aeronautical costs per passenger reported by the ACCC. The reason for this is that the passengers, the denominator in the equation, will not change. The passengers using the leased areas of the terminals have always been included in the overall passenger numbers used by the ACCC to calculate the per passenger revenue and cost metrics, even though there were no associated revenues or costs in the numerator.

While there will be a step change in these metrics, BAC notes that the costs will be more comparable with other airports once the DTLs expire. Nevertheless, there will still be differences that will need to be taken into account, such as the 24 hour operations versus curfew-constrained operating hours, number of terminals and asset valuation basis.

Similarly, the areas under the leases will also be subject to quality of service monitoring by the ACCC from 1 January 2019. BAC is concerned about the impact of this on the quality of service metrics, especially in the short term.

BAC's forward capital expenditure program and operating expenditure budgets provide for the leased terminal areas to be operated at the high standard passengers expect from BAC. This means better utilisation of the infrastructure and a higher quality of services. However, these changes will not be instantaneous as replacement and upgrade projects require time to be completed, must be completed in a brownfield terminal environment that must remain fully operational and there will be pressure from the airlines to keep costs down (while improving quality of service).

This means there is likely a period where service quality at the domestic terminal, as measured by the ACCC) will fall, and BAC's costs will increase. Airlines have expressed some concern about their loss of control on a day to day basis to ensure their day of operations are not adversely impacted. However, BAC is committed to working closely with the airlines for both short and long term planning with the goal of limited operational disruption, whilst allowing for maximum efficiency in the utilisation of its assets. It should be noted BAC is incentivised to do so and will avoid unnecessary capacity expansion by operating the terminal efficiently. Airlines on the other hand appear motivated to maximise brand recognition at the expense of efficient common user asset utilisation.

4.4. Administration and compliance costs

The Commission is seeking further information on the cost of the monitoring regime, namely:

INFORMATION REQUEST 7

The Commission is seeking evidence on the costs of complying with the price and quality of service monitoring regime, and the cost to the Australian Government of administering the regime.

The cost to BAC of complying with the price and quality of service monitoring regime is around $200,000 per annum. This estimate covers the cost of undertaking surveys, auditing of the ACCC accounts and staff and overhead costs.

The staff costs are based on the activities undertaken over and above the normal business practices and include the time to prepare financial and quality of service templates, coordinate

surveys, maintain the 'line in the sand' asset register, prepare board approvals, liaise with the ACCC and review ACCC draft reports.

4.5. Facilitation of commercially negotiated outcomes

The Commission notes that there needs to be effective remedies available for the monitoring framework to deter abuse of market power and is seeking comment on this:

INFORMATION REQUEST 8

The Commission is seeking comment on whether the remedies that are available under the current framework for economic regulation facilitate commercially negotiated outcomes in airport operations.

Participants are invited to provide the Commission with legal and other advice they have received in relation to the 2017 changes to Part IIIA of the Competition and Consumer Act.

BAC supports the AAA's view that the remedies available under the current framework provide effective constraints on the abuse of market power.[81]

BAC has achieved negotiated outcomes with its airline customers and the negotiations and agreements have become more sophisticated over time. These outcomes have been achieved without any of these remedies being applied. Rather, the existence of these remedies and the understanding of the implications were these to be implemented (for both BAC and its customers) effectively acts to constrain the abuse of market power and thus, indirectly, facilitate the commercially negotiated outcomes.

The AAA noted the range of potential remedies under the *Competition and Consumer Act 2010* (CCA), including:

- Declaration under Part IIIA, which would then make the negotiations subject to arbitration under the CCA;
- More intrusive price monitoring, either by the ACCC under its own volition or via direction by Government;
- Prices inquiry, through the Government issuing a directive to the ACCC to do so; and
- Price notification, also through a direction from the Government to the ACCC.[81]

BAC refers the Commission to the AAA's submission for further information on the effectiveness of the remedies and the implications of the changes to the CCA.

4.6. Alternatives to price and quality of service monitoring

The Terms of Reference for the review require the Commission to report on the appropriate economic regulation of airport services, which implies consideration of alternative forms of regulation to the prices monitoring. To this end, the Commission is seeking views on whether changes are required and, if so, the costs and benefits of the alternatives:

[81] Australian Airports Association, *Submission to the Productivity Commission,* September 2018

INFORMATION REQUEST 9

The Commission is seeking evidence that changes to the current 'light handed' approach to airport regulation are necessary. Participants are invited to suggest alternative approaches, the mechanisms to put such approaches into practice and the potential benefits and costs of the changes.

As noted above, BAC supports the AAA's view that monitoring should continue at Brisbane, Sydney, Melbourne and Perth, albeit with improvements to the way in which performance metrics are collected and reported by the ACCC.

The evidence presented in this submission and that of the AAA demonstrates that:

- There has been no abuse of market power – prices are not excessive, quality remains good, investments are prudent and efficient, and capacity has not been deliberately constrained;
- There are effective constraints on the abuse of any market power held – there is strong competition between airports and significant countervailing power held by the airlines; and
- Effective remedies are available if needed, including declaration under the CCA.

Airlines for Australia and New Zealand (A4ANZ) has suggested[82] that consideration be given to the ACCC's previous recommendation that the *Airports Act 1996* be amended so that specific services can be deemed as declared for the purposes of the CCA. This would effectively apply the negotiation and arbitration provisions of the CCA while bypassing the declaration process – i.e. with no determination made as to whether declaration is appropriate.

In response to ACCC's original proposal, the National Competition Council (which would ordinarily determine a declaration under the CCA) argued that the proposal would increase the risk of regulatory error, be problematic for implementation and reduce confidence in the integrity of the National Access Regime.[83] In the 2011 Review, the Commission explicitly recommended against this, stating:

> *"An airport-specific arbitration regime activated by deemed declaration of airport services under Part IIIA should not be introduced."*[84] (Recommendation 9.7)

The Commission noted at that time:

> *"This has strong parallels with the earlier price cap era in which the regulator had to form a view about price increases that arose from necessary new investment. Hence, deemed declaration could be far more intrusive than implied by the ACCC's characterisation of deemed declaration as 'business as usual' with arbitration only in rare cases."*[85]

BAC cannot find any reason why a different view would apply today. If anything, the concerns raised at that time would be even more valid today, as noted by the AAA:

[82] A4ANZ, *The Performance & Impact of Australia's Airports since Privatisation*, May 2018, page 17
[83] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011, page XXIV
[84] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011, page 2
[85] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011, page 213

"… given the recent behaviour of A4ANZ, Qantas and Rex, that airlines as a whole are more combative than they were in 2011 and as such the risks the Commission identified in 2011 are greater today."[86]

Under the current light-handed regulatory framework BAC is confident that it can continue to achieve commercially negotiated outcomes with the airlines that provides for efficient investment at the airport, consistently good quality of service and aeronautical charges that reflect a commercial return on assets. BAC believes the framework is working well overall and there is no need for a regulated arbitration framework to be developed or imposed on the aviation industry.

There are already a number of potential remedies available under the Competition and Consumer Act 2010 to address potential abuse of market power. Furthermore, aeronautical agreements generally include dispute resolution clauses that apply once an agreement is executed.

BAC notes the concerns that the AAA raised about the final offer arbitration (FOA) model that has been floated by various parties in recent months[87], namely that:

- FOA seems to have little practical application to airports in Australia;
- FOA is likely to increase the risk of regulatory error;
- The ACCC is likely to have a bias towards selecting the offer that contains the lowest price;
- FOA would result in airlines making offers just below that necessary to support investment in capacity to protect their congestion-related premiums; and
- Debt and equity providers to airports would likely see this as a risk proposition.[88]

Therefore, FOA is unlikely to produce a better outcome for the community than the current framework.

BAC refers the Commission to the AAA's submission for further commentary on proposed alternatives to the current monitoring regime.

[86] Australian Airports Association, *Submission to the Productivity Commission,* September 2018, Chapter 6
[87] See, for example: A4ANZ, *The Performance & Impact of Australia's Airports since Privatisation*, May 2018
[88] Australian Airports Association, *Submission to the Productivity Commission,* September 2018

5. Car parking and landside access

This chapter provides BAC's responses to the Productivity Commission's specific information requests regarding car parking and landside access. It demonstrates that BAC has limited market power in car parking services and has not exploited any market power. Therefore, BAC recommends the removal of price and quality monitoring of car park and landside access.

5.1. Car parking and landside access at Brisbane Airport

In 2011, the Commission found that the *"range and extent of modal options at each airport provides a competitive constraint on airports' car parking pricing, particularly long-term parking"*.[89] BAC notes that both the range and extent of modal options have increased at Brisbane Airport since the Commission's 2011 Review, with additional car parking spaces, additional drop off bays, new providers and provision for ride share options, such as Uber.

The following table details transport options currently available for accessing Brisbane Airport.

Table 2. Transport options to and from Brisbane Airport

Transport Option[1]	BAC	Other Providers[1]	
Car parking – at terminals	✓	✓	Qantas Valet, Virgin Valet
Car parking – shuttle to terminals	✓	✓	Gateway Airport Parking, Andrew's Airport Parking, Alpha Car Parking, Portside Parking, Kingsford Smith Airport Parking, Skyclean
Free pick up and drop off		✓	Private vehicles
Rental car – on airport		✓	Avis, Budget, Hertz, Europcar, Redspot / Enterprise, Thrifty
Rental car – off airport		✓	Numerous (>20)
Taxi		✓	Black & White Cabs, Yellow Cabs
Ride-share		✓	Uber, GoCatch, Taxify, Ole, Muve and Didi
Limousine / Hire car		✓	Numerous (>100)
Train		✓	Airtrain
Public bus	✓	✓	Translink (Brisbane City Council) BAC buses (free)
Private bus		✓	Con-x-ion plus a variety of others
Walk / cycle	✓		

1. While some of the services are provided by 'Other Providers', it should be noted that BAC provides the infrastructure (e.g. roads, kerbsides, facilities) to enable the 'Other Providers' to access the terminals.

[89] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011 , page III

It is important to note that, at the time the airport was privatised in 1997, there was one off-airport car park operator, no under-cover parking at the airport, no Airtrain, no public bus, no terminal buses and no dedicated cycle / walk tracks.

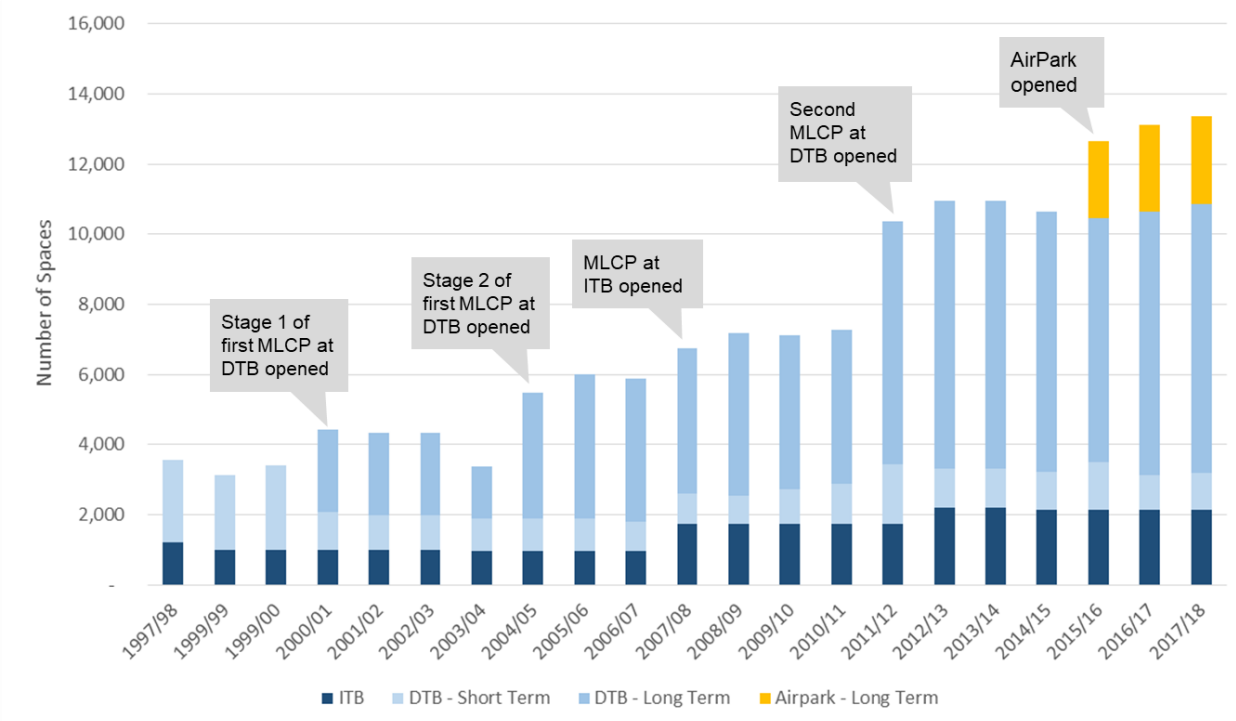
While there are new providers generally across the modal options, the key changes since the 2011 Review are in the on-airport car park capacity, drop off areas for ITB, completion of the Domestic Terminal Pedestrian Access Bridge[90] and the introduction of ride-sharing as a transport mode. These are discussed further below.

Car parking capacity (on-airport)

There were 13,127 public car parking spaces in 2016/17, compared to just 3,546 public car spaces in 1997/98. Furthermore, more than two-thirds of these spaces are now under-cover.

The following chart illustrates the growth public car parking spaces since privatisation, and demonstrates that BAC has continued to invest in car parking capacity since the Commission's 2011 Review.

Figure 13. Public Car Parking Spaces, Brisbane Airport, 1997/98 – 2017/18



Note: Excludes staff car parking and public parking spaces at the SkyGate precinct.
Source: BAC, ACCC airport monitoring reports (Various)

In 2015/16, BAC completed the development of the Airpark at the Central Parking Area. This provided for an additional 2,500 long-term public car parking spaces. Airpark was developed to ensure a full suite of parking options were available for customers at the airport. Airpark is a low cost 'Park and Ride' product where customers' cars are stored in a majority open air car park with buses transporting customers to and from the passenger terminals for free.

[90] This was still under construction at the time BAC made its submission to the Commission's 2011 Review.

BAC plans to develop a second MLCP at the ITB. This will increase the capacity at the ITB from 2,123 bays (as at 2016/17) to almost 5,000 bays by 2020. BAC is also planning a third MLCP at the DTB, with an estimated completion in 2023.

Pick up areas

BAC invested $1.8 million in the initial capital outlay in 2017 and has ongoing operating and maintenance costs at the ITB to relocate and expand the capacity of the public (free) pick-up area to 34 parking spaces. The expanded free pick-up area, which is located adjacent to the terminal building, includes a dedicated pick up area with 10 minutes free parking and a covered walkway for passengers. BAC also upgraded the wayfinding signage and coloured road lanes to assist drivers. This project was driven by a need to expand the pick-up capacity, but a lack of available space on the elevated terminal road and safety considerations meant that it needed to be located adjacent to the ITB. The new pick-up area was opened to the public on 23 November 2017.

Other free services provided by BAC to facilitate access to the terminals include:

- Buses to transfer passengers between the DTB and ITB and from the Skygate DFO precinct to the terminals;
- Public pick up road at the DTB; and
- 30-minute free public waiting area at the DTB.

Domestic Terminal Pedestrian Access Bridge

The Domestic Terminal Pedestrian Access Bridge was opened in late 2011. This project included an elevated walkway from the second DTB MLCP to the terminal and significant redevelopment of the access roads in front of the DTB. It alleviated much of the congestion in front of the terminal and provided much improved access for ground transport operators and public drop off.

Ride share

There were no (formal) ride-sharing facilities at Brisbane Airport at the time of the 2011 Review, as this mode of transport did not exist at that time. Following the legalisation of ride-sharing services in Queensland in September 2016, there are now almost 6,804 ride-share vehicles registered with BAC. This includes vehicles driving for Uber, GoCatch, Ole, DiDi, Muve and Taxify.

Ride-share options were not envisaged at the time that BAC planned the redevelopment of the forecourt at the DTB (completed in 2012). To accommodate ride-share pick-up, the second road at the DTB forecourt was made available for ride-share pick-up. BAC also invested in the integration of access systems between BAC and Uber, as well as making significant areas available for service providers in the Central Parking Area to wait for their passengers.

BAC subsequently invested in a dedicated ride-share waiting area at the Central Parking Area, which provides these operators with their own facilities, such as toilets and vending machines. The investment in this dedicated ride-share area is recovered through the fees charged to ride-share operators for pick-up only. These are temporary facilities, with a permanent facility

adjacent to the taxi and other ground transport operators area planned for completion in late 2018/19.

Ride-share operators are able to drop off passengers for free at the general public drop-off area.

5.2. Market power in car parking and landside access

The Commission is seeking comment on the level of market power in the provision of car parking and landside access at the airports, specifically:

INFORMATION REQUEST 10

The Commission is seeking evidence on the extent of market power held by Australian airports in on airport car parking and landside access services and constraints on the abuse of market power.

The Commission recommended the continuation of price monitoring for car parking and landside access at airports in its 2011 Review. While the Commission found that charges were not so high as to impede competition, it nevertheless recommended the continued monitoring regime due to the level of vertical integration in the supply of these services.[91]

The level of vertical integration in the supply of on-airport car parking and landside access will always exist given the on-airport car parks and access roads to the airport are located on land that is controlled by the airport operator. However, this does not necessarily mean that there is significant market power or that there are not effective constraints on the misuse of any market power that does exist.

Houston Kemp, who was engaged to assess the level and use of market power by BAC, concluded that BAC does not have substantial market power in car parking services and there is no evidence that BAC has exercised any market power it may hold in the provision of landside access services.[92] This is consistent with the AAA's findings that, *"whatever market power airports have in car parking is diminishing and has not been misused"*.[93]

Houston Kemp concluded that BAC does not hold substantial market power in car parking services. It noted that the *"existence of a range of potential substitute services – many of which are not provided by BAC – is likely to constrain BAC's ability to charge excessive prices for parking, since customers have the ready ability to switch between alternative modes"*[94] Reasons why BAC does not hold substantial market power in car parking include:

- There are five off-airport car park providers[95] in close proximity to Brisbane Airport, that offer high quality car parking services at prices similar to, or below, those of BAC's car parks;
- There are a range of other transport options over a wide spectrum of price points; and

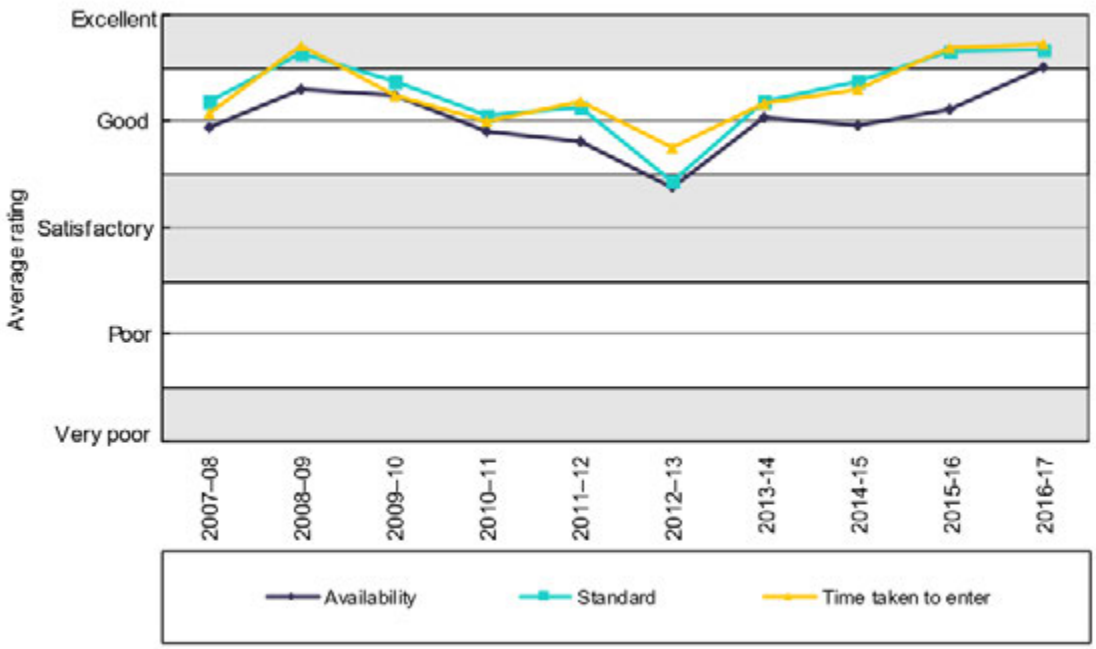
[91] Productivity Commission, *Economic Regulation of Airport Services*, Report No.57, December 2011, page XX
[92] Houston Kemp, *Car parking and ground access – market power assessment,* A report for Brisbane Airport, September 2018
[93] Australian Airports Association, *Submission to the Productivity Commission*, September 2018, Chapter 1
[94] Houston Kemp, *Car parking and ground access – market power assessment,* A report for Brisbane Airport, September 2018, page ii
[95] BAC provides free access to the terminals for passenger drop off by the off-airport car park operators.

- BAC has a strong incentive to increase total visitors to Brisbane Airport, irrespective of their mode of transport, as car parking revenue is only a small proportion of the overall BAC revenue.

Houston Kemp also concluded that there was no evidence that BAC had exercised any market power in car parking services. Regarding the prices for car parking services, Houston Kemp noted that prices had only risen slightly in real terms, and in line with investment and the locational rents associated with the value of the land near the terminal buildings. Furthermore, there was no evidence of a drop in quality or access being restricted.[96]

This is supported by the ACCC's quality of service monitoring findings. As shown in the following charts, the quality of service ratings for the availability, standard and entry time for car parking has been 'good' to 'excellent' for most of the past decade for both the domestic and international passengers.

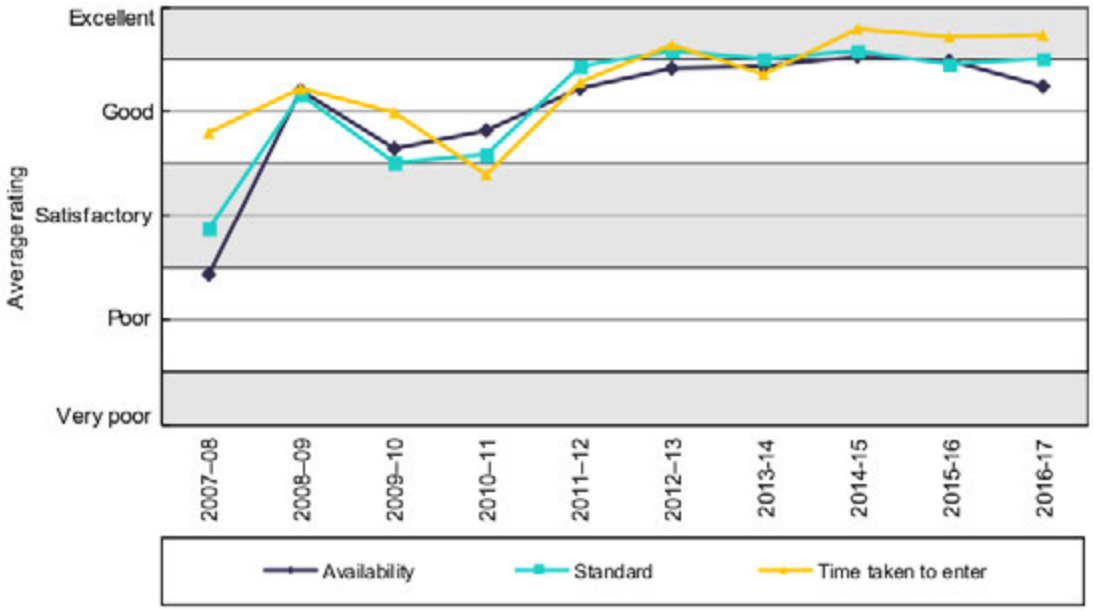
Figure 14. Quality of car parking, international passengers, 2007/08 – 2016/17



Source: ACCC Price Monitoring Report 2016/17

[96] Houston Kemp, *Car parking and ground access – market power assessment,* A report for Brisbane Airport, September 2018

Figure 15. Quality of car parking, domestic passengers, 2007/08 – 2016/17



Source: ACCC Price Monitoring Report 2016/17

BAC notes that the decline in the quality of service ratings for the international passengers in 2012/13 coincided with a new tolling system being installed. Similar, the ratings for the domestic passengers in 2007/08 to 2010/11 reflect the congestion and construction works prior to the opening of the new forecourt and MLCP at the DTB in 2012.

On landside access, Houston Kemp found that BAC is likely to have some market power in landside access, but that there was no evidence demonstrating an unreasonable exercise of market power. Specifically, Houston Kemp noted that BAC does not have an incentive to restrict access, prioritises efficient passenger movements over potential commercial returns and undertakes a range of activities to promote the use of public transport access to the terminals.

> *"BAC chooses to locate facilities for a variety of no to low yielding access modes – such as private vehicle pick-up and drop-off and taxi ranks – on high value land located proximate to terminals, thereby prioritising the efficient movement of passengers and vehicles over higher commercial returns that could otherwise be generated from this land, and over locating BAC's own car parking facilities closest to terminal."*[97]

There was no evidence to suggest that BAC restricts access to ground transport operators, provides low quality services or under-invests in landside access facilities and services.[98]

A copy of the Houston Kemp report is provided at Appendix B.

[97] Houston Kemp, *Car parking and ground access – market power assessment,* A report for Brisbane Airport, September 2018, page 48
[98] Houston Kemp, *Car parking and ground access – market power assessment,* A report for Brisbane Airport, September 2018

5.3. Monitoring car parking and landside access

The Commission is seeking comments on the effectiveness and need for of the monitoring regime for car parking and landside access:

INFORMATION REQUEST 11

The Commission is seeking comment on the effectiveness of the price and quality of service monitoring regime for on airport car parking and landside access. The Commission would welcome participant views on:

- *whether data that the ACCC collects are suitable for identifying the abuse of market power*
- *evidence that could be used to determine whether airport operators are abusing market power in car parking and landside access*
- *whether regulators have adequate remedies to deal with abuses of market power*
- *the costs of complying with the price and quality of service monitoring regime*
- *alternative approaches to detecting and deterring potential abuses of market power in on airport car parking and landside access.*

The facts presented in Sections 5.1 and 5.2 above demonstrate that BAC does not hold significant market power in car parking and has not exercised unreasonable market power it holds in landside access because there are effective constraints in place. This is consistent with the findings for the other airports, as noted by the AAA:

> *"Houston Kemp's reports show conclusively that there is no evidence of any form of market power being exercised by the monitored airports in their provision of car parking services."*[99]

BAC supports the AAA's view that:

- There is no systematic evidence of the abuse of market power in the provision of car parking and landside access;
- There is no benefit to consumers from car park and landside access monitoring;
- Effective remedies exist under the CCA if required; and
- Monitoring of car parking and landside access by the ACCC should therefore be abolished.[100]

Notwithstanding BAC's views on the need for monitoring of car parking and landside access, if it were to continue it is important that the information presented by the ACCC in its monitoring reports are balanced and considered in the context of the airports' respective environments. The AAA highlights that the ACCC has often taken an *"aggressive stance"* towards car parking charges at the airports, has previously drawn an *"incorrect and unsubstantiated conclusion from car parking profit margins"* and:

> *"… the ACCC has consistently taken a highly partisan stance in its commentary on ground access services and charges and the themes it draws of high margins and*

[99] Australian Airports Association, *Submission to the Productivity Commission,* September 2018, Chapter 7
[100] Australian Airports Association, *Submission to the Productivity Commission,* September 2018

market power do not stand up to close scrutiny. The similarity between this and the ACCC's analysis and partisanship on aeronautical services is plain to see."[101]

The AAA notes that the "*evidence collected by Houston Kemp suggests that the opportunity cost of the land used to provide car parking services by the airports is likely to be significant and has recently increased*" and that therefore "*the EBITA margins earned by the airports for car parking are likely to be explained to a significant extent by locational rents and convenience premiums"*.[101]

BAC's views on this matter are consistent with those of the AAA and BAC refers the Commission to the AAA submission for further commentary on the shortcomings of the ACCC's approach to reporting on car parking prices and profits.

To be effective, the car park prices monitoring regime needs to collect and report on information that addresses the question of whether prices or profits are excessive, and this cannot be achieved without consideration of the rate of return on car parking, the locational rents that accrue to the airport and the investment lifecycle.

BAC has not been required to provide the information that would be needed for the ACCC to report on the rate of return for car parking services and facilities. Despite this, BAC has historically provided the necessary data to the ACCC as part of its annual reporting. However, the ACCC chose to ignore this and BAC subsequently stopped providing the relevant information.

[101] Australian Airports Association, *Submission to Productivity Commission,* September 2018, Chapter 7

6. Other issues

This chapter addresses the Commission's specific information requests on other related issues including the planning and operation of transport linkages, access for regional air services in New South Wales and competition in jet fuel supply.

6.1. Transport linkages

The Commission is seeking feedback on the effectiveness of the current arrangements for the planning and development of the transport linkages to and from the airport, specifically:

INFORMATION REQUEST 12

The Commission is seeking comment on the existing arrangements for the planning and operation of land transport linkages including evidence of problems and suggestions for alternative approaches or improvements to existing arrangements.

BAC takes a holistic view in its planning for the airport, with transport linkages being an integral component of the overall planning process. This is evident in BAC's Ground Transport Plan[102], which sets out ground transport options on, and surrounding, the airport. A 5-year Ground Transport Plan is a mandatory requirement for Master Plans prepared by BAC under the *Airports Act 1996*.

Furthermore, BAC has a history of working effectively with state and local government planning and transport authorities. For example:

- BAC worked closely with Brisbane City Council (BCC) to extend Route 590 of its public bus service to ensure continued connectivity between the Skygate precinct at Brisbane Airport and Toombul Interchange, a major hub for BCC's public bus network, after the contracted service Route 369 was removed from Airport as part of the Brisbane City Council Bus network review. BAC's free buses connect the terminals with the public bus network at the Skygate precinct;
- In late 2017, BAC, BCC and the Queensland Department of Transport and Main Roads (DTMR) jointly funded the Brisbane Airport Access Study. This study, which was the result of continued engagement to identify opportunities to increase public transport offerings to the airport, identified several initiatives under the banner of Public Transport Improvements. BAC, BCC and the Queensland Government continue to work on opportunities to extend the public transport offerings to Brisbane Airport; and
- BAC is currently working with the Queensland Government and Queensland Rail to include a third Airtrain station at Brisbane Airport.

BAC notes also that the current Ground Transport Plan for Brisbane Airport included 41 programs across 10 initiatives, with the responsibility for leading the programs allocated across BAC, BCC and DTMR. The division of responsibility was determined following consultation with agencies responsible for delivering road and transport programs in south east Queensland.

[102] The Ground Transport Plan is part of the Brisbane Airport Master Plan (2014).

Overall, the existing arrangements for the planning and operation of land transport linkages are working well for BAC and have facilitated the ongoing development of transport linkages to and from Brisbane Airport, for both passengers and those who work and do business at the airport.

As noted in the previous chapter, there are a wide range of options for transport to and from Brisbane Airport. Furthermore, BAC fully supports and facilitates the growth of the alternative transport options, and works effectively with government agencies to realise its vision.

In the case of Brisbane Airport, BAC has always considered transport planning to be a continual and essential component of its obligation to operate Brisbane Airport responsibly and efficiently. Comprehensive transport plans have formed part of BAC's master planning process since 1997. In this regard, the legislative obligation to develop a Ground Transport Plan largely formalised what BAC was already doing.

6.2. Access for regional air services

The Commission is seeking information on the effectiveness and impacts of the arrangements for regional air services at Sydney Airport, specifically:

INFORMATION REQUEST 13

The Commission is seeking information on:

- *the objectives of the arrangements for providing access to Sydney Airport for airlines servicing regional destinations within New South Wales*
- *the effects of the regional ring fence and price cap regime on the availability and price of regional air services into and out of Sydney Airport*
- *the effects of the arrangements on interstate and international flights, and on Sydney Airport*
- *alternatives to the current arrangements.*

BAC has no comment on the arrangements for regional services at Sydney Airport.

6.3. Competition in jet fuel supply

The Government has requested the Commission to review competition in the jet fuel market, including the provision of jet fuel at the major airports. To assist in its review, the Commission has requested the following information:

INFORMATION REQUEST 14

The Commission is seeking evidence on the extent of competition in the jet fuel market, the effects of the current level of competition on airlines, passengers, air freight users and other parties, and options for addressing any lack of competition in the market for jet fuel.

Brisbane Airport has a single network supplying fuel to aircraft, with multiple suppliers – Air BP, Exxon Mobil Caltex Australia and Viva Energy Australia (formerly Shell) – who operate the Joint User Hydrant Installations (JUHI) at Brisbane Airport under a joint venture arrangement. The joint venture stores, manages and delivers jet fuel to the airport, including the JUHI and associated hydrants and gantries.

There are three into-plane (ITP) Operators – Caltex Australia, Air BP and Viva Energy / ZIP Airport Services – who transfer the fuel from the hydrants and gantries to aircraft using hydrant carts and refueller trucks. Each of the three ITP Operators has their own vehicles and staff

and are responsible for contracting directly with the airlines for the refuelling services and co-ordinating with the joint venture for access to the fuel supplies. The airlines contract directly with the fuel suppliers for the supply of the jet fuel itself.

The joint venture has a number of leases and licences with BAC that allow it to operate and provide services at Brisbane Airport. BAC does not own any of the fuel supply infrastructure, but works closely with the joint venture on the planning and development of those facilities. For example, BAC's current 2014 Master Plan provided for the development of additional storage capacity in the short term and also considers the longer term needs for fuel storage and supply infrastructure at Brisbane Airport.

BAC meets monthly with the joint venture on operational matters and there are quarterly senior management meetings. BAC also participates in the 6-monthly strategic planning workshops convened by the joint venture.

The Commission noted concerns by the BARA that jet fuel suppliers have difficulty gaining access to the jet fuel supply chain.[103] Overall, BAC understands that the arrangements at Brisbane Airport have been effective and is not aware of any issues regarding access to the supply chain. BAC has always facilitated the development of new capacity by the joint venture and, given that refuelling activities are essential aeronautical services, would invest directly if required.

[103] Productivity Commission, *Economic Regulation of Airports,* Issues Paper, July 2018

Appendix A – Oxera report on airport competition

Appendix B – Houston Kemp report on car parking and landside access