PerthAirport

Productivity Commission, ***Economic Regulation of Airports***

Perth Airport Pty Ltd submission

September 2018

TABLE OF CONTENTS

1. Overview

1.1. Introduction

Perth Airport Pty Ltd (PAPL), as the operator of Perth Airport, welcomes the opportunity to make this submission to the Productivity Commission's *Inquiry into the Economic Regulation of Airport Services* ('the Inquiry').

1.2. Structure of this Submission

Section 2, 'Executive Summary' summarises the key points PAPL wishes to make in relation to the Inquiry's Terms of Reference and those matters raised in the Issues Paper published on 9 July 2018;

Section 3, 'About Perth Airport', provides information on Perth Airport operations, PAPL ownership structure and the importance of Perth Airport to the social and economic development of Western Australia (WA) and Australia;

Section 4, 'Aviation Services' summarises aviation services currently operating from Perth Airport, and provides an overview of passenger segmentation and growth;

Section 5, 'Development of Perth Airport' details past aviation related capital expenditure at Perth Airport and proposed investment over the next seven years (the proposed term of most new Aeronautical Services Agreements with airlines);

Section 6, 'Market Power in Aeronautical Services' reviews Perth Airport's Quality of Service rankings, operating costs and capital efficiency, aeronautical prices and profitability to demonstrate PAPL has not wielded market power through withholding supply (and investment), allowing quality to deteriorate, operating inefficiently, earning excess returns, or imposing unreasonable prices and conditions;

Section 7, 'Airline Engagement on Charges and Non-Price Conditions' provides an overview of the history of commercial negotiations between Perth Airport and its airline customers, and details the status of current commercial negotiations;

Section 8, 'Existence and Extent of Market Power in Aeronautical Services' outlines reasons why there is no misuse of market power by Perth Airport, and why this is to be expected;

Section 9, 'Current and Future Regulation' details PAPL's view that the current monitoring regime should (with some minor modifications) continue in its current form;

Section 10, 'Ground Transport Access and Car Parking' provides information on the market for land transport services to Perth Airport, PAPL's car parking business and PAPL's views on the current and future regulation of land transport services at Perth Airport;

Section 11, 'Land Transport Linkages', provides information on significant developments in land transport linkages to Perth Airport since the Commission's last Inquiry in 2011 and describes how these have, in the main, addressed previous concerns about land transport linkages to the airport; and,

Section 12, 'Jet Fuel Supply' details current arrangements for jet fuel supply at Perth Airport, PAPL's future plans for jet fuel supply and why competitive supply arrangements are necessary to ensure not only competitive cost provision, but also reliability and security of supply.

2. Executive Summary

2.1. Provision of Aeronautical Services

- Under the 'light handed' regulatory regime:
    - PAPL made investments in aviation related infrastructure at Perth Airport valued at approximately $1 billion between 2011 and 2018, and expects to invest a further $1.0 to $1.1 billion from 2019 to 2025. Proposed works associated with these costs (including an upgrade of Terminal 1 (International)) are outlined in the indicative capital plan provided to airline customers in the current round of Aeronautical Service Agreement negotiations[1].
    - These developments have been planned and are being designed in full consultation with the airlines, taking into account their needs and the joint objective of keeping airport prices as low as reasonably possible, whilst still delivering a good passenger experience.
    - The Perth Airport Master Plan also contemplates the consolidation of domestic Regular Passenger Transport (RPT) terminals in the Airport Central precinct and the development of a second parallel (independent north-south) runway. The precise timing of these projects is not yet clear and relevant approvals have not been obtained but planning work, including a Major Development Plan for the runway, is underway. It is expected these two projects (the New Runway Project and the Integrated Domestic Terminal Project) will together cost in excess of $1 billion.
    - Through the first half of 2018 PAPL has concluded comprehensive seven-year agreements on a range of price and non-price items with various airlines, and expects to conclude additional agreements, long term or otherwise with other airlines by the end of 2018 covering at least 95% of passenger movements.
    - Increasingly sophisticated commercial relationships have evolved between PAPL and many airlines, reflecting that both PAPL and airlines are placing increasing value on agreeing commercial terms. PAPL is currently in discussions with Qantas about future commercial arrangements for the operation of Terminal 4 when the domestic terminal lease – which is held by Qantas – expires at the end of 2018.
- In PAPL's view, a decade and a half of monitoring by the Australian Competition and Consumer Commission (ACCC) shows that Perth Airport has not earned excess returns in the provision of aeronautical services.
- There is no evidence, including from the monitoring, that PAPL has allowed service quality to deteriorate or that it is seeking to under-invest in capacity or service enhancement. The content of the agreements being negotiated, PAPL's investment behaviour and the very substantial investment plans for the next decade are evidence of PAPL's commitment to service and capacity improvements.
- PAPL's market power in the provision of airport services in Perth is substantially curtailed by its very limited ability to deny airlines access to Perth Airport. PAPL also has an incentive not to use any market power it might have to avoid a range of negative impacts (reputation damage, media scrutiny, airline complaints, threat of regulation etc.) and has strong commercial motivations to reach agreements with airlines and to promote growth

[1] https://www.perthairport.com.au/Home/corporate/Work-with-us/Airline-Consultation

in passenger movements.

2.2. New Airline Agreements

- PAPL has facilitated Qantas' particular needs to operate its 787 aircraft internationally from a pre-existing domestic terminal despite this not being the most efficient solution from a whole of airport perspective.
- PAPL has been in negotiations with airlines about new agreements since mid- 2017. This length of time reflects the comprehensive nature of the discussions and the strong bargaining power that airlines have, borne of the significance of their presence at Perth Airport and their strong hold out power. The nature of the agreements arising from the negotiations confirms these conclusions.
- PAPL has engaged with airlines through an 'open and transparent' process, with all relevant information (supporting the building block model approach to pricing) being published on Perth Airport's website. All stakeholders, including airlines, government, regulators and members of the community have access to the available data.
- The nature of the agreements recently executed and those still being negotiated, including their consultation, information sharing and disputes resolution clauses, further reinforce the continuing/future role of direct commercial negotiations at Perth Airport and further limit the capacity of PAPL to abuse market power.
- The general common and competition law[2], including the ongoing potential for declaration under Part IIIA, provides material incentive to PAPL to effectively engage with airlines in relation to price and non-price terms.
- There is little or no history of use of these mechanisms by either airports or airlines and there is no evidence, from a decade and a half of monitoring, that there is a need to introduce additional regulatory or administrative processes relating to resolving disputes or breaking deadlocks at Perth Airport.
- In view of the complexity of the commercial relationships, and the competitive tensions that exist between the many airlines involved, there is a high risk of unintended consequences from intervention in complex commercial negotiations. The unintended consequences could realistically include lengthy delays to concluding negotiations, with negative impacts on the timing of infrastructure investment and delivery of the resulting capacity and service benefits, to the detriment of other airlines.
- One of the reasons for the favourable trend toward negotiated outcomes is that there are no 'easy outs' for PAPL or airlines. The difficulties in trying to graft a third-party role into complex negotiating processes were exemplified by the initial attempt by the Commonwealth Department of Infrastructure to give effect to the Commission's previous recommendation in relation to 'show cause' processes.

2.3. Ground Transport and Car Parking

- PAPL participates in a competitive market for land transport services to Perth Airport. There is considerable evidence that consumers can choose between numerous land transport alternatives and that they exercise that choice.
- There is no evidence, from a decade and a half of monitoring, to suggest that PAPL has

[2] Current mechanisms already available include dispute resolution clauses in contracts, Part IIIA and Part VIIA of the *Competition and Consumer Act 2010*, voluntary undertakings and general common law processes.

engaged in any inappropriate conduct in relation to the pricing of its car park products or the manner in which it has interacted with its competitors; there is considerable evidence to the contrary.

- PAPL has not sought to restrict access to infrastructure in the vicinity of Perth Airport terminals, nor has it applied unreasonable price or non-price conditions of access. If PAPL were to do so this would become apparent to both customers and competitors and is highly likely to be brought to the attention of the ACCC. In contrast, PAPL has invested significantly to create fit for purpose, secure and convenient parking facilities for the travelling public and prices charged reflect the appropriate rate of return required to underpin the investment.
- The Commission should reaffirm its 2006 conclusions that regulation, including monitoring, of ground access and car parking at Perth Airport is unnecessary and as such recommend to Government that it should be discontinued.

2.4. Ground Transport Access

- The Western Australian Government has acted decisively to address road access problems and PAPL is pleased with the level of consultation and coordination that is happening between PAPL and the relevant State agencies and Local Governments.
- Congestion issues on arterial roads in the vicinity of Perth Airport have decreased significantly since the Commission's last Inquiry thanks to the $1 billion Gateway road project and the Great Eastern Highway widening project. Congestion during the traditional morning and afternoon commuter peaks is not unique to the roads in the vicinity of the airport, nor to Perth. There is no material congestion on the roads near Perth Airport at times other than the morning and afternoon metropolitan peaks, which are not the peak operating periods of Perth Airport.
- Further, the $1.86 billion Forrestfield Airport Rail (FAL) Project, jointly funded by the Commonwealth and State Governments, will connect Perth Airport to the CBD and to the Eastern suburbs of Perth. With expected commissioning in 2020, this project includes construction of the Airport Central station immediately adjacent to Terminal 1. Commissioning of the project will provide people travelling to Perth Airport with additional choice with respect to their mode of transport.

2.5. Fuel Supply at Perth Airport

- The current fuel supply arrangements at Perth Airport are unlikely to encourage competition in the provision of jet fuel. PAPL is working with airlines and participants in the fuel supply chain to improve competitiveness, and to ensure security and reliability of supply.

3. About Perth Airport

3.1. The Importance of Perth Airport

Perth Airport is the international and interstate hub to Western Australia. It is located 12 kilometres east of the Perth's Central Business District (CBD) and integrates with other transport infrastructure including the Kewdale rail freight facility, major highway networks and, via these roads, the Port of Fremantle.

Perth Airport operates 24 hours a day, seven days a week, and is a vital public transport infrastructure facility. In 2017, the airport handled 14.3 million passengers and 130,115 aircraft movements and it is expected that 241,000 aircraft movements and 35 million passengers will travel through Perth Airport by 2045.

The airport employs (directly and indirectly) an estimated 12,570 aviation and 5,230 non-aviation related fulltime employees. Employment at Perth Airport is expected to grow to over 42,000 aviation and non-aviation related full-time employees by 2034.

Perth Airport's current annual contribution to the WA economy is estimated at $2.6 billion; this is estimated to rise to $7.04 billion in 2034.

The relative isolation of Perth as an Australian capital city and the vast distances between major population centres makes air travel and Perth Airport indispensable to the people of Western Australia and to the State's economic, social and cultural development. Perth Airport is both the primary airport in Western Australia and the hub through which nearly all regional aviation is serviced.

As such, the Western Australian State Aviation Strategy, published in 2015, recognises Perth Airport as:

- a key element in the movement network of the State;
- the international gateway to Perth and Western Australia; and
- the focal point for the growth of the tourism industry.

Air services are the lifeblood of Western Australia's tourism industry: 93 per cent of visitors travelling to the state use air transport. As Australia's Western hub, the aviation activities at Perth Airport promote spending from domestic and international tourists.

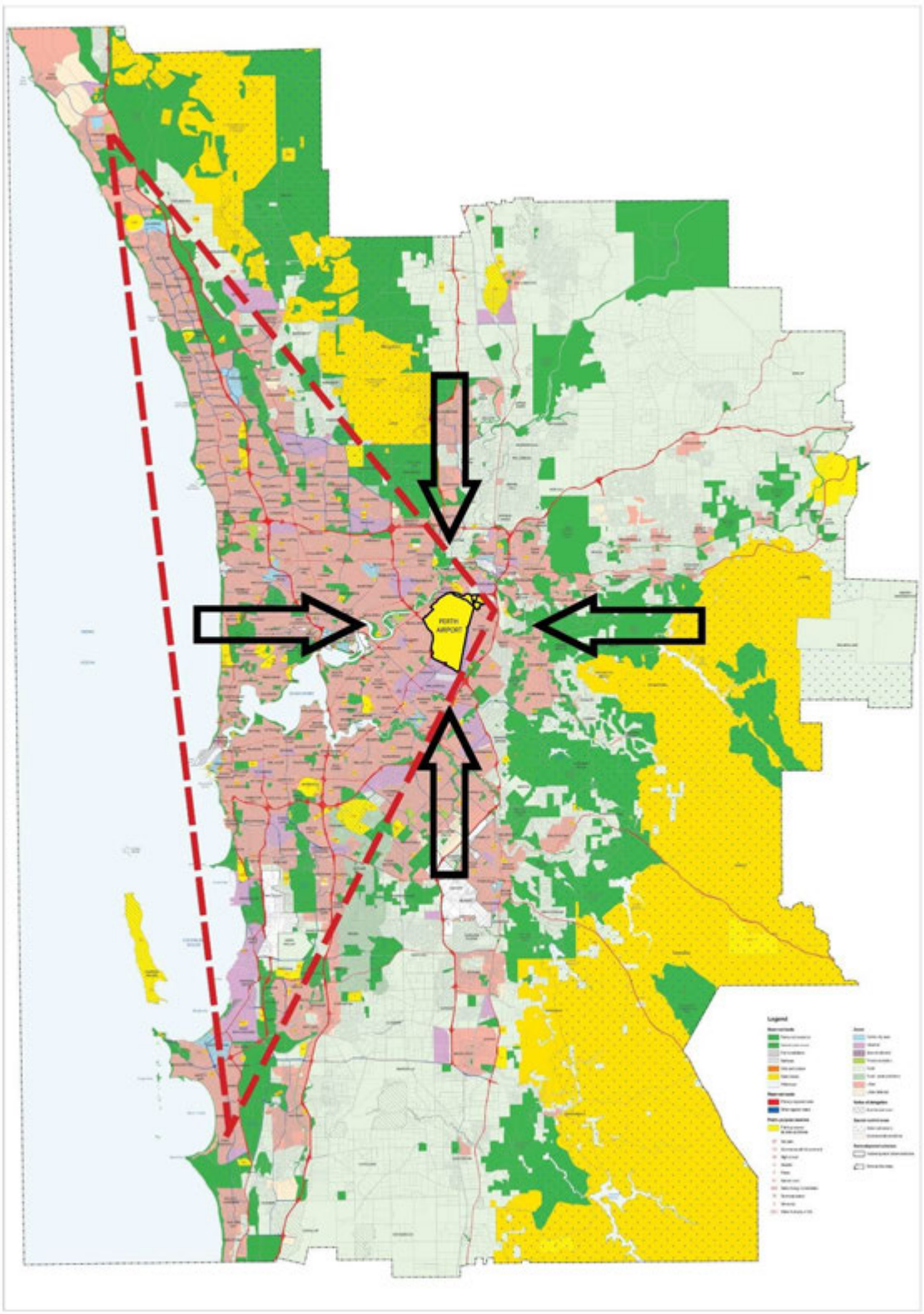
The tourism industry is significant to the state of Western Australia. In 2013 it was estimated that the tourism enabled by Perth Airport generated 41,400 direct full-time employees, adding direct value to the Gross Regional Product of $3.68 billion per year. When direct and indirect value is considered this spending generates 59,800 full-time employees and adds $6.16 billion to Gross Regional Product.

The WA resources industry has improved over the last 12 months, with regional traffic showing signs of improvement in FY18. In July 2017 the rolling growth of intrastate passengers was in decline (4.5%), but by June 2018 it grew 3.2%. The price of Iron Ore has been steady, being 24% higher than 2 years prior. Many large projects across the region are approaching the end of the construction phase, and commodities such as LNG and Lithium are expecting shipments through FY19 as operations ramp up.

3.2. The Site

Perth Airport is located at the apex of the 'metropolitan triangle' and is the largest single, active and contiguous land use in the Perth Metropolitan Regional Scheme, as shown in **Figure 1** below.

Figure 1 – Perth Airport Location



Perth Airport is approximately 2,105 hectares in size, of which approximately 1,300 hectares are required to meet long-term aviation requirements.

Approximately 450 hectares is progressively being brought into productive use for a variety of aviation related and non-aviation purposes. This development reflects that the airport estate is an important land supply for Perth, particularly for industrial activities that have transport and/or logistics requirements and for which the proximity to the airport and major highways is of strategic importance.

More recently, there has also been a trend towards retail development throughout the airport estate, including commencement of construction of a Direct Factory Outlet which is scheduled for completion in late 2018, and a proposed Costco development scheduled for completion in 2020.

Of the remaining land area some 130 hectares are reserved for environmental and indigenous heritage conservation.

3.3. Aviation Facilities

The primary aviation facilities on the site include:

- a two-runway system and associated navigational equipment;
- a multi-user freight facility, aviation fuel facility and in-flight catering facility;
- air traffic control facilities;
- four terminal buildings; and
- 24-hour rescue and firefighting facilities

The four terminal buildings comprise the following:

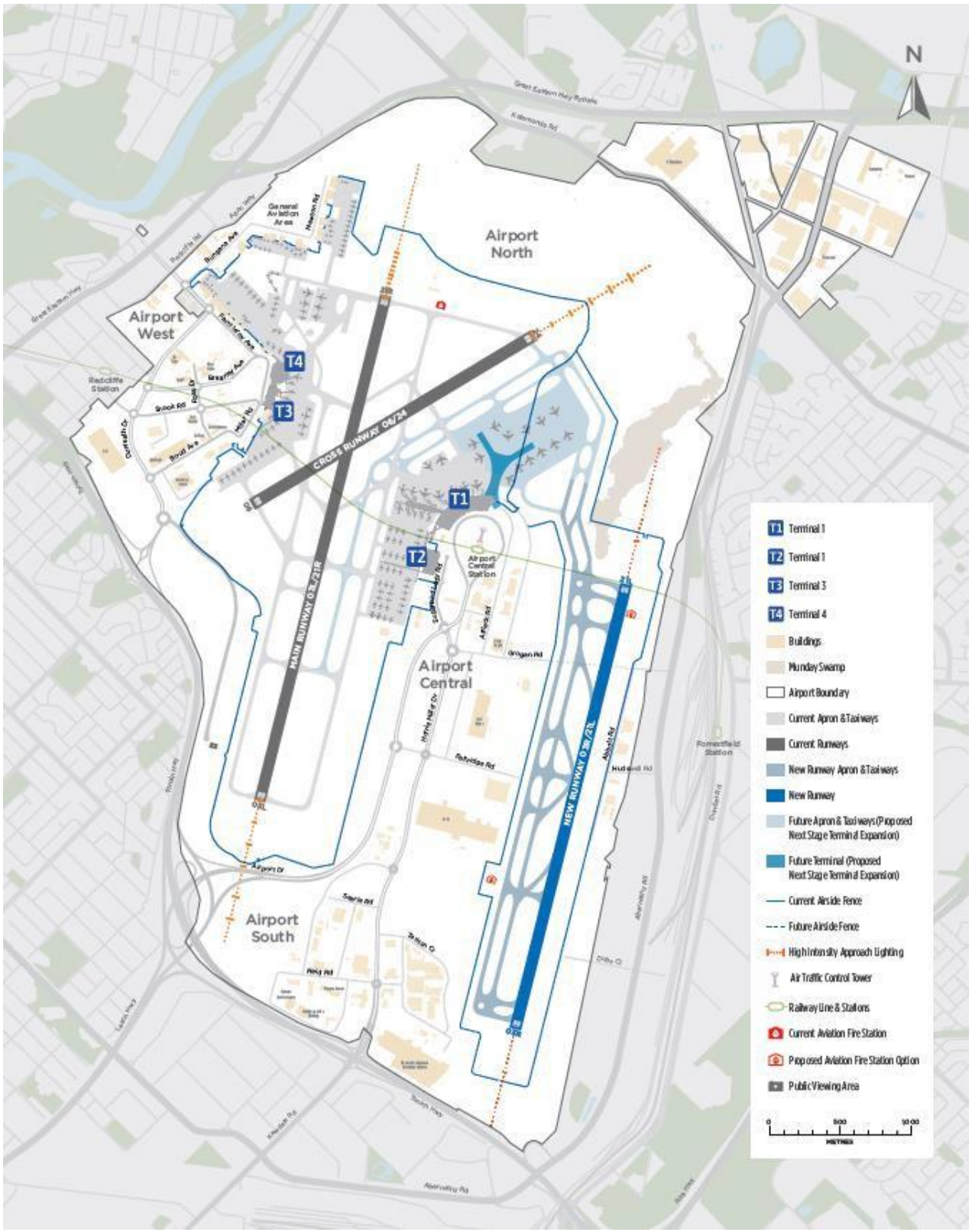
Table 1 – Terminal Nomenclature

Terminal	Referred to As:
Terminal 1, consisting of the International terminal and the common use Domestic Pier (opened in 2015 and where Virgin Domestic operates), which PAPL operates and maintains. Located in Airport Central Precinct.	T1 (International) T1 (Domestic)
Terminal 2, opened in March 2013, which PAPL operates as a multi-user domestic terminal. The airlines operating from Terminal 2 are Alliance Airlines, Rex Regional Express, Tiger Airways and Virgin Regional (VARA). Located in Airport Central Precinct.	T2
Terminal 3, which PAPL operates as a multi-user domestic terminal. The airlines operating from Terminal 3 currently are part of the Qantas Group (Qantas, Qantas Link, Network Aviation and Jetstar). Since March 2018, the terminal also accommodates Qantas' international operations. Located in Airport West Precinct.	T3
Terminal 4 (former Terminal 2), which PAPL leases to Qantas and which accommodates Qantas Group domestic operations. The 30-year terminal lease expires in late 2018. Located in Ariport West Precinct.	T4

Figure 2 is a plan showing Perth Airport site details.

(see over page)

Figure 2 – Perth Airport Site Details



Several smaller terminal operations owned/operated by airlines providing charter and general aviation services to regional areas in Western Australia are also located at Perth Airport.

Table 2 – Perth Airport Terminal Details

Terminal	Airlines	Pax pa (FY18)	Aerobridge Contact Bays	Non-Aerobridge Contact Bays	Stand Off Bays
T1 (International) (PAPL operated)	All international services except Qantas	4,289,477	6 (including 2 swing gates)	1	4
T1 (Domestic) (PAPL operated)	Virgin Australia (all interstate and some regional services)	2,498,680	6 - 10 (excluding swing gates)	Nil	Nil
T2 (PAPL operated)	Alliance Airlines (regional services) Tigerair (interstate services) Virgin Australia (most regional services) Regional Express Airlines (regional services)	1,379,611	Nil	20	16
T3 (PAPL operated)	Jetstar (interstate and regional passengers) Qantas International (international, interstate and regional services)	1,783,451	9	7	34
T4 (QF operated under DTL arrangement)	Qantas interstate and regional services)	3,740,641			

3.4. Ownership

On 1 July 1997, the Australian Government granted Perth Airport Development Group (PADG) a lease over Perth Airport for an initial term of 50 years with the option of a further 49 years. PAPL is a wholly owned subsidiary of PADG.

PADG's shareholder structure is shown in **Table 3**.

(see over page)

Table 3 – Perth Airport Development Group shareholders

Shareholder	Proportion
Utilities of Australia Pty Ltd ATF Utilities Trust of Australia (UTA)	38.26%
The Northern Trust Company (TNTC in its capacity as custodian for Future Fund Investment Company No. 3 Pty Ltd (FFIC3), a wholly owned subsidiary of The Future Fund Board of Guardians (FFBG)	30.01%
Utilities of Australia Pty Ltd ATF Perth Airport Property Fund (PAPF)	17.34%
AustralianSuper Pty Ltd	5.25%
Gardior Pty Ltd as trustee for The Infrastructure Fund	7.19%
Sunsuper Pty Ltd	1.95%
Total	**100%**

It is estimated that approximately 55% of the shares of PADG are beneficially owned by Australian Prudential Regulation Authority (APRA) regulated superannuation funds. In addition to this, PAPL understands that that the current intention of the Australian Government is that the majority of the funds held in the Future Fund will be used to meet the unfunded pension and superannuation liabilities of the Commonwealth.

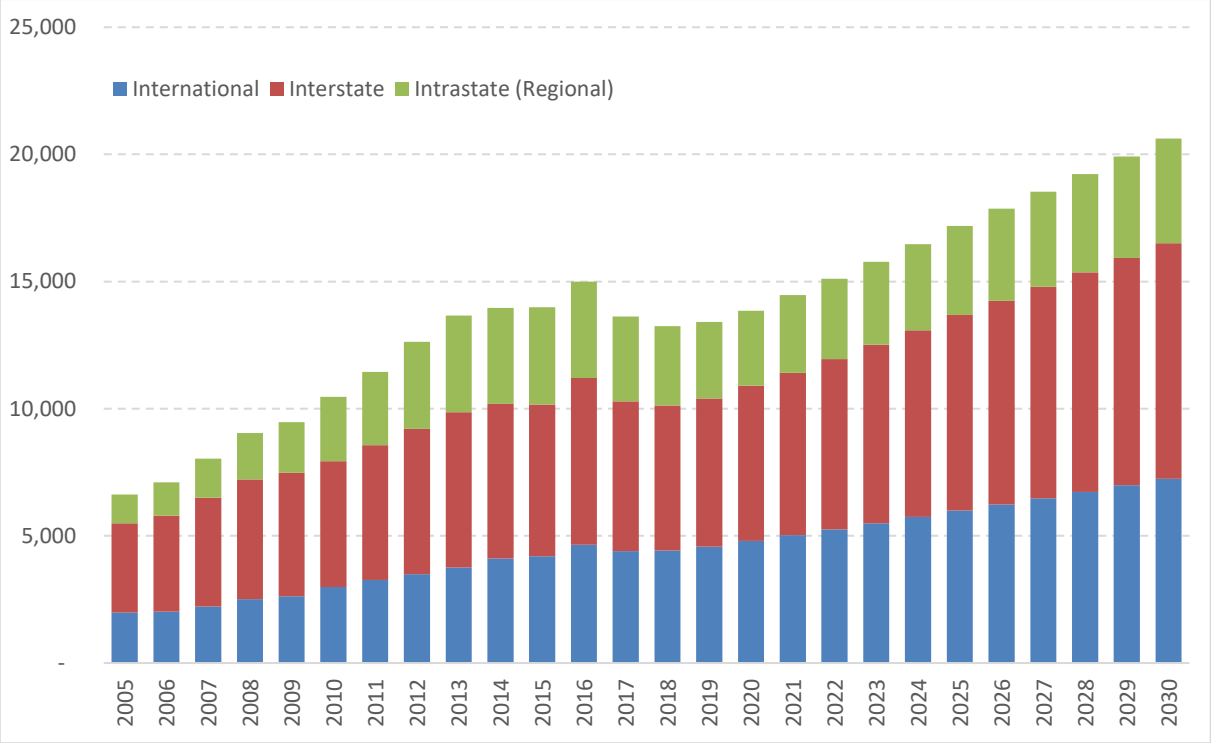
4. Aviation Services

4.1. Passenger Segmentation and Growth

There has been strong demand for Perth Airport's services following the volatile period between 2001-2004, during which there were a number of significant shocks to domestic and international aviation (9/11, Ansett collapse, SARS and Bali bombings).

Since this period, annual passenger numbers at Perth Airport have increased at an average cumulative annual rate of 6.4%, although there have been some years of slower growth in specific market sectors due to adverse economic conditions in Asia and, more recently, globally. Passenger numbers are forecasted to grow at an average annual rate of 3.2% over the next 10 years as shown in **Figure 3.**

Figure 3 – Actual and Forecast Passenger Numbers for Perth Airport ('000s passengers)



Sources: Perth Airport Annual Reports and Tourism Futures International Forecasts commissioned by PAPL

During the period 2004-05 to 2010-11, the intrastate (regional) segment grew substantially, increasing from 17% to 25% of passenger numbers, mainly reflecting an increase in fly-in fly-out activity in the resources sector associated with the mining boom (**Table 4**). The representativeness of intrastate (regional) peaked in 2012-13 at 28%, aligned with the construction period in the resources sector, having retracted to 24% in 2017-18.

Table 4 – Perth Airport Passenger Numbers by Route Type

Passenger type	2004-05		2010-11		2017-18		2024-25		2029-30	
	Number (million)	% of total	Number (million)	% of total	Number (million)	% of total	Number (million)	% of total	Number (million)	% of total
International	2.0	30%	3.3	29%	4.4	32%	6.0	35%	7.3	35%
Interstate	3.5	53%	5.3	46%	5.9	43%	7.7	45%	9.3	45%
Regional	1.2	17%	2.9	25%	3.4	25%	3.5	20%	4.1	20%
TOTAL	6.7	100%	11.5	100%	13.7	100%	17.2	100%	20.6	100%

Sources: Perth Airport Annual Reports and Tourism Futures International Forecasts commissioned by PAPL. Note: Numbers may not add up due to rounding

4.2. International Services

International routes of scheduled services to and from Perth Airport are shown in **Figure 4**. Perth Airport has a significant and growing air services route network to South East Asia, Africa and to Europe, including Qantas' new direct London service. Substantial international travel occurs between Perth and many European and UK countries both directly and through major hub airports in South East Asia, China, London and the Middle East.

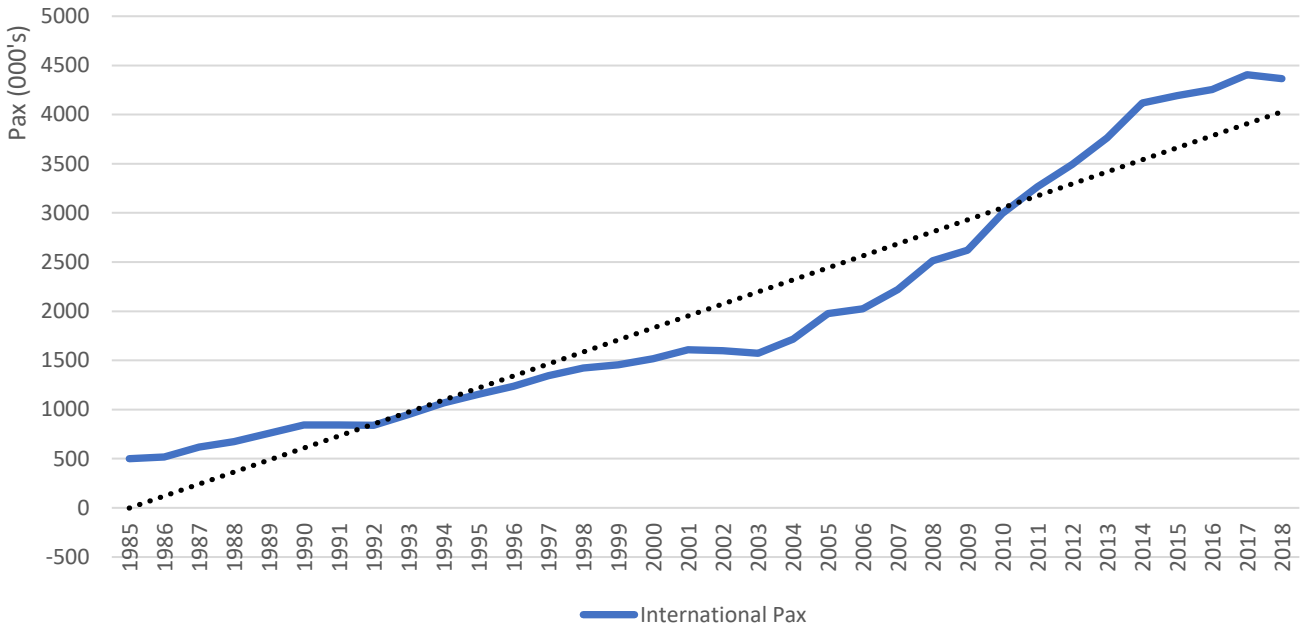
Figure 4 – Perth Airport's International Route Map

Perth Airport has a high proportion of international passengers compared to other major Australian airports. In 2011-12, international travel accounted for approximately 28% of all passengers at Perth Airport. This increased to 32% in 2017-18.

In the period following the shocks to international aviation in 2001-2004 (9/11, SARS and the Bali bombings), growth in international passenger numbers has greatly exceeded the prior long-term average (**Figure 5**).

From 2013, growth slowed as the last resources construction boom came to an end. A period of weak resident travel, terrorism across Europe, and a decline in capacity growth contributed to slowing international passenger growth. Capacity was flat from 2015-2017, although for 2018 there is seat growth in certain routes. Some highlights include the new non-stop flights to London (Qantas) as well as increased capacity to Qatar Airways (Doha) upgauging to an A380, Cathay Pacific (Hong Kong) upgauging their daily service to an A350, and Singapore Airlines (Singapore) upguaging one of their services to the B787-10 Dreamliner. Capacity growth is offset by declines in other ports, such as Etihad's withdrawal of flights to Abu Dhabi from October 2018, Jetstar Asia's withdrawal from Singapore in March this year, and the reduction in capacity to Kuala Lumpur.

Figure 5 - Growth in international passenger numbers, 1985 to 2018 ('000s passengers)

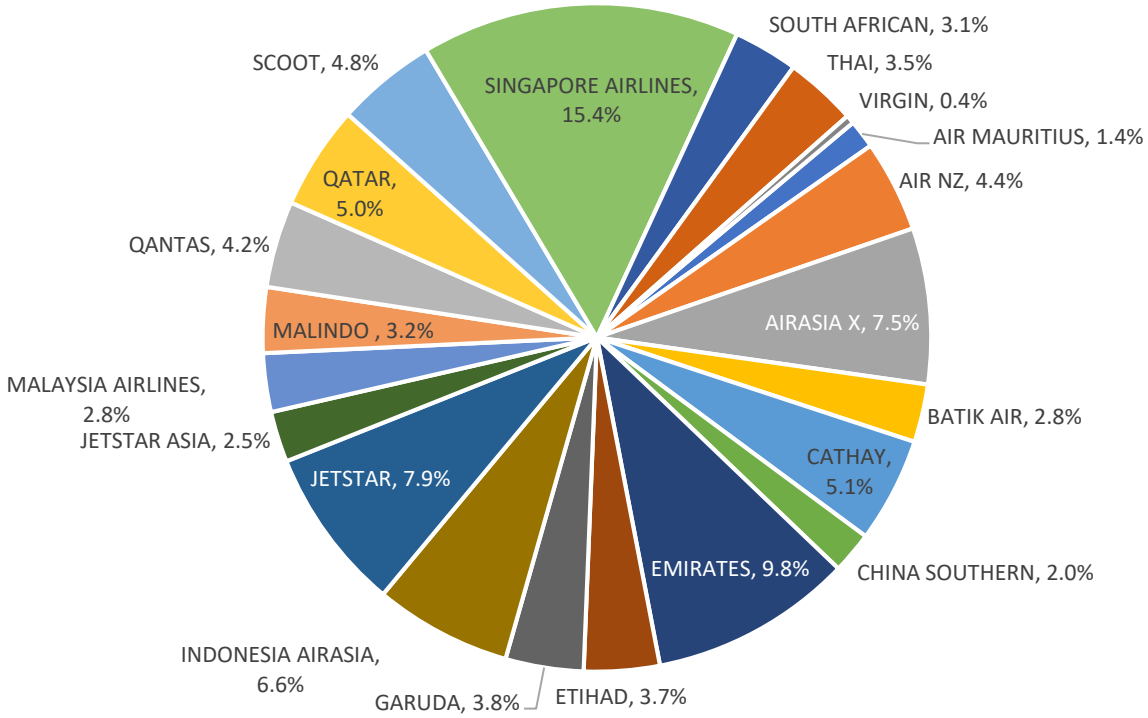


Source: Perth Airport (2018)

Perth Airport is serviced by foreign-based international airlines that account for 85% of international passenger arrivals, with Qantas Group and Virgin Group international services making up the balance. Perth Airport also has the highest percentage of foreign airline movements of the four major airports: Perth 85.3%, Melbourne 66.7%, Sydney 61.6% and Brisbane 52.8%.

In 2017-18, Singapore Airlines was the largest carrier of international passengers (15.4%), followed by Air Asia (14.2%), Jetstar (10.4%) and Emirates (9.8%) (**Figure 6**). Including both Qantas Group and its low-cost affiliate Jetstar, as well as Scoot (Singapore Airlines' low-cost affiliate), these four airlines account for around 58.8% of international passenger arrivals into Perth Airport.

Figure 6 – International Passenger Arrivals to Perth Airport by Airline, 2017-18



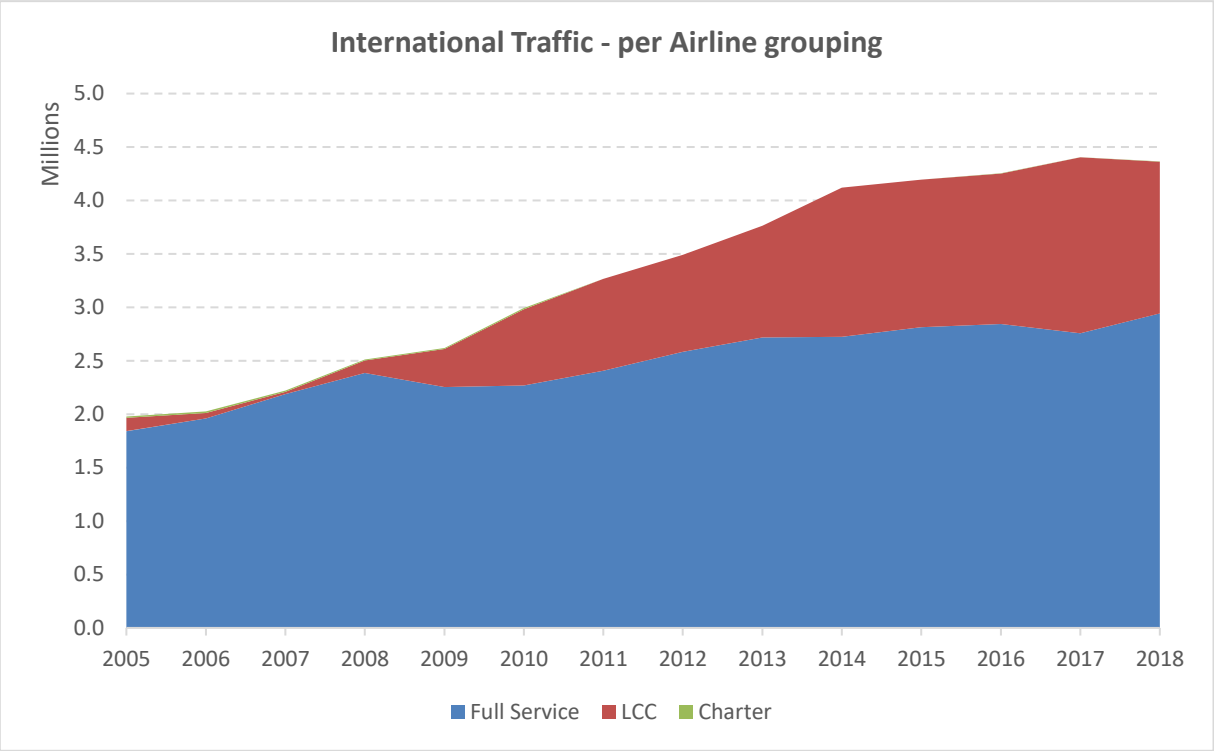
Source: Perth Airport (2018)

Perth Airport has experienced a material increase in international traffic since 2005, driven primarily by the entry of Low Cost Carriers (LCCs). The market share of LCCs[3], in terms of passenger numbers, grew from 6.3% in 2005 to 32.5% in 2018 (**Figure 7**).

Over the last 10 years, besides the growing presence of LCCs at Perth Airport, routes into the Middle East and into China have been established, with Etihad, Qatar and China Southern now servicing the Perth market.

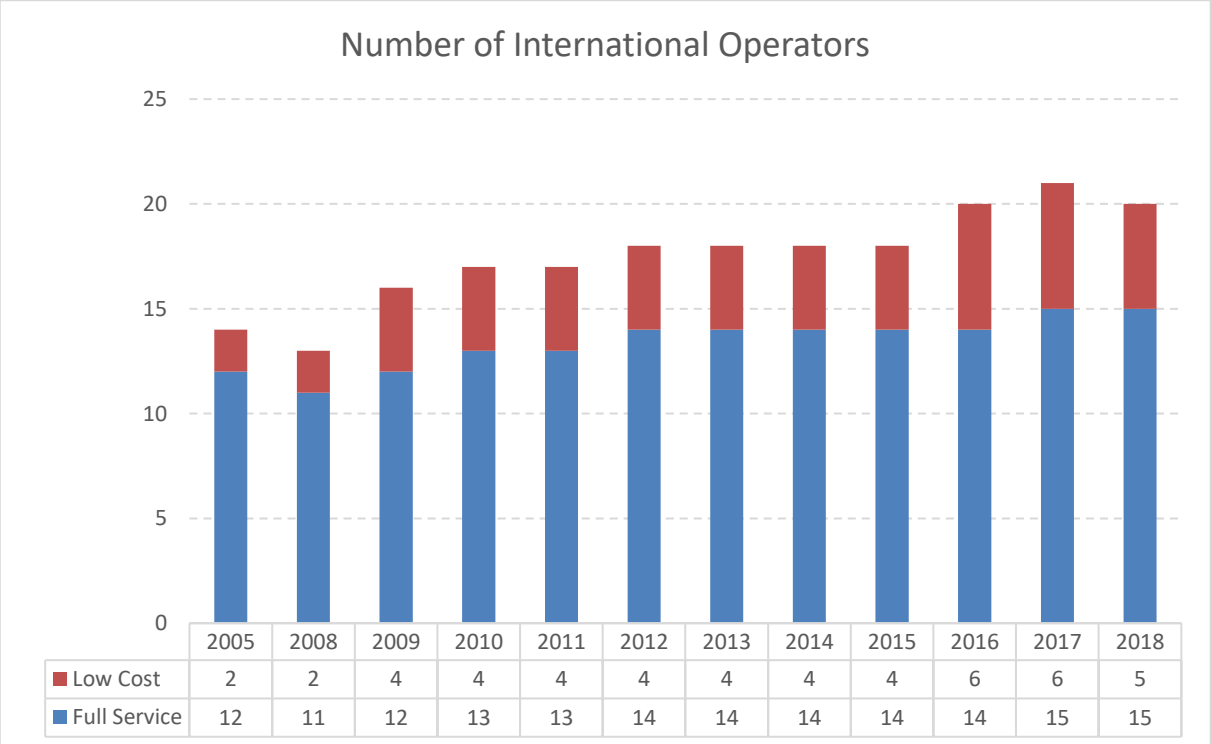
[3] Scoot, Jetstar Asia, Jetstar Australia, Indonesia AirAsia, , AirAsia X, Tigerair Australia

Figure 7 – International Traffic – Airline Grouping



During the same period there was a material increase in the number of LCCs operating at Perth Airport from 2 in 2005 to 5 in 2018 as shown in **Figure 8** below.

Figure 8 – Number of International Operators at Perth Airport 2005 - 2018



	2005	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Low Cost	2	2	4	4	4	4	4	4	4	6	6	5
Full Service	12	11	12	13	13	14	14	14	14	14	15	15

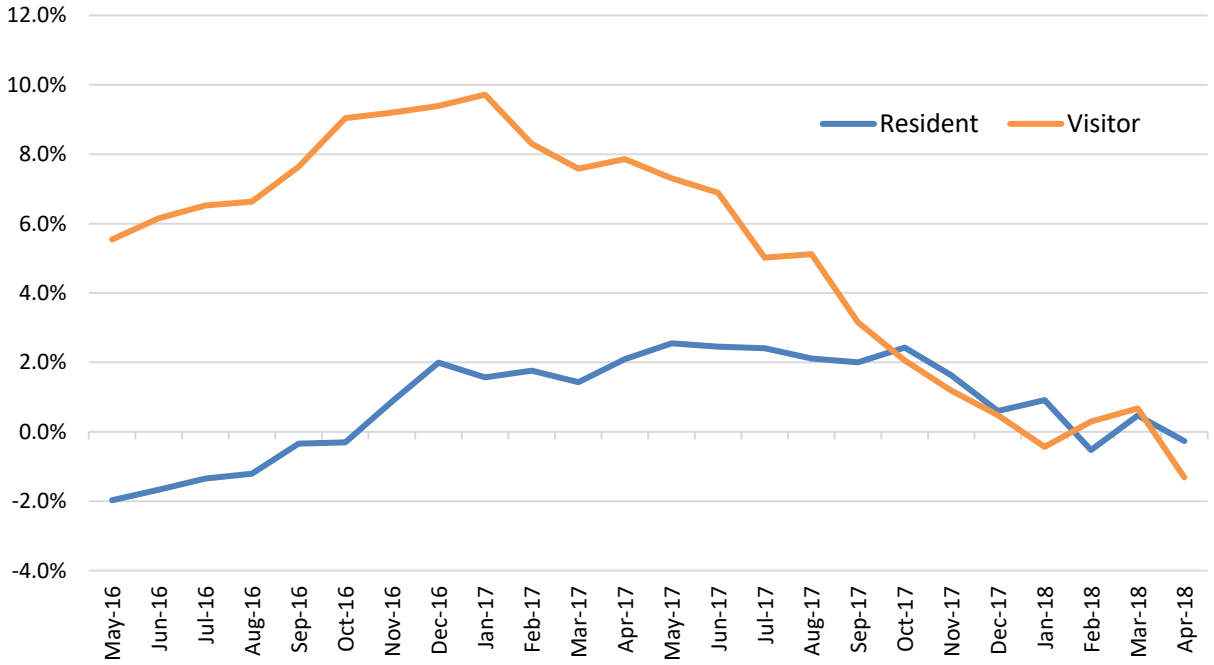
4.3. Visitor and Resident Growth

In FY16 visitors were growing at 5.6% while Resident growth was declining (1.8%). By January 2017 Visitor growth peaked at 9.6% while Residents grew around 2%. In FY18, Resident travel has been flat, as Visitor travel has declined (1.1%).

Weak Visitor growth came from the UK and parts of Europe, while Resident decline is attributed to from Indonesia, Singapore and Malaysia, after massive stimulation from a surge in capacity. Key markets such as China, Japan and India are resilient and have strong growth for Residents and Visitors.

As the WA economy improves, with increased mining projects and regional traffic, it is anticipated that Resident travel will improve when it was previously flat.

Figure 9 – Resident and Visitor Historical Rolling Growth



Source: Department of Immigration and Border Protection (DIBP)

In FY18, Bali accounted for 19.9% of total international passengers, of which more than 92% are resident travellers. As Virgin ceased flying to Phuket in January 2016, there is no longer a substitute destination for Bali. The risk is not diversified and as Bali is prone to ash cloud disruptions and other natural disasters, there is no real substitute for travellers wanting to experience a similar holiday.

International pax in FY18 declined 0.9% compared to FY17, as capacity was adjusted across many international ports. Resident international travel is expected to rebound slowly as the economy strengthens and as mining projects move into the operational phase. Following FY18, total passengers are forecast to decline slightly in FY19, but grow beyond FY19 over the next 5 years.

4.4. Low Cost Carrier Expansion

In 2007, PAPL recognised that the number of international seats provided in Perth by LCCs was materially below that which existed at other large Australian airports and that several international routes were under-serviced.

Active engagement of LCCs by PAPL (in collaboration with Tourism WA) contributed to the introduction of new services by carriers, including Tiger Airways, AirAsia X, Indonesia Air Asia and Jetstar. The increased presence of LCCs, together with the competitive response that resulted from other international airlines servicing Perth, materially contributed to the strong growth that has occurred since 2007.

In 2007, less than 4% of the total international traffic in Perth was provided by LCCs; in 2010 the figure was 23.9%, and in 2018 it increased to 33.5%. During the same period, overall international traffic increased by 46%.

Perth Airport now has the highest percentage of LCC movements of the four major airports: Perth 33.5%, Melbourne 16.3%, Sydney 9.0% and Brisbane 1.3%.

These developments coincided with the Global Financial Crisis and had the effect of offsetting some of the negative impacts of that crisis on international travel. In effect, the substantial softening of inbound demand from Europe and UK was more than offset by the stimulatory effect of the increased LCC capacity on outbound activity.

As discussed in section 8 of this submission, one of the key characteristics of market power is the inability of service consumers to find substitutes. Experience from Europe and North America indicates that the decisions being made by airlines are increasingly around allocating their aircraft between routes on a return basis. This means that the question is not about the availability of a substitute airport in a particular city but rather which substitute destinations available. For example, an airline may have to decide between operating an aircraft between Perth and Kuala Lumpur or allocating the same aircraft to a Phuket to Tokyo route. Abu Dhabi to Edinburgh might be a substitute for Perth to Abu Dhabi.

While this behaviour is most apparent in LCCs, it is increasingly common with full service carriers. While it is least common with home-based carriers, it still occurs. In May 2014 Qantas ceased all international mainline services from Perth until June 2015, apart from some ad hoc services to Singapore in July 2014 and seasonal services to Auckland from December 2014 to April 2015.

As discussed further below, PAPL understands that recent reductions in wide-body domestic operations by Virgin Australia were in part to provide aircraft capacity to operate services from eastern state capitals to Hong Kong.

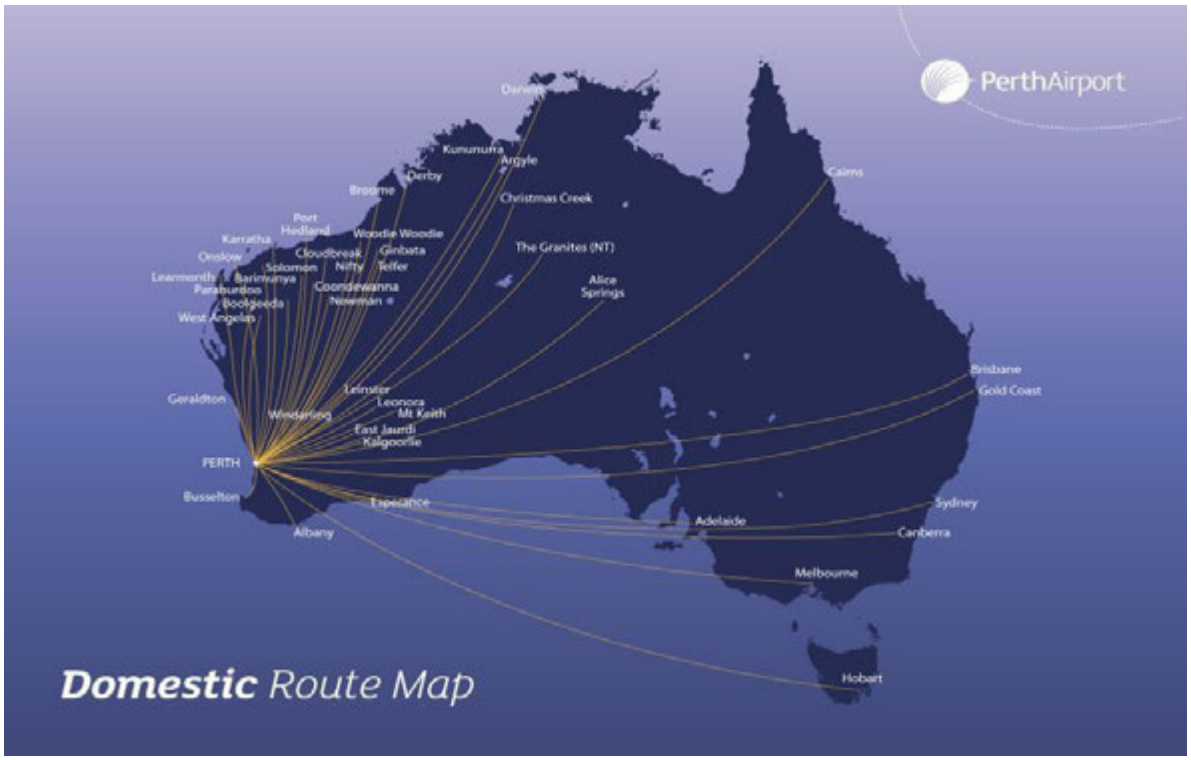
PAPL sees nothing wrong in any of this, and in fact PAPL strongly supports and encourages airline competition, including the introduction of LCCs. It does however demonstrate that airlines can easily redeploy aircraft to new routes should this be commercially desirable, in contrast to airports with their fixed assets. There is, as such, a natural tension between the shorter-term views of airline asset deployment, and the longer-term investment strategies of airports.

Finally, in seeking to diversify its traffic base by attracting carriers which can decide between a wider range of substitute destinations, Perth Airport has encouraged competition.

4.5. Domestic Services

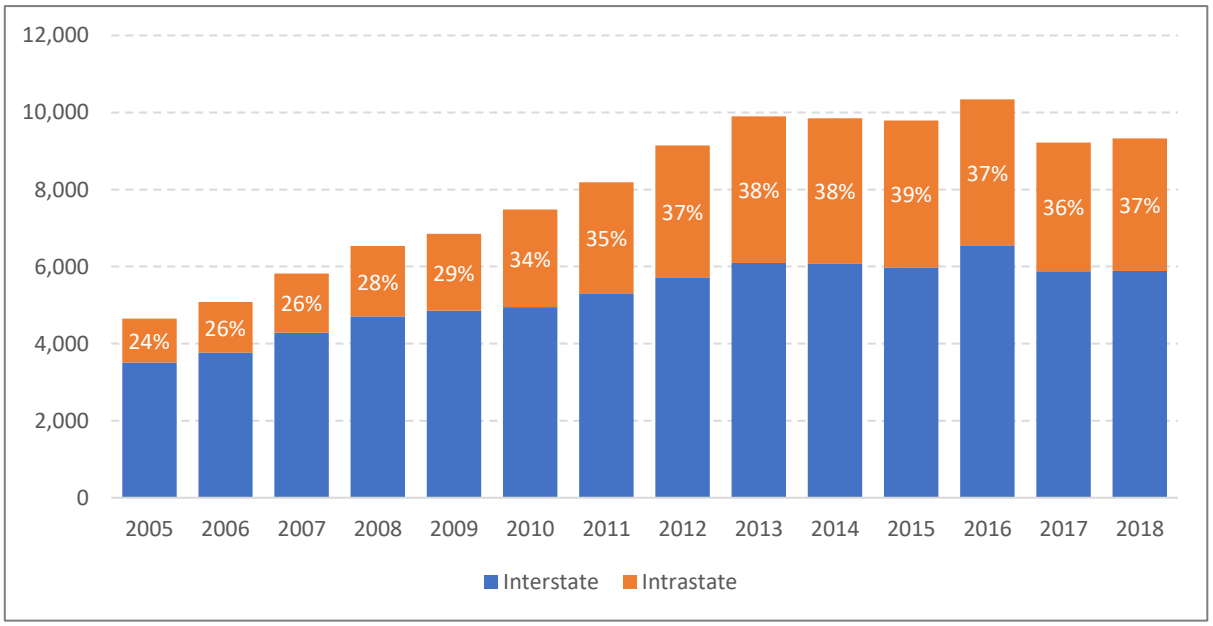
Domestic routes of scheduled services to and from Perth Airport are shown in **Figure 10**.

Figure 10 – Perth Airport's Domestic Route Map



Source: Perth Airport website (http://www.perthairport.com/)

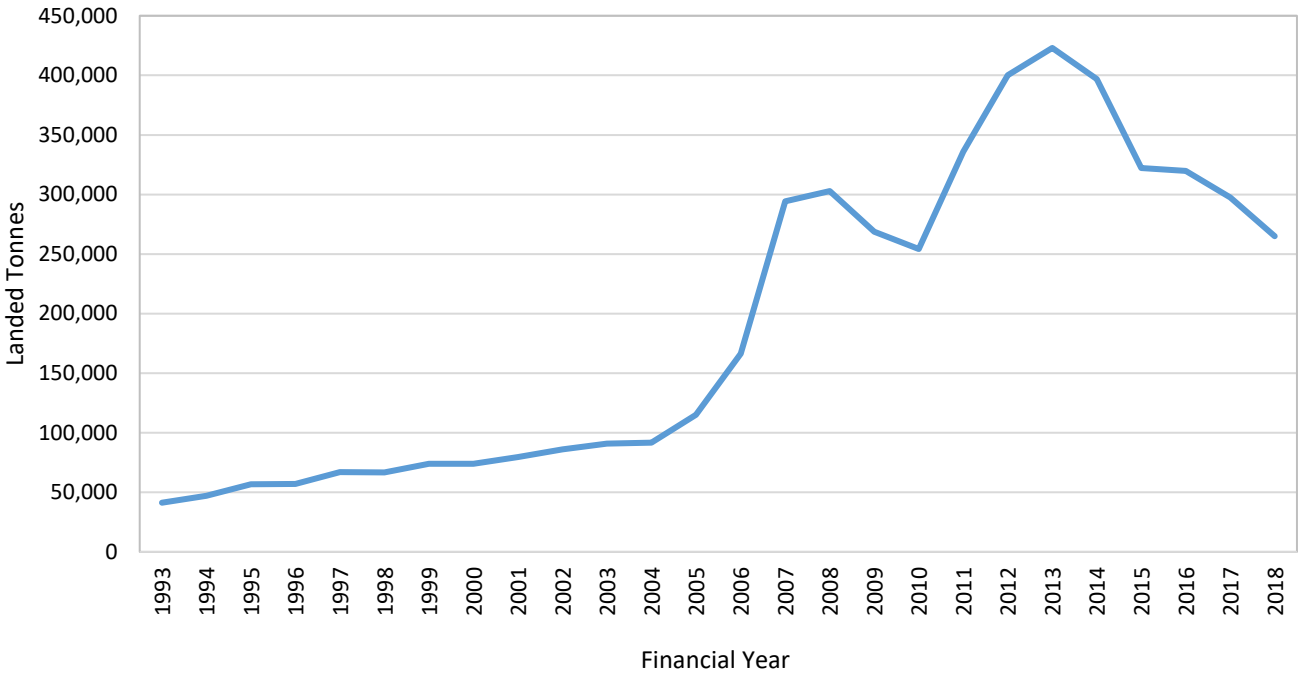
Figure 11 – Growth in Intrastate and Interstate Passenger Numbers, 2005 to 2018 ('000s passengers)



Source: Perth Airport (2018)

Domestic traffic is comprised of two distinct but related components – interstate and intrastate. Over the course of the last decade much of the growth in domestic travel has been in intrastate markets, reflecting to a great extent, very substantial growth in charter (fly-in fly-out) services to the resource sector. General aviation/charter activity has exhibited considerable volatility and is expected to continue to do so (**Figure 12**).

Figure 12 – Growth in General Aviation / Charter Activity, 1993 to 2018 ('000s landed tonnes)

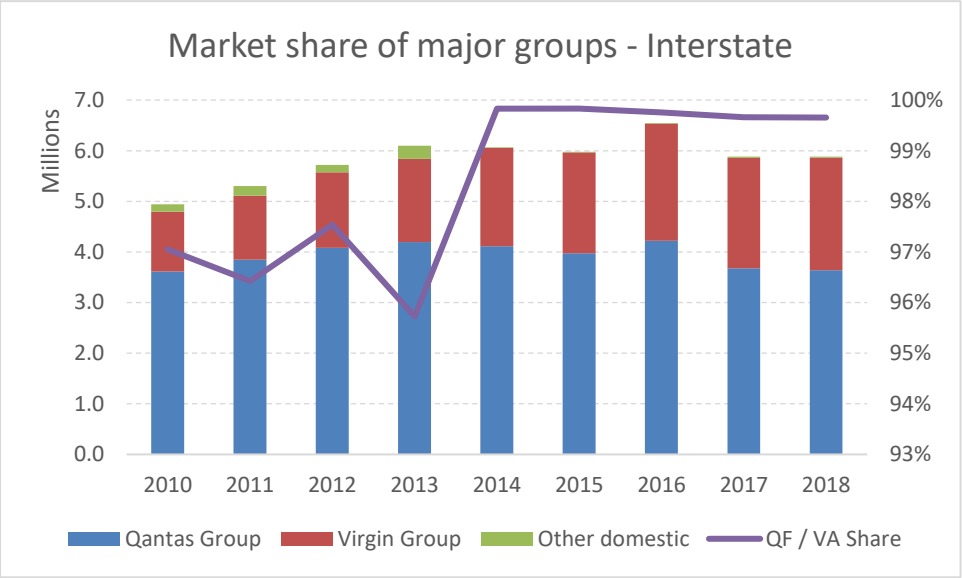


Source: Perth Airport (2018)

The interstate market peaked in 2016 with the resources construction boom, followed by more subdued levels of activity in recent years. Virgin Australia introduced widebody A330 aircraft in 2011 to take advantage of increased demand on Perth routes and to also compete with Qantas as a full-service airline. This product innovation necessitated PAPL developing a new domestic pier on Terminal 1 for Virgin (T1(Domestic)). Qantas responded by more than tripling A330 flights on Perth routes from 2011 to 2016. As traffic from the resources sector began to slow later in 2016, Qantas and Virgin both reduced capacity on interstate routes to Perth by downgauging aircraft from A330 to B737 aircraft. Both airlines have since reallocated these aircraft to international routes, mainly in Asia.

With the acquisition of Tiger Australia by Virgin Australia, the combined market share of both major domestic airlines (Qantas and Virgin) in the interstate market increased from approximately 97% at the time of the last Productivity Commission review, to almost 100% in the year ending 30 June 2018, with a minor 0.3% share from Alliance **(Figure 13).**

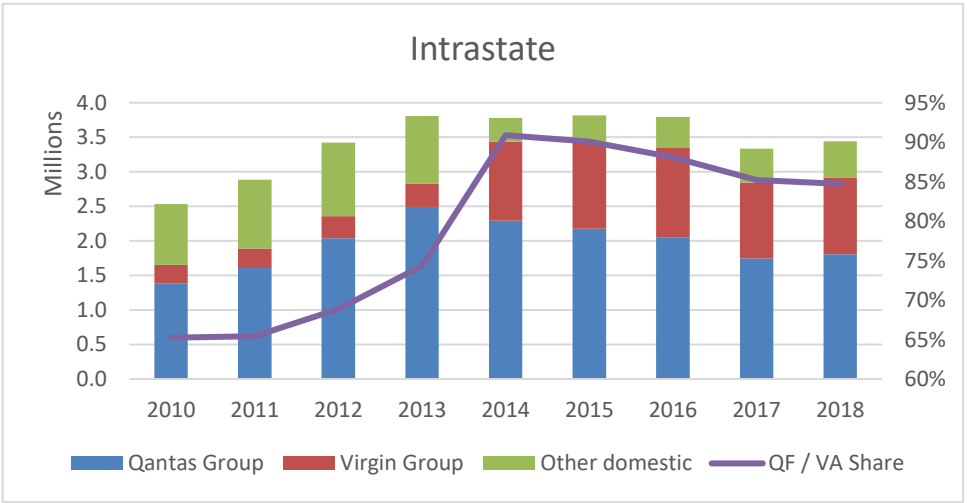
Figure 13 – Market Share of Interstate Routes



Intrastate passenger numbers increased by almost 20% in the last 7 years, peaking in FY13 at 3.8 million passengers. While contracting in recent years this activity is now a significant component of overall demand for Perth Airport's services, with regional traffic making up 37% of total domestic traffic in FY18. However, demand has fluctuated as the various resource sector projects have moved from construction to operation phase and as economic activity in the sector suffered a general decrease over the last 7 years.

As occurred in the interstate market, the combined market share of the two major domestic airlines (Qantas Group and Virgin Group) for intrastate routes increased materially, from approximately 65% in 2010-11 to 85% in the year ending 30 June 2018, mainly due to the collapse of OzJet and Air Australia in 2012 and the acquisition of Skywest by Virgin Australia in 2013. Market share from 'Other Domestic' has increased slightly since March 2016 with the commencement of Rex's operations in regulated routes previously operated by Virgin[4] **(Figure 14)**

Figure 14 – Market Share of Intrastate Routes



In FY18 domestic traffic grew slightly, at 1.2% compared to FY17. The resource sector, being the major driver of intrastate traffic, has ramped up over the last 12 months, with an increase in iron ore, LNG and Lithium shipments.

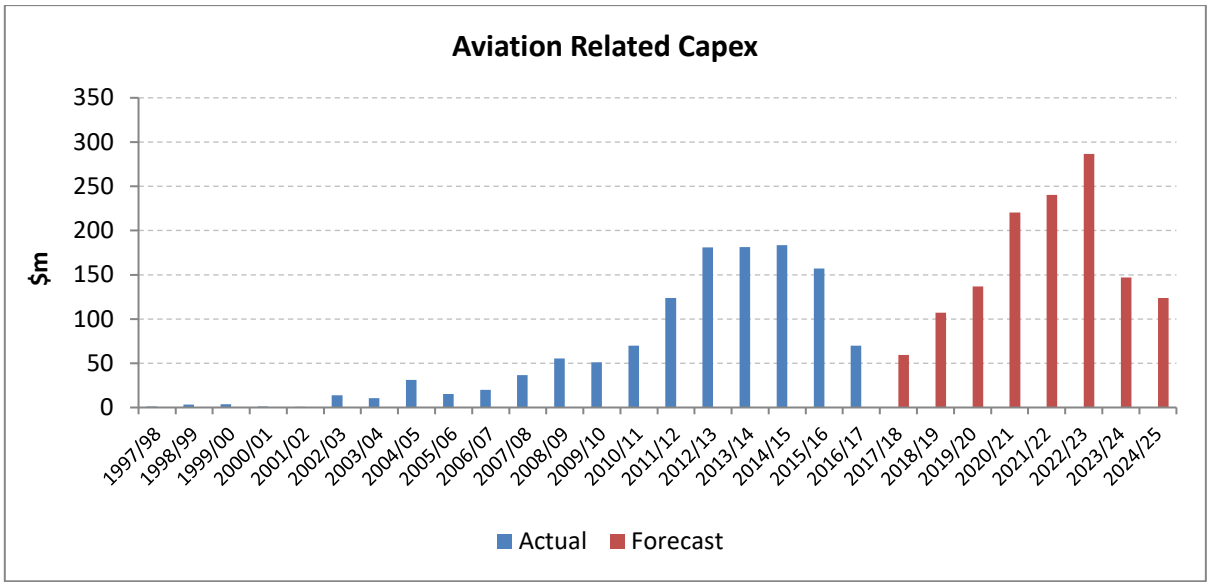
[4] http://www.aviationwa.org.au/2015/11/13/regional-express-rex-to-operate-in-wa/

5. Development of Perth Airport

5.1. Aviation Related Capital Expenditure

In response to the strong growth in demand for Perth Airport services, PAPL has made significant continuing capital investments to support growth and to improve customer service, while at the same time determining the longer-term plan for airport redevelopment. These investments have been in airfield, terminal, on-airport surface access and car parking infrastructure. **Figure 15** shows the value of capital investment in aviation related infrastructure.

Figure 15 – Capital Expenditure by PAPL in Aviation Related Infrastructure ($ million)



Source: Perth Airport (2018)

Note: FY18 data not audited until the date of completion of the report, forecast included as reference. Forecast capex includes International Terminal Upgrade investment, still being discussed with airlines and subject to review

5.2. Investment Since the Last Commission Review

Since 2011, PAPL has invested $1.1 billion in aviation, on-airport surface access and car parking infrastructure, including:

- construction of T2 ($116 million Total Capex; $97 million Aero Capex);
- construction of T1 (Domestic) ($280 million Total Capex; $215.1 million Aero Capex);
- expansion of Terminal 1 (International) departures ($100.9 million Total Capex; $74.9 million Aero Capex);
- redevelopment of T1 (International) departures lounge ($17.2 million Total Capex; $13.3 million Aero Capex);
- expansion of Terminal 1 (International) customs and screening areas ($53.7 million Total Capex; $40.6 million Aero Capex);
- expansion of Terminal 1 (International) arrivals ($97.0 million Total Capex; $66.5 million Aero Capex);
- two-staged expansion of T3 and associated aprons ($69 million Total Capex; $56.7 million Aero Capex);

- construction and commissioning of CATIII landing equipment ($36 million Total Capex; $36 million Aero Capex);
- construction of Airport Drive, improving road access to Airport Central, connected to Gateway WA, delivered by the state government ($38 million Total Capex; $26 million Aero Capex),
- various other airfield and infrastructure expansions ($288.1 million Aero Capex) including;
    - Taxiways repairs, renewals and improvements - $74.5m
    - Landside roads improvements (including forecourts, excluding Airport Drive) - $98.5m total Capex; $67 Aero Capex
    - Security-related investments - $27.0m
    - Runways repairs, renewals and improvements - $21.4m
    - Infrastructure (Electrical, water, sewerage) - $19.1m
    - Information Technology and Cyber Security - $12.0m
    - Taxiway Charlie extension - $11.6m
    - Electrical backup (Cogen) construction - $11.1m
    - Remote aprons repair and construction - $8.9m
    - Operations (vehicles, communications, etc.) - $5.0m
    - Other (admin, other equipment) - $25.1m
- Various other domestic and international terminal upgrades ($53.5 million) including;
    - Apron repair and reconfiguration - $21.5m
    - Building works - $6.4m
    - Security and Screening - $6.0m
    - Electrical - $3.6m
    - Fire Safety - $2.3m
    - Air Conditioning - $2.1m
    - Baggage Handling - $1.4m
    - Others (wayfinding, check-in, lifts and escalators, seating, etc.) - $11.3m
    - additional car parking ($119 million).

5.3. Why Investment was Needed

The significant growth in aviation services, revised traffic forecasts and the anticipated full consolidation of all commercial air services to Airport Central by early 2020s has had a profound impact on driving and delivering development plans at Perth Airport.

The first stage of consolidation of domestic services into the Airport Central precinct involved the relocation of Alliance Airlines, Virgin Australia Regional Airlines, and Tiger Air from T3 to T 2, next to Terminal 1. T2 was designed primarily to meet the needs of regional WA while being capable of supporting interstate services, and was constructed as a result of T3 and T4 operating beyond capacity with extensive bussing operations and congested terminal space providing a poor customer experience. The second significant project required towards consolidation into Airport Central was the construction of Terminal 1 (Domestic). This development provided 12 new aerobridge serviced gates for Virgin Australia's growth in domestic operations with new domestic check in, baggage reclaim, and security screening areas.

Investment in international infrastructure was required to provide sufficient capacity to meet growth forecasts to the early 2020's, to enable A380 services from Perth and to meet new Government security requirements announced in 2010. The expansion of the international departures provided two A380 capable aerobridge served gates, additional international departure lounge floor space and CIP lounge space for T1, much needed check in hall capacity as well as expanded security screening and outbound processing points. The Arrivals project provided an extended terminal footprint which enabled continuation of critical capacity for baggage reclaim, Biosecurity and Customs areas.

Table 5 below describes drivers for investment in Perth Airport's recent major projects.

Table 5 – Drivers for Recent Investments

Expenditure	Need for Expenditure
Construction of Terminal 2 ($116 million Total Capex; $97.3 million Aero Capex)	Terminals 3 and 4 operating beyond capacity with extensive bussing operations and congested terminal resulting in poor customer experience. Formed part of Airport Central consolidation strategy.
Construction of Terminal 1 Domestic Pier ($280 million Total Capex; $215.1 million Aero Capex)	Provided capacity for Virgin Australia to grow operations. Formed part of Airport Central consolidation strategy.
Expansion of Terminal 1 International Departures ($100.9 million Total Capex; $74.9 million Aero Capex)	Required to address capacity issues and to enables A380 operations. Both check-in and contact gates were at capacity in busy periods. Additional contact bay capacity deferred need for walk out and bussing operations. New level 1 departure lounge capacity provided additional space and seats as well as boarding without stairs to bays 50 & 51 improving the passenger experience. New CIP lounge helped meet airline demand for CIP lounge.
Redevelopment of T1 International departures lounge ($17.2 million Total Capex; $13.3 million Aero Capex)	Provided additional seating space, additional toilet block and upgraded F&B offer improving the passenger experience.
Expansion of Terminal 1 International	Current screening point at capacity and insufficient space to

Expenditure	Need for Expenditure
customs and screening areas ($53.7 million Total Capex; $40.6 million Aero Capex)	accommodate the lower throughout rates that would result from the new Government security requirements announced in 2010. Outbound Customs had limited queue space with queues at peak times spilling out through the landside retail area and was unable to accommodate the new SmartGates.
Expansion of Terminal 1 International Arrivals ($97.0 million Total Capex; $66.5 million Aero Capex)	Demand - inbound immigration was at capacity with queues trailing back out the ground floor area & up escalators. Reclaim hall was at capacity Secondary search was at capacity with queues trailing into the reclaim hall at times blocking passenger circulation & resulting in long wait times.
Two-staged expansion of Terminal 3 and associated aprons ($69.0 million Total Capex; $56.7 million Aero Capex)	Terminals 3 and 4 operating beyond capacity with extensive bussing operations and congested terminal resulting in poor customer experience. Expansion of Terminal 3 happened at the same time as the construction of Terminal 2, to allow for growth of domestic operations servicing both interstate and intrastate operations
Construction and commissioning of CATIII landing equipment ($36 million Total Capex; $36 million Aero Capex)	Perth Airport is operationally affected up to [15] days a year by visibility issues attributed to fog. CATIII landing equipment minimises operational disruptions and avoids costly diversions for airlines.
Construction of Airport Drive, improving road access to Airport Central, connected to Gateway WA, delivered by the state government ($38 million Total Capex; $26 million Aero Capex)	To provide upgraded passenger access to the Terminals, separate from the regional freight traffic, thereby reducing delays and to connect to the regional road network through the upgraded freeway intersection constructed as part of the Gateway WA project

5.4. Investment in the Next Contract Period

A Capital Plan for the period FY19-28 has been provided to airlines as part of the negotiations for new Aeronautical Services Agreements, noting however that price proposals are focused on 7-year agreements. The first three sections of the Capital Plan describe investments that inform price calculations and a fourth section provides background for engagement with airlines on future projects.

Ongoing capex required to maintain Perth Airport operations, or minor improvements to current activities to improve service levels or security standards are outlined in the 'Renewals' and 'Enhancements' sections of the Capital Plan.

The total capital investment allocated to renewals and enhancements in the airfield is proposed to be $459.1m over the 10-year period from FY19 to FY28, with $274.1m allocated to the Airfield, $83.9m to the International Terminal and $101.1m to the three Domestic Terminals (T1D, T2 and T3). The aeronautical portion of the investment is determined by applying the aeronautical allocation percentage to the project cost with the rationale to the calculations provided in the documentation.

The proposed capital investment associated with major aeronautical expansion is related primarily to the proposed International Terminal Upgrade, including the construction of the terminal and its associated aprons as well as expansion of the taxiway system connecting the new aprons to the runway.

As part of commercial negotiations, PAPL and airline customers continue to engage on the layout and cost of the International Terminal expansion, and costs and cash flows are likely to be updated as the engagement continues. The figures presented **Table 6** below indicate the estimates published in the Consultation Website.

Finally, the capital investment associated with 'Prospective' projects is related primarily to the New Runway Project and the Integrated Domestic Terminal project. Neither of these projects will be priced in the 7-year agreements currently being negotiated with airlines. Rather they have been included in the Capital Plan to elicit discussion with the airlines around their operational, service and design requirements for these projects.

Table 6 – Perth Airport Capital Expenditure Plan

Location	Renewals and Enhancements	Expansion	Prospective
Airfield	$274.1m	$241.4m	$742.2m
T1 International	$83.9m	$706.1m	$ -
T1 Domestic	$51.1m	$ -	$ -
T2	$41.7m	$ -	$48.9m
T3	$8.3m	$ -	$591.3m

Source: "Perth Airport Capital Expenditure Plan – Updated January 2018" document, provided to airlines in the Consultation Website (http://www.perthairport.com.au/Home/corporate/work-with-us/airline-consultation)

5.5. International Terminal Upgrade

International traffic at Perth Airport has continued to grow over recent years with continued growth forecast by Tourism Futures International (TFI). Capacity analysis indicates that current international stands will begin to reach capacity in 2019/2020 and that Perth Airport is likely to see a requirement for a small number of international services to be bussed. The situation is forecast to become incrementally worse without further infrastructure development. By FY21 the outbound baggage system will also be approaching its capacity limit.

While the international departure lounge provides sufficient floor area to meet International Air Transport Association (IATA) requirements, it provides a poor level of service due to its linear configuration and being split across two levels. It is not uncommon for one end of the lounge to be congested and over capacity while the other end is virtually empty. The poor passenger experience in the second- floor lounge has been raised by airlines in ACCC Quality of Service Monitoring reports with the requirement to go down four flights of stairs to reach aerobridges a particular concern.

To ensure international capacity at Perth Airport is maintained and to improve the passenger experience, an upgrade of the international terminal is required. Perth Airport has undertaken considerable planning on future options and is currently engaging with international airlines to select the preferred option for its International Terminal Upgrade (ITU). The ITU project aims to increase the capacity of international operations at Perth Airport, enhance the departures and arrivals experience for international passengers and facilitate more efficient airline operations.

Key aspects of the ITU development are likely to include:

- Upgrade of the terminal and construction of additional contact aircraft parking positions for wide-bodied aircraft
- A new baggage screening, sortation and make-up system, ideally connected to the

existing check-in zones within the existing T1 to integrate the new system

- New Commercially Important People (CIP) lounges providing sufficient area to meet airline requirements and with potential for direct boarding
- Improved access for Persons with Reduced Mobility (PRM)
- Aircraft taxi lanes and aprons to allow access to the new parking positions. Services and road relocations as well as taxiway works are addressed in the Airfield capital plan
- A passenger lounge and amenities including the opportunity for duty free, food and beverage and retail floor areas

The consolidation strategy outlined in the 2014 Master Plan sees all RPT operations relocate into the Airport Central Precinct. The final stage of consolidation is the move of Qantas T3 and T4 operations to Airport Central. The longer-term planning considers consolidation and future interfaces with ITU. The plans are cognisant of the need to accommodate both international and domestic growth in Airport Central with efficient airside and landside infrastructure use and products that meet airline and passenger requirements.

It is envisaged that in future gates that sit on the interfaces between ITU and domestic operations will have swing capability and that when consolidation occurs, areas such as the baggage make up hall will grow to become a combined international and domestic make up hall. These arrangements benefit both international and domestic airlines and, due to the ability to leverage off combined facilities, are more cost effective for airline operations.

5.6. Integrated Domestic Terminal

As noted above, the final stage of consolidation of all RPT services will require construction of a new open access terminal in Airport Central to cater primarily for the Qantas Group.

The Airport Central precinct has extensive land available for aeronautical expansion whereas Airport West (Terminals 3 and 4) is constrained. A study undertaken in 2008 by Landrum & Brown for PAPL reviewed several options for further aeronautical expansion at Perth Airport, including the option of commercial air services staying in Terminals 3 and 4 and an alternative option of consolidating all RPT services in Airport Central. The study concluded that consolidation of all RPT services in Airport Central was the optimal outcome.

Consolidation of all RPT services in Airport Central will address capacity constraints, provide passengers with an improved transfer experience, and will provide airlines who operate in both domestic and international markets with significant operational savings through co-location of operations.

Construction of T2 and T1 (Domestic) formed the first two stages of the implementation of the consolidation strategy enabling regional airlines and Virgin Australia to move their operations to Airport Central. The final stage of consolidation will see Qantas Group operations move to Airport Central.

As noted in sections 11.2, 11.3 and 11.4 of this submission, the State and Commonwealth Governments have invested around $3 billion on improved road and rail links to support the consolidation strategy.

The new terminal is expected to be east of the current T1 (International) building. PAPL is currently working with Qantas to finalise feasibility assessments to determine the layout and configuration of the new facilities.

The new terminal is likely to include:

- Sufficient stands and apron capacity to facilitate a balance runway operation in its ultimate form,
- Capacity to serve multiple sectors including intrastate, and interstate domestic services
- Integrated ground transport infrastructure
- Terminal layout which optimise operational efficiencies and commercial performance
- Passenger and airline lounges and retail offerings, and
- Suitable access and connectivity to T1 and T2 with integrated efficient operations.

5.7. New Runway Project

The construction of a new runway (03R/21L) at Perth Airport, parallel to the existing main runway (03L/21R), at Perth Airport has been planned since the 1970's.

The requirement for additional runway capacity is triggered when annual aircraft movements reach 145,000 movements. This figure was temporarily exceeded in 2013 due in part to the mining construction boom, when annual aircraft movements peaked at more than 151,000. This resulted in significant and costly delays to passengers and airlines with the State Government estimating in 2013 that congestion at Perth Airport was costing the airline industry and its passengers an estimated $72 million a year.

Although movements have since dipped (to 131,000 in 2017), they are expected to steadily grow and are forecasted to reach approximately 172,000 movements by 2025 and 241,000 by 2045.

Without additional runway capacity, by 2025 unacceptable delays will regularly occur at Perth Airport. Projecting forward to 2045, an estimated 140 aircraft movements will be forgone each day or approximately 51,000 aircraft movements per year, resulting in substantial costs and acting as a significant constraint to the State's population, cargo capacity and export growth.

This restriction on capacity would see unmet domestic and international passenger demand exceed five million passengers per year. Over 20 years this would equal 41.8 million passengers foregoing travel to or from Perth, impacting significantly the State's economy, including $1.72 billion lost tourism expenditure over 20 years.

The new runway will allow more efficient scheduling of regional, domestic and international flights, while improving connectivity between business, tourism and employment, all of which support WA's economic growth[5].

Thus, while operational initiatives and some moderation of aircraft movement growth have eased capacity constraints in recent years, Perth Airport is preparing for the future and planning to construct the new runway in preparation for the next upswing of growth in air traffic. It is anticipated that the new runway will be operational between 2023 and 2028, subject to demand and airline agreement.

The new runway is proposed to be 3,000m long, 45m wide and 2km east of the existing main runway (03L/21R) as shown in **Figure 16** below. The proposed new runway 21L threshold would be staggered approximately 1km south of the existing main runway 21R threshold.

The New Runway (03R/21L) Project is comprised of the following main elements:

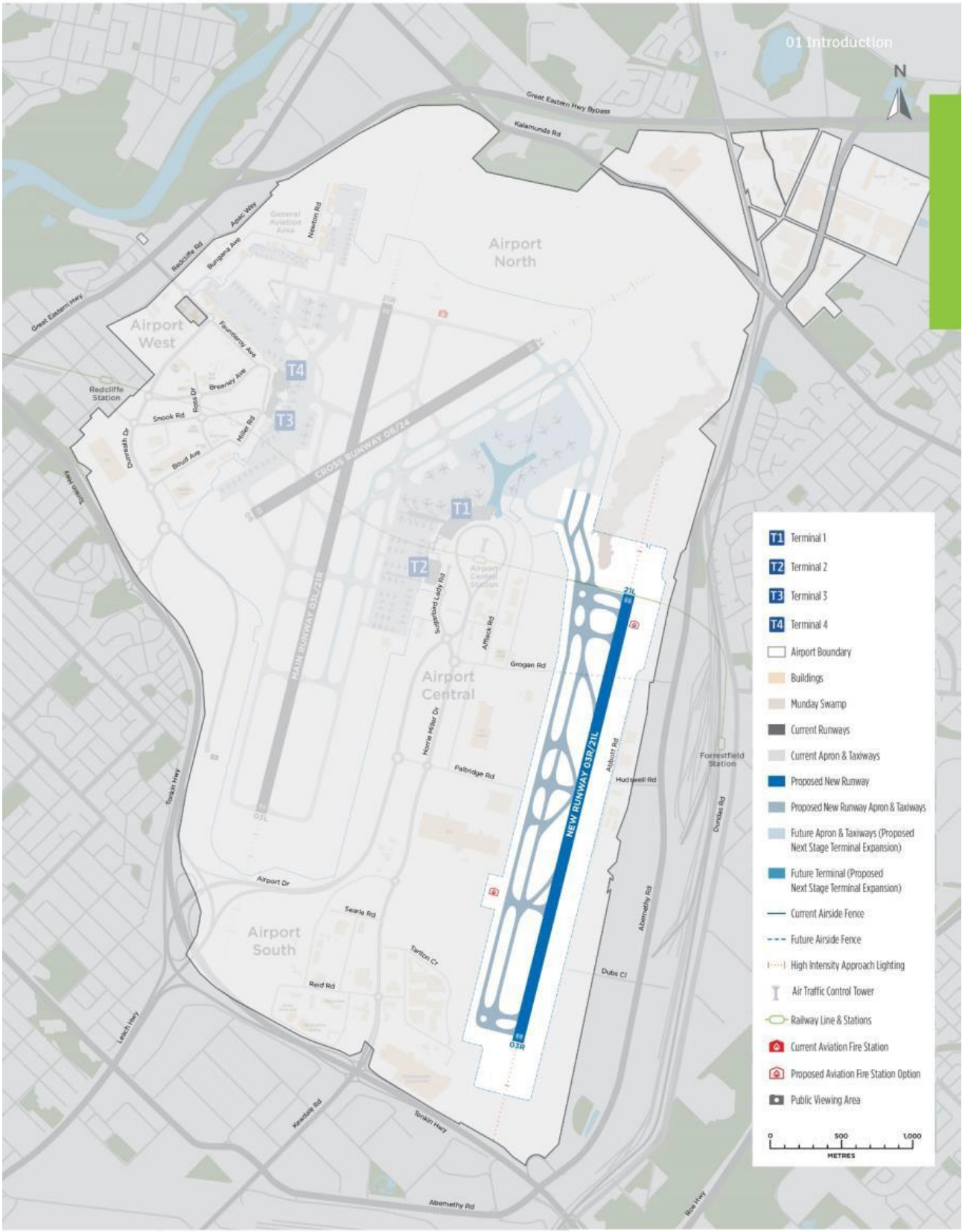
[5] More detailed information on the New Runway Project can be found at newrunway.com.au

- Site clearance and placement of fill material
- A new runway 3,000 metres in length and 45 metres wide located parallel to the existing main runway (03L/21R)
- Runway shoulders and blast pavements, graded runway strip and runway end safety areas. These are generally flat areas surrounding a runway that are provided for the safety of aircraft operations but are not used for the landing, take-off or manoeuvring of aircraft
- Associated parallel taxiways, cross taxiways and rapid exit taxiways to provide efficient aircraft taxiing between the runway and terminals
- Runway and taxiway ground lighting to provide direction guidance during restricted visibility conditions, such as night-time and heavy rainfall
- Visual guidance systems, such as High Intensity Approach Lighting and Precision Approach Path Indicators, that are used by pilots to visually identify the runway and align the aircraft for landing
- New air navigation systems, such as an Instrument Landing System, that transmit accurate vertical and horizontal guidance for pilots
- Site-wide ducting systems for communications, low voltage power, airfield ground lighting cables and a separate network for Airservices communications
- Provision of a new fire station site to meet legislated emergency response times (funded by Airservices)
- Civil infrastructure for Airservices facilities
- Relocation of all affected services such as high voltage power, sewer, potable water, irrigation water and communications
- Vehicle access road around the permitter of the new runway area, to maintain security inspections and provide access for maintenance and operational vehicles
- A new airside security fence and electronic security system to meet aviation security requirements
- New drainage systems to manage stormwater and groundwater flows around the new runway and taxiways

Approvals for the project are time-consuming and complex. They include various State and Commonwealth approvals processes. More than 35 technical studies are required to be completed that cover on-ground environmental impact assessments, economic and social impacts, preliminary airspace design and airspace impact assessments including impacts of aircraft noise and emissions. Design of the infrastructure is also required to ensure that the approvals cover all required elements. Extensive community consultation is required to gain approvals including a public engagement process. The public consultation process commenced in May 2018 and closes on 24 August 2018. It is anticipated that the draft Major Development Plan for the new runway will be submitted to the Commonwealth Minister in late 2018.

Planning has been developed following extensive independent input from Aurecon-AECOM Joint Venture which developed the 20% Design for the project.

Figure 16 – New Runway Project



6. Market Power in Aeronautical Services

6.1. Factors that Might Evidence Use of Market Power

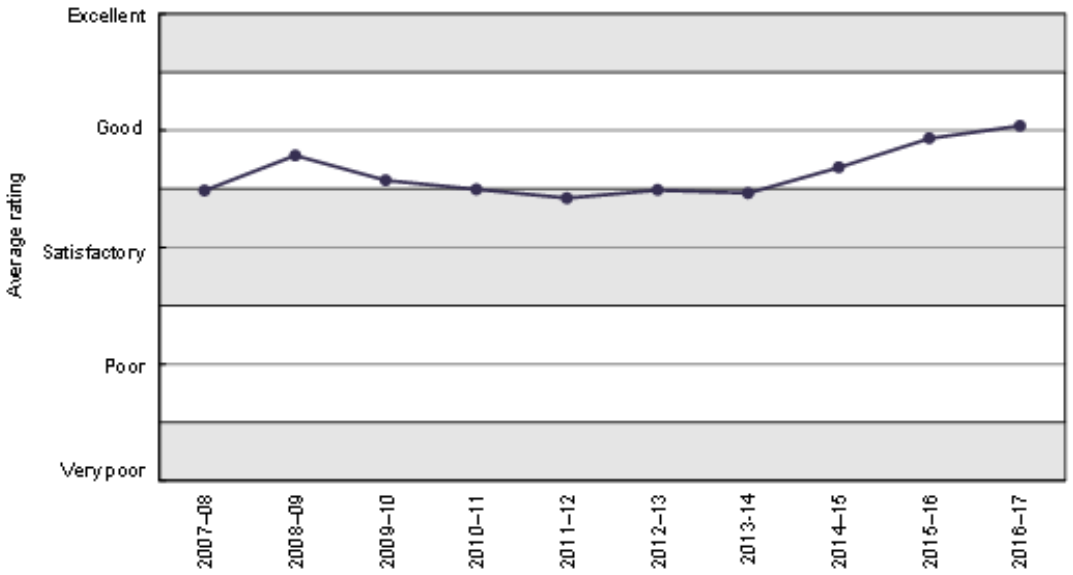
As the Commission will be aware, unconstrained market power may be misused in a number of ways: withholding supply (and investment), allowing quality to deteriorate, operating inefficiently, earning excess returns through excessive prices, or imposing unreasonable terms and conditions. PAPL's view is that there is no evidence that it has misused any market power in any of these ways.

Section 9 discusses how the legal circumstances under which PAPL provides aeronautical services constrains what market power the airport might have. Section 5 discusses PAPL's past and future investment activities and makes clear that in no sense has PAPL withheld investment to date nor does it plan to do so in the future. The discussion below demonstrates similarly for the remaining issues that there is no evidence of PAPL exercising market power.

6.2. Quality is Improving Not Deteriorating

The ACCC's 2016 -17 Quality of Service Monitoring Report found that 'Perth Airport's investment program has produced notable improvements in its quality of performance measures over the last three years'.

Figure 17 – ACCC Quality of Service Rating for Perth Airport 2007 -2017



Source: ACCC Report - PAPL Quality of Service Monitoring Results 2016-2017 (FY17 ASQ Result calibrated to match QSM scale for FY16/17)

In 2016-17, Perth Airport's average quality of service ratings for its T1 international terminal and domestic terminals both increased within the 'good' category. There have been year-on-year improvements in the average rating for the domestic terminals in each of the last five years, while the international terminal rating has improved markedly since 2013–14.

The ACCC found that the notable improvement in Perth Airport's service quality ratings directly reflected the positive impact on passenger experience that has resulted from the significant capital investments undertaken by the airport in recent years. The quality of specific passenger-related services and facilities was found to have improved across a range of indicators (including check-in and immigration waiting times, baggage processing, amenities, wayfinding, gate lounges), with the T1 Domestic Pier singled out as an example of effective

management of the challenge of congestion.

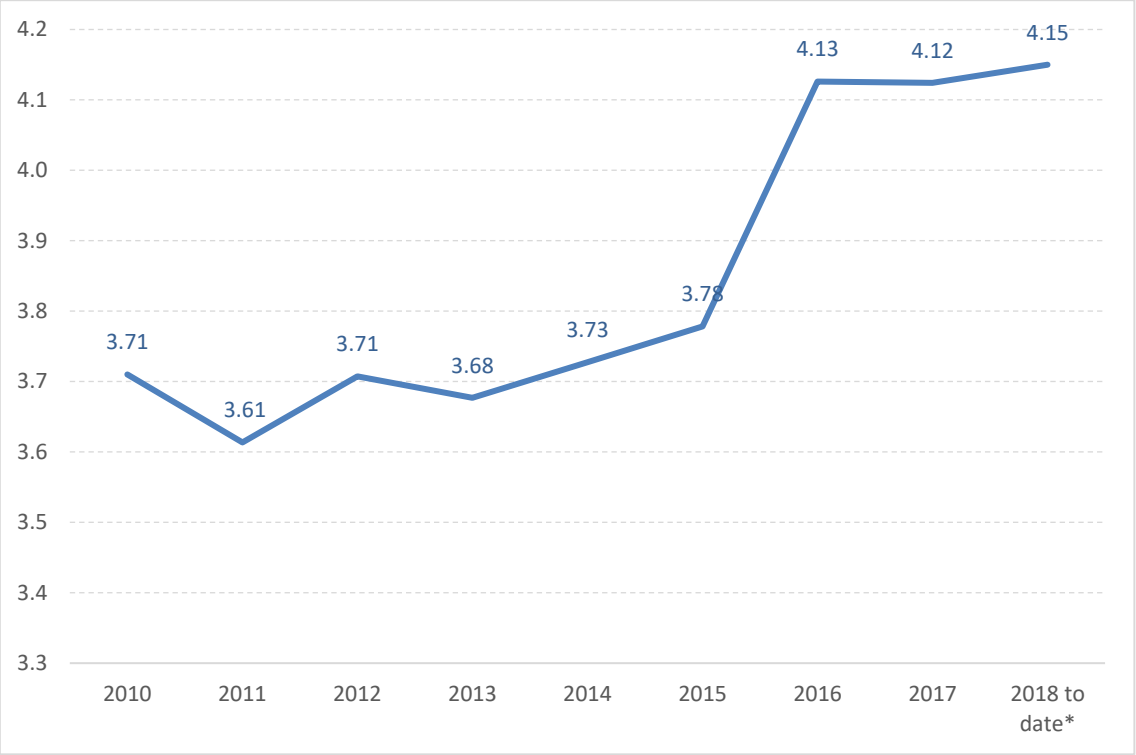
According to the ACCC's 2016-17 Quality of Service Monitoring Report, Perth Airport experienced a 'significant increase' in average airline ratings of quality of service in the past two years, increasing to 'good' for the first time in 2015–16. It found that Perth Airport has achieved the highest airline rating among the monitored airports over the past two years, and has now increased its ratings for five years in a row.

Since 2004, PAPL has conducted quality of service monitoring using customer service surveying programs provided by third party providers. Up until 2009, PAPL used the 'BAA QSM' program, and in 2010 changed to the Airports Council International (ACI) Airport Service Quality Programme (ASQ).

The ACI-ASQ program is used industry-wide as a measure of customer satisfaction; in 2017, 317 airports worldwide participated in the ACI-ASQ Survey.

The ASQ surveys are conducted across an annual sample of 2,800 customers (approximately 700 per quarter), with research spread throughout each quarter to ensure that results are representative.

Figure 18 – Overall Customer Satisfaction with Perth Airport (Annual Average ASQ Score, 2010 to Q2 2018)



Source: Perth Airport (2018)

Under the ASQ survey methodology, customers are asked to score their satisfaction with aspects of the airport including car parking, terminal access and terminal services, on a scale of 1 to 5. They are also asked to score their overall satisfaction with Perth Airport.

Perth Airport's quality of service monitoring shows that overall passenger satisfaction (as measured by ASQ) has increased at an average annual rate of (+)2.4% since 2013.

Perth Airport uses the ASQ survey results to inform customer experience initiatives and improvement across its terminals. **Table 7** includes some examples of investments made since

2012 specifically targeting an improved customer experience.

Perth Airport has adopted and embraced a customer-centric approach to business, which has resulted in Perth Airport's ASQ score increasing year-on-year for the last six years. The marked increase in ASQ scores between 2015 and 2016 can be attributed to the $1 billion investment in infrastructure projects, including the opening of T1 Domestic in November 2015.

As of July 2018, customer satisfaction is at its highest level in six years. In addition, Perth Airport's commitment to increasing service quality has also been recognised by independent bodies, resulting in the following accolades being awarded since 2015:

Figure 19 - Perth Airport awarded Best Airport Staff Service Award (Australia / Pacific) 2018 (Skytrax)

- **Best Staff Service Award –** 2016 Skytrax World Airport Awards
- **Capital City Airport of the Year** – 2016 Australian Airports Association (AAA) Industry Awards
- **Equal Best Major Australian Airport for Quality of** Service - Australian Competition and Consumer Commission's (ACCC) Airport Monitoring Report for 2015-16
- **First Prize for Terminal Operations: Passenger Experience** - The International Airport Review Awards 2017
- **CAPA Asia Airport of the Year 2017 (Medium Airport category, <30 million passengers)** - CAPA Centre for Aviation
- **Best Major Australian Airport for Quality of Service** - Australian Competition and Consumer Commission (ACCC) Monitoring Report 2016-2017
- **Best Airport Staff Service Award (Australia/Pacific category)** - 2018 Skytrax World Airport Awards

Table 7 - Customer Experience Investment at Perth Airport (2011 –2017) - Examples

Area	Examples of Investment
Infrastructure	The first new terminal to be built in 25 years, T2, opened next to T1 in March 2013. The terminal offers high quality amenities capable of handling 36 aircraft. **Total capex cost: $116m** **Aero capex cost: $97m Aero** **Completed: March 2013**
Infrastructure	Opening of public outdoor viewing platform in December 2011; this facility is free to access and provides panoramic views of the airfield to the public. **Aero capex cost: $0.7m**
Infrastructure	T1 Domestic - a common user domestic terminal currently home to Virgin Australia which allows passengers to transfer seamlessly between regional, interstate and international services. Features include 12 new aerobridges, serviced departure gates, a central retail area and 28 new check-in kiosks. **Total capex cost: $280m** **Aero capex Cost: $215m** **Completed: November 2015**
Infrastructure	The T1 International Expansion project transformed the International Arrivals and Departures areas at Perth Airport. The project included expanded Immigration, security screening areas, improved check-in and baggage reclaim facilities, expansion of the arrivals area and redevelopment of the departures lounge. **Total capex cost: $280.1m** **Aero capex cost: $202.50m** **Completed: October 2015**
Restaurant / Eating facilities	• A new central retail and dining area offering an extensive range of dining options at T1 Domestic in 2015; • Five new dining options added at Terminal 1 International (pre-security) in 2015; • The opening of dining precinct (Haymarket), gate cafe (Hudsons) and bar (Loco Poco) in the T1 International Departures area in 2016 and 2017; • Delivery of a new forecourt retail precinct at T1 International in 2016, including Crafty Swan, a dining experience designed by a Michelin-careered chef which showcases Western Australia's best local and seasonal produce, in a casual and contemporary dining space; • Delivery of new and improved food and beverage facilities at T3 which serve local produce and offer unique dining experiences (2017-2018); • Two Perth Airport restaurants were shortlisted for the 2018 FAB (Airport Food and Beverage) Awards: Loco Poco Bar for Airport Bar(s) of the Year (above and below US$3 million in Sales); Three Bears for Airport Casual Dining Restaurant(s) of the Year (above and below US$3 million in Sales) and New Food and Beverage Concept of the Year.
Internet access / Wi-Fi	• Introduction of power-seating facilities at T1 International departures lounge – 538 new seats were installed which enable passengers to charge their electrical appliances prior to their flight; • Installation of dedicated personal electronic device (PED) charging stations at T1 Domestic and T3; • Free wireless internet access rolled out within terminals in 2011; • Full Wi-Fi coverage on the Terminal 1 forecourt (2017)
Digital Infrastructure	• The Perth Airport website was redesigned in 2016 to cater for passengers, corporate and property customers and was awarded 'Highly Commended' in the Global 2017 Moodie Davitt Digital Awards;

Area	Examples of Investment
	• The Perth Airport App was developed to reduce passenger cognitive overload, create ease of access and improve passenger experience. Designed to facilitate a less stressful and more inclusive experience for users, the app features critical functionality such as: o Flight information and the ability to follow or track flights; o Push notifications for flight changes or delays; o Driving condition information and travel time estimates to and from the terminals using GPS/location awareness; o Parking information and access to online parking bookings; o The ability to pin vehicle locations, enabling travellers to find their cars within our car parks quickly upon return.
	• Installation of three 3m x 11.3m video walls at T1 International which feature real time flight, passenger and emergency information, with content able to be switched out remotely and tailored to the time of day, or for a specific passenger demographic; **CAPEX cost: $2m** • The installation of Digital Wayfinding at T1 International in 2018 – this digital infrastructure allows for multilingual and dynamic messaging to improve wayfinding in the arrivals area; • Installation of a FlightRadar tracking screen at the T1 International viewing platform, which allows viewers to monitor the arrival. **CAPEX cost: $0.06m**
Shopping facilities	• Six new or newly remodelled duty-free stores since 2013 (four in Terminal 1; two in Terminal 3); • Four new specialty and news and books outlets added at Terminal 1 International (pre-security) in 2014/15; • Six new shopping outlets at T1 Domestic in 2015; • Four new travel specialty and services outlets added at Terminal 1 International Check In, including Foreign Exchange, Baggage Services, a Pharmacy and a Convenience store in 2017.
Comfort and ambience	• The commission and installation of six major art installations as part of the Public Art Program in 2015; • The installation of a new children's play area incorporating airport-themed play equipment, interactive games consoles and a light wall in 2016; • Upgrading and enhancing the international aerobridges at T1 International to depict iconic Western Australian scenery in 2016 (initiative conducted in partnership with Tourism WA). **CAPEX cost: $0.2m** • The Terminal 1 forecourt was upgraded and expanded in 2016, which included the creation of a 27-metre landscaped plaza; **CAPEX cost: $28.8m** • Upgrades to seating in the Departures lounge at T1 International in 2015; **CAPEX costs below;** Gates 50/51 $472,463.76 2015 Gates 52 $707,948.28 2017 Gates 53-56 $984,919.73 2015
Ground Transport	• Development and introduction of an Online booking parking option in 2014 which offers discounts on drive-up prices; • Construction of new Short Term and Long-Term car parks at T1/T2 and T3/T4; • Provision of 10 minutes free to users in all Short-Term Car Parks;

Area	Examples of Investment
	• Provision of 1 hour free in all Long-Term Car Parks from 2017; • The facilitation of access for the rideshare industry including provision of infrastructure and access delivery; • The facilitation of Public Transport access to allow customers a variety of options at different price points for airport access; • Upgrade to T3/T4 Taxi infrastructure; • Construction of new Taxi facilities at T1 and T2 to facilitate taxi operation; • New car rental terminal counters and ready bay booths.
Visitor Information	• Setting up a Welcome Desk to greet International students prior to the start of their semester in 2017 (initiative conducted in conjunction with StudyPerth); • Expansion of the highly acclaimed Gold Coat Ambassador volunteering program

6.3. Perth Airport is Developing Best Practice Service Standards

Perth Airport is working with its airline customers and independent expert consultant and facilitator, 7Skies, to develop and agree best practice service standards for operational performance and customer (passenger) experience, building on 7Skies' extensive research across multiple airports.

Service standards are proposed as an agreed suite of metrics using data from Perth Airport and airline systems to measure and report on operational performance with a view to jointly deliver operational efficiencies and improvements.

Operational performance standards will focus on assisting airlines to monitor and maintain operational requirements such as On-Time Performance (OTP), security screening wait times and baggage delivery performance in 'real time'. In parallel, passenger experience standards will include matters such as airport wayfinding, cleanliness of bathrooms and overall passenger satisfaction.

The process includes two main stages:

Stage 1 – Developing Service Standards

- Parties to develop and validate the appropriate data sources, sharing principles and reporting mechanisms for the agreed measures and agree a process for review that provides for continuous improvement and jointly deliver efficiencies and improvements

Stage 2 – Developing Service Level Agreements (SLA)

- Define and agree expectations, responsibilities and accountabilities for the agreed measures and address performance outside agreed parameters for those elements within Perth Airport's direct control; include in Perth Airport's Conditions of Use.

Perth Airport is currently working with airlines to complete Stage 1 – Developing Service Standards as outlined in more detail below.

Developing Service Standards

- During 2017/18, consultation between PAPL and its airline customers (and in particular the Board of Airline Representatives Australia (BARA)) has been key to determining appropriate service standards and measures for inclusion in ASAs.
- In March 2018 PAPL presented a draft service standards proposal to its international and domestic airline customers, BARA and to the Perth Airport Airline Operators' Committee

(AOC) seeking feedback on the proposal from those groups.

- The service standards framework and overall engagement process implemented by Sydney Airport, was recommended by BARA and some airlines as a useful starting point for PAPL in developing service standards.
- PAPL consulted with Sydney Airport to gain an understanding of the process that led to the establishment of their service standards framework. This informed PAPL's next steps in establishing a similar process in the development of the Perth Airport service standards framework.
- All airlines operating at Perth Airport terminals (17 international airlines and 4 domestic airlines) were invited to participate in service standards workshops in February and March 2018 with a total of nine airlines agreeing to participate.
- The outcome of these workshops was the identification and ranking of service standards, appropriate measures and provision of a high-level implementation plan.
- A summary of the information presented at the workshop was subsequently sent to all international and domestic airlines operating out of Terminals 1 – 4 at Perth Airport. It was also presented to BARA and the Perth Airport AOC in March 2018.
- Since then, PAPL and its international and domestic airline customers have worked together to identify 20 service standards and associated measures as shown in **Table 8** below.
- In July 2018, each airline and BARA were sent an information pack including a proposed delivery timetable, example reports and issues register. Included in the pack was an opportunity to provide feedback to further refine the service standards to be reported on, and the content of those standards.
- The engagement with airlines, BARA and stakeholders to develop service standards continues to progress.
- Once the suite of service standards is developed, if an airline customer so desires, Perth Airport will enter into good faith negotiations with the airline to customise service offerings, provided the desired outcome is consistent with agreed airport wide outcomes.

(see next page)

Table 8 – Proposed Perth Airport Service Standards

	Focus Area	Service Standard
1	On Time Performance	Arrivals on time performance - Airline specific
2		Arrivals on time performance - Overall
3		Departures on time performance - Airline specific
4		Departures on time performance - Overall
5	Passenger Facilitation	Outbound Customs Processing
6		Security Search
7		Inbound Customs Processing
8		Secondary Examination Area
9	Airport Facilities	Baggage system throughput
10		Baggage system availability
11		Aerobridge downtime
		Aerobridge availability- maintenance
12		Bay and stand availability
13	Bussing Operations	Inter terminal shuttle bus service
14	Baggage Outcomes	Arrivals baggage delivery
15		Transfer bag misconnect (Dom-Int/Int-Dom)
16	Safety	Passenger incident rate
17	Airport Service Quality	Cleanliness of bathrooms
18		Airport wayfinding
19		Flight information
20		Overall satisfaction

A number of provisions have been included in the ASAs to facilitate the development of a service level framework. These are:

- *PAPL and the airline have agreed to establish a framework within 9 months after the date of the agreement that enables development and implementation of solutions to improve the safety, efficiency and passenger experience at the airport through:*
    - *i. identifying key issues and areas for improvement;*
    - *ii. developing the data and information system necessary to analyse issues;*
    - *iii. implementing an ongoing KPI framework including a scorecard to rate service quality outputs at T1, T2, T3 and T4 and which may include a service credit regime that may, in part or wholly, replace the delay rebate; and*
    - *iv. developing and implementing projects to improve safety, airline operating efficiencies and passenger experience.*
- *PAPL and the airline agree to establish an ongoing set of KPIs and scorecards that is*

capable of implementation by the date that is 18 months after the date of the agreement;

- *a process to review, vary and adjust KPIs and relevant scorecards, including at specific intervals (for example, every 2 years)*

PAPL will report to the Airline at the end of each calendar quarter on actual performance against each KPI during that quarter and for the proceeding 12-month period

6.4. Perth Airport Efficiency and Costs

The absence of effective competition means that firms with market power can allow their efficiency to slip and ultimately pass these costs on to customers. If a firm with market power can maintain its rate of return due to an absence of competition, it has the potential to over-invest at that rate without the risk of asset stranding – this is similar to the Averch-Johnson effect for rate of return regulated firms.

Over the last PSA, from 2011 to 2018, PAPL had an opex efficiency problem that was driven by increase of overhead during the delivery of various capital projects over a short period of time. PAPL has undertaken internal reviews and initiated cost cutting programs to remediate this inefficiency and have already reduced opex, with more savings being delivered in the next two years. But more importantly, none of these costs were passed onto airlines or passengers, and all of it was absorbed by PAPL.

6.4.1. Overview

The aeronautical charges at Perth Airport between 2006 and 2011 were low in comparison with other Australian and New Zealand airports. A report prepared for Melbourne Airport for the purpose of that company's submission to the Commission's last Inquiry provided a comparison of aeronautical charges across nine Australian and New Zealand airports[6]. It showed the 2011 aeronautical charges at Perth Airport to be the second lowest of major Australian airports (less than Adelaide, Brisbane and Sydney, but greater than Melbourne) and the second lowest of all nine comparator airports (the major Australian airports plus Cairns, Wellington, Auckland and Christchurch). A similar ranking of Perth Airport existed in 2006.

InterVISTAS' benchmarking study that is attached to the Australian Airports Association (AAA) submission to this Inquiry shows that while Perth Airport's domestic charges are relatively high (for the reasons discussed above), its international charges are relatively low and the lowest of the Australian airports in the sample. It is important also to note that InterVISTAS' analysis is based on 'rack rates' and does not include any discounts which InterVISTAS believe are more prevalent in Australia than in other countries. Details of PAPL's discounting behaviour is provided in its confidential submission but suffice to say in relation to domestic services, PAPL's level of discounting is in the middle of the range identified by the AAA and reported by InterVISTAS.

There is no evidence that PAPL has set or raised prices for aeronautical services above efficient cost. Despite the price increases at Perth Airport over the last 7 years, which were mainly driven by the investment in new facilities such as expansions in T1 (International) and the construction of T1 (Domestic) and T2, PAPL's margin per passenger decreased in the period, being the lowest of the four monitored airports in six of the seven years.

The pricing structure agreed with airlines in the previous Prices and Services Agreements which concluded on 30 June 2018 involved PAPL taking passenger volume risk; the fact that there had been a period of strong passenger growth until 2013 and a period of depressed

[6] Leigh Fisher Management Consultants, February 2011, Melbourne Airport Performance and Charges Benchmarking Study, prepared for Melbourne Airport

domestic volumes since 2014 meant that PAPL's business performance benefitted from assuming volume risk in the first half of the period, while being negatively impacted in the second half. In the period prior to 2004, PAPL's returns from its aeronautical infrastructure were adversely impacted by the one-off events described previously.

There is no evidence that PAPL has restricted supply of aeronautical services and facilities to increase the price it receives for these services. As the prices PAPL charges, in the main, arise from existing agreements with airlines, such conduct would only decrease revenue due to decreased passenger throughput. Since 2011 PAPL has made significant investments in aeronautical infrastructure to support growth, completing the construction of two new domestic terminals (T1 (Domestic) and T2) and significant improvements to international capacity, so that growth was not constrained.

Further investments are expected in the international terminal and the airfield in the following years, to cater for expected growth in international operations as well as the construction of a new domestic terminal for Qantas operations in Airport Central.

The fact that the major facilities expansions were delivered later than what was desired was due to a range of factors, none of which imply that PAPL has sought to constrain supply as a strategy to increase prices. The factors contributing to the later than desirable delivery included:

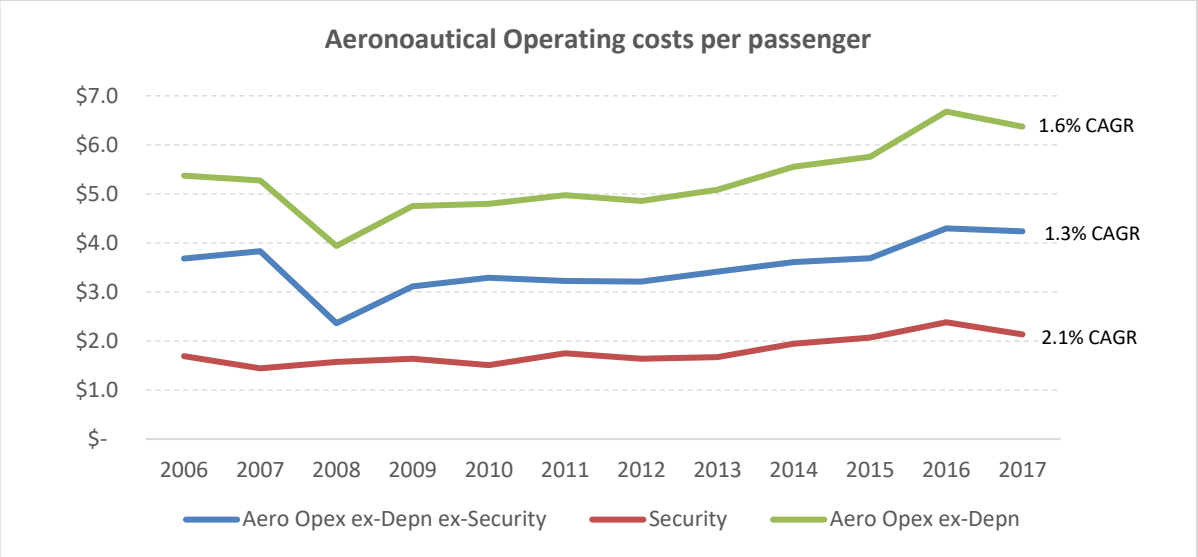
- the rate of growth in demand which was faster than PAPL, airlines, independent forecasters, governments and industry associations anticipated;
- the rate of growth and material shifts in the nature of services needed by airlines at Perth Airport required PAPL to fundamentally review and modify its airport redevelopment plans, which took time; and
- airlines have strong countervailing power in commercial negotiations which impacts the timing of investment. In a practical sense, it becomes very problematic for PAPL to make significant investments in aeronautical infrastructure in the absence of support, commercial or otherwise, from the major airlines for both the nature of the investments and the proposed future airport prices to underpin the investment. In the period 2008 to 2010 airlines exhibited a very cautious approach due to concerns, firstly about a significant increase in fuel costs (which at the time was being described by some airlines and IATA as one of the most significant threats to airline viability in decades) and then the global financial crisis.

6.4.2. Operating Cost Efficiency

PAPL is highly motivated to achieve efficient operations. The company is seeking to deliver the required levels of infrastructure capacity and service levels reliably, with low levels of operating risk and at the lowest feasible operating cost. The company seeks to benchmark its management systems and processes against relevant national and international standards and industry benchmarks. Specifically, the company has continued to improve its governance, risk management, safety, environment and integrated planning frameworks, amongst others.

Figure 20 shows trends in real aeronautical operating costs since 2006 on a per passenger basis. Operating costs include items such as labour, contractor costs, utilities and rates, and land taxes and maintenance costs. Most importantly, they do not include items associated with capital such as depreciation and interest.

Figure 20 – Aeronautical Operating Costs Since 2006 (per passenger)



Source: ACCC Airport Monitoring Reports; data in FY18 dollars

InterVISTAS has undertaken a benchmarking study to support the AAA submission to this inquiry. The study shows that although Perth Airport's operating costs are higher than those for other Australian airports, they are broadly comparable to other airports in the peer set. This is consistent with the analysis of Leigh Fisher for Melbourne Airport presented to the Commission's last inquiry. PAPL does acknowledges the inherent challenges in such international comparisons but suggests this is evidence that contributes to the view that from an operating cost perspective, Australian airports are not abusing market power via operating cost inefficiency.

Comparison of operating cost data published by the ACCC shows that Perth Airport's operating costs per passenger have grown more rapidly than other monitored airports. For the duration of the recently expired aeronautical agreements, costs were higher than expected over a number of years. This increase in cost is primarily attributed to the underestimation of the cost for the stepped increase in operations over the period including the opening of 2 additional new terminals (T1 (Domestic) and T2), exacerbated by the mining boom which drove a significant increase in labour cost. However, it should be noted that because of the fixed real price nature of the PSA agreements, these additional costs were not passed on to airlines but were instead absorbed by Perth Airport shareholders. Further, as a result of a range of efficiency initiatives introduced since 2016, operating costs per passenger in 2019 are expected to be at the same levels as they were forecast to be when the PSA contracts were entered into in 2011 and are forecast to grow below inflation until FY21.

Operating costs were expected to rise during the life of the previous agreement for several reasons:

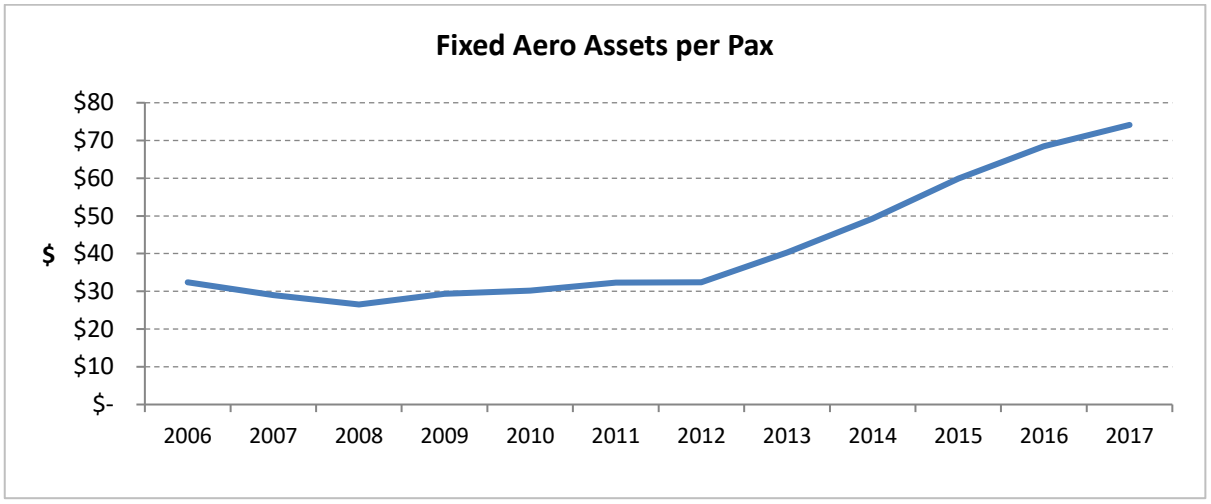
- The opening of T2 and T1 (Domestic) significantly increased the terminal floor area per passenger. Not only was this to improve the amenity for passengers but also to provide for future growth. Floor area is the key driver of the cost of cleaning and energy, which are the main operating costs of terminals;
- Operating costs have increased as a result of the changing security environment, mainly with regards to Cyber Security; and,
- Lower than expected rates of growth in passenger numbers mean that whilst operating costs per passenger are roughly where they were expected to be, on a per passenger

basis they are higher that would have been expected.

6.4.3. Capital Efficiency

PAPL's aeronautical assets per passenger declined slightly between 2006 to 2008 due largely to rapid passenger growth driven by the resources sector. As the asset base remained fixed, service quality temporarily degraded. As PAPL increased investments in aeronautical assets, this ratio increased again and will increase further as the major redevelopment of the airport is completed over the coming decade.

Figure 21 - Aeronautical Fixed Assets per Passenger (Real Values in 2017-18 dollars)



Source: ACCC Airport Monitoring Reports, 2018

PAPL acknowledges that more capital is not always better. Further, it is almost impossible to draw meaningful conclusions from various levels of this ratio between airports given differences in local conditions. For example, PAPL believes its new runway will cost in the order of $520 million and take up to four years to build, while we understand the expected cost of the new runway at Brisbane Airport is expected to cost $1.2 billion and take seven years to build – the difference being the relative costs of land preparation.

PAPL believes that a view on capital efficiency must largely be formed on an assessment of processes.

- Many major projects, including terminals and runways, must be approved by the Minister after a public consultation process. This provides ample opportunity for the community, and in particular airlines, to comment on the merits of the process. In the case of runways, formal environmental assessment is required under the Environment Protection and Biodiversity Conservation Act (EPBC Act).
- PAPL provides detailed capital plan information to airlines at the commencement and during its aviation agreements. This is not on the basis of a 'take it or leave it' offer but rather part of an extensive dialogue.
- For major aeronautical projects and others that may have operational impacts, PAPL is required under its agreements to establish project control groups. In those cases where a project is a key part of an airline's business strategy, such as T1 (Domestic) was for Virgin or the reconfiguration of T3 for international operations was for Qantas, airlines are engaged in every element of design.

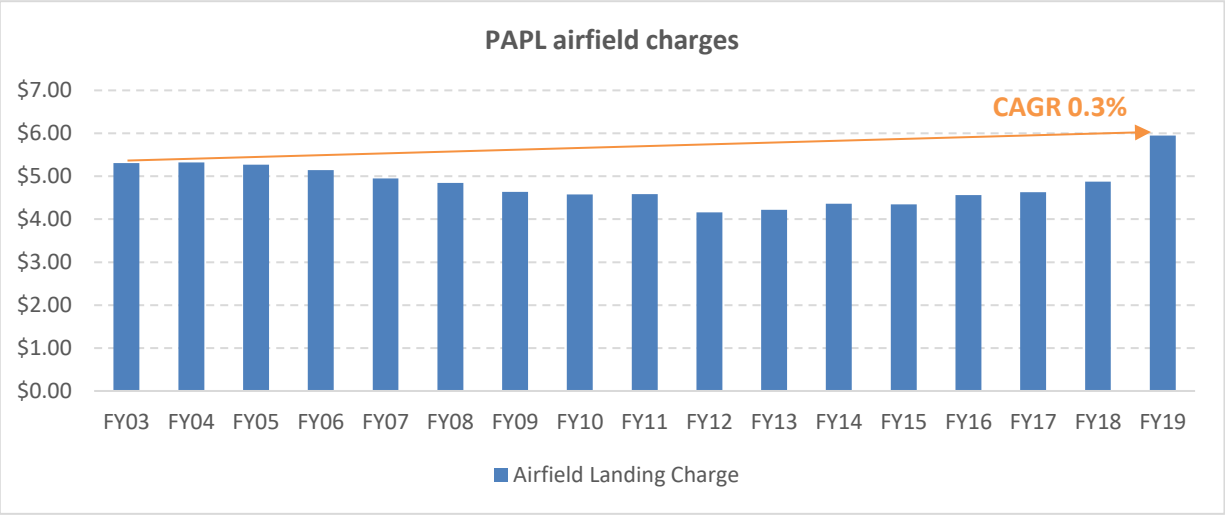
6.4.4. Aeronautical Prices

As shown in the graphs below, most aeronautical charges at Perth Airport remained constant in nominal terms between 2005-06 and 2009-10 (representing a real decline). As stated in PAPL's last submission to the Productivity Commission, material charges increases were expected by both PAPL and airlines from 1 July 2011, reflecting commercially agreed positions with airlines requiring capital investment at Perth Airport. Charges adjustments were necessary to support the requested investment, which also was reflected in improvements in customer satisfaction scores in all areas and in all terminals. However, consistent with charges at Perth Airport being based on the building block approach, domestic terminal prices for the period 2018-19 to 2025-26 are all expected to decrease, reflecting a lower capital investment profile. International terminal charges, excluding any agreement for new or expanded terminal facilities, are also expected to reduce.

Airfield Charges:

- Airfield charges remained close to constant in real terms, with a CAGR of 2.7% in the period between 2012 and 2018.
- Charges for FY19 are expected to increase 22% (or increase $1.17 per pax to $5.95 per pax) in real terms as a result of the following:
    - Capital expenditure in the pricing period from FY11 to FY18 including construction of Airport Drive, the commissioning of CATIII airfield infrastructure as well as various upgrades to the runway and taxiway systems;
    - The indicative capital plan for the FY19 to FY25 period, which includes $240m in asset renewals, with the main impacts being capital expenditure for the runway, taxiway and taxilane systems; as well as a further $155m associated with the construction of the taxiways for the International Terminal Upgrade; and,
    - The reallocation of forecourts from terminals to the airfield.
- Despite the sharp increase year-on-year when compared to FY18, overall airfield charges grew at a modest 0.7% per year CAGR since FY03.

Figure 22– PAPL Airfield Charges (Real Values in 2017 – 18 dollars)

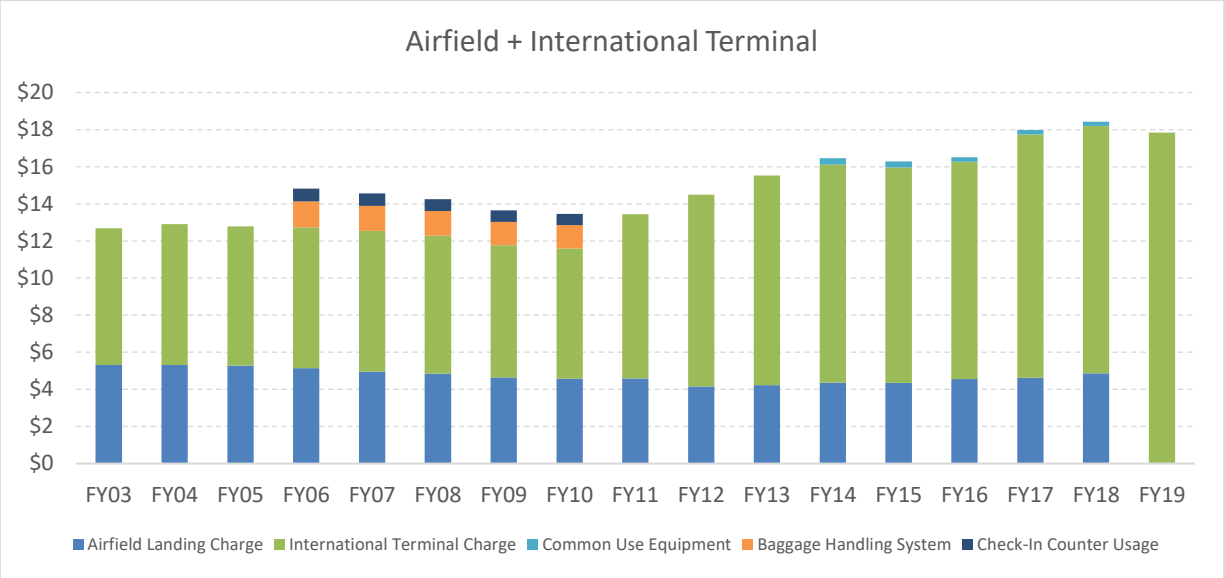


Source: Perth Airport, 2018

International Charges:

- International terminal charges increased at an average rate of 4.3% per year in the period between 2012 and 2018, reflecting major expansions in the international terminal, including works in the Arrivals area, expansion to International Departures and the construction of the international portion of the T1 Pier, including two boarding gates.
- For FY19, PAPL has proposed a 1-year holdover agreement for International operations, representing the maintenance of FY18 Airfield and International charges, with no escalation, while PAPL and airlines discuss the design, layout and cost of the International Terminal Upgrade. Charges are expected to increase when the new terminal is completed.

Figure 23 – PAPL Airfield & International Terminal Charges (Real Values in 2017 – 18 dollars)

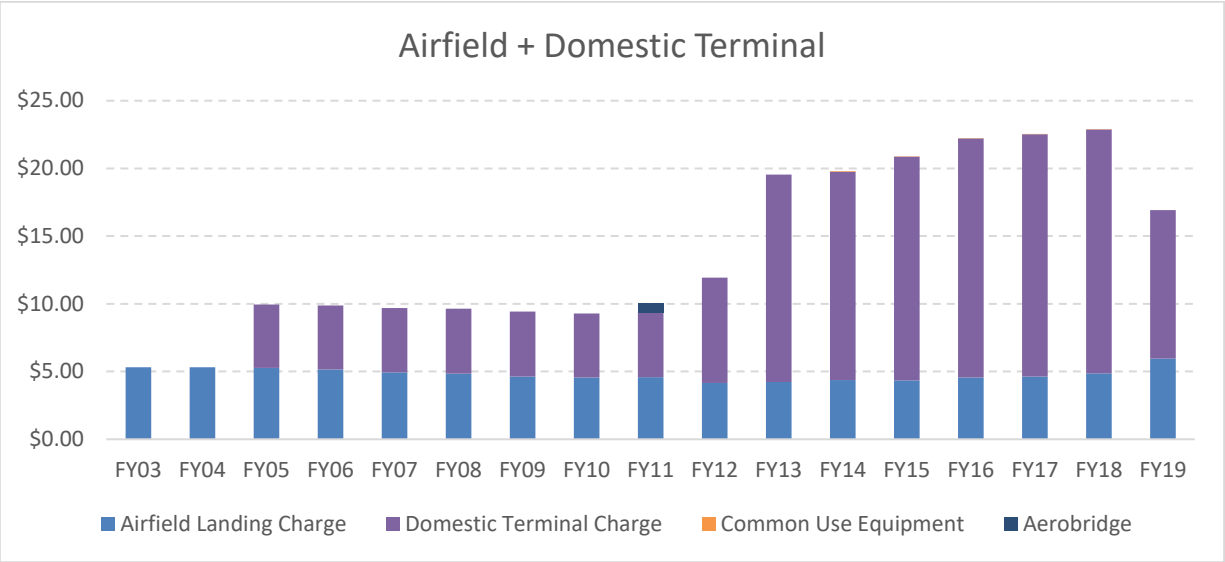


Source: Perth Airport, 2018

Domestic Charges:

- Domestic terminal charges grew at a compound rate of 15.3% in the period between 2012 and 2018, reflecting the construction of two brand new terminals (T2 in 2013 and T1 (Domestic) in 2015) as well as two major expansions of T3.
- Domestic charges in FY19 are decreasing by 39% in real terms, reflecting the new pricing cycle with no major capital expansions and after the delivery of the new terminals as well as the elimination of ACUS (Airport Common Use System) charges.
- For the duration of the price agreement, until FY25, charges are expected to grow at 2.5% per year, unless additional capital expenditure is required, either by agreement with the airlines or as a result of regulatory changes (for example new aviation security requirements).

Figure 24 – PAPL Airfield & Domestic Charges (Real Values in 2017 – 18 dollars)

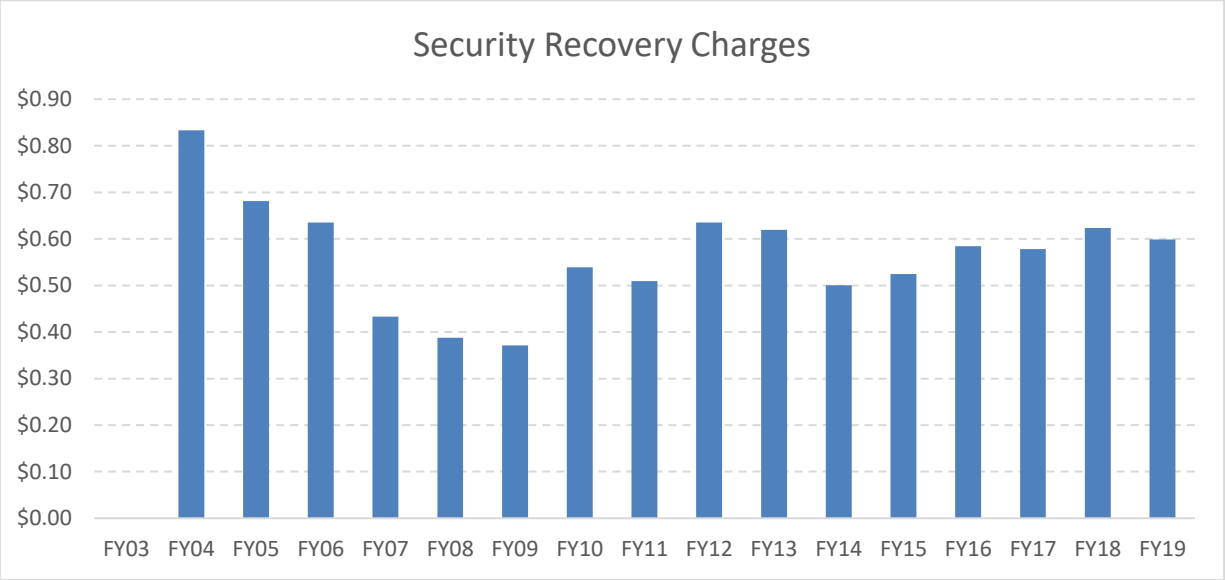


Source: Perth Airport, 2018

Security Charges:

- Security recovery charges have decreased by 2.2% per year in real terms since FY04, and have fallen by 0.3% per year in the period between FY12 and FY18.

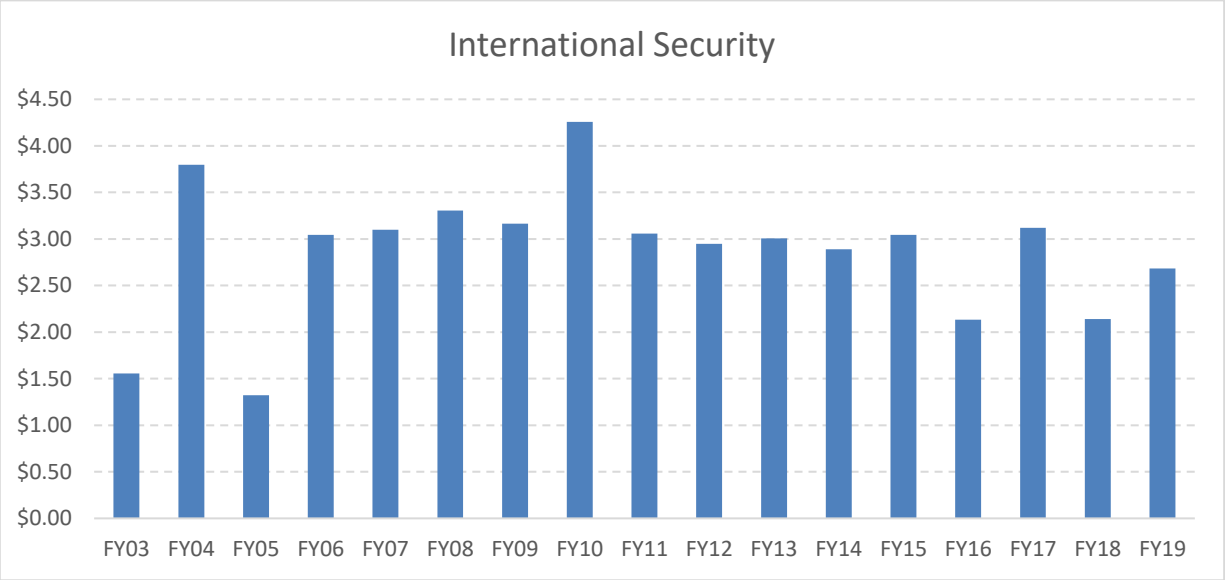
Figure 25 – PAPL Security Recovery Charges (Real Values in 2017 – 18 dollars)



Source: Perth Airport, 2018

- Passenger and Baggage Screening charges have fallen by 5.2% per year in real terms in the international terminal in the period from 2012 to 2018, reflecting increases in passenger throughput.

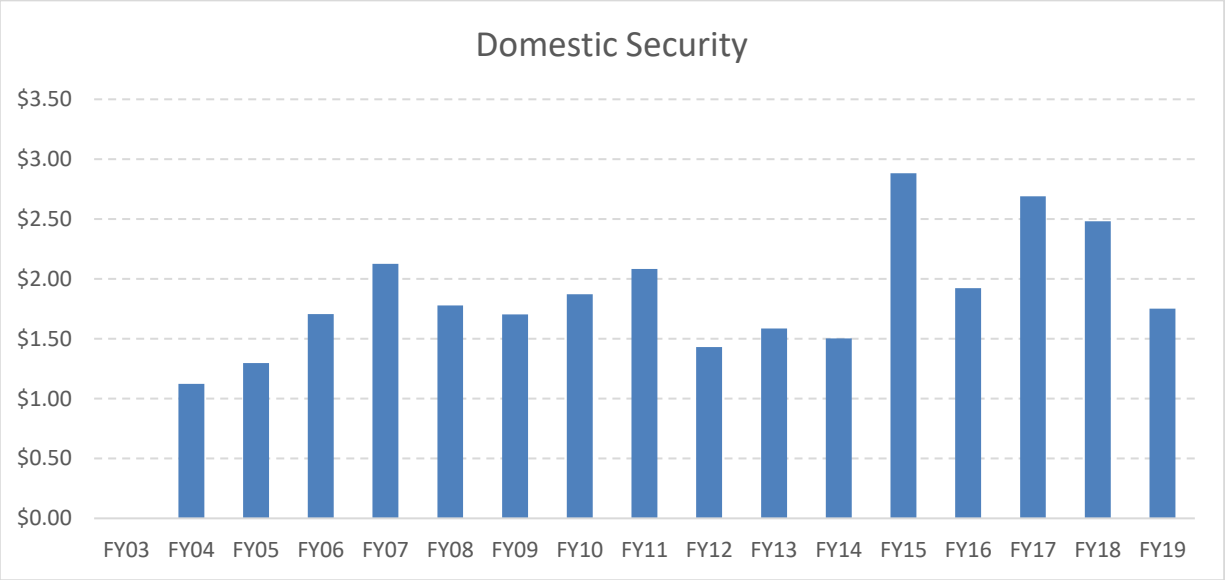
Figure 26 – PAPL International Passenger & Baggage Screening Charges (Real Values in 2017 – 18 dollars)



Source: Perth Airport, 2018

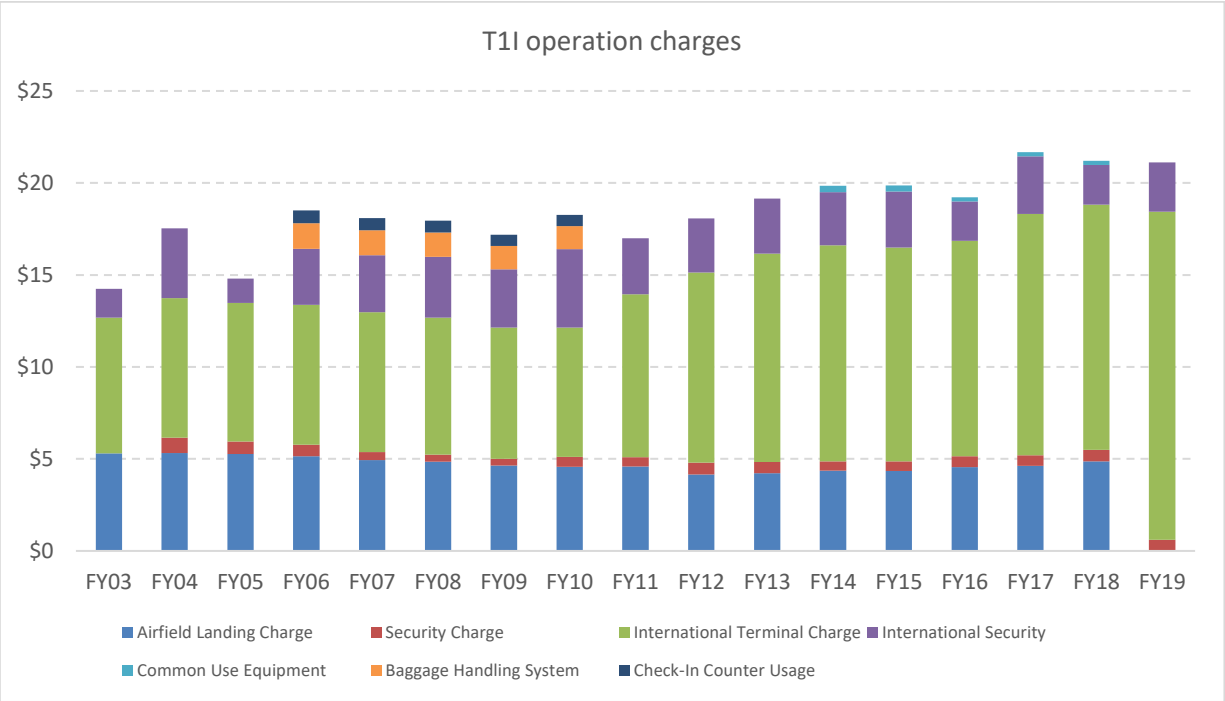
- Domestic passenger and baggage screening charges increased in FY15, after the opening of the T1 Domestic Pier, reflecting a larger number of screening points and the decreasing number of passengers. Costs have been falling in real terms since then despite falling passenger numbers, reflecting cost saving initiatives undertaken by PAPL, including the renegotiation of the security services provider contract.

Figure 27 – PAPL Domestic Passenger & Baggage Screening Charges (Real Values in 2017 – 18 dollars)



Source: Perth Airport, 2018

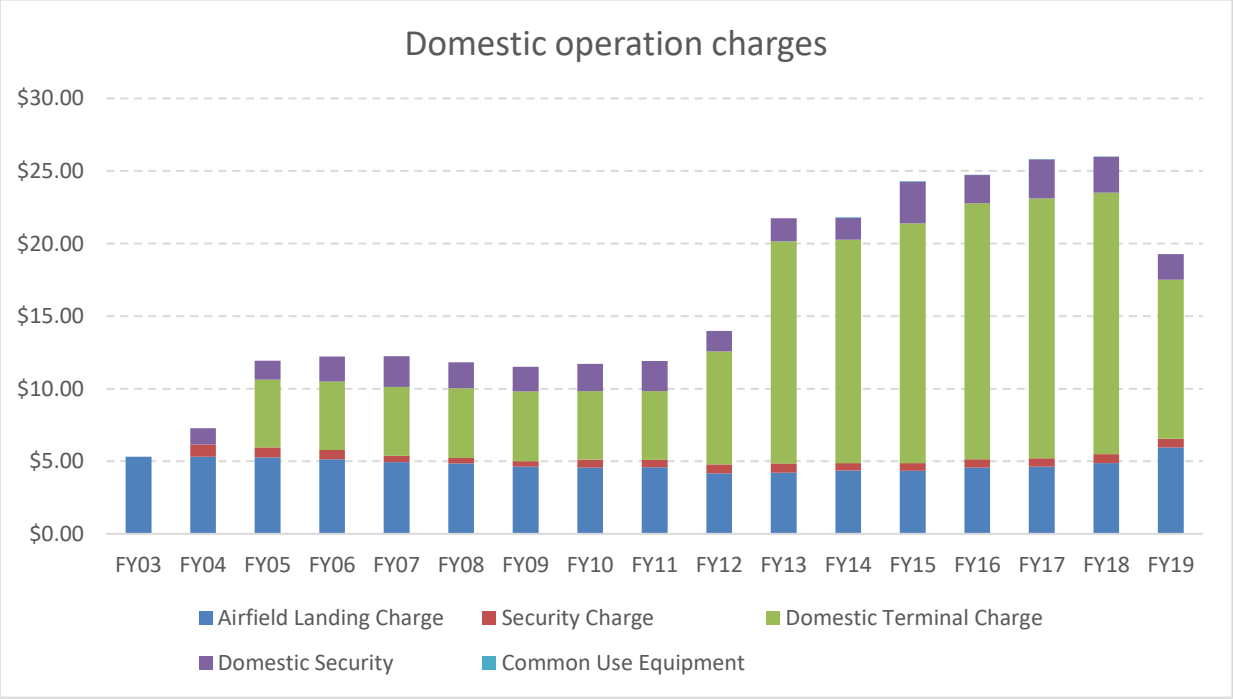
Figure 28 – T1 (International) Operations Charges (Real Values in 2017-18 dollars)



Source: Perth Airport, 2018

Note: Security, Common Use Equipment, Baggage Handling System and Check-in Counter usage charges applicable on departures only, half of the value considered

Figure 29 – T2 (Domestic) Operations Charges (Real Values in 2017-18 dollars)



Source: Perth Airport, 2018

6.5. Consumer Impacts of Airport Charges

As a result of recent media commentary linking airport charges to increases in airfares, PAPL commissioned *InterVISTAS* to examine the relationship between airport charges and airfares (measured by the base fare paid to airlines plus taxes and airport and other aviation charges) at Perth Airport. A copy of the report is at **Appendix 1.** The report's findings indicate that there is no robust statistical evidence that airport charges flow through to airline fares with key results of the analysis being:

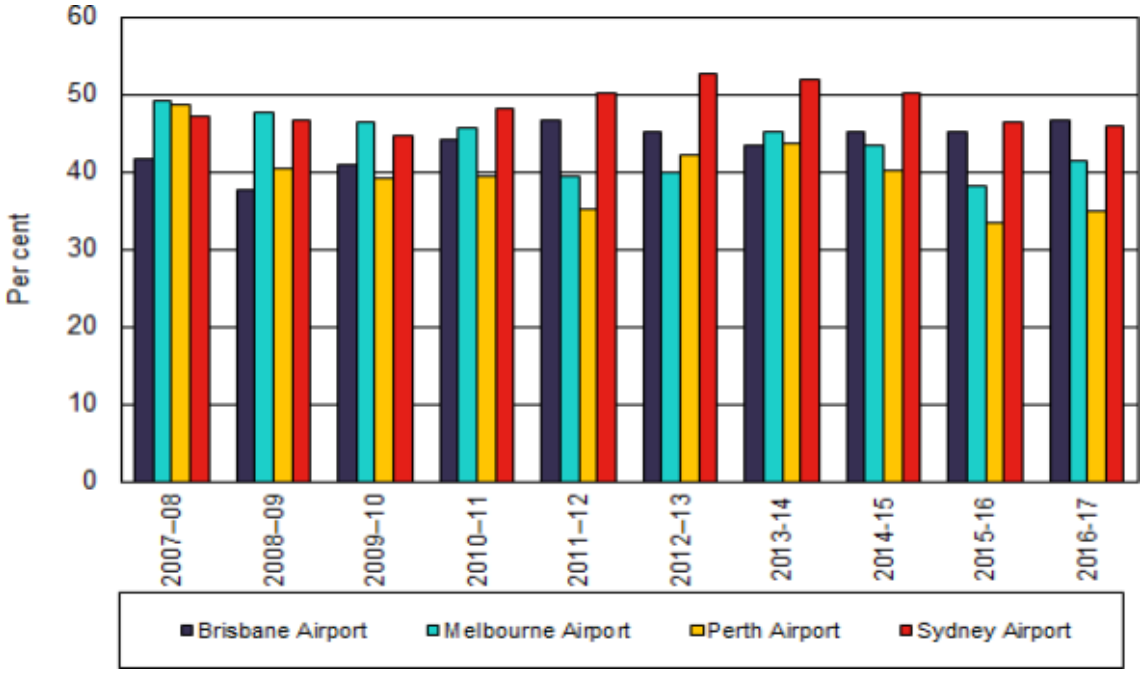
- A visual inspection of monthly average "combined fare" data for origin destination (OD) pairs by carrier does not show a response (higher combined fare) to changes in airport charges;
- Airfares at Perth showed a declining trend over the majority of the years and months under analysis -- January 2012 to December 2017;
- The change in airport charges are small relative to the month by month variation in average combined fares;
- For inter-state routes, the findings are that changes in airport charges are associated with a very small partial pass-through of these charges to the average combined airfare;
- For the international sector, there is no consistent finding; and,
- The analysis does not support a view that increases in airport charges result in proportionately higher fares. Consistent with economic theory, there is instead, evidence of a very small pass-through of airport charges, generally in a range of 5-16% - that is, if airport charges were to increase by 10%, airfares could be expected to increase by $0.50 - $1.60 depending on the market segment.

6.6. Profitability

Figure 30 shows Perth Airports' operating profit margins are currently the lowest they have been in a decade save for one year.

(see next page)

Figure 30 – Airport Comparison of Operating Margins for Aeronautical Services (Real Values in 2016-17 dollars)



Source: ACCC (2018) Airport monitoring report 2016-17, 2018, Canberra: ACCC.

In its annual reporting under the price-monitoring regime, the ACCC has made no findings and raised no concerns about misuse of market power or other inappropriate conduct in pricing of services at Perth Airport but raised its concern that the current regulatory regime was not an effective constraint on airports' market power. It is difficult to ascertain the precise basis for this claim but it seems to stem from the fact that it considers operating profit margins (measured as the ratio of EBITA to revenue) are high.

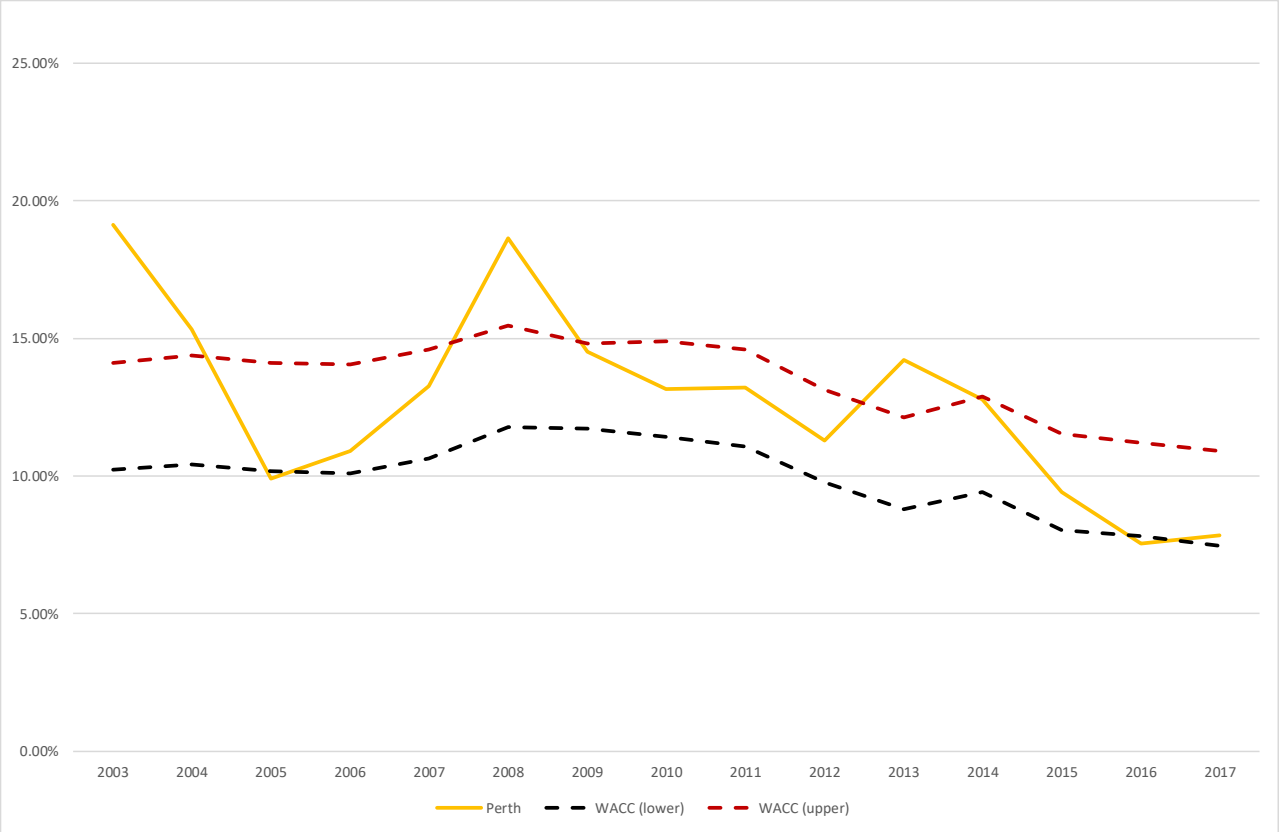
Of course, the Commission understands that margins themselves are meaningless and may simply reflect capital intensity. But putting aside the level of these margins, the general stability over a decade suggests no abuse of market power because surely a business possessed of the market power of concern to the ACCC would have moved to have increased them.

The Commission observed in its 2006 report that 'the appropriate test is whether the ex-post rate of return on aeronautical assets has been reasonable relative to the risks involved[7]. During that Inquiry both the ACCC and the Board of Airline Representatives Australia (BARA) made submissions supporting that approach. PAPL notes the Commission's expressed concerns about this approach in both its 2006 and 2011 reports but strongly suggests that this is the test set out in the pricing principle.

Figure 31 provides the pre-tax Return on Aeronautical Assets (RoAA) at Perth Airport since prices notification was removed in 2002. The dashed lines represent the upper and lower bounds of the cost of capital for the monitored airports estimated by Houston Kemp as set out in their report attached to the AAA's submission to this inquiry.

[7] Productivity Commission (2006, p19)

Figure 31 – Pre-Tax Return on Aeronautical Assets for Perth Airport



Source: ACCC Quality of Service Monitoring Report, FY17

The important question for the Commission when considering the financial performance of PAPL is not its absolute level of profitability at any point in time, but whether PAPL is setting prices excessively above the efficient cost of production for the element of its business in which it is assessed as having market power, namely aeronautical services. The following points are relevant in this regard:

- Over this fifteen- year period average RoAA was 12.7% whilst the lower and upper bounds averaged 10.1% and 13.8% respectively
- The agreement reached with airlines in 2007 to 'holdover' conditions resulted in most charges remaining constant in nominal terms in the five-year period to 2010; this agreed outcome was partially in recognition of the stronger passenger growth that had been experienced. This, combined with the investments made since 2007, resulted in aeronautical asset returns declining in 2009 and 2010.
- The investments made in aeronautical investments increased Perth Airport's aeronautical asset base by approximately 332% from 2011 to 2018, and a further 50-70% increase is expected by 2025 depending on the outcome of current ongoing negotiations with airlines.
- PAPL's overall returns since it purchased Perth Airport cannot be said to be excessive, having regard to the company's cost of capital. Its aeronautical asset returns since 2003 reflect a period of correction following the exit from the CPI-X period of manifestly inefficiently low prices, followed by a period of strong growth in the lead up to significant new investment.

7. Airline Engagement on Charges and Non- Price Conditions

7.1. Overview

Since the removal of price controls in 2002, there has been an increase in sophistication in commercial relationships between PAPL and its airline customers. Commercial arrangements have progressed from the formal price regulation prior to 2002, through a relatively unsophisticated 'prices and services accord' dialogue commencing in 2002, to far more sophisticated processes from 2007.

During the course of the Commission's last inquiry PAPL and its airline customers entered into a suite of seven-year agreements that underpinned the migration of Virgin Australia to a new Domestic Pier in Terminal 1 and the development of T2, the only dedicated regional terminal at a capital city airport. Alliance, Tiger and VARA (SkyWest at the time) were in the first wave of airlines that relocated from T3 to T2 following its commissioning in 2013. This move allowed these airlines to grow their operations and also released capacity constraints in T3, thereby allowing both Virgin Australia and Qantas to expand their operations. The delivery of capacity to accommodate the needs of airlines is consistent with Perth Airport's recognition that airports are platforms that allow airlines to operate efficiently and compete fairly for the benefit of not only airline customers but for the good of the aviation community as a whole.

In late 2015, Virgin Australia also relocated to Airport Central and commenced operations from T1 (Domestic). T1 (Domestic) is a purpose-built terminal with Virgin Australia having a high degree of input into its design to ensure the product met its requirements and expectations. Following Virgin Australia's relocation to Airport Central, the Qantas Group became the sole major operator in Airport West allowing a further expansion of their operations into T3 and alleviating traffic in T4, which is operated under a lease arrangement until the end of 2018.

In 2017 PAPL entered into an 8-year agreement with Qantas for it to undertake international operations through domestic facility T3. While this development is not the most efficient from the overall airport perspective, Qantas has gained significant operational benefits in the short term until the final stage of terminal consolidation is complete and it can gain similar synergies in the Airport Central precinct.

PAPL has recently executed seven-year agreements with all its domestic airline customers other than Qantas. Negotiations with Qantas are more complicated as they involve issues relating to the surrender of the domestic terminal lease and the migration of Qantas to the Airport Central precinct in around 2025.

PAPL has concluded negotiations with BARA as well as some LCC operators for a short-term hold over agreement until service standards and design for the International Terminal Upgrade have been completed. At the time of writing 9 out of 17 international airlines have executed agreements based on the position agreed by PAPL and BARA with remaining airlines (excluding Qantas) in the process of gaining approvals for execution.

7.2. 2002 Prices and Services Accord

In 2002, PAPL and airlines negotiated agreements of five years' duration that covered a range of price and non-price terms. The negotiation process was held at a time of considerable uncertainty for the aviation industry and PAPL and the airlines had little experience in direct commercial negotiations under the new regulatory regime.

The Prices and Services Accord addressed:

- the services and facilities to be provided by PAPL;

- PAPL's commitment to providing appropriate quality and capacity of services and facilities;
- the proposed capital expenditure program for the term of the agreement;
- the schedule of charges for PAPL's services;
- the obligations of the airlines in relation to use of the facilities and services, charges and consultation;
- the proposed consultation process and information sharing principles; and
- a proposed procedure for dispute resolution.

While effectively determining the prices paid by airlines since 2002, the agreements were not executed by the parties. PAPL negotiated the Prices and Services Accord with major airlines and BARA during 2002 and 2003.

At the same time, PAPL and Virgin Blue negotiated a reasonably extensive 10-year agreement covering Virgin Blue's operations in T3, which became available following the demise of Ansett.

7.3. 2007 Agreed Conditional Holdover

In 2007, towards the end of the Accord period, PAPL and the airlines agreed to a conditional 'holdover' of the prevailing prices and services conditions based on exchange of letters, without finding it necessary to prescribe in detail the basis of the arrangement. PAPL believes this reflected the following factors:

- airlines were being comprehensively consulted on the airport planning that was underway and there was a joint realisation that longer term agreements on prices and services could not sensibly be negotiated until the underpinning capital investment plan was properly defined based on the planning that was underway;
- PAPL was continuing to invest in aeronautical infrastructure and airlines were prepared to see prices being held (and in some cases indexed) while investment was continuing;
- Perth Airport's charges were (and remain) relatively low; and
- given the relatively longer sector length of Perth routes and the mix of travel, Perth Airport's charges represent a relatively lower proportion of airport cost/ticket price.

7.4. 2011 – 2018 Comprehensive Agreements

In 2011 and 2012 PAPL signed comprehensive 7-year agreements with airlines representing more than 97% of passenger movements.

These agreements included tailored processes for dealing with issues that had been, or might in the future be, contentious, and for allocating risk. Given their commercially sensitive nature, PAPL provided the Commission with a summary of typical agreement terms separately on a 'commercial-in confidence' basis during the 2011 Inquiry.

7.5. 2017 – 2018 Negotiation of Comprehensive Agreements

In 2017 PAPL and airlines commenced the process of seeking to agree comprehensive commercial agreements that would be valid from 1 July 2018.

PAPL's approach to the commercial negotiations was to conduct an 'open and transparent' process where high quality, comprehensive and non- sensitive information would be provided to all airlines (and indeed any interested party) through Perth Airport's publicly accessible

website. This would ensure the negotiations were conducted on a 'level playing field' with all airlines, regardless of size or operational footprint at Perth Airport, having access to relevant and non-sensitive data.

Following discussions with airlines in 2017, PAPL engaged with the airlines in three separate stages:

- Data Sharing: information related to pricing was made available online for the airline community to download the data and review it. That information can still be accessed via http://www.perthairport.com.au/Home/corporate/work-with-us/airline-consultation. Information provided included:
    - revised version of the Conditions of Use to operate at Perth Airport;
    - explanation of PAPL's methodology for Aeronautical Pricing, based on the ACCC's building block methodology;
    - a comprehensive indicative 10-year capital expenditure plan (with project by project description / justification, rationale behind the aeronautical allocation and whether projects were being considered in the price calculation or were being presented as 'prospective only' for airline comment and review);
    - 10-year passenger forecasts with supporting explanation;
    - 10-year operational cost forecast, with supporting explanation, assumptions and cost drivers;
    - a detailed assessment of the aeronautical opening asset base used to determine the aeronautical charges, including information on additions, depreciation, indexation, reallocation of assets between aeronautical and non-aeronautical and a split between the former indicative capital plan, unplanned capital and overruns;
    - information on PAPL's approach to the its proposed Weighted Average Cost of Capital (WACC);
    - detailed breakdown of all assumptions; and,
    - the proposed pricing models.
- Consultation: PAPL organised meetings with airlines to gather their feedback on the information provided. During this stage, PAPL provided answers to questions from airlines, provided additional information on each of the documents presented, and reviewed forecasts based on airline input. Similar to standard practices applied in major procurement processes, responses to questions from airlines that had general application were shared with all airlines through publication in the Consultation Website. Prices were shared with airlines only after consultation was completed, and included all reviews based on airline feedback.
- Bilateral discussion: following the consultation stage, PAPL entered into bilateral discussions with airlines and airline representatives.

Airlines showed varying levels of interest in the process and in the data presented. Qantas and Virgin engaged PAPL in a detailed discussion during the bilateral stage, with discussions on the proposed capital expenditure plan, WACC assumptions, operational costs forecast and Opening Asset Base. BARA focused mainly on what the international terminal expansion would deliver to its members and required the development of a framework to monitor service standards being provided at Perth Airport, not only the delivery of capital assets.

Some other airlines engaged in pricing discussions and commercial terms, whereas other airlines demonstrated much less interest in the process.

In February 2018, PAPL provided all airlines a further comprehensive commercial proposal, which updated the position based on planning/design for major projects and negotiations to that date.

This level of detail was provided to allow airlines to review the mechanics of the calculations made by PAPL. It provides a basis for the airlines to challenge assumptions and outcomes and to understand PAPL's position.

Throughout the process, PAPL received a number of requests for additional information. These requests were accommodated and, as noted above, updates were made available to all parties through the Consultation Website.

PAPL has received positive feedback from most airlines on the 'open and transparent' approach, with more than one airline mentioning that the engagement with PAPL was the best they have experienced in Australia. This is a far cry from the behaviour often attributed to Australian Airports by Airlines for Australia and New Zealand (A4ANZ) – an organisation that has had no involvement in PAPL's processes.

As mentioned above, PAPL has executed new agreements with the majority of its airline customers. With the exception of Qantas, PAPL has either executed agreements or reached commercial agreement pending execution with all non-GA airlines operating at Perth Airport covering operations for FY19 or longer. Negotiations continue with Qantas, notwithstanding that since 1 July 2018, there is no underlying contractual agreement for Qantas' operations at T3. The new contracts cover many of the matters included in the agreements that expired this year (these were provided by PAPL to the Commission in the 2011 Inquiry). There are a few exceptions:

- At the request of BARA PAPL has agreed to a new contractual form that enables airlines to achieve greater consistency in these agreements across airports;
- The previous agreements contained a range of operational provisions that interacted with other airport operating documents in a fairly 'clunky' way. PAPL is working with airlines to finalise a new 'Airport Operations Protocol' that addresses these matters; and,
- PAPL is working with airlines to develop an enhanced approach to service delivery. This work is a central part of the International Terminal Upgrade.

As demonstrated above, PAPL has a strong preference for reaching commercial agreement with airlines. Given the open access nature of federally leased airports in Australia and the physical impossibility of preventing an aircraft from landing it is necessary to compliment bilateral agreements with a Conditions of Use framework.

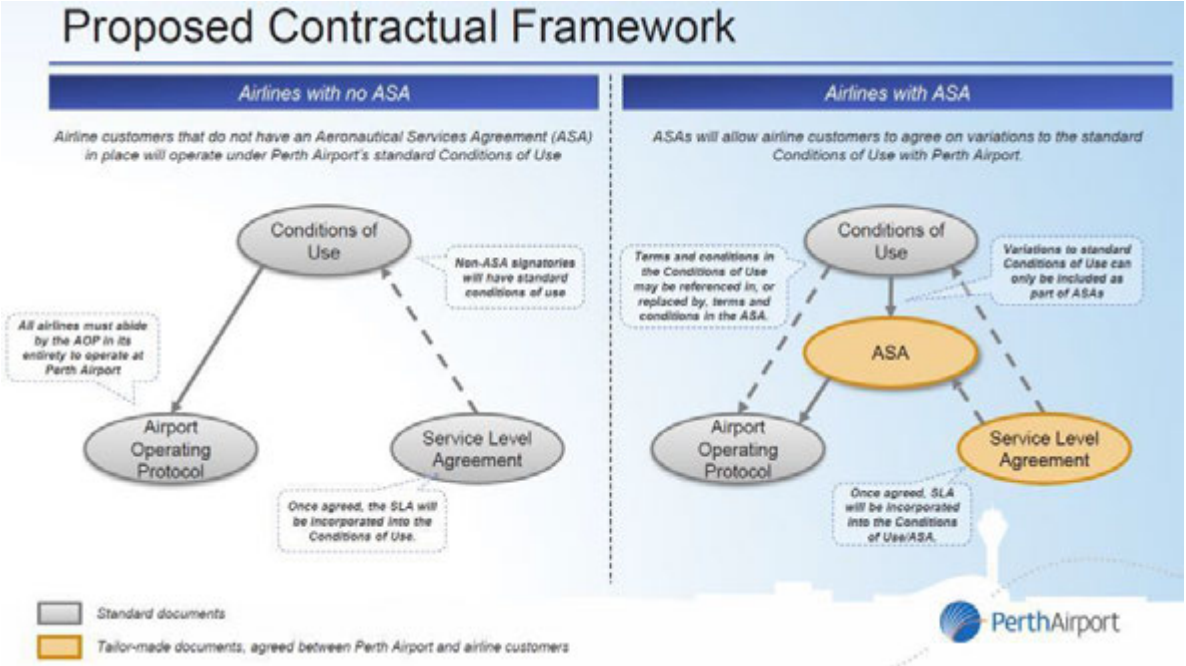
In circumstances where no agreement with an airline is established, PAPL's published 'Conditions of Use' and 'Schedule of Charges' will apply. These circumstances may include infrequent users or, in extraordinary circumstances noting PAPL's strong preference to reach commercial agreement, airlines who are out of contract.

The published Conditions of Use and Schedule of Charges will be similar to (but by no means the same) as those arising through negotiated agreements. One important difference is that airlines operating under the Conditions of Use will not have access to incentives to grow volume or operate new routes. That said, airlines operating under the Conditions of Use are always afforded the opportunity to negotiate a comprehensive term agreement at a time of

their choosing.

Figure 32 illustrates the general framework for setting Perth Airport Conditions of Use in parallel with negotiating service agreements with individual airlines.

Figure 32 – General Framework for Setting Perth Airport Conditions of Use



8. Existence and Extent of Market Power in Aeronautical Services

8.1. No Evidence of Misuse of Market Power

Section 6 demonstrates that there is no evidence that PAPL has abused market power in terms of earning excess profits, setting prices above efficient costs (and adversely impacting end consumers), or allowing quality to degrade or operating inefficiently. Section 5 discusses the recent development of, and investment in, new capacity demonstrating that PAPL has not exercised market power by constraining supply. Section 7 outlines PAPL's approach to contracting with airlines and demonstrates a process of genuine engagement and sharing of detailed information, not behaviour that can be described as 'take it or leave it'.

This section discusses why these outcomes are to be expected.

8.2. A Peculiar Kind of Monopoly

Beyond the traditional considerations referenced above, monopolies - and more broadly firms with substantial market power - are thought to be able to act unilaterally without reference to competitors or customers. Such firms are thought to be able to unilaterally impose terms and conditions of supply on a 'take it or leave it' basis – the 'leave it' meaning if the customer does not accept the imposed terms and conditions then there will be no supply.

As discussed above, airlines do not need to enter into commercial agreements with PAPL and may use the airport on a conditions of use basis. Open access obligations mean that PAPL is unable, except in limited circumstances, to prevent the airline from using the airport.

The airport lease specifically provides for the circumstances where access can be denied for non- payment:

a. where the owner or operator of the aircraft has failed to pay the Lessee (PAPL) within twenty-one (21) days after the due date any amount due to the Lessee by the aircraft owner or operator for the use of the Airport Site; and

b. where the Lessee has notified the Lessor (the Commonwealth) of its intention to refuse access at least fourteen (14) days in advance of the first day on which it intends to refuse access.

If PAPL were to deny access on some other basis, a fundamental breach of the lease may occur and the Commonwealth could take steps to terminate the lease.

To deny access, the 'amount due' would first need to be established by way of court proceedings – such proceedings would be lengthy and expensive and during which time the airline would still have access to the airport. While PAPL has not been involved in such an event, we understand that other airports have experienced persistent part payment of invoices leading to the accumulation of 'amounts due' – none of these cases have yet proceeded to court.

It is clear that whatever market power can be ascertained from an analysis of the underlying economics of markets, the legal framework in Australia means Australian airports possess less market power than those in jurisdictions where statutory rights to charge exist.

8.3. Countervailing Market Power of Airlines

Beyond the legal issues discussed above, PAPL's experience is that the countervailing market power held by airlines limits the market power of an airport in the market for aeronautical services.

Despite the high barriers to entry and low availability of substitutes in the market for aeronautical services at Perth Airport, a combination of the legal issues discussed above and the countervailing market power held by airlines means that PAPL cannot realistically exercise any market power it may have.

Perth Airport serves a relatively small number of airlines with significant countervailing market power. In the domestic market, which consists of five domestic and 11 regional airlines, Qantas (including Jetstar, QantasLink and Network) and Virgin (including Tiger Australia) carry 94% of passengers. Similarly, BARA members (which include Qantas and Virgin) account for approximately 75% of international passenger arrivals in Perth. This concentration of the customer base gives these airlines significant countervailing power.

Perth Airport is also a small airport relative to its major airport peer group, with around 31% of the passenger throughput of Sydney, 37% of Melbourne and 53% of Brisbane; and is significantly smaller than its major airline users in terms of employees and resources. The effect of the pricing outcomes at Perth Airport is of major concern to PAPL, but of less significance to an airline that is operating at many airports.

Moreover, even the smallest airlines are possessed of significant media capacity and political influence as can be witnessed from the coverage and behaviours around Regional Express' access to the airport on King Island. Major airports such as Perth can be subjected to significant pressure through the media and other stakeholder mechanisms as can be seen from matters relating to Qantas' international use of T3.

When investors make sunk complementary investments, they leave themselves open to the threat of 'hold up'. The Commission will be aware of the current issue in this regard at Townsville Airport. In negotiations over the price of the new infrastructure, an airline may be able to 'hold up' the airport by offering an unreasonably low price for the service. This problem is reflected in academic literature on the 'hold up' problem, with the absence of a finalised contract providing the proposed user of the infrastructure the power to deny access to appropriate value for the business making the investment, which in turn 'holds up' the business from making the investment in the first place. As noted by Professor Gomez Ibanez in his book *Regulating Infrastructure: Monopoly, Contracts and Discretion, '…*the expensive, durable and immobile investments make all parties – the company, its customers, and the government – vulnerable to opportunism and desirous of stability and commitment'[8].

This is not just a theoretical nicety. In a recent case about Lufthansa acquiring certain assets owned by Air Berlin, the European Union observed that in the course of its investigations:

> *Another air carrier notes that "a dominant airline has numerous possibilities to use its influence at an airport in order to foreclose the airport for competitors", notably using its negotiating power "this influence to develop the airport's infrastructure even more in its own favour".*[9]

While theoretically PAPL could proceed to commit to major capital investment without having first reached agreements with airlines, in a practical sense PAPL is most unlikely to be able to achieve funding support from equity or debt providers. The relevance of aeronautical revenue risk to PAPL's debt funding and its cost is highlighted by the attention given to the subject by credit ratings agencies in both their assessment of the airports sector generally and PAPL's credit rating specifically. PAPL's confidential submission includes more detail on this subject.

[8] Jose A Gomex-Ibanez (2003) Regulating Infrastructure: Monopoly, Contracts and Discretion, Harvard University Press, p3

[9] Case M.8633 – LUFTHANSA / CERTAIN AIR BERLIN ASSETS Commission decision pursuant to Article 6(1)(b) in conjunction with Article 6(2) of Council Regulation No 139/20041 and Article 57 of the Agreement on the European Economic Area at (172)

It could also be argued that the current strong 'hold out' power of the airlines is transitory as it arises from substantial capital investment that may well not exist in the future. This however ignores the fact that airports are involved in what is effectively a repeated game. In PAPL's case:

- The agreements currently being negotiated are comprehensive and through their various provisions (consultation, informational sharing, disputes resolution, risk sharing) are likely to have profoundly influenced the structure of future agreements;
- Perth Airport's development strategy anticipates the next material capital investments that will be required, including further expansion of the international terminal, a new runway and providing for Qantas to relocate from its current facilities to the consolidated terminal precinct. In these circumstances international airlines, represented by BARA, and Qantas will have strong hold out power. PAPL is currently in discussion with Qantas to agree terms in the lead up to the expiry of its exclusive lease of the Perth Airport T4, which serves to reinforce the strong position it holds in negotiations with PAPL.

While it could be argued that smaller airlines do not have strong countervailing power, in practice this does not result in them being unfairly treated through PAPL abusing market power. The practical outcome is that the larger airline groups do the 'heavy lifting' in the consultation and negotiations process and the outcomes from the negotiations with the larger airline groups (Qantas, BARA and Virgin) tend to flow to the numerous other smaller airlines with minimal variation. In fact, during negotiations two mid-sized airlines described this very approach as their preferred strategy.

The Commission recognised in its 2011 Inquiry Report that the activities of LCCs had reduced airport market power – as discussed in section 4.4 this is particularly the case for PAPL's international business. This is an acknowledgement in part that the business decisions being made are being based on a very different notion of substitution to the one discussed above. LCCs, and increasingly full-service carriers, view substitution at the route level, not the airport level. PAPL's market power is much less when the decision is being made to fly from Kuala Lumpur to Hanoi as opposed to Perth to Bali as compared with 'I need an airport in Perth'.

Even full-service carriers, often seen as 'national carriers', are starting to exhibit such behaviours – from April 2013 until December 2015 Qantas ceased all but one international service (to Singapore) from Perth Airport. Also, in May 2016 Virgin ceased to operate international services to Bali and Phuket from Perth Airport. If an airline doesn't need to fly to a particular airport but can simply take its aircraft to another route, then that airport has significantly diminished market power. Whether this is an example of countervailing market power or a failure in the understanding on substitutes in competition analysis is a moot point.

8.4. Some Forms of Market Power Abuse May Not Be Profit Maximising

Airlines and the ACCC often point to high margins as evidence of market power abuse. In reality these margins are a reflection of the capital-intensive nature of the industry. High margins also mean that the marginal cost of servicing the incremental passenger, aircraft movement or airline is low relative to the revenue that would be received. In the presence of surplus capacity, this would suggest pursuing additional traffic is a maximising strategy and explains, at least in part, the propensity of Australian airports to offer significant incentives for new traffic and volumes – incentives which would not occur under revenue capping regulations such as that found in the National Electricity Law.

These incentives are reinforced by the operation of the dual till. Revenues from ground

transport and retail services effectively increase margins and create a further substantial incentive for PAPL to act to increase passenger numbers passing through Perth Airport.

8.5. Summarising Market Power Considerations

PAPL submits that a useful way to summarise the relevant market power considerations as they relate to Perth Airport is as follows:

Table 9 – Summary of Market Power Considerations

The Issue	The Question	The Answer for Perth Airport (PA)
Market Structure	In theory, does PAPL have market power?	Yes, the absence of substitutes and barriers to entry are key issues.
Incentive	In practice, would you do it?	No, PAPL has strong incentives to maximise throughput and efficiency and has nothing to gain and much to lose if it were to provide high cost, low quality services, or to constrain growth
Capacity	In practice, could you do it?	No, evidence shows airlines at PAPL have strong countervailing power arising from the scale of their business presence and their capacity to hold out. The legal framework in which PAPL operates prevents it from imposing outcomes
Conduct	In practice, have you done it?	No, all conduct has reinforced the points made above in relation to incentive and capacity

9. Current and Future Regulation

9.1. Costs and Benefits of the Current Monitoring Regime

As discussed above, PAPL believes that whatever market power it has in relation to aeronautical services it provides is limited by legal and market considerations and moreover that there is no evidence it has abused what market behaviour it has. The same applies for ground transport access services as discussed in the next section.

That said, unlike its view in 2011, PAPL believes that it is appropriate for the regime to continue and indeed for Inquiries by the Productivity Commission to be held at regular intervals. While it is arguable whether monitoring acts to constrain market power, the monitoring framework supports the potential for the imposition of prices notification if the government of the day so chooses. PAPL also accepts that there is legitimate public interest in disclosure and transparency. Further, a periodic review on policy performance is likely to lead to better outcomes than more narrow rate setting exercises that would occur under some sort of rate setting regime – the costs associated with such regimes are well known to the Commission and need not be recited here.

PAPL estimated in 2011 that its annual compliance cost was around $250,000. We now estimate it to be $300,000. It does need to be kept in mind that the bulk of the financial information provided to the ACCC would in a similar form be required to meet PAPL's reporting obligations under its aviation agreements or to support negotiations.

9.2. There is more to the Regime than Monitoring

Name and Shame

In its 2002 inquiry report, the Commission stated that part of the effect of monitoring of firms pricing behaviour was through moral suasion and publicity.

PAPL currently publishes its airport charges, PAPL's financial results are in its annual report, and Perth Airport's quality of service results have been reported in the ACCC's annual monitoring reports since FY 1997-98.

The publication of data by the ACCC and its expression of opinions as to what that data might suggest are of general community and media interest. Community based investors such as industry superfunds are concerned with such commentary as part of their corporate social responsibility frameworks. But beyond this, these are issues for airports in the communities in which they operate and they also impact airport relationships with other stakeholders, most notably politicians and state and territory governments.

However, the conduct of the ACCC must change. The current Chairman, and his predecessor, continue to make false claims unsupported by the data and analysis contained in their own reports. For example, at the time of the release of the 2016/17 monitoring report the Chairman claimed that higher airport charges have led to higher airfares. The report contained no data on airfares and the facts are, as the Commission is well aware, international airfares have been falling and, until recently, so have domestic fares. Analysis presented by ourselves and the AAA demonstrates there is a very weak relationship between airfares and airport charges.

There are a Range of Mechanisms Available to Resolve Disputes

The Treasurer at the stroke of a pen, without any administrative process, can under Part VIIA of the Competition and Consumer Act order a pricing inquiry, require further, more intrusive, monitoring and impose restrictions and review of pricing via the price notification regime. With the exception of regional air services at Sydney Airport not one of these options has been exercised since heavy price control measures were lifted and light-handed regulation commenced.

Part IIIA of the Competition and Consumer Act 2010 establishes a regime to facilitate third-party access to the services of nationally significant infrastructure. The regime is designed to provide for access where commercial negotiations fail to provide for access or fail to agree terms and conditions for access.

An airline can seek access to airport services under Part IIIA through application to the National Competition Council. On satisfaction of criteria specified in the Act, the Minister may declare access to the relevant services. A declaration provides a right to negotiate the terms and conditions of access, with resort to arbitration of the terms and conditions of access if the parties cannot reach agreement.

In principle, voluntary access undertakings under Part IIIA could widen the feasible set of dispute resolution options available, especially to airports seeking to develop new facilities in the face of airline intransigence. That said, the observed history of regulators' conduct stymies the incentive for their use. Melbourne and Perth Airports commenced the process of giving access undertaking shortly after privatisation but reached a point where the conduct of the ACCC led them to the view the undertakings were not worth pursuing. Having considered the contents and operation of access undertakings that have been accepted by the ACCC and state based regulators, and the processes involved in having them accepted, PAPL has formed the view that these undertakings would represent such an intrusion into their business that they could not justify the benefits that would flow to them.

As discussed above airlines have significant legal capacity to resist pricing proposals from airports and can continue to use the airport until such time as commercial matters are resolved. It then becomes a matter for the airport to choose, on a commercial basis, whether it wishes to initiate proceedings to resolve the matter.

Both domestic and international carriers have access to a range of public messaging channels to advance their causes, including an increasingly sophisticated use of social media channels. Airlines also have significant advertising and marketing budgets to position their brand in the public arena. Qantas, for example, has invested heavily over a number of years to position itself as 'the spirit of Australia'.

It is unarguable that because of this advertising and marketing expenditure, airline brands enjoy a far higher profile than that of airports. This, in turn, gives the airlines significant influence and power in any dispute with an airport. Airlines can and do use their brand recognition to influence outcomes through both media channels and extensive government lobbying as evidenced in recent disputes between airlines and airports.

9.3. Reform of the Monitoring Regime

PAPL supports the continuation of the monitoring of aeronautical services although, as discussed in the next section, PAPL believes monitoring of ground access services constitutes an unnecessary regulatory burden and should be discontinued.

PAPL expects during the course of this inquiry concerns will be raised regarding the quality of service airlines receive from airports. PAPL's recent experience in negotiating with its airline customers is that the data that the ACCC collects and publishes bears little relationship to the matters that are front-of-mind with airlines.

PAPL is strongly supportive of the development of a greater services orientation in its planning, development and aeronautical contracting activities. However, given the outcomes desired and potentially achievable will vary from airport to airport, PAPL doubts the monitoring framework, in the form of publishing annual statistics, can contribute to these outcomes. As such, if the Commission considers quality is an issue requiring policy intervention, we would encourage it to consider doing so via the development of principles against which airport performance could be judged at the next review. If such an approach was adopted, the current airline monitoring framework could be allowed to lapse.

PAPL see no pressing matters for reform of passenger quality monitoring or the financial monitoring framework.

9.4. Arbitration Proposals

In every airports inquiry the Commission has formed the view that an airport specific access regime was not required and may even be undesirable. It formed a similar view in its 2001 review of the National Access regime. On the issue in its 2013 review of the National Access Regime, it reiterated its view from the 2012 airports inquiry that an industry specific regime would undermine the current light-handed approach to the regulation of airports.

PAPL continues to support the previous views of the Commission on the basis that sufficient alternatives to dispute resolution exist today. As was the case around the time of the Commission's 2011 inquiry, PAPL has successfully concluded agreements with all its airline customers with the exception of the Qantas Group. As noted above, there are a range of options for parties to resolve disputes, a number of which remain untested. In the absence of any apparent abuse of market power by airports and strong countervailing market power held by airlines, PAPL struggles to see a valid public policy case for the creation of another dispute resolution when it has not been demonstrated that current options are ineffective.

Evidence of disputes from time to time and lengthy negotiations is not evidence in support of arbitration. In a negotiation involving major investments and complex subjects it is to be expected that negotiations will be lengthy and robust. What is important however, is that there is a strong incentive for each party to work through the issues of contention to reach a commercial outcome. PAPL is concerned that the introduction of arbitration without a gatekeeping process would diminish that incentive.

In the absence of arbitration, the parties have strong incentives to negotiate in good faith to achieve commercial outcomes. Providing an easy arbitration process would likely undermine the incentive to negotiate in good faith. For PAPL, which is currently considerably advanced in complex negotiations with many airlines, it is difficult to contemplate how a prescribed arbitration process could function without resulting in material delay. The complexity of seeking to negotiate on a wide range of price and non-price terms with up to 28 airline entities, many in varying degrees of competition with each other, should not be underestimated. To then make

the outcomes of such negotiations subject to easy arbitration will remove incentives for the most powerful airlines to act in good faith.

In submissions to the Commission's last inquiry the ACCC proposed 'deemed declaration' under Part IIIA. In other words, parties would have access to the arbitration framework contained in Part IIIA without having to make out the associated declaration criteria. The Commission observed:

> "*it is not so long since combative airlines and airports focused on getting the best regulated outcome. Having moved to commercially focussed negotiations with at least some form of constructive engagement, it would seem retrograde to allow a reintroduction of heavy-handed regulation that could displace commercial negotiations and encourage gaming."*[10]

It must be said that arbitration under Part IIIA looks very much like heavy handed price control with an added layer of heavy non-price terms and conditions. This can be seen from the ARTC access undertaking which the ACCC sets using the same principles.

The prospect of one or more of those airlines feeling aggrieved at some point about some of the outcomes relative to their competitors is quite high. The grievance could relate to the nature of the capital program, price and access to infrastructure, among other subjects. If one or more airlines seek arbitration on any of these matters it becomes difficult to settle *any* agreements because of the inter-relationship between agreements that is necessary in relation to issues such as access. Also, airlines that have not sought arbitration could be expected to adopt a wait and see approach for fear that their competitor might achieve a better outcome via arbitration.

A4ANZ has suggested a final offer arbitration model[11]. On the basis of information available at the time of writing, this proposal seems to involve airlines being able to gain access to arbitration without a 'gate keeper' process along the lines of the declaration processes contained in Part IIIA – what seems to be different to the ACCC's proposal of 2011 is that there is a different style of arbitration to that set out in Part IIIA.

As PAPL understands it, the arbitral process would be that the airport and the aggrieved airline would submit their final position to the ACCC which would choose one of the parties' positions. A4ANZ has not indicated the criteria which the arbitrator would be required to use – we know what they are in Part IIIA. What would be subject to arbitration? How would the arbitrator deal with disputes about the nature of an airport's capital plan designed to provide capacity to increase competition or an airport's view as to how it is to meet its aviation security obligations?

We assume A4ANZ will provide more detail during the course of this inquiry but regardless, PAPL shares the efficiency concerns expressed by the ACCC in the 2001 National Access Regime Inquiry:

> *'even if the pricing principles offered precise guidance, if there was information asymmetry between the parties to the arbitration the risk that divergent offers would be made, and an inefficient price set, would remain high. There would also be a risk, if pricing was divorced from an understanding of the revenue requirements of a business, that the regulator may choose a price with the potential to bankrupt an access provider*[12]

But the threshold question remains why a dispute resolution arrangement is required. The

[10] PC 2011, p.203

[11] A4ANZ (2018)

[12] Productivity Commission (2001, p216)

Commission's analysis over seventeen years suggests that there must be a serious problem to be solved to justify access to such a regime. No such problems exist at Perth Airport and it is not clear whether they exist elsewhere – disputes between councils and a regional airline, no matter how important to the parties involved, do not form an evidentiary basis for imposing frameworks that could put substantial capital programs designed to deliver a safe and competitive aviation sector at jeopardy.

10. Ground Transport Access and Car Parking

10.1. Overview

The terms of reference for the Inquiry require the Commission to address matters that relate to the provision by airport operators of facilities and services for land transport at airports, including the provision of car parking facilities and services.

In its Issues Paper, the Commission suggests that airports could use their market power to limit the availability or price of access to the airport to increase their car park profitability. Despite the obvious illegality of such actions no prosecutions have ever been launched.

10.2. The Commission's Previous Findings

In 2002, the Commission determined that airports have a low to moderate degree of market power in provision of car parking services, but greater market power for vehicle access, including front door access to the airport for passengers, transport providers and off-airport car parking providers[13].

> *Overall, airports appear unlikely to have significant market power in long-term car parking. The market power of airports in car parking is likely to be higher for short-term and possibly staff parking, but there also are factors mitigating the extent of market power in these facilities. For example, because many of the users of short-term car parks tend not to be passengers, alternatives to using the car park are available.*
>
> *To the extent that airports have market power in car parking, it is likely to be constrained as long as landside access for competing operators (of other travel modes, such as taxis, and competing off-site parking services) is available on reasonable terms and conditions.*

The Commission reaffirmed these findings in the 2006 inquiry:

> *While airports have some market power in setting [car parking] charges, that power is constrained by the availability of off-airport parking, and by other options for travelling to and from airports. A comparison of car parking charges at the monitored airports with those at central city locations where a premium is also paid for parking convenience, suggests that these constraints have been influential[14].*

The Commission concluded that car parking and other 'landside vehicle services' should no longer be subject to prices oversight [15]

In 2011 the Commission observed in relation to car parking and ground access 'there is no evidence of misuse of market power by the five monitored airports'[16] . Despite this, the Commission recommended to the Government that monitoring continue.

Perth Airport has commissioned leading economics consultancy Houston Kemp to undertake a market power study of ground access and car parking arrangements at Perth Airport. Their report, which is attached to this submission, provides an extensive description of ground access and car parking arrangements at Perth Airport.

---

[13] Productivity Commission (2002), pp xxv, xxvi)

[14] Productivity Commission (2006, pxxvi)

[15] Productivity Commission (2006, p99)

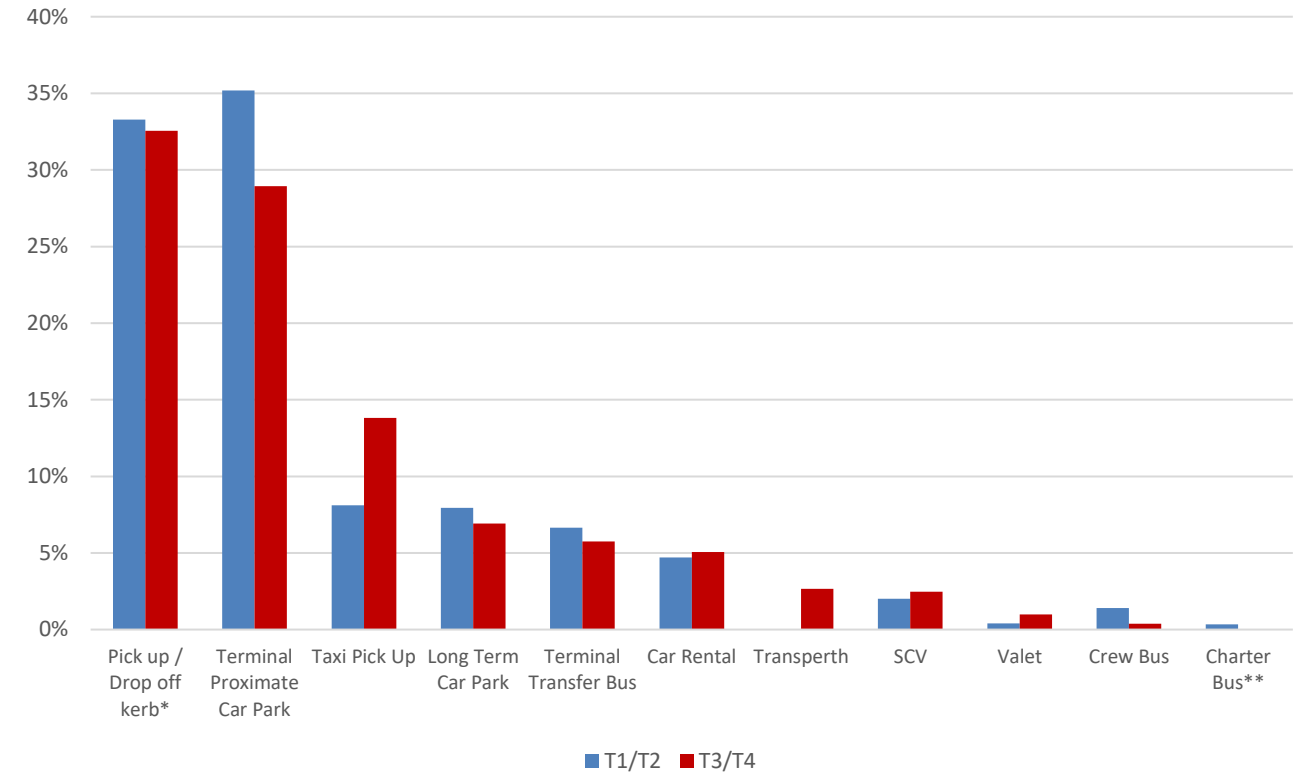
[16] Productivity Commission (2011, p251)

10.3. Access to Perth Airport

Figure 33 shows the estimated proportion of the various Perth Airport access modes, highlighting the following key points:

- Approximately 40% of Perth Airport passengers use transport options that do not generate revenue for PAPL.
- Approximately 31% of passengers use Perth Airport's car parking products.
- To increase market share, PAPL's car parking products must present a 'value proposition' relative to alternatives that are readily available, particularly pick-up/drop-off, taxis and rideshare services.

Figure 33 – Passenger Mode of Transport to Perth Airport as at May 2015



* Drop-off includes taxi drop-offs **Both pick-up and drop-off

Source: Traffic study undertaken on PAPL's behalf (sample represents 85th%ile day in 2015).

10.4. Perth Parking Context

There are several features of Perth Airport car parking demand that are relevant to understanding Perth Airport's car parking services and when making comparisons to other airports, which are described below.

Perth has historically had a materially higher proportion of people who come to the airport to meet/greet and see off passengers when compared to other large Australian airports. This is understood to be due to the fact that passengers are proceeding on a longer journey and have made more effort to come to Perth, resulting in family and friends being more inclined to greet and farewell, combined with the airport being relatively easy to access by car. As a result, there has been a relatively high demand for one to three-hour parking close to the terminal. This feature is becoming far less pronounced for the following reasons:

- air travel has become more affordable, people are travelling more frequently and so people are less likely to feel obligated to meet and take others to the airport; and,
- PAPL's investment in improved terminal forecourts has made it demonstrably easier to pick- up and drop-off passengers.

Perth has less demand for one to two-day business/corporate parking close to the terminal, compared to Sydney, Brisbane and Melbourne; given the distances, Perth business travellers are typically away for longer than their East Coast equivalents.

There is relatively higher demand for long-term car parking, again reflecting that there are fewer short duration trips. Another substantial contributing factor to the high demand for long-term car parking is the substantial fly-in fly-out market segment that is away from Perth typically from seven to ten days at a time regularly throughout the year.

The fly-in fly-out market for car parking is particularly price sensitive, reflecting that the customers are very frequent users, mostly incur the cost personally and therefore consider transport to and from the airport as an important component of their cost of living. There is also growing competition in this market segment

The strong growth in resident outbound leisure international travel experienced in the last three years has driven growth in demand for international long-term parking.

10.5. Car Park Business Overview

Overall, the following key points are relevant in considering PAPL's car parking business since 2011:

- Revenue has increased by an average of 6% per annum, driven by passenger growth and the improved value proposition offered relative to competitor modes and off-airport car parking providers.
- Operating costs have increased by an average of 12% per annum from FY11 to FY18, reflecting the increased scale of the parking areas and the targeted increases in service levels. From FY16 to FY18 operating costs have remained flat, reflecting sufficient capacity achieved from prior car park construction.
- $30 million of capital expenditure has been undertaken to increase capacity and improve the products.
- The value of the land used for car parking has increased substantially, reflecting the buoyant property markets during the period and the value of the land due to its location in the Perth metropolitan region, particularly its adjacency to transport infrastructure.

10.6. Car Parking Pricing Objectives

As with all elements of its business, PAPL is seeking to grow its car parking business and maximise returns from it. While pricing is a central factor in the overall car parking business, other factors, such as quality and ease of booking online, are important in attracting and retaining customers in an increasingly competitive ground access environment. In some instances, pricing is used as an allocative tool to incentivise customers to shift from one product to another.

The most important consideration for PAPL in setting car park prices is the impact on demand. Research conducted by PAPL shows that many customers compare the cost of parking to the cost of a taxi or a rideshare service and research also shows that many of the users of the

pick- up/drop-off facilities consider car parking to be too expensive. PAPL also monitors the prices of other off-airport car parking providers that target airport customers.

The proportionally higher price of Short Term compared to Long Term is directly related to the demand for proximate to terminal parking, particularly at T1 which has an average peak occupancy of 82%, compared to 50% in the T1/T2 Long Term network.

10.7. Pricing of Car Parking Services

The car park pricing structure for the domestic and international terminals is the same, with the only differences being the availability of Fast Track services at the domestic terminal and the two- hour limit applied to 300 domestic short-term pick-up/drop-off parking bays closest to the terminals.

The tariff structure for car parking provided by PAPL is shown in **Table 10**.

(see over page)

Table 10 – PAPL Car Park Pricing Structure and Trends

Duration	Tariff ($)												
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Short-term													
10minutes	Free	Free	Free	Free	Free	Free	Free	Free	Free	Free	Free	Free	Free
15minutes	Free	Free	Free	Free	Free	Free	Free	Free	Free	Free	5.00	6.00	6.40
30minutes	3.70	3.70	3.70	3.80	3.90	4.00	4.00	4.00	5.00	5.00	5.20	7.40	7.80
1 hour	5.20	5.20	5.20	5.40	5.40	5.60	5.90	6.00	8.00	8.50	9.00	12.60	13.00
2 hours	7.00	7.00	7.00	7.40	7.80	9.00	9.40	10.00	12.00	12.50	13.00	18.00	19.00
3 hours	8.00	8.00	8.00	8.40	8.80	10.00	10.20	12.00	14.00	14.50	15.00	21.00	22.00
4 hours	9.00	9.00	9.00	9.40	9.80	11.00	11.20	14.00	16.00	17.00	17.50	24.00	24.00
5 hours	10.00	10.00	10.00	10.40	10.80	12.00	12.20	16.00	18.00	19.00	19.50	25.60	25.60
6 hours	11.00	11.00	11.00	11.40	11.80	13.00	13.20	18.00	20.00	21.00	21.50	27.00	27.00
7 hours						14.00	14.20	20.00	22.00	23.00	23.50	28.60	28.60
8 hours						15.00	15.20	22.00	24.00	25.00	25.50	30.00	30.00
Daily rate	17.00	17.00	25.00	26.00	35.00	36.00	38.00	38.00	40.00	41.00	45.00	46.50	48.00
Fast Track													
Daily rate			42.00	42.00	45.00	46.00	48.00	50.00	50.00	52.00	57.00	59.50	62.50
Long-term													
1 day	17.00	17.00	17.00	17.00	16.00	16.00	17.00	20.00	20.00	23.00	24.50	25.00	26.00
2 days	34.00	34.00	34.00	34.00	32.00	34.00	35.00	35.00	40.00	46.00	49.00	50.00	52.00
3 days	51.00	51.00	51.00	51.00	48.00	52.00	53.00	55.00	60.00	67.00	71.00	73.00	77.00
+4 days (p/day)	2.00	2.00	5.00	7.00	8.00	9.00	10.00	10.00	11.00	11.00	11.00	11.00	11.00
General aviation													
10minutes						Free	Free	Free	Free	Free	Free	Free	Free
15minutes						Free	Free	Free	Free	Free	5.00	6.00	6.40
30minutes						Free	Free	Free	Free	5.00	5.20	7.40	7.80
1 hour						Free	Free	Free	Free	8.50	9.00	12.60	13.00
2 hours						8.60	9.00	10.00	10.00	12.50	13.00	18.00	19.00
3 hours						8.60	9.00	10.00	12.00	14.50	15.00	21.00	22.00
1 day				7.00		8.60	9.00	10.00	20.00	23.00	24.00	25.00	26.00
+2 days (d/rate)						8.60	9.00	10.00	10.00	10.00	10.00	10.00	10.00
Staff													
Daily rate						4.20	4.45	4.45	4.45	4.95	5.10	5.30	5.60
Monthly rate						76.00	80.35	80.35	80.35	84.50	86.50	89.50	94.60

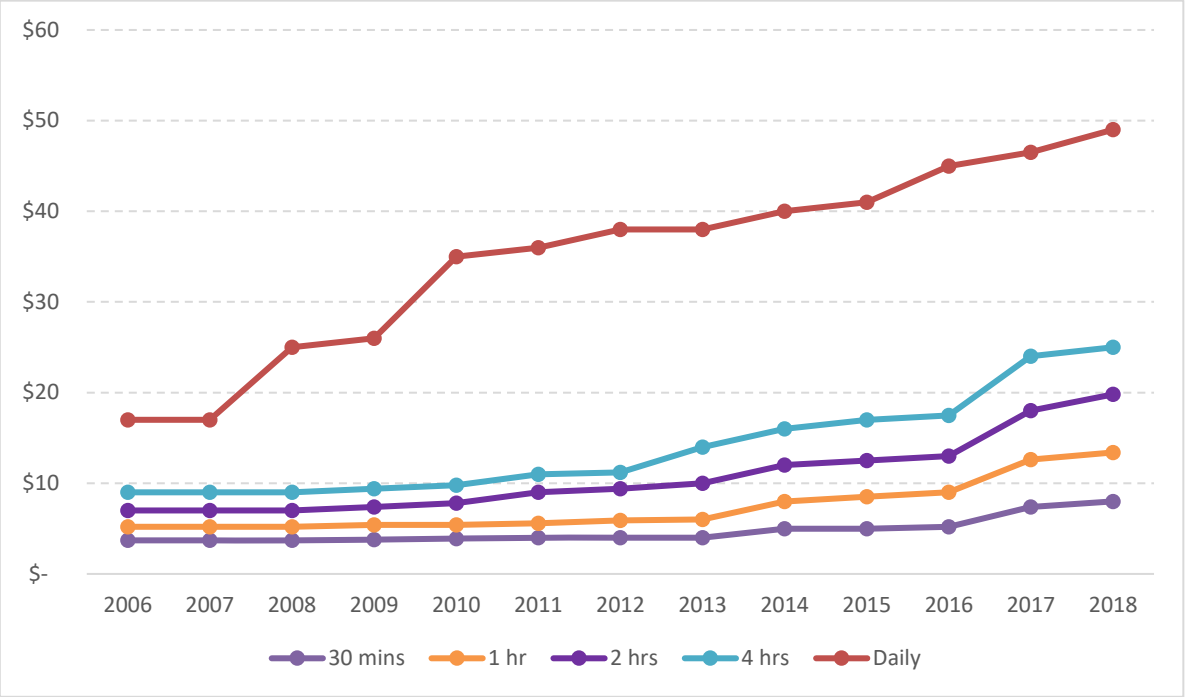
Source: PAPL, effective 01/07/2017

Figure 34 shows that, prior to 2017, Short Term parking prices sub- 24 hours had increased only moderately since 2006. An increase to these prices was made in 2017 to reflect the significant investment into car park expansion and infrastructure upgrades in both T1 and T2 Short Term. It was also identified these prices were significantly undervalued when compared to the local market and other airports.

The increases to 24-hour Short Term prices reflect the increased demand for proximate to terminal parking, and identifying that these passengers were consuming significant car park capacity near the terminal for extended periods.

Parking for 10 minutes or less is for no charge, and PAPL actively encourages customers to use this facility, including for pick-up and drop-off to ease pressure on front of terminal roads.

Figure 34 – Short-Term Parking Rates, 2006 – 2018



Source: PAPL, effective 1/07/2017

The pricing of Perth's long-term car parking is very attractive and reflects PAPL's strategy of seeking to attract customers from other transport modes. The increasing popularity of the long-term product reflects its strong value proposition relative to its competitors, noting:

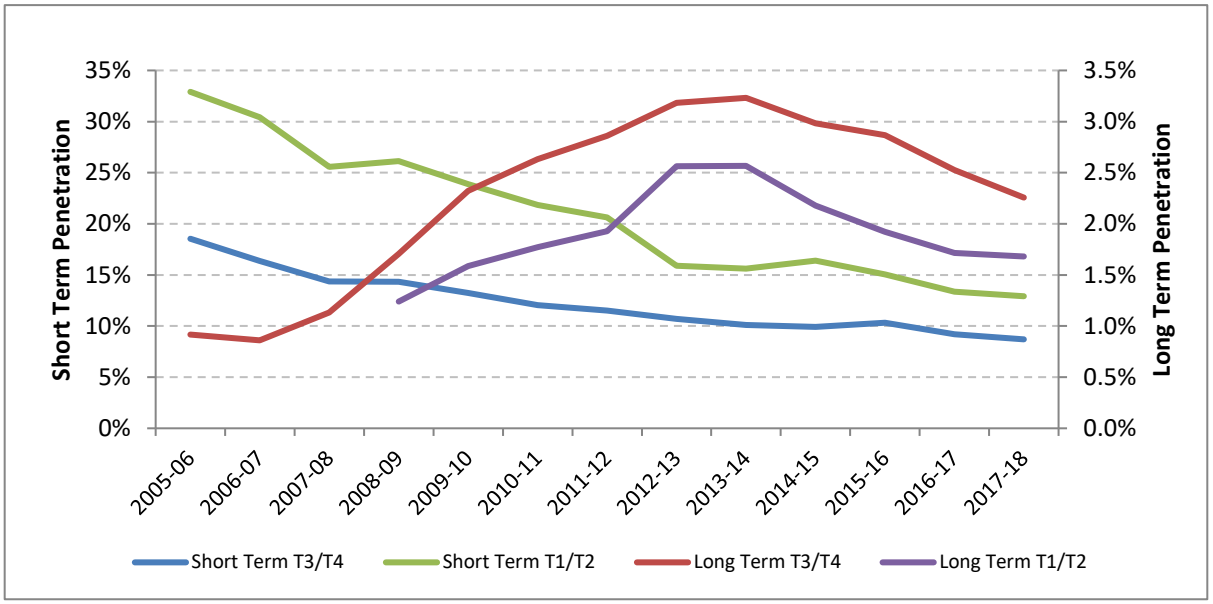
- one-day parking in the long-term car park costs $26 with a free shuttle to the terminal front with a maximum wait time of 10 minutes; and
- an average daily price of $17.71 for seven days parking.

The long-term parking +4 day rate increased from $9 per day in 2009 to $11 per day in 2018, reflecting CPI increases. At the same time as this increase has occurred:

- capacity has increased and it exceeds demand;
- pre-booked penetration (parking transactions per passenger) has increased; and
- investments have been made to substantially improve the quality of the product.

Figure 35 shows the change in penetration of each car parking product. It shows clearly that short-term car parking is experiencing a long-term decline in penetration while there has been a decline in the penetration by long-term products since the peak of the resources boom. This is further evidence of the lack of market power possessed by PAPL's car park business.

Figure 35 – Short and Long-Term Penetration



Source: PAPL, effective 30/06/2018

10.8. Investment in Car Park Capacity

PAPL has set a service standard planning parameter (related to ease of finding a car park) that sees construction of additional capacity triggered when the car parks reach 80 to 85% utilisation on the busiest day of the year.

PAPL has made significant investments in car parking capacity at Perth Airport over the last five years. In the period 2011-2018, PAPL invested $30.43 million creating 10,698 new car bays, a 65% increase on 2010 capacity. These investments are described in **Table 11.**

(see over page)

Table 11 – PAPL Car Park Expansion 2011 – 2018

Date	Parking type	Investment
December 2011	T3/T4 taxi	New taxi holding area – 220 bays
April 2012	T3/T4 long-term	Upgrade 800 bays
April 2012	T3/T4 long-term	400 new bays
May 2012	T3/T4 long-term	Upgrade 943 bays
April 2012	T1/T2 taxi	New taxi holding area – 200 bays
December 2012	T1/T2 long-term	1,637 new bays
November 2013	T2 Short Term	232 new bays
December 2013	T1/T2 Long Term	850 new bays (Long Term J)
June 2014	T1/T2 Long Term	936 new bays (Long Term J)
April 2015	T2 Short Term	204 new bays (expansion)
April 2015	T1/T2 Long Term	1,691 new bays
September 2015	T1 Short Term	1,295 new bays (expansion)
September 2015	T1/T2 Long Term	1,290 new bays (Long Term H expansion)

10.9. Existence and Abuse of Market Power

Houston Kemp has considered the extent to which PAPL:

- has the ability to sustain revenues that exceed significantly the underlying economic cost of its car parking services, with this assessment being undertaken by reference to the competitive constraints faced by PAPL from:
    - off-airport car parking facilities; and
    - other modes of transport, such as pick-up and drop-off, taxi, rideshare and public transport options; and
- whether PAPL has exercised that market power by successfully engaging in at least one of the following forms of conduct, namely:
    - increasing car parking or landside access charges to levels that exceed the underlying economic cost of providing the relevant services (including the opportunity cost of land);
    - reducing the quality of its car parking or landside access services without a corresponding reduction in prices; and/or
    - restricting unduly its competitors' access to the airport.

Houston Kemp's analysis which is **Appendix 2** to this submission, shows that PAPL does not have substantial market power in car parking services. There are several factors that strongly support this. There are at least seven 'off-airport' car parking providers in close proximity to the terminals, and which offer a door-to-door service for passengers. These operators provide an alternative to parking at the airport for people wishing to leave their car for one day or more, namely:

- the prices offered by these operators are generally similar to the prices charged by PAPL's long term parking facilities; and

- most offer high quality parking services such as undercover parking, optional extras such as car cleaning packages, and convenient online booking arrangements, although there are also some disadvantages of these off-airport alternatives.

Second, for all visitors to Perth Airport, there are a number of other transport options over a wide spectrum of price points, such as drop-off and pick-up, taxi, rideshare, bus – and a train option is currently under construction.

Third, PAPL has a strong incentive to maximise total visitor traffic, regardless of how the visitors arrive, given the small proportion of total PAPL revenue that parking represents, some 11.6 per cent. PAPL can therefore be expected to seek to maximise patronage of the airport (and the range of commercial opportunities such visitors present), rather than car parking revenue.

Further, Houston Kemp finds notwithstanding that PAPL does not hold substantial market power, several factors suggest there is no evidence that any form of market power has been exercised. Although prices for car parking have risen over the past five years, the prices charged can be explained by:

- increased costs associated with operational and capital expenditure over the period – noting that the capital expenditure required to increase capacity for car parking at Perth Airport has been significant; and
- locational rents associated with the high value of land proximate to the airport terminals.

Further there is no evidence of PAPL restricting access, or that quality standards have dropped for car parking at Perth Airport.

None of these factors are suggestive of a firm seeking to exercise its market power by charging excessive prices, reducing quality or hindering access. This is unsurprising in light of the earlier observation that PAPL is unlikely to possess substantial market power.

Whilst Houston Kemp finds PAPL is likely to hold substantial market power in relation to landside access charges, since there is no alternative means for accessing its terminals other than through the airport's facilities, there is no evidence that PAPL has exercised this market power, given that:

- unlike other airports, PAPL does not charge access fees to private vehicles, hotel shuttles, tourist buses, coaches, public buses or other similar operators;
- off-airport car parking operators, the closest competitor to PAPL's own (long term) car parking facilities, are also exempt from the charges;
- PAPL chooses to locate facilities for a variety of no-to-low yielding access modes – such as private vehicle pick-up and drop-off, and taxi ranks and supporting holding areas – on high value land located proximate to terminals, thereby prioritising the efficient movement of passengers and vehicles over higher commercial returns that could otherwise be generated from this land, and over locating PAPL's own car parking facilities closest to terminal; and
- to manage peak demand and alleviate congestion for access modes like private vehicle pick- up and drop-off, PAPL provides free parking options in its short term and long-term parking facilities, prioritising quality for customers and the efficient movement of passengers and vehicles over the potential commercial returns from these assets.

In its 2011 Inquiry report the Commission noted that despite not being able to substantiate claims made by the ACCC in relation to conduct of Brisbane and Melbourne Airport, the question whether to continue car park and ground access monitoring was 'finely balanced' because of the vertical integration of car parking and ground access and the desirability of maintaining a database to assist the ACCC identify any misuse of market power [17].

PAPL accepts the existence of vertical integration, however the Houston Kemp analysis shows there has been no abuse of market power and explains why one could reasonably expect that to remain the case.

Should PAPL exercise market power in the way suggested by the ACCC in the 2011 Inquiry, its behaviour would not go undetected – consumers would complain and there would be aggrieved competitors – the matter would become a public controversy that would inevitably come to the ACCC's attention. PAPL would by its own admission be a firm with market power in the provision of ground access services. It would be acting in a way that would damage competition in the market for car parking. In other words, it would be acting in a way proscribed by section 46 of the *Competition and Consumer Act 2010 (Cth).* The ACCC would then have available to it the extensive powers of information gathering set out in section 155 of that Act which would open up access to information far broader than what might be obtained under any monitoring regime.

The monitoring of ground access arrangements is an unnecessary regulatory burden and should come to an end – the competition law is more than adequate to deal with the sort of abuse that is of concern in this case.

The monitoring database for Perth Airport, and also Melbourne and Brisbane, now has 20 years of history, a little less for Sydney. This is the fourth time the Commission has brought its mind to these questions and PAPL is confident that it will again find no abuse of market power. Despite annual protestations from the ACCC about abuse of market power in car parking (the inadequacy of the ACCC's margins-based approach is discussed in the Houston Kemp report) it has not in twenty years publicly recommended to the Australian Government that it should undertake a formal prices inquiry under Part VIIA of the *Competition and Consumer Act 2010 (Cth).*

PAPL's car park prices, and those of its numerous competitors, are publicly available and increasingly available to consumers through smart devices. Consumers gain no benefit from the collection of monitoring data. All relevant information is stored electronically and could be acquired by the ACCC during a pricing inquiry under Part VIIA or in an enforcement action.

The current regulations requiring the ACCC to monitor Perth Airport car park pricing, financial performance and service quality should be discontinued as they serve no purpose and therefore constitute an unnecessary regulatory burden.

10.10. Car Rental Operations

Demand for car rental services at Perth Airport is satisfied by a combination of on and off airport operators.

Perth Airport provides on airport operators with infrastructure and facilities that allow them to conduct their business close to terminals, providing choice and convenience for passengers. Facilities include desks, signage and counters in the terminal buildings, pre-booking access via the PAPL website and proximate to terminal customer pick up bays and customer service

[17] Productivity Commission (2011, p291)

booths.

On airport car rental customers can walk to collect their vehicle having pre- booked or arranged their vehicle in the arrivals area of the terminal and enjoy high levels of service and amenity.

Perth Airport forgoes both car parking revenue and terminal retail income to facilitate these services as part of its commitment to provide a wide range of transport options for passengers. Car rental operators benefit from increased demand as a result of their easy access to terminals.

Off airport operators are based further away and are not located on airport land. Their customers do not receive the benefit of in terminal desks, rental staff or proximate convenient vehicle pick up and drop off.

These operators transfer their customers by bus to their facility and conduct transactions away from the airport. These operators are not currently charged to access the airport to pick up or drop off their passengers.

This choice for consumers between higher convenience and lower price allows them to select the best deal from a range of operators based on their individual priorities. Perth Airport is currently working with a few off-airport sub brand operators to facilitate their future operations on airport land.

Perth Airport has six on airport car rental operators present at each terminal. These operators were selected through a competitive tender process during 2014-15 that included both RFI and RFP stages.

A competitive bid mechanism for licensed space was utilised allowing operators to offer premium location bids to secure the most prominent terminal counter and ready bay position. This mechanism ensured PAPL allocated terminal counters and ready bays in an economically efficient manner and allowed smaller operators to compete for premium positions which were traditionally allocated to operators with majority market share.

These agreements expire at the end of 2018-19 and agreements for a new term will be sought. It is likely that the competitive process outlined above will be again be utilised.

Recovery fees imposed by car rental operators upon customers are locational fees not imposed by airports. PAPL understands they are generally higher than fees outlined in commercial agreements with the airport.

11. Land Transport Linkages

11.1. Overview

The Airports Act (1996) requires airports to include ground transport plans in their Master Plans. Perth Airport's Master Plan can be accessed on its website [18]. The Master Plan represents the mutual understanding of the airport, Commonwealth, state and local governments regarding the development of land transport linkages surrounding the airport. These have become increasingly complex given population growth to the east of the airport and the ongoing industrial development of Kewdale and adjoining areas.

Three major developments in land transport linkages have occurred since the Commission's last Inquiry, details of which are provided below along with a discussion of the impact that the new runway project will have on access to the airport from the eastern side. It is fair to say that with the completion of the projects discussed below, Perth Airport is of the view that the land transport infrastructure needed to support consolidation of all commercial air services into the Airport Central precinct will be in place and the remaining challenge will be to ensure adequate services are provided to match growing levels of demand over time.

PAPL enjoys a good working relationship with the relevant state agencies responsible for urban infrastructure in Perth as well as the Commonwealth agencies responsible for the planning and environmental regulation of the airport, and for exercising the Commonwealth's rights as the owner of the airport. This is not to say that there are not disagreements, especially in relation to the bearing of risk in relation to major construction projects but where these have arisen they have been resolved to the satisfaction of the relevant parties.

11.2. Gateway WA

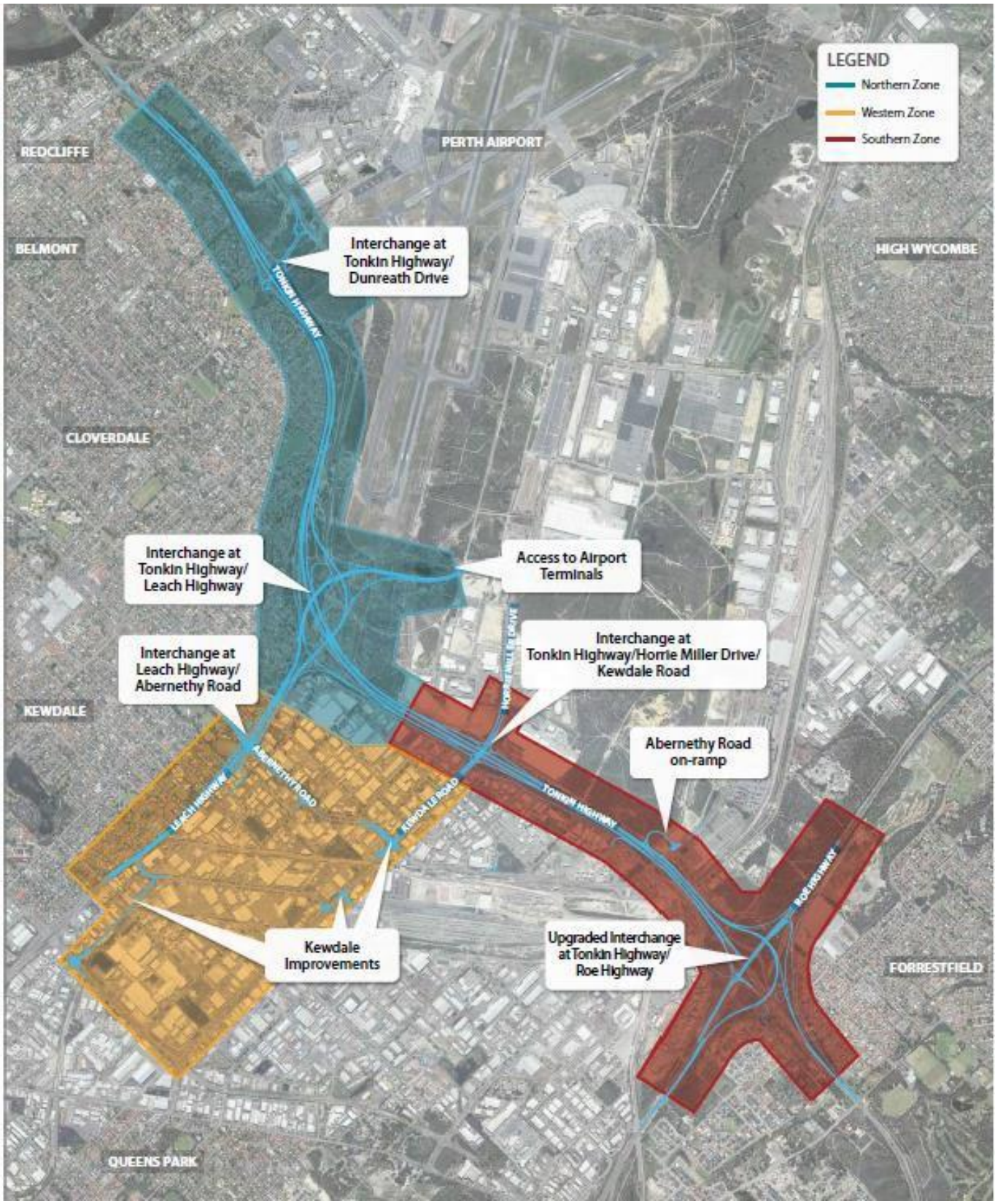
The Gateway WA Perth Airport and Freight Access Project (Gateway WA), was a $1 billion project to upgrade the road network around Perth Airport. The largest project ever undertaken by Main Roads WA, the project involved upgrades of Tonkin, Leach and Roe Highways and the construction of four new interchanges.

In coordination with the Gateway WA project, Perth Airport undertook redevelopment works which included construction of a new airport access road, Airport Drive to Airport Central (T1 and T2 terminals), allowing for separation of airport passenger traffic from freight traffic in the Kewdale Industrial Area. The portion of Airport Drive in the vicinity of its interchange with Leach and Tonkin Highways was constructed as part of Gateway WA, with the remainder – the majority of the road – part of the Perth Airport redevelopment.

To facilitate the project, Perth Airport provided almost 40 hectares of land to allow the Tonkin Highway to be widened and realigned, constructed Airport Drive at a cost of $34 million and contributed $10.3 million towards the cost of providing a new access into the Airport West Terminal precinct.

[18] https://www.perthairport.com.au/Home/corporate/planning-and-projects/master-plan-downloads

Figure 36 – Gateway WA Perth Airport and Freight Access Project



11.3. Great Eastern Highway

Although not passing through the airport, Great Eastern Highway is one of the main arterial roads linking Perth Airport to the CBD and western suburbs.

In 2011 works commenced on a significant upgrade of a 4.2km stretch of the Great Eastern Highway between Rivervale and Tonkin Highway. The works involved widening the highway from 4 to 6 lanes and upgrading all major intersections along the 4.2km stretch. Other modification such as construction of a central median strip, enhancement of pedestrian and cyclist facilities and construction of bus priority lanes were also undertaken.

The works were complete in 2013 at a cost of $280m.

The upgrade significantly improved traffic flow and reduced travel time for the main route between the Perth CBD and Perth Airport.

11.4. Forrestfield Airport Link

The Forrestfield-Airport Link is a rail development project currently under construction that will provide Perth Airport customers an additional convenient method of transport to the airport [19]. The project was approved in August 2014, with construction starting in late 2016. The $1.86 billion cost is jointly funded by the Commonwealth and Western Australian governments. Three new stations will be built as part of the Forrestfield-Airport Link, with the Airport Central station to be built on site at Perth Airport. It will be located adjacent to Terminals 1 and 2, the site of the proposed consolidated terminal for domestic and international travel.

Construction on the Airport central station began in May 2017, and the line is expected to open in 2020. By the following year, the line is predicted to generate 20,000 passenger trips on the train network each day, and this is forecast to increase to 29,000 passenger trips per day by 2031. The new link extends past Perth Airport to Forrestfield, providing a vital link to Perth's eastern suburbs. It will also connect an increased number of regional bus services to the airport, including access from over 200 regional towns in Western Australia.

Passengers on the train will have an 18-minute journey to Perth CBD from airport central for the cost of a 2-zone train fare, currently $4.70. Trains are scheduled to run up to every 15 minutes at off-peak times, and every ten minutes at peak times. This will offer Perth Airport customers an additional and cost-effective means of transportation between Perth Airport, Perth CBD and the greater Western Australia region.

Perth Airport has facilitated the project by providing land for the Airport Central Station and for the tunnels beneath the airport. Perth Airport has also worked with the relevant Commonwealth Government agencies to gain approvals for construction of the project beneath airport infrastructure.

An elevated walkway connecting the Terminal 1 forecourt with the Airport Central station will is to be constructed at a total estimated cost of $31 million, of which the WA Public Transport Authority will contribute $22.4m.

[19] See the Forrestfield-Airport Link website, https://www.forrestfieldairportlink.wa.gov.au/

Figure 37 – Forrestfield Airport Link map

11.5. Land Transport Impacts of New Runway

The new runway will require the re-closure of Grogan Road, which was previously closed to through traffic between1987 and 2005.

A transport study showed that currently up to 60 per cent of the traffic on Grogan Road during peak periods is non-airport traffic using the road as a shortcut. Initial planning considered Grogan Road being replaced by a tunnel beneath the new runway. During design work the cost for the tunnel was estimated to be in the order of $240m. This significant cost was driven by the requirements of the tunnel such as fire safety elements, monitoring and response capabilities, and the length and distance below the runway that the infrastructure needed to be for safety and aviation security.

Simulation modelling for future traffic volumes also showed that the external road network performed to a similar level with or without the tunnel constructed. The construction of a tunnel to serve the low volume of airport related traffic could not be justified.

The re-closure of Grogan Road will result in a change of access to Terminals 1 and 2 and access to the firms in Airport Central. Alternative routes to T1 and T2 will be via the Roe and Tonkin Highways.

The Forrestfield Airport Rail tunnels, whilst not running directly beneath the new runway construction, have been designed to allow for the loading from the fill required to achieve the runway levels and any aircraft using the runway.

12. Jet Fuel Supply

The cost of aviation fuel is one of, if not the largest single component influencing the price of airfares. The Board of Airline Representatives of Australia (BARA) estimates that the cost of jet fuel often represents more than 40% of operating expenses for international airlines operating to and from Australia[20].

In the Australian context, the supply and cost of jet fuel is highly sensitive in Perth and throughout regional Western Australia. Western Australia shares the tyranny of long distances that define international aviation for all of Australia. This also defines Western Australia's inter- and intra-state aviation.

Given the concentrated nature of the jet fuel market in Australia, the interests of airports, airlines and the travelling public are aligned in seeking to remove any restrictive supply arrangements currently in place and to improve fuel security. It is imperative that airports, to the extent possible, facilitate a fuel supply chain that delivers the lowest possible cost for our airline customers and the travelling public.

Perth Airport considers that the following core principles should apply to the jet fuel supply chain in order to deliver that outcome:

- Truly open access that encourages entry of more competitors;
- De-coupling of tenure and entry requirements from infrastructure, operatorship and lease arrangements.
- Security of supply, which should include multiple modes of fuel delivery and adequate on-airport storage to mitigate the risk of supply disruption;
- Adequate control of on-airport infrastructure by the airport such that it can manage future investment decisions in conjunction with its airline customers; and,
- Management of on-airport infrastructure by a committee that includes representation from the airport authority, the operator of the facilities, airlines and fuel suppliers.

12.1. Current Model – Perth Airport

As with many of Australia's major airports, Perth Airport is encumbered with legacy fuel supply arrangements that do not provide the level of transparency, access or control that is required to ensure the market for the supply of jet fuel at the airport operates freely. The current structure also does not provide appropriate levels of supply security or redundancy to manage a supply disruption.

At Perth, jet fuel is refined and stored at the BP facility in Kwinana. From Kwinana, the jet fuel is delivered (via a BP owned pipeline) to another BP facility in Kewdale, and from there it is delivered (using another BP owned pipeline) to the storage facility at the airport. BP also holds the current lease/license agreement for the land on which the on-airport infrastructure sits. The actual on-airport infrastructure, including the storage facility, hydrant system and cross-airport pipeline (connecting the storage facility to the hydrant systems servicing Terminals 3 and 4) is in turn owned under joint venture arrangements between BP and Viva Energy.

[20] Board of Airline Representatives Australia, December 2014, 'A Competitive Supply of Jet Fuel at Australia's Major Airports', p4

Figure 38: Jet Fuel Supply Chain Representation – Perth Airport

There are a number of concerns with the current supply chain:

- At present, the only delivery method for transporting jet fuel into the on-airport facilities is via the BP owned pipelines from Kwinana to Kewdale and then to the airport. In light of concerns around the remaining design life of sections of these pipelines, this represents a potential single point of failure in the supply chain. That risk is further heightened due to the lack of transparency over the pipelines' current condition, maintenance, upgrade or replacement plans or emergency processes that apply in the event of a failure;
- The current supply chain is constrained by the throughput capacity of the Kewdale to airport pipeline and on-airport storage capacity, which is less than 50% of that recommended by the International Air Transport Association (IATA). As a result of these constraints, there is not adequate protection against major supply disruptions such as that recently experienced at Auckland Airport. Further, the supply chain is not sufficiently equipped to cater for growth in aircraft traffic, as experienced during the mining boom and the MH370 search in 2014 when the supply chain reached effective capacity;
- Perth Airport understands that fuel suppliers who wish to supply fuel to the airport are required to join the Joint Venture and in doing so make a capital investment in the on-airport infrastructure.
- Required capital investment in on-airport infrastructure is subject to constraints associated with the commercial relationship between the Airport, BP (as Lessor and operator) and the Joint Venture as asset owner. New capital investment in on-airport infrastructure necessarily occurs in advance of any increase in throughput meaning there is little return on the capital investment.
- There is currently no formal avenue for the airport authority and its airline customers to have input into the management of on-airport infrastructure (maintenance requirements, expansion decisions and so on); and,
- Empirical evidence suggests that fuel prices at Perth Airport are materially higher than what would be expected in a normal marketplace, under a truly open access supply chain.

12.2. Preferred Model

PAPL is currently planning the relocation of the existing JUHI storage facility as the current location has been earmarked to be used for apron and terminal expansions under the Perth Airport Master Plan. As part of that project, the opportunity exists for the airport to achieve strategic change in the fuel supply model, including:

- Construction of a storage facility such that fuel could be delivered to the airport via multiple modes, thereby reducing dependency on the Kwinana to Kewdale pipeline and mitigating the risk of a single point of failure;
- Increasing the amount of on-airport storage to meet IATA standards and assist in mitigating the risk of supply disruption;
- Increased control of on-airport infrastructure (storage, hydrants and pipelines) by the airport authority to ensure that, in conjunction with its airline customers, PAPL has appropriate control over future investment decisions; and,
- Establishment of a formal Fuel Asset Management Group (FAMG), with representation from PAPL, airlines, the operator of the facilities and fuel suppliers, to ensure that all relevant stakeholders are involved in management of this critical infrastructure.

12.3. Perth Airport's Position in the Market Place for Jet Fuel

The trading of jet fuel occurs directly between the airlines and the fuel suppliers. Whilst Perth Airport fully understands the constraints that current JUHI JV models place on the effective operation of the fuel market, Perth Airport is concerned that it does not have any visibility into or effective control over that marketplace. It should be recognised that the airlines however, through their purchasing power, can provide significant impetus to the changes desired by the industry.

Thus, whilst the airlines require support from the airport in regard to the commercial frameworks around access to on-airport assets, the simple act of providing improved access to those assets does not guarantee change. Even in the circumstance that Perth Airport is successful in achieving those goals stated above, it cannot provide any certainty into future improvement of the jet fuel marketplace.

In their policy document published in December 2014, BARA proposed that one potential mechanism for opening up competition in this market would be for airport operators to procure off-airport storage facilities and provide use of them on a fair and open basis to any jet fuel suppliers interested in using them[21]

While the procurement, development or management of off-airport infrastructure is not currently part of PAPL's plan, we do expect that the new model outlined above will establish a truly open access environment that facilitates the creation of alternate supply chains. It will also address jet fuel supply chain reliability and the security of its supply – a matter that is currently being reviewed by the Commonwealth government[22]. This review will be concluded by the end of 2018. However, if airlines are not willing to use their market power to support the on-airport shift, or to support the investment in off-airport assets required for multiple supply chains, then the best efforts of the airport in changing the on-airport paradigm may fail to achieve the objectives.

The lack of competition in the jet fuel market in Australia was also an issue highlighted as

[21] Ibid, p8

[22] Hon Josh Frydenberg, Minister for the Environment and Energy, 7 May 2017, 'Fuel Security Review' media release

needing further consideration and work by government in the final report of the Competition Policy Review in March 2015:

'Competition in jet fuel supply… should be a focus of further reform efforts in the sector. [23]

With increased production of jet fuel in the Asia-Pacific region, and the barriers currently faced by globally recognised jet fuel providers seeking to enter the Australian market, the time for reform is right even if the pathway towards achieving that reform may not be obvious or easily reached.

Both BARA and the AAA, with PAPL's support, acknowledge that reforming Australia's jet fuel supply chain will be no easy task. However, increased competition in the supply of jet fuel will contribute towards the growth and maintenance of a strong aviation sector in Australia, and assist with the delivery of affordable airfares and lower airfreight costs, both of which are important considerations in Western Australia.

- End of Document –

[23] Australian Government Competition Policy Review, March 2015, Final Report – Part 3, Competition Policy, p206