

# Adelaide Airport Ltd Submission to the Productivity Commission Inquiry – Economic Regulation of Airport Services

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## Executive Summary

The purpose of this inquiry is to examine the effectiveness and efficiency of the current economic regulation and services and the effectiveness of the price and quality of service monitoring in achieving the following objectives:

- promoting the economically efficient and timely operation, use of and investment in airports and related industries;
- minimising unnecessary compliance costs;
- facilitating commercially negotiated outcomes in airport operations; and
- whether new arrangements are needed.

Whilst Adelaide Airport Ltd (AAL) has found the continuation of price and quality of service monitoring not to be onerous or overly expensive to comply with, it believes that as it does not exercise substantial market power; price and quality of service monitoring is unnecessary or failing that, it more appropriately should be included with Canberra, Darwin, Gold Coast and Hobart airports under the second tier self-administered monitoring.

Under the price monitoring environment, AAL has been able to engage with its airline customers and to develop strong commercial relationships supported by formal commercial agreements. Any change to a more heavily regulated environment is seen as prejudicial to the current commercial relationships and may return airport/airline relationships to a more adversarial nature.

Although AAL finds the current price and quality of service monitoring regime not to be onerous, it is critical of the interpretations placed on the information provided to Australian Competition and Consumer Commission (ACCC) in their annual reports. Should AAL continue to be subject to price and quality of service monitoring it would suggest that some improvements be made in the guidelines for reporting and the collection of financial data to better provide more realistic and meaningful reporting. In AALs view, quality of service monitoring is unnecessary, as a commercial provider of services, quality of service is of fundamental importance to airport management and as such is closely monitored and actively acted upon. AAL also has legally binding service level agreements in place with its major customers and these include real commercial penalties. In addition, failure to maintain service levels in line with public expectations would lead to the brand damage which AAL would want to avoid.

In respect of land access, AAL makes only a minimal charge for taxis and limousines. Of this charge 80% is used to provide concierge services as well as providing funds to the South Australian Taxi Board to provide for taxi driver education. The balance of the charge funds capital investment in providing amenities for taxis and taxi drivers at the airport.

AAL contends that in relation to car parking that it does not have substantial market power because;

- currently only 16% of passengers use the car park facilities;
- it competes against other modes of transportation;
- it competes against off and on airport car parking services;

- of ease of drop off and ancillary waiting areas around the airport for which there is no charge;
- of its proximity to the Adelaide CBD;
- the ease of transport within the Adelaide metropolitan area; and
- the price expectations of South Australians as indicated by the level of car park pricing in the CBD.

Because of these reasons AAL believes that there is no need for price monitoring of car park charges.

AAL has achieved a planning environment which is properly integrated with local planning instrumentalities through its own initiatives set against the regulatory requirements of the Airports Act 1996. AAL has further demonstrated its willingness to share the economic costs arising from the activities of the Airport.

AAL submits that Adelaide Airport does not have substantial market power in respect of its aeronautical charges and car parking charges. Whilst it does not find compliance with the current light handed regulation too onerous or expensive, in the case of Adelaide Airport, it believes regulation to be unnecessary. Should AAL be on the same footing as all other private business, there are sufficient remedies under the *Trade Practices Act* to ensure that it does not act in any way contrary to responsible business practice.

This submission should be read in conjunction with the submission by the Australian Airports Association (AAA).

## Airline countervailing power

### International Passenger Services

International and Regional routes serviced from Adelaide Airport are dominated by very marginal 'thin' routes, which are highly sensitive to airport charges and consequently AAL has very limited market power in the provision of airport services in these market segments. AAL currently offers regional and international airlines a level of airport prices which are below long run average costs and also offers incentives for growth. AAL's ability to exercise any market power is heavily curtailed by the difficult nature of its international and regional markets.

### Domestic Passenger Services

In the larger and highly concentrated domestic airline market, there could be a theoretical potential for market power, but this is heavily curtailed by the strong countervailing power of airlines and the condition within the Airport Lease that the Lessee must at all times provide for access to the airport by interstate, intrastate and international air transport. This is illustrated as follows:

- When airport charges at Adelaide Airport were negotiated in 2002, the negotiated pricing was 28% below the cost-based prices being sought by AAL, at the end of that agreement in 2007 the negotiated outcome for the next 5 years was 25% below AAL cost-based prices. One domestic airline did not engage in the price negotiations for 12 months which was after agreement had been reached with all other domestic airlines. Subsequently a lower price was agreed and this reduction passed on to all domestic airlines in line with the terms of AAL's commercial agreements with airlines. It should be noted that the airline continued to access Adelaide Airport during that time and only paid the pre-increase charges until agreement was reached. No action was taken by AAL to recover the underpayment during the course of the year, nor was any attempt made to refuse access on the grounds of the substantial "arrears" accumulating in AAL's books.
- In 2011, the Passenger Facilitation Charge (PFC) for the use of Adelaide's new Terminal (T1) was reset under very prescriptive terms and conditions of a formal long term agreement; here, even though the calculation under the terms of the agreement yielded a 26% decrease in price, a further 2% decrease was negotiated with the airlines.
- In the 2007 landing charge negotiations, AAL conceded to a Compound Annual Growth Rate (CAGR) for domestic passengers of 5.75% over the 5 year term of that agreement. So far, the CAGR for the first 4 years of the agreement (based on latest forecasts) is 4.3%.



## Adelaide Airport's Track Record

AAL has a proven track record of regard for its customers whether required under its negotiated commercial agreements or in recognition of changes in circumstance. This is illustrated as follows:

- Discounts negotiated with a new entrant airline post the 2007 pricing negotiations were immediately offered to all other incumbent airlines servicing Adelaide Airport in accord with the commercial agreements in place. AAL offers a range of discounts based on servicing new routes and recognising airline growth over and above that allowed for in the agreed prices.
- During the Global Financial Crisis the annual CPI increase agreed in the pricing agreement was foregone by AAL in recognition of the adverse circumstances facing the industry at that time.
- AAL also offers a choice of charges based on passenger (pax) or tonnes, to give airlines added flexibility depending on their business model. Airlines are allowed to elect from year to year which method of charging will apply. Notably, Tiger Airlines elected to change from a passenger based charge to a landed tonnes basis for the year commencing July 2010. This facility enables airlines to elect whether they or AAL bear traffic risk. Currently AAL has two domestic carriers electing for per passenger charging and three who have elected to be charged on a per landed tonne basis.

Airlines have mobile assets that can be redeployed on more profitable routes at very short notice or withdraw services entirely. For example, at short notice Qantas Link commenced operations in Adelaide in December 2005 with 36 services per week and in June 2006 it ceased all operations. Fortunately it recommenced services in 2010. Tiger Airlines reduced its services by 43% in late 2010 after being the main driver for growth in Adelaide during the previous 2 years.

## Pricing Agreements

AAL has in place formal pricing agreements for aircraft services which have been negotiated with and agreed to by all of its major airline customers. The agreements are for a period of 5 years, the second such arrangement was negotiated in 2007 and expires in 2012. Prices are negotiated based on a cost based price calculated using the ACCC approved building block model. Prices are only escalated during the period of the agreement by CPI adjustments each year. The pricing agreements are underpinned by AAL's "Conditions of Use" which include Performance Principles and Dispute Resolution clauses.

Passenger charges are covered by specific legal contracts with the two major domestic carriers (Qantas and Virgin Blue) and less formal but documented agreements with the international airlines. The PFC essentially recovers the capital cost and the cost of capital of the T1 terminal over a period of 15 years. 5 year reviews enable the charge to be adjusted for any over/under recovery arising from traffic being different to forecasts used in setting the price. Incremental operating costs (that is additional to the passenger processing costs being recovered prior to the completion of the T1 through aeronautical charges) are also recovered in perpetuity under the agreement. The charge for the operating costs for each reset period is set with regard to forward forecasts of costs and traffic.

These agreements effectively constrain AAL's ability to vary prices at will.

Whilst AAL believes that pricing should be based on the Depreciated Optimised Replacement Cost of aeronautical assets, it has found that the “line in the sand” asset valuations have removed a previously contentious area of pricing negotiations.

## Investment

Airline agreement to major airport investment is a necessity to provide certainty to shareholders and financiers that it will earn an adequate return on the investment. The Airlines therefore effectively have a veto on any significant expansion project if they do not wish it to proceed. By the same token they are able to delay or modify a project should they see it as being constructed too early or not be priced reasonably, or even be at a perceived competitive advantage to another carrier. If there is no agreement by the airlines to support aeronautical expansion then it will not proceed.

AALs experience to date has been that the major airlines have been very willing to engage on expansion projects and negotiate mutually acceptable outcomes. This has been evidenced in the recent negotiations regarding the amount of investment of an aeronautical nature in AAL’s proposed multi-deck car park and which will be recovered through an addition to the current landing charges.

Such negotiations, although necessary, may impact significantly on the timing of projects.

## Conclusion

AAL submits that;

- neither does it have and has not exhibited any behaviour to suggest that it might exercise market power
- the countervailing market power of the airlines in the circumstance of an airport the size of Adelaide Airport is sufficient to balance the natural monopoly inherent in an airport.
- Commercial negotiation in an unregulated environment is likely to achieve a better outcome than any return to adversarial negotiations or regulatory game playing.

## Price and Quality of Service Monitoring

AAL has not found the current price and quality of service monitoring environment to be overly onerous or expensive. It does, however, wish to raise some concerns with the quality and usefulness of the information compiled and the way in which it is used and reported upon by the ACCC.

### Price Monitoring

In its reporting on the Price Monitoring information provided by AAL, the ACCC uses measures which are capable of misleading the readers of the report as to whether the airport's pricing is as a result of the exercise of market power.

For example, in its 2009-10 report the ACCC stated

"In the most recent period, aeronautical revenue per passenger (a proxy for prices) increased only slightly to \$11.72.

- Over the entire reporting period, aeronautical revenue per passenger increased by 47.5 per cent from \$7.95 in 2005-06, while passenger numbers increased by less than half this rate (22.9 per cent)."

This statement is misleading because:

- 2005-06 is a somewhat misleading base year to use for this analysis as Adelaide's New Terminal (T1) was not operational for the majority of that year; hence the cost and revenue structures were completely different for that period. Between 2007 and 2010, revenue per passenger increased by only 3.5%.
- The construction of Terminal 1 in 2005-06, and the large increase in debt and asset values as a result, had a significant impact on the financial risk profile of the Airport asset and the revenue return on the asset.
- AAL's recovery of the capital cost of Terminal 1 following its construction is fully compliant with negotiated agreements with the Airlines and ACCC guidance

Despite the ACCC being advised of the above, the statement was still published without qualification in the key points section.

The ACCC report for 2009-10 compared prices over a 5 year period commencing 2005/06. AAL opened its new terminal in February 2006 together with the commencement of a new charge, the Passenger Facilitation Charge (PFC). As the full effects of the introduction of the PFC did not occur until 2006/07, income comparisons are not meaningful using the 2005/06 base.

The PFC consists of a recovery of capital expenditure and cost of capital (75%) and the recovery of incremental operating costs (25%). The ACCC under 4.1.2 Aeronautical revenue per passenger in the report note the increase in revenue but do not recognise the capital portion and in calculating the "margin" include only operating costs. This has the effect of the report reader being led to believe that AAL's "margin" grew disproportionately to aeronautical revenue.



The graphic chart 4.1.5 in the ACCC 2010 report - total airport revenue, operating expenses and operating margin includes the annual movements in the fair value of investment assets as revenue.

Although this is noted in the text, the graphic remains misleading in showing the “operating margin” including these revaluations which are non-cash and represent as yet unrealised future income.

Adelaide Airport is the only airport which has full control of its entire terminal assets, all of the other major airports have significant terminal assets leased to domestic airlines which are not subject to regulatory reporting. Adelaide Airport is the only one of the major Australian Airports to have a total common user terminal. This provides distortions when making any comparisons with other major Australian airports, one size certainly does not fit all. Adelaide Airport appears to be much more expensive than the other capital city airports, whilst it is more expensive because of its lower traffic against which it has to recover fixed costs; the following factors make it appear even more expensive:

- Income from the domestic terminal leases at other major Australian Airports is included in property income whereas at Adelaide the PFC is included in aeronautical income.
- Adelaide Airport is responsible for and recovers the cost of all of the mandatory security requirements at Adelaide whereas at other airports some of this responsibility remains with the airline and therefore airport fees appear lower.

Discounts provided by airports for route development and growth performance need to be taken into account when comparing airport to airport.

The ACCC has little understanding of the airport operations and Adelaide common user dynamics. As a result the ACCC report abounds in anomalies and it attempts to portray the “margin per passenger” as a proxy for profitability. Little attention is paid to more relevant (and comparable) measures such as the return on equity or return on assets.

### **Quality of Service Monitoring**

AAL believes that quality of service monitoring by a regulator is unnecessary. As the airport is a commercial provider of services, quality of service is of fundamental importance to airport management and as such is closely monitored and actively acted upon.

AAL has regular surveys conducted by Airports Council International (ACI) which provide both customer satisfaction results across the services provided by AAL as well as comparisons with airports across the world.

Adelaide Airport has performed very well in these surveys ranking first in 2010 for the Australia and New Zealand area for overall customer satisfaction.

AAL takes note of these surveys and takes appropriate corrective action. For example, AAL is currently dispensing with paper towels in its toilet facilities and replacing hand dryers with the latest turbo dryers following poor survey results due to the untidiness of the toilets arising from the use of paper towels.

Whilst AAL finds the passenger survey conducted for ACCC monitoring very useful, it is critical of the airline and border agency surveys. These surveys have resulted in some unusual results which undermine their credibility, not helped by the lack of transparency.

For example the availability of aerobridges for international services has fallen from a position just below good to satisfactory in 2008/09 and 2009/10. The following points were advised to ACCC and AALs view was noted in its report:

- The numbers of aerobridges have not changed, and, in line with the Standard Operating Procedures that have been in place since 2005/06 no scheduled passenger international aircraft has arrived or departed Adelaide Airport without the use of an aerobridge since that period.
- AAL understand that the Adelaide bases of the vast majority of International carriers operating at the Airport have won internal awards for punctuality including Cathay Pacific, Malaysia Airlines and Singapore Airlines, which it is considered reflects favourably on the Terminal service at Adelaide.
- AAL is of the view that the 'satisfactory' rating is due to airlines desiring access to specific gates and/or a preference for 'standing' connected to aerobridges for periods far longer than is operationally required.

AAL is also critical of the way the ACCC reports on the survey findings. For example the chart shown at page ix of the 2009/10 ACCC monitoring report was published without any consultation and is deceptive in that what is shown is only a portion of the full chart. This places Adelaide apparently at the lower end of quality where it is fact rated at 3.8 on a scale of 5.

The criteria for the measures in the report, Excellent, Good, Satisfactory, Poor and Very Poor are not defined so are open to interpretation. What is satisfactory?

AAL has legally binding service level agreements in place with its major customers and these include real commercial penalties. In addition, failure to maintain service levels in line with public expectations would lead to the brand damage which AAL would want to avoid.

## Access

AAL submits that there is no need for price monitoring or other regulation for car park pricing at Adelaide. AAL does not charge any competitor other than taxis (and like services) and competes against taxis, off airport parking, on airport parking (such as use of IKEA car park), valet parking, public drop off and public transport.

Adelaide is still a comfortable environment for road transport with most journeys achievable in half an hour. As the airport is in close proximity to the city, alternative transport is relatively cheap and quick.

Car parking charges in Adelaide generally are much lower than other Australian Capital cities other than Perth and this exerts a constraining effect on airport pricing. Adelaide Airport car parking is closely aligned with CBD prices and compares favourably the longer the term.

The following table compares Adelaide Airport car parking rates with competitors and CBD rates.

PROVIDER	Short Term				Long Term		
	1 hr.	4 hrs.	8 hrs.	24 hours	1 day	7 days	14 days
Adelaide Airport	\$ 4.00	\$ 14.00	\$ 26.00	\$ 30.00	\$ 25.00	\$ 70.00	\$ 105.00
Airport Security Parking							
Open				\$ 21.00	\$ 21.00	\$ 110.00	\$ 135.00
Under Cover				\$ 30.00	\$ 30.00	\$ 150.00	\$ 195.00
Qantas Valet				\$ 47.00	\$ 47.00	\$ 245.00	\$ 365.00
CBD							
Wilson							
North Tce	\$ 4.00	\$ 12.00	\$ 12.00				
Central	\$ 8.00	\$ 21.00	\$ 25.00				
Centrepont	\$ 3.50	\$ 14.00	\$ 25.00				
City West	\$ 6.00	\$ 12.00	\$ 14.00	\$ 14.00			
Hindley St	\$ 8.00	\$ 21.00	\$ 25.00	\$ 25.00			
UPark							
Central Market	\$ 2.60	\$ 12.00	\$ 25.00				
Frome Road	\$ 3.00	\$ 8.30	\$ 18.00	\$ 25.00			
Gawler Place	\$ 3.50	\$ 14.00	\$ 27.20				
Grenfell St	\$ 3.50	\$ 14.00	\$ 27.20				
Rundle St	\$ 3.50	\$ 14.00	\$ 27.20				
CBD Indicative Average	\$ 4.56	\$ 14.23	\$ 22.56	\$ 21.33			

Source: company web sites

AAL makes only a minimal charge for taxis and limousines. This charge has been fully discussed and accepted by the South Australian Taxi Council. 80% of the charge is used to provide concierge services as well as providing funds to the South Australian Taxi Board to provide for taxi driver education. The balance of the charge funds capital investment in providing amenities for taxis and taxi drivers at the airport.

Prior to the construction of the new terminal, Adelaide Airport had no direct public transport services. AAL lobbied hard with the State Government to introduce public bus services which have subsequently been introduced and are now frequent and well patronised. AAL has also committed to a “Light Rail” or rapid transit system by reserving a transport corridor within the airport boundary to the passenger terminal in its 2009 Master Plan. AAL clearly shows on its website the options open to passengers for transport to and from the airport including vehicle parking, public transport, car rental, taxi and shuttle bus services. These actions are not indicative of a company trying to use its market power to preserve or enhance its income.

AAL contends that in relation to car parking that it does not have substantial market power because;

- currently only 16% of passengers use the car park facilities;
- it competes against other modes of transportation;
- it competes against off and on airport car parking services;
- the ease of drop off and ancillary waiting areas around the airport for which there is no charge;
- of its proximity to the Adelaide CBD;
- the ease of transport within the Adelaide metropolitan area; and
- the price expectations of South Australians as indicated by the level of car park pricing in the CBD.

## Airport Planning Regulation

Adelaide Airport is the major gateway to the State of South Australia and services international, domestic and regional flights with a total passenger throughput of in excess of 7 million passengers per annum and 100,000 aircraft movements. The airport is located 6 kilometres due west of the CBD of Adelaide City and 2 kilometres from the shores of the Gulf St Vincent. It is surrounded by residential, recreational and light industry developments.

The Airport is bounded by 2 major arterial roads running north/south and east/west. Equally as the airport has impacts on these roads, the growth of passing traffic also impinges on access to the airport.

AAL recognises the potential impact on external road systems of both the growth in aeronautical activity and commercial developments taking place on airport land. AAL liaises closely with both State and Local Government on these matters through the Master Plan and Major Development Plan requirements of the Airport Act as well as various consultative committees and direct access to appropriate local and state officials.

To assist in the planning process with the State Government, AAL has funded partially or in full several surface access traffic studies. At the request of Local Government for assistance AAL has wholly managed and funded major intersection work outside the airports boundaries where the need for this has arisen from the impact of urban infill growth and airport activities. AAL does not believe that it should be liable for road works beyond those needed to address the immediate impacts of the Airport along its boundaries.

In regard to land use planning for that land not required for aviation purposes, AAL has worked collaboratively with the State Department of Planning and Local Government since privatisation to identify the most suitable layout of land use precincts within the airport boundary. Once the precincts were identified and agreed, AAL adopted the State's Objectives and Principles of Development Control for approved or complying uses within those precincts.

Having adopted the State Planning guidelines; AAL is of the opinion that in combining the Commonwealths requirements and the State Governments guidelines, it now has an effective planning regime between the Airport and the State.

AAL was the first Airport to include its Environmental Strategy and a traffic study in its Master Plan. AAL has had a Consultative Committee since its inception (1998). It has hosted a planning forum for the past six years and has an independent chairman for the Consultative Committee for the past 4 years, both well before these requirements being proposed by the Federal Government.

Of more concern are deficiencies in planning protection for airports outside their boundaries. For example, the planning approval of a redevelopment of a site at 43, Knight Street, Richmond which is within the 35 ANEF contour and being a two storey building shares its height with the Obstacle

Limitation Surface (OLS) boundary at that location. This was not a preferred outcome but was strictly within the law as it stands.

AAL has always considered the need to work closely with State and Local Government essential to its business and has worked tirelessly to achieve a good working relationship with both bodies. It has pre-empted significant approaches to planning now required under regulation. It submits that it has achieved a planning environment which is properly integrated with local planning and is willing to bear its share of the economic costs arising from the airports activities.