MAp Airports Limited

Submission to the Productivity Commission Inquiry: Economic Regulation of Airport Services

April 2011

Executive summary

MAp Airports Limited (MAp) is an experienced investor in and operator of airports, having made significant investments in eight airport companies across several regions of the world. MAp's approach is to be an integrated investor in and strategic operator of airports, and our experience is that strong financial performance is best achieved through customer-focussed innovation. In particular, we recognise that the protection and development of the route network is paramount. MAp, the airlines and the communities served by the airports have benefited from strong commercial relationships between MAp's airports and their airlines.

MAp hopes that this submission will assist the Commission by providing some international context to some of the issues in the Terms of Reference.

Airport competition is substantially greater than when MAp made its first investments in 2002, largely as a result of changes in the airline industry. Competition has been further increased by more commercially focussed airports (often in private ownership) and the increased involvement of other stakeholders (including governments). It is likely that the level of airport competition will only increase further in the future, as these trends continue.

The major trends that have increased airport competition have been the rapid growth of:

— **Leisure passengers**: who have a wider choice of travel options
— **Low cost airlines**: which have the ability and willingness to operate between any two airports within a broad catchment area – and frequently run competitions for new bases.
— **Network airlines with bases in multiple countries**: which have increased choice of aircraft deployment.
— **Travel from Asia and through the Middle East**: which has shifted the majority of growth to airlines which have the choice of destinations anywhere in the world.

The result of these developments is that airports compete globally for aircraft movements.

MAp's experience is that both airports and airlines benefit from strong commercial relationships. Put simply, commercial relationships provide 'win-win' opportunities which do not arise during formal regulatory processes and may effectively be excluded by the focus on the regulatory game. These commercial opportunities typically outweigh any regulatory 'win' that either party could reasonably expect to achieve on airport charges which typically represent only a small component of the air fare.

For example, at both Brussels and Copenhagen airports, opportunities have been identified in consultation with the airlines to improve the experience of transfer passengers with modest operational changes or investment. These changes will increase the competitiveness of both airports and airlines for transfer passengers, therefore also supporting long haul route development. In addition, Copenhagen Airport has opened CPH Go, a new facility designed with input from low cost airlines to facilitate growth in the point-to-point leisure market.

In addition to increased competition, the current environment has been made more difficult both as a result of the series of traffic disruptions which have occurred and the reduced availability of capital post the GFC. The downgrading by S&P of seven of the nine European airports they rate is evidence of the changed market perception. The reduced availability of debt and increased costs of debt and equity have made investment more difficult.

Investors are also concerned about regulatory risk, including the potential for regulatory truncation of returns (arising from the asymmetrical intervention of regulators or governments) and the intrusion of 'one-size-fits-all' regulation into the development of commercial relationships and product differentiation. Confidence to invest has been provided by the commercial agreements which have been negotiated, and the expectation that a track record of commercial negotiations with the airlines would be reflected in reduced regulatory risk.

In MAp's experience the greatest cost of regulation is the distraction from these commercial relationships between airports and airlines that results, as well as the likelihood that statute based regulatory processes will restrict product and price differentiation.

It is clear that the increased competition and uncertain commercial and investment environment have reduced any benefits likely to arise from regulation. At the same time, the regulatory costs of reduced flexibility – whether to respond to different airline priorities or the changing environment – have also increased.

1. About MAp

MAp was listed on the Australian Securities Exchange in April 2002, with a mandate to invest in airports – MAp's investors are predominantly Australian and international superannuation funds and Australian mums and dads. It is an experienced investor in and operator of airports, having made significant investments in eight airport companies across several regions of the world, and currently has investments in Sydney, Brussels and Copenhagen airports.

MAp employs an experienced team with backgrounds in airport management, low cost airlines, network airlines, and infrastructure financing and investment. These employees have had extensive experience of commercial and regulatory negotiations across a large number of jurisdictions and from both airport and airline perspectives. In addition MAp's Head of Europe gave regulatory advice to the UK Treasury in relation to BAA prior to its privatisation in 1987, and a number of airports, airlines and governments on regulation between 1994 and 2000.

MAp hopes that this submission will assist the Commission by providing international context to some of the issues in the Terms of Reference. It is not a comprehensive response to all of the issues raised – instead it shares our international experiences of competition, commercial relationships and collaboration, regulation and investment. In the expectation that the Productivity Commission will receive many submissions which relate entirely to Australia, the examples used in this submission will largely relate to MAp's longest term European investments which have been in Bristol (March 2002 to December 2009), Brussels (December 2004 to present) and Copenhagen (February 2005 to present).

1.1 MAp's airport investments

The airport companies in which MAp has or had significant investments are:

— **Bristol Airport**. A regional airport in England, west of London and close to the Welsh border, with approximately 6 million passengers.
— **Birmingham Airport**. A regional airport located south-west of London and south of Manchester, with approximately 9 million passengers.
— **Sydney Airport**. MAp initially invested in Sydney Airport in June 2002, and currently owns approximately 74%. Sydney Airport is MAp's largest investment.
— **Aeroporti di Roma**. Rome Fiumicino (36 million passengers) and Rome Ciampino (5 million passengers), the two airports in the Rome (Italy) airport system.
— **Brussels Airport**. The primary airport serving Brussels, the capital of Belgium and the European Union, with approximately 17 million passengers.
— **Copenhagen Airport**. The only airport serving Copenhagen, the capital of Denmark, with approximately 22 million passengers.

MAp has also had smaller investments in airports in Japan and Mexico, and has evaluated potential investments in many other airports in Europe, USA, Asia and Australia.

1.2 MAp's investment and management approach

MAp's approach is to be an integrated investor in and strategic operator of airports.

Airports provide a range of services to meet the different needs of different passengers travelling for different reasons. In doing so, they generate substantial benefits for the local community in terms of jobs, economic activity and connectivity to the world – benefits which are well documented. The interests of airports are closely aligned with

those of the communities in which they are located – for both the airport and the community the protection and development of the route network is paramount. This alignment of interests with the community is closer than it is for airlines, which have a wider choice of communities to fly to.

However, airports do not act in isolation. Rather, they provide the service to passengers jointly with airlines[1], land-based transport providers, accommodation providers and a range of other stakeholders including government agencies. Our experience is that strong financial performance is best achieved through customer-focussed innovation, and we encourage strong commercial relationships between our airports and their key stakeholders. We also encourage information sharing between our airports.

MAp, the airlines and the communities the airports service have benefited from these commercial relationships. For example:

- Bristol Airport grew three-fold from 2.1 million passengers to 5.9 million passengers between 2000 and 2007. It is one of the few airports in Europe with both easyJet and Ryanair bases, whilst continuing to have a strong network carrier and charter presence. These successes have relied upon strong relationships with the airlines and innovative commercial contracts.
- Copenhagen Airport has strategic partnership agreements with its largest airlines and the Danish railway operator to reduce the minimum connection time for transferring passengers, improve the transfer experience for passengers, and improve the rail connections to the airport throughout Denmark and Southern Sweden. As a result, more passengers can conveniently access – or transfer through – the airport. easyJet was closely involved in the design of CPH Go, a new pier opened in 2010, and now operates to eight destinations from Copenhagen Airport.
- Brussels Airport agreed a €460 million investment plan with its airlines[2]. The plan includes shorter walking distances for passengers and hence reduced minimum connection times, increased capacity and only modest increases in charges to support the investment – and will facilitate the growth of Brussels Airport as a hub for the Star Alliance, already reflected in recent announcements of new routes.
- Sydney Airport negotiated 17 year commercial agreements with Qantas, Virgin Blue and other airlines in 2002 for the use of Terminal 2 (T2). These agreements provided the airlines with strong incentives to use the terminal efficiently, enabled the entry of Tiger Airways into Sydney Airport, and facilitated the growth of Regional Express and other regional airlines at Sydney Airport. T2 now handles more than double the passenger volumes achieved when it was operated by Ansett, which is reflected in lower average charges than would otherwise be the case.

[1] The appendix provides an example of the extent of interdependence within passenger check-in and baggage
[2] http://www.brusselsairport.be/en/corporate/news/13772/#

2. Global developments in aviation

Airport competition is substantially greater than when MAp made its first investments in 2002, largely as a result of changes in the airline industry. Competition has been further increased by more commercially focussed airports (often in private ownership) and the increased involvement of other stakeholders (including governments). It is likely that the level of airport competition will only increase further in the future, as these trends continue.

The major trends which have been responsible for the increased level of airport competition have been the rapid growth of:

— Leisure passengers
— Low cost airlines
— 'Multinational' network airlines
— Travel in all of the emerging markets, which has supported the growth of large airlines based in these regions.

These trends have a common theme – the increased flexibility by airlines to deploy their aircraft anywhere in the world, giving rise to global competition amongst airports for aircraft movements. Whilst the examples given below largely relate to MAp's European experience, the same trends have emerged in the Asia-Pacific region (and specifically in Australia).

2.1 The growth of leisure passengers

Leisure passenger numbers have grown significantly more quickly than business passengers, as a result of higher disposable incomes, lower real air fares, new route opportunities and a wider community desire to experience different cultures and natural environments. Importantly, competition for leisure passengers – and relevant airlines – tends to be greater than competition for business passengers.

First, from the perspective of an airport, leisure passengers are often more valuable since they are both less dependent on travel in peak periods (and hence are less likely to result in new capital expenditure), and more likely to contribute towards retail income.

Second, leisure passengers have a wide choice about where they travel to and from, how they travel, and how often. For example:

— Residents of Singapore can choose any destination for their holiday. They could choose to travel to any of the locations served by MAp's airports, but could equally fly to any airport in the world, take a boat elsewhere in the Asian region, or stay in Singapore.
— Residents of Copenhagen going on holiday to the Mediterranean could fly from Copenhagen Airport, catch the train or drive. Despite a distance of over 1500 km, both land-based options are popular for travellers visiting multiple locations on their trip.
— Expats working in Brussels can choose how often to travel home to visit friends and family.

With such a wide choice, the decisions of leisure passengers will depend on a variety of factors, including the perceived attractiveness of different destinations, the accommodation options, the availability of convenient flights and air fares. Many governments and tourism authorities have recognised the benefits of tourism and actively develop their attractions, encourage hotel development and incentivise airlines to operate to their airport.

Airports are even more conscious of the benefits of convenient flights and low air fares to attracting leisure traffic. All the airports that MAp has worked with have significant airline marketing departments and incentive schemes in place to attract new services – particularly outside the peak – and many have successfully built relationships with local and national tourism authorities and other tourism-related businesses to jointly promote tourism development. Airports identify underserved and unserved routes in their networks, and market to specific airlines which might be attracted to them – often flying overseas to visit the head offices of each airline. Airports also work with airlines to grow the market, and share the financial risks of new routes.

Airports also attend Routes conferences, at which airports and airlines from around the world discuss route opportunities (and at which airlines will meet multiple airports bidding for their aircraft). The larger airports (including Sydney, Brussels and Copenhagen in 2010) now also pay for marketing booths at the IATA Slots Conferences, which airports did not generally attend until recently.

2.2 The growth of low cost airlines (LLCs)

The growth of leisure passengers has been supported by, and a catalyst for, the growth of LCCs. The success of the LCC business model has changed the landscape for both airlines and airports – and for the entire tourism and travel industry. The LCC business model typically includes:

- A focus on maximising the number of hours each aircraft is in the air by minimising turnaround times and operating from early in the morning to late in the evening. As a result LCCs tend to prefer infrastructure which is simpler to use, and tend to utilise airport infrastructure more productively.
- The ability and willingness to operate between any two airports within a broad catchment area. For example, easyJet operates from 19 bases in eight countries, and flies to approximately 130 airports[3]. Similarly, Ryanair operates from 44 bases to 160 airports across 27 countries[4]. When making route decisions LCCs seek to maximise the profitability of their entire network, and will assess the best options from all of their bases – including whether current routes should be replaced by new routes.
- A strong cost focus, founded originally on a very simple product, low marginal fares and very high load factors. As a result airports are very conscious of the need to ensure that all airline costs at their airport (of which airport charges are but one component) are competitive – including indirect costs such as taxi time.
- Disaggregation of the product, allowing passengers to only pay for the services they want. This facilitates lower air fares without unduly compromising the service for those willing to pay. The LCCs expect the airports to be able to facilitate the disaggregation of the passenger experience – for example, by providing different check-in alternatives.
- Participation in the other travel activities of the passenger. This includes both disintermediation (such as booking only via the airline's website) and involvement in activities as diverse as airport car parking, buses to the airport (eg easyBus) and hotels.

The success of the airport in negotiating with the LCCs, and in maintaining the relationship, can be very important to its success – particularly since the LCCs can and do make decisions to add or remove seat capacity equivalent to a million passengers or more. LCCs such as easyJet and Ryanair hold annual competitions for their new bases. In addition, LCCs routinely close or downgrade bases that are not performing as well as expected – and charter airlines have responded. For example:

[3] http://www.easyjetcareers.com/careers-in-the-air/map-of-our-bases.aspx. Sourced 25 March 2011
[4] http://www.ryanair.com/en/about. Sourced 25 March 2011

— Transavia closed its Copenhagen Airport base on 1 April 2011[5], and in 2007 Ryanair closed its Malmo-Sturup base (Copenhagen's nearest competitor)[6].
— Jetairfly (a charter airline) relocated an aircraft from Brussels Airport to Charleroi Airport in 2008[7], in order to compete with Ryanair which carries in excess of four million passengers to Charleroi each year.
— Ryanair opened new bases to Barcelona, Seville, Valencia, Malta, Oslo Rygge and Leeds Bradford in 2010 and closed Marseille and Belfast City[8].

Airports need to respond to the characteristics of LCCs with an approach different to that appropriate for traditional network airlines. Different infrastructure is required as are commercial agreements that encompass both aeronautical and commercial activities.

2.3 The growth of multinational network airlines and alliances

Whereas network airlines have traditionally had a single national home market from which all international routes commence, there are now many airlines which have a home market that includes several countries. The larger number of home markets gives the airlines the flexibility to respond to changing demand and competition on specific routes by allocating and reallocating aircraft. By increasing the choice of new routes, the airlines gain increased negotiating power with the airports.

The growth of the multinational network airlines has arisen through a combination of airline mergers (eg Lufthansa's acquisition of Swissair, Austrian, BMI and Brussels Airlines), liberalisation of air rights, and joint ventures between (foreign) airline operators and domestic investors.

The establishment by several network airlines of LCC subsidiaries has also increased the airlines' range of options and therefore their negotiating power with airports. LCC subsidiaries have been established by airlines such as AirFrance–KLM (Transavia), Lufthansa (Germanwings) and Qantas (Jetstar).

2.4 The growth of travel from the emerging markets and on the emerging airlines

The fastest growing markets are in the emerging regions – Asia, Latin America, Africa and the Middle East – with the importance of different regions to an individual airport depending on geographic proximity. Of these regions, the two which are expected to have the greatest long term impact are Asia and the Middle East.

In 2009, Asia Pacific overtook North America as the world's largest aviation market, and IATA forecasts that Asia Pacific will account for 45% of the growth in traffic to 2014[9], increasing the Asia Pacific market share from 26% to 30% of total world traffic. This growth is supported by a huge population and a growing middle class. The growth of Asian travel represents a large pool of passengers that are free to choose from a multitude of destinations – whether in Europe, North America, Asia, Australia or elsewhere. These passengers also have a wide choice of airlines on which to travel. Competition for these passengers is strong amongst airports and airlines around the world – to miss out on these passengers is to miss out on 45% of the potential growth of the airport.

The Middle East is also important, albeit less for its outbound traffic and more for its geographic location and oil-funded airline growth. From the Middle East it is possible to

[5] http://www.anna.aero/2010/09/29/transavia-com-first-to-blink-in-copenhagen-low-cost-battle/
[6] http://www.thelocal.se/8693/20071004/
[7] http://www.charleroi-airport.com
[8] Ryanair website – compilation of individual press releases
[9] http://www.iata.org/pressroom/speeches/Pages/2011-02-14-01.aspx

reach every airport in the world without a stop. As a result, an airline based in the Middle East can connect any two airports in the world with only one stop. This has two implications: first, it provides the Middle East carriers with an important strategic advantage and makes them an important source of growth for airports; second, it allows secondary airports to be connected with only one stop to destinations that were previously unrealistic. Airports are therefore keen to attract this traffic and will compete strongly to do so.

2.5 Investing in the presence of risk

In order to invest it is necessary to meet two inter-related criteria:

— It is possible to raise the capital (debt and/or equity) to make the investment.
— The forecast return on the investment is at least high enough to compensate for the assessed risks.

It is MAp's experience that the investment environment is more difficult now, and in recent years, than it was previously. In the first instance, the assessment of traffic risk has been changed by both debt and equity providers, as a result of the series of disruptions which have occurred. To put this series of disruptions into context, it is worth recognising that prior to 2001; the only events which had materially disrupted world traffic had been the oil crises in the 1970s-1980s.

The increased assessment of traffic risk is evidenced, for example, in the greater number and severity of traffic sensitivities requested by potential lenders during the refinancing of debt. Compared to previous years, this sensitivity to risk is reflected in the terms of the debt – higher debt margins, reduced debt quantities, and stricter debt covenants.

The availability of capital is also affected directly by the GFC, which generally reduced availability regardless of risk.

The combined impact of the increased risk perception and lower market liquidity has been experienced at all of our current airports:

— Brussels (BBB to BB+; July 2009) and Copenhagen (BBB+ to BBB-; 2nd downgrade was in February 2010) were both downgraded by S&P.
— Sydney Airport recapitalised its balance sheet by $1.4bn in late 2008 and early 2009 to support a significant investment programme.

Investors are also very conscious of regulatory risks, particularly:

— Regulatory truncation arising from the asymmetrical intervention of regulators or governments. This could be by intervention in one area of the airport which is 'too' profitable despite the presence of other areas of the airport in which profits are low – or by intervention in years in which the airport is more profitable than average despite below-normal profits in the preceding years. It could also result from the removal of upside potential, without the creation of equivalent downside protections.
— The intrusion of 'one-size-fits-all' regulation into the development of commercial relationships and product differentiation, either directly or through the creation of regulatory precedent reducing the ability of the airport to differentiate its offering and therefore to compete.

Investments at all of MAp's airports have been made in the expectation that the regulatory regimes would remain stable, and that a track record of commercial negotiations with the airlines would be reflected in reduced regulatory risk.

3. The influence of regulation

Economic regulation is introduced to safeguard against the abuse of market power to achieve excessive returns – whether through excessive pricing, withheld investment or the degradation of service quality. Whether regulation is appropriate (and if so, in what form) will depend on the extent of market power, the existence of other deterrents to the use of any market power, and the costs of regulation.

The previous section demonstrated how changes in the aviation industry have given rise to substantially greater competition amongst airports – and increased airline countervailing power. Consequently the need for and potential benefits of regulation have decreased. At the same time, the costs of regulation have increased due to the increased differentiation of airline models and greater uncertainty.

Whilst there are direct costs of regulation, in MAp's experience the greater costs of regulation are the unintentional influences on the behaviours and performance of airlines and airports. These include:

— The distraction from constructive commercial relationships between airports and airlines.
— Statute based regulatory processes which restrict the potential to embrace product and price differentiation.
— The tendency for regulators over time to seek (with the best of intentions) to refine regulation, with the result that its intrusiveness and burden can increase.

3.1 Regulation as a distraction from commercial negotiations

MAp's experience is that regulatory processes almost inevitably cause some impediment to the development of commercial relationships. At one extreme, airport-regulator and airline-regulator relationships can almost replace the direct airport-airline commercial and strategic relationships. This is traditionally the case where the regulator determines pricing and a large investment programme gives rise to a large and contentious increase in charges. Even where the regulator encourages commercial interaction as part of the regulatory process, the sheer length of the regulatory process and the fact that the final decision is a regulatory one can prevent the full benefits of commercial interaction materialising. Time and effort that could be spent on developing commercial oriented solutions is diverted to the regulatory processes.

Even where there are strong relationships between the airport and the airlines, the regulatory process can take a life of its own that is contrary to the overall strategic interests of both parties. This is more likely if the representatives in the regulatory process don't have sufficiently broad perspectives of their businesses[10].

The distraction from commercial negotiations is likely to reduce the potential to identify opportunities to collaborate – through the diversion of attention, the loss of goodwill and in some cases regulatory posturing. These opportunities might include projects which are clearly beneficial for both the airport and the airline – such as the reduction in the minimum connection time (MCT) at Copenhagen. More common, however, will be many projects which provide a benefit to the airline at the expense of the airport – or vice-versa. As with the provision of CUTE at Sydney Airport, a separate fee could be negotiated for these services. Alternatively, contra-agreements can set off two projects with overall gains to both parties. These opportunities are best identified and realised in a commercial context.

[10] See the confidential appendix

3.2 Statute-based regulation restricts product and price differentiation

Our experience is that many airlines are open to differentiation of products and prices, to reflect their specific needs. At Bristol Airport, which is unregulated, most or all airlines receive pricing levels and structure specific to their circumstances and requirements – equally, airlines with similar circumstances receive similar pricing levels and structure. Most importantly, the degree to which each airline contributes to the productive use of infrastructure is clearly reflected in the price – as is the extent to which each airline is promoting new routes to the airport.

Product and price differentiation is difficult for regulators. It demands a degree of flexibility to changing commercial circumstances which sits uneasily with rigid regulatory timetables and inevitably limited knowledge of the individual requirements of airports and airlines. For example, different charges structures may be appropriate for different airlines. An airline that is curfew constrained will not be influenced by off-peak discounts but might respond to a charges structure that encourages larger aircraft – whilst an LCC will be more likely to respond to off-peak discounts. Assessing the relative value of these arrangements in changing circumstances is difficult for a regulator. Yet applying one structure to all airlines, or constraining the development of alternatives, is likely to be to the disadvantage of the airport and the airlines.

3.3 Risk of ever-increasing regulatory involvement

Our experience is that, in order to facilitate commercially negotiated outcomes, it is necessary to protect against the easy involvement of the regulator – whether through compulsory arbitration at the instigation of one party, or the involvement of the regulator at its own discretion.

The reason that strong protections are necessary is that there are potential pressures for regulatory involvement from a large number of parties. These include the airport, individual airlines, the airline representative bodies, and the regulator itself.

- **Airport**. Since there is a high degree of traffic risk and regulators cannot guarantee prices in an uncertain and/or competitive market, regulators cannot effectively protect airports but can limit their upside. Hence the airports have little incentive to involve the regulator. Nevertheless, whilst an airport is unlikely to seek regulator involvement, it will of course seek to get the best outcome from any regulatory process.
- **Airlines**. Unless the regulatory regime has specific provisions otherwise, individual airlines can seek regulatory intervention. Minimum thresholds (eg airlines representing 25% of passengers) are included in some jurisdictions to reflect this. Any given airline could seek regulatory intervention for a number of reasons unrelated to an airport's use of market power, such as:
  - It has a policy preference for regulatory arbitration, and won't reach a commercial agreement unless it is clearly better than a regulator's decision would be. This could include airlines based in jurisdictions that have high regulatory involvement.
  - It has already available to it a standard deal that has been negotiated with other airlines, and therefore believes there is limited risk from pursuing a regulatory intervention which may offer some further advantage
  - It believes a regulator would impose a charges structure which would benefit that airline relative to other airlines.
  - It believes, based on statements or past decisions of the regulator, that the regulator tends to favour airlines rather than airports.
- **Airline representative bodies**. Whilst in our experience organisations representing the airlines can and do negotiate commercial agreements (albeit within the constraint of a single deal for all of the airlines represented), their negotiating positions will often reflect their own policy positions in addition to the

airport-specific needs of the airlines. Such policies may encourage these organisations to seek further regulatory involvement and a broader 'one-size-fits-all' goal:

"Whilst there are many different methods of economic regulation in use across a range of industries around the world, it is IATA's position that Incentive Regulation (CPI-X) is the most appropriate ..."[11]

"IATA does not agree to price discrimination in the forms of peak/off-peak pricing, marginal pricing and discriminatory & non-cost related discounts and rebates."[12]

— **Regulator**. There is ample evidence that individual regulators differ, from those who will initiate intervention to those who are reluctant to intervene. In MAp's experience it is difficult to see how commercially negotiated deals could survive in the long term if the regulator is easily available and pre-disposed to intervene – and leadership changes can change the regulator's attitude towards intervention over time.

Once the regulator has become involved, overseas experience is that the level of regulatory involvement increases over time. In the first instance, there is a tendency for each individual regulatory decision to set a precedent for future commercial agreements – progressively narrowing the scope for innovative and flexible agreements, and eventually becoming equivalent to the reintroduction of regulatory price setting by default.

In addition, there is the tendency for regulatory determinations to become more complicated. For example, the regulatory determination for London Heathrow includes specific adjustments to charges related to the completion of individual capital investment projects. This determination was made to align the interests of the airport with completion of the projects included in the charges. These were introduced in 2003 and covered five aspects of the T5 build[13]. By 2009 the number of triggers had expanded to 23[14]. Moreover, due to the difficulties that occurred on the opening of T5 some other projects were delayed and it has been necessary for the airport and airlines to revise some of these triggers. Similarly, at London Gatwick following new ownership there also had to be significant review of the investment triggers[15]. There has also had to be regulatory involvement at both airports since 2008 on account of differing interpretations of the trigger events[16].

The CAA determinations for these airports now occupy more than two years out of every five, and contain extensive detail on many areas – despite the intention of the regulator to broker commercial negotiations evidenced in the requirement for "constructive engagement" introduced in 2005[17].

The evidence of increased competition and the more uncertain commercial and investment environment tend to reduce both the need for – and any benefits likely to arise from – regulation. The costs of reduced flexibility to respond to different airline priorities and a changing environment has also increased, and the inherent pressures for enhanced regulatory involvement also needs to be taken into account in assessing the costs of regulation.

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[11] IATA submission to Productivity Commission 2006. Page 7
[12] ibid, page 9
[13] http://www.caa.co.uk/docs/5/ergdocs/erg_ercp_triggersdecision.pdf. Page 2
[14] http://www.caa.co.uk/docs/5/ergdocs/20090227HeathrowTriggersSpec.pdf . Table 3.1
[15] http://www.caa.co.uk/docs/5/ergdocs/20100505RevisedGatwickTriggers.pdf
[16] For example, http://www.caa.co.uk/docs/5/ergdocs/20100218BushGilthorpeT4BaggageSorterDecision.pdf
[17] http://www.caa.co.uk/docs/5/ergdocs/erg_ercp_airportregulation_may05.pdf

4. Commercial relationships

MAp's experience is that both airports and airlines benefit from strong direct commercial relationships. Put simply, commercial relationships provide 'win-win' opportunities which do not arise during regulatory processes.

These commercial opportunities typically outweigh any regulatory 'win' that either party could reasonably expect to achieve on airport charges which typically represent only a small component of the air fare. A 10% 'win' on a regulatory decision would represent an even smaller component of the air fare. There is much more to gain from ensuring the airport facilitates improvements in airline efficiency or passenger experience. It should therefore be in the airlines' interest to work with and incentivise the airport to ensure investments or innovations which reduce the airlines' other costs, increase their revenue yield (through improved passenger service), or increase traffic volumes (through more flights or higher load factors). Similarly, commercial agreements which increase traffic volumes, add new commercial services to airlines, or increase commercial revenues from passengers, can be of significant value to the airport.

The potential benefits of strong commercial relationships to both the airports and the airlines are borne out in MAp's experiences at its airports, some examples of which are described below. These benefits are strongest at Bristol Airport which, like most airports in the UK, is unregulated – and individual agreements have been reached with all airlines which have encouraged route development and efficient use of the infrastructure. Brussels and Copenhagen airports have also benefited from commercial relationships, but the benefits have been limited by the respective regulatory regimes – for example, the need for 'one-size-fits-all' solutions has limited the options to encourage efficient use of the airport infrastructure.

4.1 Bristol Airport

Bristol Airport has highly differentiated charges to reflect different capacity constraints at different times of the day and year, and different airline priorities. The charges encourage airlines to introduce new routes by offering heavily discounted charges, particularly during the off peak or during winter. The two major European LCCs, in particular, have taken advantage of these arrangements. This benefits the passenger as they are offered a more comprehensive route network, and the airlines as they can be flexible on yield to attract passengers as their costs are lower. It also benefits the airport as there is an increased utilisation of infrastructure.

Bristol Airport has also offered incentive arrangements to advertise car park bookings on the airlines' websites. Airlines are paid a commission for every booking with Bristol Airport – and passengers are provided with one stop shopping for car parking and air travel.

4.2 Brussels Airport

In September 2010 Brussels Airports reached an agreement with its airlines[18] on the charges for the five years commencing 1 April 2011. This agreement followed a six month period of consultation and negotiation with all of the airlines or their representatives on the development of the airport and the appropriate level and structure of airport charges.

[18] Airlines or their representatives representing in excess of 90% of passengers and cargo formally supported the charges proposal in writing, as did the major cargo airlines

The discussion of the plans for infrastructure, services and charges was guided by a set of agreed principles and objectives[19]. Overall, the intent was to improve the competitiveness of flights operating from Brussels Airport relative to other airports, and to better align the interests of Brussels Airport and the airlines.

The discussion was assisted by the collaborative relationships Brussels Airport had already developed with many of the airlines. As a result of these relationships the draft Development Plan already incorporated the airport's understanding of the various airlines' priorities – and proposed an investment programme in alignment with these priorities.

The final development plan and charges agreement varied significantly from previous plans and the minimum requirements of the regulatory framework, reflecting the changes in the airlines' strategies (the most significant being Brussels Airlines' entry into the Star Alliance) and also the level of uncertainty.

For example:

— The 'Connector Building' project, which provides above-ground access to the main pier (currently accessed via a tunnel). The passenger benefits delivered, including shorter walking distances and reduced MCTs, as well as the increased security capacity are now considered more important than the slightly reduced flexibility for aircraft movement. Whilst beneficial for all passengers, this project should make Brussels Airport significantly more attractive for transfer passengers in particular – supporting the growth of long haul and short haul traffic. It also provides an opportunity to improve the retail offering to passengers.
— A number of renovations to the existing terminal infrastructure are planned to improve the experience of passengers who are bussed from the aircraft to the terminal (bussed passengers). These investments will increase the capacity of the bussing lounges and reduce walking distances for bussed passengers – and will also release aprons for additional long haul capacity.
— Agreement was reached on a formula for the remuneration of Pier A West, which is the next major expansion of the airport. This investment will commence during the current regulatory period, and the timing, detailed design and cost remain flexible to changes in airline priorities. As a result, it was agreed that the airport will be remunerated as the investment is incurred, with a 0.25% increase in charges for every €10 million invested.

4.3 Copenhagen Airport

Copenhagen Airport and Scandinavian Airlines (SAS) have formed a strategic partnership to promote the development of SAS traffic at Copenhagen Airport. A key element of this partnership has been a joint working group to enable a reduction in the minimum connection time (MCT) from 40 to 30 minutes. A passenger can only book a connecting flight (eg Aarhus-Copenhagen and Copenhagen-Malaga) if the time between the scheduled arrival of one flight and the scheduled departure of another exceeds the MCT. A reduction in the MCT therefore increases the number of feasible connecting flights offered by SAS via Copenhagen Airport. These additional services will all have quick (30-40 minute) connections at Copenhagen Airport, and will be particularly attractive to passengers compared to longer connections at other airports. The reduced MCTs (being implemented progressively from January 2010) are expected to increase passenger volumes for Copenhagen Airport and SAS, and improve passenger service.

Copenhagen Airport has also agreed a strategic partnership with Norwegian Air Shuttle (Norwegian). Related to both partnerships, Copenhagen has reorganised the gate

[19] These are presented in the confidential appendix

allocation for different flights to concentrate SAS in Piers B and C, and Norwegian in Pier A. This further facilitates the transfer traffic of both airlines and also helps the airlines reduce their labour costs. The other airlines, with fewer flights, are not disadvantaged by the changes.

In October 2010 CPH Go was opened, with easyJet as the launch customer. CPH Go is a new facility specifically designed to facilitate growth in the point-to-point leisure market – a market segment which is highly price-sensitive and values turnaround efficiency and cost more highly than premium passenger services.

— It was very cost-effective to build (approximately $40 million for 6 gates) due to the absence of infrastructure such as a transfer baggage system or aerobridges that are not required for this market segment.
— As a result of the lower construction cost, simpler service offering and higher capacity utilisation arising from faster aircraft turnarounds, the facility attracts passenger charges which are 35% lower than for the main terminal.
— The design was jointly developed with airlines experienced in the point-to-point leisure market. As a result, the design of the terminal facilitates efficient operations, whilst providing an appropriate passenger experience for this market. For example, turnaround time is reduced by the use of walk-on gates allowing passengers to disembark or board from both the front and rear of the aircraft.
— For Copenhagen Airport, CPH Go offers the potential for both higher traffic growth and reduced capital expenditure. After two years of rapid growth from Copenhagen Airport, easyJet now operates to eight destinations.
— Users of the main facilities also benefit in the long run from lower charges as a result of the reduced overall capital expenditure and increased passenger volumes. In addition, the relocation of easyJet into CPH Go has facilitated the gate reallocations described above

Copenhagen Airports and its major airline customers have also taken a commercial approach to charges negotiations. In September 2009, in the midst of the global financial crisis (GFC), Copenhagen Airport agreed a 5.5 year charges agreement with the airlines. Recognising the impact of the GFC, Copenhagen Airports agreed to freeze charges for 18 months to 1 April 2011, in exchange for higher charges in the later years of the agreements.

APPENDIX

Joint service provision: passenger check-in and baggage

Passenger check-in and baggage sorting are two related processes which are jointly provided by airports and airlines – and potentially facilitated by other stakeholders. For both of these processes, airports are responsible for providing the infrastructure to all airlines, while each of the airlines is individually responsible for operation of the infrastructure. The processes include a number of steps, commencing well before passengers arrive at the airport:

— **Investment in check-in counters and baggage sorting facilities**. Airport decisions to invest reflect the forecast peak demand for the facilities. The forecast demand for these facilities will reflect forecast peak passenger flows, which is likely to develop very differently to the annual passenger volumes – and will develop differently for different facilities. As a result investment requirements are not well correlated to annual passenger growth.

The relationship between peak flows and annual passengers can be affected by a multitude of factors such as changes in the mix of business (focussed before and after work on work days) and leisure (more flexible on time but with a weekend focus), the growth or decline of a hubbing function (hubs are usually organised in waves of flights, creating high peak demand for gates and aprons) or the collapse of home airlines (which often have distinctive traffic flows). Examples from MAp's airports include the collapse of Sabena (which resulted in the loss of long haul traffic outside the peak hour), the growth of LCCs at all of the airports (which tend to spread traffic more evenly throughout the day, week and year) and the Sydney Olympics (which increased the peak day more than the full year).

In addition, the forecast peak demand for the facilities will take into account forecast changes in passenger behaviour – whether as a result of changing travel profiles or new technologies. For example, the increasing penetration of internet check-in and check-in kiosks has reduced the need for traditional check-in counters – and some airlines have introduced punitive charges for use of check-in counters to discourage their use. The Air New Zealand and Qantas initiatives for their frequent flyers demonstrate the future potential for self-service check-in, which gives control of the process back to the passenger and reduces requirements for airline staffing and investment in check-in desks.

The airport's investment decisions will be based on the efficient use of check-in counters and baggage sorting facilities – it is inefficient for airports to make investments that provide more capacity than necessary, which would lead to increased airport charges.

— **Allocation of check-in counters**. At least twice a year the airport, in consultation with the airlines, will allocate check-in counters to airlines. This will be based on the requests of each airline, both for the number of counters and the specific locations. It is MAp's experience that some airlines request more check-in counters than they will require – potentially to achieve a future competitive advantage over other airlines.

— **Passenger check-in and bag-drop**. As already noted, passenger check-in is increasingly taking place off-airport or at check-in kiosks. At Copenhagen Airport, electronic and self-service check-in account for more than half of locally departing passengers – with check-in available over the internet, in railway stations, in the Hilton Hotel, and at check-in kiosks.

For those passengers who use check-in counters, the perceived service will depend on the ease with which they can find their counter (an airport responsibility), a sufficient number of check-in counters and adequate queuing area (an airport responsibility), and the number of check-in staff and their efficiency (an airline responsibility). It will also rely on sufficient capacity in the baggage sorting facilities (an airport responsibility) and the appropriate use of the baggage sorting facilities (an airline responsibility), as discussed below.

In our experience it is common to see queues of passengers standing in front of check-in counters than are not staffed – an occurrence which airports discourage but cannot prevent. Whilst this is less common during the peak periods, it is more common in the hours immediately prior to the peaks – allowing queues of passengers to develop that then contribute to the peak hour demands. Improved airline staffing during these periods would reduce staffing requirements during the peaks, increase the efficiency of the check-in counters and improve the passenger experience.

— **Baggage sorting**. Baggage checked in is sorted by the infrastructure provided by the airport and made available for the airlines to load onto the aircraft. This process is designed to be automated, using bar-code readers to read the luggage tags. Failures in the process can result from a range of factors: equipment failure due to poor design or maintenance (an airport responsibility), equipment failure due to damage caused by luggage that is too large or not correctly placed on trays (an airline responsibility, although corrected by the airport), misreads due to luggage tags that are incorrectly coded or attached to the bag (an airline responsibility), or misreads due to bags that are not correctly placed on trays (an airline responsibility). All of these failures will have an effect on the reported performance of the baggage sorting facilities, but will rarely have any impact on the passenger experience or on-time performance of the aircraft.

Optimising these linked processes for the benefit of all stakeholders is best achieved through direct collaboration between the airport and the airlines. For example, airports and airlines can jointly improve the training for airline staff to increase the efficiency and availability of the baggage sorting equipment. Similarly, the high take-up of electronic and self-service check-in at Copenhagen Airports has been the result of a proactive approach by the airport and its largest airline customers.