

ECONOMIC REGULATION OF AIRPORTS

SUPPLEMENTARY SUBMISSION

TO THE PRODUCTIVITY COMMISSION INQUIRY

DECEMBER 2018

PREFACE

The overall objective of A4ANZ's submissions to the Productivity Commission (PC)'s Inquiry into the Economic Regulation of Airports (the Inquiry) is to contribute to an informed debate on what constitutes effective policy in this area; focusing attention on the minimum change required to create a regulatory environment that facilitates commercial negotiations and ultimately delivers better outcomes for consumers and society.

We have set out this supplementary submission so that it again addresses the key areas of the Inquiry, with a focus on ensuring that claims made in other submissions are balanced by facts. The airports, their representative body, the Australian Airports Association (AAA), and airport investors, presented a case for maintaining the status quo; arguing that there is no problem and that change will bring instability. These propositions are based on a number of unsubstantiated, and in some cases, false statements made to the PC, summarised in a Fact Check (see next page).

A4ANZ understands the natural hesitancy around change but it must not stop us properly examining genuine alternatives to the current system. It is important that claims are challenged with facts, and are not given equal weight when considered against evidence. In other submissions to the PC, a range of experts and airport users provided evidence to show the impact of Australian airports' monopoly powers, which cannot be ignored. Further detail is available in our [original submission](#), as well as those of other airport users, to which we have referred. Having now analysed all the submissions, we are satisfied that the options we have presented meet the needs of stakeholders, but most importantly, the Australian consumer. We note the concerns raised about change and have made genuine attempts to address them, acknowledging the PC's appeal for evidence to support claims; our response is supported by both international evidence and expert analysis.

Sensible policy cannot rely on guidelines and goodwill alone. What is needed is to comprehensively address the issue of airport monopolies and market power, through a regulatory environment that encourages innovation and efficiency. As our original submission shows, a vibrant aviation sector is good for both consumers and the economy.

ABOUT AIRLINES FOR AUSTRALIA & NEW ZEALAND

A4ANZ is an industry group, established in 2017 to represent airlines based in Australia and New Zealand, including: Air New Zealand, QANTAS, Virgin Australia, Regional Express (REX), Jetstar and Tigerair. Member-funded and representing international, domestic, regional, full service and low-cost carriers, A4ANZ advocates on key public policy issues relevant to airline operations, including efficient access to domestic airport infrastructure.

The A4ANZ Board identified at the time of the organisation's formation that one of its highest priority issues was ensuring that the regulatory and pricing environment for monopoly airports:

- Encourages competition and innovation;
- More accurately reflects cost inputs;
- Accurately reflects a reasonable and fair return on assets;
- Keeps growth at reasonable not exponential rates;
- Supports investment and maintenance of infrastructure that is fit for purpose, efficient and timely; and
- Maintains accessible airfares for consumers across all areas of Australia and New Zealand.

AUSTRALIA'S AIRPORTS

MYTHS vs FACTS

Australia's airports are monopolies and behave as such. With no incentive to charge reasonable prices, their profits have continued to grow over time, with the ACCC's price-monitoring regime powerless to control this. The impact is felt by every Australian airport user, but especially consumers. The airports say the system is working fine and doesn't need to change. This is just one of the many myths in submissions to the Productivity Commission that must be dispelled.

MYTH:

The threat of regulation constrains airports' profitability and exercise of market power.¹

FACT:

Analysts describe our region's airports as having unregulated revenue, with free rein on pricing.²

This has allowed Australian airports to earn margins more than double the international average.^{3,4}



MYTH:

Airport charges have risen only moderately, and high levels of airport profitability have abated since 2011.⁵



FACT:

Airports have been independently assessed as earning "supernormal profits" since 2011.⁶ **Revenue per passenger has risen 25% in a decade.**⁷ Operating profits/passenger in 2017 place Australian airports well above global comparators.⁸

REVENUE:



MYTH:

Airports have not exercised market power in non-aeronautical areas.⁵

FACT:

9 of the top 10 most expensive airports in the world for rental car operators are in Australia, more expensive than Heathrow, LAX and Paris CDG.⁹



MYTH:

Airports' market power is neutralised by airlines being able to change routes if they object to contract terms.⁵

FACT:

Destination substitution isn't a realistic option¹² for Australian travellers.

Network airlines are not in a position to readily withdraw from routes.¹³



MYTH:

Changing the regulatory regime is unnecessary and risky.¹⁰

FACT:

Regulatory reform is needed to generate **\$18 billion** in economic benefits, including:

- **\$5.9B consumer surplus**
- **\$10.9B GDP benefit**
- **7000 jobs**
- **\$819M travel time savings**
- **\$480M boost to tourism.**¹¹

MYTH:

Airport charges only account for **4-8%** of an airline ticket price.⁵

FACT:

Evidence presented by airports shows that charges can actually be **>20%** of the ticket.¹⁴ **They make up the single largest cost to Australian airlines on some domestic routes (>30%),** but account for a much smaller proportion in the EU and US.¹⁵

MYTH:

Quality standards at Australian airports have improved.⁵

FACT:

ACCC data show no increase in quality at any monitored airport since 2015.⁷



MYTH:

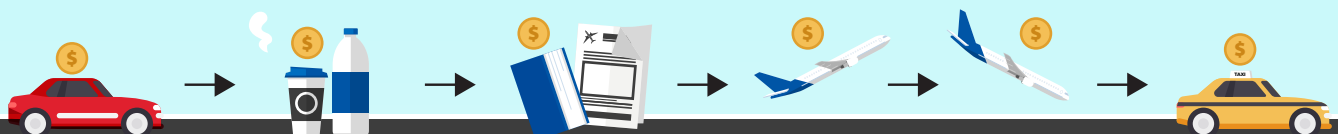
There is no evidence that airports make excessive profits on car parking.⁵

FACT:

Airports can earn a profit of over 70 cents from every dollar consumers spend on parking.⁷



Consumers are paying the price of monopoly airports at every stage of their journey



References:

1. Houston Kemp 2018
2. UBS, Morgan Stanley 2018
3. Leigh Fisher 2017
4. Frontier Economics 2018
5. Australian Airports Association 2018
6. Grattan Institute 2017
7. ACCC 2018
8. Department of Infrastructure, Regional Development and Cities 2018
9. Australian Finance Industry Association 2018
10. Australian Airports Investor Group 2018
11. Frontier Economics 2018
12. Copenhagen Economics 2012
13. Norton White 2018
14. Melbourne Airport 2018
15. Qantas 2018

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IS THERE REALLY A PROBLEM WITH AUSTRALIA'S AIRPORTS?

Under the current regulatory settings, airports have been able to earn profits that have been objectively assessed as excessive, and exert market power over airport users, both aeronautical and landside.¹ This is indeed a problem, for consumers and the economy as a whole.

In this section, we present further evidence to address the argument that change to Australia's regulatory system for airports is not required. Specifically, we address the erroneous claims regarding airport profitability and the impact of charges on airport users and consumers.

Scale of profitability and growth

A4ANZ's position has never been, nor will ever be that Australian airports should not be profitable; a prosperous aviation sector is good for the economy and for consumers. However, A4ANZ believes that the excessive profits earned by Australian airports shouldn't be at the expense of further advancements in quality and innovation in the sector, nor at the expense of Australian travellers.

While the AAA's submission to the Productivity Commission claims that airport charges have risen only moderately, and high levels of airport profitability have abated since 2011², this does not marry with the available data. Successive ACCC Monitoring Reports document the steady rise in charges per passenger³, and a 2017 report from the Grattan Institute^a describes airport earnings over that same period in the following way: *"Nearly half of returns earned by airport operators were super-normal profits^b, on average, from 2010-11 to 2015-16."*⁴

Presented in support of the AAA's claims was a report from HoustonKemp, in which they argue that while the airports may be assumed to have some market power, they do not exercise it.⁵ The empirical analysis supporting this finding is based on comparing a series of returns on aeronautical assets, contained in the ACCC's airport monitoring data, with an estimate of a reasonable return on capital for the airports. While Frontier Economics have previously undertaken a profitability analysis of the four monitored airports, we asked them to repeat this using the WACC estimates from the HoustonKemp report. This analysis is presented in **Appendix A**.

It is worth noting that while there is agreement between Frontier and HoustonKemp on aspects of the appropriate approach to assessing whether airports are exercising market power; that is, that it requires a comparison of some measure of return against the opportunity costs of capital invested in the airport's operation, the outcomes and interpretation of the analysis differ.

Both Frontier and HoustonKemp's analyses rely on the ACCC's monitoring data as a key input and for consistency and comparability, Frontier have adopted HoustonKemp's estimates of WACC. There are, however, two key points of difference in the approaches they have taken.

^a We note that Perth Airport sought an amendment to the Grattan Institute's original report, and accordingly, we have ensured we used the revised text in the quote above. We further note, however, that the revision does not change their characterisation of the airport profits as super-normal. Both documents are available on the Productivity Commission Inquiry page: <https://www.pc.gov.au/inquiries/current/airports-2019/submissions#initial>

^b "Super-normal" profit is defined as extra profit above that level of normal profit, that is, the excess profit a firm makes above the minimum return necessary to keep a firm in business

Firstly, Frontier consider returns across the airport, rather than restricting analysis to aeronautical services. Frontier's approach correctly accounts for market power that is held by airports in non-aeronautical services and avoids arbitrary cost allocations that reduce returns attributed to aeronautical services.

Secondly, Frontier estimate excess returns using several methods, including the most theoretically appropriate measure of excess returns – the internal rate of return, or (equivalently) the net present value. This analysis uses cash flow data and opening and closing asset values. Frontier have also cross-checked these results against other measures including return on capital employed, assets and equity, and margins.

In all cases, Frontier found the monitored airports have persistently earned returns above the cost of capital, while margins are the highest in a broad international sample. Frontier have also estimated the present dollar value of the excess returns accruing to the owners – noting that the dollar value of the overcharging to airport users (including both airlines and other users) is large. In NPV terms in years of the sales, the excess return is more than \$3 billion. Taking into account the time value of money and bringing the value of excess returns to 2017 dollars shows the likely value of excess return at around \$7 billion.

While HoustonKemp reached the conclusion that airports are not exercising their market power, Frontier's analysis of the same profitability data clearly leads to a different conclusion: that there is in fact strong evidence that the major Australian airports *do* exercise their market power. While Houston Kemp objected to what they described as *"the increasing strength of Frontier's conclusions on airport market power"*, it is perhaps salient to note that Frontier's conclusions are consistent with those made not only by the ACCC in its most recent Monitoring Report⁶, but the Grattan Institute⁷, the International Air Transport Association (IATA)⁸ and independent expert submissions to the Productivity Commission's Inquiry.⁹

Australian airports outperform their global peers on profitability

While Frontier's benchmark returns for the measures described above come from estimates of the airports' cost of funds, another benchmark that can be used is the returns earned by airports that are subject to either competition, or effective regulation.

It is important to consider the basis for making comparisons as, while international benchmarking studies can provide some useful information on comparative airport performance, the studies are generally orientated to operational (technical) efficiency and not designed for the purpose of identifying the use of market power. In the InterVISTAS report produced for the AAA, for example, the "peer airports" in fact have significantly different characteristics to the Australian comparator airport – with the only similarity generally being the total number of passengers.¹⁰

Given the unique characteristics of Australian airports - the high proportion of domestic travel, type of ownership, connectivity network, and variable hub characteristics - it is difficult to find appropriate international airports for meaningful comparison; they are in fact more likely to match other Australian airports. Attempts to assess efficiency or performance against international airports may therefore produce flawed results to be interpreted with caution.

Frontier undertook an international comparison of margins, as a cross-check on their main results. Airports that were selected for comparison purposes were chosen on the basis that they are constrained in some way; by competition, regulation, or ownership structure. This comparison indicates that all of the monitored Australian airports have average EBITDA margins well above the average margin calculated across the sample of

comparator airports. Sydney earns the highest margin of any airport in Frontier's sample (more than 8 of every 10 dollars earned contributes to profits), and the other airports analysed are all in the top 6.

It is apparent from these data that:

- average EBIT margins at all the Australian monitored airports, at between 60-64 per cent are extraordinarily high by international standards (average 29 per cent). Only Auckland – another airport subject only to price monitoring – has margins comparable to the Australian airports.
- claims from airports that the high EBITDA margins are due to by comparatively high capital investment¹¹ cannot be justified when we see that EBIT margins are also relatively high. Sydney Airport's higher relative depreciation charges narrow the gap with other Australian airports, but still leave its margins the highest in the comparator set.

Frontier posit that these comparisons provide further support for the conclusion that the earnings of the Australian airports are consistent with the exercise of market power. Frontier's full analysis is available at **Appendix A**.

Australian airport charges some of highest in the world

The above findings are consistent with analysis undertaken by McKinsey for IATA, referred to in their submission to the PC, in which they cite Australia's regulatory model as the reason our monitored airports perform so much better than global peers, noting: *"[This analysis] shows the disparity between Australian airports and other airports analysed in terms of regulatory oversight. It is clear that the lack of effective regulatory intervention has allowed the four Australian airports in this sample to continue increasing prices without adequate safeguards."*¹²

Despite this, the AAA and various airports have allocated significant space in their submissions and public commentary attempting to demonstrate that airport charges only account for very small proportion of an airline ticket price, and that the relationship between airport charges and airfares is tenuous.¹³ This has been done by using a significant number of assumptions (as noted by *InterVISTAS*)¹⁴, and through cherry-picking data from both domestic and international airfares to suit the particular narrative.

While there is indeed variability in the proportion of airport charges in a single ticket across airports, carriers, routes, and fare types, what is consistently clear is the economic evidence which demonstrates that, as a whole, airport charges make up a significant proportion of Australian airlines' overall costs.^{15,16}

Furthermore, this proportion is significantly more than that spent by carriers in the United States or the European Union¹⁷, with evidence presented in the AAA's own submission, demonstrating the disproportionately high percentage of overall airline costs attributable to airport charges in Australia, up to twice as much as in the EU.¹⁸

This is of course an issue not only for Australian airlines but international airlines seeking to land in Australia, as A4ANZ highlighted in our original submission, and was also noted by the Board of Airline Representatives Australia (BARA).^{19,20} In 2015, AirAsia Chief Executive Tony Fernandes noted that *"When you put Australian airport charges and taxes against the world, it is probably one of the highest in the world."*²¹

Attempting to minimise the impact of high and growing airport charges by selectively referencing individual ticket contributions misses the major point, well described in a recent report by CEG, commissioned by Airlines

for Europe and IATA, investigating airport charges in Europe. The authors note that competition between airlines has led to improvements in the affordability of and access to air travel, enabling people to travel more readily to visit family and friends, and supporting businesses in connecting with suppliers and customers.

However, these gains in affordability will be limited in future or even reversed if excessive airport charges are able to continue.²² As the CEG report notes, *“a commercially operated airport that faces no competitive constraint can be expected to set its charges at the monopoly level so as to maximise overall profits.”* Clearly, Australian airports are doing just that, and there is nothing compelling in the airports’ and AAA’s submissions to the PC to challenge this.

Claims that airports routinely offer discounts to airline customers as evidence that all is not what it seems with pricing²³, should be read with caution. The CEG report notes that monopolists can in fact maximise their profits through setting customer-specific prices. Furthermore, they make the salient point that *“a discount offered on an already inflated level of airport charges may not be sufficient to lead to actual charges being in line with competitive levels.”*²⁴

A brief scan of the submissions to the Inquiry makes it clear that experience with high charges and dissatisfaction with the current situation for airport regulation in Australia go beyond the airlines. The following section builds on our initial submission to highlight the subsequent evidence of airports exercising their market power over other airport users; who shared anecdotes strikingly similar to the experiences of the airlines.

IS IT JUST THE AIRLINES COMPLAINING?

Consumers, rental car operators, taxis and retailers all face high charges at airports, well in excess of what they pay in other settings. Yet submissions from groups other than the airlines appear to have been ignored by the AAA, who appear intent on creating the myth that the public and indeed policy-makers should view this as little more than a stoush between airlines and airports. Clearly, consumers do not accept this.

The consumer experience at airports is perhaps best depicted in a humorous tweet from earlier this year which attracted more than 375,000 likes. While it was written by an American, it has now been retweeted many times internationally, suggesting that the description is a highly relatable one.

The airport is a lawless place. 7am?
Drink a beer. Tired? Sleep on the floor.
Hungry? Chips now cost \$17

24/5/18, 2:05 am

87.7K Retweets 376K Likes

That travellers are stung by high prices and limited services at some airports around the world is not new. What is worth serious consideration in this Inquiry, however, is the *additional* hits Australian travellers are expected to take compared to their overseas counterparts. When unconstrained monopoly airports can – and do – apply the same principles to *all* their customers, without a realistic avenue for recourse, it is the consumer who ultimately pays.

Landside impact of market power

In their original submissions to the Inquiry, the AAA and several airports claim that Australian airports have not exercised market power in landside access.²⁵ Specifically, the AAA notes analysis undertaken by HoustonKemp which argues that there is no demonstration of substantial market power in the provision of car parking services.²⁶ From this, the AAA conclude that there is no basis for further ACCC monitoring of car park services at the airports, claiming that it represents an unnecessary regulatory burden; and ask the PC to recommend its abolition.

While the ACCC themselves note that the current monitoring regime does not provide an effective constraint on airports' market power,²⁷ removal of the regime without an appropriate regulatory framework in place, would leave consumers even more exposed. The Consumer Action Law Centre has noted that the cost of airport carparking is tantamount to price-gouging, and that regulatory oversight remains necessary; stating that airports providing the ACCC with information regarding car parking should not be a regulatory burden if airports are doing the right thing.²⁸

Under the current regime, the effect of an airport's unconstrained monopoly power on landside access is, to an extent, demonstrated in the ACCC's annual Airport Monitoring Reports. The 2016-17 Report noted that landside access revenue at each of the monitored airports increased in real terms – with profit margins for car parking remaining very high across all airports; up to \$27 profit per vehicle.²⁹

While the ACCC report does note that consumers can generally access cheaper (40% on average) parking at off-airport car parking at a distance from the terminals,³⁰ the operators of off-airport car parks are negatively impacted by an airport's monopoly behaviour too. The Andrew's Airport Parking Group, for example, cited examples of some airports continuing to increase access charges, while withholding or delaying information, and with disappointing levels of consultation.³¹

For other landside customers, the AAA again refer to HoustonKemp reports in arguing that airports have not exercised substantial market power in relation to landside access charges.³² The submission by the Australian Finance Industry Association (AFIA), however, paints an altogether different picture to these assertions. The AFIA, on behalf of its rental car operator members, provided data highlighting the fact that 9 out of the top 10 most expensive airports in the world for rental car operators are in Australia – more expensive than Heathrow, LAX or Paris-CDG.³³ Their submission also shows that in Australia, rental car companies are in some cases charged up to three to seven times more to operate at airports compared with city locations.³⁴

Airports exercising market power is not a new experience for taxi operators, either, as evidenced in the submission from the Essential Services Commission (ESC). The ESC describes a situation in which airports can unilaterally increase access fees for taxi operators; with Melbourne Airport imposing almost a three-fold increase in rank access fees over a two-year period.³⁵ This example provides yet another indication of the exercise of market power: a monopoly airport's ability to unilaterally increase fees, without the provision of transparent information.

Finally, and perhaps most significantly, the exercise of monopoly powers is even present when an airport's customer is the Government, and by default, the taxpayer. Recent reports document a dispute between the owners of Darwin Airport and federal border agencies over customs and security services, which has seen the Government face rent demands in what they have described as "an unprecedented lease agreement."³⁶

The effect of the exercise of airport market power all in of the cases outlined above ultimately flows to the consumer, and the Government is justified in demanding a system which serves Australians better.

ARE QUALITY SERVICE STANDARDS IMPROVING?

Arguably, Australian airports should be among the best in the world, given the high airport charges and levels of profitability. A reasonable assumption to make as charges have climbed higher is that quality service standards would make improvements commensurate with these increases. However, quality standards at Australian airports have *not* been improving over time, despite claims to the contrary.³⁷

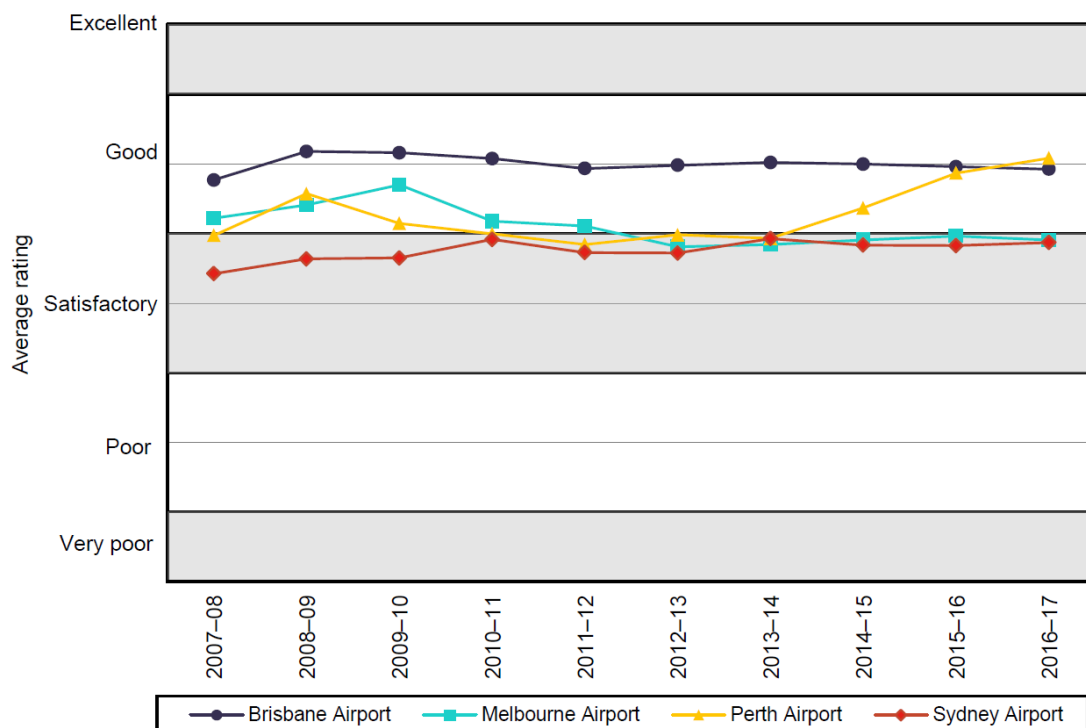
There is a disconnect between Australian airport charges and quality, which has been noted not only by the ACCC and domestic airlines, but also by international carriers. As a China Eastern Airlines spokesman recently said, “*Australian airports – especially the larger airports – continue to increase their charges, but offer deteriorating services to both the Chinese airlines and the inbound Chinese visitors*”.³⁸

Quality standards at Australian airports have stagnated

A threat-based regulatory model is indeed based on the theory that the existence of a threat is enough to constrain monopoly operators from exploiting their market power. However, in order for it to work effectively, there must be a credible threat.

Rather than selectively using one specific metric, we looked at the ACCC’s single overall quality of service rating. This overall rating covers aeronautical, car parking and some landside operations, and represents the average score that the airport achieved across the measures based on airline surveys, passenger surveys and objective indicators. The ACCC analysis makes clear that, with the exception of Perth Airport, quality service levels have not improved overall in a decade.³⁹ And the two largest airports, Melbourne and Sydney, only rate as “satisfactory”, as this graph from the ACCC’s latest report shows.

ACCC: Overall quality of service rating: 2007–08 to 2016–17



Source: Airline surveys, passenger surveys, and objective indicators.

IATA's submission to the PC reminds us, from their global vantage point, that we ought not to be surprised by this situation in Australia. Our monitoring regime does not allow for the ACCC to do much more than just report the data; they are not able to question the efficiency or potential innovations that *could* be possible for the airports. The IATA submission goes on to say that *"at best, the monitoring model seeks to perpetuate the status quo, to prevent gross deterioration."*⁴⁰

To be clear, A4ANZ is not suggesting that service quality at any of the monitored airports is poor. However, questions remain about whether increasing charges can be justified when quality ratings are not following the same trajectory. It is of course possible that the increased charges are being directed to investments elsewhere, but both the ACI and AAA submissions to the Inquiry note that Australian airports have invested in expanding capacity *and* maintaining and improving quality over many years.^{41,42} While we have no reason to doubt these claims, they are worthy of further interrogation; not least to ask, who is ultimately paying for these investments?

As the CEG report notes, *"airports that set their aeronautical charges to fully recover infrastructure costs will be earning excessive profits overall. This is because airports earn significant revenues above costs from their retail and other non-aeronautical services."*⁴³

It is therefore unsurprising that priority for quality improvements is given to revenue-generating areas of the airports. Comparing consumer amenities and public areas with the retail or food and beverage precincts at many of Australia's domestic terminals provides a simple illustration of this point, also noted by other airport users⁴⁴ and reflected in the ACCC monitoring reports.⁴⁵

The dual-till approach to charging at Australian airports provides a disincentive for this situation to change, without intervention. Or as IATA's submission describes it, *"dual till can incentivize airports to invest in potentially higher-return commercial activity to the detriment of essential aeronautical infrastructure."*⁴⁶

As IATA's submission further explains, *"the dual till approach in Australia has resulted in higher overall charges for users, further exacerbated by the lack of fit-for-purpose regulatory oversight regime. A dual till approach to charging is possible only because airports do not operate in a competitive environment and are able to ring fence individual high-yielding business streams to extract profit."*⁴⁷

Like A4ANZ, IATA also argued that the application of a hybrid till should be considered for Australian airports. Progressing towards this provides one way to reflect the pricing mechanisms airports would apply if they were operating under genuine competition.

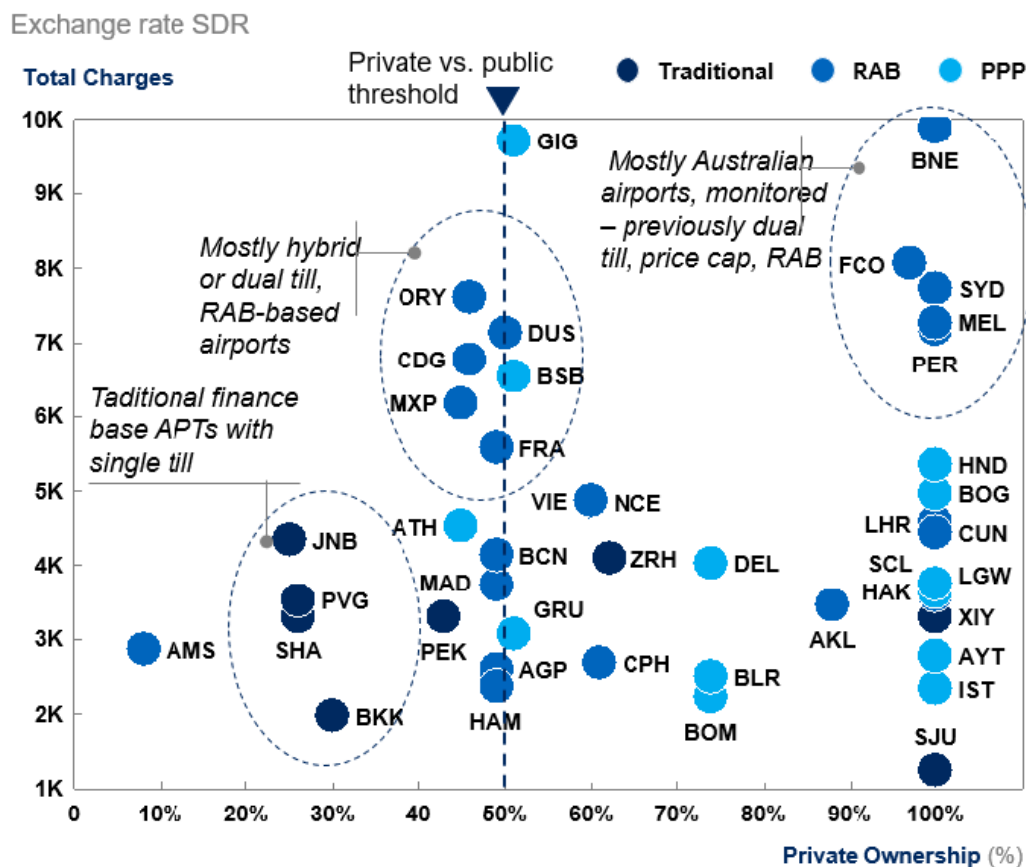
In the following sections, we consider the claims of inter-airport competition, and other arguments for the existence of conditions which mitigate market power: countervailing power of customers, and regulation.

DO AUSTRALIAN AIRPORTS COMPETE WITH EACH OTHER?

“When you have an infrastructure monopoly, the default situation is not choice; it's not competition in markets; the default is a monopoly.”⁴⁸

The AAA's claim, repeated in submissions by individual Australian airports^{49,50,51}, that airports are in competition with each other, and that this creates a “strong incentive” to price aeronautical services competitively⁵², must be considered with a degree of scrutiny.

Firstly, while there may be a *theoretical* driver for competition between airports in the international market, Australian airports are not actually considered to be price-competitive by international standards. If such limited competition does indeed exist, it does not appear to be driving down pricing at all, with the Chinese airlines cited earlier explaining that all Australian ports are expensive. Analysis by McKinsey, presented in IATA's submission to the PC, shows that the Australian airports are considerably more expensive than others around the world, even when compared to others under private ownership (see graph below).⁵³



Sources: Airport performance database created by McKinsey & Company for IATA.

Total Turnaround costs for an aircraft A320-200 in 2015.

SDR (Special drawing rights) is a currency instrument used by the IMF, representing a combination (weighted average) of multiple currencies comprising the US dollar, Euro, British Pound and Yen.

Secondly, there are very few circumstances in which it could genuinely be demonstrated that there is competition between airports which might pose a material constraint on the airports. This is because Australian

airports have unique characteristics, particularly in terms of the passenger mix, which is approximately 75% domestic, 25% international.⁵⁴

What this means is that while there may theoretically be some competition for the international market flying into Australia – and we have seen above that it is limited at best – it does not affect deals made with the domestic airlines, who cannot readily choose a different port (an issue we explore below).

Even where there is the prospect of choice, factors such as access time, and the frequency of air services and connections from an airport, drive passenger decision making. This holds true even for Brisbane Airport, for which a theoretical argument could – and has been - mounted for competition in some markets⁵⁵; yet it is clearly not having the positive impact claimed.

The fact is, inter-airport competition is largely irrelevant in the Australian context. Airports making claims about its existence and apparent effects on pricing would perhaps benefit from reflecting on their own assessments of competition in the jet fuel market. Their commentary on this issue displays a shared policy position; one which not only acknowledges the harms caused by a lack of competition and having to negotiate with a monopoly supplier, but has the AAA seeking to “*break up any restrictive supply arrangements currently in place*”.⁵⁶ The question therefore remains as to why monopoly airports believe their businesses should be immune to similar Government interventions and reforms?

ARE AUSTRALIAN AIRLINES SO POWERFUL IT OFFSETS AIRPORT MARKET POWER?

In contrast to airports, airlines are in genuine competition with each other. As IATA observed, given this competition, there is clear economic logic against the statement that such airlines could have countervailing market power, similar to the airports who do not compete. Airlines “*seek profitable opportunities to serve passengers, and rightly win business from each other. The Australian aviation industry is mature and market opportunities are hard fought over.*”⁵⁷

This does not, however, give them the “significant” and “enormous” countervailing power claimed by airports in their submissions.^{58,59} Such claims ignore the inalienable fact that any business negotiating with a monopolist is placed at a significant disadvantage. This condition holds, regardless of the strength of their business, their corporate reputations or negotiating skills.

Airlines cannot readily change or withdraw from routes

Many of the airports’ submissions made the claim that any market power that does exist is neutralised by airlines being able to change routes if they object to contract terms.⁶⁰ However, network airlines are simply not in a position to readily withdraw from routes. This was well documented in multiple submissions to the PC^{61,62,63} and supported by expert analysis from Norton White and Frontier Economics.^{64,65} It is important to carefully consider all of these factors when assessing the *actual* levels of countervailing power, as opposed the persistent myths that it could exist, and therefore does.

An example of this is the claim from Canberra Airport that modal substitution by the Jetstar-Murrays bus arrangement is a display of countervailing power which impacts “more than a third” of their 1 million passengers.⁶⁶ This simply doesn’t hold up when we look at the actual numbers of passengers choosing this option; between January 2016 and August 2018, a total of 74 seats have been sold, which equates to just 2.3 seats a month, or less than 0.01% of the airport’s total passengers.⁶⁷ While the bus fare was cheaper than Canberra Airport’s charge, customer take-up of this option has clearly been poor, and hardly an example of countervailing power through modal substitution.

As European analysis has shown, destination substitution is rarely a realistic option for travellers⁶⁸ and it is even less so in the Australian context. The idea that airlines can “*fly anywhere, anytime*” simply ignores the realities of travel in Australia. Capital city airports provide the linchpin to all the major airlines’ networks, and domestic routes have remained stable and relatively static over time.⁶⁹ Therefore, the suggestion that airlines can just opt out of routes should not simply be accepted by policy makers without proper examination, particularly given historical evidence leaves this as little more than a hypothetical scenario.

It is also worth challenging the notion that domestic airlines have countervailing power against airports through their own market power over international competitors. Australia has prided itself on having one of the most liberal, highly competitive environments in the world, in which all our domestic airlines operate.

IATA’s submission to the PC highlights the fact that airports can – and do – raise charges, with the airline having no option but to accept the increase in charges. Even if they are to resist initially, bills must be paid in the end, leaving an airline with no leverage in negotiations.

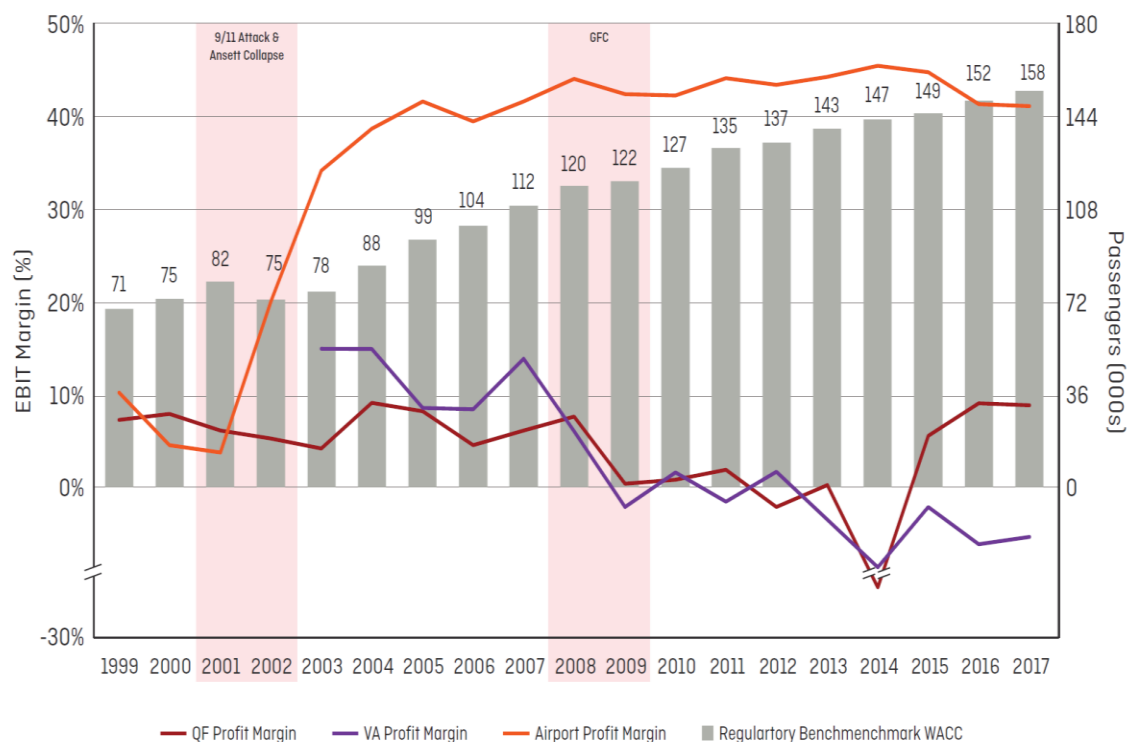
As outlined in Frontier Economics' report on Market Power⁷⁰, and further explained in IATA's submission to the PC, "An airline does not have a credible threat to reduce services at an airport, to damage the airport's business, because a competing airline could easily replace the reduced service. In this scenario, the negotiating airline would suffer a loss in business, but the airport would retain the same business, merely seeing a transfer in passengers from one airline to another."⁷¹

Profitable airlines ≠ no exercise of market power by airports

In the AAA's supplementary submission, and submissions from individual airports, quite a bit of space is dedicated to tracking and describing the recent profitability of airlines.^{72,73} The AAA go on to say that "these data indicate that Australian airlines are in robust economic good health".⁷⁴

Leaving aside the fact that airline profit margins are significant orders of magnitude lower than those of airports, the AAA and its members seem to be suggesting that, in order for there to be evidence of a problem, airlines ought to be struggling or unprofitable. Indeed, the fact that a proportion of their follow-up submission is dedicated to highlighting the recent profitability of airlines in Australia suggests they view this as something that somehow counters the market power that airports hold. This is a false equivalence, however, and the reasons for this are outlined below.

The fact that airports were able to maintain their charges and margins through the economic shocks caused by events such as 9/11 and the Global Financial Crisis, shows the protection airports have from such conditions, while airline margins are far more volatile. This also reflects the disparity in the risk profile of airlines and airports. Volatility within the market due to terrorism, SARS, global financial crisis and geopolitical conflict, dramatically impact an airline's ability to fill planes. This position forces *airlines* to lower fares, while such pressures are not felt by airports, as evidenced in the figure below, extracted from Qantas' submission to the PC.⁷⁵



Sources: ABS, ACCC Airport Monitoring Reports, BITRE, Annual Reports

Melbourne, Sydney and Brisbane Airports have all acknowledged this extremely positive performance, unaffected by economic downturns, in statements to investors, examples of which are shown here:

“Our passenger numbers and EBITDA have increased on an annual basis since the privatisation of Sydney Airport in 2002 to 31 December 2017, including in periods of challenging economic and operating conditions, such as the global financial crisis, the European sovereign debt crisis, the SARS outbreak, the Ebola outbreak, ongoing geopolitical conflicts and acts of terrorism.”⁷⁶

“Melbourne Airport’s passenger numbers have stayed resilient in the face of strong adverse shocks to both the demand and supply for air travel, and it has typically seen recovery of passenger numbers and a return to passenger number growth within 12 months of the adverse shocks.”⁷⁷

“Brisbane Airport Corporation (BAC) believes that consistency in passenger number growth rates have supported the stability of BAC’s revenues and cash flows, including during the global financial crisis and the European sovereign debt crisis. Between FY12 and FY17, BAC’s passenger numbers demonstrated consistent growth despite a severe deterioration in the global economic environment.”⁷⁸

A4ANZ’s ultimate objective is for the whole aviation sector to prosper. Consumers benefit when airlines do well, as we outline later in this submission. What is important to conclude from the discussion on profitability, however, is that the presence of airline profitability does not indicate the absence of airport market power.

Furthermore, if airports are genuinely of the belief that the cause of disputes and challenging negotiations between airports and airlines is the countervailing power of airlines; the regulatory amendments we have proposed would allow the airports easier access to dispute resolution mechanisms in such scenarios.

DO THE CURRENT REGULATORY SETTINGS CONSTRAIN AIRPORTS' EXERCISE OF MARKET POWER?

It is now abundantly clear that the current regulatory regime is not constraining the market power of airports. The evidence on airports' growing profitability, presented earlier, and Australia's performance globally, clearly illustrates this lack of constraint.

While the AAA and its advisers have suggested that airport behaviour and profitability *is* constrained by the existing regime^{79,80,81} the submissions by airport investor groups – anxious to avoid any change to the system – suggest otherwise.^{82,83} The lack of regulatory constraint on earnings and profitability is confirmed in analyst statements,^{84,85} and, as shown in the previous section, by the airports themselves.

Against this background, there is also good reason for the PC to question claims made about the regulatory regime's effectiveness based on the repeated citation of the one example that demonstrates it in action (e.g. the declaration application for Sydney Airport 2006).⁸⁶ Such claims need to be weighed against the large and growing body of evidence showing the system failing to work as intended.

Existing regime lacks a credible threat

As we noted in our initial submission, for a light-handed regime to work as intended, it requires a credible threat of greater regulatory intervention, such as arbitration, in the event of a dispute.⁸⁷ The current pathway to arbitration in the case of disputes is, despite claims to the contrary, not acting as a credible threat to constrain airports' market power when negotiating the terms and conditions of access. Given they have acknowledged the inability of the current system to hold airports to account, recent claims made by the AAA and legal advice produced by DLA Piper at their direction⁸⁸, require further scrutiny.

We maintain that recent amendments to the Competition and Consumer Act 2010 (CCA), specifically to declaration criterion (a), *will* have a negative affect an airline's ability to obtain declaration, and ultimately arbitration of terms, under Part IIIA. We sought further, independent legal opinion from Mr Michael O'Bryan QC^c on the memorandum prepared by DLA Piper with respect to criterion (a) of the declaration criteria in Part IIIA of the CCA.⁸⁹

Mr O'Bryan's full advice is attached to this submission as **Appendix B**. The advice notes his disagreement with the view presented in the AAA's DLA Piper memorandum which states that "*the recent changes to criterion (a) have not significantly increased the threshold that must be met for declaration of services supplied by non-vertically integrated infrastructure operators, such as airports.*" Mr O'Bryan's advice concludes that, following changes to criterion (a), with effect from 6 November 2017 it will be more difficult to satisfy the new criterion (a) in the case of non-vertically integrated natural monopolies, such as airports.⁹⁰

As is the case when proposing any change, it is important to acknowledge the concerns that have been expressed in relation to amendments to the regulatory settings for airports. We work through these in subsequent sections,

^c Mr O'Bryan QC was a member of the panel appointed by the Commonwealth Government in 2014 to conduct a review of Australia's competition laws and policy (now known as the Harper Review), which resulted in the enactment of the Competition and Consumer (Competition Policy Review) Act 2017.

but it is also worth noting that there is really only one party to the Inquiry objecting to suggested changes in these settings; the airports.

The AAA have stated that they believe that, *“whilst airlines generally receive from airports the information they require to negotiate, additional guidance from the government in this regard would help clarify expectations, reduce friction in the negotiating process and reduce transactions costs.”*⁹¹

While it may at first glance seem staggering that businesses of the size, scale and complexity of airports require guidelines for the purpose of undertaking commercial negotiations with their customers, it is perhaps not entirely surprising. Businesses that have operated as monopolies do not have incentives to look for the most efficient way to do things, nor do they have incentives to work in partnership with their customers. Guidelines alone, however, will not be enough to change behaviour, particularly as all parties have acknowledged the fact that adherence to the existing Aeronautical Pricing Principles is poor.

The AAA have in fact conceded that, under the current regulatory model, there are behaviours that fall short of the existing guidelines.⁹² At the same time as seeking Government guidance, however, they are also asking for the regulatory model to remain as it is for a further 5 years, no matter the cost. As the AAA’s Chief Economist said, *“People’s expectations aren’t being met and if the Government was able to provide some guidance about what reasonable expectations are then I think there’s a pretty fair chance that people will act accordingly. If that comes about, and in five years’ time the same sorts of conduct are being seen, I think we’re probably in for a much poorer outcome next time.”*⁹³

Guidelines alone will not change behaviour

Rather than relying on Government guidance alone and simply hoping for better conduct, however, A4ANZ is presenting a more constructive way forward to address the challenges created by the lack of a clear pathway to arbitration for dispute resolution. There is now a strong case for developing an industry-specific regulatory model for Australian airports.

This is not a new concept, and the PC will have seen a number of working examples from other sectors (e.g. broadcasting, gas) in the submissions received thus far. Furthermore, Mr Trevor Evans MP, who has prior experience as a regulatory economist, made the following observations in a recent speech to Parliament.

*“The regulation of infrastructure monopolies, whether it’s electricity, trains, gas pipelines, telco—you name it—is now well established. It has been happening around the Western world since the 1970s. However, just because the regulation is well established doesn’t mean that it stays up to date. The way we regulate the sector needs to be reviewed and kept up to date if we’re going to keep attempting to mimic competition where there would otherwise be strong monopolistic tendencies.”*⁹⁴

Although the comments were made in relation to the energy sector, they are highly relevant to airports. Accordingly, In the following section we consider what a revised regulatory model for airports could look like in terms of:

- the pathway to access arbitration;
- who undertakes the arbitration;
- what the arbitrator must have regard to in making a decision;
- what forms of arbitration they are permitted to use; and
- which airports are covered.

WHAT ARE THE BEST OPTIONS FOR AMENDED REGULATION?

The focus of this work has been to find the simplest, most pragmatic solution, to deliver the outcome required; that is, to have a credible threat of arbitration to drive commercial negotiations between airports and airport users, on reasonable terms and conditions.

A more effective alternative to the current regime is to create an industry-specific regulatory model. In designing this, A4ANZ is seeking the minimum change possible to provide an effective pathway to arbitration in the case of disputes and negotiation breakdowns between airports and their customers.

The ACCC's submission to the PC supported this goal, arguing that, *"Airlines should be provided with a more direct access to arbitration (rather than having to go through the Part IIIA declaration process) to reduce the imbalance in bargaining powers of airlines and monopoly airports. Moreover, using a qualified commercial arbitrator (similar to that under the gas regime under Part 23 National Gas Rules) to conduct these arbitrations, instead of the ACCC, may help result in timely outcomes."*⁹⁵

Airports-specific regulatory framework

While we acknowledge the initial reluctance of the PC to consider a sector-specific approach for airports, it is worth noting that a range of other industries have taken this option, as outlined in earlier submissions.^{96,97,98} The establishment of these models have all been informed, at least in part, by Part IIIA provisions, but importantly, their development recognises the need to approach specific industries and their needs differently.

This was a key point made in Dr Michael Vertigan's *Examination of the current test for the regulation of gas pipelines*, which highlighted the unequal levels of bargaining power and access to information that shippers face when seeking access to pipeline services. The report recommended the establishment of a new commercial arbitration framework, pricing principles and information disclosure requirements, to apply to unregulated pipelines that provide access to third parties.⁹⁹ From this, the national gas framework^d was introduced into the National Gas Law (NGL), to provide access for binding arbitration in the event parties are unable to reach a commercial agreement.¹⁰⁰ Introducing the framework acknowledged the fact that it is not appropriate for access to dispute resolution be predicated on whether or not the infrastructure asset (in this case, a pipeline) is covered by an access scheme.

As noted by the ACCC above, the framework has attributes that are also attractive in the context of airport users seeking to access services at Australia's monopoly airports.¹⁰¹ It may therefore be useful to now contemplate such a framework, given the advantages it could offer over deemed declaration options that still place reliance on the broad parameters of Part IIIA in resolving disputes.

After discussions with a variety of stakeholders, including Government and the ACCC, and considering other positions raised in submissions to the PC, we believe that the introduction of an airports-specific regulatory framework could be approached by amendments to the *Airports Act 1996*¹⁰² and Airport Regulations 1997.¹⁰³

^d The gas framework, agreed to by the COAG Energy Council and becoming operational in August 2017, provides for a staged approach to assist shippers seeking to access pipeline services. The stages consist of information disclosure by non-scheme pipelines, access negotiations, and the arbitration of access disputes.

The objectives of any amendments would be that arbitration could be activated where parties to a negotiation are unable to reach a commercial resolution.

Arbitration framework characteristics

Characteristics for an arbitration framework could include the following:^e

- Commercial negotiation between parties would occur whenever any party sought access or services at airports;
- After negotiations had commenced either party could signal a breakdown which would trigger the arbitral process;
- Arbitration would be commercially-based, with the arbitrator (drawn from an approved pool) appointed by mutual agreement of the parties, but with provision for imposition of an arbitrator where there is no agreement;
- The framework would be designed for expeditious resolution of the dispute with provisions to avoid delay and gaming. Structures such as ‘final offer arbitration’ would be considered for inclusion;
- The decision of the arbitrator would be binding on both parties;
- Oversight and maintenance of the framework will be required, including in relation to procedural rules, pricing principles and the power to appoint an arbitrator to a dispute in the absence of agreement between the parties;
- The ACCC is the logical institution to undertake the oversight role.

As the AAA have pointed out, commercial arbitration is currently already available to airlines and airports under State and Territory laws, in the case of intractable disputes over access or contract terms. However, as the AAA also acknowledge, proceeding down this path relies on both parties to the dispute agreeing that independent arbitration is desirable, and to be willing to bear the costs. Unsurprisingly, there are no known cases where an airport has proposed or agreed to such arbitration or any other kind of expert determination. We have therefore proposed, in the above characteristics, that either party could trigger the process.

Importantly, A4ANZ is not putting forward this proposal so that only airlines may have access to arbitration. Rather, the principle of the negotiate-arbitrate option proposed by A4ANZ is that in the event that commercial negotiations break down, either party can access arbitration.

However, as noted by Vertigan, where commercial processes are working effectively, resorting to arbitration should rarely be required,¹⁰⁴ and this has been the experience with the new gas rules. As A4ANZ has said previously, the framework would be designed to incentivise parties to negotiate, rather than relying on arbitration, which accords with international experience.

Arbitration process

The framework characteristics outlined above would provide an effective and streamlined mechanism to resolve disputes according to agreed-upon standards, including existing pricing principles that are already in force, or equivalent principles,^f and criteria which guide arbitrators in making their decisions. Mandating these principles would lend greater clarity and efficiency to the operation of the framework.

^e Adapted from the Vertigan report

^f In an airport specific regulatory framework, this could be the existing *Aeronautical Pricing Principles*

Appropriate criteria in the airports' environment may include aspects such as: reflecting outcomes of a workably competitive market, assessments of cost benefit, cost effectiveness, investment efficiency, and a rate of return which is commensurate with prevailing market rates. Given these criteria guide the decision-making, further direction would be necessary in the potential scenario of neither party's offers being within agreed parameters. The Options Paper suggested that if the arbitrator believes a fair and reasonable settlement lies between the disputant's final offers, the rules of final offer arbitration (FOA) are used, and if it falls outside the range provided by the final offers, conventional arbitration rules are used.¹⁰⁵

It should be noted that A4ANZ is not opposed to the use of conventional or combined arbitration, where appropriate, and believes that, in addition to clear objectives and principles, the key to any arbitration framework is ensuring there are appropriate provisions regarding timeframes, information disclosure and mandated pricing principles.

Regime coverage

Following our review of submissions and discussions with key stakeholders, A4ANZ explored potential legislative mechanisms which could be used to prescribe which airports an industry-specific regulatory regime could cover, to allow for the implementation of a negotiate-arbitrate framework.

It is important to note that the Terms of Reference for this Inquiry did not limit the PC to consideration of matters pertaining to the four monitored airports alone, and, as can be seen from multiple submissions to the Inquiry, monopoly behaviours certainly extend well beyond these airports. It is therefore helpful to again look at how this issue was approached in the gas sector, where the Vertigan Report argued that it was not appropriate for access to dispute resolution to be predicated on whether or not the infrastructure asset was covered by an existing scheme; rather, that *all assets with natural monopoly characteristics* should include such a provision.

We believe, therefore, that the most practical way to implement a proposed negotiate-arbitrate regime for airports may be to start with those under Commonwealth control; specifically, those defined in the Act as *core regulated airports*⁹, with provision for inclusion of further airports as required.

Given the issues of monopoly behaviour are clearly not limited to the airports listed above, and there is sound rationale and precedent in the gas pipeline sector, there remains a strong desire to expand coverage of such a regime to airports not on federally-leased land. Powers could be given to either the Minister or Department Secretary to designate airports so they come under the regime's coverage, similar to powers contained in other legislative instruments, e.g. *Crimes Legislation Amendment (Police Powers at Airports) Bill 2018*¹⁰⁶ and *Aviation Transport Security Act 2004*.¹⁰⁷

Regardless of the mechanisms used, it is for the benefit of efficiency, competition, and the community generally that there exists an appropriate framework to enable disputes between airport access providers and access seekers to be resolved within an appropriate framework.

⁹ Core regulated airports include the following: Sydney, Western Sydney, Melbourne, Brisbane, Perth, Adelaide, Gold Coast, Hobart, Launceston, Alice Springs, Canberra, Darwin and Townsville.

WOULD CHANGES TO THE REGULATORY MODEL HARM INVESTMENT?

A common contention running through many of the airport and investor submissions to the PC is that continued investment in airports would be at risk if the current light-handed airport regulatory regime was replaced by a more rigorous economic regulatory approach.

Aside from this being an admission that investment is effectively being paid for by the airlines and other airport users, there is a large question mark over whether current settings incentivise efficient investment – submissions from airlines and other airport users suggest otherwise.

To explore and address these claims of investment risk, A4ANZ engaged Frontier Economics, who consider this argument to be simplistic and largely without basis – as high levels of investment can, and have been, achieved in regulated industries. Frontier’s full analysis is included in **Appendix C**, however the main points are that:

- under current regulatory arrangements, it cannot be presumed that airports are investing the right amount on the right things, as airports face many incentives to invest inefficiently;
- it is the specifics, rather than the existence of a regulatory regime, that affects investment. Experience has shown that carefully designed regulatory regimes can and do provide appropriated incentives for investment whilst protecting against the misuse of market power; and
- dismissing the case for regulation on the basis of the *possibility* it might impact on investment is short-sighted – rather more careful consideration should be given to the specifics of the regime adopted.

Effective regulation delivers investment and economic gains

High levels of investment can, and have, been achieved in sectors subject to effective or changed regulatory regimes, including, but not limited to, financial institutions in Australia and other airports around the world.

The AAA’s submission notes that capital expenditure (per passenger) incurred at Australian airports is broadly consistent with peers.¹⁰⁸ In other words, Australian airports have been investing to a similar degree as other international airports on a per passenger basis. These international airports are under different, and often heavier-handed regulatory arrangements and have equally been investing to keep up with growing demand. This implies the presence of a regulatory regime does not necessarily act as a barrier to investment. The level of investment that has taken place at Heathrow and Changi, which are subject to price and revenue caps respectively, are good examples of this. Heathrow Airport is highlighted as a case study in Box 1, below.

To be clear, A4ANZ is not advocating for more heavy-handed regulation; our proposals simply give effect to a negotiate-arbitrate mechanism for the existing light-handed regime. Economists agree that effective regulation delivers greater certainty and economic gains. As indicated previously, A4ANZ wants to see continued investment in airport infrastructure, and recognises that further airport investment is absolutely necessary given predicted growth.¹⁰⁹ However, investment must be fit-for-purpose, aligned with the needs of airlines and passengers using the facilities, and demand for air services.

Box 1: Investment Case Study - Heathrow Airport

Heathrow Airport provides a helpful case-study of how a privately-owned airport can deliver significant investment under a form of price control.^h

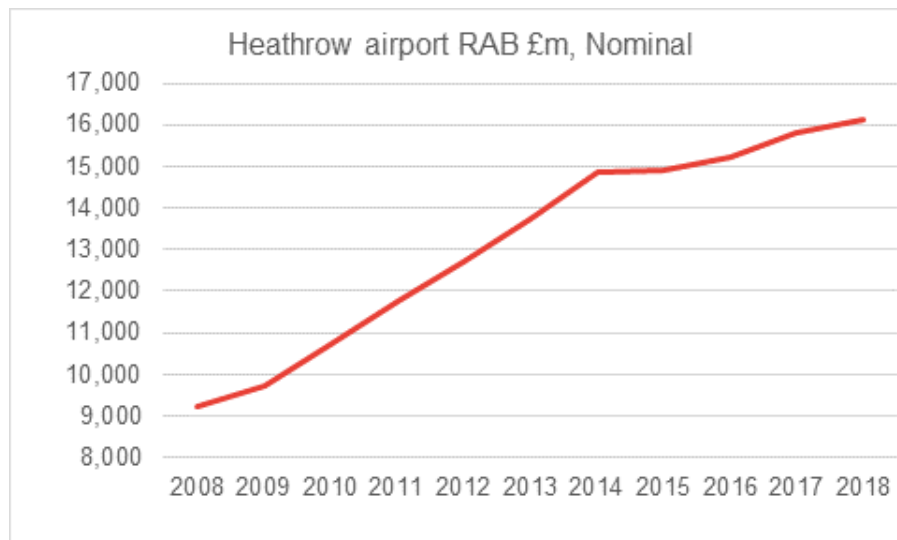
Heathrow is subject to *ex ante* price caps set to recover an efficient level of future expenditure for the airport, based on the airport's proposal and submissions of users. This requires forecasts of future demand and expenditure which can be complex. The forecasts included in the regulatory determination are informed by "constructive engagement". Under this process airports and airlines directly negotiate with each other to determine traffic forecasts, service requirements, and investment programmes.

The AAA's submission notes that since 2002 Australian airports have invested over \$15 billion in infrastructure, of which around \$10 billion has been in aeronautical assets¹¹⁰. They further suggest that this investment is a direct result of the current light-handed airport regulatory regime. While these figures appear sizeable, as highlighted in the AAA's own submission, for all but one Australian airport, capital expenditures per passenger are *higher* at Heathrow Airport, which is subject to more heavy-handed regulation.

Irrespective of whether Heathrow's regulatory regime is viewed as a success, it is clear that it has enabled significant investment to occur.

Furthermore, as demonstrate in the figure below Heathrow's Regulatory asset base has grown significantly by 174% from £9,233 in 2008 to £16,108 in 2018. This implies that investment at the airport has involved major augmentations and not just capital expenditure to maintain and replace the existing assets.

Heathrow Airport's RAB growth from 2008 to 2018



Source: RAB data published by Heathrow Airport¹¹¹

^h A4ANZ uses this an example of investment under different regulatory models, not to advocate for price control which we have explicitly said does not represent good policy in the Australian airports environment.

WILL CONSUMERS REALLY BENEFIT FROM CHANGES?

As A4AZ noted in our original submission, historically, when airlines have been able to reduce costs in any part of their business they have reinvested in improving the consumer experience, including: reducing fares, increasing capacity on routes, renewing fleet capacity, preserving essential regional air services, collaborating with airports to progress innovations in customer experiences, improving domestic and international service levels and technological innovation; and other new and important initiatives such as pilot academies.

A4ANZ acknowledges that Houston Kemp, at the direction of the AAA, have provided a critique of some of the assumptions underpinning analysis included in A4ANZ's original submission to the Productivity Commission – including the extent of cost pass-through.¹¹² While these assumptions were in fact acknowledged in the initial analysis, Frontier Economics has now provided additional commentary regarding Houston Kemp's critique – this is included in full in **Appendix D**.

While Frontier agree with Houston Kemp that there is no economic theory that supports the prior assumption about the extent of cost pass-through, it is important to note that Frontier's economic evaluation report states that the exact amount of pass-through will depend on the nature of demand and the competitiveness of the air travel on any route.¹¹³

Frontier further note that whilst assumptions about cost pass-through are important when formally assessing pricing outcomes for the purpose of a market power assessment, this is less critical when used as an input into the connectivity analysis. For example, if it is assumed that there is zero pass-through of airport charges to airfares, this would still impact on an airline's costs on any route i.e. a rise in airport charges will increase the fixed costs of airlines, making routes less viable. Similarly, if it is assumed that there is 100% pass-through of airport charges to airfares, the rise in airport charges will reduce demand and therefore make routes less viable.

Given the primary purpose of Frontier's original analysis was to explore connectivity and determine route viability, any fall in airport charges (as a result of changes to the regulatory regime) could be viewed as beneficial to passengers, if it drives new connectivity, irrespective of whether this comes through lower fares or through lowering the fixed costs of airlines.

These conclusions are supported by international evidence, for example, in the UK and Europe, where effective regulatory frameworks have led to substantial consumer benefits.¹¹⁴ We expect similar effects in the Australian environment, which were documented our original submission.¹¹⁵ Even with the revised, considerably more conservative estimates, Frontier estimate that the reforms would produce a benefit:cost ratio of 14:1 (**Appendix D**). Clearly, there is a far greater cost to society if we maintain the status quo.

CONCLUDING COMMENTS

Our objective is that this submission returns our collective focus once again to the Government's policy objective: that the framework put in place for the economic regulation of Australia's monopoly airports facilitates commercial negotiations.

As IATA notes, successful airport privatisations should deliver the following:

- A more efficient, cheaper and better service for passengers and airport users;
- Cost effective and fit-for-purpose investment;
- Normal market-based returns on capital for investors; and
- Economic benefits for local community and the wider economy

We cannot expect these objectives to be met if we simply “set and forget” regulatory settings on a regulatory model. This Inquiry is timely, because it is now abundantly clear that these objectives are not all currently being met.

All parties to the Inquiry have acknowledged, at some level, the challenges of commercial negotiations between airports and airport users. How we build a regulatory framework to address that is the critical question to be answered.

This submission, together with A4ANZ's earlier submission, puts forward practical, readily-implementable options, for consideration by the PC and others. Not only do the options proposed address the shortcomings of the current model for all airport users, but they reflect global best practice and will deliver critical economic benefits that are currently being lost.

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