MELBOURNE AIRPORT

Productivity Commission Inquiry into the Economic Regulation of Airports

Response to Issues Paper

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Please direct any enquiries to:
Jai McDermott
Executive, Corporate and Public Affairs
Melbourne Airport

Mail: Locked Bag 16, Tullamarine, VIC 3043

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1 Executive summary

Melbourne Airport appreciates the opportunity to make this submission to the Productivity Commission Inquiry into the Economic Regulation of Airports.

1.1 About Melbourne Airport

Melbourne Airport is owned and operated by Australia Pacific Airports Pty Ltd (Melbourne) (APAM). APAM is owned by Australia Pacific Airports Corporation Limited (APAC), which also owns Australia Pacific Airports (Launceston) Pty Ltd (APAL). APAL and Launceston City Council own Launceston Airport, which is operated by APAL. APAC is a privately held corporation owned by institutional investors, predominantly superannuation/pension funds.

Melbourne Airport is the major aviation gateway to Victoria and southeast Australia for passengers and freight. In 2017-18 the airport welcomed 36.7 million passengers, of which 25.8 million were domestic and 10.9 million were international travellers.

Melbourne Airport has experienced sustained, long-term growth in line with global aviation trends. In March 2018 the airport celebrated nine years of consecutive passenger growth and in July recorded its busiest month ever on record, when almost 3.3 million international and domestic passengers passed through.

At the time of privatisation in 1997, 14 million passengers used Melbourne Airport and only one in seven travelled internationally. Today, that figure is one in three. Remarkably, while it took around 37 years to break through the 5 million international passengers per year barrier, it took only another decade to hit 10 million annually.

Passenger numbers are forecast to almost double to more than 67 million over the next 20 years, by which time Melbourne is forecast to be Australia's largest city by population.

Airfreight is an underappreciated aspect of the economic benefits supported by airports. Airfreight is used to move high-value, time-sensitive and perishable items that need to be delivered to customers or markets quickly. Almost half a million tonnes of airfreight passed through Melbourne Airport in 2016-17. Melbourne Airport's 24-hour operation, and the growing number of international services, provides new opportunities for exporters in south-east Australia to reach the growing demand of international markets.

In 2017-18 Melbourne Airport handled 307,000 tonnes of international airfreight worth $17.5 billion. This represents over 30 per cent of Australia's international airfreight market. Approximately 85 per cent of international airfreight that moves through Melbourne Airport is carried in the belly of passenger aircraft, with the remainder transported on dedicated freighters.

The airport precinct is an anchor employer that directly supports more than 20,600 full-time equivalent (FTE) jobs. It is an important employment hub for the local community, with nearly two-thirds of employees living within the seven surrounding municipalities.

A typical daily international flight contributes $109.1 million to the Victorian economy and supports more than 1,000 jobs per annum. A typical daily domestic service used by interstate visitors adds $16.2 million to the state's economy.

1.2 The Productivity Commission's inquiry

The Productivity Commission's inquiry into the economic regulation of airports is particularly important in this context. Significant investment in runway, terminals and supporting infrastructure capacity will be required to facilitate growth while maintaining a high quality traveller experience.

In addition to expanding capacity, there is also a significant task in the maintenance and replacement of existing infrastructure, much of which has been in place since the 1960s.

Major investment in long-life infrastructure requires a stable, predictable regulatory environment. Unnecessary regulatory change creates risk for investors, increases funding costs and compromises the delivery of economic infrastructure at the time it is needed.

Fortunately, the existing light-handed regulatory framework has served the sector well, evolving and maturing in the 15 years since it was first introduced. This submission will outline the effectiveness of the regime, how it has organically evolved, and underline why it should be maintained.

Australia's major international airports exist in the service of their host cities and states, facilitating economic growth, connectivity and trade in partnership with airlines, tourism bodies and a range of other stakeholders. Melbourne Airport is a critical piece of economic and social infrastructure that delivers significant economic returns to the state and commonwealth.

1.3 Key points of this submission

The incentives of Melbourne Airport

Melbourne Airport's success is predicated on volume growth in passenger numbers. This fundamental characteristic of the airport business model is strongly aligned with the public interest.

Timely investment in infrastructure to facilitate this growth is a critical factor in the delivery of sustainable returns to shareholders. Melbourne Airport is mostly owned by Australian superannuation funds who manage the retirement savings of millions of Australians. In addition to revenue from the provision of aeronautical services, growth in passenger numbers provides further revenue growth opportunities through supporting businesses including retail, car parking and ground access.

More airlines, flying to more destinations more often, creates greater choice for passengers. Competition helps to keep airfares low, evidenced by the decrease in international airfares by approximately 40 per cent over the past 10 years as the number of carriers servicing Australia has increased.

Over the past two years in the domestic market where the market consists of primarily just two airline groups, the growth in passenger demand exceeded the growth in the supply of seats by 2.3 million. This growth in demand, which has not been met with corresponding supply, has coincided with the recent strong growth in domestic airfares.

Over the past two years, domestic airfares have increased by 13.2 per cent in real terms (17.4 per cent nominal), with domestic airfares now higher than they were five years ago. This is not good for travellers or airports alike. While airline groups point out that airfares in real terms are lower now than they were a decade ago, this ignores more recent trends.

While considered as natural monopolies, Australia's airports compete with other ports domestically and internationally in airline attraction. Indeed, airports and state-based tourism bodies are increasingly working in partnership to win business from overseas carriers, combining the attractiveness of the destination with competitive offers and incentive schemes.

While airports are anchored to their host city, airlines are free to move aircraft to the most profitable routes. This creates a strong incentive for airports to price aeronautical services competitively, catering to individual airline needs as much as possible within the constraints of common user infrastructure.

Light-handed regulation is effective

Successive Productivity Commission reviews have concluded that the existing regulatory framework is serving the sector well and that there is no case for a move away from light-handed regulation.

In particular, this submission notes that the regime continues to result in mutually beneficial commercial agreements between Melbourne Airport and airlines for the supply of aeronautical services, which are increasingly mature and sophisticated.

Commercial negotiation is evolving relatively quickly in the context of a system that is just 15 years old and where agreements are generally struck once every five years. Melbourne Airport's most recent Aeronautical Services Agreement (ASA) features a number of elements which increase the input and influence of airlines into the capital planning process and increases accountability on the airport for service delivery. For example, it includes:

- A Capital Consultation Group (CCG) that involves airlines in the scope of major projects, such as new gates. In addition to representatives from across the airline community, the CCG process includes an Independent Engineer (IE) review of major project costs for pricing purposes, to ensure that infrastructure is delivered efficiently.
- A Quarterly Consultation Forum to specifically review quality of service issues and share data on airline on-time performance (OTP). Melbourne Airport chairs the forum and ground handlers are included, noting their critical impact on day of operations.
- An Immediate Service Failure Rebate if Melbourne Airport's equipment is not available for use and causes an OTP issue in excess of 15 minutes.
- A commitment to the Airport Collaborative Decision Making (A-CDM) process to improve the airline turnaround and pre-departure sequencing process. A-CDMs are used in Europe to improve operations outputs.
- An annual price reset if actual expenditure falls short of planned expenditure, reducing the risk to airlines of any underinvestment.

These new features are adapted from, and build upon, the best elements of deals struck elsewhere by participating airlines. This approach is resulting in the continual evolution of the negotiation process, without the need for further regulatory intervention. An increase in regulation or the threat of it (such as the proposal for deemed declaration) could retard the progress being made within the existing framework.

The regime has resulted in efficient prices, with Melbourne Airport's average return on aeronautical assets being within the range of reasonable estimates for a benchmark provider of aeronautical services. The right amount of infrastructure is being provided at the right time; Melbourne Airport has no incentive to underinvest, while the countervailing market power of airlines ensures that overinvestment or 'gold plating' has not occurred.

Quality of service has been maintained at an efficient level while at the same time strong passenger growth has required expansion of capacity to meet demand from passengers and the needs of airlines, all within Melbourne's 24/7 operating environment.

The bespoke commercial outcomes resulting from the light-handed regulatory regime also reflect that any market power held by airports in commercial negotiations is significantly constrained for a number of reasons, including:

- the strong countervailing power of airlines – particularly in circumstances where the Australian aviation industry is structurally dependent on two dominant airlines;
- international airlines are authorised by the ACCC to collectively negotiate with airlines;
- airports are required by their Commonwealth leases to provide access to airlines;
- the ability and practice of airlines to withdraw or reduce the number of services operated from any airport; and
- a degree of competition from other airports – domestic and global.

These factors are in turn supported by the regulatory framework, which provides transparency and accountability in the supply of aeronautical services, and a genuine threat of additional regulation should market failure issues arise. Transparency and accountability are provided the ongoing monitoring of prices, costs, profits and quality of service by the ACCC, and the threat of more heavy-handed regulation through the price inquiry and notification provisions of Part VIIA of the CCA and the National Access Regime under Part IIIA of the CCA. These provisions further limit any ability of Melbourne Airport to charge excessive prices.

In addition, any risk that airports may use their market power in a manner adverse to competition between airlines (or in other downstream markets) is curtailed by the general restrictive trade practices provisions of Part IV of the CCA, including the recently expanded prohibition on the misuse of market power under s46 of the CCA.

Where specific issues are raised through primary submissions by other stakeholders, Melbourne Airport may make additional submissions with the objective of providing constructive input to consideration of any remedies that might be necessary.

No case for change

While there have been calls in previous reviews by some stakeholders to increase levels of economic regulation on airport assets, a case for change has not been made.

In 2017 A4ANZ was established as a lobby group representing Qantas Group, the Virgin Group, Rex and Air New Zealand, to campaign primarily for reform of economic regulation relating to airports. A4ANZ's case is that airport privatisation has failed, resulting in increased charges on airlines, and that consumers are being impacted.

Proposals to increase the threat of regulation when the existing mechanisms have been so rarely called upon, are short-sighted and self-serving. They would increase the risk of regulatory error and would threaten the efficient delivery of economic infrastructure to facilitate growth of the sector.

As previous Productivity Commission reviews and other research have noted, airport charges have little effect on airfares.

Research commissioned by Airports Council International Europe finds that airport charges are not passed directly through to consumers, that airline ticket prices are driven by supply and demand factors, and that revenue managers set ticket prices largely without cost in mind. The Productivity Commission, too, has previously concluded that "airport charges make up such a small proportion of total airfares that even large increases in these charges are unlikely to have significant welfare effects, and will largely represent a 'distribution' between airlines and airports."[1]

Some airlines and representative groups have claimed that while airfares have declined over the past decade, airport charges have gone up, representing an exercise of market power in relation to airport

[1] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, p. 72-3

pricing. Setting aside that domestic airfares have increased significantly over the past two years, and are now higher than they were five years ago, this longer-run trend in airfares has reflects significant declines in the key costs of providing services for airlines. This is not the case with aeronautical infrastructure services; in fact, it has been the opposite in Australia.

As passenger demand has grown strongly, particularly in the peak periods, extra capacity has been required to meet that demand, and the costs for an airport that needs to meet growing demand by increasing capacity is significantly more than an airport that has adequate infrastructure. Investment in airport capacity enables the supply of airline services and expanded airline competition, while investment in new assets, such as modern check-in facilities, creates efficiencies and reduces costs for airlines. The strong passenger growth at Melbourne Airport demonstrates that the benefits of added capacity have outweighed any potential costs of impacts on supply, reflecting efficient prices.

Without increases to aeronautical prices for international passengers at Melbourne Airport (for which there is a higher cost to serve and charges are therefore higher), the strong passenger growth in recent years would not have been possible as the infrastructure to service them would not exist. The travelling public would have less choice, airlines would have less competition, and airfares would be higher as a result. The only beneficiaries from this scenario would be incumbent airlines, which by already holding market share, would have been able to improve yields on existing services through higher airfares.

While the ACCC reports that revenue per passenger at Melbourne Airport has increased by 31 per cent over the past decade, this measure without context does not clearly articulate that most of this increase has been caused by changes in passenger mix rather than rising prices.

At Melbourne Airport, international passenger numbers (for which the cost to service and hence charges are higher) growing faster than domestic passenger numbers have driven much of this increase, while incrementally higher prices for international passengers have funded the infrastructure required to meet demand. The price for use of the airfield by domestic airlines has increased by just 15 cents per passenger in real terms over the past decade.

Changes in price need to be considered against the backdrop of a replacing legacy infrastructure, which at Melbourne Airport is now almost 50 years old. The cost of doing so at an airport that is a live operating environment 24 hours a day, seven days a week, is much higher than the cost of greenfield development of facilities when the airport was first built.

Existing regulation is sufficient

Melbourne Airport regards the ACCC's annual monitoring report as an important aspect of the effective functioning of the economic regulatory regime covering airports. However, there are some areas where Melbourne Airport would recommend some refining of the processes and communication.

Melbourne Airport's principal concern with the ACCC monitoring approach is the use of earnings before interest, taxes and amortisation (EBITA) as a measure of profit. As EBITA does not capture the full capital cost associated with the provision of services, it excludes a significant expense for an expanding infrastructure asset, being interest payments.

Interest expense is a significant cost for an airport that is investing to meet growing demand. Over the past decade, Melbourne Airport has incurred $1.3 billion in interest expense, reflecting 35 per cent of total expenses incurred over the past decade. Interest expense has more than doubled over the past decade even as interest rates have declined, reflecting the increase in debt to fund the delivery of infrastructure.

Melbourne Airport acknowledges the challenges for the ACCC to measure profitability, particularly for specific services types that are measured in the ACCC reports, as it is difficult to allocate interest expense for different activities. However, by not capturing this expense, EBITA profits fail to accurately

reflect the most significant cost of operating, maintaining, and adding capacity to a 50-year-old infrastructure asset. As such, it can dramatically inflate the profitability of airports.

Melbourne Airport considers that return on assets is a more accurate measure of airport profitability when compared to measures of operating profit or operating profit per passenger.

Whilst both operating profit and the return on assets measures do not include interest expense, return on assets better captures the investment in assets that expand the capacity and improve the efficiency of the airport, which are associated with rising interest expense.

In the case of Melbourne Airport, the aeronautical return on assets has generally decreased over the past decade, from 15.6 per cent in 2007-08, to as low as 8.2 per cent in 2014-15 and 2015-16 with the opening of Terminal 4, before increasing slightly to 9.7 per cent in 2016-17.

The rate of return on aeronautical assets at Melbourne Airport since introduction of the light-handed regulatory regime has generally been within the range of returns that would be expected of an Australian airport.

1.4 Structure of this submission

In line with the weight given to aspects of the economic regulation of airports covered in the Issues Paper, this submission devotes most attention to matters relating to aeronautical services.

Chapter 2 provides a comprehensive overview of Melbourne Airport. It puts the development of the airport in an historical context, illustrating the looming constraints on runway capacity, the road network and the need to upgrade and enhance ageing infrastructure, including terminals. The economic significance of Melbourne Airport, including its importance for employment and tourism, is also covered in this chapter.

Chapter 3 discusses the growth of Melbourne Airport – over the longer-term, and more recently. It looks at the growth in peak demand which drives the need for aeronautical capacity, and future forecasts for passenger growth.

Chapter 4 provides an overview of why the current light-handed regulatory regime works; setting out the mix of incentives and regulation that form the current regime, and the benefits that arise from the current settings.

Chapter 5 describes the way Melbourne Airport conducts commercial negotiations, including how aeronautical prices are determined. The benefits that arise from the commercial negotiation process are explained, including the features that emerged from recent commercial negotiations with airlines.

Chapter 6 discusses aeronautical services at Melbourne Airport. It outlines how airport operations are efficient in terms of the prices set and the returns earned, and the impacts that aeronautical charges have on aviation markets. It describes how Melbourne Airport ensures the efficient delivery of infrastructure investment, and describes the investment that has been made over the past decade. It also shows the efficiency of airport operations, and the quality of service that has been provided at Melbourne Airport.

Chapter 7 sets out the features of the current regulatory framework, and the constraints that exist on airport market power. Discussion covers the role of the ACCC and its monitoring activities, and the various regulatory remedies available to deal with any exercise of market power by airports. The implications of potential changes to the current regime are also discussed.

Chapter 8 covers issues relating to car parking and ground access, while Chapter 9 deals with other matters, including retail, property and jet fuel. Concluding remarks are outlined in Chapter 10.

For ease of reference, Appendix A (page 150) provides a guide to specific sections of the submission with reference to the Issues Paper.

2 Overview of Melbourne Airport

Chapter summary:

- Melbourne Airport is the major aviation gateway to Victoria and south-east Australia, and is located approximately 22 kilometres north-west of Melbourne's central business district.
- The airport has two intersecting runways and four terminals in an integrated terminal complex.
- Melbourne Airport is curfew-free, operating 24 hours per day, seven days per week.
- The airport precinct is an anchor employer that directly supports more than 20,600 full-time equivalent jobs.
- Melbourne Airport was privatised in 1997, and is owned by institutional investors, predominantly superannuation/pension funds.

2.1 About Melbourne Airport

2.1.1 History

Melbourne Airport has been Victoria's gateway to the world for almost 50 years. In 1939 the Commonwealth Minister for Defence identified the need for a new airport site for Melbourne to replace Essendon Airport. The Tullamarine site offered opportunity for long-term growth, and was accessible to the city but far enough away from established areas to be able to operate without constraint.

Early plans for Melbourne Airport were based on meeting the long-term needs of international and domestic traffic. Initially, two runways were proposed and eventually constructed. Since the 1960s it has been envisaged that the airport would have four runways. Much of the present core airport infrastructure, including the two existing runways and the main terminal complex, was constructed in the 1960s. The first scheduled international flights took place in 1970, followed a year later by the first domestic flight.

2.1.2 Location

Melbourne Airport is the major aviation gateway to Victoria and south-east Australia for passengers and freight. The airport is located approximately 22 kilometres north-west of Melbourne's central business district and is well connected to Melbourne's freeway and arterial road network.

It is in close proximity to major industrial areas and three of Melbourne's residential growth corridors. This location and accessibility means the airport serves as a hub for the freight and logistics industry, as well as capitalises on growing labour markets.

The Melbourne Airport site is approximately 2,663 hectares in area. It is predominantly surrounded by non-urban uses to the immediate north and west. This helps protect the community and safeguards the airport from encroachment of sensitive and incompatible uses. There is urban development to the east and south of the airport, comprising a mix of residential and industrial uses.

2.1.3 Facilities

Melbourne Airport operates curfew-free – 24 hours per day, seven days per week. The airport has two intersecting runways, which are operated in different modes, mainly in response to daily wind direction or to reduce aircraft noise impacts.

The terminal complex is located on the east side of the north-south runway and south of the east-west runway. The passenger terminal complex combines international facilities (Terminal 2) with three domestic terminals (terminals 1, 3 and 4). This integrated terminals precinct enables Melbourne Airport to provide the shortest minimum connection time between domestic and international flights of all major Australian airports. The terminals precinct is served by approximately 60 hectares of apron to accommodate aircraft for loading or unloading of passengers, mail or freight, and for fuelling, parking or maintenance.

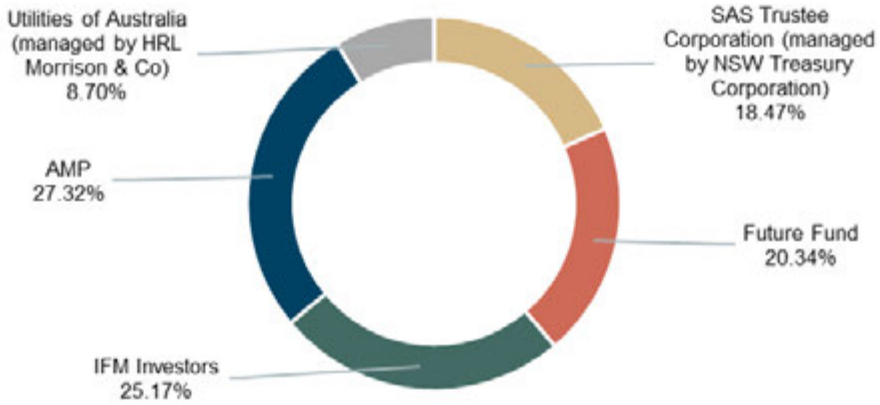
Airservices provides air traffic control, aeronautical information services, airport rescue and firefighting and navigation services for Melbourne Airport. These facilities are located in the midfield of the airport. Aircraft maintenance, repair and overhaul facilities are provided to the south of the airport.

2.1.4 Ownership

Melbourne Airport was owned and operated by the Commonwealth Government for the first 27 years of operation. In 1997, when Commonwealth airports were privatised, Australia Pacific Airports (Melbourne) Pty Ltd (APAM) became the airport-lessee company for Melbourne Airport.

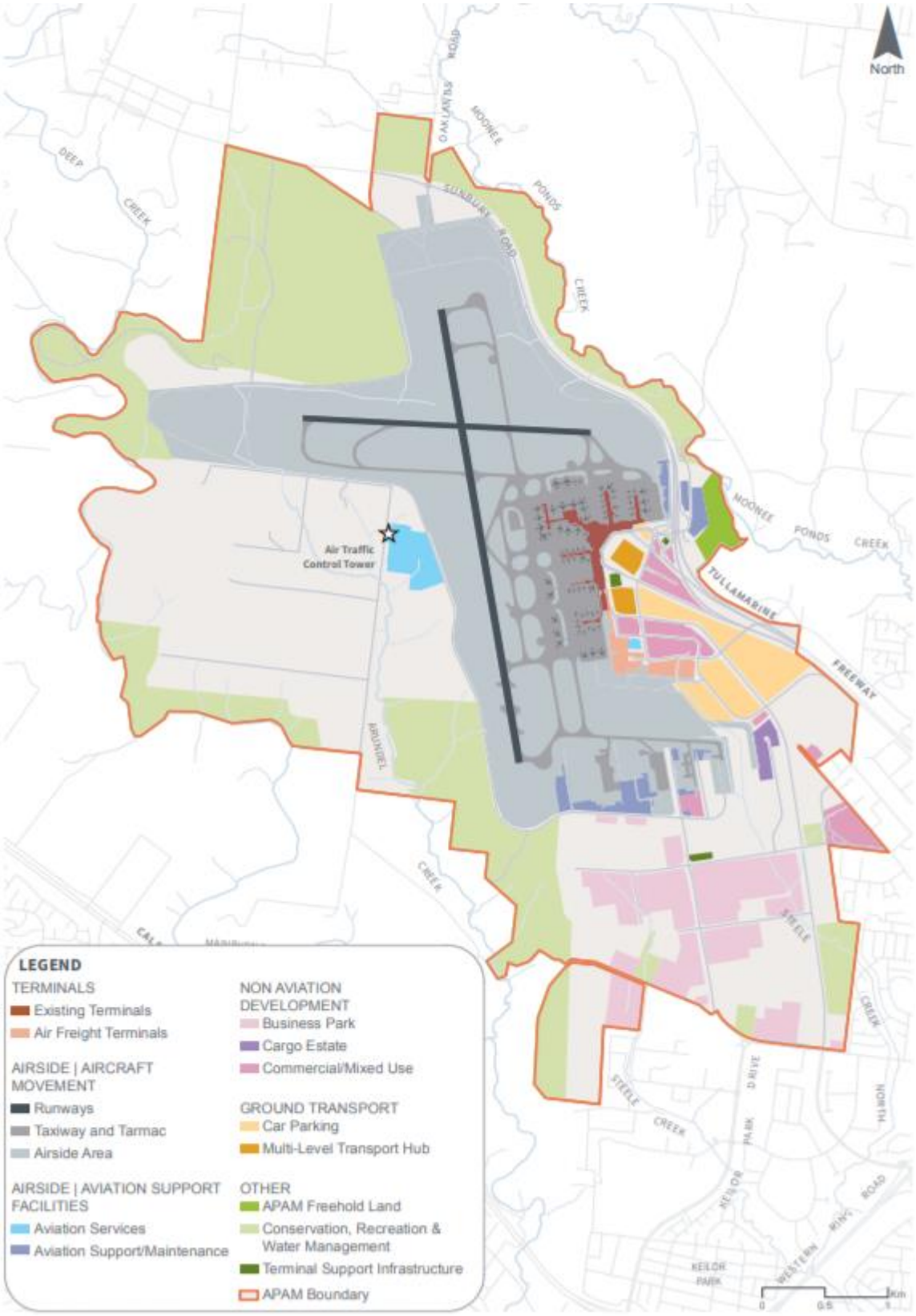
APAM is owned by Australia Pacific Airports Corporation Limited (APAC). APAC is a privately held corporation owned by institutional investors, predominantly superannuation/pension funds. The funds are owned, managed or represented by the following five entities.

Figure 2.1: APAC ownership structure



The Commonwealth Government retains ownership of the site and has responsibility for control over land-use planning and development on airport land, including all leased land under the provisions of the *Airports Act 1996* (Cth).

Figure 2.2: Map of Melbourne Airport



2.1.5 Melbourne Airport Vision and Strategy

Melbourne Airport's guiding vision is to create an airport Melbourne can be proud of. A number of key areas of focus have been identified, to be able to deliver upon this vision:

- capturing an unprecedented growth opportunity through increased airport capacity, amenity and scope;
- delivery of a modern facility that enables airline customers to grow sustainably, at an efficient airport committed to the traveller experience;
- delivering tangible benefits to communities; and
- achieving consistently strong returns for our shareholders while driving job-creating growth and adding value to the entire airport estate.

Melbourne Airport has the following five strategic pillars that articulate how Melbourne Airport will deliver on this vision:

- drive aviation growth;
- generate additional value through commercial businesses and improve efficiency;
- build the right infrastructure at the right time, and at the right price;
- operate safely and meet regulatory obligations; and
- be the best we can be.

2.2 Economic contribution

Melbourne Airport makes a significant contribution to the Victorian economy as a critical component of tourism and trade-based industries that support jobs and create economic growth.

As Australia's second busiest passenger airport, Melbourne Airport connects passengers to their destinations across Australia and right around the world. It also facilitates tourism and airfreight that contribute to the national economy.

A report commissioned by the Victorian State Government found that in 2015-16 the economic activity of businesses operating within the airport precinct contributed $7 billion to the Victorian economy.[2] Melbourne Airport contributed to $20.7 billion of economic activity across Australia in 2015-16, including $17.6 billion in Victoria. This is equivalent to almost seven per cent of Victoria's total economic activity.

This includes airfreight that was transported through Melbourne Airport that facilitated $4.3 billion in economic activity, of which $3.7 billion was in Victoria. In 2016-17 exports passing through Melbourne Airport were worth $5.5 billion.

A typical daily international flight contributes $109.1 million to the Victorian economy and supports more than 1,000 jobs per annum. A typical daily domestic service used by interstate visitors adds $16.2 million to the state's economy.[3] As Melbourne Airport continues to grow, so will the economic activity that it supports.

2.2.1 Employment

The airport precinct is an anchor employer that directly supports more than 20,600 full-time equivalent (FTE) jobs.[4] It is an important employment hub for the local community, with nearly two-thirds of employees living within the seven surrounding municipalities.

[2] The economic contribution of Victoria's major airports, DEDJTR September 2017
[3] Ibid
[4] Economic Impact Assessment, Runway Development Program (unpublished)

Proximity to Melbourne Airport can create significant benefits for those who are involved in airport-related industries, such as the export and import of goods, while passengers travelling through Melbourne Airport support other industries in the local economy such as hospitality.

There are 237,000 jobs located in the local region surrounding the airport. The most significant industries in the area include manufacturing, retail, transport and warehousing, construction, and health care. Around 44 per cent of employed people who live in the local region surrounding Melbourne Airport also work in the region.

The local region has an unemployment rate higher than the unemployment rate across Greater Melbourne. The role of the airport as a local employment hub is particularly important for the local community.

More broadly, economic analysis for the Victorian Government found that Melbourne Airport directly and indirectly supports around 170,000 jobs across Australia, of which almost 150,000 are in Victoria. The movement of airfreight supported more than 31,000 of these jobs nationally, of which more than 28,000 were in Victoria.

2.2.2 Tourism

Melbourne Airport is a key tourism hub for Australia, which facilitates 29 per cent of all international visitor nights to Australia and 21 per cent of total visitor expenditure across the country. During 2015-16 Melbourne Airport facilitated 71.9 million visitor nights and $8.9 billion in tourism spending in Victoria, supporting 75,100 FTE jobs across the state and another 10,000 throughout Australia.[5]

International students are a key source of international visitors, representing nearly 30 per cent of international visits to Victoria. In 2016-17 more than 200,000 international students were enrolled in Victorian education institutions, generating $9.1 billion in export revenue for Victoria, supporting almost 58,000 Victorian jobs.[6]

[5] The economic contribution of Victoria's major airports, DEDJTR September 2017
[6] https://economicdevelopment.vic.gov.au/priority-industries-sectors/international-education

3 Growth at Melbourne Airport

Chapter summary:

- From servicing around 3 million passengers per year in the early 1970s, passenger numbers have grown at an average of 5.5 per cent a year to reach 36.7 million passengers in 2017-18.
- It took Melbourne Airport 22 years of operation to reach 10 million annual passengers, an additional 14 years to then reach 20 million annual passengers, and just 10 years to reach 30 million annual passengers.
- Domestic passengers account for over 70 per cent of traffic through Melbourne Airport, with 25.8 million domestic passengers flying through Melbourne Airport in 2017-18.
- International passenger numbers have more than doubled over the past 10 years to 10.9 million passengers annually.
- Growth in passenger numbers during peak travel periods has increased significantly over the past 12 years.
- Total passenger numbers are forecast to grow from 36.7 million in 2016-17 to 67.8 million in 2037-38.

3.1 Passenger growth

Strong passenger growth has been the long-run trend at Melbourne Airport since it was opened in 1970, consistent with the strong global growth in the aviation industry as technology has advanced, making air travel more affordable than ever before. Despite strong long-run passenger growth, it has been shown that demand is vulnerable to economic downturns or shocks to the aviation industry.

More recently, passenger growth has been a result of international demand from emerging economies such as China, and lower airfares have supported growth. Strong growth rates off a mature passenger base have been stretching airport capacity, particularly in peak periods.

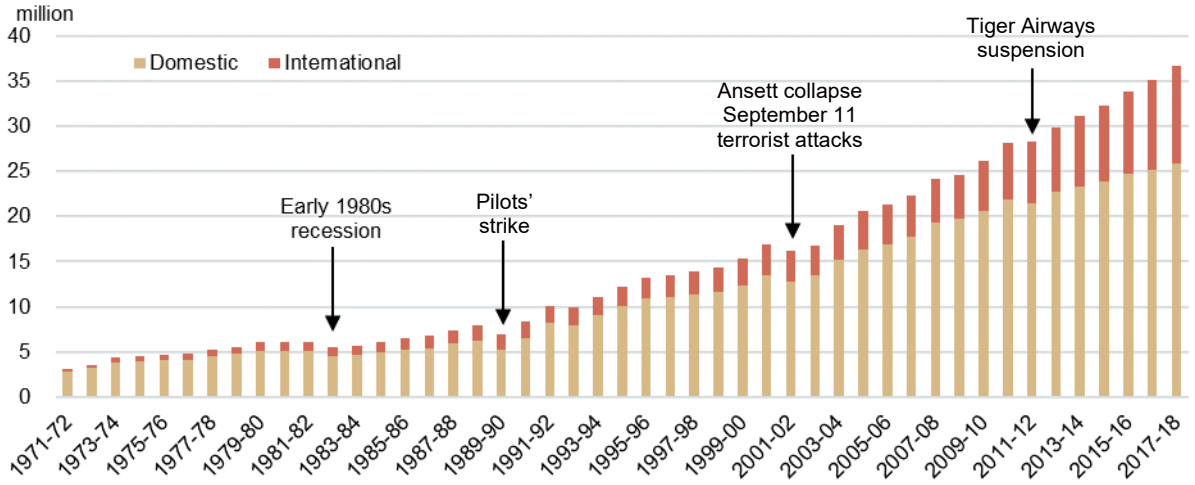
3.1.1 Long-run passenger growth

The aviation industry has continued to grow and expand over the past 50 years, and Melbourne Airport is no exception. From servicing around 3 million passengers per year in the early 1970s, passenger numbers have grown at an average of 5.5 per cent a year to reach 36.7 million passengers in 2017-18.

Long-run growth in passenger numbers has been strong, however passenger numbers can be subject to downturns because of economic shocks, or developments in the aviation industry. In terms of economic shocks, in the early 1980s five consecutive quarters of negative economic growth from March 1982 to March 1983 coincided with flat passenger growth in 1981-82, and a 9.3 per cent decline in 1982-83. The less-severe early 1990s recession coincided with a year of strong passenger growth, but this was due to the pilots' strike in 1989-90 that had significant impacts on aviation services in Australia.

The collapse of Ansett, which occurred around the same time as the September 11 terrorist attacks in 2001, also negatively impacted passenger growth, whilst more recently, the suspension of Tiger Airways services in 2011, which was followed by reduced services, resulted in a decline in total domestic passengers travelling through Melbourne.

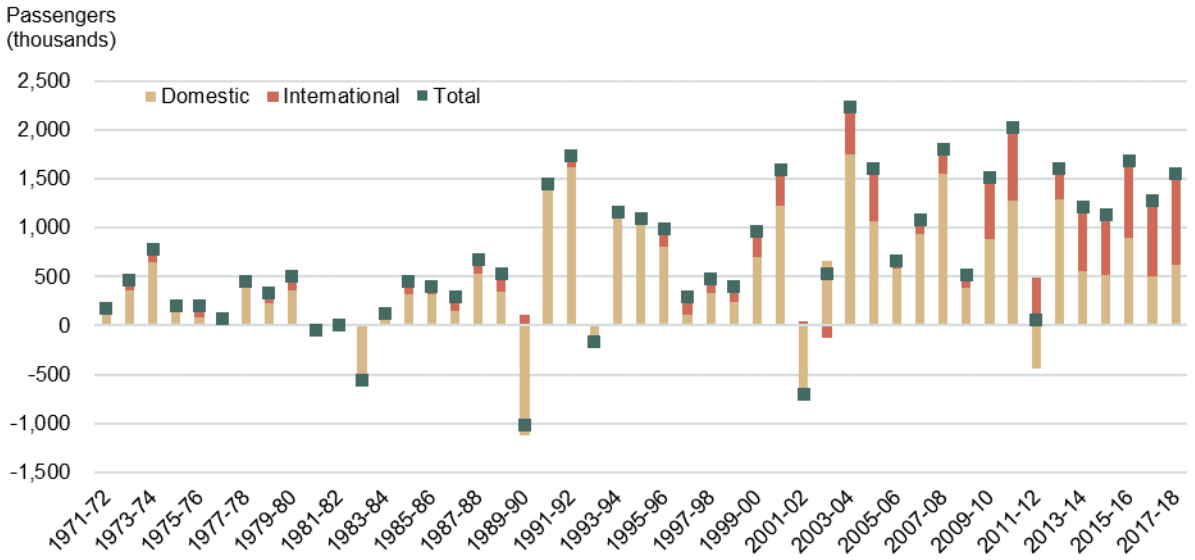
Figure 3.1: Annual passenger numbers, Melbourne Airport



Source: Melbourne Airport

Recent passenger growth, whilst in line with long-run average growth, is historically high in terms of the volume increase in passengers using Melbourne Airport. Annual passenger numbers have increased by more than 1 million passengers a year for each of the past six years. For example, it took Melbourne Airport 22 years of operation to reach 10 million annual passengers, an additional 14 years to then reach 20 million annual passengers, and just 10 years to reach 30 million annual passengers.

Figure 3.2: Additional annual passengers, Melbourne Airport



Source: Melbourne Airport

3.1.2 Industry trends over the past decade

Air travel around the world has increased by 60 per cent over the past decade, driven by developments in the aviation industry and strong economic growth in emerging markets. Air travel is now affordable and accessible to more people.

Low-cost carriers have become important parts of both the domestic and international markets over the past decade. In Australia, both Jetstar and Tigerair (and Virgin under its earlier brand of Virgin Blue) have become major suppliers of air travel to the domestic market. This growth has been supported out

of Melbourne Airport with the construction of Terminal 4, specifically designed for the primary service of these airlines.

More recently, lower fuel costs for airlines have continued supporting growth in the supply of air travel, increasing competition and supporting lower fares, particularly in the international market. This growing competition within the aviation industry has led to increased customer expectations and pressure to reduce costs.

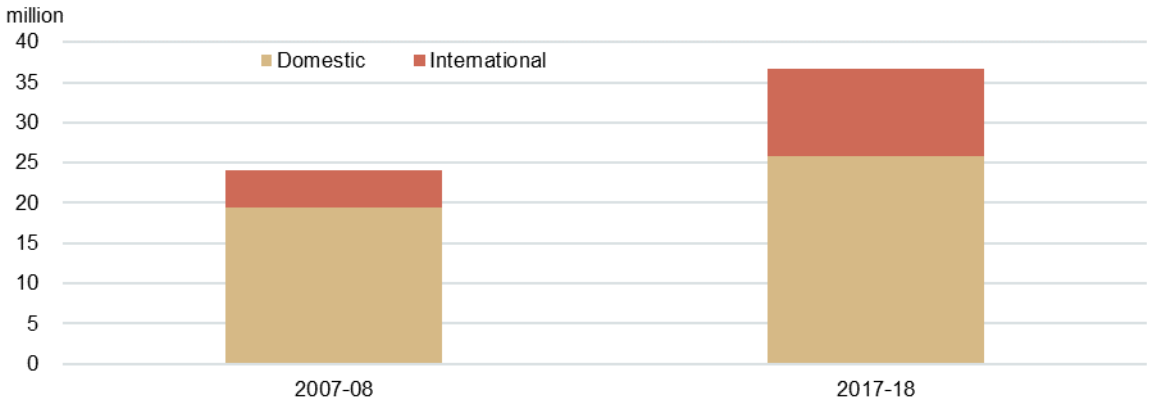
Strong economic growth in emerging markets has created a new middle class in these countries, which has been a key driver for demand of international travel for both tourism and business. Australia has benefited from economic growth in Asia, particularly countries such as China.

Over the past two years, domestic seat capacity has not kept pace with growth in demand and domestic operators have increased airfares substantially (see Box 6.1, page 58).

3.1.3 Passenger growth over the past decade

In 2017-18 Melbourne Airport serviced 36.7 million passengers – 12.6 million passengers more than it did just a decade earlier (24.1 million). This reflects a 52.1 per cent increase in total passenger numbers, including 6.5 million additional domestic passengers (33.5 per cent increase), and 6.1 million additional international passengers (a 127.6 per cent increase).

Figure 3.3: Change in Melbourne Airport passengers over past decade



Source: Melbourne Airport

3.1.3.1 Domestic market

Over the past decade, domestic passenger numbers have increased by 33.5 per cent to 25.8 million passengers, up from 19.4 million in 2007-08, reflecting average growth of 2.9 per cent a year.

Sydney is the largest market, with 8.7 million passengers flying between Australia's two largest cities in 2017-18, representing an increase of 2.3 million passengers over the decade. The Melbourne-Sydney market is more than double the size of the Melbourne-Brisbane market, with 3.5 million passengers flying between the two cities in 2017-18.

Of the top 10 domestic destinations out of Melbourne, passenger growth was the strongest on the Melbourne to Cairns route, with a 79.6 per cent increase in passenger numbers over the past decade. Growth on the Melbourne to Hobart route was also strong, increasing by 50.6 per cent. Growth in passengers travelling to these destinations reflects the emergence of low-cost carriers over the past decade.

Table 3.1: Top 10 domestic destinations, Melbourne Airport

Passengers ('000)	2007-08	2017-18	Change	Change (per cent)
Sydney	6,332.6	8,667.2	2,334.6	36.9
Brisbane	2,496.3	3,541.0	1,044.7	41.8
Adelaide	1,890.8	2,449.3	558.5	29.5
Perth	1,643.1	2,031.5	388.4	23.6
Gold Coast	1,557.2	1,922.3	365.1	23.4
Hobart	1,070.6	1,612.7	542.2	50.6
Canberra	1,009.6	1,153.7	144.1	14.3
Launceston	816.5	954.2	137.7	16.9
Cairns	460.8	827.7	366.9	79.6
Sunshine Coast	441.7	523.2	81.4	18.4

Source: Melbourne Airport

3.1.3.2 International market

The international market has experienced strong growth over the past decade, growing from 4.8 million passengers in 2007-08 to 10.9 million passengers in 2017-18 – a 127.6 per cent increase reflecting average growth of 8.6 per cent a year.

This strong growth in international demand has seen the number of international carriers operating out of Melbourne Airport increase to meet the market, from 21 in 2007-08 to 35 in 2017-18. This reflects the growing demand for international air travel, and the competitive environment in which international carriers operate.

Table 3.2: International carriers operating out of Melbourne Airport

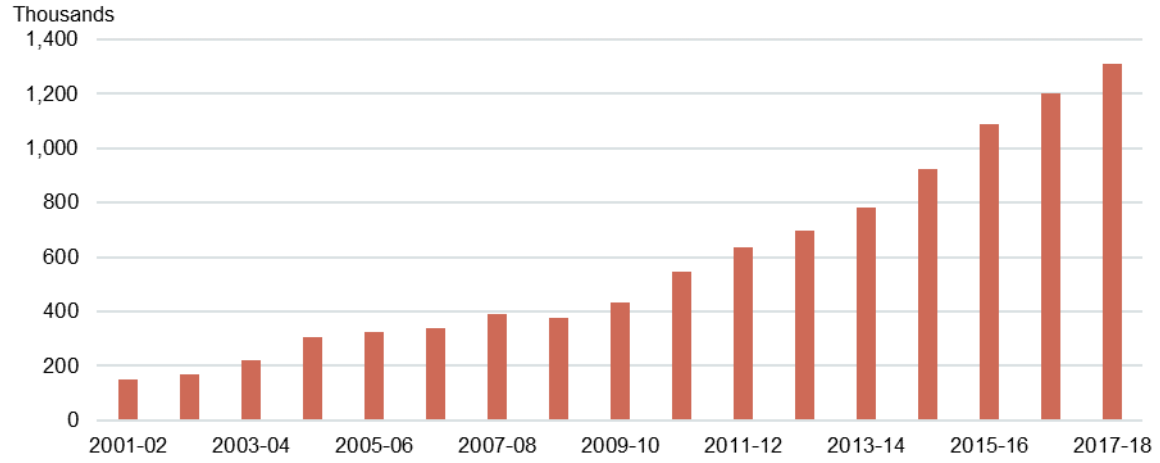
Airlines operating in 2007-08 and 2017-18	Airlines that have ceased operating since 2007-08	Airlines that are now operating that were not in 2007-08
Qantas	Korean Air	AirAsia X
Jetstar	Air Mauritius	Etihad
Virgin Australia	Asiana	Qatar
Emirates	Freedom Air	Royal Brunei
Singapore		Sri Lankan
Air New Zealand		Japan
Cathay Pacific		Hainan
China Southern		Air India
Thai		Xiamen
Malaysia		China
Garuda		Sichuan
China Eastern		LATAM
Air China		Beijing Capital
Vietnam		Tianjin
United		Aircalin
Fiji		Air Canada
Philippine		Scoot
		Malindo

Source: Melbourne Airport

The emergence of the Chinese market has seen strong growth in this sector. In 2001-02 there were just 151,000 passengers flying to or from China. By 2007-08 this had increased by 158 per cent to 390,000 passengers. At that time, there were three dedicated Chinese carriers servicing three different destinations directly.

In 2017-18 there was over 1.3 million passengers flying to China, a 236 per cent increase reflecting annual average growth of 12.9 per cent. There are now eight Chinese carriers flying to 12 different destinations. These carriers now have a 10 per cent market share of all international traffic flying out of Melbourne, up from just three per cent a decade earlier.

Figure 3.4: Number of passengers travelling to/from China, Melbourne Airport

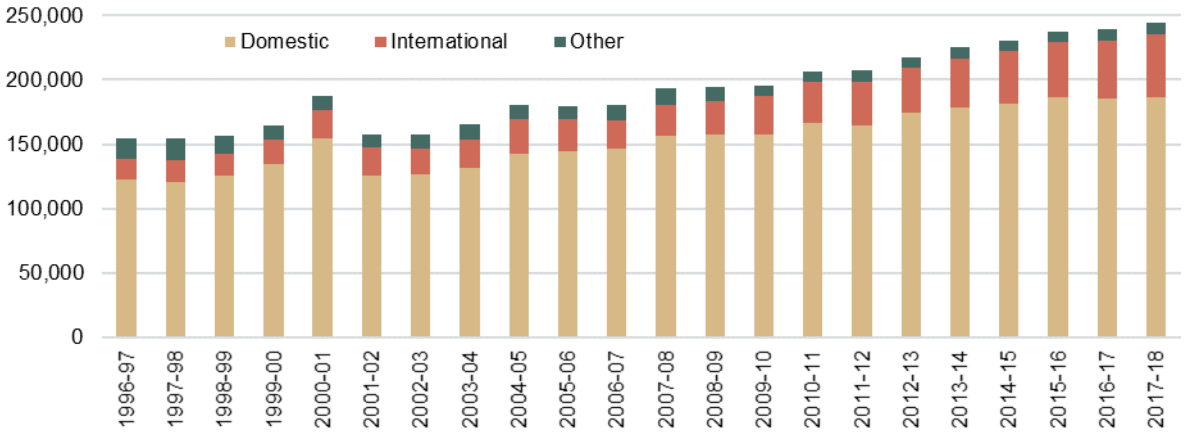


Source: Department of Home Affairs

3.2 Aircraft movements

The total number of aircraft movements in and out of Melbourne Airport since privatisation has increased from 154,200 in 1996-97 to 244,500 in 2017-18 – a 58.5 per cent increase, equivalent to an additional 247 aircraft movements per day.

Figure 3.5: Long-run aircraft movements, Melbourne Airport



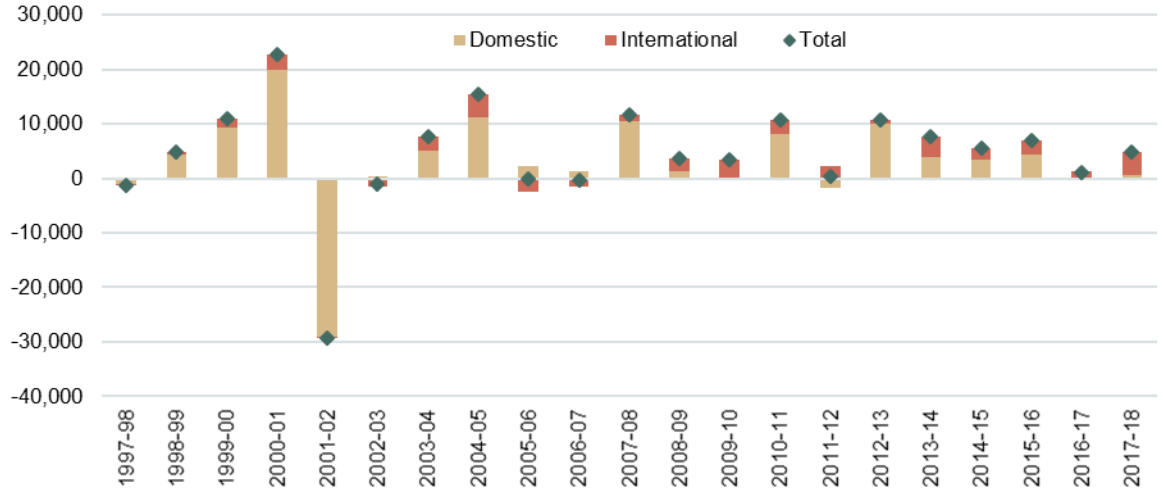
Source: Air Services Australia, Melbourne Airport

Domestic aircraft movements have driven most of the increase, with an additional 64,200 domestic passenger flights to or from Melbourne since 1996-97 – an increase of 52.6 per cent. International movements have increased by 190.8 per cent since privatisation, reflecting an additional 32,000 international flights in 2017-18.

The number of other aircraft movements, which includes freighter aircraft, has fallen since privatisation by 39.4 per cent, from 15,300 flights per year to 9,300. This downward trend in freighters reflects airlines increasingly carrying freight in the belly of passenger aircraft to improve the profitability of passenger flights, reducing the need for dedicated freight aircraft.

International movements have grown at a faster rate than domestic movements, but off a smaller base. This can be seen in the change in annual aircraft movements, which has been driven primarily by domestic aircraft. The impact of strong international passenger growth on aircraft movements is not as strong as international aircraft are generally larger and carry more passengers. Despite this, over the past five years the increase in international aircraft movements has exceeded the increase in domestic aircraft movements (Figure 3.6).

Figure 3.6: Change in annual aircraft movements, Melbourne Airport



Source: Airservices Australia, Melbourne Airport

3.3 Freight

Airfreight is used to move high-value, time-sensitive and perishable items that need to be delivered to customers or markets quickly. Almost half a million tonnes of airfreight passed through Melbourne Airport in 2016-17. Melbourne Airport's 24-hour operation and the growing number of international services provide new opportunities for exporters in south-east Australia to reach the growing demand of international markets.

In 2017-18 Melbourne Airport handled 307,000 tonnes of international airfreight worth $17.5 billion.[7] This represents over 30 per cent of Australia's international airfreight market. Approximately 85 per cent of international airfreight that moves through Melbourne Airport is carried in the belly of passenger aircraft, with the remainder transported on dedicated freighters.

A diverse range of products are exported, from fresh fruit, vegetables, dairy products, meat and fish, to medicines and medical products, electrical parts, and precious stones and metals. These goods are delivered to multiple destinations, with leading export countries being China, Singapore, Malaysia, New Zealand and the United Arab Emirates.

Four international dedicated freight airlines currently service Melbourne Airport. Melbourne is also a key domestic airfreight hub, with 186,000 tonnes of airfreight delivered around the country in 2016-17.[8] Around half of this was transported in passenger aircraft.

Melbourne Airport does not levy any direct charge on the freight that is carried by passenger aircraft, where only per passenger fees apply (dedicated freight terminals are subject to individual lease agreements). Dedicated freighter aircraft incur fees for the use of the airfield which are based on weight.

[7] MariTrade, based on ABS data
[8] Melbourne Airport Master Plan 2018 Preliminary Draft

3.4 Peak demand

The strong growth in passenger numbers through Melbourne Airport increases the demand for airport services and infrastructure. This demand is concentrated around specific time periods, creating significant peaks which are outlined and examined in this section.

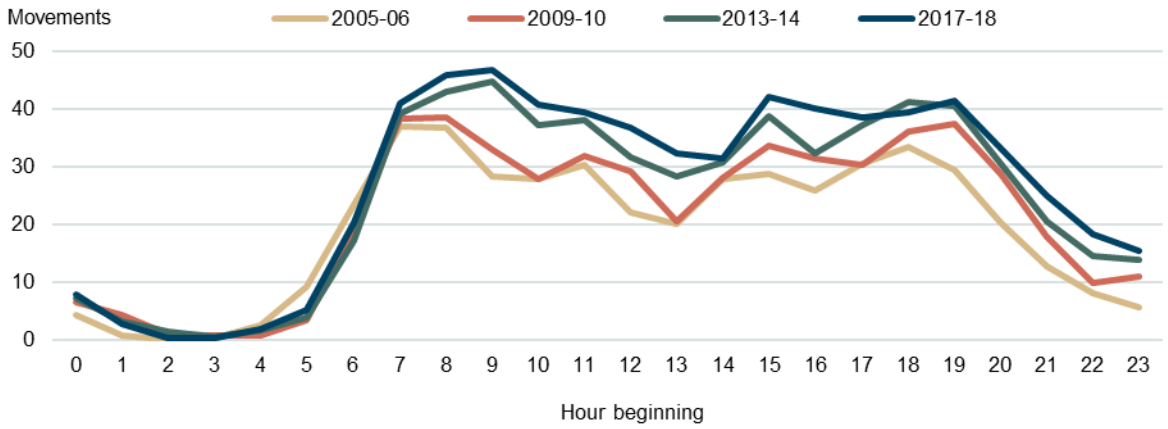
3.4.1 Peak aircraft movements

The amount of aircraft that can operate in peak periods is determined by the limitations of the existing airfield infrastructure at Melbourne Airport, including runways, taxiways and aprons, and terminal gates.

In 2005-06 the peak hour for aircraft movements was between 7am and 8am, where on average there were 37 movements per hour. In 2017-18 the peak hour has increased in number to 47 movements, with the peak spread much wider across the morning. Similarly, the afternoon peak is also now much wider than it was previously. The spreading of the peak can be attributed to, in part, the constraints of existing capacity.

Melbourne Airport is an end-of-line destination, servicing hub airports such as Singapore, Hong Kong and Dubai. As such, Melbourne is a time-taker, with departure and arrival times driven by airlines providing connections to passengers transferring to other flights in those hubs. Melbourne's international peak overlaps with the domestic peak, driving demand for shared airport infrastructure such as future runway capacity, taxiway capacity, landside roads and additional aircraft parking apron across the precinct. This is reflected in the shift in the peak to become slightly later, given the strong growth in international passenger traffic.

Figure 3.7: Average aircraft movements by hour, Melbourne Airport



Source: Melbourne Airport

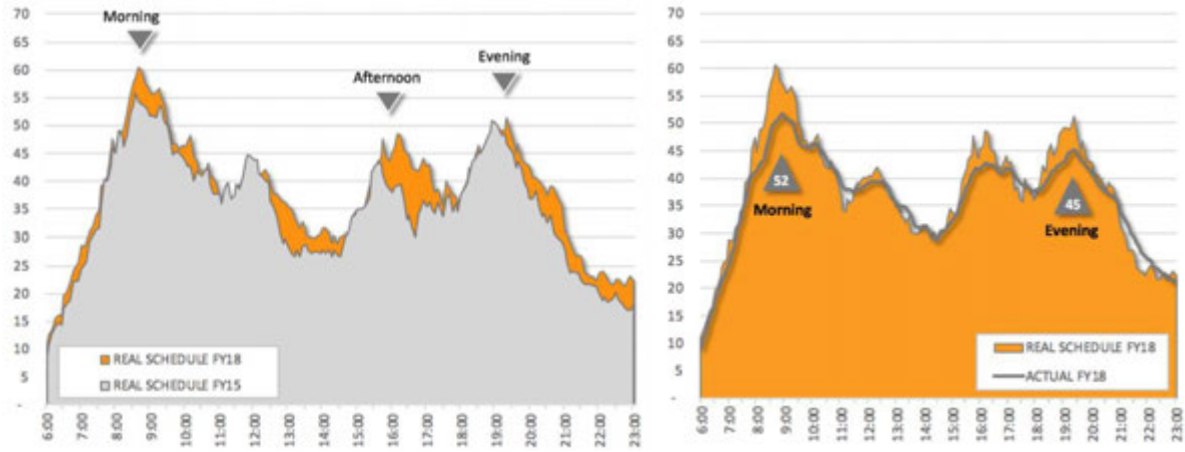
This increase in peak and shoulder demand is resulting in constrained runway capacity. Airservices Australia has determined that crossing runway modes have a capacity of between 48-60 movements per hour, with capacity reduced to as few as 18 movements per hour in very unfavourable weather conditions.

The average aircraft movements outlined above reflects the simple average over the entire year. In practice, actual peak periods are higher than presented as aircraft movements will be greater on weekdays compared to weekends for example. While not shown in the growth in aircraft movements, the midnight peak is now experiencing congestion on apron assets due to the high amount of domestic inactive aircraft parked overnight on remote aircraft stands.

Where runway capacity is unable to meet demand, flights can suffer delays affecting the on-time performance of airlines and causes flight cancellations. Currently, average scheduled demand exceeds

average runway capacity by 20 per cent in the weekday morning peak. This is a combination of both international and domestic aircraft movements, driven primarily by the larger domestic market serviced by smaller aircraft earlier in the morning, with stronger international growth adding to growth in aircraft movements later in the morning.

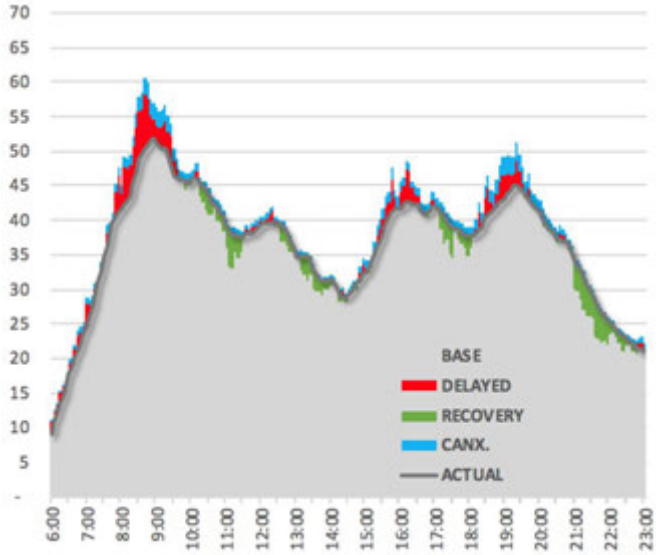
Figure 3.8: Scheduled and actual aircraft movements (business days), Melbourne Airport



Source: Melbourne Airport

This oversubscription of morning services results in delayed flights, with time then recovered throughout the day (Figure 3.9).

Figure 3.9: Pattern of delayed services and recovery, 2017-18 business days, Melbourne Airport



Source: Melbourne Airport

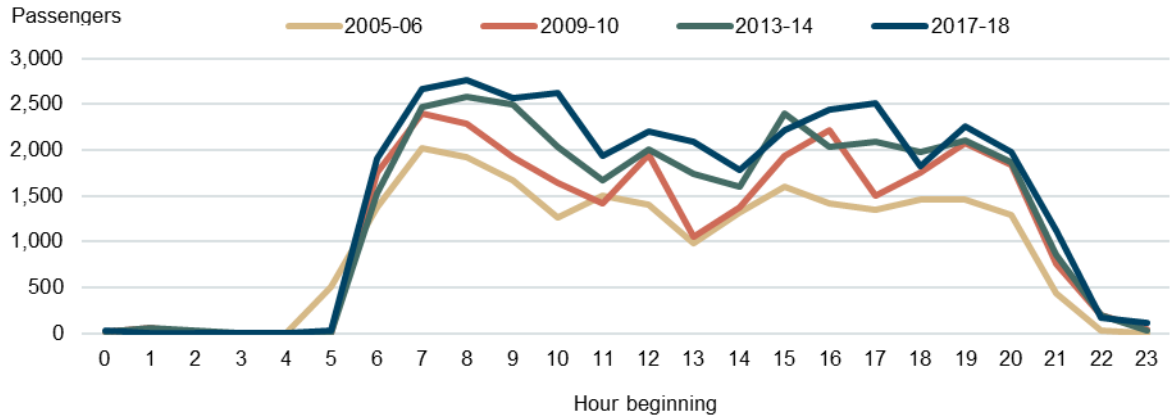
For peak-hour capacity to continue to grow, a third runway will be required to allow for a parallel runway system to operate. Melbourne Airport is one of the busiest airports in the world without a parallel runway system. Capacity on the current crossing runway system is being exceeded today, with scheduled flight cancellations and delays becoming increasingly frequent, and recovery from delays becoming more difficult to achieve. Melbourne Airport is currently developing a Major Development Plan for an additional east-west runway (see Box 6.8, page 84) as part of its Runway Development Program.

3.4.2 Peak passenger movements

While aircraft movements give an indication of the demand for the use of airfield infrastructure, passenger movement profiles reflect the demand for terminal infrastructure.

The number of domestic passengers departing Melbourne Airport peaks between 8am and 9am, with an average of 2,755 domestic passengers departing Melbourne Airport during that hour over the 2017-18 year. This represents a 36.3 per cent increase in the number of passengers on average departing in this peak time slot compared to the peak in 2005-06. As passenger numbers have grown the morning peak has spread, with a 51.9 per cent increase in departing domestic passengers between 6am and 11am. The domestic afternoon peak between 4pm and 6pm has also experienced strong growth, increasing by 79.3 per cent since 2005-06.

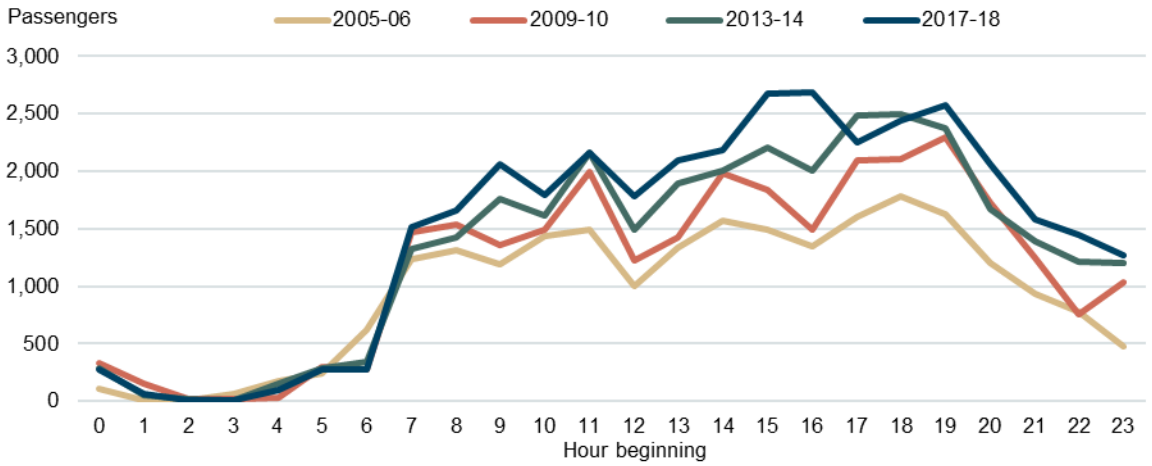
Figure 3.10: Average domestic passenger departures by hour, Melbourne Airport



Source: Melbourne Airport

In terms of domestic passenger arrivals, the peak has increased by 50.1 per cent since 2005-06, and has shifted to an earlier time in the afternoon. The peak between 3pm and 5pm now has around 2,700 passengers arriving each hour on average – an 88.4 per cent increase on the same time period from 2005-06.

Figure 3.11: Average domestic passenger arrivals by hour, Melbourne Airport



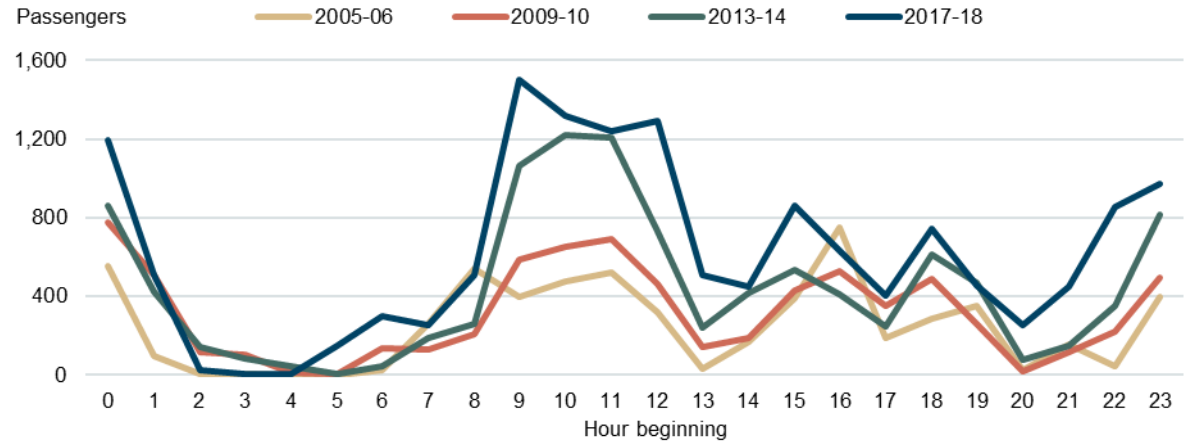
Source: Melbourne Airport

International passenger growth has been much stronger relative to domestic passengers, and this is reflected in the growth in peak periods of international passenger demand. The departure peak has moved from the afternoon to the morning, and increased from around 750 passengers per hour in

2005-06 to around 1,500 passengers per hour in 2017-18. The morning peak is now wider, with more than 1,200 passengers departing the international terminal every hour between 9am and 1pm.

A second overnight peak period has also emerged, with the per hour average number of passengers departing between 11pm and 1am increasing from around 480 in 2005-06 to almost 1,080 in 2017-18.

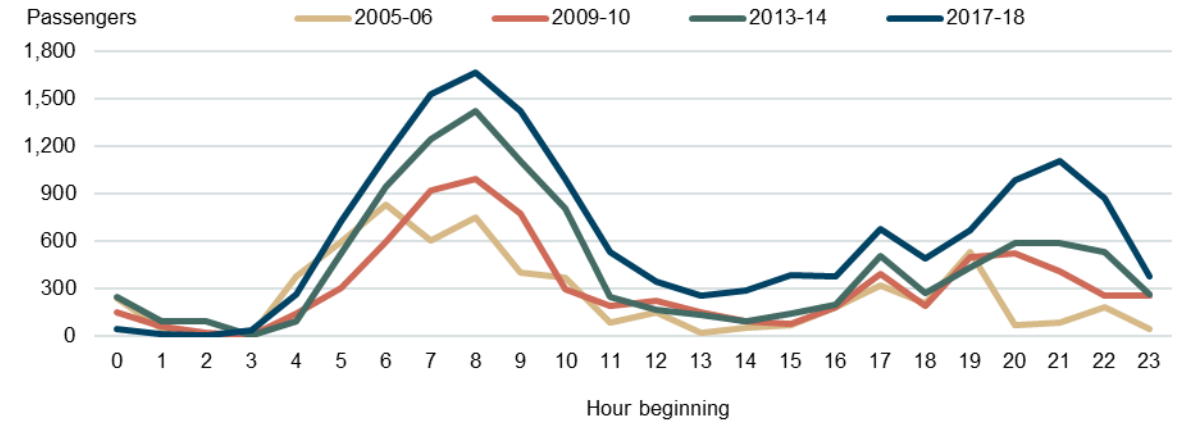
Figure 3.12: Average international passenger departures by hour, Melbourne Airport



Source: Melbourne Airport

For international, arrival peak is highest in the morning. In 2005-06 there were around 830 passengers on average arriving between 6am and 7am. In 2017-18, the morning peak hour is now between 8am and 9am, with an average of 1,660 passengers arriving. Between 6am and 11am an average of over 6,700 international passengers arrived at Melbourne Airport every day, up from just under 2,950 in 2005-06.

Figure 3.13: Average international passenger arrivals by hour, Melbourne Airport



Source: Melbourne Airport

As indicated, international passenger demand facilitated at Melbourne Airport predominantly originates or departs to a combination of point-to-point cities and global hub airports. There are similar demand drivers to domestic traffic in terms of passenger preferences; the international traffic is more dependent on external factors to Melbourne Airport such as hub windows at key global hub airports including Abu Dhabi, Dubai, Doha, Singapore, Hong Kong, Bangkok and Kuala Lumpur, where passengers transfer when travelling to other continents.

More than 45 per cent of Melbourne Airport's international traffic travels through global hub airports. These large airports have constrained slot-coordinated schedules which both restrict movement in flight times as well as encourage windows of operation to achieve high levels of short transfer times to reach

other continents such as Europe before their airport curfews impact operations. These factors have driven growth in the midnight peak, with additional services and up-gauging of aircraft primarily made up of arrival and departures to the Middle East or Asian hub airports for access to Asia and onwards to Europe, and departures to New Zealand in time for the following business day.

For airlines, the ability to move outside the peak is limited, as the times they can fly are dictated by the larger international hubs. In order to better utilise existing infrastructure and to grow international air services, Melbourne has worked with airlines to move their operations out of the 'super' peak to the shoulders, or off-peak periods where possible.

3.5 Forecasts

Total passenger movements are forecast to grow from 36.7 million in 2016-17 to 67.8 million in 2037-38. The increase of 31.1 million passengers represents overall growth of 85 per cent and an average annual growth rate of 3.1 per cent.

The domestic market is expected to account for the majority (64 per cent) of overall passenger growth, but the international market is expected to grow more quickly than the domestic market (3.6 per cent per annum versus 2.9 per cent per annum). The number of seats per aircraft in both domestic and international markets continues to grow due to revised seating layouts and larger-capacity aircraft. This trend results in a lower growth rate for aircraft movements compared with the domestic and international passenger growth rates.

Figure 3.14: Annual passenger forecasts, Melbourne Airport

Source: Melbourne Airport Master Plan 2018 Preliminary Draft

3.5.1 International passenger forecasts

International passengers are forecast to more than double by 2038, from 10.9 million in 2017-18 to more than 22 million. This reflects an average rate of growth of 3.6 per cent, with more than 11 million extra international passengers forecast to be using the airport by 2037-38.

Future growth in international passenger numbers is expected to be driven by increases in airline competition and developments in aircraft technology that reduce the cost of international travel, and the continued economic development of Asia.

Opportunities for capacity growth in new services to north Asia and the Americas are expected to be particularly strong. There is scope for continued growth to leisure destinations, primarily in Asia, while strong growth from China is expected to continue as its economy continues to develop.

Advances in aircraft technology have increased the potential range of direct services out of Melbourne, which has created the opportunity for sustainable direct connections to North American cities such as San Francisco, Vancouver and Dallas.

This outlook is in line with Tourism Australia forecasts, which over the next decade expect international visitor numbers to Australia from China to triple from 1.3 million to 3.9 million, and the United States to increase from 750,000 to 1.3 million over the same period.[9]

3.5.2 Domestic passenger forecasts

Domestic passengers are forecast to increase from 25.8 million in 2017-18 to 45.7 million by 2037-38. This increase of 19.8 million passengers reflects an overall increase of 77 per cent, or annual average growth of 2.9 per cent. Growth rates in domestic passengers have moderated recently due to the lack of any major structural changes in the domestic aviation market such as new carriers, the current economic environment that has been influenced by a slowing resource sector, and the strong growth in international outbound travel.

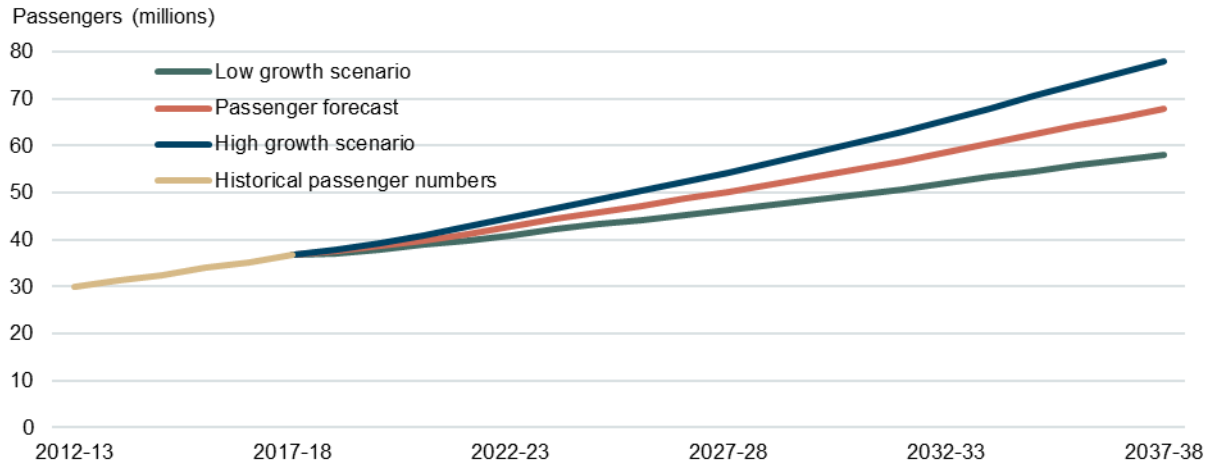
However, growth in domestic passengers is expected to be supported by advances in aviation technology and continued growth in the size of the domestic population, which reflects the size of the potential domestic traveller market in Australia. Melbourne's population is projected to grow from 4.2 million to almost 8 million by 2050, with Melbourne expected to become Australia's biggest city by 2036.

3.5.3 Passenger forecast scenarios

Total passenger movements are forecast to grow at an average of 3.2 per cent each year to reach 67.8 million in 2037-38. Given the uncertainty that comes with forecasting into the future, different forecast scenarios can provide an indication of the range which future passenger numbers could be expected to fall.

Figure 3.15 shows the Melbourne Airport passenger forecasts alongside low growth and high growth forecast scenarios. Under the low growth scenario, passenger numbers are forecast to reach 58.1 million by 2037-38, reflecting an average growth rate of 2.4 per cent a year. Under the high growth scenario, passenger numbers are forecast to grow by an average of 3.9 per cent a year to 2037-38 to a total of 78 million.

Figure 3.15: Annual passenger forecast scenarios, Melbourne Airport



Source: Melbourne Airport 2018 Master Plan Preliminary Draft

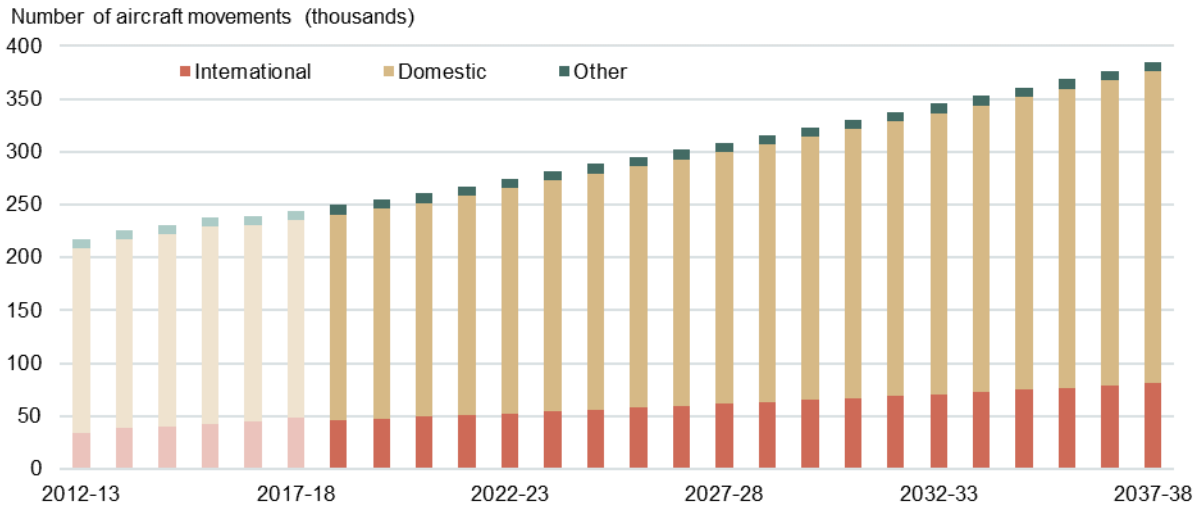
[9] *Tourism Forecasts 2017*, Tourism Research Australia, Canberra

3.5.4 Aircraft movement forecasts

Aircraft movements at Melbourne Airport are forecast to grow from 244,500 in 2017-18 to more than 384,000 in 2037-38, reflecting an overall increase of 57 per cent, at an annual average growth rate of 2.3 per cent.

The overall rate of growth in aircraft movements is lower than the projected growth in passenger movements of 3.1 per cent because the average number of seats per aircraft movement is expected to continue to increase over the forecast period.

Figure 3.16: Annual aircraft movement forecasts, Melbourne Airport



Source: Melbourne Airport Master Plan 2018 Preliminary Draft

4 Aeronautical services under the light-handed regulatory regime

Chapter summary:

- Under the light handed regulatory regime, airports are incentivised to act efficiently, including by engaging with airline customers, supporting passenger growth, making timely and necessary investments in airport infrastructure, and promoting airline competition.
- Expectations for the commercial conduct of airports are set down in the Government's Aeronautical Pricing Principles. Melbourne Airport conducts itself in accordance with these principles, and negotiates in good faith with airlines.
- The significant countervailing power of airlines constrains any exercise of market power by airports. Airports also operate under the threat of increased regulation should they attempt to exercise market power or otherwise not comply with the Aeronautical Pricing Principles.
- The light-handed regulatory regime is working, and has resulted in significant necessary investment, strong passenger growth, maintaining quality of service, and efficient prices and returns, all underpinned by voluntary agreements with airlines reached through commercial negotiation.

The move to a light handed regime was intended to give airports greater scope to undertake aeronautical investment, and more flexibility to respond to a changing aviation environment. That intention has been rewarded at Melbourne Airport: since the introduction of the current regulatory regime, there has been significant capital investment to facilitate the strong growth in passenger numbers, demonstrating that the current regulatory regime has been successful at Melbourne Airport for passengers, airlines, and the Victorian community.

Continuing to provide a quality level of service throughout a period of significant investment, in a live operating environment that never closes, is a significant achievement that should not be understated. Delivering infrastructure in this environment adds significant costs to capacity delivery when compared with the original greenfield construction costs when the airport was first constructed.

There has been much public discourse on the outcomes of privatisation generally in recent times, with much of the focus on the electricity and banking sectors in particular. The problems which have been identified in these industries have not emerged at Melbourne Airport. The light-handed regime for airport agreements works for reasons that are unique to airports. The incentives that exist in the commercial negotiation process between airports and airlines with countervailing market power provides for balanced negotiations between two parties.

Overlaid with the monitoring of airport activities by the ACCC, and other regulatory mechanisms available to the ACCC and airlines, the current framework provides the appropriate balance to enable commercially efficient outcomes, with an appropriate level of regulatory oversight.

4.1 Incentives under the light-handed regime

Under the current regulatory regime, airports are incentivised to act efficiently – including in relation to providing access to airlines, the price and terms of that access, and investment in necessary airport infrastructure.

Airports are not vertically integrated in aeronautical services, meaning that airports have no incentive to refuse access to airlines. In addition, restrictions in law and under Melbourne Airport's lease from the Commonwealth Government significantly limits any ability to deny access to airlines in practice. As a result, airports are incentivised to engage constructively with airline customers.

Further, airports charge airlines for aeronautical services on a user-pays basis – such as per passenger charges, or aircraft weight-based charges. Airports also earn revenue from non-aeronautical services (such as retail and car parking). Accordingly, the success of the airport business model is predicated on passenger numbers, and airports have a strong incentive to grow passenger numbers, to the benefit of airports and airlines.

In turn, airports have a strong incentive to invest in infrastructure necessary to meet rising demand for airport services - timely investment in infrastructure to facilitate growth is a critical factor in sustainable commercial success. Importantly, such investment must be tailored to the needs of airlines as a priority, and in practice, requires airline agreement through commercial negotiation. Melbourne Airport engages extensively with its airline customers on an ongoing basis to agree necessary investment in airport infrastructure. In addition to facilitating growth in demand, such investment creates operating efficiencies for airlines, and promotes airline competition – more airlines, flying to more destinations, which creates greater choice for passengers and works to keep airfares low. A strong airport sector delivers material economic benefits for host cities and state economies, and benefits the airport as more passengers generally drive greater profits in non-aviation airport activities.

There are 38 different airlines offering regular public transport services out of Melbourne Airport, transporting almost 37 million passengers a year. Airports need to balance the needs of these different airline customers through a mix of common user infrastructure and dedicated facilities. This results in complex agreements between airports and airlines.

Most importantly, airports are best placed to understand the implications of these agreements on the travelling public. Unlike other types of regulated infrastructure, people are at the core of the service that an airport provides. Moving people through an airport is far more complicated than sending electricity down a wire, or water through a pipe. There is a significant risk that the greater regulation of agreements between airports and airlines would result in a loss of the efficiencies that result from these complex commercial negotiations, which ultimately benefit the travelling public.

While some airports are often described as monopolies, in reality there is competition amongst airports. Melbourne Airport faces competition from domestic airports, including Avalon Airport, as well as international airports to attract airline customers. Such competition occurs on the basis of several factors, including airport charges and quality of service. Airports are therefore incentivised to adopt reasonable and competitive charges, operate efficiently and provide quality of service in order to attract airlines. Melbourne Airport is also incentivised to maximise efficiency by the terms of its commercial agreements with airlines, which include provisions regarding quality of service and set prices for extended periods of time (typically five years).

The incentives of airlines also play an important role in the current framework. As airlines price discriminate between consumers in setting airfares, any rising costs are borne primarily by airlines in the form of reduced profits, rather than by consumers through higher airfares. This gives airlines a strong incentive in commercial negotiations to minimise aeronautical prices. This incentive would be stronger than in other regulated industries where increased costs are be passed on to the end consumer, particularly in the case where the price elasticity of demand for those goods is low. In any case, increases in airline costs through airport charges reflect necessary investment in airports, which can create efficiencies and reduce costs for airlines.

4.2 Commercial negotiations under the light handed regulatory regime

Expectations for negotiations

Under the current regulatory regime, airports are free to negotiate prices and other terms and conditions of access with airport users, but are expected to do so in accordance with particular pricing principles issued by the Government and recommended by the Productivity Commission.

Those pricing principles effectively direct airports to provide aeronautical services as if those services were subject to economic regulation. In particular, the principles include that:

- prices be set to generate expected revenue that is at least sufficient to meet the efficient costs of providing the relevant service, and include a rate of return commensurate with the risks involved in providing the service;
- prices and service levels should be established through commercial negotiations undertaken in good faith, with open and transparent information exchange, and with a reasonable sharing of risks and returns; and
- aeronautical service level outcomes be consistent with users' reasonable expectations.

Melbourne Airport seeks to comply with these principles in commercial negotiations with airlines – and does so, for example, by including service levels in commercial agreements with airlines, basing aeronautical prices on a regulatory building block model, and providing the information underlying that model to airlines in negotiations.

Airline countervailing power and the threat of further regulation

In addition to being incentivised and expected to engage in good faith commercial negotiations with airlines, airports are not able to exercise any market power in negotiations with airlines for a number of reasons, including:

- the strong countervailing power of airlines – particularly in circumstances where the Australian aviation industry is structurally dependent on two dominant airlines;
- international airlines are authorised by the ACCC to collectively negotiate with airlines;
- airports are required by their Commonwealth leases to provide access to airlines;
- the ability and practice of airlines to withdraw or reduce the number of services operated from any airport; and
- as stated above, airports face competition from other airports – domestic and global.

Further, airports also operate under the threat of increased regulation should they attempt to exercise market power or otherwise not comply with the Government's expectations for airport conduct set down in the Aeronautical Pricing Principles. The threat of increased regulation exists through the potential application of the price notification regime and the National Access Regime, as well as through the risk of more direct Government intervention, such as a change in policy and legislation to return airports to heavy handed pricing regulation.

This threat is supplemented by the monitoring of airport pricing and quality by the ACCC, which acts as an 'early warning system' of potential monopolistic behaviour. Should the ACCC identify potential issues through its airport monitoring, it may recommend a pricing inquiry to the Minister, with a view to determining whether an airport has exercised any market power. To Melbourne Airport's knowledge, the ACCC has not ever recommended an airport pricing inquiry to the Minister on the basis of the

ACCC's monitoring results. To the extent that the ACCC uses its annual monitoring results to suggest further airport regulation is necessary, such suggestions are unwarranted. For example, the ACCC focuses on the metric of 'revenue per passenger' in its reports and related press coverage, which for Melbourne Airport has increased by 31 per cent over the past decade. However, most of that increase has been caused by changes in passenger mix rather than rising prices. The ACCC does not focus on the more significant metric – return on aeronautical assets – which for Melbourne Airport has fallen over the past decade.

4.3 The light-handed regulatory regime is working

Melbourne Airport considers that the light-handed regulatory regime is working, promoting necessary investment underpinned by commercial agreements and ensuring quality of service at efficient prices. Since the introduction of the regime, there has been significant and necessary capital investment at Melbourne Airport to facilitate growth, underpinned by successive, mutually beneficial commercial agreements with airlines for the supply of aeronautical services. Melbourne Airport has not exercised any market power in the form of excessive prices for aeronautical services, inefficient investments or operations, or low quality of service.

In particular, under the current regulatory regime:

- there has been significant and necessary capital investment at Melbourne Airport to facilitate growth and replace aging infrastructure – involving $1.8 billion in aeronautical investment over the past decade, including over $600 million of investment in the international terminal, and the construction of the new domestic Terminal 4;
- airport investment has involved extensive consultation with airlines to ensure that Melbourne Airport delivered the right infrastructure solution, at the right time, and has been underpinned by successive, mutually beneficial commercial agreements with airlines. While commercial negotiations with airlines can be complex and challenging, this reflects the bargaining power of both parties and the balanced nature of negotiations, and is to be expected in significant commercial negotiations between sophisticated businesses;
- quality of service has been maintained over this period of rapid change, investment and growth, an achievement that should not be underestimated;
- prices for aeronautical services at Melbourne Airport remain efficient and reasonable. The price of using the airfield for domestic aircraft has increased by just 15 cents per passenger in real terms over the past decade, while increases in international prices per passenger reflect necessary investment in airport infrastructure and remain reasonable when compared to the prices at other airports; and
- the rate of return on aeronautical assets at Melbourne Airport has generally been within the range of returns that would be expected of an Australian airport.

In summary, the light-handed regulatory regime has not resulted in any market failure. As a result, there is no justification for further economic regulation of airports.

5 Commercial negotiation of aeronautical agreements

Chapter summary:

- By directly engaging in commercial negotiations with airlines, airports are able to deliver efficient outcomes that best meets the needs of all parties, including the travelling public.
- The regulatory framework influences the commercial negotiation process, resulting in a set of conventions on which commercial negotiations are based, including the building block model.
- Efficiencies emerge through the consultation that takes place as part of the commercial negotiation process, which results in benefits for all parties.
- The 2017 ASA negotiations reflect the ongoing revolution of agreements between airports and airlines, resulting in a number of new features.
- Airlines bring significant market power to negotiations supported by the regulatory framework, which enables meaningful and beneficial negotiations.

5.1 Commercial negotiations with airlines

One of the key features of the light-handed regulatory approach is the commercial outcomes that are negotiated between airports and airlines. By directly negotiating with airlines, airports are able to deliver an efficient service that best meets the needs of the travelling public, and the wider Victorian and Australian economies.

Commercial negotiations between Melbourne Airport and airlines are underpinned by a set of conventions. These include the Aeronautical Pricing Principles set down by the Government and recommended by the Productivity Commission, which underpin the building block model used to formulate aeronautical prices, and the line-in-the-sand valuation of aeronautical assets that has been in place since 2005. These conventions arise from the light-handed regulatory framework that currently applies to aeronautical agreements.

While not strictly enforced, these conventions reflect the approach that would be used by a regulator if it became involved in determining aeronautical agreements. The use of these conventions by Melbourne Airport indicates that the threat of regulation under the current light-handed settings is real, and influences Melbourne Airport's approach to commercial negotiation.

For the most part, major commercial negotiations are undertaken with four main organisations: Qantas Group, Virgin Group, the Board of Airline Representatives of Australia (BARA), and Rex. These four organisations comprise the majority of Melbourne Airport's customers, giving them significant countervailing power in the negotiation process. The countervailing market power of airlines is strengthened due to the terms of the lease under which Melbourne Airport operates, which limits the ability for it to refuse access to airport facilities.

Negotiations with airlines are complex and often difficult. They involve agreements that not only include an agreed level of service, but detailed plans for the future development and investment of the airport. Consultation on planned investment forms a key part of the negotiation process, which results in the most efficient solutions being found to what are complex challenges, particularly when growth in demand has been so strong.

While commercial negotiations can be complex, protracted and not always pleasant, this reflects the bargaining power of both parties, and is to be expected in significant commercial negotiations between sophisticated businesses. As the Productivity Commission noted in 2011, such commercial tensions are not reflective of systemic failure of the light-handed regime:

> *Airports are passenger throughput-based businesses with long-term horizons whereas airlines typically operate with shorter horizons. Commercial tensions are to be expected and airlines' dissatisfaction is not indicative of systemic failure…*
>
> *…Given these characteristics, it would be remarkable if commercial negotiation was conducted smoothly.*[10]

As a federally leased airport, Melbourne Airport is required to provide access to airlines that request it. This, alongside the current threat of the light-handed regulatory regime, the countervailing power of airlines, and the incentives for Melbourne Airport to grow, means it is not in the interest of Melbourne Airport to simply adopt a 'take it or leave it' approach to negotiations.

In that context, Melbourne Airport approaches commercial negotiations constructively, and ultimately reaches agreements with airlines that are entered into voluntarily by both parties, which benefit airlines, the airport, and the travelling public.

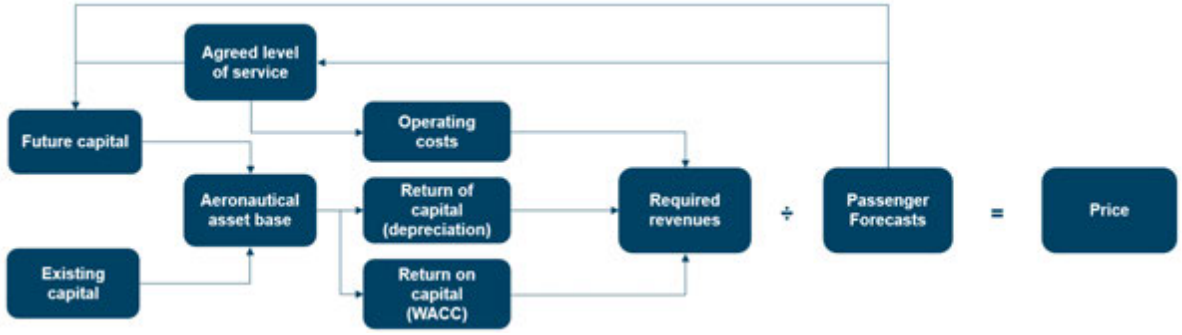
5.1.1 Setting aeronautical prices at Melbourne Airport

Aeronautical prices are based on a building block model that is consistent with the Pricing Principles (the Principles) outlined by the Productivity Commission. Melbourne Airport has continued to use a pre-tax nominal pricing approach since the light-handed regulatory regime commenced in 2003.

The Principles guide how infrastructure access providers (the airport) and access seekers (airlines in this case) can determine prices and terms for access for aeronautical services and facilities (as defined in Part 7 of the *Airports Regulations 1997*). These pricing principles are critical to understanding the services offering from Melbourne Airport. At the core of the Pricing Principles is service and the level of service acceptable to airlines.

The inputs into the building block model are based on an agreed level of service that is acceptable to airlines. Service can be defined in terms of available capacity i.e. do we have enough boarding gates allowing access when airlines require for peak periods, are the facilities available when needed, and for 'soft services' – are they cleaned and maintained to an acceptable level?

Figure 5.1: Building block model of aeronautical prices



These components of the building block model form the basis on which negotiation takes place between Melbourne Airport and airline customers. Through these negotiations Melbourne Airport consults closely with airlines to reach agreement on all aspects of the agreement, including the capital plan for

[10] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, p.171-2

airport investment. Once this agreement is reached, this determines the price that is charged for aeronautical services.

5.1.1.1 Return on capital

The formula Melbourne Airport uses to calculate the return on capital is consistent with that used by both regulators and private businesses when assessing investment and an appropriate return for that investment.

The calculation of the pre-tax nominal weighted average cost of capital (WACC) is set out below:

$$WACC_{\text{nominal, pre-tax}} = R_e \bullet \frac{E}{V} \bullet \frac{1}{(1 - t_c(1-\gamma))} + R_d \bullet \frac{D}{V}$$ [11]

With the return on equity, R_e calculated as follows:

$$R_e = R_f + \beta_e (R_m - R_f)$$[12]

Returns relative to other regulated infrastructure

In recent years several parties have commented, including in the media, on appropriate returns for airports and justified their position based on comparisons with regulated energy infrastructure assets. This comparison is not an appropriate one given the vastly different market drivers and risk profiles between airports and regulated energy infrastructure.

Airports assume passenger risk. With air travel being a discretionary spend for both corporate and leisure travellers, passenger demand can be quite sensitive to external factors such as economic downturns, or disruption in the aviation industry (see section 3.1.1). Melbourne Airport is exposed to the risk that demand is different from its forecast. This risk can be exacerbated during periods of strong growth, as the shocks that impact on passenger demand are difficult to anticipate ahead of time, and incorporate into forecasts of future passenger volumes.

The risk is significantly greater than the risk of gas or electricity volumes that energy infrastructure operators assume. Demand for these essential type goods will be less sensitive to other external factors relative to air travel for two primary reasons. The first, is that its base of customers is highly stable, i.e. the number of households that are serviced by the infrastructure. Second, given the good is more of an everyday essential rather than a discretionary purchase, demand for power will be less sensitive to price, relative to air travel.

Given these key differences in the demand profile of air travel relative to other regulated infrastructure, Melbourne Airport remains of the view that when determining the equity beta, a peer group of comparable airports should be used.

5.1.1.2 Return of capital

Melbourne Airport recovers capital expenditure of its assets through depreciation expenses that are incorporated into the building block model. Depreciation is forecast at an asset category level, using straight-line depreciation (consistent with Melbourne Airport's accounting policy) with all assets within each class assigned weighted average standard rates based on remaining life. New asset depreciation

[11] E = value of equity, V = sum of equity and debt, t_c = corporate tax rate, R_d = cost of debt, D = value of debt, γ = dividend imputation factor (gamma)
[12] R_f = risk-free rate of return, β_e = equity beta, R_m = average expected market return

is according to weighted average useful lives for each asset group. Existing asset depreciation is over their remaining useful lives.

The depreciation basis is the useful life of the assets or category of assets. This enables Melbourne Airport to have its capital returned at a rate consistent with the decline in the asset life. The useful life of an asset is the estimated period that the asset will be useful in its current, or intended, function in the business. This approach to depreciating aeronautical assets allows for stable aeronautical prices in the long run providing certainty to airlines, as the cost is spread evenly over time.

Valuation of aeronautical assets

In 2005, the ACCC mandated the “line-in-the-sand” valuation of aeronautical assets for the purpose of airport monitoring and regulatory accounting, where the historical asset base could no longer be revalued for pricing purposes. Melbourne Airport has adhered to this requirement as part of its pricing principles, and as a result has not revalued aeronautical assets since privatisation.

The asset base reflects the costs (as at 2005 line-in-the-sand), plus any additions agreed with aeronautical users, less depreciation or disposals over that period. This approach is important to providing the confidence for airlines that they can enjoy access in the future without unexpected increases in costs for historical expenditure of which they have not agreed to.

However, given the cost of new aeronautical assets is much higher than the historical recorded cost under this approach, this has resulted in strong increases in the value of the aeronautical asset base.

At the time of sale in 1997, the airport’s aviation asset base was valued at a depreciated optimised replacement value of $460 million. At that time Melbourne Airport serviced 14 million passengers annually. The average value of infrastructure per passenger was $32.8.

Following privatisation, the average value of infrastructure decreased to $23.8 per passenger in 2007, reflecting aeronautical assets worth $548 million, servicing 23 million passengers per annum. This trend was a result of utilising the surplus capacity that existed at the time of privatisation.

By 2017 the ratio of infrastructure per passenger had increased to $53.7 per passenger, a result of a significant increase in the aeronautical asset base to $1,881 million. The increase in assets reflects adding new capacity to service 35 million annual passengers, and new-for-old replacement of historical assets, and the incremental cost of adding capacity in an increasingly brownfield site. As the value of infrastructure per passenger has increased so significantly, increases in aeronautical prices should not be unexpected.

The increase in the book value of assets by $1,421 million over the 10-year period from 2006-07 to 2016-17 represents a material increase in Melbourne Airport’s contractual risk at the expiry of each ASA agreement, as pricing and service expectations are re-negotiated each period. In 2022 the asset base risk is forecast to increase to $2,500 million, a 5.4 times increase since light-handed regulation commenced in 2003. This increase in the aeronautical asset base reflects the investment needed to meet growing demand, and to maintain the existing infrastructure, based on consultation and agreement with airlines.

Given the costs of new aeronautical assets at Melbourne Airport are much higher than the recorded costs of historical assets, the marginal costs of infrastructure are much higher than the overall average costs. The use of the building block model to set price (as is used at Melbourne Airport) would be expected to result in prices that are lower, compared to competitive markets with the same cost structure where price is set based on the marginal cost of supply.

Box 5.1: New-for-old replacement of assets

The cost of replacing new-for-old assets contributes to increases in the aeronautical asset base, without adding to airport capacity.

A simple example of new-for-old and the impact on price is apron replacement (airside concrete). At Melbourne Airport there are over 30,000 slabs that have an asset life of approximately 40 years. Many of these are at the end of their life, and need to be replaced. A rolling program to replace them has been included in airline agreements.

The current average book value of concrete slabs in $4,300 per slab, while the cost for new concrete is approximately $40,000 per slab, with a design life of 40 years. Rapid-set concrete has been used in select areas of the airfield to minimise disruption to airfield operations. The cost of rapid-set concrete is over three times the price of conventional concrete at approximately $130,000 per slab, and it also has a much shorter design life of 10 years.

While new slabs will result in better reliability and safety (a new slab greatly reduces the risk of foreign object debris being ingested into aircraft engines), it does not itself provide any more airline capacity. Similar examples exist with other supporting infrastructure such as utilities and security systems.

5.1.1.3 Operating costs

Melbourne Airport uses activity-based costing (ABC) principles to determine current operating costs, and to forecast future operating costs. The allocation of costs between aeronautical and commercial activities is based on the ACCC *Airport prices monitoring and financial reporting guideline* (June 2009).

The ABC methodology identifies activities across airport operations and assigns the cost of each activity to services the airport supplies. This assigning of costs is direct where possible, or based on a methodology such as consumption where costs are indirect. ABC seeks to identify causal relationships (cost drivers) that objectively assign costs and assets.

Melbourne Airport costs and assets are allocated either as:

- Direct costs: expenditure directly identified as pertaining to a particular service or activity.
    - For example, all staff costs relating to full-time airfield operations employees; airside bussing operational costs; maintenance costs associated with taxiways and aprons; airfield lighting; contracted trolley and baggage services; and airfield assets.
- Indirect costs: refers to expenditure that cannot be directly identified as pertaining to a particular service or activity and must therefore be classified on an allocation basis.

For indirect costs, there are two primary allocation bases that are used:

- Cost driver allocation – this is used where there is a strong causal relationship to support the allocation of costs to the ASA activities or second order if required.
    - Examples include operating expenditure relating to heating and cooling; maintenance of aero bridges, vehicles and mobile plant and equipment; and roads.
- Corporate overhead allocation – this is used where there is no direct causal relationship by which to allocate costs across products and services.
    - For example, airport membership fees; fire protection audits; office maintenance; ICT hardware maintenance; WAN communications; Director and Officer insurance; and audit fees.

5.1.1.4 Passenger forecasts

Passenger forecasts are a key variable in determining aeronautical prices. Forecasts influence the planned investment program, and determine the volume from which required revenues need to be generated.

Melbourne Airport's annual passenger forecasts are based on the combination of short-term and long-term forecasts. Annual forecasts are important to determine the expected trends in overall demand, and are used to estimate the number of passengers which required revenues can be required from when setting prices.

The short-term forecast (bottom-up) is centred on knowledge and intelligence on how airlines will change their frequencies, add new routes, up-gauge their aircraft or modify the aircraft fleet. The long-term forecast is based on statistical relationships (top-down), and econometric demand-based modelling.

To estimate the capital required to meet the expected growth in demand, forecasts of peak demand reflected by the 'busy hour' are used. Further information on busy hour forecasting is outlined in section 6.2.1.

5.1.1.5 Agreed level of service

We have included service levels in all of our ASA agreements since 2002-03 (the first agreement). The service loop in negotiations is critical. Melbourne Airport formulates a capital plan from detailed demand analysis with an underpinning view of the quality of service that airlines expect. In the first instance, this is informed by existing standards and is refined as required during detailed negotiations. Increase in service expectations will generally come at a cost to the community.

The issue is complex as parties such as ground handlers and the airlines themselves affect the delivery of high quality service. On-time performance (OTP) is an example. OTP is defined as 15 minutes plus or minus scheduled time i.e. the 15 minutes is an acceptable variation. If an airline is, for example, 30 minutes late, all three parties may contribute i.e. airport infrastructure failure, ground handler equipment failure and another airline affecting the airline trying to depart or arrive.

A solution could be to have spare gates or backup equipment supplied by the airport, but this comes at a cost. It is reasonable to assume that to achieve a service level above 90 per cent the cost is exponential. The logic of planning to the 90th busiest day is seen by the industry as an acceptable way of avoiding over investment, but it means there will be days were service is compromised.

Service levels provide the basic measure of whether the airport is adequately meeting its obligations to airlines and ultimately the passenger. In principle, the service levels should quantify the expectations of airlines (and passengers) in a way that matches reasonable expectations as negotiated between the parties.

In reality, quantifying 'reasonable expectations', tracking them, and monitoring them, can be difficult. Technologically this can be challenging; roles and responsibilities may not neatly match between airport's area of control and differing airlines' benchmarks for overall service levels; and some measures may be difficult to define.

The use of service levels emphasises the role of the airport to deliver an adequate service but should not specify how the airport delivers the service levels. Adequate service levels pair with the airport's incentive to meet airlines' expectations efficiently.

For some assets or projects, it is unrealistic to expect that an airport can actually deliver the predicted service level without delivering the required projects to meet that level of service. This is the case with

capacity projects. In these cases, the delivery of a project may be a service level in and of itself, and 'reasonable expectations' may be the timely cost-efficient delivery of the project.

5.1.1.6 Pre-funding

Pre-funding describes the charging of services prior to the delivery of the services. This concept is important for airports, particularly for capital investment, as many projects have long lead times and funding the working capital can be problematic.

Pre-funding is an issue that has been looked at in previous Productivity Commission inquiries. In its 2011 inquiry the Productivity Commission found:

> *The pre-funding of airport investments is a recognised component of the Pricing Principles. There is not a strong case for a prescriptive approach to pre-funding airport investments, and the current arrangement (negotiation between an airport and airlines) appears to have resulted in satisfactory outcomes since privatisation. While this approach appears to have worked well so far, the construction of a new runway at Brisbane Airport (the first in the world by a privatised airport) could be a significant challenge to this approach.*[13]

The method of price setting for aeronautical contracts is based on the building block model, consistent with the pricing principles. By its nature, the building block model always contains elements of pre-funding as well as post-funding, dependent on the ultimate price path.

For example, at Melbourne Airport there are approximately 250 projects that are covered by the ASA, all in different stages of delivery. If it was possible to track individual projects with its share of price, some would be pre-funded and some post-funded. Hypothetically, if the pre-funding of projects could be and was excluded from pricing agreements, then there would be potentially 250 price changes that could occur as projects were delivered under this agreement.

Such an outcome is not practical nor desirable for airports and airlines alike, and contradictory to the requests from airline customers throughout commercial negotiations. Melbourne Airport has previously accommodated airline requests to smooth price paths, according to the needs of the aviation community, whilst ensuring that the same required revenues are recovered over the life of the agreement.

In the case of pricing the delivery of a large infrastructure project, such as a new runway, the issue of pre-funding for airports is material. Ultimately, aeronautical pricing reflects the costs of providing an agreed level of service. If a major infrastructure project is required in the future to provide access to new entrants while maintaining that agreed level of service, then the long-run cost of providing that infrastructure would be reflected in an efficient price, as the same level of service is being provided to airlines both now and into the future. On this basis, the pre-funding of major projects is consistent with Part (d) of the Pricing Principles, in that it aids efficiency, including the efficient development of aeronautical services.

Airlines may argue they are yet to receive the specific services being constructed, therefore a contribution is not required; or it may not use the services when the asset is completed, therefore an early contribution may represent a mismatch of service utilisation in the short run. This position fails to recognise that airlines rarely leave the markets they enter; the rationale for such an argument is also inconsistent with what would be expected to take place in a competitive market.

In a competitive market where access was not sufficient to meet demand, the first response would be for prices to increase as demand exceeds supply. Prices would therefore be higher, even though no

[13] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, p. 123

additional service has been provided. This would then be followed by a supply response given the higher prices to meet the excess demand.

Given that aeronautical prices are formed on the basis of a building block model, prices only rise when driven by a component of the model – in this case new capital investment. Pre-funding future projects through inclusion in the building block model, and the subsequent increase in price, is consistent with the response expected in a competitive market where supply does not meet demand.

If pre-funding was not available to airports, the ultimate ability for an airport to fund infrastructure expansions would be determined by a mixture of criteria such as the overall strength of the airport's balance sheet at the time, its credit ratings, and the debt and equity market for risk.

The absence of pre-funding would be expected to increase the risk associated with this investment and result in delays in the development of capital projects, relative to what would be expected in a competitive market. In this case, other types of funding arrangements, which may include support from government, may be required to ensure that the timing of airport infrastructure is delivered efficiently.

Ultimately, aeronautical charges reflect an agreed level of service that an airport provides to airlines, whilst continuing to provide open access. Where growth in demand requires investment in capacity in order to provide access, the cost of providing the same level of service increases. The pre-funding of investment reflects the cost of future investment in order to continue to provide access, importantly at the same level of service that is provided to current users. On this basis, the pre-funding of capital investment – a premium for the use of congested infrastructure – is consistent with the pricing principles, in that it is consistent with the efficient provision of airport infrastructure.

5.1.2 Conventions of negotiation arise from the threat of regulation

Many of the 'rules of the game' within regulatory environments are set within National Rules, detailing specific aspects of the access arrangements in legislation. Amendments to those rules take place within public discussions and submissions, and are in full view of all market participants. This is not the case for Melbourne Airport under the current regulatory regime.

There are many conventions applicable to how airports and airlines negotiate terms and prices for access, however these are not legally binding rules. These convention - including use of the building block model to inform prices - reflect the approach that would be used in a more regulated system, but provide greater flexibility to all parties to best meet their needs.

These non-binding rules assist the aviation sector responsiveness to changing requirements for airlines over time. This is particularly true for the aviation industry which has undergone rapid growth and change since privatisation and requires flexible solutions to strong demand growth.

The flexibility of this approach allows for departures from the negotiated pricing model during the agreement (so long as the airport continues to deliver according to agreed service standards). Melbourne Airport and airlines have consistently departed from the model in agreeing pricing terms for its ASA in order to respond to emerging issues.

It is important for an airport to have this flexibility. Airlines are always evolving in the way that they operate, whether it be the introduction of new aircraft technology, or introducing new business models (e.g. low-cost carriers). An airport can best respond to the evolving needs of the industry when it can be flexible.

By convention, the assets deemed as aeronautical and agreed in prior agreements form the asset base of future agreements. This understanding prevails with airlines, but it is not set down in contract or firm rules (as is the case with the National Electricity Rules, for instance). Rather, this convention is subject

to the commercial negotiation process, which creates a risk carried by airports under the current light-handed framework.

5.1.3 Aeronautical agreements at Melbourne Airport

There are two main types of aeronautical agreements that Melbourne Airport enters into with airlines. The first is the Aeronautical Services Agreement (ASA). This agreement covers all airlines, and applies to use of the airfield including runways and taxiways, and the use of the international terminal.

The second type of agreement covers the use of domestic terminals operated by Melbourne Airport, currently Terminal 3 and Terminal 4. These are negotiated bilaterally with airlines, given the small number of domestic airline operators in the Australian domestic market. This approach allows these agreements to meet the specific needs of these airlines.

5.1.3.1 Aeronautical services agreement

Typically, the development of each of the ASAs has taken approximately two years to complete, including approximately 12 months of direct negotiation with airlines. The most recent negotiation was conducted with four key parties: Qantas Group (Qantas, Jetstar), Virgin Group (Virgin Australia, Tigerair), Rex, and BARA representing the majority of the international airline community. Wider consultation also takes place with interested parties, such as key members of BARA, and Chinese airlines (some of which are not members of BARA).

Since the introduction of the light-handed regulatory regime in 2002-03, Melbourne Airport has negotiated four ASAs with airlines. Over this period, commercial negotiation has resulted in consistent evolution of agreements between Melbourne Airport and airlines. The agreements have become more sophisticated over time, adapting to the changing needs of airlines over time in a market that has undergone significant change. The 2017 ASA represents a further evolution of the commercial negotiation process, with a number of new features being included in the current agreement.

Melbourne Airport was the first airport to successfully agree an ASA for 2002-03 after the introduction of the light-handed regulatory regime. Key features of the first agreement included:

- five-year term;
- change from a maximum take-off weight (MTOW) charge to a per passenger charge for all regular passenger transport (RPT) services;
- agreed service levels;
- agreed consultation mechanisms; and
- an indicative capital plan to guide airport investment.

Subsequent ASAs have evolved over time, with new features introduced in each new agreement to meet the needs of airline customers. Additional features include the introduction of a Necessary New Investment clause, to provide a mechanism to progress significant projects during an ASA period; a Carbon Scheme clause to deal with any carbon trading requirements that may impact future costs; and an extra ordinary price review clause in case passenger numbers decreased by 25 per cent or more.

The 2017 ASA represents a further evolution of the commercial negotiation process, with a number of new features being included in the current agreement. More specifically, these features include:

- A **Quarterly Consultation Forum** was agreed to specifically review quality of service issues and share data on airline on-time performance (OTP). Melbourne Airport chairs the forum and ground handlers are included, noting their critical impact on day of operations. The forum is currently in operation (see Box 6.10, page 91).
- An **Immediate Service Failure Rebate** if Melbourne Airport's equipment is not available for use and causes an OTP issue in excess of 15 minutes.
- A commitment to **Airport Collaborative Decision Making** (A-CDM) process to improve airline turnaround and pre-departure sequencing process. A-CDMs are used in Europe to improve operations outputs.
- A **Capital Consultation Group** to report and involve airlines in the scope of major projects. The purpose is to have airline input for major projects, such as new gates.
- An **annual price reset** if actual expenditure falls short of planned expenditure, reducing the risk to airlines of any underinvestment.

These features, a result of the commercial negotiation process, ensure Melbourne Airport best meets the needs of airlines, provides formal processes for consultation on capital projects and certainty that airlines only pay for the investment that they receive.

5.1.4 Countervailing market power in negotiations

Commercial negotiations are undertaken with four main organisations: Qantas Group, Virgin Group, BARA and Rex. These four organisations comprise the majority of Melbourne Airport's customers, giving these parties significant countervailing power in the negotiation process.

For the most part, these organisations are not small, and have significant resources at their disposal to dedicate to the negotiation of aeronautical agreements. This results in extensive, complex and protracted detailed commercial negotiations. The requirement for Melbourne Airport to provide access to airlines as a federally leased airport strengthens the countervailing market power of airlines in these negotiations, as it requires Melbourne Airport to continue to provide airlines service, even if no formal agreement is in place.

Through the negotiation process, Melbourne Airport undertakes extensive consultation with airlines on all aspects of the building block model that form the basis of the agreement, including the planned capital investment program.

Further evidence of the countervailing market power of airlines is provided in confidence to the Productivity Commission to inform this inquiry.

5.2 Domestic terminal leases

Melbourne Airport has a domestic terminal lease (DTL) with the Qantas Group for Terminal 1 that will expire on 30 June 2019, after the original 30 year lease was extended by 6 months to allow for an orderly transition. The lease is accounted for under Melbourne Airport's property portfolio and is excluded from any ACCC reporting. During the lease period Qantas is responsible for the maintenance of the terminal along with aviation operations and commercial activities.

The DTL originally provided Qantas a large area of land for development, and a rental mechanism for Qantas to grow into the site. At the same time, Terminal 2 (international) had sufficient expansion areas

to accommodate decades of growth. The lease provided Qantas with certainty at Melbourne Airport, with Melbourne Airport comfortable it could accommodate the wider industry growth as required.

Melbourne Airport is currently in negotiations with Qantas to reach an agreement on the arrangements for the operation of Terminal 1 beyond the expiry of the current DTL in June 2019.

In general terms, a DTL provides the airline greater control of terminal operations, including the operating costs of services. This also gives the airline greater control over the quality of service provided to passengers within the terminal. Differences in the incentives for an airline operating a terminal relative to an airport could impact on the quality of service provided.

There is also potential for inefficient use of the overall airport infrastructure, if the operator of the DTL has spare terminal capacity when other areas of the airport are constrained. This could have impacts on competition in a case where terminal infrastructure is constrained.

Box 5.2: Impact of domestic terminal leases on revenue per passenger

Since privatisation, Terminal 1 at Melbourne Airport has been operated under a domestic terminal lease (DTL) by Qantas. Previously, both Qantas and Jetstar operated out of Terminal 1, but now Jetstar operates out of the new Terminal 4 building, owned and operated by Melbourne Airport.

Melbourne Airport does not charge a terminal fee per passenger to operate out of Terminal 1, only a charge to use the airfield. Therefore aeronautical revenue not is collected for these passengers using the terminal, but only for use of the airfield. Lease payments are received for the DTL, but not accounted for as aeronautical revenue.

Such arrangements can distort the measure of revenue per passenger. It can result in revenue per passenger being understated at airports that have DTLs, relative to airports that do not have a DTL, as those without DTLs are collecting revenue on more services than those that do, without any adjustment to the denominator of the revenue per passenger calculation.

It can also affect the comparison of changes to revenue per passenger over time. Distortions can occur when a DTL ends, or an operator moves between a DTL-operated terminal and an airport-operated terminal. In the case of Melbourne Airport, when Jetstar moved from Terminal 1 to Terminal 4, this resulted in a step-change in aeronautical revenue being collected for the additional services being provided by Melbourne Airport. However, the number of passengers used for the revenue per passenger did not change. Therefore, the revenue per passenger measure increased much more than any actual rise in prices.

To correct this issue Melbourne Airport would need to disclose the number of passengers travelling through each terminal, which would be in breach of commercial agreements. Qantas' DTL is due to expire at the end of June 2019. In the event that Melbourne Airport takes over operation of Terminal 1 at some point in the future, this would be expected to result in another step-change increase in the revenue per passenger measure that is not reflective of changes in price.

6 Aeronautical services at Melbourne Airport

Chapter summary:

- The price of aeronautical services at Melbourne Airport are efficient and reasonable, and do not reflect the exercise of market power.
- The price of international aeronautical services over the past decade has increased in real terms by $5.67 per passenger. Over the same period it was necessary to invest more than $600 million in the international terminal, and international passenger numbers have more than doubled.
- The price for use of the airfield by domestic airlines at Melbourne Airport has increased in real terms by 15 cents per passenger, or 3.6 per cent since 2007-08.
- The use of EBITA as a measure of airport profitability does not reflect the interest expense incurred from funding new investment. Over the past decade Melbourne Airport has spent $1.3 billion in interest payments.
- Aeronautical return on assets has decreased over the past decade, from 15.6 per cent in 2007-08, to as low as 8.2 per cent in 2014-15 and 2015-16, before increasing slightly to 9.7 per cent in 2016-17.
- Changes in passenger mix at Melbourne Airport contributed to the majority of the increase in revenue per passenger over the past decade, adding $2.28 in real terms while increases in price have added just $0.69 per passenger.
- Rises in aeronautical prices are not passed on to passengers directly, as airlines price discriminate when setting airfares, based on the willingness to pay by consumers.
- Melbourne Airport has undertaken significant investment in airport facilities to increase capacity, improve efficiency, replacing ageing assets old-for-new, and meet legislative requirements. This investment creates efficiencies which reduces costs for airlines.
- In a period of strong growth and investment, airport operations have remained efficient, and quality service levels have been maintained – an achievement that should not be understated.

6.1 Prices and returns of aeronautical services

The prices of aeronautical services at Melbourne Airport are efficient and reasonable, and do not reflect the exercise of any market power. They reflect the commercially negotiated prices that are agreed voluntarily by airlines. Where prices have increased, it has funded significant investment in airport infrastructure.

Measuring airport prices is not simple, and attempts to measure airport prices and profits can lead to conclusions which are misleading. Measures such as revenue per passenger and earnings before interest, tax and amortisation (EBITA) profits indicate that aeronautical prices and profits do not give a true indication of what they are attempting to measure. This has supported claims from organisations such as A4ANZ which, while factually correct, lead to the wrong conclusions when it comes to prices or profitability at Melbourne Airport.

6.1.1 Aeronautical prices at Melbourne Airport

There are two components to domestic aeronautical charges: an airfield charge and a terminal charge. The airfield charge is for use of the airfield, and is charged per domestic passenger that uses the airfield. The terminal charge is for use of the Melbourne Airport operated terminals (terminals 3 and 4 only).

In real terms, the airfield charge at Melbourne Airport has increased by 3.6 per cent over the decade since 2007-08. This has been reflected in an increase in the landing charge of 15 cents per passenger over that 10 year period. In that time, there has been over $500 million of investment in airfield infrastructure.

Table 6.1: Domestic airfield landing charge per passenger, Melbourne Airport

$	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15	15-16	16-17	Change
Nominal	3.46	3.46	3.46	3.46	3.46	3.80	3.95	4.07	4.22	4.40	30.1%
Real	4.25	4.11	4.02	3.90	3.82	4.09	4.15	4.20	4.29	4.40	3.6%

Source: Melbourne Airport, excludes GST

The domestic terminal charge is not simple to measure over time. These charges reflect agreements negotiated individually with domestic airline customers, rather than agreements that apply to all airlines. These agreements meet the specific services required by airlines, with Virgin Australia the major operator out of Terminal 3, and Jetstar and Tigerair operating out of Terminal 4.

Aeronautical prices for international services at Melbourne Airport have grown over the past decade. Despite per passenger price increases, international demand has been strong, growing by 127.6 per cent over the past decade.

In real terms, international prices per passenger have increased from $15.33 in 2007-08, to $21.00 in 2016-17. This reflects a real terms increase of 37 per cent, or an additional $5.67 per passenger.

Table 6.2: International terminal price per passenger, Melbourne Airport

$	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15	15-16	16-17	Change
Nominal	12.50	13.03	13.32	13.69	14.17	15.75	16.80	17.95	19.50	21.00	68.0%
Real	15.33	15.50	15.48	15.43	15.61	16.97	17.62	18.51	19.83	21.00	37.0%

Source: Melbourne Airport, excludes GST

The increases in these charges have funded the infrastructure which has enabled strong international passenger growth at Melbourne Airport, including over $600 million of investment in Terminal 2 since 2007-08. Without the increase in charges, the facilities would not have existed to enable the strong international passenger growth at Melbourne Airport. In addition, substantial parts of the terminal and airfield have been replaced at current market prices. This is much higher than the original depreciated optimised replacement cost (DORC) value in 1997. The effective result is a similar processing capacity for a higher price.

6.1.1.1 Benchmarking of Melbourne Airport prices

Another way to assess aeronautical prices is by benchmarking prices to those of comparable airports. As part of the ASA process in September 2016, Melbourne Airport commissioned a report by Leigh Fisher (Jacobs) experts in airport benchmarking, to evaluate for both domestic and international charges where Melbourne was scaled relative to other airports.

The report shows that based on a number of different aircraft sizes, domestic charges at Melbourne were ranked fifth out the seven airports benchmarked. For international charges based on a number of aircraft sizes, Melbourne was ranked sixth out of the seven airports benchmarked. On a wider sample of 55 airports internationally, Melbourne was ranked 21st in terms of airport prices.

The findings from this benchmarking report indicate that aeronautical prices at Melbourne Airport are reasonable, and in line with other airports around the world.[14]

[14] LeighFisher (Jacobs), *Melbourne Airport aeronautical charges benchmarking*, September 2016

6.1.2 Prices, costs and profits monitoring

Melbourne Airport acknowledges the concerns of the ACCC that the monitoring process does not specifically allow it to identify whether prices set by airports reflect an exercise of market power. As outlined previously in this submission, that is not the purpose of the monitoring process, which is to act as an early warning system.

There are characteristics of the approach used by the ACCC that would allow it to develop a more informed view of the prices and profitability of monitored airports. These include:

- giving higher credence to return on assets over EBITA profits as a measure of profitability;
- understanding the impact of changes in passenger mix on its proxy measure of revenue per passenger; and
- noting the arbitrary nature of using CPI as a deflator, and that the cost of providing airport services is very different to the costs of the typical household on which the CPI is based.

6.1.2.1 Measures of profitability

The ACCC monitoring reports measure the profitability of aeronautical activities, and of car parking. When measuring aeronautical services, the ACCC uses two approaches to measure profitability: EBITA profits and return on aeronautical assets. For car parking, only EBITA profits are used.

To measure profit the ACCC uses EBITA as a measure of profitability for both aeronautical services and car parking.

The ACCC provides the following explanation as to why it uses EBITA to measure profitability:

> *The ACCC uses EBITA for its airport monitoring reports because it is not affected by management decisions regarding capital structures and taxation arrangements which vary substantially among different airports.*[15]

EBITA is used to inform a number of different financial measures included in the monitoring report, including expenses per passenger, operating profit per passenger, total expenses (aeronautical/total), and profits (aeronautical/total). However, using EBITA does have shortcomings which the ACCC acknowledges:

> *EBITA provides a measure of airport operating performance, as distinct from financial performance. It is useful for revealing trends in operating performance over time. However, as a measure of profitability it does not take into account the full capital cost associated with the provision of services.* [16]

As EBITA does not capture the full capital cost associated with the provision of services, it excludes a significant expense for an expanding infrastructure asset: interest payments. Excluding this key expense can inflate the perceived profitability of airport operations. Despite the limitations of this measure, it is used by the ACCC as its key measure of airport profitability, and features in its media releases.

Interest expense is a significant cost for an airport that is investing to meet growing demand. Over the past decade, Melbourne Airport has incurred $1.3 billion in interest expense, reflecting 35 per cent of total expenses incurred over the past decade (Table 6.3). Interest expense has almost doubled over

[15] ACCC, *Airport Monitoring Report 2016-17*, p. 33
[16] ACCC, *Airport Monitoring Report 2016-17*, p. 184

the past decade as interest rates have declined, reflecting the increase in debt to fund the delivery of infrastructure.

Table 6.3: Expenses including interest, Melbourne Airport

Total Airport ($m)	**07-08**	**08-09**	**09-10**	**10-11**	**11-12**	**12-13**	**13-14**	**14-15**	**15-16**	**16-17**	**Total**
Expenses	149.2	160.7	175.5	194.5	219.3	247.0	260.4	298.5	376.4	395.2	2,476.7
Interest	88.6	94.0	112.5	123.7	132.7	138.3	152.2	158.2	172.7	166.4	1,339.2
Total expenses	237.8	254.6	288.0	318.1	352.0	385.3	412.6	456.7	549.1	561.6	3,815.9
Interest share of total	37%	37%	39%	39%	38%	36%	37%	35%	31%	30%	35%

Source: ACCC regulatory accounts

Melbourne Airport acknowledges the challenges for the ACCC to measure profitability, particularly for specific services types that are measured in the ACCC reports, as it is difficult to allocate interest expense for different activities. However, in Melbourne Airport's case, by not capturing this expense, EBITA profits do not reflect the most significant cost of operating, maintaining, and adding capacity to a 50-year-old infrastructure asset. Therefore, a measure that excludes these costs can significantly overstate profitability.

Melbourne Airport considers that return on assets is a more accurate measure of airport profitability when compared to measures of operating profit or operating profit per passenger.

Whilst both operating profit and the return on assets measures do not include interest expense, return on assets better captures the investment in assets that expand the capacity and improve the efficiency of the airport, which are associated with rising interest expense.

In the case of Melbourne Airport, the aeronautical return on assets has decreased over the past decade, from 15.6 per cent in 2007-08, to as low as 8.2 per cent in 2014-15 and 2015-16 with the opening of Terminal 4, before increasing slightly to 9.7 per cent in 2016-17. The rate of return on aeronautical assets at Melbourne Airport since introduction of the light-handed regulatory regime has generally been within the range of returns that would be expected of an Australian airport.[17]

[17] Houston Kemp, *Assessing market power in aeronautical services*, p. 27

Table 6.4: Aeronautical services accounts, Melbourne Airport

Aeronautical services	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15	15-16	16-17
Non-current assets ($m)	593	729	833	898	1,007	1,108	1,374	1,790	1,823	1,881
Aeronautical operating profit ($m)	92.5	94.4	98.7	106.3	96.0	112.3	139.7	146.8	150.4	182.5
Return on aero assets (%)	15.6	12.9	11.9	11.8	9.5	10.1	10.2	8.2	8.2	9.7

Source: ACCC regulatory accounts

Given the line-in-the-sand valuations that are used for the ACCC monitoring purposes, the aeronautical non-current asset base has not been revalued since privatisation. This approach underpins the relatively low $593 million value of aeronautical non-current assets from 2007-08. However, investment over the past decade, which is accounted for in the asset base at the cost of delivering additional investment, has seen the aeronautical asset base grow to $1.9 billion in 2016-17.

While Melbourne Airport does not specifically object to the line-in-the-sand approach to the valuation of assets, what this approach implies is that the return on the economic value of the aeronautical assets at Melbourne Airport would reasonably be expected to be lower than the accounting return on assets that is reported in the ACCC monitoring report, as the economic value of the asset base is likely to be much higher.

Therefore, the ACCC can give due consideration to what the accounting return on assets is likely to imply for the economic return on assets of an airport's aeronautical services, given the line-in-the-sand valuations, when assessing any potential use of market power.

For the reasons outlined above, Melbourne Airport considers that the ACCC should also place greater emphasis in its reports on return on assets, and use this as its headline measure of profitability over EBITA which is currently given greater emphasis. For example, EBITA profit appears in the infographic of the most recent ACCC report, where return on assets does not.[18]

The emphasis of a misleading measure of profitability can portray airports to be far more profitable than they are. This has been used by A4ANZ to exaggerate the profitability of airports when making its case for greater regulation.

6.1.2.2 Measure of aeronautical prices – revenue per passenger

Revenue per passenger is used as a proxy by the ACCC to monitor and compare the profitability of monitored airports. It is considered to be a proxy for airport charges, as it is based on the simple calculation of total aeronautical revenue, divided by the total number of passengers.

The ACCC measures revenue per passenger by dividing total aeronautical revenue by the total number of passengers.

Figure 6.1: Calculation of revenue per passenger

$$revenue\ per\ passenger = \frac{total\ aeronautical\ revenue}{total\ passenger\ numbers}$$

In its monitoring reports, the ACCC has noted that average revenues per passenger have increased by 25.9 per cent in real terms across the four monitored airports over the past decade[19] and that the four

[18] ACCC, *Airport Monitoring Report 2016-17,* p. 1
[19] ACCC *Airport Monitoring Report 2016-17*, p. 2

monitored airports have received $1.57 billion additional payments in real terms from airlines over a decade to 2015-16 due to prices rising beyond inflation.[20]

These observations, while factually correct, do not give an indication of what is driving the changes in revenue per passenger, whether it is changes in price – what the ACCC is trying to measure – or whether it is driven by changes in volume. Such insights can provide greater insight as to whether the prices set by an airport are appropriate.

These drivers of change in revenue per passenger are important in understanding the change in airport pricing over time, as well as between airports. This is mainly due to charges for international passengers being higher than for domestic passengers. These higher charges reflect the greater cost of servicing international passengers relative to domestic passengers. The relocation of airlines from a leased terminal to a terminal operated by the airport can also have an impact.

In the event where international passenger growth is stronger than domestic passenger growth, revenue per passenger will increase over time (in-line with costs per passenger), even in the absence of any price increases. An airport that has a higher share of international passengers could be expected to have higher revenue per passenger than an identical airport that had a lower share of international passengers.

Understanding these drivers of the revenue per passenger proxy measure as part of the monitoring process would allow the ACCC to make a more accurate determination of whether an airport was misusing its market power.

6.1.2.3 Revenue per passenger at Melbourne Airport

As reported by the ACCC, at Melbourne Airport revenue per passenger has increased in real terms from $9.47 in 2007-08 to $12.44 in 2016-17, a real terms increase of $2.97 per passenger over the decade, or 31.4 per cent.

The ACCC acknowledges that the increase in revenue per passenger was driven by both higher charges, and the increasing share of international passengers, but does not include any analysis as to what extent revenue per passenger was driven by higher prices, relative to changes in passenger volumes.

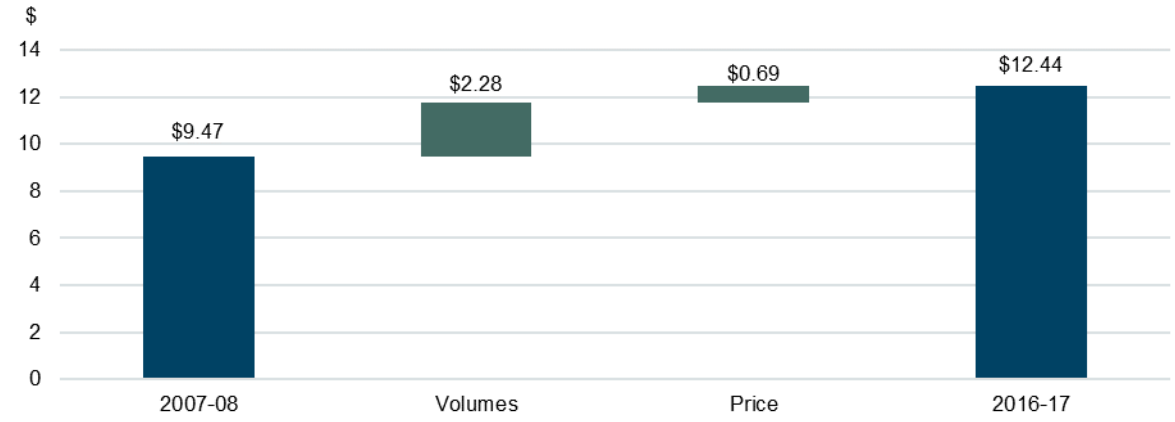
> *Aeronautical revenue per passenger continued its upward trend by growing 5.7 per cent in 2016-17 to $12.44. This growth would have been driven by a combination of higher passenger charges and the increasing share of international passengers (who incur higher charges than domestic passengers). Melbourne Airport's revenue per passenger has grown every year since 2010-11. It is now 31.4 per cent higher than it was a decade ago.*[21]

Melbourne Airport analysis of the drivers of revenue per passenger shows that most of the increase in revenue per passenger was driven by changes in volumes rather than price increases. In total, changes in price added $0.69 to revenue per passenger in total over the past decade, or increased revenue per passenger by 7.3 per cent, an average of 0.7 per cent per year. Over the same period the value of the aeronautical asset base has more than tripled from around $600 million, to $1.9 billion.

Changes in passenger volume mix contributed to the majority of the increase, adding $2.28 per passenger, increasing revenue per passenger by 24 per cent. This reflects the stronger growth in international passengers relative to domestic passengers, and distortions created in this measure due to the impact of the Terminal 1 domestic terminal lease.

[20] ACCC, *Airport Monitoring Report 2015-16,* p. 5
[21] ACCC, *Airport Monitoring Report 2016-17*, p. 86-7

Figure 6.2: Revenue per passenger contributions to change, Melbourne Airport



Source: ACCC, Melbourne Airport analysis

This demonstrates how the overall proxy measure of revenue per passenger can be misleading when measuring changes in price. Whilst revenue per passenger did increase by 31.4 per cent in real terms over the past decade, this is much higher than the changes in price of aeronautical services at Melbourne Airport.

Melbourne Airport considers that future ACCC monitoring reports should consider the drivers of changes in revenue per passenger in more detail, to more accurately assess changes in price over time.

6.1.2.4 CPI deflator of financial measures

The ACCC monitoring report uses the consumer price index (CPI) as the deflator for a number of financial benchmarks that it reports, including revenue per passenger as a measure of prices. Melbourne Airport does not object to the use of the CPI as a deflator, which is a standard deflator for analysis of trends over time.

The CPI in itself reflects a 'basket of goods' that are consumed by a typical household, and is calibrated by the Australian Bureau of Statistics (ABS) accordingly. This 'basket' covers a wide range of goods and services, categorised into 11 different groups.

Airport prices are driven by different costs that are very different to a typical household. Not only are the costs of delivering infrastructure different, but Melbourne Airport faces additional challenges from upgrading aging infrastructure in a live operating environment that add to cost. For example, areas of the airfield have required quick-set concrete to be used for upgrades so operations can be maintained, with quick-set concrete costing more than three times the cost of regular concrete.

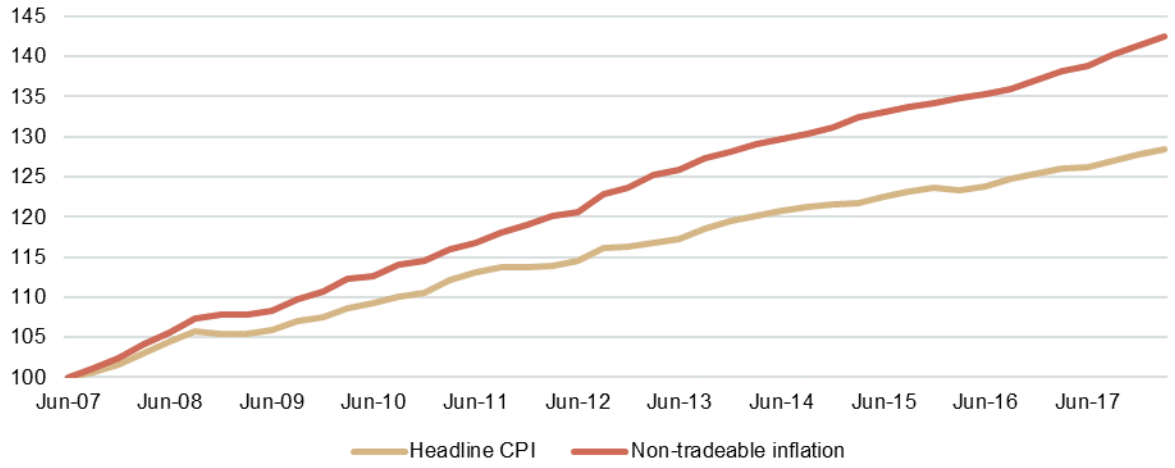
The ABS publishes a number of different analytical series, which reflect subsets of the CPI. These analytical series can allow users to analyse changes in particular areas of the economy, such as specific groups outlined above, or the types of transactions, such as the changes in the price of goods compared to services.

There are some particular analytical series of the CPI which whilst not directly linked to the drivers of aeronautical charges, could be considered more closely aligned or provide a good basis of comparison, relative to the overall CPI.

For example, non-tradeable inflation reflects the prices of goods and services that are exposed to a low degree of international competition. Whilst airport services are provided globally, airport services in Australia must be provided in Australia, and are therefore non-tradeable.

In Australia over the past decade, non-tradeable inflation has been stronger than the overall headline CPI. Over the decade to June 2017, headline CPI increased by 26.2 per cent, compared to a 38.8 per cent increase in non-tradeable inflation.

Figure 6.3: Headline CPI and non-tradeable inflation



Source: ABS Cat. 6401

If revenue per passenger was deflated by non-tradeable inflation, then the reported increase over the past decade would be 18.8 per cent, rather than the reported 31.4 per cent. If deflated by prices in the regulated utilities industry, then revenue per passenger would have fallen over the past decade.

Melbourne Airport accepts that the use of CPI as a deflator is standard, and is not recommending any change, but notes that as outlined above CPI is arbitrary, and non-tradeable inflation is more likely to reflect the changes in price that Melbourne Airport is exposed to.

6.1.3 The impacts of aeronautical charges

When considering the effectiveness of the light-handed regulatory framework, it is important to acknowledge both the incentives for airports when setting prices, but also the impacts that aeronautical charges have on the market for aviation services.

Airports do face competition, particularly for international services. There is a global market of international airlines looking to deploy their services for which international airports compete. This provides an incentive for airports to have aeronautical prices that are as competitive.

Some airlines and representative groups have claimed that while airfares have declined over recent years, airport charges have gone up, and that reflects that airports are exercising market power in relation to airport pricing.

While the key costs of providing services for airlines have declined significantly, this is not the case with aeronautical infrastructure services; in fact, it has been the opposite in Australia. As passenger demand has grown strongly, particularly in the peak periods, extra capacity has been required to meet that demand, and the costs for an airport that needs to meet growing demand by increasing capacity is significantly more than an airport that has adequate infrastructure. Investment in new assets, such as modern check-in facilities, creates efficiencies and reduces costs for airlines.

Rising aeronautical prices may have a very small impact on the supply of services that are provided by airlines. But aeronautical charges fund increases in airport capacity plays in enabling the supply of airline services and expanded competition. The strong international passenger growth at

Melbourne Airport demonstrates that the benefits of added capacity have been outweighed any potential costs of higher aeronautical charges, reflecting efficient prices.

While airline groups point out increases in revenue per passenger (as reported by the ACCC), at Melbourne Airport much of this increase has been driven by international passenger numbers (for which charges are higher) growing faster than domestic passenger numbers have driven much of this increase. The price for use of the airfield by domestic airlines has increased by just 15 cents per passenger in real terms over the past decade. With this context, there is no evidence that changes to aeronautical prices at Melbourne Airport have resulted in negative outcomes for consumers.

6.1.3.1 Competition for services

Melbourne Airport competes with other airports in order to win airline services, particularly for international routes. Competition exists for new and existing capacity within Australia, primarily with eastern seaboard airports, but also airports overseas.

Aeronautical prices are one, but not the only, factor considered by airlines when deciding how to deploy their services. Main consideration factors include the market size potential, market segments, competition, yield and freight where applicable. The combination of potential revenue sources is then compared with the cost of servicing the route.

Airlines consistently review aircraft profit performance and redeploy aircraft in order to maximise their returns. There are many factors that determine where an airline chooses to deploy its services. One of them is the price of airport services, but other costs and market dynamics tend to play a more prominent role.

Competition between airports is strongest in the international market. Like all major airports, Melbourne Airport works with industry partners like tourism boards to grow the market. The international aviation industry has events that host and facilitate one-on-one dialogue between airlines and airports. For example, routes conferences are international annual summits which host these discussions. These conferences can run in regions (for example Routes Asia) as well as global conferences (Routes World).

These conferences often involve a joint effort from airports in conjunction with their respective tourism bodies and governments. Melbourne Airport works with Victorian Government agencies to pitch Melbourne as an attractive destination for airlines.

For example, Melbourne Airport, along with Visit Victoria, worked proactively with Air Canada to secure a direct service to Melbourne Airport. Air Canada has been in a growth phase the past two years. With modern aircraft capable of servicing ultra-long-haul routes, this opened up new opportunities from its key hubs of Vancouver and Toronto.

Melbourne Airport and Visit Victoria worked with Air Canada, sharing insights about North American routes to the Victorian market. Collectively, sales channels, destination appeal triggers and the price points for the potential non-stop service to Vancouver were identified. This effort was successful, with a direct service between Melbourne and Vancouver now in operation by Air Canada.

Avalon Airport also brings direct competition to Melbourne Airport. Jetstar currently operates domestic services out of Avalon Airport, with support from the State Government,[22] while AirAsia will soon move its services away from Melbourne Airport to Avalon. This move by AirAsia has been assisted by the $20 million in funding provided by the Commonwealth Government to develop the new international terminal at Avalon.

[22] The Victorian State Government has provided $12 million over 10 years to support Jetstar's Avalon services in 2015. See http://www.abc.net.au/news/2015-04-27/victorian-government-signs-new-deal-to-keep-jetstar-at-avalon/6424890

With the investment in new facilities at Avalon Airport, the degree of competition it will bring as a second airport for Melbourne could be expected to increase over time. Demonstrated particularly by the move of AirAsia to Avalon, it does provide a real alternative for airlines to service the Melbourne market. With both domestic and international services operating out of Avalon Airport, it is expected to play an increasingly important role in the future of aviation services in Victoria.

6.1.3.2 Claims of A4ANZ

A4ANZ compare changes in the price of airfares to changes in the price of airport prices, claiming that:

> *Airfares have been kept low and in fact declined over the same period that the airports have enjoyed uninterrupted growth in revenue per passenger*[23]

There are three flaws in this statement from A4ANZ. Firstly, it ignores the reduction in costs for airlines due to investment in airport facilities, including technology which reduces labour costs.

Secondly, it uses the ACCC's measure of revenue per passenger, which at Melbourne Airport has increased over the past decade primarily due to changes in the passenger mix, rather than higher prices (see section 6.1.2.2). This trend is likely to be similar at other major airports.

Secondly, it is based on the premise that airport prices should be driven by the same economics as airfares. The costs of providing these two very different services, are as would be expected – very different. For example, a major cost for airlines is fuel, the cost of which has decreased significantly over the past decade (fuel cost per passenger for Qantas has fallen by 40 per cent over the past decade – see Box 6.2, page 62).

Lower airline costs have reduced fares and increased demand; this increases the costs for airports that supply the infrastructure required to meet this extra demand. On this basis, lower airfares can reasonably be expected to result in rising airport charges, where additional infrastructure is required to meet additional demand, particularly given the cost of adding and replacing aeronautical assets is higher than the accounting costs recorded for historic assets.

A4ANZ also references International Air Transport Association (IATA) analysis which claims that if airport charges had remained flat since 2008, passengers would have saved $180 million through lower charges, and that this would have resulted in an additional 1.23 million passengers.[24]

No further detail on how these estimates were determined is provided, which prompts the following questions:

- Without higher aeronautical charges, would there have been sufficient airport infrastructure to enable both the strong passenger growth that has taken place over the past decade, and the additional 1.23 million passengers that A4ANZ claims would have flown?
- How would passengers save $180 million? Would airlines have passed on the savings to passengers? Or does it assume they would have saved through lower airfares resulting from increased supply? If so – would there have been sufficient infrastructure for increased supply?

[23] A4ANZ, *The performance & impact of Australia's airports since privatisation,* p. 5
[24] A4ANZ, *The performance & impact of Australia's airports since privatisation,* p. 15

Melbourne Airport considers that if aeronautical prices had not increased, the number of passengers flying would have been lower rather than higher, as airport infrastructure would have been undersupplied for the efficient level. This would not have resulted in savings to passengers either, as evidence indicates that airlines do not directly pass on changes in their costs to passengers through airfares.

Other benefits for airlines, from the operating efficiencies created from investment, would also have been lost. The travelling public would have less choice, airlines would have less competition, and airfares would be higher as a result. The only beneficiaries from this scenario would be incumbent airlines, which by already holding market share, would have been able to improve yields on existing services through higher airfares.

Rather, it is the operational decisions of airlines that ultimately have the most significant impact on what passengers pay for air travel, particularly in the domestic market where there are just two main airline groups. As shown in Box 6.1 (page 58), domestic airfares have increased over the past two years as the supply of domestic air services has not kept pace with demand. This trend, consistent with recent public statements from Qantas Group, emphasises 'capacity discipline' as a key driver of improved financial results:

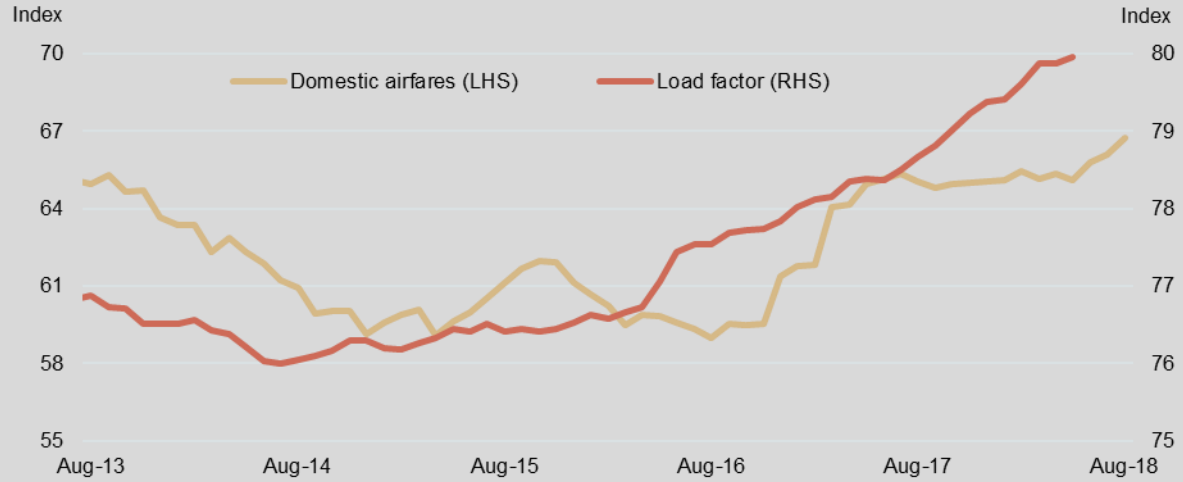
> *We're seeing healthy demand across key sectors matched with improving levels of capacity discipline, which is a positive sign for the year ahead.*
>
> *The Group's domestic flying operations delivered EBIT of $1.1 billion, which is 25 per cent higher than FY17 and represents a new record for the business.*
>
> *This was achieved through the combination of Qantas and Jetstar's network, schedule and product strengths in key markets, and supported by capacity discipline driving higher seat factors and higher unit revenue.*[25]

[25] https://www.qantasnewsroom.com.au/media-releases/qantas-group-reports-record-full-year-profit/

Box 6.1: Trends in domestic airfares

Domestic airfares in real terms are lower now than they were a decade ago. However, more recently domestic airfares have shown a different trend. Over the past two years, domestic airfares have increased by 13.2 per cent in real terms (17.4 per cent nominal), with domestic airfares now higher than they were five years ago.

Figure 6.4: Rolling annual average domestic airfares and load factors



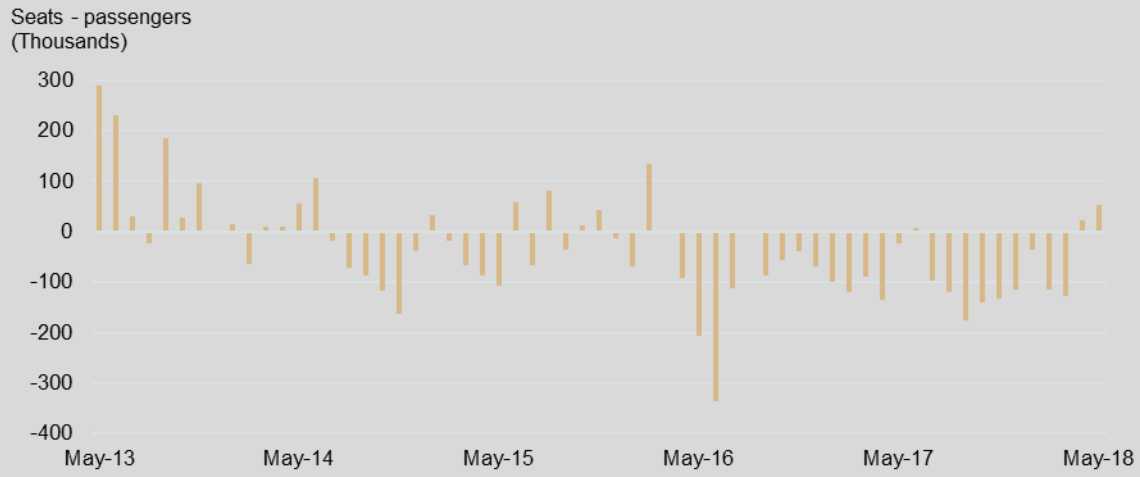
Source: BITRE best discount airfares, Melbourne Airport analysis

This rise in airfares has coincided with rising load factors (percentage of airline seats sold). In the year to April 2016, the load factor across the domestic network was 76.7 per cent. In the most recent data available, the year to May 2018, this had increased to 80.0 per cent. The increase in load factor reflects the trend where the growth in the supply of seats available on the domestic network has been outstripped by passenger demand.

This change can be seen when comparing the balance of demand from passengers against the supply of seats. Following the 'capacity wars' between Qantas and Virgin earlier in the decade, where the two major airlines were competing for market share and growth in the supply of seats was strong, passenger demand has outstripped supply in the domestic market for around four years.

Particularly in the past two years, where the growth in passenger demand exceeded the growth in the supply of seats by 2.3 million. This growth in demand, which has not been met with corresponding supply, has coincided with the recent strong growth in domestic airfares.

Figure 6.5: Change in seats less change in passengers, domestic network



Source: BITRE, Melbourne Airport analysis

6.1.3.3 Impact on consumers

Research for the Airports Council International Europe (ACI Europe) by ICF finds that airport charges are not passed directly through to consumers, and that airline ticket prices are driven by supply and demand factors. It also shows that revenue managers set ticket prices largely without cost in mind.[26]

The Productivity Commission noted in its 2011 inquiry that:

> *The extent to which airlines can price discriminate against passengers (including the degree to which it can discriminate which passengers pay airport charges) reduces the welfare effects of an increase in airport charges. In practice, airport charges make up such a small proportion of total airfares that even large increases in these charges are unlikely to have significant welfare effects, and will largely represent a 'distribution' between airlines and airports.*[27]

Melbourne Airport agrees with the Productivity Commission's position on this issue in 2011. Airlines vary airfares in order to maximise the revenue that they collect from a particular service, based on supply and demand, influenced by the customer's willingness to pay.

Price discrimination is evident when analysing airfares advertised by airlines. A one-way economy airfare on Virgin Australia between Melbourne and Sydney over a one-week period varies between a low of $160 and a high of $699. The cost to the airline for providing each of these services would broadly be the same, depending on the type of aircraft used there may be some variance. However, the including total itemised airport charges of $15.44[28] when purchasing the fare do not vary, regardless of whether the airfare is $699 or $160.

Table 6.5: Melbourne to Sydney Virgin Australia economy airfares (one-way)

MEL-SYD	27 July 2018	28 July 2018	29 July 2018	30 July 2018	31 July 2018	1 August 2018	2 August 2018
Lowest fare	$160	$160	$160	$160	$160	$160	$160
Highest fare	$480	$699	$430	$380	$380	$440	$380

Source: virginaustralia.com, obtained 26 July 2018

The trend is similar for low-cost-carriers. Jetstar fares range over a one-week period from a low of $71 to as much as $339. These fares are before any additional costs that come with flying with Jetstar (such as baggage) are included.

Table 6.6: Melbourne to Sydney Jetstar economy airfares (one-way)

MEL-SYD	23 August 2018	24 August 2018	25 August 2018	26 August 2018	27 August 2018	28 August 2018	29 August 2018
Lowest fare	$171	$149	$101	$93	$101	$71	$71
Highest fare	$239	$285	$199	$339	$171	$101	$93

Source: jetstar.com, obtained 22 August 2018

The above airfares are clear examples of price discrimination where prices differ for the same level of service. Under this pricing approach airline costs are not passed directly through to the consumer, even if they are itemised on the ticket sold by airlines. Even while aeronautical charges may reflect a larger percentage of the advertised airfare for low-cost-carriers, price discrimination by airlines in setting airfares means that aeronautical charges are not directly passed on to passengers, even if they are itemised on the ticket.

[26] ICF 2018, *Identifying the Drivers of Air Fares*
[27] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, p. 72-3
[28] Excludes security charges

Rather, airfare prices reflect the demand and willingness to pay of passengers for a particular service, relative to the amount of supply of services available. This was noted by ICF.

> *The price of an air fare can vary significantly due to the balance of demand and supply, and there is not a strong mechanism by which costs are transmitted to the ultimate price that consumers pay.*[29]

This is not to say that the costs of providing airline services have no effect on the airline market. Rather, the costs of providing airline services impact on consumers in a more indirect way, meaning the impacts are relatively insignificant.

> *However, clearly costs do influence airline behaviours in the medium to long term. Airlines will be monitoring their costs at various stages of the planning and sales cycle and will consider their options in the wider context of their own business, the competition and the likely impact from their customers, i.e. passengers.*[30]

Melbourne Airport agrees with the ICF assessment, that airlines consider all of the costs of providing a service, relative to the demand of providing that service. If there is sufficient demand relative to the costs to provide a sufficient return, then an airline would proceed to provide that service.

6.1.3.4 Aeronautical prices and supply

For rises in aeronautical prices to reduce supply, an airline would need to find that considering all of its costs relative to the demand for that service, it will either get higher returns from either operating a different service at another airport, or that it will be better off not operating that service at all. Any reduction in supply would then have a flow-on impact on airfares.

Given that aeronautical charges fund the supply of aeronautical infrastructure, for an increase in airport prices to have an overall negative impact on the aviation market or the broader economy, the increase in prices would need to reduce supply of airline services at a cost that exceeds the benefits from the infrastructure that is enabled by the increase in aeronautical charges, and any operational efficiencies that investment in airport infrastructure creates for airlines.

Unlike the major costs for an airline, such as fuel and labour costs, airport charges are a much smaller share of costs, and also a variable cost that is directly linked to the number of passengers that fly. For example, on a service that has a lower load factor and generates less revenue in ticket sales for the airline, airport charges will be lower relative to a service with a higher load factor, whilst fuel and labour costs would be relatively unchanged. This arrangement involves airports sharing passenger risk with airlines as revenue is based on number of passengers, not the number of aircraft services provided.

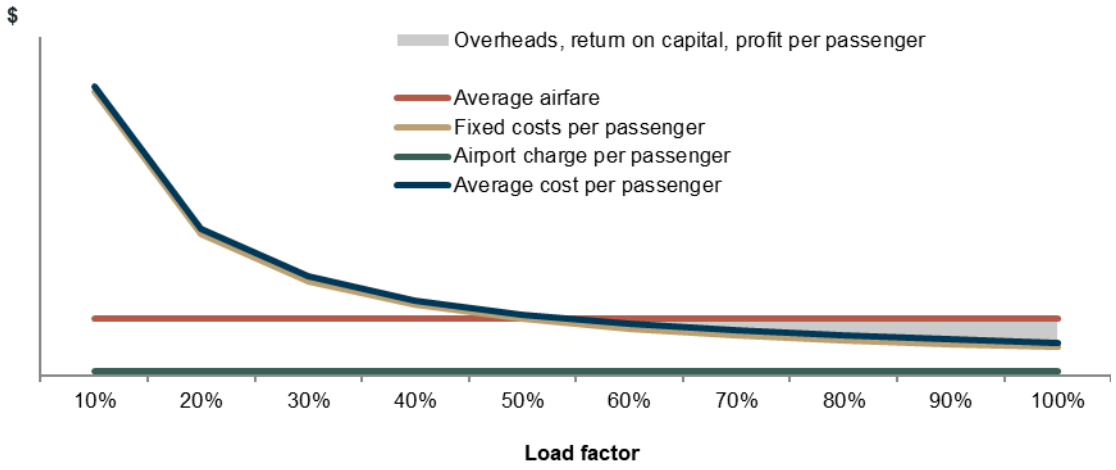
The margin of an airline service can be measured on a per passenger basis as an average. The difference between the average revenue per passenger and average cost per passenger is the margin gained from that service. Where the margin meets the required returns of an airline, the airline will choose to provide that service.

As aeronautical services are charged on a per passenger basis, any increase in the price of aeronautical services will have a minimal impact on that service being profitable, relative to fixed costs. This is demonstrated as an example below (Figure 6.6), where it is assumed airport charges account for 10 per cent of the average airfare (a relatively high assumption given airport and route navigation charges account for around 10 per cent of Qantas Group's costs – see Box 6.2, page 62).

[29] ICF 2018, *Identifying the Drivers of Air Fares*, p. 36
[30] Ibid

In this simple example airport charges have minimal impact on the average cost per passenger curve that would influence whether an airline provides a service or not.

Figure 6.6: Average revenue and costs of an airline service (example)



Ultimately, for increases in airport charges to have a negative impact on consumers, this would only take place if there are other inefficiencies taking place, such as inefficient pricing or service delivery, poor quality of service, or the over-provision of infrastructure. As is demonstrated throughout this submission, there is no evidence that this has occurred at Melbourne Airport.

Box 6.2: Qantas Group – impact of airport charges

As the largest airline group in Australia, Qantas Group pay a significant amount of airport charges, mostly in Australia. Qantas publish the annual *Qantas Data Book* which includes more detailed financial and operational information that is not published in its annual reports.

Data that is published includes the annual cost of the 'aircraft operating variable' (AOV). The AOV includes route navigation charges, landing fees, airport security charges, maintenance of aircraft, passenger expenses (in-flight consumables and amenities), and crew expenses.

The route navigation charges and landing fees are combined in the data presented in the *Qantas Data Book*. The data presented is for the whole of Qantas Group, therefore includes Jetstar Asia, which does not operate in Australia. Jetstar Asia accounts for around eight per cent of Qantas Group passengers. It will also include landing fees incurred at overseas airports.

While this data does not provide a perfect breakdown of airport charges that are incurred by Qantas Group in Australia, trends in this data series are likely to give a good indication of trends over time, given the majority of services provided fly to or from Australian airports.

Table 6.7: Qantas Group, selected financial and operational data[31]

	08-09	09-10	10-11	11-12	12-13	13-14	14-15	15-16	16-17
AOV ($m)	2,834	2,675	2,768	2,980	3,061	3,303	3,206	3,346	3,436
AOV share of 'expenditure'	20%	20%	19%	19%	20%	16%	22%	23%	23%
Route navigation and landing fees (as % of AOV)	40%	41%	43%	43%	43%	45%	44%	44%	44%
'Implied' route navigation and landing fees ($m)	1,134	1,097	1,190	1,281	1,316	1,486	1,411	1,472	1,512
Implied share of 'expenditure'	**8.0%**	**8.2%**	**8.2%**	**8.2%**	**8.6%**	**7.2%**	**9.7%**	**10.1%**	**10.1%**
Total passengers ('000)	38,438	41,428	44,456	46,708	48,276	48,776	49,181	52,681	53,659
Route navigation and landing fees per passenger ($)	29.5	26.5	26.8	27.4	27.3	30.5	28.7	27.9	28.2

Source: Qantas Data Book, 2008-09 to 2016-17, Melbourne Airport analysis

What the information in the *Qantas Data Book* reveals is that on a per passenger basis, route navigation and landing fees per passenger for Qantas Group have increased from around 8 per cent of 'expenditure' to 10 per cent of total expenses over the past decade.

This increase is due to reduction in other expenses for Qantas, as route navigation and landing fees on a per passenger basis have broadly remained flat since 2008-09. In fact, compared to 2008-09, this expense line on a per passenger basis has decreased from an average of $29.5 per passenger in 2008-09 to $28.2 per passenger in 2016-17 in nominal terms.

Given that airport charges would account for a significant share of this expense line, there does not appear to be any evidence of a significant increase in the cost of airport landing charges for Qantas Group since 2008-09.

[31] Based on published rounded percentages, estimates will not be exact but indicative

Other costs for Qantas Group have decreased over this period. The cost of fuel per passenger is 40 per cent lower in 2016-17, and the cost of labour per passenger is down by 22 per cent over the same period.

Table 6.8: Qantas Group, selected costs per passenger

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Route navigation and landing fees per passenger ($)	29.5	26.5	26.8	27.4	27.3	30.5	28.7	27.9	28.2
Fuel cost per passenger ($)	93.7	79.2	81.6	90.3	86.0	91.5	80.1	61.7	56.6
Manpower and staff cost per passenger ($)	95.8	82.2	83.1	80.8	79.7	77.3	73.3	73.4	75.2

Source: Qantas Data Book, 2008-09 to 2016-17, Melbourne Airport analysis

These significant declines in costs reflect the broader industry trends. The reduction in fuel costs has enabled an increase in the supply of air services, which has added to the demand for airport services, requiring additional investment.

6.1.4 Security charges

Each of Melbourne Airport's aeronautical agreements, the ASA agreement or separate terminal agreements allow for the pass-through of security costs. This expenditure is passed through on a non-profit basis. Service requirements for security are embedded in charging and are common to all airlines using that security service, with the exception of VIP security queues. Melbourne Airport provides security services in terminals 2, 3 and 4. Security services in Terminal 1 are managed by Qantas as part of its domestic terminal lease.

Melbourne Airport works with airlines and the suppliers of security services to deliver the required security services as efficiently as possible. Melbourne Airport and airlines regularly discuss service issues such as queue lengths relative to cost and Melbourne Airport provides the service to match airline expectations.

For example, a study to reduce Terminal 2 costs through a lane reduction program has been undertaken. Melbourne Airport, its supplier ISS and the airlines used the Terminal 2 screening point to test savings against service outcomes for a number of different ways to deliver security screening services. This allowed Melbourne Airport to identify the most efficient approach to providing security services.

New mandated security requirements can add cost to the system by either requiring additional labour, slower processing or more sophisticated equipment, and broader infrastructure modifications. However, there are also opportunities to reduce security costs through the introduction of new technology and modernised processes.

In 2017-18 the cost of security services per passenger was $3.76 in Terminal 2, **[Commercial-in-Confidence]** in Terminal 3, and **[Commercial-in-Confidence]** in Terminal 4. The per passenger cost of providing security services at Melbourne Airport terminals has decreased for both Terminal 2 and Terminal 3 in 2017-18 relative to the year prior. While the cost per passenger of security for Terminal 4 increased slightly in 2017-18, the increase was small, and the cost of **[Commercial-in-Confidence]** per passenger is low and reflects the efficient design and scale of the terminal design.

6.2 Delivery of efficient investment

Melbourne Airport has invested in its facilities to provide access to Melbourne for more services from more airlines, supporting competition and growth, enabling air travel to be more accessible to more people than ever before. Without this investment, the strong growth in travelling passengers, and all the economic benefits that this brings, would not have been possible.

Since the international terminal expansion delivered in 2010, international passenger numbers have almost doubled. The construction of Terminal 4 has delivered a purpose-built facility for low-cost carriers, with the capacity to service 10 million passengers a year. The light-handed regulatory framework has enabled the efficient delivery of these significant investments.

The challenge of delivering such significant capacity whilst maintaining quality of service should not be understated. Passenger growth, whilst mature, is still going strongly, meaning volume increases in passenger numbers remain high, with further capacity expansions required to meet demand, including a new runway required within the next five years. Melbourne Airport is nearly 50 years old; capacity investment needs to fit in with the existing airport infrastructure, whilst ageing assets to be replaced, new-for-old.

6.2.1 Efficient investment

At Melbourne Airport, there are a number of processes in place to ensure that the right amount of infrastructure is built, at the right time. The first step is to ensure that existing infrastructure is being used efficiently. Determining when additional infrastructure will be required is done through forecasting demand profiles. Then Melbourne Airport works to determine the best infrastructure solution to meet future demand, in consultation with the airline community.

The key determinant of capital expenditure is peak slot demand from airlines, which is dictated by the aviation markets. At Melbourne Airport, this demand requires new investment to cater for marginal, but profitable, airline growth during peak periods.

In the delivery of airport services Melbourne Airport is the middle-party between airlines and passengers, with Melbourne Airport's interests aligned to both. Through the commercial negotiation process, airlines have an incentive to minimise the costs for the level of service required, while a good passenger experience and a sufficient supply of infrastructure are in the interest of the passenger. The commercial tension between airports and airlines results in efficient levels of service delivery that strike the right balance for both passengers and airlines.

6.2.1.1 Efficient use of existing infrastructure

The first stage in efficient investment evaluation is whether the existing facility is at capacity. Busy hour demand analysis is matched against capacity choke points on the airport, for example demand for baggage reclaim versus number of reclaims. This sets the agenda for new investment.

Day of operations planning attempts to schedule flights to maximise utility of infrastructure with the airlines utilising the infrastructure prior to investment. For example, common ground handlers for airlines may use adjacent check-in desks, or airlines with multiple flights leaving in similar time frames may use the same check-in areas. Gates are allocated where possible to maximise airside efficient operations for airlines.

Design of infrastructure is all about maximisation of existing facilities. Examples include boarding and deplaning of aircraft via aerobridges and rear stairs, and extending reclaim belt presentation length to accommodate multiple flights; for example, two Code C aircraft using a belt designed for a Code F

aircraft. On the airfield adding rapid exit taxiways from the runways has decreased runway occupancy times; and on landside adding lanes to roads rather than new roads of grade separation.

All of these measures are employed prior to new investment taking place. In addition at an industry-level, Melbourne Airport is working with Airservices Australia on A-CDM (Airport Collaborative Decision Making) which is about pooling industry resources to improve on-time performance (OTP) through the sharing of information and better utilisation of existing infrastructure.

Despite these measures, in each ASA agreement period Melbourne Airport has invested in excess of the proposed capital plan to cater for increased passenger growth, without seeking a change in prices for the contract period. Melbourne Airport would not take this action unless it was absolutely required, and the existing infrastructure was already being used efficiently. The current regulatory framework works well to drive this positive behaviour.

Airlines use of airport infrastructure

While airlines have significant influence over airport capital expenditure decisions, airports do not have an influence over airline capital expenditure. For example, airlines make major decisions on fleet procurement without primary consideration given to the airport infrastructure the aircraft will require and consume.

The decisions by airlines to change their fleet mix on domestic routes are likely due to other operational factors, such as improved economics of narrow body aircraft both in terms of cost and revenue generation, and greater market positioning by offering a greater number of frequencies, with quicker turnaround times.

Melbourne Airport considers that while this can result in the inefficient use of airport infrastructure, the overall outcome is likely to be an efficient one. The benefits for the ability of airlines to make their decisions based on other aspects of their operations is likely to outweigh the inefficient use of airport infrastructure.

However, it does highlight the challenge for airports in delivering the right amount of infrastructure, and that for other reasons outside the airport's control airport infrastructure is not used as efficiently as it could be. The implication for Melbourne Airport is that a greater number of frequencies, often in the critical peak hours, are required to serve the same number of passengers. Over three Boeing 737 services are required to deliver the same number of seats as two A330 services.

The current practice of charging for airport services on a per passenger basis, at the request of the airline community, provides no direct incentive to use airport infrastructure efficiently. Benefits of this approach for airlines include reduced risk, as airport charges are only realised when revenue from ticket sales is realised, which also impacts the risk for airports.

More efficient use of airport infrastructure by airlines would result in lower aeronautical prices due to lower capital investment. However, the benefits of per passenger charging for airlines, and the higher costs of other airline operations relative to aeronautical charges, are likely reasons why the current approach is preferred by airlines.

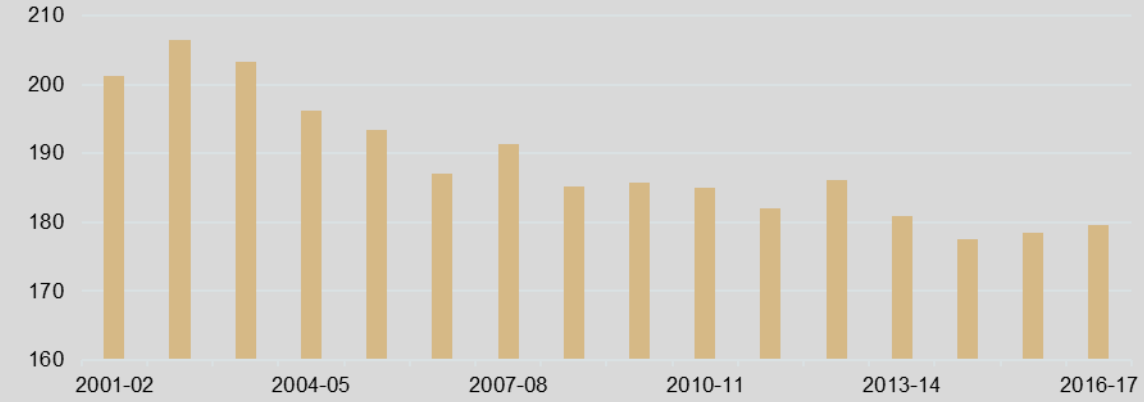
Box 6.3: Changes in the domestic aircraft fleet

In the domestic market, operators of wide-body aircraft made fleet decisions that increase the frequency of lower-seat-count narrow-body aircraft at the expense of higher capacity wide-body aircraft. Recent examples of the downsizing of aircraft include:

- Qantas' retirement of domestic wide-body Boeing 767 aircraft in 2015, replaced with predominantly smaller 737 aircraft;
- redeployment of domestic Airbus A330 aircraft to international markets such as Beijing, Hong Kong and Tokyo by both Qantas and Virgin; and
- the Boeing 787 order made by Qantas which was initially made to replace domestic wide-body aircraft has been delayed, with orders received to date deployed to international markets.

The effect of these decisions is particularly notable on the Melbourne to Sydney route, where seats per service have decreased from over 200 in 2002-03 to below 180 in 2016-17. As such the actions of airlines can increase the inefficiency of airport infrastructure, to achieve overall airline efficiency.

Figure 6.7: Melbourne to Sydney, seats per service



Source: BITRE

6.2.1.2 The timing to build infrastructure

Forecasting when to build is key to optimal investing. Therefore, peak period passenger demand plays a fundamental role in the development of capacity infrastructure at Melbourne Airport due to the passenger demand profiles.

This forecasting forms the basis of how Melbourne Airport determines infrastructure needs and its delivery. While forecasts of annual passenger numbers inform the aeronautical prices determined through the building block model, 'busy hour' forecasts are used to determine the future need for airport capacity.

Development of busy hour forecasts

The domestic passenger profile across a typical 24-hour period is driven by passenger preferences for flying, origin and destination airport curfews, high number of rotations per aircraft, maintaining optimal schedules and the typical business passenger needs revolving around business day operating hours.

Melbourne Airport defines the busy hour metric as the 90th percentile daily busy hour. Both arrival and departures busy hour measures are recorded historically and forecasted forward based on trends in historical peaking factors between annual passengers to busy hours.

In addition to the impact of hub traffic operating to and from Melbourne Airport, airport slot availability, geographic location for preferable arrival/departure times and competitive pressures between airlines shape the international peak periods as shown previously in section 3.4.

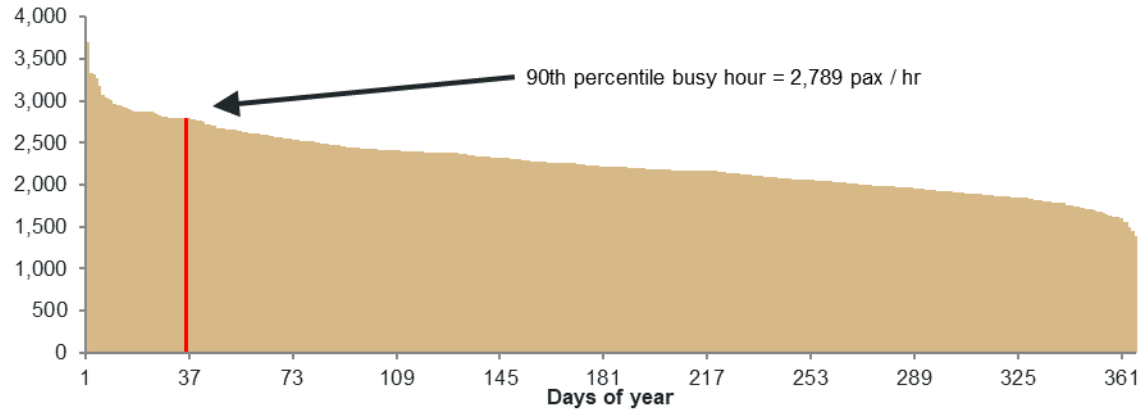
Domestic demand at Melbourne Airport can be segmented into two key peak periods: morning (0600-1000) and evening (1700-2000). Whilst there are steady volumes of domestic passenger demand occurring outside of these key periods, they tend to serve point-to-point leisure destinations which are more flexible in scheduling.

Beyond the impact of traffic profiles during peak periods, significant growth in international traffic during the peak has rapidly increased the key planning measure of busy hour passengers. The busy hour passenger measures for arrival and departures assist with assessing and developing airport capacity and planning options across the airport. Increases above forecasted busy hours impact triggers for investment in airport capacity earlier to maintain existing levels of service.

A critical output of busy hour forecasts is the future planning flight schedules which use a range of metrics from the busy hour passengers, annual forecasts, historic flight times, short-term sales forecasts, aircraft fleet mix, future aircraft purchases from airlines and historic load factor performance to develop detailed future flight schedules.

Planning busy hour forecasts provide a basis for the planning of key capacity processing elements within the terminal such as check-in, security, immigration, baggage reclaim and secondary examination areas. Figure 6.8 demonstrates the variation in international departure busy hours across 2015-16. Whilst the maximum busy hour recorded in 2015-16 was 3,719 passengers, the 90th percentile is the key planning metric and was 2,789 passengers per hour.

Figure 6.8: International departures busy hour, 2015-16



Source: Melbourne Airport

6.2.1.3 Determining and delivering the infrastructure solution

To support efficient and effective development Melbourne Airport has established clear and defined development processes and procedures to ensure appropriate checks and balances are in place throughout the development process. The development process is modelled on industry best practice models and guides developments through the key project stages: plan, develop, deliver and operate.

The staged process is designed to guide the development, monitoring and evaluation of capital investments and ensure Melbourne Airport is efficient and effective in its use of capital. Key stages in this process are as follows:

- plan – identification of the opportunity, initiative or project;

- develop – develop business cases through the development of the project scope and design (a key part of the airline consultation process);
- deliver – implement the approved project (in conjunction with airlines particularly where day of operations impacts are necessary); and
- operate – measure the benefits derived from operation of the completed project. This process is all about how efficiently Melbourne Airport is using the existing and now new capacity prior to new investment.

During the development process airline consultation happens at a number of touch points. During the negotiation process, capital plans and the drivers are discussed in detail prior to agreeing to the plan. Throughout the contractual cycle, reporting on major project progress is delivered and during the implementation process any day of operations impacts are discussed through either specific project working groups or the Airline Operators Committee.

Planning stage

Melbourne Airport develops and maintains a 20-year capital plan for future aviation development. Plans include the development of existing facilities and the creation of new facilities to provide additional capacity to meet growth.

The purpose of the capital plan is to optimise the allocation of resources, maximise asset and investment value, ensure there is sufficient capital investment to meet capacity, growth, replacement, refurbishment, compliance, and commercial business needs.

From both the Master Plan and capital plan, teams develop individual precinct plans that plan for the next 10 years of development. The timing for the delivery of programs and projects planned for is assessed short-term (0-5 years) and medium-term (5-10 years) periods across landside, terminal and airfield facilities.

Development stage

The development team then prepare the business case and project brief for each identified project including detailed plans for the delivery of identified projects. Where appropriate, projects are grouped into programs of work to deliver time, cost and coordination benefits.

These programs and projects pass through a set development and delivery process with key gateways that must be passed before progressing to subsequent stages, testing that projects and programs provide an efficient and effective use of capital expenditure to meet the capacity need.

At the end of each development stage projects must demonstrate that they have met the set requirements of the stage prior to proceeding to the next design or delivery phase. A priority for Melbourne Airport through this process is that these developments provide benefits to the airline community and passengers. Key development gates are set out in Table 6.9.

Table 6.9: Melbourne Airport development process gates

Gate	Purpose	Outcome
A	**Short Form Business Case** – Identifies the business need and opportunity, consistency with strategy (corporate and business unit), the benefits and high levels cost and budget.	Project is approved for inclusion in Capital Plan and to progress through further stages.
B	**Preliminary Business Case** – Defines in detail the opportunity/need, identifies the options assessed and the preferred option, defines strategic alignment and business unit alignment, identifies and quantifies business benefits, quantifies cost and timing of the investment, the delivery time.frame and procurement approach.	Project has been approved to progress through the design stages.
C	**Final Business Case** – Updates the Preliminary Business Case based on the work undertaken through the design development phase including detailed and final definition of scope, cost, schedule, risk, benefits identified, quantified and ranked with operating model and procurement plan finalised.	Project has been approved to be procured and delivered.
D	**Benefits Realisation Report** – Reviews outcome of project and assesses performance against benefits identified in the Ready to Proceed Business Case. Documents lessons learned to be applied to future investment decisions.	Project realised benefits are reviewed against business case assumptions and lessons learned captured.

Source: Melbourne Airport

Cost planning and management

Melbourne Airport has developed a comprehensive and robust approach to estimating and cost management to support the project lifecycle phases. This approach is supported by an external cost consultant who provides Melbourne Airport with independent cost planning and cost management services to support capital expenditure.

Key to the cost planning process is ongoing update of development cost data, including benchmark data from previously completed projects and Melbourne Airport key cost planning principles. This sets out the additional costs that are unique to development on an airport site, such as security costs.

On a six-monthly basis the Melbourne Airport cost planning team benchmark tendered cost of key cost elements with the external market to ensure the costs included in our cost plans are consistent with the wider construction market. For large projects Melbourne Airport undertakes external peer review of cost plans using an independent cost consultant to provide a further benchmark check to ensure costs are not excessively conservative or excessively aggressive.

As part of the cost planning process identified, project risks are costed and quantitative risk analysis is applied to projects in excess of $5 million in capital value.

Delivery stage

Melbourne Airport's procurement processes ensure the selection of contractors and consultants to deliver capital projects is based on selecting the right supplier with the right skills and experience to undertake the works at the right price to obtain best value. Different approaches are used dependent on the specific requirements of individual projects. Melbourne Airport has well established procurement processes used for supplier procurement. The current main procurement approaches used are outlined in Table 6.10.

Table 6.10: Melbourne Airport procurement procedures

Procurement type	Use
Traditional fully documented	Generally used on more complex, operationally critical projects where Melbourne Airport needs to retain control of the design to ensure key requirements are met.
Design and construct	Used on less complex non-critical projects where contractor input can add value and reduce overall cost through buildability methodologies.
Minor works	Used on projects of low risk, low value and low complexity. Melbourne Airport defines scope to be delivered then contractor engaged to design (if required) and construct.
Document and procure	Used on simple procurement of equipment or items of plant.

Source: Melbourne Airport

Suppliers are procured through a competitive procurement process, with pricing based on a fixed price lump sum basis or a guaranteed maximum price basis for the defined scope of works to be delivered. Supplier submissions are assessed in two distinct areas:

- technical – assessment of the supplier's technical submission including methodology, proposed schedule, project team, approach to safety and quality; and
- cost – the proposed cost of the scope of works to be delivered.

Technical and cost submissions are provided by suppliers in separate submissions, known as a two-envelope process. Only on completion of the technical assessment is the cost assessment undertaken. Single sourcing is used only where specialist suppliers or contractors are required to deliver specific expertise or services where no other suitable supplier or contractor can be found.

Development challenges

The age of existing infrastructure and the complexity of working in a live environment are key challenges for planning and developing infrastructure at Melbourne Airport.

Large areas of the existing terminal buildings are in excess of 40 years old. When undertaking development of these facilities projects often need significant structural works, building services works, and require replacement of many of the existing facilities to meet current Australian Standard and Building Code requirements. Often these works are unseen in the 'finished project', as they can be hidden behind walls or above ceiling spaces.

Melbourne Airport operates 24 hours a day, seven days per week, every day of the year. Maintaining these operations is a key requirement in all development projects. Teams invest significant time and resources planning and sequencing works to minimise the impact on day-to-day operations. Where required, works are undertaken out of hours, and work zones are sequenced to minimise disruption. This often extends construction durations and increases costs given the phasing and sequencing required to deliver the works.

Delivering investment in this environment significantly adds to costs, relative to the greenfield development of Melbourne Airport when it was first built. Whether it is adding check-in desks to an operating terminal, or replacing concrete on the airfield, these works are undertaken in a live environment operating 24 hours a day, seven days per week, which significantly adds to the cost of delivering capacity and replacing aging infrastructure.

6.2.2 Infrastructure investment at Melbourne Airport

Since privatisation in 1997, Melbourne Airport has continually invested in infrastructure to facilitate growth in airline and passenger activity and the multiple supporting functions that operate on airport land.

There are a number of different drivers of infrastructure investment, which include capacity expansions to accommodate passenger growth, infrastructure upgrades to meet changing industry needs, replacement capital expenditure to replace ageing airport assets new-for-old, and investment required to meet any new legislative requirements for operations such as security and customs.

These various change factors have required Melbourne Airport to invest in people, processes and substantial infrastructure in order to provide appropriate facilities to meet airline needs, accommodate growth, fulfil legislative obligations and provide an appropriate experience and level of service for passengers. Figure 6.9 outlines at a high level the key infrastructure developments at Melbourne Airport since it was opened in 1970.

6.2.2.1 Melbourne Airport Strategy 1990

In response to long-range passenger and aircraft movement forecasts (1990-2050), the Federal Airports Corporation and the Victorian Government jointly developed a long-term strategy for the airport's development and management – the Melbourne Airport Strategy 1990.[32] Its objectives were to:

- maximise the use of Melbourne Airport to achieve the greatest economic benefit for the state, the aviation industry and the airport operator;
- ensure Melbourne Airport has the capability required of a major Australian international and domestic airport by planning adequately for aviation traffic, passenger flows and ground traffic, within agreed social and environmental constraints;
- agree on an airport design that balances airside and landside operations;
- enable progressive development of facilities (when economically justified) in terms of passenger capacity and/or aircraft operations, passenger convenience and freight movements;
- retain, where practicable, flexibility in the plan to meet changing demands or circumstances within agreed criteria.

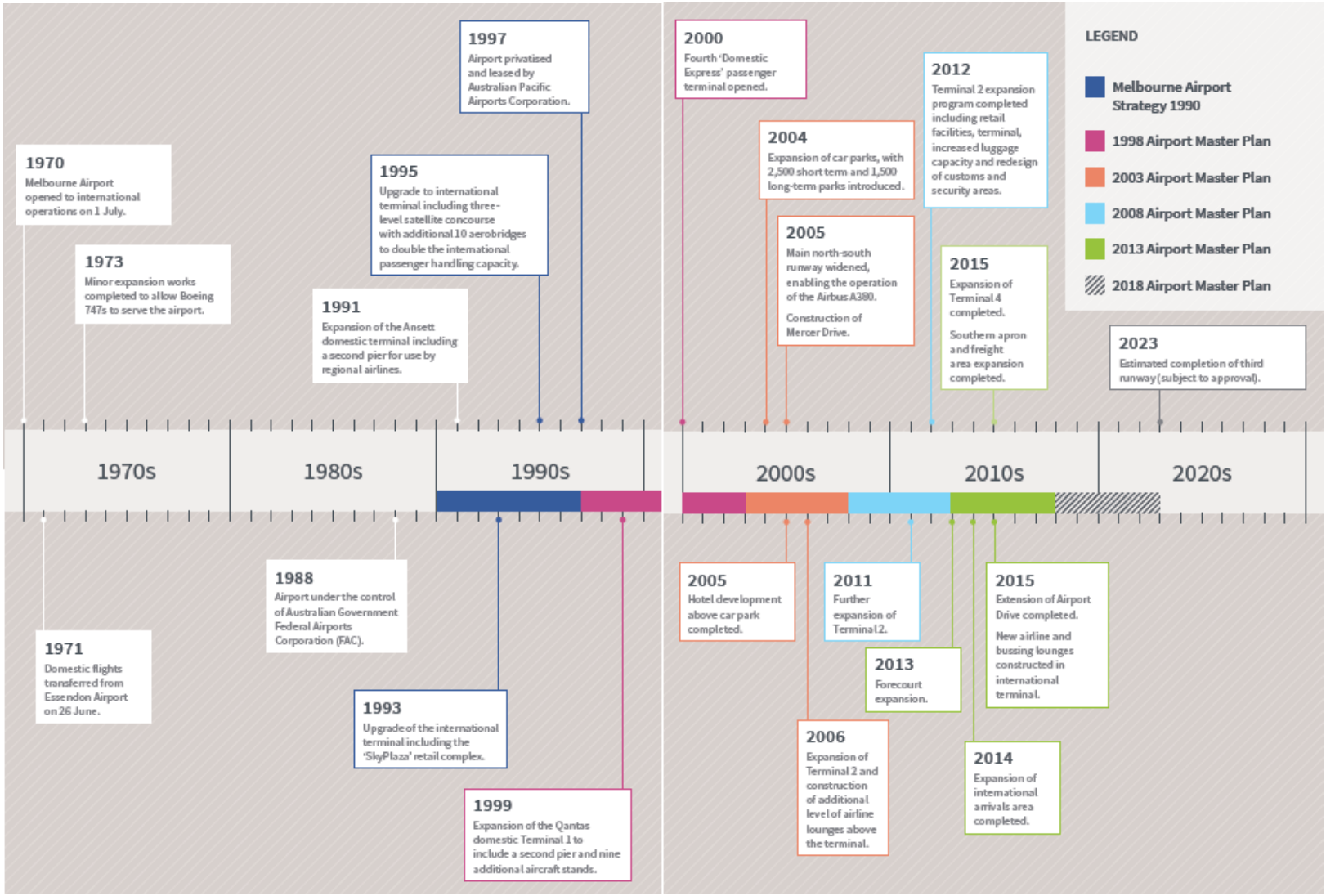
The Commonwealth and Victorian governments formally endorsed the Melbourne Airport Strategy in 1990 following a comprehensive Environmental Impact Statement involving extensive community and industry consultation. The Environmental Impact Statement was prepared under the Commonwealth *Environment Protection (Impact of Proposals) Act 1974* and was subsequently approved by the then Minister for the Arts, Sport, the Environment, Tourism and Territories on 12 November 7, 1990.

The Melbourne Airport Strategy provided a broad framework for orderly airport development, road and rail access and external land-use control to protect the airport's 24-hour, curfew-free operation and formed the forerunner to the current master planning process. A key feature was provision for the future development of wide-spaced parallel north-south and east-west runways to optimise hourly and annual capacities and operational flexibility.

These features have provided the basis of every long-term plan and the progressive infrastructure development for Melbourne Airport since 1990.

[32] https://infrastructure.gov.au/department/ips/files/log/1990-Melbourne-Airport-Strategy.pdf

Figure 6.9: History of investment at Melbourne Airport



Source: Melbourne Airport Master Plan 2018 Preliminary Draft

6.2.2.2 Investment to expand capacity

Since privatisation, annual passenger volumes have more than doubled from 13.5 million passengers in 1996-97 to 36.7 million passengers in 2017-18. This strong growth in demand has resulted in peak capacity constraints of the existing infrastructure, which has required significant expansion of airport facilities including taxiways and terminals, and more efficient use of the existing infrastructure. Major capacity investments include the Terminal 2 expansion in 2010, and the construction of the new Terminal 4, designed to meet the needs of low-cost carriers.

Use of the airport infrastructure has also become more efficient since privatisation, as passenger demand has grown into the legacy infrastructure. In the international terminal at Melbourne Airport significant investment has been undertaken in all facilities including check-in counters, baggage reclaim and aircraft gates, which has seen the number of these facilities approximately double. As outlined in Table 6.11, the utilisation of these facilities has also increased significantly, with the number of annual passengers using each facility increasing by around 250 per cent for check-in-counters and aircraft gates, and around 220 per cent for baggage reclaim carousels.

Table 6.11: Terminal 2 facilities per passenger, Melbourne Airport

	1996-97		2017-18	
	Number	**Annual passengers per facility**	**Number**	**Annual passengers per facility**
Check-in counters	72	33,600	130	83,600
Reclaim carousels	4	605,300	8	1,358,300
Aircraft gates[33]	14	172,900	25	434,700

Source: Melbourne Airport

[33] Includes contact and remote aircraft gates

Box 6.4: Terminal 4

In 2013-2015 Melbourne Airport constructed Terminal 4 (T4) – a new domestic terminal, a pier and aircraft parking aprons to accommodate Jetstar's strong growth in operations which could no longer fit in Terminal 1 alongside Qantas.

Designed for a capacity of 10 million passengers annually to also accommodate growing Tigerair and Regional Express operations, this new terminal investment provided equivalent operating capacity to Perth Airport, in a relatively compact 15,000-square-metre footprint.

Key components of the investment program included the following items, noting that were many other ancillary projects necessary to facilitate the new terminal:

- the new T4 – $225 million development, the first terminal in Australia with only automated, self-service check-in function to provide maximum operational and cost efficiency for airlines;
- the $178 million southern apron expansion program comprising 12 aircraft parking positions for Jetstar, relocated freight apron (three aircraft positions) and new remote apron for three wide-body aircraft;
- the new Terminal 4 car park and transport interchange to accommodate car parking, pick-up and drop-off vehicles, taxis and buses. The combined package value of car park, access roads, services and enabling works was approximately $277 million; and
- a new subterranean services tunnel to provide necessary utilities supply.

T4 was designed in close collaboration with airlines who were seeking a 'low-cost' terminal with appropriate infrastructure to facilitate efficient airline operations at a cost-effective price. This included building a single level pier without aerobridges, providing self-service technology at check-in and undertaking several value management initiatives to keep costs low.

Since opening in late 2015, both Jetstar and Tigerair have experienced strong growth at much higher rates than their full service counterparts. In a recent industry survey, T4 was voted as the third best 'low-cost' terminal in the world and is further demonstration of Melbourne Airport providing necessary, cost-effective and appropriate investment to benefit airlines and the Victorian economy.

6.2.2.3 Investment to meet industry needs

Infrastructure upgrades have also been necessary to respond to changing industry needs, such as new standards and new equipment; for example, upgrades were required to accommodate the Airbus A380 aircraft, an aircraft that was never imagined when the airport was originally constructed nearly 50 years ago.

As airlines continually strive to grow, operate more efficiently and create product differentiation in a competitive market, this has resulted in the introduction of larger aircraft, new technology (such as self-service check-in) and product enhancements.

Box 6.5: A380 introduction

In the mid-2000s the Airbus A380 aircraft entered into service representing a step change in the product offering by airlines, size of aircraft and the infrastructure required to support it. With an 80-metre wingspan, this aircraft was 15 metres wider than the next largest (e.g. B747).

It was the first of a whole new category of aircraft type (Code F) both in terms of spatial requirements and volumes of passengers and bags that could be carried. The first fully double-deck aircraft carrying approximately 500 passengers, all new terminal connections and servicing equipment were required to reach the upper level.

To prepare for introduction of the A380 by several airlines Melbourne Airport delivered several large infrastructure projects including but not limited to:

- widened runway 16/34 by 15 metres to comply with Code F standards;
- taxiway amendments;
- redevelopment of existing aircraft gates requiring new aerobridges, building interfaces, larger departure boarding lounges, and apron infrastructure;
- facilitation of new, bespoke ground service equipment including upgrading of airside roads and storage areas; and
- one new baggage reclaim carousel greater than 90 metres long (followed by a further two in subsequent years) and baggage handling system to accommodate larger volumes of bags.

Since inaugural operations with a single Qantas A380, demand has increased and now Melbourne airport typically accommodates four to five A380 aircraft simultaneously on the ground during morning and late night peaks.

Airlines operating include Qantas, Emirates, Qatar, Malaysia, Etihad and Singapore, with Qantas and Emirates typically operating two aircraft during peak periods. Melbourne Airport's A380 infrastructure investment responded to and facilitated product and growth opportunities, delivering a lower cost per seat for airlines. This has created commercial benefits for airlines, and cheaper fares for passengers.

6.2.2.4 Investment to replace existing infrastructure

There have been numerous maintenance, replacement and refurbishment projects over the years to ensure the facilities can continue to operate and support functions at an appropriate level. As with any infrastructure asset, this is an ongoing regime that is undertaken as a considered approach in order to keep existing assets operating appropriately throughout their entire life cycle prior to replacement with new equipment.

There is a large volume of small value projects and cyclical maintenance regimes for all manner of assets, including but not limited to airfield lighting, baggage handling systems, air conditioning units, escalators, lifts, electrical cabling and switchgear, distribution boards, water mains, stormwater networks, sewer systems, road maintenance, landscaping, line-marking and IT and communication systems.

Melbourne Airport also cross-checks maintenance programs with proposed capacity redevelopments and expansions in order to ensure that there are no overlaps or maintenance works undertaken that would effectively become abortive. Conversely, if capacity projects can replace old equipment that is at end of life and/or expensive to maintain annually, then these opportunities are assessed in order to deliver the best cost-benefit outcome.

In the last ASA period Melbourne Airport invested approximately $220 million in maintenance, replacement and refurbishment projects across airfield, terminals, roads, utilities and general infrastructure. Of this, approximately half was on airside assets (pavements, lighting, services, etc) with the majority ($86 million) being related to one principal pavement replacement program described below.

Box 6.6: Airfield Pavement Maintenance and Replacement programs

Airfield pavement maintenance and replacement is an essential activity for airports in order to minimise any disruptions or potential hazard risks to aircraft operations that could result from runway/taxiway closures, or pavement failures, or pieces of loose pavement being ingested by aircraft engines.

Melbourne Airport was constructed almost 50 years ago and many of the main taxiways and apron areas have been the same concrete pavements that were laid at that time. Melbourne Airport aims for a 40-year service life when designing concrete pavements and so these original areas have exceeded their theoretical life due to the comprehensive maintenance practices undertaken.

In addition to concrete, Melbourne Airport also has several areas of asphalt pavements, including most notably the runway. Asphalt pavements are flexible in nature and due to movement they require more regular maintenance including cyclical overlays with new asphalt every 12-15 years depending on condition. Melbourne Airport last undertook an overlay of both runways in 2011 at a cost of $45 million.

Reactive repairs are undertaken when required, but airports take a very proactive and thorough approach through regular inspection and maintenance regimes to minimise risk of failures and implications for airline customers and travellers. Maintenance works include regular crack sealing, line-marking, sweeping and localised repairs of pavement failures.

Having said that, during the last ASA period it was necessary to rebuild the concrete pavements in several major taxiway and apron areas due to excessive cracking and pavement failures resulting from underlying structural failures in the sub-pavement layers.

This pavement replacement in taxiways Papa, Uniform and Golf (PUGs) was undertaken as a single program. Details of the PUGs program included:

- replacement of poor condition 40-plus-year-old pavement in critical Papa, Uniform and Golf taxiways and 20 aircraft parking bays at Pier C, Pier D and Pier E;
- staging was carefully coordinated with airlines to ensure no more than two aircraft bays were out of service simultaneously and access was maintained to remaining bays;
- traditional concrete pavements (typically 500mm thick) provided with a 40-year design life; and
- $86 million total cost, with each taxiway area delivered in three separate phases between 2013 and 2016.

In several critical taxiway entrance and intersection areas, new technology Rapid Set concrete was used. This allowed one slab to be removed, new concrete poured and hardened to accept aircraft movements within a five-hour window overnight. Much more expensive than traditional methods requiring 28 days of curing time and months of outage, this technique was used sparingly and only in critical locations in order to minimise disruption to airline operations.

Separate to the PUGs program, other pavement maintenance and replacement works undertaken at Melbourne Airport required include general crack sealing, pavement maintenance and emergency repair works. Specific works have also been required for other taxiways.

Taxiway Alpha required an asphalt overlay applied to a section of taxiway north of Runway 09/27, to address very poor pavement condition including excessive cracking and surface degradation. This was a cost-effective approach to extend pavement life on a section of taxiway that is critical for operational movements and cannot be removed from service for extended periods of time to rebuild the underlying concrete pavement.

Taxiway Juliet also required the replacement of very poor to failed condition concrete slabs on a section between Taxiway Alpha and Runway 16/34. This work was done in conjunction with construction of the new Taxiway Victor, in order to take advantage of the necessary closure of Juliet. This optimised construction efficiencies and reduced cost and operational disruptions relative to the works being done separately.

The above approach to deliver taxiway upgrades in a live operating environment comes at a significantly higher cost than if the same works were delivered on a greenfield site.

6.2.2.5 Investment in response to legislative requirements

Melbourne Airport has had to adapt to changes in legislative requirements and facilitate the necessary activities of various government agencies such as Australian Border Force, Australian Federal Police and Department of Agriculture and Water Resources (e.g. Quarantine). Legislative requirements relating to security screening of passengers and bags, border control and also quarantine screening of plants, animals and food have changed and for the most part become more stringent over the past 10 years.

Introduction of liquids, aerosols and gels (LAGs) screening requirements resulted in changes to screening protocols and the length of time it took to process passengers through screening points, Introduction of more staff and expansion of screening areas to accommodate more x-ray lanes and introduction of full body scanners was all necessary.

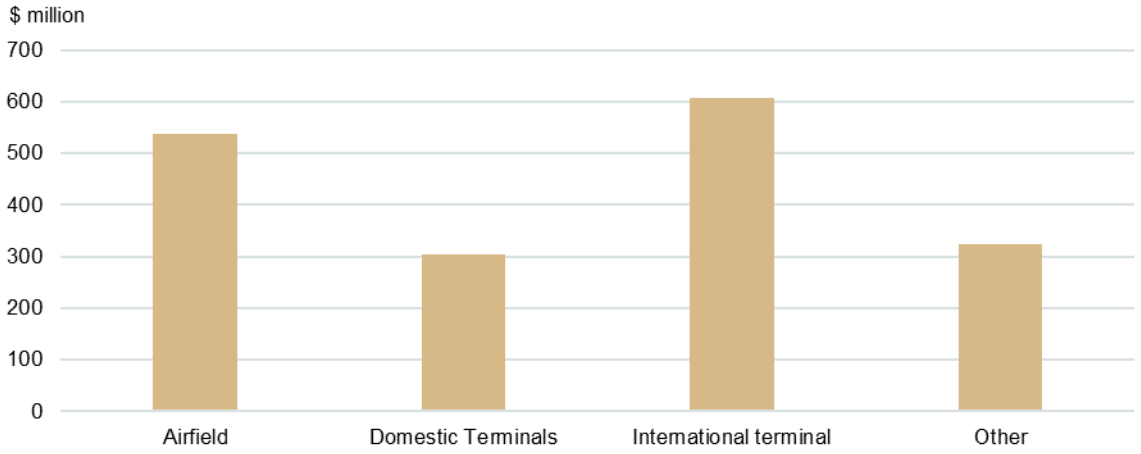
In 2014, Melbourne Airport redeveloped the Australian Quarantine Inspection Service (AQIS) Secondary Examination Area (SEA) to facilitate appropriate search and processing areas necessary for the agency to meet intervention requirements. In 2016 the Border Force introduction of automatic ‘SmartGates’ at departure emigration points required the redevelopment of the outbound processing area in order to install the new units.

The Federal Government announcement earlier this year of new legislation requiring the introduction of computed tomography (CT) technology for screening passengers and checked baggage will require substantial investment in infrastructure change over the next two years to accommodate this larger and heavier equipment. Melbourne Airport has already commenced construction on a $25 million redevelopment of the international departures security screening area to accommodate the new technology equipment and future passenger growth.

6.2.2.6 Infrastructure investment over the past decade

Over the past 10 years, the airport has experienced very strong growth, particularly in international activity as new markets have opened up and airline competition has increased. This has required significant investment in aeronautical assets over the past decade. Total capital investment across the airfield, domestic terminals (operated by Melbourne Airport) and the international terminal was over $1.4 billion between 2007-08 and 2016-17, with over $300 million invested in other aeronautical infrastructure. This program of investment was developed in consultation and agreement with airlines.

Figure 6.10: Aeronautical investment at Melbourne Airport, 2007-08 to 2016-17



Source: Melbourne Airport

Investment in the international terminal was highest at over $600 million over the decade, reflecting major projects including the major terminal expansion on 2010. Airfield capital investment was also over half a billion dollars, with the Southern Apron Expansion to accommodate Terminal 4 the largest project, delivered in 2015. Investment in domestic terminal projects was over $300 million over the 10-year period, which included the construction of Terminal 4. Other aeronautical investment includes investment that is funded through aeronautical charges, such as roads, utilities, and other required infrastructure.

Whereas the original airport infrastructure had headroom within which to accommodate growth to that point, this recent 10-year period has required more significant infrastructure expansions and reconfigurations to meet demand within the underlying configuration and confines of the main terminal precinct.

Figure 6.11 and Figure 6.12 are aerial photos demonstrating the significant extent of airfield and terminal expansion associated with the Terminal 4 development and the Terminal 2 expansion.

Figure 6.11: Melbourne Airport 2009

Figure 6.12: Melbourne Airport 2018

Airside infrastructure investment

Melbourne Airport has invested in airside infrastructure projects over the past decade to increase the capacity of aircraft that can be serviced at Melbourne Airport, and replace ageing assets. Significant airside investments include the Southern Apron Expansion, which was built to provide parking facilities for aircraft using Terminal 4, whilst the PUGS (apron and taxiway areas) concrete replacement capital project involved the replacement of concrete that was nearing the end of its useful life and in poor condition. Table 6.12 outlines the key airside infrastructure projects at Melbourne Airport over the past 10 years.

Table 6.12: Airside infrastructure projects, Melbourne Airport

Project	Value	Category	Delivered	Description
International (Delta Pier) Apron expansion	N/A (part of overall $330m) program)	Capacity	2010	+5 wide-body (e.g. A380, B777) aircraft contact gates and associated pier, as Aircraft Gate Expansion component of overall $330m T2 Strategic Terminal Expansion Project (STEP).
Runway overlays	$45m	Replacement	2011	Periodic overlay to rejuvenate runways with new pavement surface to service increasing passenger volumes and larger, heavier aircraft types.
Northern Apron Aircraft Parking	$1m	Capacity/airline needs	2012	Conversion of GSE area to +2 narrow-body (e.g. A320) aircraft parking positions to meet Jetstar growth.
Delta GSE	$9m	Capacity	2014	New 9,000m^2 ground service equipment (GSE) storage area to accommodate airlines' needs following the introduction of additional gates.
Airside Road Extension	$6m	Capability	2013	New 1.6km road to connect main terminal precinct to new cargo/logistics precinct. Particularly providing access to a maintenance facility for ground handlers' GSE.
Airside Security Gate relocation	$3m	Capacity/airline needs	2013	Main airside/landside security gate relocated to make room for new T4 site.
Foxtrot Apron	$30m	Capacity	2013	New 30,000m^2 apron providing flexible parking for 2 wide-body or 4 narrow-body aircraft. Used by REX airlines (6 x aircraft) since completion of T4.
Southern Apron Expansion program	$178m	Capacity/airline needs	2015	Redevelopment and expansion of southern apron area to facilitate aircraft parking associated with new T4 project and overall airport growth: Pier G (T4) Apron – 12 narrow-body (e.g. A320) hydrant fuelled aircraft bays to support Jetstar parking demand. Sierra Apron – new 60,000m^2 apron providing flexible parking for 3 wide-body or 6 narrow-body aircraft. Used for bussing arrival flights or long layover parking. Freight Apron – relocation of 3 wide-body aircraft bays to new apron to create room for new Pier G.
Taxiway Victor	$71m	Capacity	2017	New north-south taxiway to support additional aircraft activity in the Southern Apron precinct caused by the T4 development.
PUGS Concrete Replacement	$82m	Replacement	2016	Replacement of poor condition 40+-year-old pavement in critical Papa, Uniform and Golf taxiways and aircraft parking bays at Pier C, Pier D and Pier E.
CAT IIIB and High Intensity Approach Lighting (HIAL)	N/A	Capability	2015	Upgrade of airfield lighting and aircraft guidance systems to higher standard CAT IIIB improving operational capability in poor visibility (fog) conditions to reduce delays and diversions for airline services.

Project	Value	Category	Delivered	Description
Pier C Aerobridge Upgrade	N/A	Airline needs	2013	Qantas upgrade of aerobridges at bay C11 to serve A330 wide-body aircraft required reconfiguration of taxiway centreline and apron area.
Pier B Bay 29	N/A	Airline needs	2013	Apron extension to provide new Q400 parking position for Qantas.
Aerobridge Replacement Program (T2 and T3)	N/A	Replacement	2013-15	Ongoing program of upgrading and replacing old aerobridges to reduce operational disruptions due to outages and therefore provide appropriate level of service for airlines.

Terminal infrastructure investment

Strong international passenger growth over the past decade, particularly in peak periods, has required significant investment to meet demand. Key investments include the major expansion of Terminal 2 in 2010 to growing international demand, and the construction of Terminal 4, designed specifically for low-cost carriers.

Installation of the eighth baggage reclaim in Terminal 2 is a good example of the challenges in adding additional capacity to a 50-year-old building. Much of the cost of delivering the eighth reclaim was not for the baggage reclaim itself, but was due to the cost of reconfiguring the building in order to make space. In order to deliver the reclaim a reconfiguration of the building structure was required, as lift wells and stairwells needed to be removed. A number of other operations were also relocated. Table 6.13 outlines the key terminal infrastructure projects at Melbourne Airport over the past 10 years.

Table 6.13: Terminal infrastructure projects, Melbourne Airport

Project	Value	Category	Delivered	Description
T2 Strategic Terminal Expansion Project (STEP) – Aircraft Gate (Delta Pier) Expansion	$330m	Capacity	2010	International terminal pier expansion providing +5 wide-body (e.g. A380, B777) aircraft contact gates, as component of overall $330m T2 Strategic Terminal Expansion Project (STEP).
T2 Strategic Terminal Expansion Project (STEP) – Central Core Expansion		Capacity	2010	International terminal expansion providing new outbound baggage handling system capacity, new security/emigration processing area and departures lounge. Component of overall $330m T2 Strategic Terminal Expansion Project (STEP).
T2 Common User Self Service (CUSS) check-in – zones D & J	$4m	Capacity/airline needs	2012	Redevelopment of retail areas to provide additional check-in capacity to meet airline growth and efficiency goals for Jetstar and Air New Zealand. Self-service kiosks and automatic bag drops (ABDs) were provided to improve operational flexibility and efficiency and also reduce operating costs for airlines.
T2 6th & 7th Baggage Reclaim carousels	$41m	Capacity	2012	Redevelopment and expansion of international baggage reclaim hall to provide two new Code F (A380) capable baggage carousels to serve additional airline services in the peak. Redevelopment of existing areas required relocation of multiple services to create space.
T2 Quarantine and Customs inspection facilities	$53m	Govt. agency needs	2015	Reconfiguration and expansion of queuing and processing areas to facilitate increased inspection requirements and passenger volumes.
Terminal 4	$225m	Capacity/airline needs	2015	New domestic terminal to facilitate Jetstar growth and relocation from T1. Also accommodates Tigerair and Regional Express.

Project	Value	Category	Delivered	Description
T2 Emigration (departures) SmartGates	$1m	Govt. agency needs	2016	Redevelopment of Emigration area to remove manual service desks and replace with new Australian Border Force automated SmartGates as part of national program.
T2 8th Baggage Reclaim carousel	$40m	Capacity	2017	Expansion of international baggage reclaim hall to provide new Code F (A380) capable baggage carousel. Redevelopment of existing areas required relocation of heat exchanger services room, gas supply room, Australian Border Force control room and offices; plus removal of three lifts, stairwell and reconfiguration of building structure. The new carousel provided necessary capacity to accommodate additional flights in the peak morning and late-night periods.
T2 Common User Self Service (CUSS) check-in – zones O, N & M	$10m	Capacity/airline needs	2017/18	Redevelopment of existing check-in areas to remove manual check-in desks and install self-service kiosks and automatic bag drops (ABDs) to improve operational flexibility and efficiency for airlines. The technology allows airlines to redeploy staff, reducing operational costs and infrastructure usage charges. Airlines using the areas have included new services by United and Air Canada, with Singapore also moving to the more efficient infrastructure.

Landside infrastructure

Growing passenger numbers have also created the need for greater landside capacity to access the airport precinct. The largest investment over the past decade has been the Terminal 4 ground transport hub, to enable landside access to the new Terminal 4 building. The Apac Drive freeway on-ramp has reduced congestion on the airport's road network, whilst upgrades to the airport forecourt have been made to reduce congestion. Table 6.14 outlines the key landside infrastructure projects at Melbourne Airport over the past 10 years.

Table 6.14: Landside infrastructure projects, Melbourne Airport

Project	Value	Category	Delivered	Description
Apac Drive freeway on-ramp	$24m	Capacity	2012	Additional entry point to freeway reducing congestion at main (Melbourne Drive) freeway entrance.
Francis Briggs Road extension	$2m	Capacity	2013	Provides access to new airside gate as well as back-of-house facilities such as staff car park, which was necessary to allow construction of new Terminal 4.
Widening to Terminal Drive (2-lanes to 4-lanes)	$8m	Capacity	2013	Provides additional storage capacity for vehicles using the main freeway exit to the airport, reducing queue lengths on the freeway.
Main terminal forecourt expansion	$11m	Capacity	2013	Forecourt lanes expanded and reconfigured to provide additional throughput for pick-up traffic and shuttles, reducing queues and wait times.
Ring and Ride	$2m	Customer service	2014	New parking area to allow for vehicles to wait safely away from forecourt area (and safely off freeway) if driver arrives in advance of passenger pick-up time.
T4 ground transport hub	$277m	Capacity	2015	Additional passenger pick-up and drop-off area and additional bus, shuttle and taxi areas provided to accommodate Terminal 4 expansion and overall airport growth.

Project	Value	Category	Delivered	Description
Airport Drive (Sharps Road to Mercer Drive)	$93m	Capacity	2015	New access point into the airport from the west/south to provide alternative route into the airport (other than Tullamarine Freeway) to improve network resilience and travel time reliability. Work included rectification of substantial drainage issues in the south of the airport.
Melrose Drive duplication	$3m	Capacity	2015	Additional at-grade capacity to accommodate additional Airport Drive traffic.
Taxi Holding Area upgrade	$1m	Efficiency	2017	Integration of e-tag technology to allow for better operational management of taxis and taxi throughput.
Parking and Forecourt optimisation	$15m	Efficiency	2018	Modifications to main terminal forecourt to reduce congestion, create a free public pick-up zone and improve the experience for car rental customers to meet passenger preferences.
Dynamic Lane Allocation	$7m	Efficiency	2018	Installation of full colour, electronic directional signage to dynamically allocate lanes during peak hour to reduce queueing/travel time for passengers entering the airport off the freeway.
Taxi management system	$2m (TBC)	Efficiency	2018	New electronic system to improve the management of taxis throughout the airport precinct.

Source: Melbourne Airport

6.2.2.7 Future planned investment

Over the next five to 10 years Melbourne Airport will need to continue to invest in new, expanded and also redeveloped infrastructure to continue to meet forecasted growth and provide appropriate facilities for efficient airline operations and a quality passenger experience.

Having effectively and efficiently developed the original airport infrastructure to accommodate significant growth, Melbourne Airport is facing a step-change period over the next 10 years in order to appropriately position the airport to accommodate long-term growth, evolving industry trends and airline initiatives to improve their operational efficiency and market competitiveness. Government changes to regulation, such as the recently announced requirements to introduce computed tomography (CT) screening, will require substantial building structure and baggage system reconfiguration in order to fit the new, larger and heavier machines.

In particular the strong growth in international demand and introduction of next generation aircraft will drive significant investment. Airline initiatives to adopt new technologies, enhance product offerings and be flexible with use of aircraft between international and domestic services will require ongoing redevelopment and re-purposing of existing infrastructure.

The international terminal (Terminal 2) is located between domestic terminals and is therefore inherently constrained. Providing new aircraft parking gates, expanded baggage handling systems capacity and check-in facilities will require expansion and clever re-purposing of existing terminals to provide flexible facilities and accommodate growth.

Due to the nature of the existing terminals, further expansion to the south will be necessary in the form of an expanded T4 or new T5 to shift domestic activities and allow international operations to expand into T1 and T3 in a flexible use manner. This will alter the configuration and centre of gravity of the precinct and is therefore a step-change for the airport. This means that in addition to terminal and airfield development, landside vehicle access, utilities and even the proposed rail station all need new investment in order to optimise the capacity, utilisation and efficiency of the assets.

Box 6.7: International aircraft gates

Melbourne Airport aims to fulfil the capacity requirements with appropriate investment that responds to airline needs in a pragmatic, cost-effective manner. During recent negotiations for development in the 2018 ASA period, solutions for additional aircraft gate capacity were a notable example.

Melbourne Airport initially presented a proposal to provide additional aerobridge (contact) gates by extending the Delta Pier concourse. The airlines objected to the overall cost, so Melbourne Airport responded with a simpler, low-cost solution for bussing operations to additional remote aircraft stands.

Many airlines objected to this proposal on the basis of the level of service being less than desirable and additional operational requirements of running the bussing operations. Melbourne Airport revised design thinking to develop a hybrid proposal of some additional bussing facilities (to address strong growth and insufficient time to build new concourses) and in consultation with airlines, particularly Qantas, re-purposing of latent domestic piers to provide 'swing gates' that can be used for both international and domestic operations.

Shifting international services from T2 gates to Pier C, for example, in turn frees up capacity in T2 for additional services for all airlines, thus this hybrid proposal was supported and included in the ASA.

Box 6.8: Runway Development Program

With its existing two-runway system, Melbourne Airport is expected to reach its practical capacity during peak periods between 2020 and 2022 with cancellations and delays already impacting passengers and airlines today.

This capacity constraint will inhibit the efficient functioning of the airport, leading to significant delays for passengers and freight, increasing fuel costs for airlines, increasing ticket prices in peak periods (which are already increasing significantly), increasing emissions, lost economic growth and consequential disruption to the Australian aviation network.

To address this the Runway Development Program (RDP) project includes the development of an east-west oriented parallel runway system. The two major components of the RDP are the construction of a new parallel east-west runway and extension of the existing east-west runway, along with associated infrastructure such as taxiways, navigational aids, security fencing and utilities.

In 2016-17, Melbourne Airport experienced 117 weekdays with morning peak on-time performance of 75 per cent or less. This is forecast to increase to almost every weekday by 2023, causing more disruption to passengers and the Australian aviation network. By 2022 the cost of delays to airlines caused solely by Melbourne Airport's existing runway system will exceed the cost of investing in the RDP.

The RDP will be released for public consultation in December 2018. Subject to gaining the required approvals, the runway will be operational by 2023.

Infrastructure developments required over the next 10 years will add capacity and increase efficiency (reducing costs for airlines) to respond to this need. Projects will include but not be limited to:

- RDP – providing dual parallel runways for fully independent operations;
- aircraft parking and airfield infrastructure to accommodate next generation aircraft such as new B777-X;

- ‘swing gates’ redevelopment of existing concourses to facilitate international and domestic operations including flexible switching of aircraft between these uses by airlines;
- technology enhancements for passenger processing, for example:
    - self-service check-in/automatic bag drops;
    - Border Control SmartGates;
    - new baggage and passenger screening CT machines;
- baggage handling (departures) system and reclaim carousel capacity;
- elevated road including reconfiguration of vehicle access and repurposing of existing At Terminal 123 car park structure to accommodate pick-up/drop-off functions;
- rail station – following recent Government announcements of commitment to a rail link connection to Melbourne Airport, a station will be developed within the main terminal precinct to provide simple, efficient passenger access to/from terminals; and
- Terminal 5 to accommodate domestic airlines and allow international expansion beyond Terminal 2.

The scale of investment planned is substantial, with the once-in-a-generation third runway project estimated to cost around $1.3 billion (subject to final design being completed), and at least $2 billion in other airport infrastructure planned over the next five years. Current plans indicate that the subsequent five-year period is likely to involve development of a similar scale, when significant projects like Terminal 5 and a rail station are likely to be required

This scale of investment is required. It is not an option, nor would it be economic, to build small units of incremental capacity. For example, you cannot build an additional runway to deliver five years of capacity. These are investments that deliver capacity for the long-term. The legacy infrastructure is being used as efficiently as possible at Melbourne Airport, which dictates that to enable passenger growth to continue, investment in significant infrastructure projects will be required.

Box 6.9: Major international terminal expansion

Whilst there have been numerous projects over recent years, it has been 10 years since the last major terminal expansion investment (Terminal 2 Strategic Terminal Expansion Project) was in construction. International passenger volumes have increased from 5.5 million in 2009-10 to 10.9 million in 2017-18, and the capacity provided by the project for additional aircraft gates, expanded departure concourse and new baggage system has been able to support that growth. Over the next 10 years this passenger volume is forecast to increase to 16 million passengers by 2027-28, requiring further substantial expansion and the redevelopment of existing facilities.

Melbourne Airport will exploit new technologies wherever available to deliver this growth in a cost effective way. However, additional capacity is particularly required for aircraft gates and baggage systems. These are physical items, for which improved technology or other efficiencies cannot alter the need for physical space. With airline preferences being for 'contact' gates (direct aerobridge connections from terminals to aircraft), this requires additional building infrastructure.

Delivering this growth in and around an existing facility that must remain operational has its challenges and will make additional capacity more expensive to deliver than it would be in a greenfield site. However, the option of abandoning the significant investment made in the existing facility and starting again is far more expensive, and is not an economic proposition.

The ability to expand within Terminal 2 is limited due to physical infrastructure constraints, therefore part of the plan is to integrate with and re-purpose adjacent domestic T1 and T3 infrastructure to meet growing international demand.

The planned Terminal 2 North Infill and Pier C Swing gates project is the prime example of this. This proposed project includes the re-purpose of latent gate capacity in Pier C of Terminal 1 to facilitate international operations through provision of flexible 'swing gates' to alternate between international and domestic flights. This development responds to key international growth needs and the operational efficiency direction that Qantas wishes to pursue. The early concept definition of this proposal was developed in conjunction with Qantas during early ASA negotiations.

The outbound baggage handling system capacity will also be expanded, providing a larger 'make-up' area to process bags for additional flights. The system will link to new international check-in being provided in Terminal 1, and incorporate new checked bag screening requirements and a bag store system for better operational efficiency.

Expansion of the airside departures lounge is also planned, to provide area to support additional international gates. This area will include expanded Duty Free and specialist retail to improve passenger experience and also help subsidise the overall project cost with non-aeronautical revenues.

The following tables outline key proposed investments in the upcoming 10 years, noting that there are multiple other smaller scale capacity projects and maintenance programs not shown here.

Table 6.15: Planned airfield infrastructure projects

Project	Category	Planned delivery	Description
Runway Development Program (RDP)	Capacity	2023	The construction of a new parallel east-west runway and extension of the existing east-west runway, along with associated infrastructure such as taxiways, navigational aids, security fencing and utilities. This will increase the runway capacity, reducing delays and enabling growth.
Taxiway Zulu Project	Capacity	2022	This investment has a number of benefits to the airline community including the provision of dual Code F taxiways around T2 and T1 which will improve the efficiency of aircraft movements around the airport. Additionally this investment enables a future pier expansion for the international terminal which responds to the airline request of aerobridge stands and reduce bussing operations. It also has a significant maintenance component, replacing 40-year-old taxiway concrete slabs.
T1 stand upgrades	Capacity/airline needs	2022	Increasing the capability of Pier C stands to accommodate larger aircraft (A330s, B787s) for international operations provides the opportunity to increase the utilisation of these stands outside of domestic operations for international use.
Delta South GSE	Capacity	2020	This investment provides additional GSE storage area to improve ground handling operations.
Alpha Apron	Capacity/airline needs	3-5 years	Increase remote parking capacity adjacent to T1. This will improve towing operations for international and domestic airlines.
T2 Apron Expansion	Capacity	5+ years	This investment will extend the existing T2 Pier to accommodate additional stands. These new stands will be able to cater for future aircraft such as B777-9X and A350-1000 for which a number of airlines in our community have orders.
Midfield Apron	Capacity	5+ years	Post-implementation of RDP, a new apron will be built in the midfield to accommodate tow operations. Proximity to the existing precinct and no crossings of the east-west parallels provide efficiencies to tow operations and no impact to the capacity of the parallel system.
Runway 16/34 rapid exit taxiways (RETs)	Capacity	5+ years	With RDP in place, operational efficiencies to Runway 16/34 will be introduced to reduce the runway occupancy time through the introduction of RETs. This will increase the capacity of the runway and reduce delays for airlines.
Taxiway Concrete Pavement Replacement	Replacement	1-5 years	Ongoing program to replace failed or poor condition concrete slabs on taxiways and aircraft parking areas.

Table 6.16: Planned terminal infrastructure

Project	Category	Planned delivery	Description
T2 Security Screening Expansion	Capacity/legislative requirement	2018	Redevelopment of current area to remove physical constraints (dividing wall and level change ramp) to facilitate introduction of next generation smart-security screening equipment including government-mandated CT technology. Upgraded facility will accommodate two additional screening lanes (totalling 10) and improved throughput to accommodate increased passenger volumes within existing building footprint.
T2 Baggage Make-up	Capacity	2018	Extension of existing make-up carousel for wide-body aircraft capability plus provision of new wide-body capable carousel to accommodate more peak period flights.
T2 Bussing Enhancement	Capacity	2018	Augmentation of two existing Delta Pier gates to facilitate bussing operations from same terminal gate lounge as aerobridged aircraft operations. Project optimises asset utilisation for flexibility of dual-purpose contact gate and bussing operations.
T2 Check-in Zone L	Capacity	2018	Replacement of existing 9 traditional (manual) check-in counters with 12 hybrid bag drops providing flexibility for either manual check-in or self-service automated check-in.

Project	Category	Planned delivery	Description
T2 Check-in Zone X	Capacity	2019	Redevelopment of current retail zone to provide new check-in zone with 16 check-in positions to accommodate 2 additional wide-body aircraft departures in the peak period.
T1 International Check-in	Capacity/airline needs	2020	Redevelopment of portion of T1 check-in hall to utilise latent capacity (post Jetstar vacating) to provide international check-in capacity for an additional 3-4 wide-body aircraft in the peak period.
T2 Landside Arrivals Hall	Capacity	2021	Redevelopment and expansion of existing landside arrivals hall to provide more space for passengers and meeters/greeters. The reconfiguration of space will ease congestion, provide a greatly improved level of service and 'welcome to Melbourne' experience. Other benefits are a new tunnel to remove baggage trolley movements through the hall and new vertical transport escalators to improve the movement of passengers to upstairs check-in areas.
T2 Immigration SmartGate Upgrade	Govt. agency needs	2021	Supporting Australian Border Force nationwide program to replace traditional manual counters with next generation SmartGates to facilitate automated processing and greater passenger throughput.
T2 North Infill & Pier C Swing Gates	Capacity/airline needs	3-5 years	Expansion of T2 to integrate with T1 including apron level expansion of outbound baggage handling system capacity and redevelopment of T1 Pier C to provide 3 wide-body aircraft parking positions. Refer separate description in Case Study.
Checked Bag Screening X-ray Replacement	Legislative requirement	2-3 years	Replacement of current x-ray machines with new computed tomography (CT) machines to comply with recently announced Federal Government regulations. 13 existing machines across all terminals need to be replaced. Extensive modifications to existing building structure and baggage handling systems will be required to fit the larger and heavier machines.
T2 9th & 10th Baggage Reclaim	Capacity	3-5 years	Additional wide-body aircraft capable baggage reclaim belts to service forecast airline growth in peak period services.
T3 Expansion	Capacity/airline needs	2021	Redevelopment and expansion of T3 to serve customer airline Virgin Australia's desire to increase capacity and refurbish one of their busiest terminals. The project will include redeveloping check-in with self-service kiosks and hybrid bag drops, providing a new outbound baggage make-up carousel and expanding the baggage reclaim hall with 2 additional carousels. It will connect T3 with T4 to create a single optimised security screening point, reducing operating costs for Virgin. It will also create a premium check-in area with dedicated security screening and direct access into the Lounge and Club, to improve product offering for premium travellers.
Echo Pier Swing Gates	Capacity	5+ years	Planned future expansion of T2 to connect with domestic Pier E and redevelop gates for 'swing' international and domestic capability. Repurpose and optimise existing infrastructure to provide flexible facilities to serve forecasted growth.
T2 Pier Delta Extension	Capacity	5+ years	Extension of existing international Delta Pier to provide additional 5 wide-body aircraft contact gates.
T2 Reclaim & Arrivals Hall – Phase 2	Capacity	5+ years	Planned future expansion of arrivals hall into the forecourt to provide appropriate space for forecast passenger volumes. The development will also allow provision of a new, expanded Secondary Examination Area for Customs and quarantine inspections, which will in turn free up existing space for lengthening 4 original baggage reclaim carousels for additional wide-body aircraft capacity.
Terminal 5	Capacity	7-10 years	To accommodate long-term forecasted growth in domestic and international passenger volumes it is highly likely that a 5th terminal will be required within 10 years. This can be provided within the current terminal precinct, most likely to the south of T4, and therefore unlike other airports, Melbourne Airport can continue to offer a consolidated, 'under one roof', single-terminal precinct. This has connectivity and operational benefits for airlines plus reduced capital costs compared to duplicating facilities in separate areas of the airport like at Sydney, Brisbane and Perth.

Table 6.17: Planned landside infrastructure

Project	Category	Planned delivery	Description
T4 connector	Capacity	2020	Will consolidate all terminal pick-up and drop-off traffic on to one freeway exit making for more intuitive wayfinding for infrequent travellers. The link will also provide a direct connection from Tullamarine Freeway to T4 ground transport hub making it easier for Terminal 4 passengers to reach their desired destination faster, and reducing pre check-in times.
Elevated Road and Forecourt	Capacity	2023	Will expand capacity of pick-up and drop-off in main forecourt and relieve intersection constraints at Terminal Drive/Centre Road and Melbourne Drive/Centre Road, and capacity constraints along Departure Drive. This will improve the passenger experience through shorter journey times and a reduction in vehicle/pedestrian conflicts.
Northern Transport Hub	Capacity	2027	Allow for an expansion of pick-up/drop-off capacity opposite Terminal 1 to ensure that the passenger benefits delivered as part of the Elevated Road and Forecourt project will continue to be realised as passenger numbers grow.
T4 Transport Hub – Stage 2	Capacity	2024	Expand pick-up/drop-off capacity for Terminal 4 to meet growing passenger demand.

6.3 Efficient provision of services

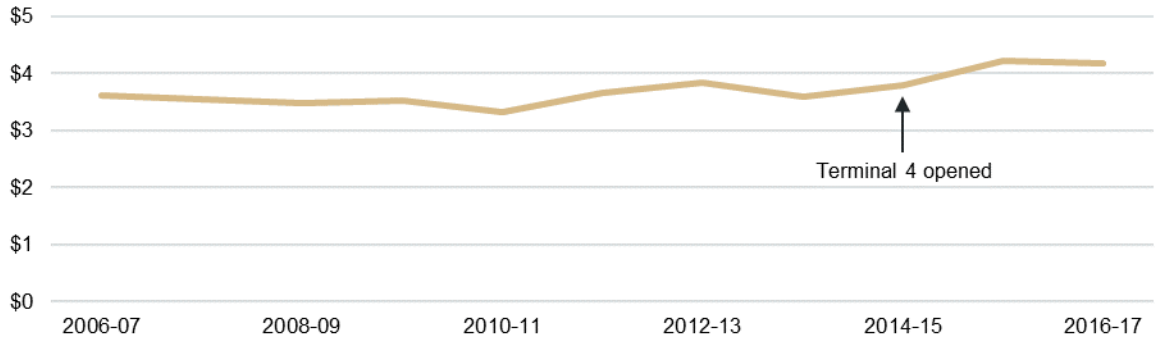
Melbourne Airport has maintained efficient operations, reflecting the incentives for an airport under the light-handed regulatory regime to operate efficiently.

6.3.1 Historical operational expenditure

Using the regulatory accounts reported to the ACCC, aeronautical operating costs (aeronautical expenses less depreciation) per passenger have increased by 15.4 per cent in real terms over the past decade, from $3.62 in 2006-07 to $4.18 in 2016-17. This estimate is based on the total number of passengers that use Melbourne Airport, so it is affected by the Terminal 1 lease as Terminal 1 passengers are included in this calculation, but Terminal 1 is operated independently by Qantas (see Box 5.2 on page 46 for explanation of terminal leases on per passenger measures).

Upon the opening of Terminal 4, additional passengers were being serviced by Melbourne Airport as Jetstar moved its operations without additional passengers using the airport in total, creating a step-change increase in operating costs per passenger. Up until the year before Terminal 4 opened, operating costs per passenger in real terms had broadly remained flat, decreasing marginally from $3.62 in 2006-07 to $3.60 in 2013-14 (Figure 6.13).

Figure 6.13: Aeronautical operating costs per passenger (real terms), Melbourne Airport[34]



Source: Melbourne Airport

6.3.2 Incentives for efficient operations

There are incentives for Melbourne Airport to operate and provide services and facilities in the most efficient way. One of the key metrics for our ability to earn income from retail operations is passenger dwell time.

Greater dwell time in terminals increases retail revenues. Departing processes such as an efficient internal road network, check in, outbound baggage systems and security all play a part in maximising dwell time per passenger. These in turn are influenced by design, agreed capacity expansions and day of operation systems and procedures.

The way agreements with airlines are structured provides an incentive for an airport to operate efficiently. Once an agreement commences, airports have an incentive to operate efficiently in order to reduce costs and maximise profits over the life of the agreement. Any efficiency gains would then form the basis for the agreed price for the next five-year agreement, and the process again repeats.

6.4 Quality of service

Ensuring that quality service is provided at Melbourne Airport is embedded into the airport's operations. Agreements with airlines specify the quality standards that are required to be met, and extensive surveys of passengers are undertaken to monitor the quality of service provided to passengers.

6.4.1 Agreed levels of service

A key element of every aviation commercial agreement is a commitment to quality of service. The first ASA agreed in 2003 contained quality of service measures (QSM). Key performance indicators (KPIs) are embedded in current agreements with airlines. These KPIs include measures of runway and taxiway availability, baggage system performance, check-in facility performance, aerobridge performance, and the results of our passenger surveys. Rebates are payable by Melbourne Airport to airlines where KPIs are not met.

New features in the latest ASA to provide greater certainty for airlines for the quality of service provided include the Quarterly Quality Forum to improve airport operation efficiency, and the Immediate Service Failure Rebate, which provides a mechanism for airlines to request a rebate where airport services have resulted in aircraft delays.

[34] Excludes depreciation

Box 6.10: Quarterly Quality Forum

A new feature agreed as part of the 2017 ASA is the introduction of the Quarterly Quality Forum (QQF). Melbourne Airport chairs the forum with airline customers (including the Board of Airline Representatives of Australia), as well as ground handlers that operate at Melbourne Airport.

The purpose of the QQF is to share information to improve airport operation efficiency. An initial meeting of the QQF agreed the terms of reference for the group, and a smaller subcommittee was formed to brainstorm ideas.

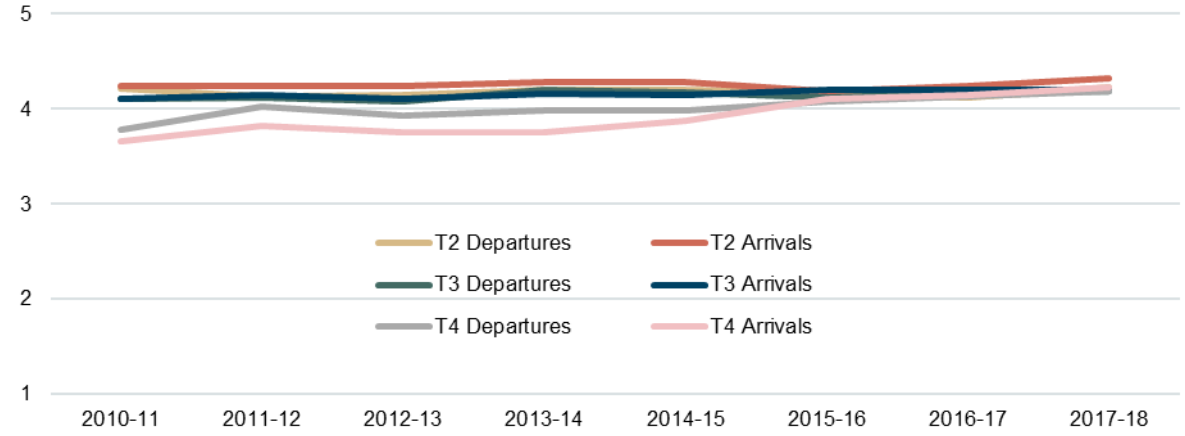
The forum will also monitor the Immediate Service Failure Rebate scheme in place. In its full form, the QQF will agree the best measures to improve efficiency, recommend capital expansions and improvements to the Capital Consultation Group (CCG).

6.4.2 Quality results

During a period of strong passenger growth, Melbourne Airport has maintained a high quality of service, an achievement that should not be understated. Based on passenger surveys, the overall experience score for terminals 2 and 3 has been above 4 out of 5 every year since 2010-11, with scores for Terminal 4 also above 4 since the new Terminal 4 building opened in 2015-16.

Scores in 2017-18 were the highest since 2010-11 for all Melbourne Airport operated terminals for both arrivals and departures, with the exception of Terminal 3 departures which scored 4.19 – marginally lower than 4.20 in 2013-14. Passenger ratings of Terminal 4 have increased significantly since 2010-11, reflecting the opening of the new Terminal 4.

Figure 6.14: Overall passenger experience survey results, Melbourne Airport



Source: Melbourne Airport

6.4.3 Measuring quality

Melbourne Airport has extensive and thorough procedures in place to measure the quality of service provided at the airport for passengers. Melbourne Airport's Quality of Service Program involves interviews with more than 20,000 passengers annually on their experience at Melbourne Airport, with interviews conducted across all terminals. The program is ISO20502 accredited, and measures passengers' levels of satisfaction with airport services on a 5-point scale (1 = Extremely Poor, to 5 = Excellent). Management reviews the results of quality service monitoring on an ongoing basis, to inform decisions around projects and initiatives to improve the customer experience at Melbourne Airport.

These surveys inform the monitoring data used by the ACCC in its monitoring of quality at Melbourne Airport.

6.4.4 Quality and service monitoring

The ACCC monitors the quality and service of the four monitored airports. These monitoring activities include:

- surveys of passengers
- surveys of airlines
- objective indicators.

These monitoring activities cover aeronautical, car parking and landside operations. The indicators are aggregated into an overall rating of the quality of service for the airport, with average ratings for the standard and availability of total airport services and facilities also published.

The difference between availability and standard quality ratings is important for the ACCC to consider, as these two measures of quality can be caused by different drivers, particularly when it comes to considering the market power of an airport.

The availability of services and facilities reflects their supply, whilst the standard reflects quality. For an airport that is experiencing strong passenger growth as Melbourne Airport has been, continuing to provide the same level of availability of services will be more challenging than maintaining the standard.

6.4.4.1 Benchmarking quality of service

The ACCC guidelines indicate that the ratings of satisfaction for airport services and facilities are based on a scale of 1 to 5 for surveys undertaken by airlines and passengers.

> *All survey participants are asked to rate the airport operators' performance for particular services or facilities on a scale of 1 to 5. The ACCC considers that ratings of 3 (satisfactory) and above represent service at an efficient level.*[35]

Table 6.18: ACCC rating of satisfaction for airport services and facilities

Scale	1	2	3	4	5
Rating	Very poor	Poor	Satisfactory	Good	Excellent

Source: ACCC, Guideline for quality of service monitoring at airports, June 2014

Melbourne Airport considers that this approach to benchmarking is appropriate. The purpose of the ACCC monitoring report is to monitor airport activities to determine whether there is any exercise of market power.

This approach to benchmarking quality of service is not reflected in the ACCC monitoring reports. The reports have focused on changes in service quality over time, with expectations from the ACCC that the quality of service must improve on the basis that revenue per passenger (for which increases have primarily been driven by changes in passenger volumes – see section 6.1).

> *Despite these much higher revenues per passenger, ratings of service quality are not materially different from those seen a decade ago.*[36]

[35] ACCC, *Guideline for quality of service monitoring at airports*, June 2014
[36] https://www.accc.gov.au/media-release/quality-of-service-improves-as-airports-collect-substantially-more-money-per-passenger

This falls outside the scope of the monitoring regime, for which the purpose is not to ensure that airports provide the efficient level of services. By the ACCC's own definition, all four monitored airports have provided a quality of service that is at an efficient level, every year for the past 10 years.

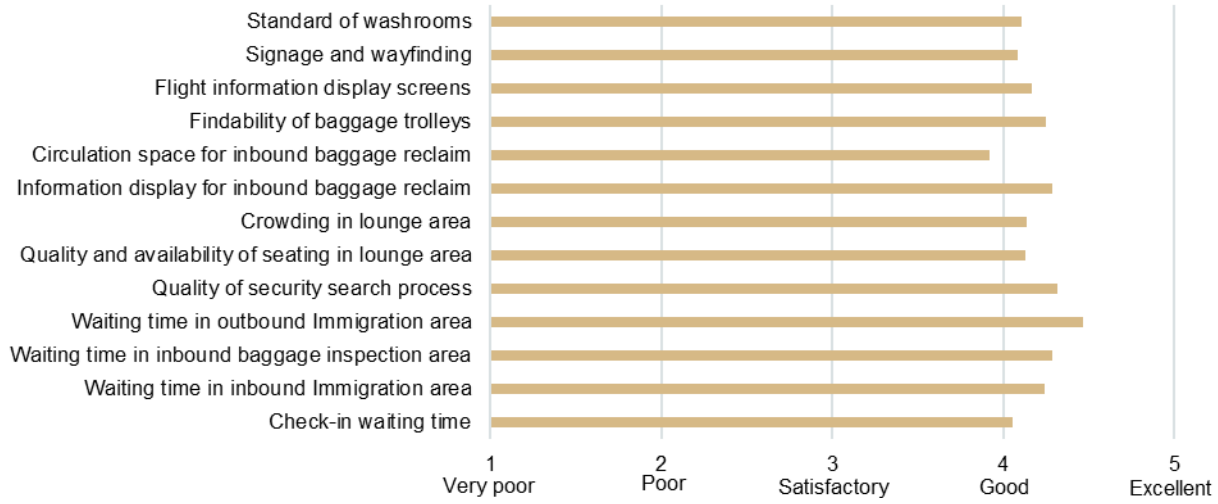
That outcome should be sufficient to satisfy the ACCC that there has been no exercise of market power that has resulted in a poor quality of service.

6.4.4.2 Surveys of passengers

Passenger surveys that inform the ACCC monitoring process are undertaken by Melbourne Airport as part of its overall quality and service monitoring (QSM) processes, and provided to the ACCC. Passengers have generally rated airport services higher than airlines, which is noted by the ACCC.

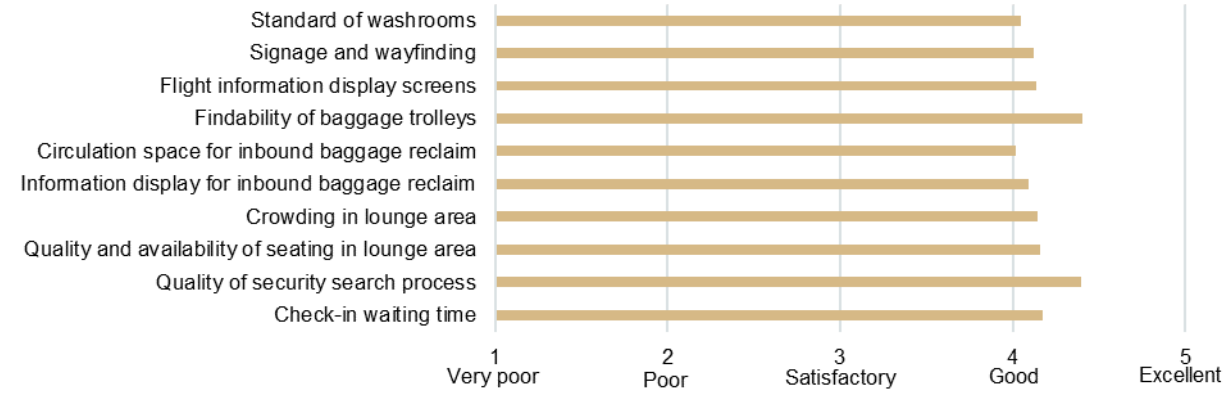
In 2016-17, all aeronautical-related services have been rated as good by passengers as per the ACCC monitoring results below, well above the satisfactory benchmark.

Figure 6.15: Terminal 2 passenger survey ratings, 2016-17



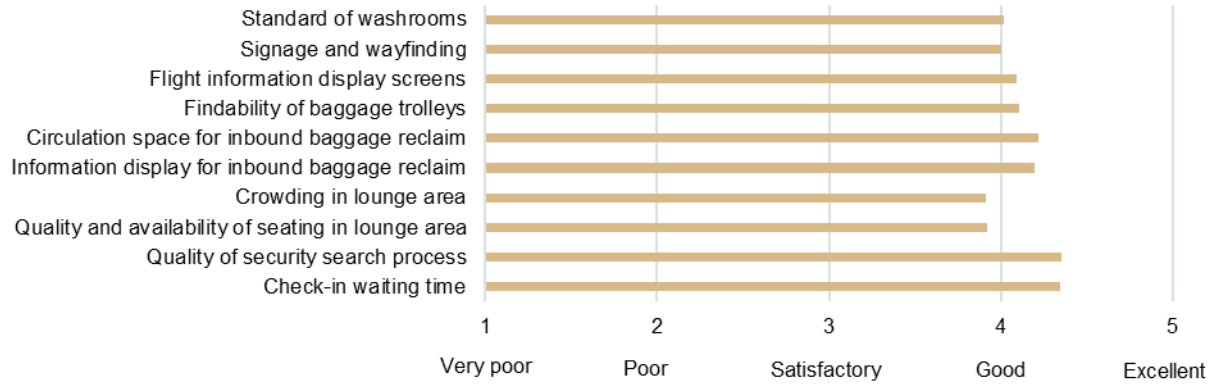
Source: ACCC

Figure 6.16: Terminal 3 passenger survey ratings, 2016-17



Source: ACCC

Figure 6.17: Terminal 4 passenger survey ratings, 2016-17



Source: ACCC

Despite forming an important part of the monitoring of quality and service, passenger ratings are provided little commentary in the ACCC monitoring report, relative to the airline surveys. Providing greater weight to the passenger survey results in the accompanying commentary would provide a more complete picture of the quality of service provided.

6.4.4.3 Surveys of airlines

The ACCC also surveys airline customers directly on the quality of services provided. Generally, the ratings of these surveys are lower than those from passengers, but they do assess different aspects of airport operations, so are an important part of the monitoring framework.

There are a number of methodological challenges with the airline surveys. Unlike passenger surveys which have a large sample size, airline responses to these surveys are provided by the airlines themselves.

It is not clear how robust the airline survey responses are, in terms of the processes that are used to inform them and the percentage of airlines that respond to the ACCC surveys. Melbourne Airport notes that the ACCC guidelines state that the ACCC will request that participants provide commentary explaining their ratings, but is not in a position to comment on how this works in practice. Greater disclosure of detail on responses and response rates received by the ACCC would give a better indication of how reliable the results from these surveys actually are.

There is the potential with this process for airlines to understate their ratings, in order to put airports under greater scrutiny, but whether this occurs in practice is not clear.

The commentary from airlines in the latest ACCC report reflect the current challenge of congestion at Melbourne Airport.

> *Airlines' ratings on the availability and standard of runways both dropped in 2016-17 but remained rated 'satisfactory' and 'good' respectively. The ongoing runway works and repairs occasionally had an adverse impact on runway availability. Some airlines said that the peak periods were significantly impacted by international demand and a lack of a slot management system, so flight delays were experienced at Melbourne airport on a daily basis due to extensive runway congestion.*
>
> *Airlines' ratings on the availability and standard of aprons improved within the 'satisfactory' range during 2016-17. The availability and standard ratings of aircraft parking facilities and bays also improved within the 'satisfactory' range during 2016-17. Despite this improvement, several airlines raised concerns about the shortage of parking bays during peak periods. Airlines mentioned that the capacity*

> *did not match demand resulting in gate holds, remote parking, bussing delays and a negative impact on the passenger experience.*[37]

There has been strong passenger growth at Melbourne Airport, with demand growing particularly strongly in peak periods where airlines and passengers prefer to fly. These impacts on quality, whilst within management's control to an extent, rely on investment in new infrastructure to cope with rising demand, which is ultimately agreed between Melbourne Airport and airline customers. Works to meet this growing demand can also affect the quality ratings provided by airlines.

> *Airlines' ratings on the availability and standard of taxiways both declined within the 'satisfactory' and 'good' ranges respectively during 2016-17. While there had been regular closures and works on many of the taxiways throughout the year, a number of airlines acknowledged that because of the huge amount of works, the standard of the taxiways might have reduced in the short term, but the ongoing work would improve performance in the long run.*[38]

Despite the various issues with airline ratings of airport services, all aircraft-related services were rated as satisfactory or good in 2016-17, meeting the ACCC guidelines for what qualifies as an efficient service.

6.4.4.4 Objective indicators

The ACCC also collects data on objective indicators, to measure the usage of facilities at monitored airports. These measures are usually measured in either total count, or the number of passengers per facility during peak periods. The measure of these indicators is reported, along with movements compared to the previous year, and the decade earlier.

What is not clear from the way these indicators are reported is that unlike surveys, there is no measure or benchmark of what represents an appropriate level of service. Many of these indicators are driven primarily by changes in passenger numbers during peak periods, rather than changes in the services provided, particularly for year-to-year movements.

For example, in Terminal 4 at Melbourne Airport the number of passengers per flight information display screen during peak hour was 153.7 passengers in 2016-17. This quality measure declined compared to the year prior, due to growth in passenger numbers during peak periods. This does not reflect whether or not the number of passenger display screens was adequate or not, or whether the amount of display screens is sufficient. All this really indicates is that the terminal was busier during the peak compared to the year before.

It is unclear from the ACCC monitoring report how much weighting these measures are given to the overall quality of service rating. However, the way they are measured currently does not necessarily reflect on the quality or efficiency of service that is provided by airport facilities.

Melbourne Airport would welcome greater transparency on how these measures impact overall quality ratings, and an assessment of whether the recorded levels of these measures reflect an efficient level of service or not, as is done with surveys.

[37] ACCC, *Airport Monitoring Report 2016-17*, p. 94
[38] Ibid

7 The regulatory framework for aeronautical services

Chapter summary:

- The incentives for airports, alongside the countervailing market power of airlines and the threat of further regulation, provide a framework which sufficiently constrains the market power of airports.
- The pricing and quality of airport services is monitored by the ACCC, and acts as an 'early warning system' of monopoly pricing behaviour, to inform the ACCC whether further action available to it is warranted.
- The current regulatory regime provides a threat of increased airport regulation beyond price monitoring. Pricing inquiries, the price notification regime, and the National Access Regime all provide a credible threat of regulation for airports that exercise market power.
- The deemed declaration of airport services is unlikely to promote commercial negotiations; would encourage regulatory gaming; and would potentially result in arbitration becoming the default outcome, increasing the prospect of regulatory error.
- Final offer arbitration would encourage regulatory gaming, and risk inefficient outcomes. It is not a process suited to negotiating or resolving disputes regarding complex and many-layered agreements such as airport service agreements.
- Given the absence of any evidence of market failure, additional economic regulation of aeronautical services is unwarranted.

Melbourne Airport considers that the current light-handed regulatory regime is working well. In particular:

- the regime continues to result in mutually beneficial commercial agreements between Melbourne Airport and airlines for the supply of aeronautical services, which are increasingly mature and sophisticated;
- the regime has resulted in efficient prices, with Melbourne Airport's average return on aeronautical assets being within the range of reasonable estimates for a benchmark provider of aeronautical services;[39] and
- quality of service has been maintained at an efficient level despite strong passenger growth requiring extensive capital works to expand capacity to meet demand from passengers and the needs of airlines, all within Melbourne's 24/7 operating environment.

That is, the light-handed regulatory regime has not resulted in any market failure, but has delivered increased airport investment as it was needed, a key driver in moving to a light-handed regulatory regime. There is no justification for further economic regulation of airports.

The commercially negotiated agreements resulting from the light-handed regulatory regime reflect Melbourne Airport's natural commercial incentive as a non-vertically integrated infrastructure owner to reach mutually beneficial agreements with its customers, facilitate and drive passenger growth and make appropriate investments in airport infrastructure. While negotiations for such agreements can be

[39] Houston Kemp, *Assessing market power in aeronautical services*, p. 27

complex and at times protracted, this reflects the bargaining power of both parties and is to be expected in significant commercial negotiations between sophisticated businesses.

The bespoke commercial outcomes resulting from the light-handed regulatory regime also reflect that any market power held by airports in commercial negotiations is significantly constrained, including on account of:

- the strong countervailing power of airlines – particularly in circumstances where the Australian aviation industry is structurally dependent on two dominant airlines;
- international airlines are authorised by the ACCC to collectively negotiate with airlines;
- airports are required by their Commonwealth leases to provide access to airlines;
- the ability and practice of airlines to withdraw or reduce the number of services operated from any airport; and
- a degree of competition from other airports – domestic and global.

These factors are in turn supported by the regulatory framework, which provides transparency and accountability in the supply of aeronautical services, and a genuine threat of additional regulation should market failure issues arise. Transparency and accountability are provided through the ongoing monitoring of prices, costs, profits and quality of service by the ACCC, and the threat of more heavy-handed regulation through the price inquiry and notification provisions of Part VIIA of the CCA and the National Access Regime under Part IIIA of the CCA. These provisions further limit any ability of Melbourne Airport to charge excessive prices.

In addition, any risk that airports may use their market power in a manner adverse to competition between airlines (or in other downstream markets) is curtailed by the general restrictive trade practices provisions of Part IV of the CCA, including the recently expanded prohibition on the misuse of market power under s46 of the CCA.

In light of the above, and in the absence of any evidence of market failure, additional economic regulation of aeronautical services is unwarranted.

7.1 The current regulatory framework

Since 2002, airports have operated under the light-handed regulatory framework. Under this regime:

- airport prices for aeronautical services are not set by regulation. Rather, airports are free to negotiate prices and other terms and conditions of access with airport users, but are expected to do so in accordance with particular pricing principles issued by the Government;
- the pricing and quality of airport services is monitored by the ACCC, to increase airport transparency and accountability, and to act as an 'early warning system' of monopoly pricing behaviour. Should the ACCC identify potential issues through its airport monitoring, it may recommend a pricing inquiry to the Minister, with a view to determining whether an airport has engaged in monopoly pricing or otherwise exercised its market power.
- airports are subject to the threat of further regulation should they engage in monopolistic behaviour, which acts to facilitate commercial negotiation and act as an extra constraint on airports' market power;
- the threat of further regulation exists through the potential application of the price notification regime and the National Access Regime, as well as through the risk of more direct government

intervention, such as a change in policy and legislation to return airports to heavy-handed pricing regulation.

The move to a light-handed regime was intended to give airports greater scope to undertake aeronautical investment, and more flexibility to respond to a changing aviation environment. That intention has been rewarded at Melbourne Airport, with investment to date enabling strong passenger growth, and meeting the needs of airlines.

7.1.1 The current framework provides sufficient constraint of market power

As noted by the Productivity Commission,[40] there are five ways that an airport could exercise market power:

- excessive fees or charges for aeronautical services;
- inefficient investment decisions (underinvestment and overinvestment);
- inefficient operation;
- low quality/limited range of services; and
- commercial negotiations.

The ACCC monitors the airports directly in two aspects of the above through its two main activities:

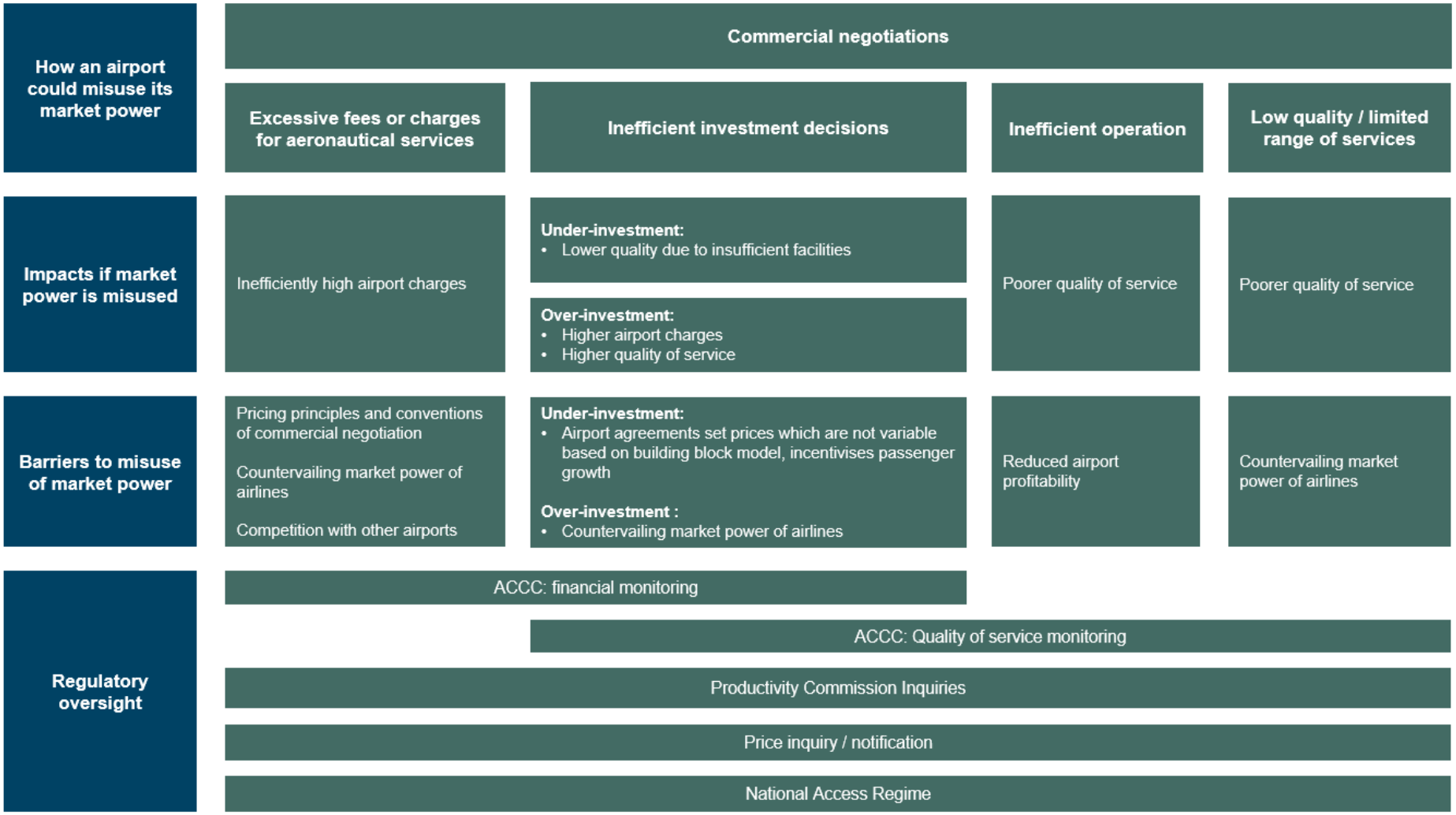
- aeronautical price monitoring and financial performance results; and
- quality of service monitoring.

Any of the types of exercise of market power identified by the Productivity Commission would ultimately result in either inefficiently high aeronautical prices, or inefficient levels of service quality, either low or high. These two potential outcomes that are both monitored by the ACCC in the current regulatory framework. To the knowledge of Melbourne Airport, it has not used its powers to initiate further investigation based on its monitoring results.

This monitoring process, the constraints and incentives that exist within the light-touch regulatory framework, and the threat of additional regulation, provide sufficient protections from any potential exploitation of market power. The detail of ways an exercise of market power are constrained or could be identified in the current regulatory framework are outlined in Figure 7.1.

[40] Productivity Commission 2018, *Economic Regulation of Airports Issues Paper*, p. 6

Figure 7.1: Current regulatory framework



Underinvestment

The impact of underinvestment in airport facilities would be expected to result in either higher airport charges arising from capacity constraints, or lower quality of airport services due to undersupplied or poor quality facilities being provided.

In practice, higher airport charges would not result in underinvestment given the way airport pricing is formed in commercial agreements with airlines. Agreements between airlines and airports by convention are based on per passenger airport charges based on the building block methodology, and typically are set over periods of at least five years. These commercial arrangements provide for flat charges per passenger charges.

Under this framework, there is no incentive for an airport to underinvest to restrict supply, as prices would not increase accordingly. Rather, given that prices are set as per aeronautical services agreements, and that non-aeronautical revenues for airports are driven by passenger throughput, airports are incentivised to increase revenue through growing passenger volumes, which incentivises more investment rather than less.

Given that airports do not have financial incentives to underinvest given that pricing is based on the pricing principles, any impacts of underinvestment would be expected to result in poorer quality. Quality of airport services is measured by the current ACCC quality service monitoring framework.

Overinvestment

If an airport were to overinvest in infrastructure above an efficient level, then this would be expected to result in higher airport charges, improvements in the quality of service provided, or both.

An important constraint on the ability of an airport to overinvest is the countervailing market power of airlines. As outlined in section 6.2.1, Melbourne Airport undertakes extensive consultation with airline customers, to ensure that the right amount of infrastructure is delivered, and that it is designed to meet the needs of airline customers and passengers. The relevant costs of this infrastructure are then incorporated into airport charges.

Where the resulting charges are too high airlines have the ability to shift capacity to other markets that provide a better return. As airport revenues are passenger based, optimising capital expenditure to expected demand is motivated.

The information collected by the ACCC allows them to identify airports that are increasing investment, by way of the regulatory aeronautical accounts. Where an airport is investing in infrastructure, the ACCC can consider this investment alongside any other issues that may be relevant, such as growing demand, or the age of the airport's infrastructure, to consider whether an airport may have been overinvesting. This information is sufficient for the ACCC to decide whether further investigation is warranted.

Inefficient operation

The way agreements between airports and airlines work in practice provides airports with a financial incentive to operate efficiently. Given that common use airport-wide agreements are typically over a five-year period for and 10 years for more specific terminal agreements, once an agreement commences airports have an incentive to operate efficiently in order to reduce costs and maximise profits.

Any efficiencies gained during the life of an ASA agreement would then form the basis for the agreed price for the next agreement. Once this next agreement is agreed, airports again have an incentive to operate efficiently to maximise profit, and so on. Given that agreements under light-handed regulation

have matured since the introduction of light-handed regulation, long-run efficiency would now have been reached. An airport operating inefficiently could also result in lower quality of service.

As demonstrated in section 6.3, Melbourne Airport now operates efficiently with operating costs per passenger flat in real terms for much of the past decade at the same time quality of service has been maintained.

Melbourne Airport considers that the financial incentives for efficient operation and ACCC monitoring of quality provide sufficient mechanisms to ensure efficient operations under the current regulatory framework.

Commercial negotiation

The Productivity Commission note that airports could exercise their market power in the way they approach commercial negotiations. Monitoring this activity specifically falls outside the scope of the current ACCC monitoring process.

However, if this were to occur, then it would present through one of the four other ways an airport could exercise its market power, and is therefore covered by the current monitoring regime, albeit indirectly. Periodic inquiries from the Productivity Commission provide government oversight of the behaviour of airports with regard to commercial negotiation.

As demonstrated throughout this submission, Melbourne Airport adopts a collaborative, transparent approach to commercial negotiation. These negotiations are based on conventions that reflect the principles of the light-handed regulatory regime, including the Pricing Principles. By going through the commercial negotiation process, there are many benefits that result in positive outcomes for airlines, airports, and most importantly passengers.

7.2 ACCC monitoring

A key aspect of the light-handed regulatory regime is ACCC monitoring of airport prices, investments, costs, profits and quality of service. Price monitoring is intended to ensure airport transparency and accountability, and provide an 'early warning system' for potential issues of market failure. The ACCC publishes an annual report of the findings of its monitoring, which is also provided to the Minister.

While monitoring of aeronautical services does have limitations, Melbourne Airport considers that it should continue. Its role as an ‘early warning system’ is an important part of the light handed regulatory framework, and it provides transparency and accountability to the supply of aeronautical services.

In respect of Melbourne Airport, the ACCC monitors:

- the prices, costs and profits of Melbourne Airport's aeronautical services and car parking services, pursuant to a government direction under the Prices Surveillance provisions in Part VIIA of the CCA;[41]
- the financial accounts of Melbourne Airport, which involves Melbourne Airport providing annual regulatory accounting statements and financial reports to the ACCC;[42] and
- the quality of service of Melbourne Airport's aeronautical services, pursuant to the *Airports Act 1996* (Cth) and the *Airports Regulations 1997* (Cth).[43]

[41] The ACCC does so pursuant to a direction under s95ZF of the CCA issued by the former Assistant Treasurer, Mr David Bradbury, on 12 June 2012.
[42] Pursuant to Part 7 of the Airports Act and Part 7 of the Airport Regulations.
[43] Pursuant to Part 8 of the Airports Act and Part 8 of the Airport Regulations.

The ACCC's price and quality of service monitoring does not extend to the Qantas domestic terminal at Melbourne Airport (Terminal 1) which is currently occupied and operated by Qantas under a domestic terminal lease, which is due to expire in June 2019.

7.2.1.1 The purpose of monitoring is to act as an early warning system

As the ACCC acknowledges, while the monitoring regime provides transparency and accountability regarding the supply of aeronautical services, the information collected does not enable the ACCC to assess in detail whether an airport has exercised market power.[44]

In that context, the **purpose** of the monitoring regime, as previously noted by the Productivity Commission, is to act as an 'early warning system' – that is, to identify and highlight potential areas of use of market power that warrant further investigation or regulation.

Should the ACCC identify potential use of market power by an airport in relation to the airport's pricing or other conduct, the ACCC may recommend to the relevant Minister that there be an investigation of an airport's pricing and conduct under Part VIIA of the CCA (addressed further below), which would allow the ACCC to undertake an in-depth investigation, and determine whether an airport had exercised market power to earn monopoly profits.[45] Further, a pricing inquiry may lead to the Minister subjecting an airport to the price notification regime in Part VIIA (also addressed below), or taking further steps to regulate the airport.

In this way, by acting as an 'early warning system' of airport misconduct, the monitoring regime is designed to facilitate commercial negotiation in the industry, and constrain any use of airport market power by contributing to a credible threat of further regulation.[46]

Further information on the ACCC's monitoring activities is set out in Annex 2 of the ACCC's *Airport Monitoring Report 2016-17*, and in section 6.1.2 of this submission.

7.2.1.2 Positioning by the ACCC regarding monitoring results

Melbourne Airport expects the ACCC to argue that the light-handed regulatory regime is not working well, and to call for a system of 'deemed declaration' of airport services, as the ACCC did in the Productivity Commission's Inquiry in 2011. In doing so, the ACCC will presumably rely on its annual airport monitoring results. Melbourne Airport rejects that the monitoring results indicate market failure or are justification for further economic regulation of airports. Rather, this reflects the prices and level of service that is agreed with airlines through commercial negotiation.

Melbourne Airport's expectation of the ACCC's position is based on the position taken by the ACCC when publishing its annual monitoring reports, in which the ACCC exclaims about headline airport profit or revenue figures, without making important qualifications as to the meaning and reasonableness of those figures.

It appears that the ACCC does so in order to criticise the light-handed regulatory regime and call for an expanded ACCC role in airport negotiations. For example, in releasing its monitoring report for 2016-17:

- the ACCC referred to the headline operating profits of major airports, stating, “It's not surprising that airports are so profitable, given that they face little competitive pressure and no price regulation”;

[44] ACCC, *Airport Monitoring Report 2016-17*, Appendix A4.3
[45] Further, should the ACCC identify conduct which would potentially contravene the general prohibition on the misuse of market power, the ACCC may conduct an investigation of that conduct, including by using its mandatory information gathering powers. This general prohibition is contained in s46 of the CCA, and focuses on conduct which has the purpose or likely effect of substantially lessening competition in a market.
[46] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, p. 216-7

- the ACCC commented that "We remain concerned that the current regulatory regime which is limited to monitoring the covered airports, doesn't constrain the market power of four of Australia's major airports".[47]

In making such statements, the ACCC implies that major airports may be using their market power to charge excessive prices, and that increased economic regulation of airports is warranted. However, any claim that further regulation is needed to regulate the use of market power based on ACCC monitoring results is necessarily unsubstantiated and positional, since the monitoring regime is not intended to enable the ACCC to assess in detail whether an airport has exercised market power.

Rather, the purpose of the monitoring regime is to act as an early warning system. Instead of mentioning this in its press releases or the summary of its report, the ACCC relegates this central qualification to the end of its 200-odd page report, in an annexure.

Further, when releasing its monitoring report, the ACCC frequently fails to mention that:

- the detail of the monitoring reports also contains measures which indicate the reasonableness of Melbourne Airport's pricing, such as that Melbourne Airport's *return* on tangible non-current aeronautical assets has fallen consistently over the past decade;[48]
- there is a clear process available to the ACCC should it actually consider that the monitoring results are an early warning of an airport potentially exercising its market power – that is, the ACCC could recommend a pricing inquiry to the Minister under Part VIIA. However, to Melbourne Airport's knowledge, the ACCC has not ever recommended an airport pricing inquiry to the Minister on the basis of the ACCC's monitoring results.

It is disappointing that the ACCC continues to communicate the way it does in relation to its monitoring results, particularly in circumstances where:

- the Productivity Commission has previously acknowledged concerns with selective messaging by the ACCC regarding its monitoring results;[49] and
- any early warning of the exercise of market power in the ACCC's monitoring reports is not borne out by the facts. In reality, Melbourne Airport's returns on aeronautical assets are within the range of reasonable estimates for a benchmark provider of aeronautical services.[50]

Further, it is telling that despite the ACCC's strong messaging regarding airport profits, the ACCC has not ever recommended an airport pricing inquiry to the Minister. This is particularly so in circumstances where the ACCC has recently conducted numerous other pricing inquiries at the direction of the Minister, and where the Productivity Commission has previously recommended a more structured pricing inquiry recommendation procedure (a 'show cause' mechanism) to ensure that if the ACCC were to identify a genuine concern in its 'early warning' airport monitoring, this is followed by a 'determined' response and not 'passive inaction'.

In this light, Melbourne Airport considers that the ACCC's annual criticism of airports and its ongoing calls for greater regulation is not evidence of the light-handed regulatory regime being ineffective, or of a need for the ACCC to have a greater role in airport negotiations.

[47] ACCC press release 26 April 2018 – 'Airport profits continue to grow': https://www.accc.gov.au/media-release/airport-profits-continue-to-grow
[48] ACCC, *Airport Monitoring Report 2016-17*, p. 91
[49] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, p. 234-237
[50] Houston Kemp, Assessing market power in aeronautical services, p. 27

7.2.1.3 Compliance costs of ACCC monitoring

There are compliance costs of complying with the ACCC monitoring regime. These costs include collecting survey data to measure quality of service, and the preparation of financial information required, including the auditing of regulatory accounts.

Melbourne Airport considers that the compliance costs of meeting the ACCC monitoring requirements are not excessive. It is estimated that the cost of complying with the monitoring requirements is approximately $300,000 per annum.

7.2.1.4 Alternative forms of monitoring

The Productivity Commission Issues Paper asks for views on alternative forms of monitoring airports, including analytical approaches such as data envelopment analysis and stochastic frontier analysis. Melbourne Airport considers that simpler methods, similar to what is currently used by the ACCC, accompanied with the appropriate context (as outlined above), are likely to be the best approach. However, further information on how these methods would be implemented in practice would be welcomed.

Melbourne Airport notes that the use of these economic modelling methods could result in the factors that influence the ability of an airport to operate efficiently not being properly captured in the model estimation under such approaches. Every airport is different in many ways; factors such as the age and design of the legacy infrastructure, for example, may be difficult to quantify in the use of such statistical techniques.

7.3 The threat of further regulation

The current regulatory regime provides a threat of increased airport regulation beyond price monitoring. Pricing inquiries, the price notification regime, and the National Access Regime all provide a credible threat of regulation for airports that use market power.

7.3.1 The threat of further regulatory scrutiny through pricing inquiries

Under the light-handed regulatory regime, airports operate under the threat of further regulatory scrutiny in the form of a pricing inquiry under Part VIIA of the CCA.

A pricing inquiry must be directed by the Minister. The Minister may direct the ACCC to hold an inquiry into specified matters, or request any other body to hold such an inquiry. Typically, the matters relevant to an inquiry may include the prices charged in particular industries or by particular businesses, and the factors affecting those prices, such as the market structure and level of competition. Further, the ACCC may recommend a pricing inquiry to the Minister – for example, if the ACCC considered that such an inquiry was warranted on the basis of its airport monitoring results.

During such an inquiry:

- service providers are prohibited from raising prices without the authorisation of the ACCC; and
- the ACCC may conduct public hearings, and compel the provision of information, document and other evidence.

Upon completion of the inquiry, the ACCC (or other inquiry body as relevant) must provide a report to the Minister.

The ACCC has conducted several such inquiries recently, including inquiries into:

- the dairy industry – this inquiry was directed by the Treasurer in October 2016 – the ACCC published a final report in April 2018;
- retail electricity pricing and supply – this inquiry was directed by the Treasurer in March 2017 – the ACCC published its final report in July 2018;
- wholesale gas supply – this inquiry was directed by the Treasurer in April 2017 – the ACCC published interim reports in September and December 2017, and April 2018;
- residential mortgage pricing – this inquiry was directed by the Treasurer in May 2017 – the ACCC published an interim report in March 2018;
- insurance supply in Northern Australia – this inquiry was directed by the Treasurer in May 2017 – the ACCC published an initial update report in June 2018; and
- digital platforms – this inquiry was directed by the Treasurer in December 2017 – a preliminary report is to be submitted by December 2018.

The ACCC has also recently conducted several market studies of its own volition, including studies into the communications sector, cattle and beef, and the new car retailing industry.

7.3.2 The threat of further regulation through the price notification regime

The threat of further regulation under the light-handed regulatory regime comes in several forms, one of which is the price notification regime under Part VIIA of the CCA.

Under this regime:

- the Minister may subject an airport and particular goods or services to price notification requirements;
- an airport which is subject to the price notification regime is prohibited from raising the price of the relevant services above the highest notified price in the preceding 12 months, unless it first notifies the ACCC;
- the effect of an airport notifying a proposed price increase to the ACCC is to start a 'price-freeze period' of 21 days. During that time, the ACCC can approve or object to a proposed price increase, or propose a lower price increase;
- if the ACCC objects to a proposed price increase, the airport can still implement the price increase at the end of the price-freeze period (that is, the ACCC's objection is not legally binding). However, such an objection has 'moral suasion',[51] and would act as a strong disincentive for an airport to implement its proposed price increase – doing so could create a strongly adverse public reaction, and potentially trigger increased regulation.

In assessing a price notification, the ACCC must have particular regard to certain statutory considerations,[52] which the ACCC interprets as being met by economically efficient prices, which reflect an efficient cost base, and a reasonable return on capital.[53]

Currently, the price notification regime applies to regional air services at Sydney Airport, as well as to certain services of Airservices Australia and Australia Post.

[51] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, p. 32
[52] Per s95G(7) of the CCA
[53] See ACCC: Statement of regulatory approach to assessing price notifications under Part VIIA of the CCA, March 2017, p. 12

7.3.3 An additional threat under light-handed regime: the National Access Regime

A further aspect of the light-handed regulatory regime is the threat of additional economic regulation arising from the application of the National Access Regime under Part IIIA of the CCA.

The National Access Regime provides a process whereby an airport user can seek access to a declared airport service, and refer an access dispute to the ACCC for arbitration if the user is unable to negotiate access to the service commercially. For an airport service to be declared, the airport user (or any party) must first apply to the NCC for a recommendation that the service be declared. In turn, the NCC will then make a recommendation to the Minister, who decides whether to declare the relevant service.

In order for the Minister to declare a service, the service must meet the four declaration criteria, being that:

(a) access (or increased access) to the service, on reasonable terms and conditions, as a result of declaration of the service, would promote a material increase in competition in a market (other than the market for the service);

(b) the facility used to provide the service be a natural monopoly;

(c) the facility used to provide the service be of national significance; and

(d) access (or increased access) to the service, on reasonable terms and conditions, as a result of declaration of the service, would promote the public interest.

These criteria were amended in November 2011 following recommendations from the Productivity Commission and the Harper Competition Policy Review.

7.3.3.1 The National Access Regime is a credible threat

The threat of declaration and ACCC arbitration under the National Access Regime is a real aspect of the light-handed regulatory regime, which Melbourne Airport has always considered as an important factor in its approach to commercial negotiations with airlines.

Indeed, as a non-vertically integrated infrastructure owner, Melbourne Airport has a strong incentive and preference to reach mutually beneficial, commercially negotiated agreements with its customers. Doing so provides certainty to Melbourne Airport regarding its ability to operate and invest in the airport, and certainty to Melbourne Airport's shareholders regarding their investment in Melbourne Airport.

In negotiating such agreements, Melbourne Airport has strong incentives to negotiate on reasonable terms and in good faith, including on account of the need to avoid a declaration application under the National Access Regime. Such an application could delay and destabilise a commercial negotiation process, creating a high degree of uncertainty for Melbourne Airport and its shareholders, particularly in circumstances where there is an absence of a commercially negotiated agreement until the resolution of the declaration process.

The credibility of the National Access Regime as a threat is also evidenced by the conduct of airlines. This conduct reflects a previous statement by Qantas that:

> *Although…there have been comparatively few applications for declaration under Part IIIA, the possibility of seeking declaration of a particular airport's facilities is something that Qantas looks at with reasonable regularity…*[54]

[54] Qantas Group Submission on Productivity Commission Draft Report on National Access Regime Inquiry 2013, p. 3

Further, airlines have actually applied for declaration on two occasions:

- Virgin Blue sought declaration of domestic airside services at Sydney Airport, which resulted in the declaration of those services in 2005 for a period of five years. No airline sought to have the declaration renewed at the end of this period; and
- Tigerair sought declaration of terminal services at Sydney Airport in 2014, but withdrew its application after reaching a commercial agreement with Sydney Airport.

7.3.3.2 Criticism of the National Access Regime: cost, timing and uncertainty

The National Access Regime in Part IIIA has previously been the subject of criticism by the ACCC and airlines, who assert that it does not provide an effective constraint on airports given the time, costs and uncertainty faced by airlines seeking declaration.

In place of the declaration process, the ACCC and airlines have proposed greater economic regulation of airports – in particular, the deemed declaration of airport services under the National Access Regime, such that those services would be automatically subject to the negotiate/arbitrate model of regulation. Melbourne Airport addresses these concerns below.

It is true that there have previously been high profile and lengthy declaration processes under the National Access Regime. However, as the NCC has previously stated: [55]

- such lengthy cases are not representative of declaration applications in general;
- to the extent that timeliness in making declaration decisions is an issue, this requires a general response rather than the adoption of ad hoc measures to bypass the process in particular cases (the NCC has previously suggested the removal of merits review as an example of such a general response);
- as the interpretation of the provisions of Part IIIA become more settled, the incidence of disputes regarding declaration decisions should diminish – Melbourne Airport considers this is particularly the case now, as the recent legislative changes to the declaration criteria should resolve much of the debate regarding the application of the criteria; and
- rather than increasing regulatory certainty, deeming declaration may indicate that regulation of third party access can more readily be achieved through lobbying and ad hoc interventions than through the mechanisms in Part IIIA, which would reduce the transparency and predictability of such regulation.

In its inquiry into the National Access Regime in 2013, the Productivity Commission weighed the views of the NCC, as well as those of Qantas, Virgin and others, and concluded that the National Access Regime poses a credible threat of further economic regulation:

> *Although some isolated cases have involved an extraordinarily costs and length declaration process, these are not typical cases. Some infrastructure services have been declared and the Commission considers that the threat of declaration is credible.*[56]

Melbourne Airport agrees with this conclusion, and notes further, to the extent that declaration processes involve uncertainty regarding outcomes and timing, that uncertainty provides Melbourne Airport with a strong incentive to avoid a declaration application by negotiating in good faith and on reasonable terms. This is particularly the case given that, in the absence of a commercially

[55] National Competition Council, Submissions to Productivity Commission Inquiry into Economic Regulation of Airports, April 2011, p. 10–14, September 2011, p. 3-4, Submission to Productivity Commission Inquiry into the National Access Regime, November 2012, p. 2-6

[56] Productivity Commission 2013, *National Access Regime*, Inquiry Report no. 66, p. 227

negotiated agreement (i.e. potentially until the resolution of a declaration process), airlines continue to use airport services.

7.3.3.3 The National Access Regime remains relevant under the light-handed regulatory regime

In its recent publication and various media engagements in the lead up to the Productivity Commission's Inquiry, A4ANZ appeared to assert that the National Access Regime is no longer a relevant part of the light-handed regulatory regime. For example, A4ANZ's publication states that:

> *…following amendments to the CCA, the regime is now entirely missing a credible threat. Legal advice sought by A4ANZ confirms that there is now effectively no regulatory provision in Australian competition law that constrains a monopolist from exerting its power to extract monopolist rents, fees and charges for deficient services.*

Presumably, A4ANZ is referring to the changes to the declaration criteria under Part IIIA which came into effect in November 2017, and intends to assert that as a result of those changes, there is no scope for an airline to seek declaration of airport aeronautical services under the National Access Regime.

A4ANZ is incorrect to assert that the recent changes to the declaration criteria render the National Access Regime irrelevant under the light-handed regime. Melbourne Airport addresses this issue further below.

The new declaration criteria

Table 7.1 below compares the old and new declaration criteria under Part IIIA.

Table 7.1: Comparison of the old and new declaration criteria

Declaration criterion	Old law (pre-November 2017)	New law (post-November 2017)
Competition criterion	Required the decision maker to consider whether access (or increased access) would promote a material increase in competition.	Requires the decision maker to consider whether access (or increased access) on reasonable terms and conditions as a result of declaration would promote a material increase in competition.
Natural monopoly criterion	Required the decision maker to consider whether it is uneconomical for anyone to develop another facility to provide the service.	Requires the decision maker to consider whether total foreseeable market demand could be met by the facility over the declaration period at least cost when compared to two or more facilities.
National significance criterion	Required the decision maker to consider whether the facility is of national significance, having regard to its size, importance to constitutional trade or commerce and to the national economy.	No change.
Public interest criterion	Required the decision maker to consider whether access (or increased access) would not be contrary to the public interest.	Requires the decision maker to consider whether access (or increased access) would promote the public interest.

Melbourne Airport assumes that the arguments put forward by A4ANZ are based on the change to the competition criterion. As indicated in the table, the competition criterion previously required the decision maker to consider whether access (or increased access) would promote a material increase in competition in a dependent market. Historically, this criterion was interpreted as requiring that *declaration* would promote competition in a dependent market. The approach adopted was to compare the status quo to the future state of competition in a market with declaration.

However, in the *Sydney Airport* case of 2006, the Full Federal Court applied a new interpretation of the competition criterion – which asked whether *any* access to the relevant service (as compared to no

access) would promote competition in a dependent market. The Court's decision significantly lowered the bar for meeting the competition criterion, including in the airports context, in which an airline would simply need to show that airlines being able to access an airport would promote competition relative to a hypothetical world in which airlines were refused access to an airport (despite airports being required to provide access under their leases with the Commonwealth). This interpretation was later upheld by the Full Federal Court in the *Port of Newcastle* case in 2017.

The competition criterion was amended by the Government in November 2017, following the recommendations of the Productivity Commission and the Harper Review of Competition Policy that the criterion should be amended to better focus on the effect of declaration on competition. The effect of the amendment is to make the competition criterion more closely resemble the competition criterion as it was interpreted prior to 2006. This was recently noted by Edelman J of the High Court, who stated that the amendment "effectively reverses the result of the Full Court in Sydney Airport"'.[57]

The assertions of A4ANZ

Melbourne Airport presumes that A4ANZ intends to assert that the National Access Regime is no longer a relevant part of the light-handed regulatory regime, on the following basis:

- the competition criteria now focuses on whether declaration would promote competition (rather than whether any access to a service would promote competition);
- airports are not vertically integrated, and therefore will always be incentivised to provide access to airlines (as well as being required to do so under their respective leases);
- declaration would therefore not result in increased access, but instead would potentially result in different terms and conditions of access to airport services on account of ACCC arbitration;
- any decrease in airport prices as a result of declaration (and subsequent ACCC arbitration) would not promote competition in airline markets, which are already competitive; and
- accordingly, the new competition criterion will not be satisfied in the case of airport services, meaning that airport services cannot be declared under Part IIIA.

A4ANZ's assertion that the National Access Regime is no longer a relevant part of the light-handed regulatory regime is incorrect, and reveals much of the motivations of A4ANZ's members in advocating for deemed declaration.

It is true that the primary objective of Part IIIA is not to address monopoly pricing. Rather, the objects of Part IIIA are to:

> *i. promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and*
>
> *ii. provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.*

However, this does not mean that Part IIIA has no role in the light-handed regulatory regime, or that Part IIIA cannot be used to address monopoly pricing issues in particular (rather than pure access issues). As the Productivity Commission has previously noted:

> *The Commission considers that it is appropriate that criterion (a) – reframed to consider the effect of declaration rather than access – allows for declaration where*

[57] *Port of Newcastle Operations Pty Ltd v. The Australian Competition Tribunal & Ors* [2018] HCATrans 55 (23 March 2018) per Edelman J. See also the comments of Keane J.

> *the prevailing terms and conditions of access are so poor that they disrupt competition in another market.*[58]

Further, the Harper Panel stated:

> *The regulatory issue that arises in respect of airports is generally one of monopoly pricing rather than access. Although airports are bottleneck facilities, their operators are not vertically integrated into upstream and downstream markets. Hence, they have limited incentive to reduce competition in dependent markets, but they have power to impose monopoly charges on users of their facilities. To some extent, Part IIIA can be used as a means of addressing monopoly pricing at airports…*
>
> *…Part IIIA will continue to provide a back stop to…airports and ports. Although the primary economic issue at ports and airports is monopoly pricing, access problems might arise in the future that could be addressed by Part IIIA.*[59]

Indeed, Part IIIA continues to play the same role it has always had in the light-handed regulatory framework, including because the competition criterion now focuses on the effect of declaration on competition, as it did from the start of the light-handed regime until 2006. Airport services have previously been declared by applying this type of competition criterion (i.e. one focused on the effect of declaration) – being Sydney Airport's airside services, which the Competition Tribunal declared for five years in 2005.

Further, for A4ANZ to allege that Part IIIA has no relevance under the light-handed regime is effectively to say that declaration of airport services would not ever promote competition between airlines. This is a curious admission by A4ANZ – in that it suggests that A4ANZ's members seek deemed declaration for purely financial reasons, and without any expectation of deemed declaration promoting competition between airlines, or of any financial gain to airlines arising from deemed declaration being competed away through lower airfares to the benefit of consumers. This is consistent with previous findings of the Productivity Commission that:

> *…overall the evidence indicates that the concerns about aeronautical charges mainly reflect a distributional tussle between airports and airlines, rather than inefficient impacts on the demand for air travel by consumers. While distributional issues involving people are clearly important, it is less clear that battles by corporations over profits have any significant regressive impacts.*[60]

In summary, Melbourne Airport considers that the threat of declaration and ACCC arbitration under Part IIIA continues to play a key role in the light-handed regulatory regime, and provides a strong incentive for Melbourne Airport to negotiate with airlines in good faith and on reasonable terms.

7.4 Response to deemed declaration proposal

In the Issues Paper, the Productivity Commission notes that some have argued for a fundamental change to the current regulatory regime, and have contended for a mandatory role for the ACCC to arbitrate disputes between airports and airlines – that is, 'deemed declaration' of airport services under Part IIIA.

Specifically, such a change was suggested by A4ANZ earlier this year, and was also proposed by the ACCC and airlines during the Productivity Commission's 2011 inquiry into airport regulation. In contrast, in its 2011 report, the Productivity Commission recommended that an airport-specific arbitration regime

[58] Productivity Commission 2013, *National Access Regime,* Inquiry Report no. 66, p. 173
[59] *The Australian Government Competition Policy Review*, p. 427-8
[60] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, p. 182

activated by deemed declaration of airport services under Part IIIA should not be introduced, noting that:

> *it would seem retrograde to allow a reintroduction of heavy-handed regulation that could displace commercial negotiations and encourage gaming.*

The Productivity Commission affirmed this view two years later in 2013, stating:

> *[In 2011, the] Commission noted that deemed declaration could undermine light-handed regulation and be far more intrusive than the current price monitoring approach, and that, given the evidence of progress made in commercial negotiations since moving to light-handed regulation, 'it would seem retrograde to allow a reintroduction of heavy-handed regulation that could displace commercial negotiations and encourage gaming'. The Commission remains of this view.*[61]

The Productivity Commission's view was supported by the NCC, which stated:

> *It is critically important that regulation of access is predicated on an objective decision maker being satisfied that the declaration criteria are met. If it is not, there is no basis for confidence either that such regulation is likely to enhance competition and efficiency or that access decisions will be made consistently, fairly and with minimal risk of error…*
>
> *…Deemed declaration appears expedient in that it circumvents the consideration of the declaration criteria and the merits review and judicial review processes that have so extended the Pilbara rail matters. However, those criteria and review rights exist for good reason. They are the means by which the National Access Regime pursues the objects of Part IIIA.*

Melbourne Airport submits that the Productivity Commission's reasoning in this respect is still applicable today, and therefore that there is no cause to adopt a system of deemed declaration. Indeed, the case for deemed declaration is weaker today than when the Productivity Commission considered the issue in 2011 and 2013. The light-handed monitoring regime continues to result in mutually beneficial commercial agreements between Melbourne Airport and airlines which are increasingly mature and sophisticated, all the while Melbourne Airport's average return on aeronautical assets is reasonable. Melbourne Airport considers that such a change to the regulatory regime would adversely affect commercial negotiations and airport investment.

7.4.1.1 Deemed declaration is unlikely to facilitate commercial negotiations

Melbourne Airport considers that a system of deemed declaration of airport services is unlikely to promote commercial negotiations. Instead, such a system would encourage regulatory gaming, and would potentially result in ACCC arbitration becoming the default outcome. In turn, this would increase the prospect of regulatory error, and reduce the efficiencies and innovations that have come from a commercial negotiation process.

In this respect, Melbourne Airport agrees with the conclusions of the Productivity Commission in 2011, that:

> *expedited access to arbitration by the ACCC at the contract formation stage could fundamentally undermine light-handed regulation.* ***It is difficult to conceive how provision for ACCC arbitration would provide both airports and airlines with***

[61] Productivity Commission 2013, *National Access Regime,* Inquiry Report no. 66, p. 276.
Melbourne Airport also notes the views of the Harper Competition Policy Review in 2015 that '*The price monitoring and 'light-handed' regulatory approach in aviation appears to be working well overall.*'

> ***strong incentives to engage in genuine commercial negotiations**. For example, during this inquiry the ACCC's public comments on airports' behaviour suggest that one party – the airlines – would have an incentive to expeditiously seek arbitration by the ACCC. As the Commission has noted previously:*
>
> > *… it seems likely that arbitration would come to be viewed by airlines as the default option, with negotiations increasingly centred in a narrow band around previously arbitrated outcomes. The net effect would therefore be a return to 'institutionalised' determination of charges and conditions for airport services, with its attendant costs. (PC 2006, p. xxv)*

The Productivity Commission went on to note the risk of ACCC arbitration (rather than commercial negotiation) becoming the 'default option', stating:

> *…Arbitration by the ACCC could well become the default option for an airport customer. Notwithstanding that agreements have captured greater complexities over time (such as service levels, dispute resolution, and information exchange) there is a risk that airlines might see it in their interests to have building block parameters examined by regulatory decisions – **an arrangement that might, through precedent, lead to a default form of revenue capping, antithetical to commercial negotiation…***
>
> *…Given the weight that airports and airlines would attach to the regulator's decisions, its arbitrations would likely set precedent. To the extent that the arbitrated outcome becomes the new benchmark, the likelihood of one side preferring arbitration over continued commercial negotiation increases. This **could amount to 'shadow' price-setting that not only detracts from the ability to negotiate tailored outcomes but also discourages innovation in agreements.***

At the time, the ACCC sought to argue that deemed declaration would, in practice, result in few disputes being arbitrated by the ACCC, on the basis that the threat of ACCC arbitration would incentivise commercial negotiations. In doing so, the ACCC noted that airlines had not seen arbitration as a 'default option' during the declaration of Sydney Airport's aeronautical services from 2005 to 2010. In response, the Productivity Commission rightfully noted that:

> *A difficulty with citing a lack of recourse to ACCC arbitrations as evidence of a well-functioning regulatory framework is that the previous declarations operated concurrently with commercial agreements, which already had dispute resolution mechanisms…*
>
> *…the Commission notes that commercial agreements are now primarily about price paths arising from new investment. 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.*

The notion that deemed declaration would not result in ACCC arbitration becoming the 'default option' is contrary to the ACCC's own experience with services declared under the previous telecommunications access regime (in Part XIC of the CCA) – see Box 7.1 below.

Box 7.1: ACCC arbitration as the default option in the telecommunications industry

The 'deemed declaration' model proposed by A4ANZ is similar to the access regime which previously applied to telecommunications services. Under that regime, 182 access disputes were referred to the ACCC for arbitration.

The sheer number of arbitrations occurring under the regime made it clear that the regime did not provide an effective incentive for parties to negotiate, nor did it produce effective outcomes for industry or consumers. As a result, the regime was repealed from 1 January 2011.

When repealing the regime, the Government stated:

> *The negotiate-arbitrate model within the telecommunications access regime has been extensively criticised by a range of stakeholders across the industry… Stakeholders' main areas of concern have been that the negotiate-arbitrate model is very slow, cumbersome and open to gaming (if not outright obstruction) and that Part XIC does not provide sufficient regulatory certainty for investment.* [62]

7.4.1.2 Deemed declaration will increase the risk of regulatory error

It is commonly accepted that regulated access and pricing entails a risk of regulatory error – such as the setting of prices that are either too high or too low relative to the optimal level. If a regulator sets prices below the optimal level, this can lead to delayed investment, or the non-provision of infrastructure services.

The risk of regulatory error in regulated airport pricing is substantial. Regulatory decisions concerning access and pricing of airport services would be highly complex and technical, and involve significant regulatory judgement. This reflects the fact that airport services themselves, and commercial agreements for those services, are complex and highly technical.

Further, such regulatory decisions would be complicated by the conflicting incentives and objectives of airports and airlines:

- Airports are passenger throughput-based businesses with long-term horizons, given the cost and life of airport assets. As a result, airports are incentivised to grow new markets and expand existing markets, and to promote competition between airlines.
- Further, airports service numerous and varied airline customers, and are required to balance the needs of all customers to ensure the safe and efficient operation of the airport. A natural result of this is that airport decisions will have different impacts on different customers, and may be welcomed by some more than others.
- In contrast, airlines typically have short or medium-term commercial incentives, with a focus on yields. While smaller or new airlines seek airport investment and capacity to allow entry or expansion, dominant airlines typically seek to entrench their position and oppose airport investments that will increase airline competition.

The Productivity Commission has previously accepted that the consequences for efficiency from setting access prices too low are, all else equal, likely to be worse than setting access prices too high – because deterring infrastructure investment (from setting access prices too low) is likely to be more costly than allowing service providers to retain some monopoly rent (from setting access prices too high).[63] As there

[62] Explanatory Memorandum to the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010

[63] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, p. XXV, 95-96, 182

is no mechanism for an airport to be compelled to invest, if an arbitrated price is set too low then an airport will simply not invest. If this were to eventuate, it would be to the detriment of passengers.

7.4.1.3 Deemed declaration would adversely affect airport investment

Melbourne Airport considers that deemed declaration would adversely impact airport investment – not only through the risk and uncertainty associated with regulatory error, but also through undermining commercial negotiations, and the efficiencies and innovations that arise from negotiations (as discussed above).

Under the light-handed regime significant investment has taken place at Melbourne Airport to meet the strong passenger growth that has occurred. This investment has been delivered with the agreement of airlines through the commercial negotiation process which requires genuine consultation on matters of great complexity. This approach produces the most efficient solutions to the infrastructure challenges for the airport, benefiting all parties.

In the long term, underinvestment in airport infrastructure would lead to an undersupply of airport services, which in turn could adversely impact competition between airlines and further entrench the dominant position of incumbent airlines.

7.4.1.4 Deemed declaration would undermine the National Access Regime

Melbourne Airport agrees with the position previously put by the NCC that deemed declaration would substantially undermine the National Access Regime in Part IIIA of the CCA.

As the NCC stated in 2011:

> *If there are concerns about the operation of the Part IIIA declaration process, such as uncertainty of outcome or delay (which the Council considers are unlikely to be justified in light of the recent amendments), then these concerns apply to all industries and all potentially declared services. It is not apparent to the Council why aeronautical services constitute a special case…*
>
> *…If a service would not satisfy the declaration criteria, then it should not be regulated under Part IIIA. To so impose regulation by legislative fiat is inconsistent with s 44AA and reduces confidence in the integrity of the National Access Regime…*[64]

Further, the NCC went on to state that:

> *…To deem certain services to be subject to access regulation is to side-step the checks and balances of the declaration process envisaged by the Hilmer Committee and enacted by Parliament….*
>
> *…… rather than increasing regulatory certainty, deeming declaration may indicate that regulation of third party access can more readily be achieved through lobbying and ad hoc interventions than through the mechanisms set out in Part IIIA. In the Council's view this is likely to reduce the transparency and predictability of such regulation, not enhance it.*[65]

[64] National Competition Council submission to Productivity Commission, April 2011, p. 16
[65] National Competition Council submission to Productivity Commission, September 2011, p. 3

7.4.1.5 In summary, there is no case for deemed declaration

Given that the light-handed regulatory regime is working well, there is no justification for deemed declaration as a matter of economic policy. Further, deemed declaration would entail numerous substantive risks – it would weaken commercial negotiations and the efficiencies and innovations associated with such negotiations, adversely affect airport investment (and in turn, airline competition), and would also undermine the National Access Regime in Part IIIA.

7.5 Final offer arbitration

In its recent publication, A4ANZ proposed that the ACCC adopt a policy of 'final offer arbitration' when arbitrating access disputes for declared services under Part IIIA. This proposal is said to involve the ACCC determining an access dispute by choosing between the final offers of each party (or parts of each party's final position) without the possibility of compromise or variation. The stated rationale for the proposal is that it would 'raise the risk' of arbitration and thereby incentivise the parties to negotiate prior to the ACCC's determination.[66]

Were the ACCC to adopt a policy of final offer arbitration, the effectiveness of this policy would be dependent on the ACCC committing to choosing one of the party's final offers (or parts of those offers), rather than making an independent decision which may involve a compromise between the final offers of the parties. Were the ACCC to adopt the policy as a 'guideline' only, from which it may decide to deviate from based on the circumstances, the rationale for such a policy would be lost.

It is difficult to see how the application of such a policy by the ACCC would be consistent with the ACCC's statutory role under Part IIIA. In particular, such a policy would conflict with:

- the ACCC's obligation to take into account particular considerations;
- the ACCC's discretion to not grant access in any particular scenario; and
- the restrictions on the ACCC from making determinations which have certain effects.

Further, final offer arbitration could also result in merits review of ACCC decisions becoming the 'default option' for determining airport prices, and may also increase the incidence of judicial review of ACCC decisions. As a result, final offer arbitration would entail even more costs, delays and uncertainty than if ACCC arbitration were to become the 'default option'.

Finally, as a practical matter, the process of final offer arbitration would encourage regulatory gaming and risk resulting in inefficient outcomes. It is not a process suited to negotiating or resolving disputes regarding complex and many-layered agreements such as airport service agreements.

These issues are discussed below.

7.5.1.1 Conflict between final offer arbitration and the mandatory considerations for determining access disputes

It is difficult to see how a policy of final offer arbitration would be consistent with the ACCC's obligation to take into account certain considerations when arbitrating access disputes under Part IIIA.

[66] A4ANZ, *The performance & impact of Australia's airports since privatisation*

The mandatory considerations which the ACCC must take into account include:[67]

(a) the objects of Part IIIA, which include the object of promoting the economically efficient operation and use of, and investment in, the relevant infrastructure;[68]

(b) the legitimate business interests of the service provider/infrastructure owner;

(c) the interests of all persons who have rights to access the service;

(d) the direct costs of accessing the service;

(e) the economically efficient operation of the facility; and

(f) certain statutory pricing principles, including that regulated access prices should:
   (i) be set so as to generate expected revenue that is at least sufficient to meet the efficient costs of providing access to the regulated service; and
   (ii) include a return on investment commensurate with the regulatory and commercial risks involved.[69]

Were the ACCC to adopt a policy of final offer arbitration, this could result in the ACCC being required to choose between the parties' final offers (or parts of those offers) even where the ACCC considers that the optimal and efficient outcome which is consistent with the objectives of Part IIIA and the other mandatory considerations is not reflected in either party's final offer (or a combination of parts of those offers).

For example, such a policy may result in the ACCC making an arbitration decision which is not economically efficient. This prospect of such regulatory error would in turn adversely affect investment in airport infrastructure (as discussed above), which could adversely affect airline competition in the long term.

7.5.1.2 Conflict between final offer arbitration and the legislative scope of ACCC determinations

A policy of final offer arbitration would also conflict with the ACCC's statutory right to refuse to grant access to a service when determining an access dispute.[70] While it may be unlikely that the ACCC would exercise this right in the case of an airport access dispute, such an outcome is not impossible. Final offer arbitration could also conflict with the statutory restrictions on the ACCC's ability to determine access disputes, such as the prohibition on the ACCC making a determination which prevents an existing service user from obtaining a sufficient amount of the service to meet their reasonably anticipated requirements.

7.5.1.3 Final offer arbitration would increase merits review appeals of ACCC decisions

The ACCC's adoption of a final offer arbitration policy would also risk increasing the incidence of parties seeking merits review of ACCC decisions before the Australian Competition Tribunal.

On review, the Tribunal would be tasked with reconsidering the matter – 'standing in the shoes' of the ACCC – bound to take into account the same statutory considerations as the ACCC, but not bound by the ACCC's policy of final offer arbitration.[71] Accordingly, any party considering they would be better off with a decision which focused on identifying the optimal and efficient outcome, rather than a decision

[67] See CCA s44X
[68] See CCA s44AA
[69] See CCA s44ZZCA
[70] This right is contained in s44V(3).
[71] See CCA s44ZZBF

made by choosing between the parties' final offers (which could be close or far apart), would have an incentive to seek merits review of the ACCC's decision.

Final offer arbitration may therefore result in merits review by the Australian Competition Tribunal becoming the 'default option' for determining airport prices. Such a result would entail even more costs, delays and uncertainty than if ACCC arbitration were to become the 'default option' (as discussed above).

7.5.1.4 Final offer arbitration may also increase the incidence of judicial review

The ACCC's adoption of a final offer arbitration policy may also increase the incidence of parties seeking judicial review of ACCC access determinations in the Federal Court. For instance, were the ACCC to adopt the final offer of a particular party in an access arbitration, the ACCC's decision may be open to judicial review on the grounds that the ACCC has improperly exercised its discretionary power in accordance with a rule or policy without regard to the merits of the particular case.[72]

7.5.1.5 Final offer arbitration would result in inefficient outcomes and encourage gaming

As a practical matter, the process of final offer arbitration would potentially result in inefficient or sub-optimal outcomes (as discussed above), which in turn would adversely affect investment in airport infrastructure. Further, the process could encourage regulatory gaming and a focus on manipulating the other party and the ACCC, rather than a focus on reaching a mutually beneficial commercially negotiated outcome.

Airport agreements are often very complex, particularly agreements that cover all airlines such as the ASA at Melbourne Airport. The ASA is an agreement for all of the airlines that use Melbourne Airport, parties which can have differing interests. These agreements cover all the dimensions of airport operations, including investment, quality, and service. For example, a single agreement can include hundreds of different capital projects that are planned over the life of the agreement. All of these different aspects of an agreement are interconnected; changes to one aspect can have significant flow-on effects for other aspects of the agreement.

The risk of regulatory error for such agreements would be high, particularly under a final offer arbitration framework. It would be extremely difficult for a regulator to accurately disentangle all the implications of different proposals with such complex agreements.

The number of parties involved would only further complicate the task of the regulator. To reach an efficient decision, the regulator would need to determine what the best overall outcome would be. Where agreements cover many different users, such as the ASA, this would come with the high risk of regulatory error.

7.6 Access for regional air services

Regional flights provide an essential access service for regional communities, with Melbourne currently servicing 40 flights for regional services per week during peak periods. As a major infrastructure asset for the nation, any airport like Sydney or Melbourne Airport needs to balance the need for this essential service provision against the significantly greater economic impact that flights operated by larger aircraft can potentially deliver to the state and national economies. Melbourne Airport considers currently this balance about right.

There is merit in ensuring that regional flights are afforded an appropriate level of access at airports. However, the displacement of larger aircraft from periods of peak demand needs to be carefully

[72] See ADJR Act s5(2)(f) and s6(2)(f)

managed and considered. The benefits of regional access being provided to aircraft in periods of high demand need to be weighed against the costs of those services being provided at different times, and the alternative services that are displaced. In Melbourne, Essendon Fields Airport plays an important role to provide access for regional air services.

8 Car parking and ground access

Chapter summary:

- Car parking at Melbourne Airport operates in a competitive market where customers have choice between numerous modes of transport.
- The price of car parking at Melbourne Airport reflects the location, convenience and service provided by each of the different parking products, reflecting the locational rent associated with different car parks, and any additional services that are provided.
- Investment has been made to facilitate different forms of ground access, enabling competition between different modes and operators to give passengers choice.

Passengers travelling to and from Melbourne Airport have a wide variety of choice including taxi or rideshare, private or public bus, rental car or share car, or being picked up or dropped off free of charge. Where passengers choose to drive, they have the choice to park on-site at one of several facilities provided by the airport, or at one of the many different off-site car parking providers.

Over 100,000 vehicles use the airport precinct every day. Melbourne Airport provides various facilities for private and commercial vehicles to access the airport to ensure that the landside road network operates efficiently and minimises congestion.

The choice that passengers have provides real competition to the provision of on-airport parking services. The price of different car parking options available at Melbourne Airport reflects the convenience and location of the service that is offered. Access is provided free of charge to private vehicles dropping off or picking up passengers. Commercial vehicles are subject to charges for access that reflect the cost of the facilities and services that are provided.

8.1 Car parking

Melbourne Airport offers 10 different car parking options that cater for the needs of passengers and visitors. The parking options can be classified in five broad categories, ranging from lower priced value options, all the way to valet parking located adjacent to the terminal precinct. Free parking options are also available for drivers picking up and dropping off passengers.

New parking products have been added over time, giving customers greater choice. The Value car parks offer lower priced options away from the terminals, whilst the introduction of premium parking options have provided products for customers willing to pay for a higher level of service and convenience.

Table 8.1: On-airport car parks, Melbourne Airport

Value car parks		**Long Term Car Park**	**At Terminal car parks**		**Premium parking**			**Valet parking**	
Value Short Stay	Value Car Park	Long Term Car Park	At Terminal 123	At Terminal 4	At Terminal 123	At Terminal 4	Business	Melbourne Airport Valet	Virgin Valet

Figure 8.8.1: Map of on-airport car parks, Melbourne Airport

8.1.1 Supply of car parking

There are more parking bays at Melbourne Airport than any other Australian airport, with a total of 23,603 public parking bays in 2016-17, including 10,201 short-term parking spaces and 13,402 long-term parking spaces. Melbourne Airport has around almost 45 per cent more public parking spaces Brisbane Airport, and almost 30 per cent more than Sydney Airport. Factors that are likely to have influenced this trend include the greater distance of Melbourne Airport from the CBD relative to other airports.

Table 8.2: On-airport public parking bays, ACCC monitored airports

Airport	Total parking spaces	Difference to Melbourne
Melbourne	23,603	
Brisbane	13,127	-44.4%
Perth	21,673	-8.2%
Sydney	17,094	-27.6%

Source: ACCC Airport Monitoring Report 2016-17

Melbourne Airport has increased the supply of parking over the past seven years, with the total number of spaces increasing by 3,754 over this period. Total long-term parking spaces increased by 902, whilst total short-term parking bays increased by 2,672. The largest increase in supply has come from the introduction of the At Terminal 4 car park, which has added 2,720 spaces since it was opened.

Table 8.3: On-airport car parking bays, Melbourne Airport

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Value parking							
Value Short Stay	0	0	0	0	0	0	202
Value Car Park	0	0	0	0	0	0	1,861
Long-term parking							
Long Term Car Park	12,500	12,100	12,250	14,500	13,830	13,830	11,541
At-terminal car parks							
At Terminal 123	7,358	7,270	7,270	6,279	5,498	5,455	5,831
At Terminal 4	0	0	0	0	0	2,720	2,720
Premium parking							
Premium at Terminal 123	0	0	0	0	326	326	326
Premium at Terminal 4	0	0	0	0	0	0	122
Business Car Park	171	171	171	171	171	171	171
Valet parking							
Melbourne Airport Valet	0	0	0	379	379	379	379
Virgin Australia Valet	0	0	0	371	371	371	371
Other							
Ring and Ride	0	0	0	79	79	79	79
Total short-term	**7,529**	**7,441**	**7,441**	**7,279**	**6,824**	**9,501**	**10,201**
Total long-term	**12,500**	**12,100**	**12,250**	**14,500**	**13,830**	**13,830**	**13,402**
Total public	**20,029**	**19,541**	**19,691**	**21,779**	**20,654**	**23,331**	**23,603**

Source: Melbourne Airport

8.1.1.1 Value car parks

There are two different parking products in the value parking category – the 'Value Short Stay' product which has 202 bays, and the 'Value Car Park' product with 1,861 bays. The Value Short Stay product provides a low-cost option for visitors to the airport, offering four hours parking for $10, with a shuttle bus running to the terminal precinct every 10 minutes. The Value Car Park opens during peak periods to meet additional demand, for example during school holidays. The parking rates are equal to, or cheaper than, those in the Long Term Car Park.

8.1.1.2 Long Term Car Park

The Long Term Car Park is the largest at Melbourne Airport with 11,541 bays. Drive up prices start at $25 for one day and $99 for seven days, with discounts available for parking that is pre-booked online. Shuttle buses run from the Long Term Car Park to the terminal precinct every five minutes, 24 hours a day, all year round.

8.1.1.3 At Terminal car parks

There are two multi-level car parks located adjacent to the terminals – one located across the forecourt of terminals 1, 2 and 3, and the other located outside Terminal 4. With a total of 8,551 parking spaces

across the two car parks, these terminal facilities provide a more convenient option for visitors to the airport, as they are within walking distance of the terminals.

Drive-up pricing is higher than the Long Term Car Park for stays longer than three hours reflecting the more convenient location, but cheaper for stays less than three hours for those farewelling or meeting passengers. Prices start from $4 for up to 15 minutes, which encourages people to park and farewell friends and family, rather than adding to traffic in the free drop-off and pick-up areas which can become congested during peak periods.

8.1.1.4 Premium parking

Premium car parking is located in both the multi-level car parks located adjacent to the terminal precinct. The premium car spaces are located close to the walkways from the terminals, allowing for faster access to vehicles. This product, catering for passengers with a high value of time, accounts for 5 per cent of bays (326) in the Terminal 1, 2 and 3 car park, and 4.5 per cent of bays (122) in the Terminal 4 car park.

The Business Car Park is located adjacent to Terminal 1, providing convenience for Qantas passengers that prefer to park in close proximity to the terminal. There are 171 bays within the Business Car Park.

8.1.1.5 Valet parking

Valet parking is available at the Terminal 1, 2 and 3 car park, with 750 parking bays in total dedicated to valet parking under two different brands – Melbourne Airport Valet and Virgin Australia Premium Valet. The drive-up rates for valet parking reflect the proximity of the car park to the terminals, and the additional services provided. Qantas also independently operates a valet parking service at Melbourne Airport.

8.1.2 Car park pricing

Car park pricing at Melbourne Airport reflects the location, convenience and service provided by each of the different parking products, reflecting the locational rent associated with different car parks, and any additional services that are provided, such as valet parking.

These values are reflected in customer demand for different products, with pricing used as a mechanism to manage utilisation, to ensure that there is always parking available for drive-up customers.

Pricing also reflects the need to manage the efficient operation of the airport road network, to minimise congestion, particularly in the airport forecourt which is used by 30,000 vehicles on an average weekday.

Table 8.4: On-airport parking prices, Melbourne Airport (August 2018)

	VALUE CAR PARKS		LONG TERM CAR PARK	AT TERMINAL CAR PARKS		PREMIUM PARKING			VALET PARKING	
	Value Short Stay	Value Car Park	Long Term Car Park	T1 T2 T3	T4	T1 T2 T3	T4	Business	MA Valet	Virgin Valet
0 to 15 mins	$10	$25	$25	$4	$4	$25	$25	$72	$25	$25
15 to 30 mins	$10	$25	$25	$8	$8	$25	$25	$72	$25	$25
30 to 60 mins	$10	$25	$25	$12	$12	$25	$25	$72	$25	$25
1 to 3 hrs	$10	$25	$25	$24	$24	$40	$40	$72	$40	$40
3 to 4 hrs	$10	$25	$25	$34	$34	$77	$61	$72	$77	$77
4 to 6 hrs	$25	$25	$25	$44	$44	$77	$61	$72	$77	$77

	VALUE CAR PARKS		LONG TERM CAR PARK	AT TERMINAL CAR PARKS		PREMIUM PARKING			VALET PARKING	
	Value Short Stay	Value Car Park	Long Term Car Park	T1 T2 T3	T4	T1 T2 T3	T4	Business	MA Valet	Virgin Valet
6 to 24 hrs	$25	$25	$25	$51	$51	$77	$61	$72	$77	$77
2 days	$49	$49	$49	$102	$102	$144	$122	$132	$144	$144
3 days	$69	$69	$69	$121	$111	$189	$141	$192	$189	$189
4 days	$75	$75	$75	$140	$130	$234	$170	$252	$234	$234
5 days	$79	$79	$79	$159	$149	$279	$199	$312	$279	$279
6 days	$89	$89	$89	$178	$168	$324	$228	$372	$324	$324
7 days	$99	$99	$99	$197	$187	$369	$257	$432	$369	$369
8 days	$109	$109	$109	$216	$206	$414	$286	$492	$414	$414
9 days	$114	$114	$114	$235	$225	$459	$315	$552	$459	$459
10 days	$119	$119	$119	$254	$244	$504	$344	$612	$504	$504
11 days	$124	$124	$124	$273	$263	$549	$373	$672	$549	$549
12 days	$129	$129	$129	$292	$282	$594	$402	$732	$594	$594
13 days	$134	$134	$134	$311	$301	$639	$431	$792	$639	$639
14 days	$139	$139	$139	$330	$320	$684	$460	$852	$684	$684
Per extra day	$10	$10	$10	$19	$19	$45	$29	$60	$45	$45

Source: Melbourne Airport

These prices reflect recent changes to the price of parking across a number of different car parks at Melbourne Airport introduced in March 2018, including up to 20 per cent price reductions for At Terminal parking.

8.1.2.1 Market response to pricing

Customers have demonstrated that they can and do substitute to other modes in response to price changes. Previously, when prices have increased in certain categories, demand has fallen. Conversely when prices have been decreased, demand has increased. This indicates that customers do have the willingness and ability to choose alternative modes of transport, whether it be to off-airport car park, taxi or rideshare, public or private bus, or free pick-up and drop-off.

This is evidenced in recent transaction growth at Melbourne Airport which shows parking demand has not grown as strongly as aviation passenger growth, demonstrating that on-airport parking has been losing market share to other modes of transport. Average daily throughput for both the short-term and long-term car parks has fallen despite rising airline passengers. The ACCC notes that this could be related to increased numbers of airport visitors using SkyBus and off-airport car park operators, or taking advantage of free drop-off and pick-up zones.[73]

Recent price changes reflect market research undertaken by Melbourne Airport. This research provided insight into the preferences of our consumers, relative to other car parks and other modes of transport. The research undertaken surveyed 2,600 customers to identify their willingness to pay for each type of car park product when compared to other options. This included existing service levels and different length of stays across each option. This information was used to create a price elasticity model for Melbourne Airport car parks.

[73] ACCC, *Airport Monitoring Report 2016-17*, p. 101

Research found that the Value and long-term products were appropriately priced compared to other options, and pricing was kept constant as a result. In contrast, research indicated that At Terminal parking was too expensive compared to other transport options.

The price elasticity model identified several optimal price points for the airport to consider when changing parking rates. The model then considered the expected increased demand from reducing pricing and the subsequent impact to the car park occupancy. This led the airport to identify an optimal price structure for the At Terminal car parks which balances a customer's willingness to pay with efficient utilisation of available car park capacity.

For example, some drive-up prices at the Terminal 1, 2 and 3 car park increased in October 2015. These price increases reduced demand from passengers for these products, with passengers switching to other modes of transport to the airport, reflecting the competitive market in which Melbourne Airport parking operates (Table 8.5). Subsequently prices for At Terminal parking have been reduced in order to win back market share from competitors, as would be expected in a competitive market.

Table 8.5: Impact of price changes on transaction volumes

Price adjustment October 2015 – At Terminal 1, 2 and 3 car park	Transaction impact
[Commercial-in-Confidence]	[Commercial-in-Confidence]
[Commercial-in-Confidence]	[Commercial-in-Confidence]

Source: Melbourne Airport Parking transaction data

8.1.2.2 Demand management

Different parking options form part of the wider traffic demand strategy of the airport precinct. With an average weekday volume of 118,300 vehicle trips to and from the airport in 2016, it is important that the parking pricing strategy management of parking demand plays a role in the efficient operation of the airport road network.

Providing parking services at Melbourne Airport also requires parking spaces to be available on demand for passengers when they need them. A passenger driving to the airport expects to be able to park at the airport on demand, in order to make the scheduled flight.

Therefore if prices of on-airport car parks were set too low, demand would exceed supply and there would be no available spaces for drive-up passengers. The introduction of the value long stay car park, which opens only in peak periods, facilitates the management of demand by providing additional capacity in periods when demand is higher.

In order to best utilise the parking spaces available, prices should be set at a level to maximise the utilisation of car parks, without them ever being full. Looking at car parking utilisation over the year to May 2018, the Terminal 1, 2 and 3 car park was recorded as being up to 97.3 per cent full, with 12 days throughout the year where over 90 per cent of the car park was being utilised.[74]

There have been times where the Long Term Car Park has become full, with drivers redirected to the value car park at the same rates in the first instance, and then offered discounts to park in other on-airport car parks.

In light of competition with other modes, such high rates of utilisation of airport car parks reflect the balance of managing demand to provide a service that comes with certainty for passengers to have access to drive-up parking on demand.

[74] This data understates the extent to which the car parks are utilised, as data is only recorded at two points during the day (9am and midnight).

8.1.2.3 Online pricing

Customers are also able to book parking for Melbourne Airport car parks online, at a discount to the drive-up rates advertised. Greater discounts are available by booking further in advance, which allows Melbourne Airport to best manage demand for the limited car parking spaces. Online discounts form part of the demand management approach, to better utilise car parks in quieter periods, whilst ensuring that parking is always available for drive-up customers.

8.1.3 Competition

Car parking at Melbourne Airport operates in a competitive market where customers have a choice between numerous modes of transport including:

- on-airport parking;
- off-airport parking;
- taxi;
- hire car;
- rideshare;
- on-airport car rental;
- off-airport car rental;
- car share;
- free pick-up and drop-off;
- public buses such as SkyBus and PTV services; and
- private businesses such as groups and charters and route buses.

8.1.3.1 Mode share

Free pick-up and drop-off is the most used mode for passengers to get to and from the airport, reflecting 36.8 per cent of passengers using Melbourne Airport. Taxi is the second most popular option, followed by on-airport car parking third. Around 20 per cent of passengers use bus services, including SkyBus, regional and chartered services.

In terms of car parking, in 2016-17 it is estimated that 4.8 million passengers parked in on-airport car parks, representing 13.6 per cent of passengers, whilst an additional 1.4 million passengers (four per cent) used off-airport car parks.

Table 8.6: Ground access mode share estimates, Melbourne Airport (2016-17)

Mode	Passengers (m)	Mode share (%)
Public pick-up and drop-off	13.0	36.8
Taxi	6.8	19.3
Car parking (on-airport)	4.8	13.6
SkyBus	3.5	9.9
Busses (charters & regional)	3.3	9.3
Busses (off-airport parking providers)	1.4	4.0
VHA	1.4	4.0
Car rentals	1.1	3.1
Total	**35.2**	**100**

Source: Melbourne Airport analysis

8.1.3.2 Off-airport car parks

Significant competition exists in the car parking market for Melbourne Airport. There are at least 15 different off-airport parking operators[75] offering parking services for passengers using Melbourne Airport, with 19 different operators identified at the time of writing this submission.

Figure 8.2: Map of off-airport car parks, Melbourne Airport

Source: Houston Kemp, Car parking and ground access – market power assessment

Estimates undertaken in 2014 found that off-airport operators had around **[Commercial-in-Confidence]** of the total volume of airport parking bays that service Melbourne Airport,[76] reflecting a significant share of the airport parking market.

Prices of off-airport car parks vary, as different types of products and services are offered amongst providers. Analysis from Houston Kemp has found some prices off-airport were higher than the long-

[75] ACCC, *Airport Monitoring Report 2016-17*
[76] LEK analysis, 2014

term parking prices offered on-airport. The location closer to the airport precinct tended to be reflected in higher prices, reflecting the locational rent of car parks closer to the airport precinct.

Off-airport operators also have the ability to generate other efficiencies that are not possible for an on-airport car parking product. For example, as off-airport operators are not associated with the airport, they are able to completely fill their parking capacity in order to maximise revenue, and set their pricing accordingly.

Off-airport operators can also use their land more efficiently, with some operators parking vehicles end-to-end and side-by-side, to fit more cars on the area available than is the case for on-airport car parking, which is self-service. These operational efficiencies could allow off-airport operators to charge lower prices, even before any locational rents are reflected in price.

8.2 The current regulatory framework for ground transport and car parking

As with aeronautical services, prices for ground transport access services are not set by regulation. Rather, airports are free to negotiate prices for ground transport access with airport users.

The conduct of airports in providing ground transport access services is constrained by the restrictive trade practices provisions of the CCA, which target anti-competitive conduct. Those provisions have particular relevance in this context since airports are vertically integrated in ground transport services (through the provision of on-airport car parking services), and therefore compete other providers of ground transport services.

In addition, the regulatory framework for ground transport services potentially includes the application of:

- the pricing inquiry and notification regimes under Part VIIA of the CCA (addressed above in section 7.3); and
- the National Access Regime under Part IIIA of the CCA (addressed above in section 7.3.3).

Further, airport car parking services are monitored by the ACCC under Part VIIA of the CCA, which is addressed in detail at section 8.2.3.

In the section below, we address the relevance of general competition laws to Melbourne Airport's provision of ground transport access services, including the recent expansion of those laws which came into effect in November 2017.

8.2.1 Restrictive trade practices under the CCA

8.2.1.1 Section 46: the prohibition on the misuse of market power

Of the prohibitions on restrictive trade practices in Part IV of the CCA, the most relevant to airports is section 46: the prohibition on the misuse of market power. This prohibition does not necessarily focus on the potential uses of market power identified by the Productivity Commission in the Issues Paper, such as excessive fees or inefficient investment decisions (although it may, depending on the circumstances). Instead, section 46 focuses on anti-competitive conduct (in whatever form), and accordingly, has more relevance to aspects of airport businesses which are vertically integrated and which compete in downstream markets.

Section 46 has been in place since before major airports in Australia were privatised, and is an important part of the legal framework which restricts the conduct of airports. Further, as a result of recent

amendments (in November 2017, following recommendations of the Harper Competition Policy Review), section 46 now captures an even broader range of conduct.

The amended section 46 prohibits a company with substantial market power from engaging in any conduct which has the purpose, effect or likely effect of substantially lessening competition in a market, being a market in which the company supplies or acquires goods or services, directly or indirectly. In contrast, the previous section 46 required that a company use (or misuse) its market power for a proscribed anti-competitive purpose. The amended provision is broader than its previous iteration, in that:

- the amended provision focuses on both the purpose and effect of conduct; and
- under the amended provision, there is no need to prove that a company used (or misused) its market power – only that the company's conduct had the requisite purpose or effect.

There has been much public debate about whether the amended provision is overly broad, and may capture legitimate, competitive conduct – given that competitive conduct by one firm can often diminish the competitiveness of another. Indeed, the Harper Panel itself recognised the potential of the new prohibition to result in 'over-capture', and recommended that legislative guidance be adopted to mitigate this risk,[77] however, that recommendation was not implemented.

The impact of section 46 on airports

In its 2011 report, the Productivity Commission found that airports have market power in ground transport services, as they are the only supplier of landside access to the airport. The Commission further noted that airports could potentially use this market power to deny or frustrate land access to terminals, by imposing excessive access fees, or imposing unacceptable access conditions. However, the Commission went on to conclude that there was no evidence of major airports misusing their market power.

Melbourne Airport considers that section 46 remains a credible and immediate threat to the behaviour of any firm with market power – indeed, this is especially the case following the recent amendments to the prohibition.

Given the risk that Melbourne Airport would be considered to have substantial market power in ground transport services, section 46 compels Melbourne Airport to consider the effect on competition of any action it takes regarding landside access – including whether its actions would hinder ground transport operators from competing with each other, or with Melbourne Airport's own car parking services. Section 46 is therefore a constraining factor in any decision of Melbourne Airport regarding landside access, including decisions regarding access pricing, terms and conditions, operations and capital investment.

The significance of the restraint imposed by the legislative prohibition on the misuse of market power is amplified by:

- the ACCC's significant investigation and enforcement powers, and vigilance in the use of those powers;
- the extensive penalties that can be attached to a contravention of section 46; and
- the time, cost and reputational damage in facing and defending misuse of market power proceedings.

In that context, Melbourne Airport considers that the currently regulatory regime is more than sufficient to prevent any misuse of market power in the provision of ground transport services. The market share

[77] *The Australian Government Competition Policy Review*, p. 340-345

of on-airport car parking of 13.6 per cent demonstrates that passengers choose alternative modes of transport to get to Melbourne Airport.

8.2.1.2 Other restrictive trade practice provisions

Melbourne Airport also notes the other restrictive trade practice provisions which exist under Part IV of the CCA, such as the prohibitions on cartel conduct and bilateral arrangements which substantially lessen competition. These provisions also act to restrict airport conduct and promote competition in downstream markets.

8.2.2 Future regulatory arrangements for ground transport

In its recent publication and in various remarks to the media in the lead up to the Productivity Commission's Inquiry, A4ANZ proposed that 'all services in which airports have a substantial degree of market power' should be deemed declared under Part IIIA of the CCA. It is unclear from these remarks whether A4ANZ proposes any regulation of landside services, or whether it is only focused on the airside services which are acquired by the airline members it represents.

Melbourne Airport also notes that the ACCC has previously called for heavier regulation of landside airport services – in 2011, through mandatory access undertakings – although it considered at that time that regulation should not set car parking charges.

The Productivity Commission rejected the proposal for mandatory access undertakings, as there was no evidence of major airports having used any market power in landside services, and given the various legal and administrative complications and costs which such a change would involve. The Commission noted particular concerns that such a proposal could lead ACCC to effectively determining the price range and conditions for ground transport access, and to an 'ongoing compliance loop' of airport negotiations with the ACCC regarding the terms of access, in which the ACCC would need to account for the airport's changing requirements related to security and congestion.

Melbourne Airport submits that the Productivity Commission's reasoning in this respect is still applicable today. Further, the Commission's reasoning in previously rejecting deemed declaration of aeronautical services is also applicable to landside services, and remain valid – that is, heavier regulation of landside services would also involve an unacceptable risk of regulatory error and adversely affect airport investment. Accordingly, Melbourne Airport considers that heavier regulation of landside services is unwarranted, and inappropriate.

8.2.3 Car parking and ground access quality

The ACCC monitors the quality of car parking and ground access facilities through passenger surveys. As with financial monitoring activities for car parking, this provides accountability and transparency for a service that is often subject to public debate.

However, the level of competition from other modes of transport is more likely to give an indication of any use of market power rather than monitoring activities. For ground access, all categories measured by the ACCC were considered ‘good’ in 2016-17.

8.3 Ground access

Ground access at Melbourne Airport is provided through the roads and other ground transport facilities that provide access to the terminals. These facilities are owned, controlled and operated by Melbourne Airport.

Over 100,000 vehicles use the airport precinct every day. Melbourne Airport provides various facilities for private and commercial vehicles to access the airport to ensure that the landside road network operates efficiently and minimises congestion. Access is provided free of charge to private vehicles dropping off or picking up passengers. Commercial vehicles are subject to charges for access that reflect the cost of the facilities and services that are provided.

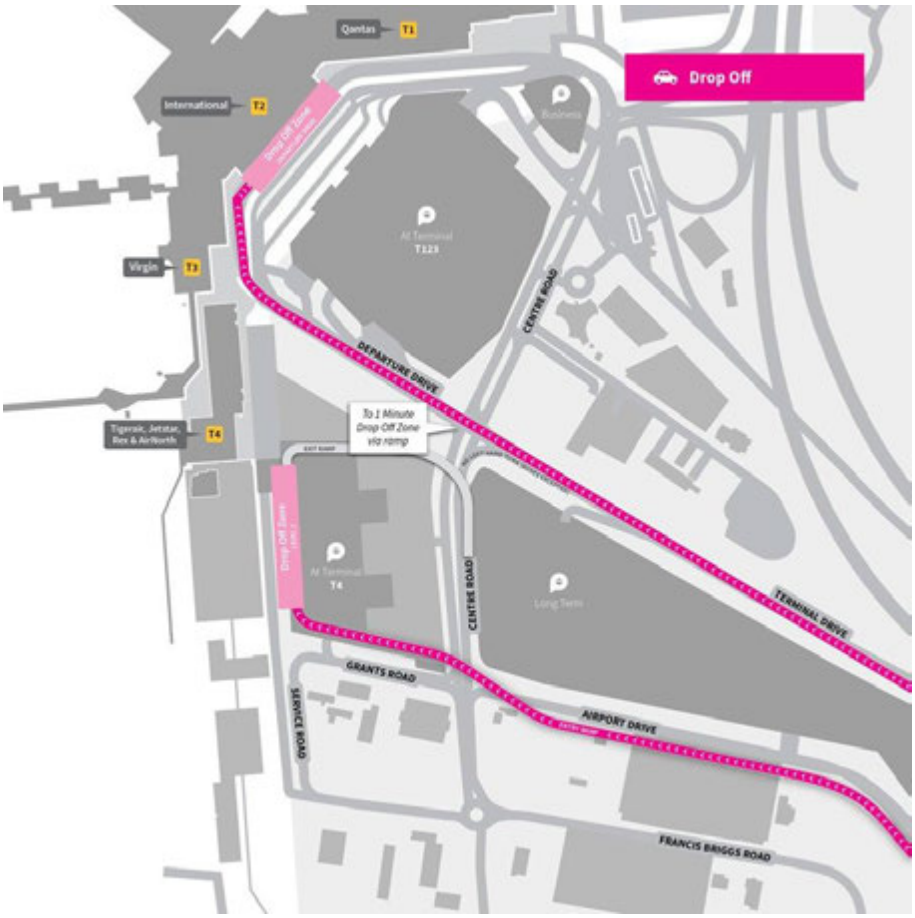
8.3.1 Private vehicles

Free pick-up and drop-off is the most common way users get to or from Melbourne Airport, comprising 36.8 per cent of passengers. Access to the airport for vehicles dropping off and picking up is provided free of charge.

8.3.1.1 Drop-off

Vehicles can drop passengers off at the airport in two locations. For terminals 1, 2 and 3 the drop-off zone is on Departure Drive, level 2 of the airport forecourt. The drop-off zone for Terminal 4 is located in level 2 of the Terminal 4 car park. These drop-off zones are open to both private vehicles, and commercial vehicles such as taxis or ride-sharing.

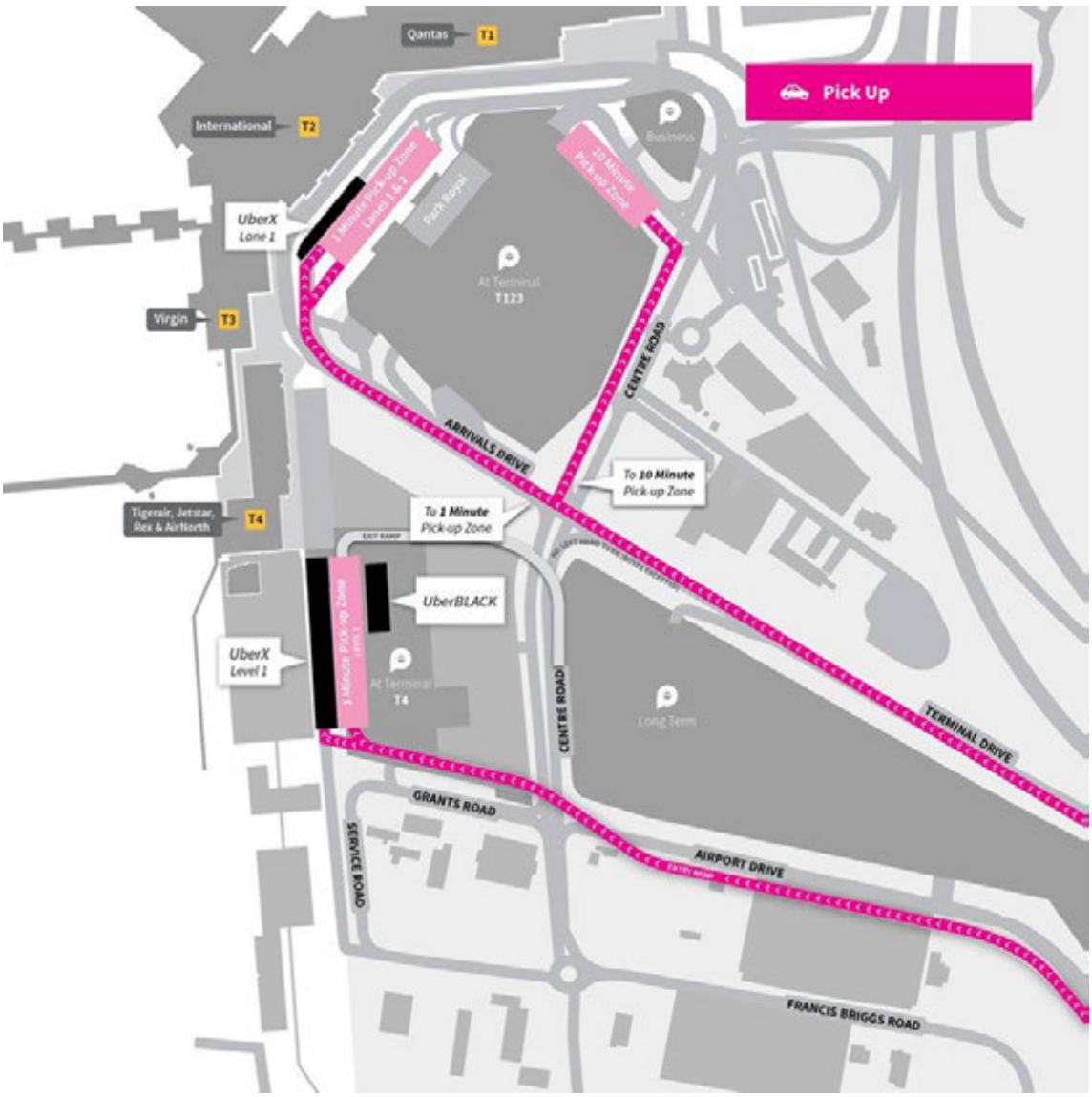
Figure 8.3: Passenger drop-off zones, Melbourne Airport



8.3.1.2 Pick-up zones

There are two one-minute pick-up zones at Melbourne Airport. The first is located on the ground level of the forecourt outside of terminals 1, 2 and 3, whilst Terminal 4 pick-ups are located in level 1 of the Terminal 4 car park. These pick-up zones are restricted to a one-minute standing requirement in order to avoid congestion.

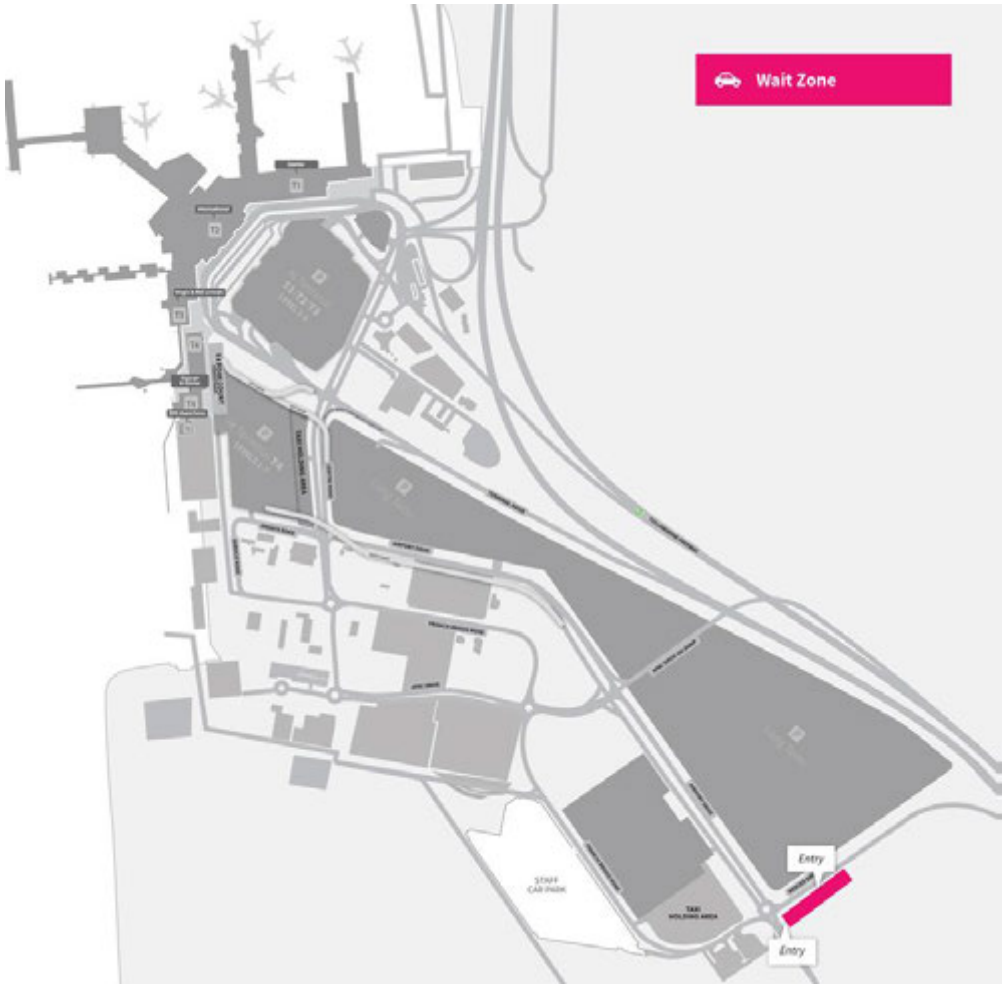
Figure 8.4: Passenger pick-up zones, Melbourne Airport



For private vehicles that want more time to pick up their passengers or wait for them to arrive, there are two waiting areas. The first is a 10-minute pick-up zone located in between the At Terminal 1, 2 and 3 car park and the Business Car Park. This allows drivers more time to pick up their passengers. To avoid congestion in this area, parking rates apply beyond stays of 10 minutes.

The second facility is the wait zone, located further away from the terminal precinct. This waiting area allows drivers that arrive early or if their passenger is delayed, to wait until they are ready to be picked up from either the one-minute wait zone or 10-minute wait zone. Parking in the waiting area is free for the first 20 minutes, with 60 minutes parking costing only $4, after which drive-up parking rates apply to ensure the area is not used for longer-stay parking.

Figure 8.5: Passenger pick-up wait zone, Melbourne Airport



Current prices for extended stays at the 10-minute pick up and wait zones are as follows.

Table 8.7: Prices for 10-minute pick-up and wait zones, Melbourne Airport

Duration	10-minute pick-up	Duration	Wait zone
0 to 10 minutes	Free	0 to 20 minutes	Free
10 to 15 minutes	$8	20 to 40 minutes	$2
15 to 30 minutes	$12	40 to 60 minutes	$4
30 to 60 minutes	$16	60 minutes to 3 hours	$24
1 to 3 hours	$28	3 to 4 hours	$34
3 to 24 hours	$78	4 to 6 hours	$44
2 days	$128	6 to 24 hours	$51
3 days	$178	2 days	$102
Per extra day	$50	Per extra day	$19

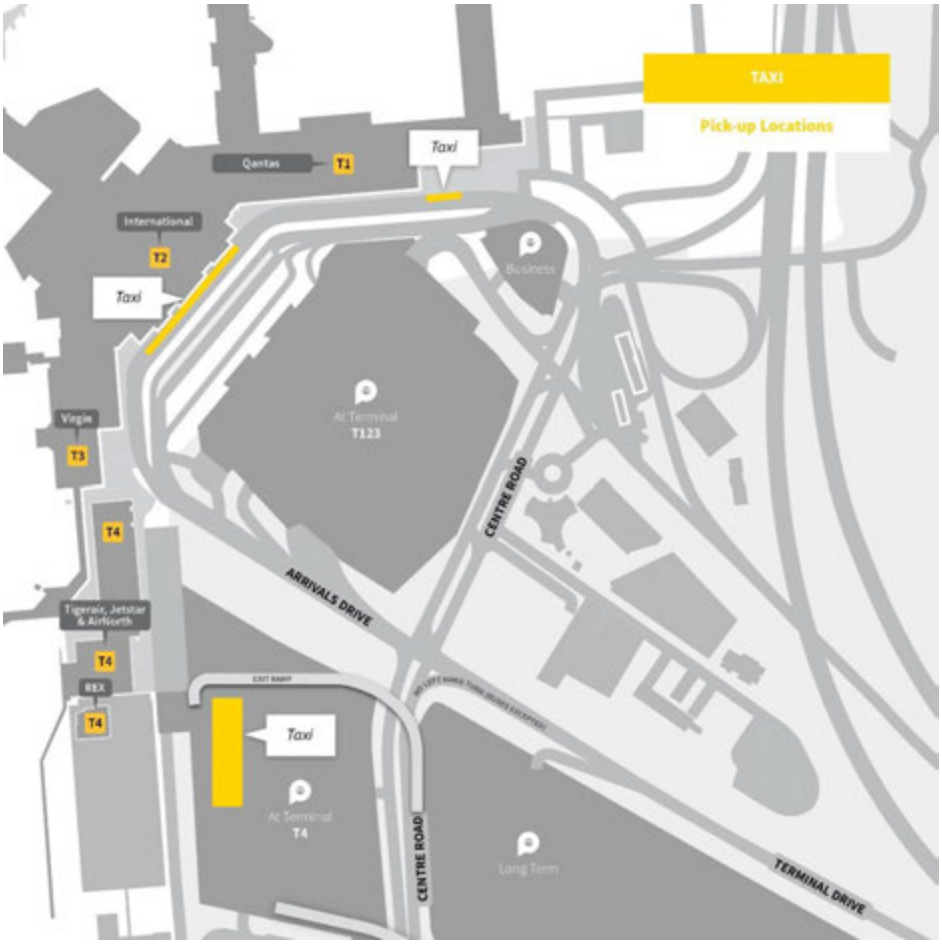
8.3.1.3 Commercial vehicles

Commercial vehicles are subject to commercial agreements for ground access at Melbourne Airport. Access charges vary, depending on the type of vehicle and the type of access. Charges have been determined based on the cost of providing and operating the infrastructure to enable access to the airport.

8.3.1.4 Taxis

In 2016-17 6.8 million passengers used taxis to get to or from Melbourne Airport. Taxis are able to drop off passengers to the airport free of charge. A fee is applicable for taxis that are collecting passengers. Currently the fee is $3.65 per vehicle pick-up. Taxi facilities include two waiting areas for taxis, a prayer room in the waiting areas, café and rest rooms, technology to efficiently manage taxi flows from the waiting areas into the terminal precinct and the taxi pick-up areas adjacent to Terminal 1, outside Terminal 2 and Terminal 4.

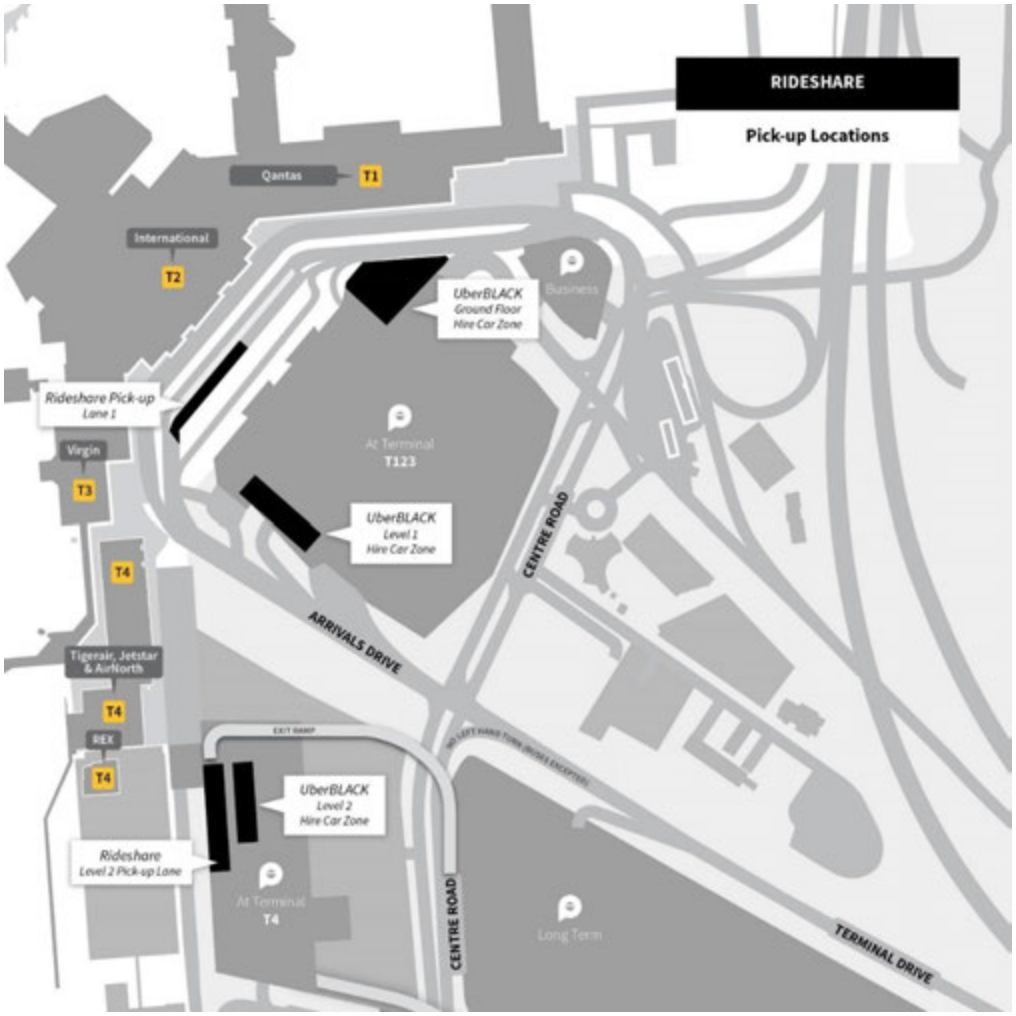
Figure 8.6: Taxi pick-up locations, Melbourne Airport



8.3.1.5 Ridesharing

There are currently four ridesharing operators that have agreements to operate at Melbourne Airport. These operators include Didi, GoCatch, Ola, and Uber. As with taxis, there is no charge for ridesharing services to drop passengers off at Melbourne Airport, whilst there is a charge of $4.48 for ridesharing vehicles to pick up passengers. Facilities provided for ridesharing services include a dedicated ride sharing waiting area, café and rest rooms, and dedicated pick-up zones in the forecourt outside Terminal 2, and in the Terminal 4 car park.

Figure 8.7: Rideshare pick-up locations, Melbourne Airport

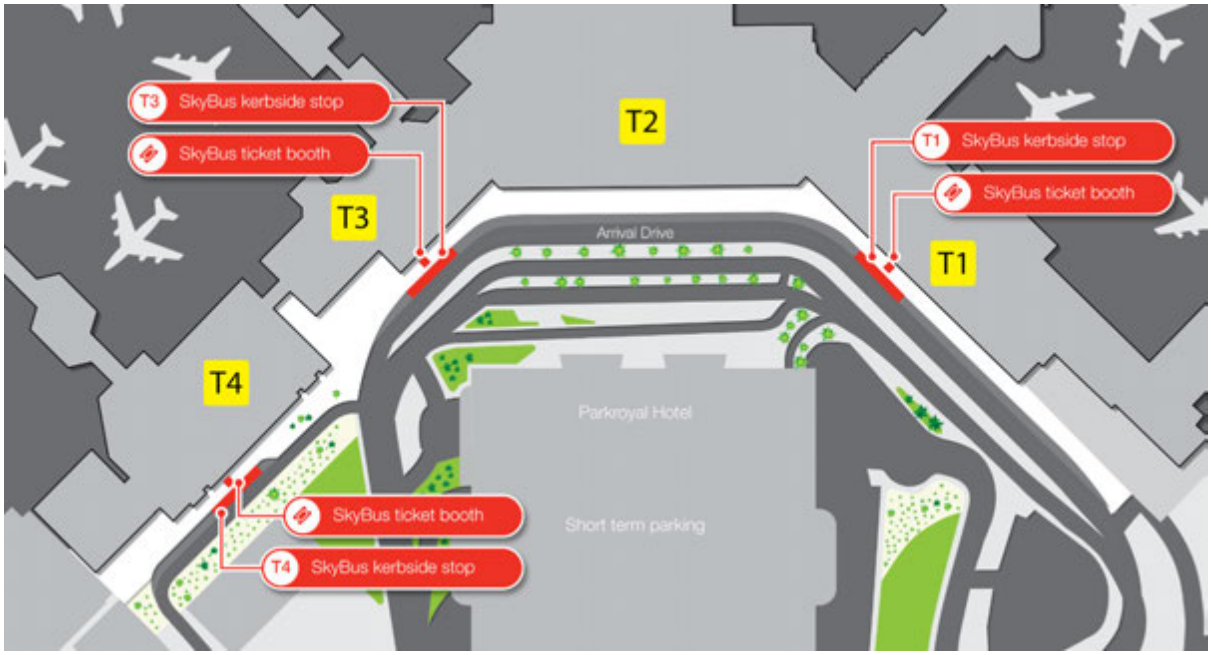


8.3.1.6 SkyBus

In 2016-17 3.5 million passengers used SkyBus to travel to or from the airport. SkyBus operates its main service from the airport to Southern Cross Station in the CBD. Other routes operated by SkyBus include services to Docklands, St Kilda, Frankston and the Mornington Peninsula, and Werribee. Melbourne Airport has worked with SkyBus to facilitate the introduction of these additional services. SkyBus has three stops at Melbourne Airport at terminals 1, 3 and 4. SkyBus stops are kerbside, allowing passengers direct access into the terminals, with dedicated lanes allowing buses efficient access in and out of the terminal precinct.

Melbourne Airport has a commercial agreement with SkyBus to allow access to these areas of the forecourt; as of 2018 the charge is **[Commercial-in-Confidence]**. The walk-up rates of an adult fare for SkyBus are $19.50 one way, or $37 return, children are free, with discounts available for purchasing online, family tickets, or purchasing a saver 10-trip ticket.

Figure 8.8: SkyBus stops, Melbourne Airport



Source: SkyBus

8.3.1.7 Buses

Melbourne Airport is serviced by numerous direct, regional, off-airport and charter buses. In 2016-17 it is estimated 3.3 million passengers used these ground transport services at Melbourne Airport. The pick-up and drop-off location of these services is dependent on the operator and type of service. Public bus services also operate at Melbourne Airport, with bus routes 478, 479, 482 and 901 all operating from the Terminal 4 transport hub.

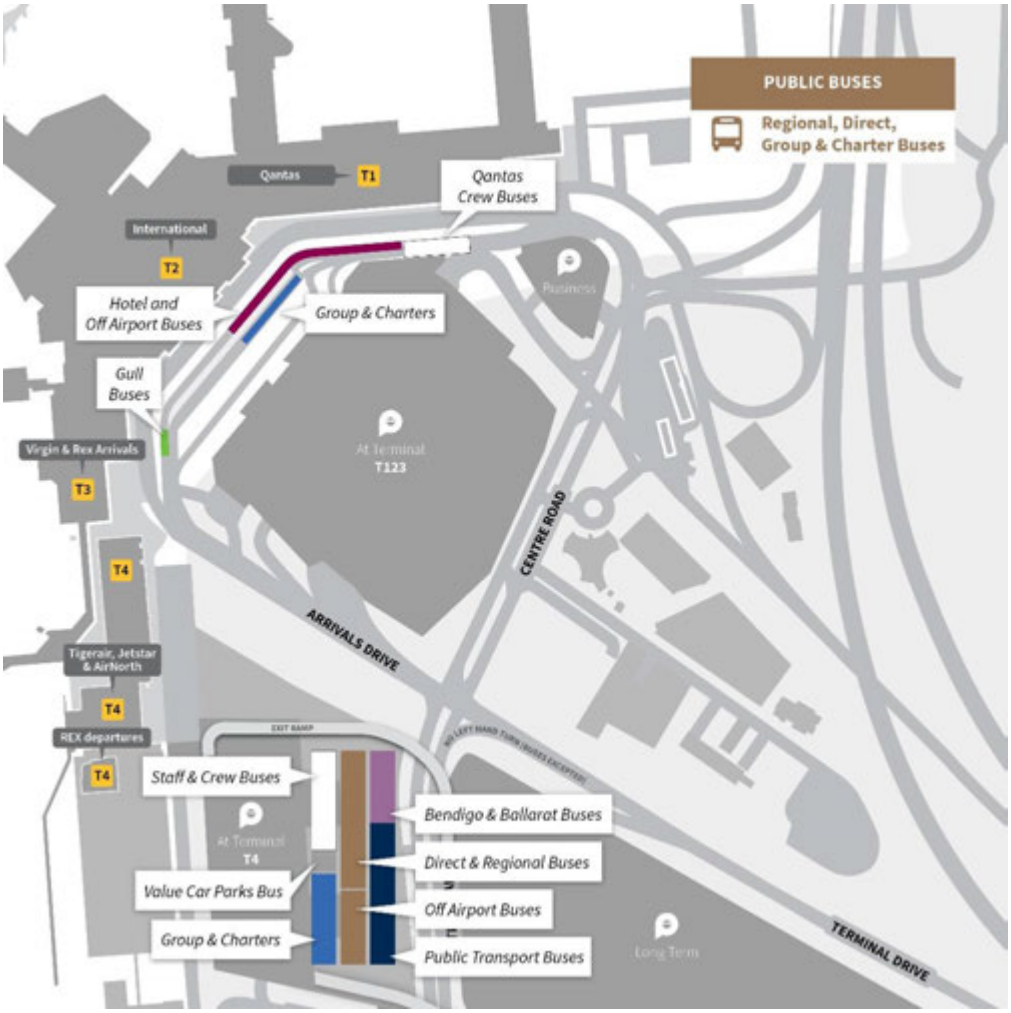
Public buses operate at the airport free of charge. Private bus services are charged for access based on the number of seats of each bus.

Table 8.8: Melbourne Airport ground access prices – buses

Bus size	Price
Public bus	Free
Small	$4.04 - $5.00
Medium	$6.05 - $7.50
Large	$12.12 - $15.00

Source: Melbourne Airport

Figure 8.9: Private and public bus stops, Melbourne Airport



8.3.1.8 Future rail

Melbourne Airport is the largest airport in Australia that does not have ground access by direct rail. Melbourne Airport has long been supportive of the construction of a rail link, as it will provide passengers with more choice in how they access the airport, will help meet future demand for ground access services, and provide for a better service for passengers. Melbourne Airport has welcomed the recent commitments from the Federal and State governments in 2018.[78]

8.3.2 Market power in ground access

Melbourne Airport has invested in ground access facilities to enable the supply of more efficient ground access charges across different modes of access. Investment has been made to facilitate different forms of ground access, enabling competition between different modes and operators to give passengers choice. Prices charged for ground access are cost-reflective, and not prohibitive in a way that they may encourage users to substitute to other modes of transport. These investments have enhanced the passenger experience in accessing the airport, despite strong growth in demand continually needing to be met.

[78] https://www.melbourneairport.com.au/Corporate/News/Melbourne-Airport-welcomes-rail-funding

8.3.2.1 Investment in ground transport

Melbourne Airport has actively made investments in facilities that have provided customers with more choice in how they can get to or from the airport.

The 'ring and ride' wait zone was introduced in 2014 with 79 parking bays, to facilitate drivers picking up passengers.

With the emergence of ride-sharing, a purpose built ride share holding area with 200 bays was completed in 2017-18. Rideshare pick-up zones have also been integrated into passenger pick-up areas in the forecourt and in the Terminal 4 transport hub. These investments have facilitated the increased demand by passengers to ridesharing services such as Uber.

Further detail on past and future investment in ground transport is included in section 6.2.2.

8.3.2.2 Pricing of ground transport

Pricing for ground access services reflect the cost of providing the facilities to enable the efficient movement of people in and out of the terminal precinct, with the facilities provided built to provide efficient access, without the cost of access becoming prohibitive for operators.

Melbourne Airport developed a new pricing structure for ground access charges in 2014-15, which was updated in 2016-17. This user-pays model is based on accepted building block methodology and looks to recover operational and capital costs of providing ground access services, and is also overlaid with a locational rent.

The building block model is similar to that of aviation charges (section 6.1) in that it takes existing and new assets and seeks recovery of capital expenditure of its assets through depreciation expenses that are incorporated into the building block model.

The cost of assets used in the building block model is determined by either a direct or common use allocation, after any recovery through aeronautical charges is removed. Costs are directly apportioned where possible, however if the facility is common user, then the cost is apportioned by mode share usage of the asset.

For any costs relating to the forecourt, a locational rent is then applied to ensure that modes of transport who enjoy closer access to the terminal pay a higher return than transport modes located in the furthest lane. This model is then overlaid with operational costs using an activity-based costing approach.

Melbourne Airport has been transparent in the development of this model, briefing the ACCC and the ground transport industry on the development of the pricing model and the subsequent changes to pricing which followed.

The ground access fees charged as part of the building block model are not prohibitive to the extent that they would be expected to result in passengers choosing a different mode of transport. If ground access charges were prohibitive and set too high, it would be expected that demand for services where the access charge is passed onto the consumer, such as taxis and ride-sharing, would be lower, whilst the lower supply would be the result where the service provider incurs the cost, like in services such as off-airport car parking.

Given that growth in car parking transactions has not kept pace with growth in passenger numbers,[79] this would indicate that passengers have been substituting away from car parking rather than towards it at Melbourne Airport.

[79] ACCC, *Airport Monitoring Report 2016-17*, p. 101

Taxis and ridesharing

Historically, taxi growth at Melbourne Airport has been in line with overall passenger growth. Since the emergence of ridesharing, the combined growth of ridesharing and taxis has been much stronger, at about nine per cent.

Melbourne Airport does not consider that ground access charges distort consumer decision making in a significant way given the relative cost of fares for ground transport access. For example, for a total return taxi fare from the city to the airport, the ground access charge of $3.65 for the journey departing the airport would account for 3.1 per cent of the total round-trip fare. Alternatively, using an Uber for the same journey, the $4.50 ground access charge would add 5.4 per cent to the round-trip minimum cost of $84.

Table 8.9: Estimated ground access fares to and from Melbourne Airport

Destination	Return taxi fare ($)	Ground access charges (%)	Return Uber fare (minimum) ($)	Ground access charges (%)
Southern Cross Station	$117	3.1	$84	5.4
University of Melbourne (Parkville)	$108	3.4	$75	6.0
Frankston	$332	1.1	$243	1.9
St Kilda	$142	2.6	$109	4.1
Ground access charge	$3.65		$4.50	

Source: Houston Kemp, Melbourne Airport analysis

Such small charges would not be expected to distort consumer behaviour in any significant way, given the relative cost of fares. Even if there were no ground access fees, the minimal impact on fares, and other factors such as the personal preferences of the passenger and the number of consumers likely to substitute towards taxis from other modes including car parking would expected to be minimal.

Buses

The impacts of ground access fees on off-airport car park operators work differently to taxis or rideshare, as the costs are paid for by the operator, rather than the end consumer. So rather than this resulting in demand dropping from consumers, this is more likely to reduce the supply of services.

Private and chartered bus services account for 9.3 per cent of passengers travelling to or from Melbourne Airport. There are ground access agreements in place with over 300 private operators.

There is a strong supply of off-airport car park operators at Melbourne Airport. There are more off-airport operators than any other Australian airport, comprising **[Commercial-in-Confidence]** of the total 'stay' parking market (for parking stays beyond four hours).[80]

Pricing of private buses varies depending on the size of the vehicle. For small buses (up to 13 seats), the price of access is similar to that for rideshare vehicles, ranging from $4.04 to $5.00 per vehicle, or as low as $0.31 per seat. Prices are higher for medium and large-sized buses, but are similar on a per-seat basis.

[80] LEK Analysis, 2014

8.4 Assessment of market power for parking and ground access

Houston Kemp has prepared an assessment of the market power held by Melbourne Airport in relation to car parking and ground access. The report considers whether Melbourne Airport has substantial market power in the provision of car parking or ground access services. Where Houston Kemp found that Melbourne Airport did in fact hold market power, it found no evidence of any exercise of this market power.

The Houston Kemp assessment found that Melbourne Airport does not have market power in relation to car parking. The existence of a competitive market is evident due to alternative options for accessing the airport, and the competition from off-airport car parks, with the prices offered by these operators generally similar to the prices in the long-term car park operated by Melbourne Airport.

The assessment also found there was no evidence of any market power being exercised, with parking prices either flat or falling in real terms since June 2012 despite increased costs in operational and capital expenditure, with prices reflecting the locational rent of their location in proximity to the terminal precinct.

The findings of this assessment are consistent with the findings of the Productivity Commission in its 2011 inquiry, where it found that:

> *While there is a locational premium attached to the convenience of parking in close proximity to an airport terminal, the range and extent of modal options at each airport provides a competitive constraint on airports' car park pricing, particularly long-term parking.*[81]

With regards to ground access, Houston Kemp found that Melbourne Airport has not exercised market power, with the fact that Melbourne Airport provides access for private vehicles free of charge, provides facilities for other modes of access on high-valued land adjacent to the commercial precinct, and has provided free parking options for private vehicles to manage peak demand and congestion on the airport road network.

The assessment undertaken by Houston Kemp is attached to this submission.

8.5 Monitoring of car parking and ground access

For car parking these monitoring activities include measuring the number of car park spaces, and the annual and average daily throughput of cars through these facilities. Prices are measured for both drive-up rates, and average online rates.

The profitability of the car parking business include revenue, profit and expenses per car, as well as total EBITA profits. The use of EBITA as a measure of profitability has the same shortcomings as outlined above, as it doesn't include any interest expense attached to the supply of car parking facilities, such as the Terminal 4 car park which was built in 2015, nor does it reflect the locational rent associated with the location of car parking relative to the terminal precinct.

The ACCC monitoring report does discuss the role of off-airport parking operators, albeit briefly. The most significant issue to consider when assessing market power with regards to car parking is competition with other modes of transport. As demonstrated in section 8.1 Melbourne Airport parking faces significant competition from other modes of transport, including off-airport car parking. This is largely ignored by the ACCC throughout the monitoring process.

[81] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, finding 11.2

Ground access prices are also monitored by the ACCC, with real terms price changes measured over a five-year period, alongside changes in total ground access revenue, as well as revenue collected by different modes of ground transport operators. In the case of Melbourne Airport, these fees and charges reflect the costs to provide the facilities required to access by these operators. Melbourne Airport has consulted with the ACCC on the development of the ground access cost recovery model which underpins these charges. See section 8.1 where this is discussed in more detail.

Melbourne Airport considers that changes to the financial monitoring of parking and ground access services are not warranted. They provide accountability and transparency to the public for ground access and parking services at major airports.

However, given the competition that exists from other modes of transport for car parking, monitoring prices and revenues is not going to provide as much insight into the use of any market power for car parking relative to observing other constraints on market power that exist, namely competition.

8.6 Land transport planning

The planning and operation of land transport linkages to and from the airport is the primary responsibility of the State Government. Two state government agencies are specifically responsible for land transport planning – Transport for Victoria and VicRoads.

Melbourne Airport welcomes the recent commitment from both State and Federal governments towards the development of a rail link to Melbourne Airport.

Melbourne Airport engages with state government agencies, and the Federal Government with regard to future transport planning, but also on the operation of the airport road network and its interaction with publicly owned roads. Melbourne Airport considers that the current arrangements work well in Victoria, and that no alternative approaches are required.

9 Other airport services

9.1 Retail

The retail offer at Melbourne Airport plays a key role in not only funding part of the airport's infrastructure, but it also plays a key role in providing the best possible customer experience.

The availability of food and beverage options, a children's play area and change facilities, shopping and retail, or space to comfortably sit and wait are all offerings that enhance the passenger experience.

9.1.1 Leasing process

Leasing at Melbourne Airport is based on procedures that include customer research to determine the type of offer that passengers want, and choosing operators that are able to adapt to the changing airport environment.

Tenancy of new and replacement retail sites is determined through a combination of direct negotiation with retailers, and a request for proposal (RFP) process. Under the RFP process, a set of tender documents is sent to the market with the responses considered against all of the following required criteria: commercial terms, service, operational capability, fit-out, usage, and pricing. The decision is linked to customer research and usage for the site.

9.1.2 Retail pricing

A clause relating to competitive pricing is included in all retail leases. Melbourne Airport frequently conducts price comparisons for airport retailers against similar retail offerings in the city, for example price comparisons of convenience stores located in train stations against retailers at the airport. These comparisons have found that prices are comparable to city retailers, as well as retail stores in Terminal 1, where retailers are managed by Qantas Group. While pricing is not dictated, checks are undertaken to ensure value for money for the passengers and other customers.

Retailers must adhere to appropriate regulation as it pertains to screening, security and generally operating in the environment. All goods going airside are subject to the same screening processes as passengers and work hard to ensure a safe secure terminal for travel.

All retailers and their staff must pass rigorous testing in order to get an 'ASIC' – the security clearance required for someone to work at the airport and access restricted areas. All retailers must adhere to these requirements, which would be expected to entail costs for airport retailers, relative to other retail environments.

9.2 Property

Melbourne Airport's Property business delivers long-term, sustainable growth, enhancing and realising the value of land and contributing to the Airport's overall amenity, reputation and economic strength. The existing investment portfolio is valued at over $1 billion across more than 200 hectares of developed land, with over 250 hectares of land still available for commercial property development. The growing investment portfolio provides additional economic benefits to the local region, facilitating new employment opportunities for the local community.

Melbourne Airport has over 150 leases over the landside precinct, over 180 leases across the terminal precinct and vacancy rates of less than one per cent. Many of our tenants operate businesses that benefit from the close proximity to the airport, including:

- freight companies such as Menzies Aviation, dnata and Australia Post;
- organisations directly involved with aviation activities, including jet fuel distribution, dnata Catering and First Point Animal Services; and
- distribution centres such as Toll IPEC and TNT.

Over half of the investment portfolio income is drawn from industrial assets, whose tenants benefit from the proximity to the airport and to major freeways (Tullamarine Freeway, Calder Freeway and Western Ring Road). The Melbourne Airport Business Park is the largest industrial business park in Australia. Over the last five years we have developed 39 hectares of land for a wide variety of tenants. This growth is set to continue over the coming years.

9.2.1 Property precincts at Melbourne Airport

The Landside Main Precinct is the gateway to the airport for most people. It provides access to the terminal facilities via the freeway and road networks.

The Forefront (previously known as Gowrie Park) area of Melbourne Airport is currently the most visible because it is bounded by the main entry and exit points to the Tullamarine Freeway. A number of commercial developments are located within the 8.6 hectare site including two hotels.

The Melbourne Airport Business Park is located in the southern area of the airport. It is an established business park of around 311.8 hectares. More than 122 hectares of land is already developed, providing 30 facilities for 34 tenants.

The majority of the facilities are large distribution warehouses supporting logistical operations, although other occupiers include a manufacturer and a self-storage facility. Smaller facilities have been developed in terraced formats to accommodate new entrants to the business park. A Quest serviced apartment hotel and a small commercial café have been developed to support the businesses and employees, providing a level of amenity needed for such a large estate.

MACE (which has now been incorporated within the Melbourne Airport Business Park) is an industrial warehouse precinct on Airport Drive in the southeast corner of the airport. The long-term planned area of the estate is approximately 40.3 hectares, with 39,000 square metres of warehousing and offices developed for freight and industrial warehouse uses (aviation and non-aviation-related uses). The location and design of the buildings are such that aviation-related operators can be provided with facilities that have an airside and landside boundary.

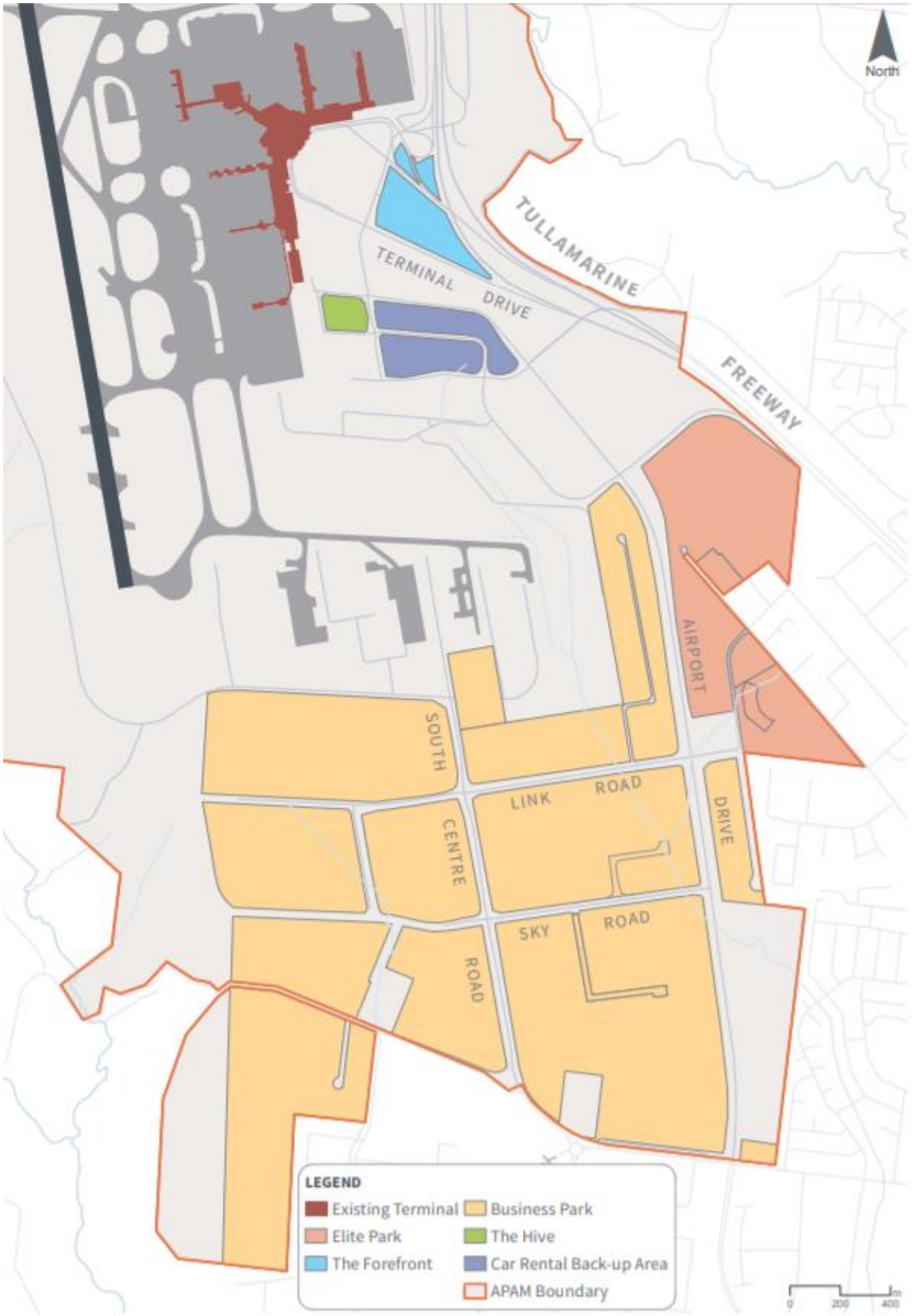
The Hive precinct, adjacent to the At Terminal 4 car park, is currently home to government departments that require proximity to the terminal precinct, including the Australian Federal Police, the Department of Home Affairs, and the Department of Agriculture and Water Resources.

In 2019 and subject to approval of a Major Development Plan (MDP), Melbourne Airport is due to commence construction on a new 464-room, dual-branded Novotel and Ibis Styles hotel in the Hive precinct. The hotel precinct will provide substantial amenity to the area, including a restaurant, café, bar, conference facilities and a pool and gym. The 2018 Preliminary Draft Master Plan allows for future commercial office developments in the Hive precinct to provide additional amenity and space for the airport community.

The 54.3-hectare Elite Park occupies a visible position along both the Tullamarine Freeway and Airport Drive. The site is currently home to three occupiers, including a pet hotel and Essendon Football Club. In early 2019, construction will finish on Australia's first man-made wave park, UrbnSurf Melbourne.

Melbourne Airport also provides substantial commercial office and lounge tenancies to the airline community and other stakeholders that require space in the terminal precinct. Three new open access lounges were opened in early 2018 and continued strong passenger growth will result in additional space being developed.

Figure 9.1: Map of non-aviation property precincts, Melbourne Airport



9.3 Jet fuel

The Melbourne Airport jet fuel supply consists of a mix of imported and locally refined Jet A-1 supplied via pipeline and road from three storage terminals located around Port Phillip Bay to the Melbourne Airport Joint User Hydrant Installation (JUHI) facility. Situated adjacent to Melbourne Airport, the JUHI facility is owned by an unincorporated joint venture comprising Exxon Mobil, BP, Viva Energy and Caltex (the JUHI JV). Management responsibility for the Melbourne Airport JUHI rests with Exxon Mobil.

Two refineries operate in the state of Victoria – the Exxon Mobil refinery at Altona and Viva Energy refinery at Geelong. Both refineries supply their local terminals via pipeline. Each of the terminals below receives Jet A-1, shipped from interstate or international suppliers.

The three terminal facilities operated in Victoria are:

- Exxon Mobil, Yarraville (with fuel storage and truck load-out facilities owned jointly with BP)
- Viva Energy, Newport
- Caltex, Newport.

Melbourne Airport understands that each of the terminals have recently increased their capacity to store Jet A-1 through a mix of dedicated and multi-product tanks, with the latter requiring recertification before Jet A-1 use. An additional 20 megalitres of fuel storage is available at the Somerton depot, supplied by users of the Somerton pipeline.

9.3.1 Fuel distribution

Jet A-1 is transported from the off-site terminal facilities to the JUHI facility via either pipeline or road. All fuel providers utilise road transport to deliver fuel, whereas only certain fuel providers utilise the pipeline network to deliver their product.

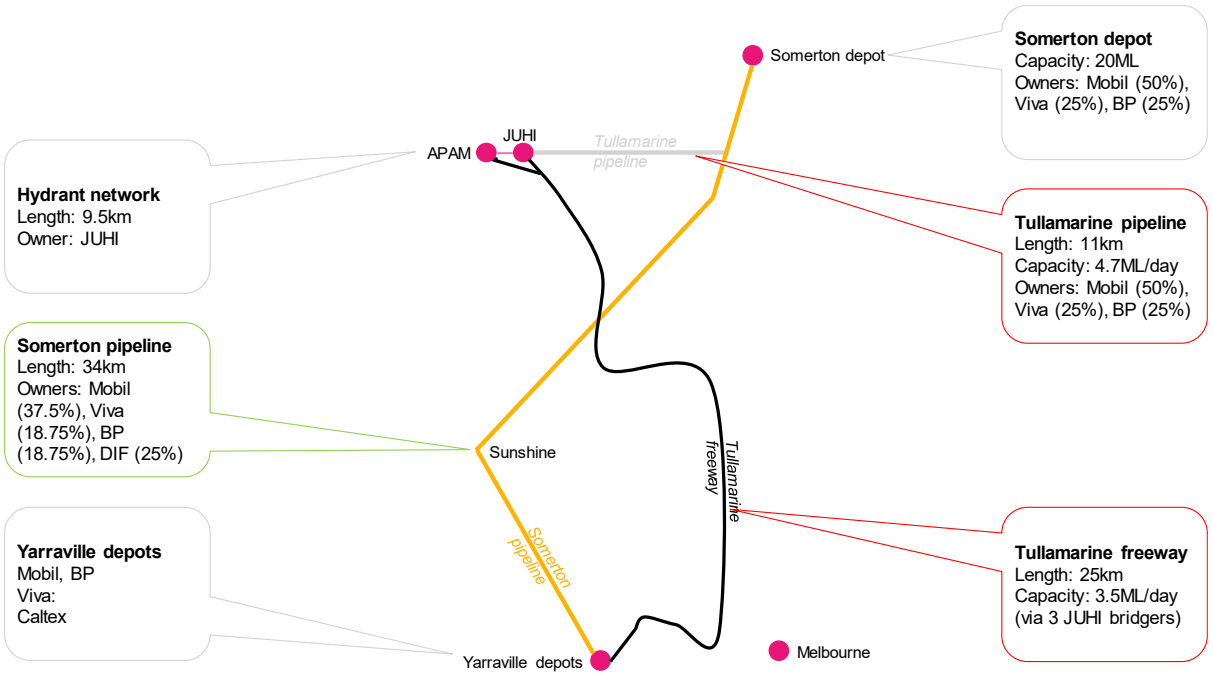
The pipeline network consists of the 34-kilometre Somerton pipeline (terminating at the Somerton fuel depot managed by Exxon Mobil) and the Tullamarine pipeline, an 11-kilometre pipeline connecting the Somerton pipeline to the Melbourne Airport JUHI facility.

The pipeline infrastructure is owned jointly by three of the four petroleum companies supplying fuel to Melbourne Airport – Exxon Mobil, BP and Viva Energy. In the case of the Somerton pipeline an institutional investor also maintains a minority equity interest. The Somerton pipeline capacity is over three times the existing operating capacity of the Tullamarine pipeline, which is the constraint in the pipeline infrastructure.

Fuel receipted at Melbourne Airport occurs at the JUHI facility, which consists of three bridger bays (unloading points for fuel tankers) and two fuel tanks capable of storing a maximum of approximately seven megalitres of fuel, but operates slightly below that level. The existing on site storage represents 1.27 times average daily capacity, below IATA guidelines of three days operating supply.

Jet A-1 is transferred to airline customers via one of the three into-plane operators on the airport, owned by Viva Energy, BP and Exxon Mobil. Jet fuel is delivered into-plane to international and domestic aircraft via an in-ground hydrant system servicing aircraft parking positions on the aprons. Hydrant lines are approximately 9.5 kilometres long and capable of supplying 11 megalitres a day. The jet fuel supply chain to Melbourne Airport is illustrated in Figure 9.2 below.

Figure 9.2: Jet fuel supply chain, Melbourne Airport



[Commercial-in-Confidence]. Even with the new open access provision in the agreement between Melbourne Airport and the JUHI participants signed in 2017, accessing the other elements of the supply chain is a challenge and reduces competition for Jet-A1 in Melbourne – access to storage at the port, pipeline infrastructure and into-plane services are critical.

9.3.2 Jet fuel supply issues

Following a jet fuel supply disruption at Sydney Airport in 2003 the Australian Government established the National Operating Committee on Jet Fuel Assurance (NOC). The NOC is comprised of an independent person together with representatives of the major oil companies, one of whom chairs the committee on a rotating basis. It focuses on the eight major Australian Airports as well as Christchurch, Auckland and Nadi, being those airports managed by one of the Australian-based arms of the major fuel companies.

The NOC was created with the purpose of ensuring that any future disruptions to jet fuel supply is minimised. It draws on information from fuel suppliers to compile a Jet Fuel Summary Report which uses a traffic light system to highlight supply issues at different airports.

During the 12-month period to 1 August 2018 Melbourne Airport has posted either a red or black traffic light for approximately 10 per cent of the time as a result of upstream supplier infrastructure issues and supplier inventory levels.

A red traffic light means “NO capacity to recover should there be a problem with planned production or ship arrival”. A black traffic light means “Problem identified and unable to be avoided from a supply perspective”.

9.3.2.1 Recent jet fuel developments at Melbourne Airport

In November 2017 Melbourne Airport announced a new long-term agreement reached with fuel suppliers securing investment in JUHI facility infrastructure for the coming 20 years.

The new agreement addresses four critical issues:

- increase in storage capacity to improve resilience;
- minimum input capacity to improve ability to re-stock after any supply shocks;
- commitment to invest in hydrant infrastructure in line with airline customer growth; and
- open access.

Storage capacity

Under the new agreement jet fuel storage at Melbourne Airport will be brought into line with IATA guidelines of at least three days operating requirements. The JUHI JV is currently constructing two new 20-megalitre tanks on their expanded Melbourne Airport site and expect them to be completed in October 2019.

Input capacity

The JUHI JV will also ensure the input capacity for receipting fuel will be at least 110 per cent of average 'peak day' daily operating requirements to allow Melbourne Airport to recover from any supply shocks.

Hydrant infrastructure

Hydrant infrastructure is critical to ensure efficient use of airport infrastructure and ensuring Melbourne Airport is able to meet the forecast demand going forward. The commitment from the JUHI JV to invest in hydrant infrastructure in line with airline customer growth will ensure on-airport infrastructure is developed in unison with the airline demand.

Open access

An open access regime is included in the new agreement to facilitate additional competition in the Jet-A1 market at Melbourne Airport. To date Melbourne Airport is aware of four parties who have applied for access, and are awaiting a response from JUHI to their application for access. The new agreement also includes a provision enabling an additional pipeline to connect to the JUHI facility.

10 Conclusion

Melbourne Airport appreciates the opportunity contribute to this important inquiry. The issues being considered are of vital importance to the aviation industry, and the role it plays in servicing the Australian community.

The experience at Melbourne Airport is that the light-handed regulatory regime works and has supported positive outcomes for airlines, passengers, employment and the Victorian and national economies.

Investment has taken place to facilitate strong growth in passenger numbers. There is no evidence of under or over investment, both potential indicators of abuse of the airport's monopoly position. Since privatisation and throughout the light handed regulatory regime, Melbourne Airport has continually demonstrated the ability and motivation to drive greater efficiency of existing infrastructure.

Observed increases in revenue per passenger over the past decade have been caused primarily by changes in passenger mix rather than rising prices. Specifically, more rapid growth of International passenger numbers (for which there is a higher cost to serve and charges are therefore higher) compared to domestic passengers has driven much of this increase.

To the extent prices have risen due to other factors, they have been in support of prudent infrastructure investment to facilitate and support passenger volume growth. It is also true that in many cases, such as Melbourne's Terminal 4, infrastructure investment in technology has enabled airlines to drive costs out of their businesses.

It is compelling that the price for use of the airfield by domestic airlines has increased by just 15 cents per passenger in real terms over the past decade. This is despite the significant differential in the cost of new for old infrastructure and the logistics and cost challenges to maintain, replace and augment infrastructure while minimising impacts on operations.

Likewise, maintaining service quality levels throughout a period of significant investment, in a live operating environment that never closes, is a significant achievement that should not be understated.

There has been much public discourse on the outcomes of privatisation generally in recent times, with much of the focus on the electricity and banking sectors in particular. The problems which have been identified in these industries have not emerged at Melbourne Airport. The light-handed regime for airport agreements works for reasons that are unique to airports. The incentives that exist in the commercial negotiation process between airports and airlines with countervailing market power provides for balanced negotiations between two parties.

Overlaid with the monitoring of airport activities by the ACCC, and other regulatory remedies that are available but which have been rarely called upon, the current framework provides the appropriate balance to enable commercially efficient outcomes.

Airports have met the challenge of congestion created by strong growth in passenger numbers, as noted by the ACCC:

> *While total passenger numbers have gone up by around 30 million across the four airports in the past 10 years, various measures indicate that the airports appear to be managing the challenge to date*[82]

[82] ACCC, *Airport Monitoring Report 2016-17, p. 5*

Over the next five to 10 years investment in runway, terminals and supporting infrastructure capacity will be required to facilitate growth while maintaining a high quality traveller experience. This major investment in long life infrastructure requires a stable, predictable regulatory environment. Unnecessary regulatory change creates risk for investors, increases funding costs and compromises the delivery of economic infrastructure at the time it is needed.

Appendix A – Information request reconciliation

The table below provides a guide to specific sections of the submission with reference to the Issues Paper.

Table A.1: Information request reconciliation

Information Request	Relevant Sections
Information request 1	Chapters 4, 5, 6, 7
Information request 2	Chapters 4, 5, 6, 7
Information request 3	Chapter 6.1, 6.4, 7.2
Information request 4	Chapter 6.1, 6.4, 7.2
Information request 5	Chapter 6.1, 6.4, 7.2
Information request 6	Chapter 5.2
Information request 7	Chapter 7.2
Information request 8	Chapter 7
Information request 9	Chapters 4, 5, 6, 7
Information request 10	Chapter 8
Information request 11	Chapter 8.2, 8.5
Information request 12	Chapter 8.6
Information request 13	Chapter 7.6
Information request 14	Chapter 9.3