Productivity Commission Inquiry into Economic Regulation of Airport Services

Response to Issues Paper

April 2011

Contents

INTRODUCTION

Melbourne Airport is pleased to have the opportunity to make this submission to inquiry by the Productivity Commission, Economic Regulation of Airport Services, of January 2011. It is our view that the approach adopted by successive Commonwealth Governments in relation to aviation policy in general and airports policy in particular, has generated significant benefits across a wide range of areas.

Melbourne Airport would like to emphasise that the current regulatory regime involving the monitoring of prices, costs and profits and the quality of service of aeronautical services and car parking services has met its objectives. This 'light handed' regulatory regime has led to investment in airport facilities and, under the regime, Melbourne Airport has been able to achieve significant productivity, quality of service and economic efficiency gains over the current monitoring period of 2005/06 to 2009/10.

Since privatisation in July 1997, Melbourne Airport has developed a reputation as a growth-focused, low cost provider of high quality airport services. This is borne out in the monitoring reports by the Australian Competition and Consumer Commission (ACCC). In its Airport Monitoring Report 2009/10, the ACCC states that Melbourne Airport had the lowest aeronautical revenue per passenger and is now ranked among monitored airports for overall quality of service. Similar results are shown by independent research of international airport performance and charging. The LeighFisher Benchmarking Study, provided as Attachment 1 of this submission, finds that Melbourne's charges are the lowest within a sample of nine airports in Australia and New Zealand and compare favourably to 58 international benchmarks. Further, the airport faces competition from other domestic airports such as Sydney Airport, competition with other airports as destinations for international flights, in addition to direct competition from Avalon Airport (currently in relation to domestic carriage, but the airport has plans to develop an international terminal).

The ACCC states in its monitoring report that Melbourne Airport appears to have reduced the ability of off-airport parking and private bus operators to compete with its own car parking services and that this allows the airport to earn monopoly profits from car parking services. The report by PricewaterhouseCoopers (PwC), Car Parking Services Benchmarking, which is provided as Attachment 2 of this submission, analyses competition between different modes of ground transport in relation to Melbourne Airport. PwC concludes that there is competition within all modes of ground transport and that the prices for car parking at the airport reflect the objective of efficiently managing access to the terminal complex. Further, the car parking prices applied are below those for comparable benchmarks, commercial car parks in the Melbourne CBD and are not considered to be indicative of monopoly profits. Ground transportation charges are generally consistent with the provision of services elsewhere. Importantly all commercial users of our forecourt are charged equitable a non discriminatory way.

The ACCC's focus on car parking price comparisons, revenues and operating margins has the potential to be misleading for consumers and does not take into account the individual characteristics of the airports or the inter-related dynamic of the ground transportation market at the airport. The ACCC draws conclusions about monopoly pricing based on the

fact that Melbourne Airport has a higher percentage of revenue from car parking services than other monitored airports. This outcome is however, the result of Melbourne having a high proportion of private vehicle access, the lowest average revenues from aeronautical services and that it provides a high number of parking bays per passenger relative to the average of the other airports.

We wish to emphasise that the airport-airline relationship is dynamic. The existing basis of commercially negotiated agreements, which provides airlines with mutually agreed price paths, service standards and dispute resolution mechanisms, has proven to be efficient and effective. Further, there have been significant changes since the last Productivity Commission review in 2006, most notably in the terms of the commencement of commercial airline operations from Avalon Airport in competition with Melbourne Airport. In the context of this dynamic, competitive nature of the industry and the effectiveness of negotiated agreements in providing appropriate access prices, terms and conditions, additional regulation would only serve to apply additional cost, risk and potential for delay, for no effective benefit for airlines and airports also for passengers and the broader community.

Section (i) below describes the structure and contents of this Melbourne Airport submission.

Section (ii) explains how the issues raised by the PC and by the ACCC, are addressed in this submission.

(i) Overview of this Submission

The contents of this submission are described below. In section (ii) we set out how this submission addresses the issues raised by the Productivity Commission (PC) in its Issues Paper, Economic Regulation of Airport Services, of January 2011 (PC issues paper).

Chapter 1 provides the PC with a range of information about Melbourne Airport's business - it is primarily focused on the aeronautical business and the aviation industry more generally. As the PC has access to the monitoring reports produced by the Australian Competition and Consumer Commission (ACCC), when making comparisons with other airports, our analysis is largely concerned with similar airports overseas. To this effect, Melbourne Airport commissioned an international benchmarking report by LeighFisher Management Consultants (LeighFisher). This report, which is discussed further to Chapter 7, is provided as Attachment 1 of this submission.

The LeighFisher report takes the same form as two reports produced for the same purpose in 2006, in connection with the previous PC Inquiry on the same topic, by the UK Transport Research Laboratory (TRL). In both cases, the work was carried out by or under the supervision of Peter Mackenzie-Williams, who has developed the widely recognised aviation benchmarking publications Airport Performance Indicators and Review of Airport Charges over a period of over twenty years. Peter moved from TRL to LeighFisher at the end of 2006, and the rights to publish these and other publications previously produced by TRL also passed to LeighFisher. In both cases, the work for Melbourne Airport has closely followed the established methodologies used in the published work.

Chapter 2 describes the economic value of the airport in terms of employment generated, investment and contribution to the Victorian and Australian economy. The airport performs a crucial role in the local and national economy and has operated efficiently and effectively under existing arrangements.

This chapter also sets out the benefits of Melbourne Airport in terms of direct and indirect employment and its contribution to the Gross State Product (GSP) of Victoria. The GSP impact of the airport was calculated by Sinclair Knight Merz (SKM) in its study, The Economic Impact of Melbourne Airport. This study also sets out the value of Melbourne Airport's curfew-free status and the value of the airport.

Chapter 3 provides information on the effectiveness of Melbourne Airport's planning and operations. Melbourne Airport works very closely with Government at all levels to ensure that there is strategic planning for future operations, both aeronautical and ground transport. Melbourne Airport's planning processes are being integrated with the new Planning Co-ordination Forum and the Community Consultation Aviation Group. Melbourne Airport also supports the State Government in establishing a rail link between the airport and Melbourne's CBD.

This chapter also details of Melbourne Airport's major investment commitments. The airport expects to invest $1 billion in infrastructure development projects over the next 5 years. These committed projects comprise a combination of aeronautical and commercial developments including roads, airfield aprons and terminal facilities. Importantly, Melbourne Airport has invested $800 million in airport facilities since privatisation and the annual investment amount has increased since the repeal of the heavy handed price cap regime which applied to airport services until 2002. This indicates that the heavy handed regulation may have had the effect of constraining investment, in contrast to the current light handed regime, which has facilitated growth in investment.

Chapter 4 provides an analysis of aeronautical services and car parking services.

In relation to aeronautical services, the services considered in this submission are international passenger services, domestic passenger services and freight services. In Chapter 4 we show that the market power of the Melbourne Airport is limited. The key constraints on the market power of the airport are:

- Network planners, when determining where to place aircraft fleet, consider a range of international destinations that can be reached by the aircraft they are looking to place. This means that there can be some competition between airports on a global basis.

- international passenger services– the power of Melbourne Airport is mitigated by the ability of international carriers to fly to other international ports that have domestic links to Melbourne;

- domestic passenger services - in negotiating commercial agreements with Melbourne Airport on the capacity, quality and price of aeronautical services and facilities, airlines

have bargaining power through the existence of Avalon Airport as an alternative avenue of supply; and

- freight services - the preparedness of freight service operators to move coupled with a general availability of airport capacity gives airports little market power in relation to freight services.

In relation to car parking services, these are considered in the context of the range of modes of ground transport in relation to the airport. It is possible for substitution to occur across all of the services that may be used to access the airport. There may be particularly strong substitution effects between like services eg private vehicle pick-up/drop-off and private vehicle combined with the short term car park; and private vehicle combined with the long term car park or with off-airport car parks serving the airport.

Melbourne Airport's objectives in setting the charges and determining terms and conditions for its services - that is, terminal forecourt access and car parking services – is to efficiently manage access to the kerb in front of the terminal complex and to effect the safe and efficient flow of traffic in the forecourt area.

Chapter 5 sets out the general regulatory mechanisms applying to Melbourne Airport. Essentially, these comprise the monitoring of prices, costs and profits of aeronautical services and car parking services under the prices surveillance provisions of the Competition and Consumer Act 2010 (CC Act); and the quality of service monitoring of airport services and facilities under the Airports Act 1996 (Airports Act) and the Airports Regulations 1997 (Regulations).

The monitoring arrangements under the CC Act and under the industry-specific legislation above can be characterised as representing a light handed regulatory regime. This is because the relevant regulatory agency, the ACCC, is empowered only to monitor the performance of the regulated services and regulated service providers. It does not have the power to determine aspects of the performance of the service providers, such as in the area of pricing. Light handed regulation is consistent with the fact that Melbourne Airport faces competition and countervailing power in relation to the services that it provides.

Chapter 5 also sets out the third party access regime to essential services provided under Part IIIA of the CC Act. The case of the declaration of airside services at Sydney Airport provides evidence that the access regime in Part IIIA may be used effectively by an airline to facilitate access to aeronautical services. Part IIIA serves not only as an available remedy for airlines or other access seekers but also, potentially, a deterrent to misconduct by airports.

The access regime under Part IIIA, should it apply to Melbourne Airport, could be heavy handed in its effect. Once a service is declared under this part, access seekers have a right to negotiate access to the service. The negotiation process involves private negotiations between the access seeker and access provider. Where access agreements are entered into they are registered with the ACCC. If parties are unable to agree on access arrangements or pricing, disputes may be arbitrated by the ACCC. Access arbitrations are conducted in accordance with specified criteria which include the objects of Part IIIA, the legitimate

business interests of the access provider and the direct costs of providing access to the service.

In promoting an environment where commercial negotiations continue to drive airport investments, while ensuring that the community has confidence that airports do not overcharge for their services, Melbourne Airport also suggests a framework to apply to the resolution of disputes between the airport and airlines. The process suggested by Melbourne Airport acknowledges that the mechanisms of a formal inquiry under Part VIIA and the possibility of declaration under either Part IIIA (binding arbitration by the ACCC) or Part VIIA (prices notification) are always available to the Government of the day, at anytime, should they wish to instigate them.

Chapter 6 sets our views on the quality of service monitoring arrangements. Melbourne Airport wishes to emphasise that quality of service monitoring is important and, even if there was not a regulatory requirement for monitoring it, Melbourne Airport would continue to undertake quality of service monitoring. This is consistent with the airport's customer service focus and its desire to ensure that it is meeting customer expectations as agreed through commercial negotiation.

The rationale for the original introduction of quality of service monitoring reflected a concern that, under the former regulatory regime of price capping, an airport operator could reduce the quality of its services as a means of increasing its profit margin. Once price caps were removed in 2002, however, this rationale in effect disappeared.

In the present situation where airports are not price controlled, airports have every commercial incentive to offer airlines the quality of service they desire for themselves and their passengers. Given that airlines are able to negotiate and mutually agree a reasonable price for providing service at the airline's desired standard, it is reasonable to present that there is no longer a regulatory need for quality of service monitoring.

Melbourne Airport suggests that the quality of service monitoring arrangements should be undertaken on a self-administered basis, where the airports (and also other relevant service providers) would continue to undertake quality of service monitoring in meeting customer needs and would make the results of its monitoring generally available.

Chapter 7 sets out our views of the operation of the monitoring regime for prices costs and profits in relation to aeronautical services and car parking services. We provide a particular focus on car parking services, given that the ACCC has adversely commented on results from the monitoring of the car parking services at Melbourne Airport. Car parking prices reflect the locational rent associated with the proximity of the individual car parks to the terminal complex.

We note in this chapter that the direct costs of complying with the ACCC's financial monitoring requirements and the nature of the information required to be made available to the ACCC do not, of themselves, present material concerns to Melbourne Airport. However, Melbourne Airport has concerns about the monitoring of prices, costs and profits due to the unsubstantiated interpretations made by the ACCC in relation to the monitoring outcomes.

This chapter sets out that car parking prices, rather than being indicative of monopoly profits, reflect the objective of efficient management of access and vehicle flows in relation to the constrained space at the terminal forecourt. Further, in the face of concerns expressed by the ACCC is relation to the relatively high proportion of airport revenue derived from car parking services at the airport, we demonstrate that Melbourne Airport's high proportion of revenue from car parking is a consequence of its low average revenue in relation to aeronautical services combined with the high number of car parking bays at the airport, relative to other monitored airports. The latter, in turn, represents a response by the airport to users' preferred modes of accessing the airport. The preferred modes involve the use of private vehicles. This is a function of the large distance of Melbourne Airport from the CBD, the timing of international flights departing between 1pm and 1am and the flexibility and control of using a private vehicle.

Importantly this chapter contains the key findings on the international comparison of airport pricing and efficiency from the LeighFisher Benchmarking Study which is provided as Attachment 1. The key findings of the study are that:

- Melbourne Airport's prices are the lowest within a sample of 9 airports in Australia and New Zealand;

- Melbourne Airport's prices compare favourably against a wider sample of 58 international airports; and

- Australian airports are generally the most efficient in cost and staff productivity terms and derive the lowest levels of revenue from their airline users. Within a 12 airport international sample, they may be regarded as representing industry best practice.

Chapter 8 examines ground transport and car parking services in relation to Melbourne Airport, relative to other airports. This chapter incorporates key findings from the PwC Car Parking Benchmarking Study which is provided as Attachment 2.

PwC found that the efficiency of ground access services and, in general, the value placed on services by users and by commercial entities using the forecourt, will reflect the extent to which that service provides the user with time control over the journey to their flight. PwC also found that pricing of Melbourne Airport car parking services reflects the proximity of the car park concerned to the terminals. This is consistent with the efficient operation and management of finite access to the terminals which, in turn, supports the timely operation of aeronautical services.

It is further noted that the services provided by car parking sites have a high amenity value in the same way that car parking at CBD locations has a high amenity value and embodies a commensurate locational rent. Prices at commercial car parks in the CBD are determined by the general process of competition between car parking operators in the city centre. Car parking prices at Melbourne Airport are generally lower than those at commercial car parks in the CBD.

Melbourne Airport has expanded its car parking capacity by 23% over the monitored period since 2005/06. This is in excess of the growth in passengers passing through the airport. These additions to capacity have been made in a timely manner in response to user demand and to provide better quality products to compete with off-airport parking and other modes of ground transport.

Chapter 9 sets out Melbourne Airport's position that while the objectives of the present regime have been largely met, this does not mean that there should be no change to the regime. The success of recent years has not been a result of the light handed regulatory regime per se, but that it has permitted the market to evolve to a position in which ongoing monitoring by the ACCC is no longer necessary.

The relationship between the airport and airlines has advanced since the time of privatisation to a mature and normal commercial situation. In recognition of such developments, the PC has previously recommended a move from heavy to lighter regulation and Governments have generally accepted this position.

(ii) Issues raised by the Productivity Commission and the ACCC

The Productivity Commission Issue Paper, Economic Regulation of Airport Services, of January 2011 sets out number issues on which it wishes to receive information and comment.

This submission provides comment on each PC issue that is relevant to Melbourne Airport. The issues are not commented on in the order in which they are listed in the PC issues paper, but according to how each issue relates to the matters raised in the general structure of this submission.

The PC's issues and our comments in response to the issues are identified in italicised text.

We have numbered each issue based on the order of listing in the PC issues paper. The PC raises 27 issues, a number of which pose more than one question.

For ease of reference, Attachment 3 sets out the full list of the PC's issues that we have addressed and our comments in relation to each issue.

This submission also comments on matters raised by the ACCC in its submission to the PC in relation to this inquiry. The ACCC submission[1] reiterates comments that it made in the Airport monitoring report 2009/10 to the effect that certain airports may have earned monopoly rents by inefficiently delaying investment and/or by failing to provide access on reasonable terms.

On 29 March 2011, the PC wrote to the Chief Executive Officers of Sydney, Melbourne and Brisbane Airports to invite submissions to respond to the ACCC's findings, including whether the airports made their views known to the ACCC regarding its findings from the monitoring results and, if so, how they were acted on.

Melbourne Airport's responses to the matters raised in the ACCC submission to the PC are contained in sections 7.2 to 7.4 of this submission.

[1] Submission to the Productivity Commission's inquiry into the economic regulation of airport services, March 2011

1. MELBOURNE AIRPORT

1.1 Corporate Structure

Melbourne Airport is the trading name of Australia Pacific Airports (Melbourne) Pty Ltd (APAM). This company holds the airport lease acquired for $1,307 million for Melbourne (Tullamarine) Airport granted by the Commonwealth Government on 2 July 1997 under the Airports Act and several similar leases that have been subsequently granted over land ultimately needed for the airport.

APAM is wholly owned by Australia Pacific Airports Corporation Pty Ltd (APAC). APAC also has a 90% interest in Australia Pacific Airports (Launceston) Pty Ltd (APAL), the company that holds the airport lease for Launceston Airport granted by the Commonwealth Government on 28 May 1998. The City of Launceston has the remaining interest in APAL. This lease was acquired for $17 million.

APAC has five shareholding entities which now represent the superannuation investment of hundreds of thousands of Australians and indirectly every Australian via the investment of the Future Fund. APAC is wholly Australian owned. These are set out in Table 1 below.

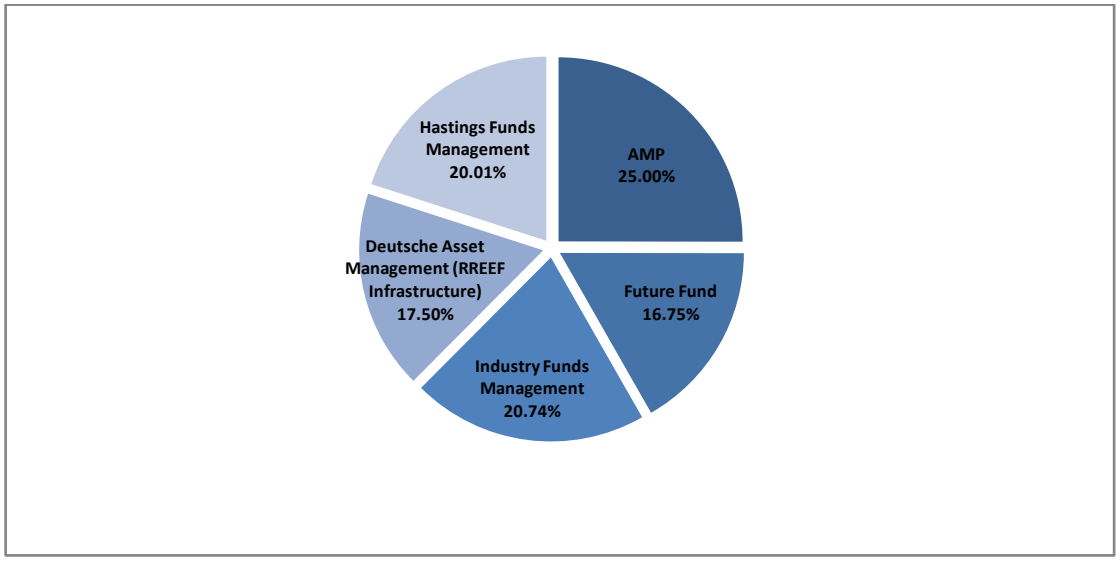

Table 1: Distribution of equity in APAC.

Table 2 depicts the distribution of equity in APAC at the time of the last review in 2007 and now.

	2007	2011
AMP Capital Investors	40.99%	25.00%
RREEEF Infrastructure (a division of Deutsche Asset Management)	26.06%	17.50%
Hastings Funds Management	13.13%	20.01%
BAA plc	19.82%	n/a
Industry Funds Management	n/a*	20.74%
Future Fund	n/a	16.75%

*Previously managed by AMP

Table 2: Shareholding of APAC
Source: Melbourne Airport

1.2 Demand

Total passengers

Melbourne Airport is Australia's second busiest airport. In FY 2009/2010, 26.3 million passengers travelled through Melbourne Airport[2]. In 2009/10, Melbourne Airport passengers accounted for 20.4% of all passenger movements through Australian airports.

Since the 1996/1997 financial year, total passengers through Australian airports have grown on average 4.9% per annum. Melbourne Airport experienced the second highest level of growth of 5.1% during this period. Brisbane experienced the greatest rate of growth at 5.3%.[3]

The following chart is based on Melbourne Airport's 2008 Master Plan and includes long term passenger forecasts. According to these projections. Melbourne Airport will experience 3.4-4.3% increase of passenger growth over the next 16 years.

[2] Melbourne Airport
[3] BITRE

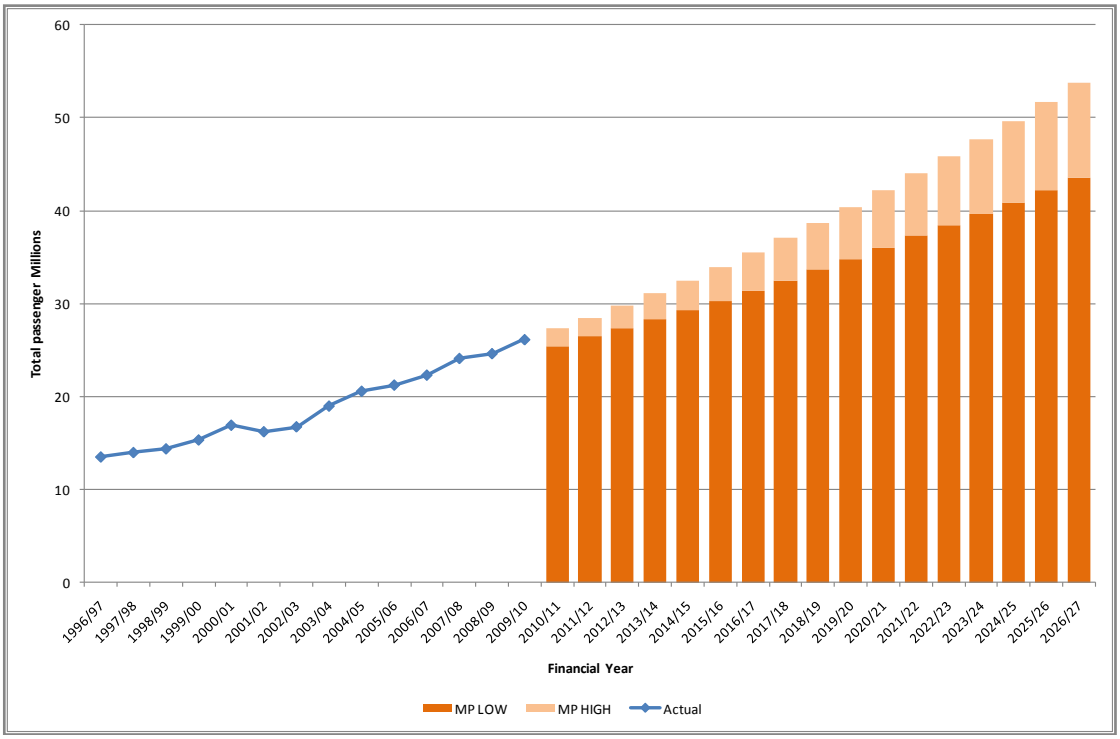

Table 3: Passenger throughput of Melbourne Airport
Source: Melbourne Airport 2008 Master Plan; Melbourne Airport statistics

Domestic passengers

Since 1997 domestic passengers through Australian airports have grown on average of 4.9%. Over this period, Melbourne Airport experienced 5.21% growth[4].

The Australian domestic aviation industry has a highly concentrated route structure. This enables the industry as a whole, both airline and airports, to develop reasonable economies of scale on a route by route basis. The following Table shows that 72% of the domestic passengers travelling through Melbourne Airport are travelling between Melbourne and other mainland state capitals or Canberra.

[4] BITRE

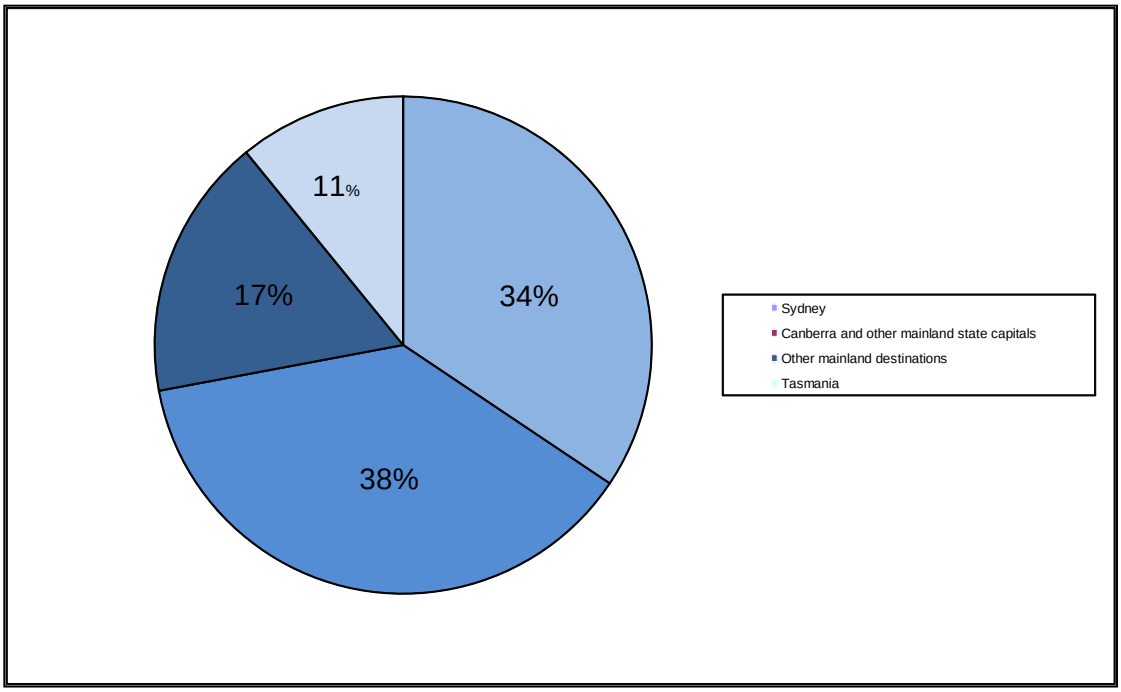

Table 4: Melbourne Airport arriving and departing domestic passengers 2010FY
Source: Melbourne Airport

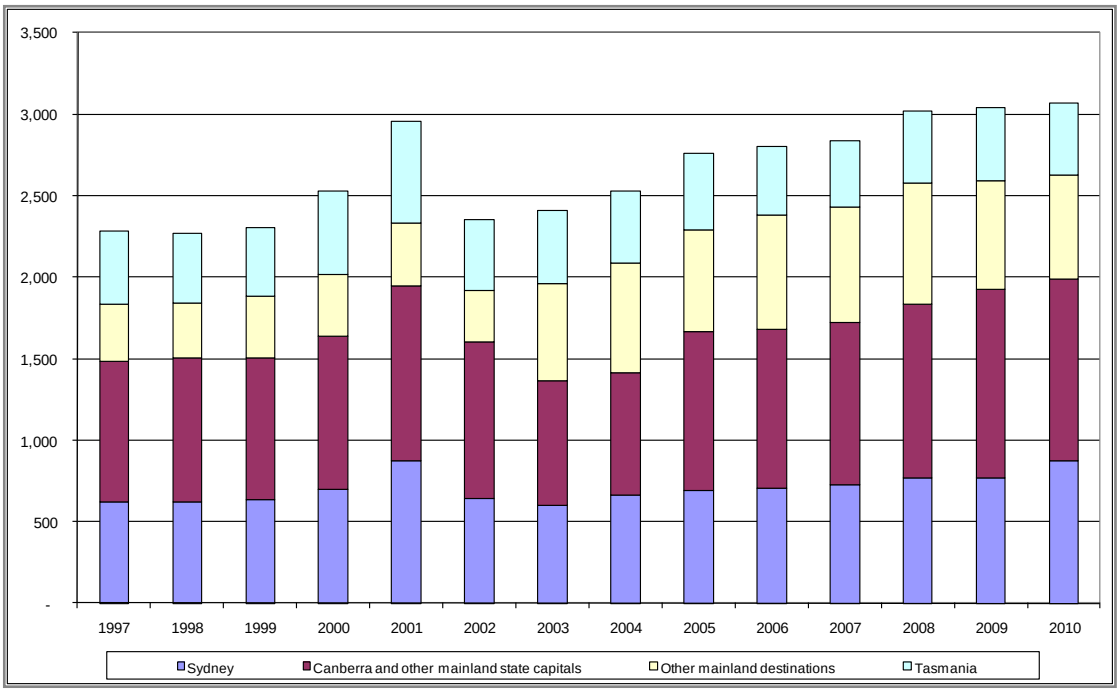

Table 5: Weekly domestic services to and from Melbourne Airport
Source: Melbourne Airport

1.2.3 International Passengers

Since 1997 international passenger numbers through Australian airports have grown on average by 4.9% per annum[5].

In 2009/2010 financial year, international passengers accounted for 21.4% of international passenger movements through Australian airports. Sydney dominates with 43.4%.

Melbourne Airport experienced a growth rate of 6.9%. This is the second highest level of growth. Over the same period, Sydney grew by 4.05, Brisbane by 4.8%, Perth 6.3%, Adelaide 7.4%[6].

The following chart shows the number of services operated by airlines each week.

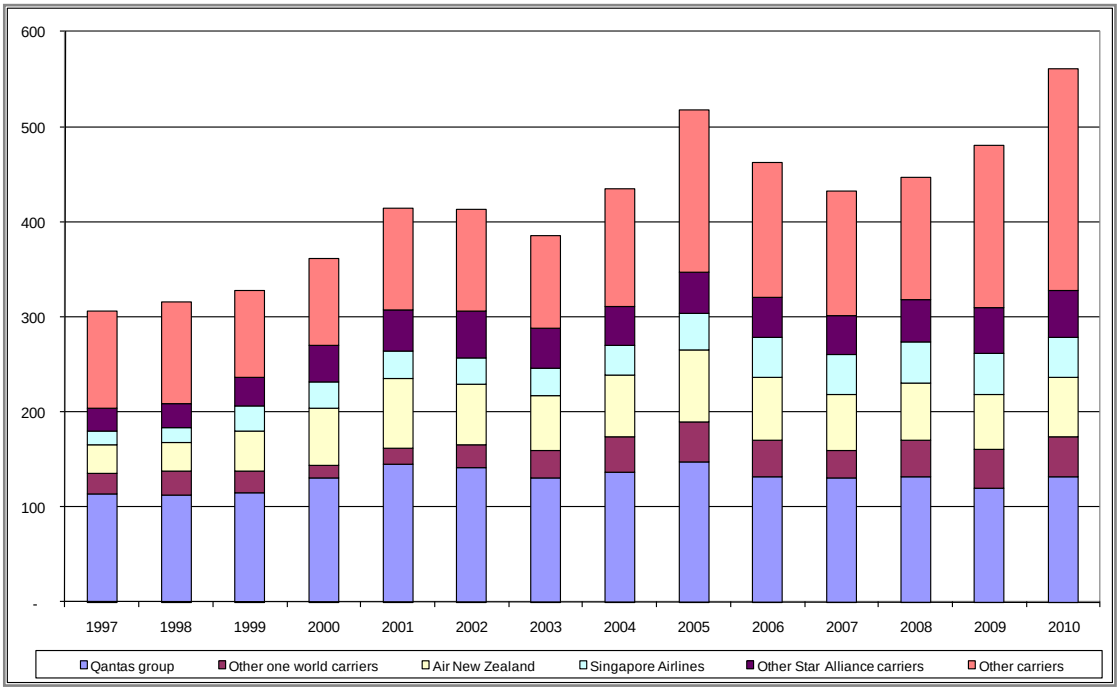

Table 6: Weekly international services at Melbourne Airport
Source: Melbourne Airport (2011)

[5] BITRE
[6] BITRE

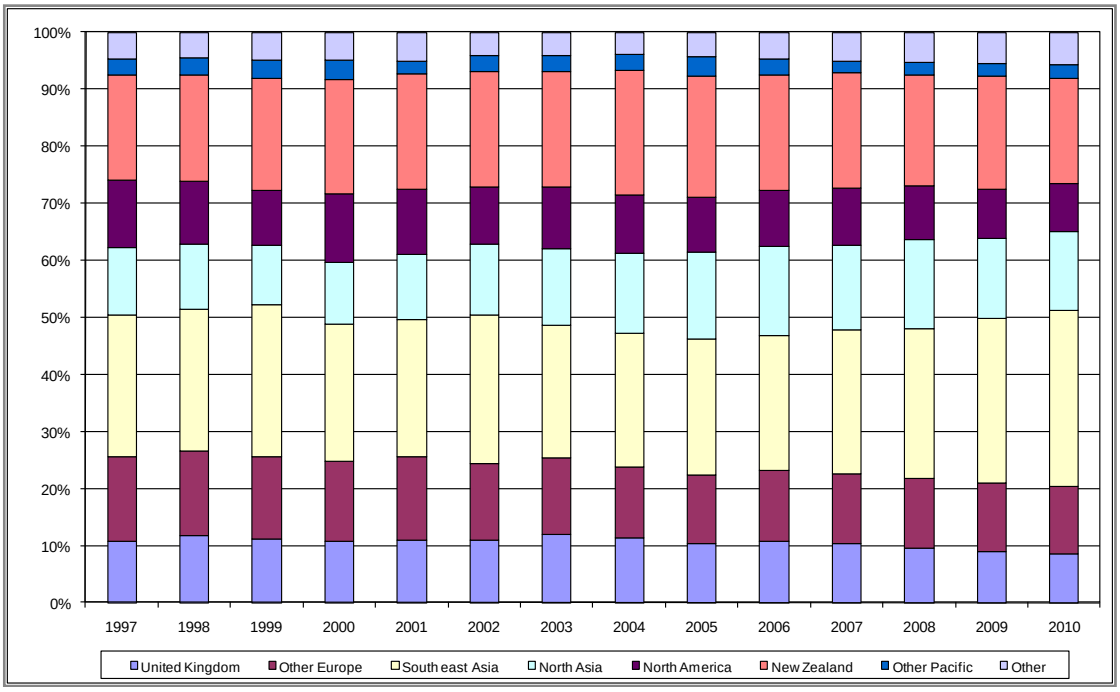

Table 7: Weekly international services at Melbourne Airport
Source: Melbourne Airport (2011)

Melbourne is a largely well established market that has experienced positive international growth in recent years. Most notable has been the increased passenger traffic has predominantly been in South East Asia.

Melbourne Airport believes that it will not be able to sustain recent levels of growth without further access rights being provided to international carriers, particularly in the key Asian growth markets.

Melbourne Airport therefore continues to be an active proponent of further liberalisation of Australia's international aviation policy, especially as it appears that the additional capacity received in recent years is servicing well established existing markets with the China market being a key example.

Any restriction on international services not only reduces the value of Melbourne Airport's business but it is clear that it inhibits tourism growth in Victoria, Tasmania and the broader Southern Australia region.

Any restriction of direct international flights could be expected to hinder economic development more generally and in particular the development of education markets in Melbourne and major regional cities in Victoria. Also, from a social aspect, as Melbourne continues to attract and retain diverse and significant numbers of overseas immigrants, any restriction on international services puts at risk the maintenance of family and cultural ties.

1.2.4 Freight

Melbourne Airport handled in excess of 215 tonnes of international freight in financial year 2009/2010.This accounted for 31% of all international freight through Australian airports. Sydney accounted for 46%

Melbourne Airport experienced a 10% growth rate during financial year 2009/2010. Sydney's rate over this period was 11%. Most of Melbourne's growth was due to imports. Melbourne's imports grew by 23% compared to a 19% growth in Sydney.

Approximately 85% of all freight arriving at Melbourne Airport arrives in the hold of passenger aircraft and network links into Asia, Europe and North America are important.

Like international freight, the majority of domestic freight is carried in passenger aircraft. That said Australian Air Express conducts a dedicated freight operation using larger jet aircraft. There are also a number of smaller operators although they operate much smaller aircraft.

Whilst freight is an important part of Melbourne Airport's property business and of the businesses of its airline customers, issues relating to freight are not significant in the terms of the Commission's inquiry and therefore not covered in great detail in this submission.

1.3 Efficiency

1.3.1 Operating efficiency

The benchmarking study undertaken by LeighFisher (formerly TRL) which appears as Attachment 1 to this submission replicates analysis undertaken by TRL in 2006 and presented to the Productivity Commission during the course of its previous Inquiry into the Economic Regulation of Airports. The study compares a range of efficiency indicators for Australia's monitored airports as well as a range of comparably sized airports in Auckland, North America and Continental Europe.

As with the benchmarking analysis conducted in 2006, the conclusions reached by LeighFisher are as follows:

- Overall cost levels at Australian airports are lower than other airports in the sample;
- Melbourne and Brisbane have historically produced the lowest cost Tables throughout the period, with Melbourne Airport's costs having remained relatively stable throughout the period compared to a much stronger growth trend at the other airports
- Staff costs per passenger at southern hemisphere airports are significantly lower and as a proportion of overall cash expenditure continue to trend downwards; and
- Staff productivity rates at the southern hemisphere airports are significantly greater than at the northern hemisphere airports with Melbourne Airport achieving the highest productivity in all years since 2001

Despite differences, all Australian airports in the sample significantly outperform their northern hemisphere comparators. Melbourne's relative performance is shown in Table 8

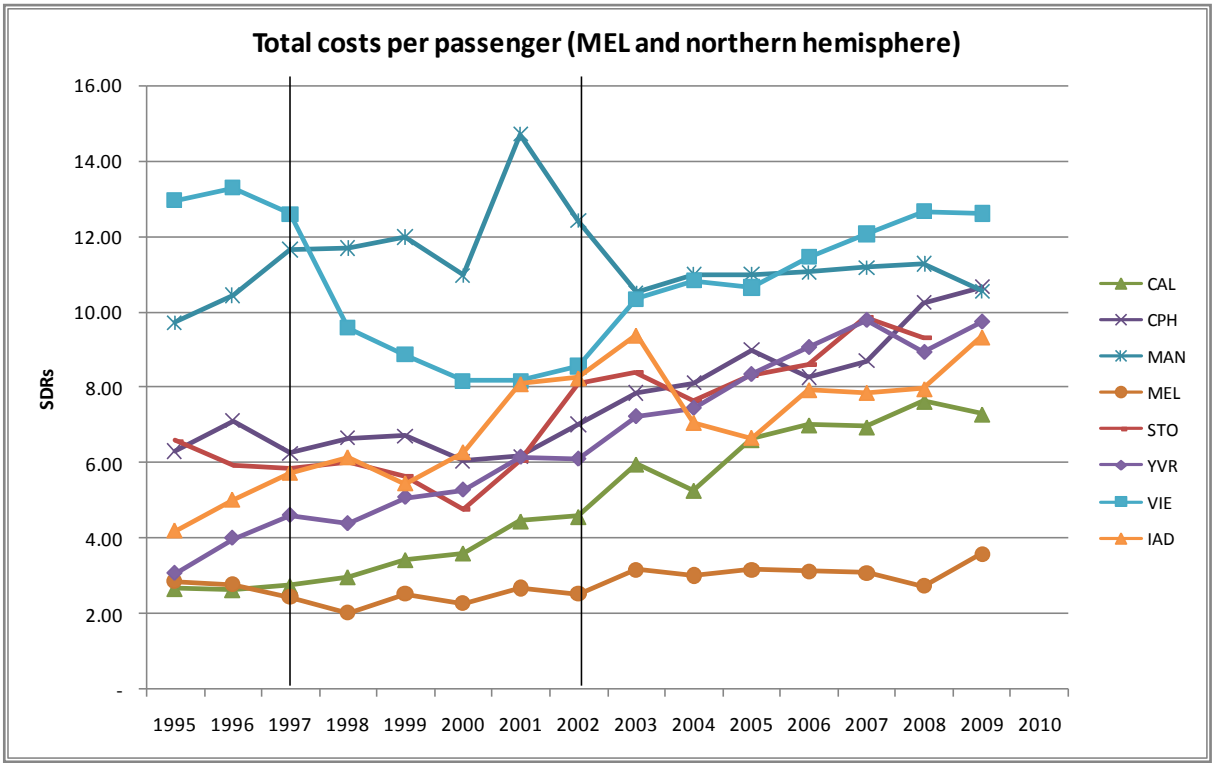

Table 8: Total costs per passenger for selected airports
Source: LeighFisher (2011)

1.3.2 Capital efficiency

Given the capital intensive nature of airports, capital efficiency is an important driver of efficient prices. Comparisons within fairly homogeneous regions are useful, but within a broader geographical context some caution needs to be exercised in making comparisons. This is because of widely varying airport construction costs, and hence asset values, around the world. Different asset valuation policies also make comparisons difficult. Some airports revalue assets on a regular basis, while others, and in particular Melbourne, do not.

Fixed assets per passenger can be used as an indicator of capital efficiency although this measure needs to be treated with some caution. High levels could be a sign of unnecessary over-investment but alternatively simply reflect unavoidable surplus capacity resulting from the lumpy nature of airport investment or peaky demand. The relative levels will also necessarily be affected by the relative age of assets.

Rapidly growing passenger numbers will have a diluting effect on performance in this measure. Examinations of longer term trends are therefore more instructive although the very long nature of the capital cycle means caution needs to be exercised in reaching

conclusions. As this information is not generally published by the ACCC information on both Australian and overseas airports is provided.

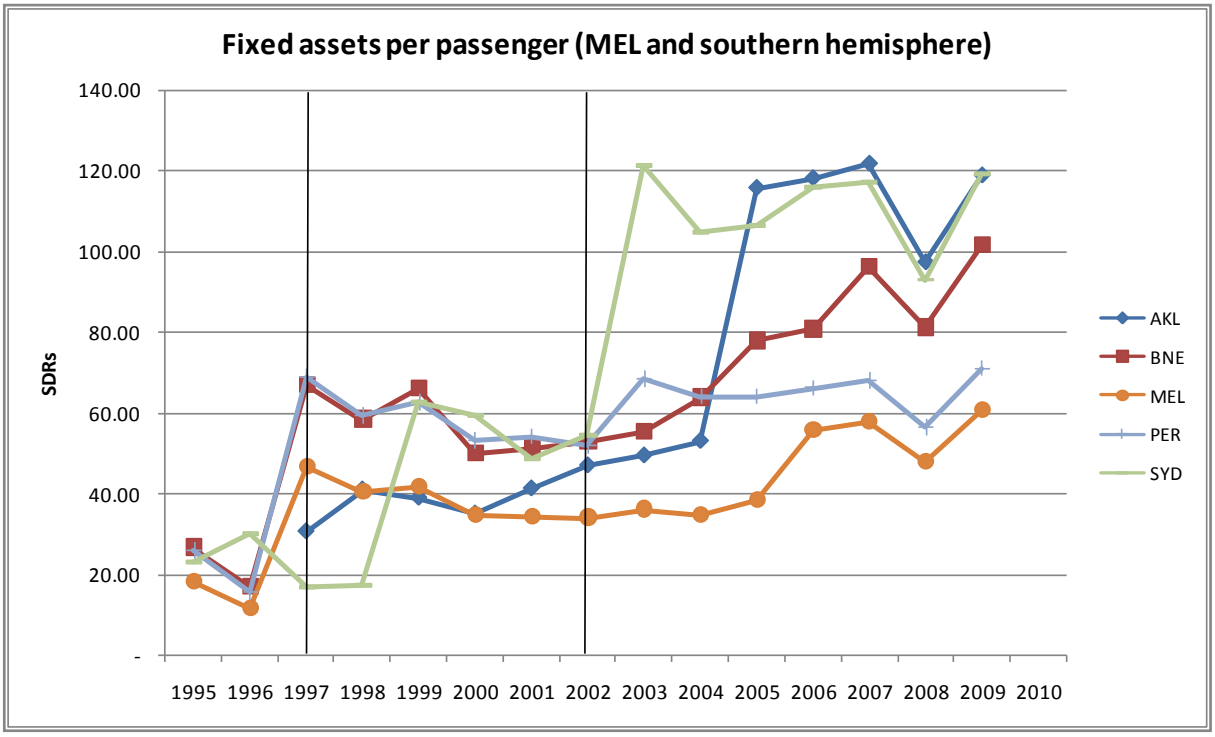

Table 9: Fixed assets per passenger for Australia and New Zealand
Source: LeighFisher (2011)

This illustrates the extent to which the value of airport assets were understated at the time of their administration by the Federal Airports Corporation. As at the time of the previous Productivity Commission Inquiry, the heavy investment of Sydney Airport prior to 2000 continues to stand out.

Melbourne's performance increased substantially in 2006/07 and its relative performance within this sample can be attributed to a number of factors including:

- 24 hour curfew free operations serve to spread passenger movements more widely across the day allowing it to achieve higher levels of asset utilisation;
- It's assets in the majority of cases are older and larger that all airports in the sample with the exception of Sydney Airport; and
- This measure is driven strongly by passenger numbers;

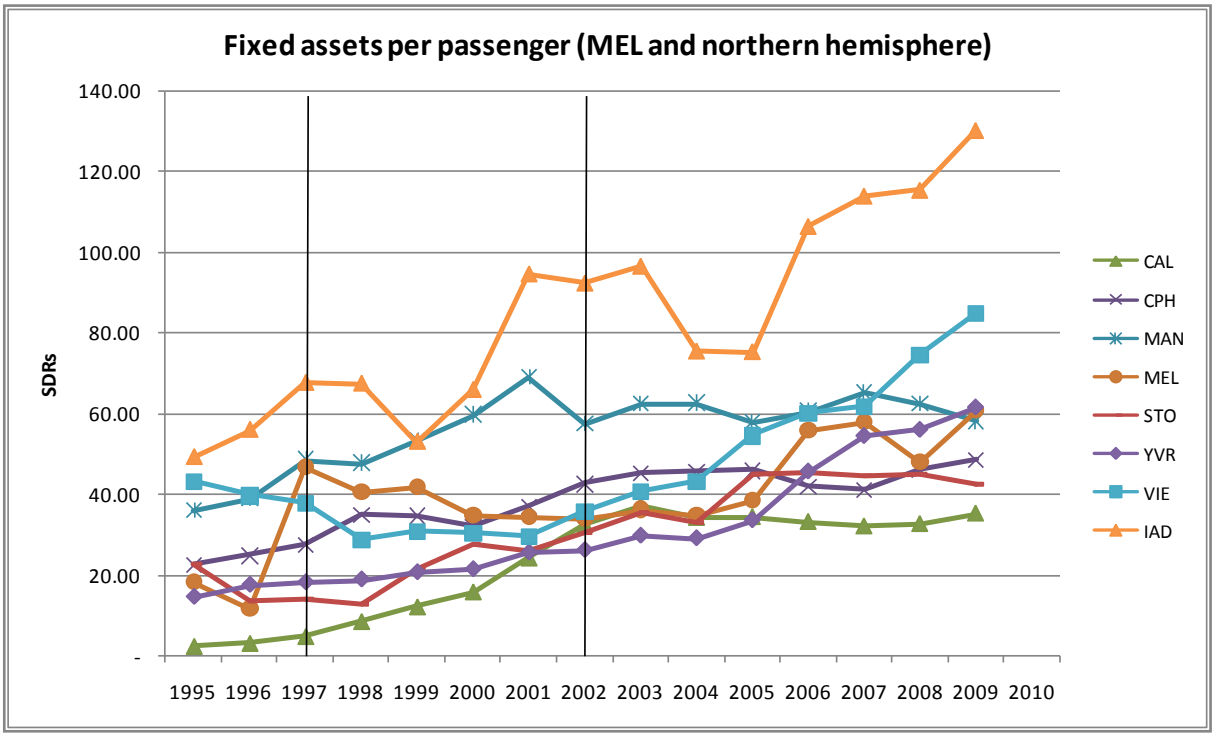

Table 10: Fixed assets per passenger for selected airports
Source: LeighFisher (2011)

There is a clearer upward trend within the northern hemisphere sample though is more likely to reflect high local construction costs and hence asset values than above average levels of capital investment.

1.4 Assets and investment

Airport assets have extremely long lives – terminals can have lives of more than 40 years whilst parts of the runway structure have, if constructed properly, almost infinite asset lives. Capacity also comes in large increments. It is therefore important to be careful in interpreting information on asset values and investment.

Melbourne Airport is no longer able to support growth through utilising surplus capacity acquired from the Commonwealth. To support future levels of activity Melbourne Airport continues to invest in major capacity expansions as shown in Table 11.

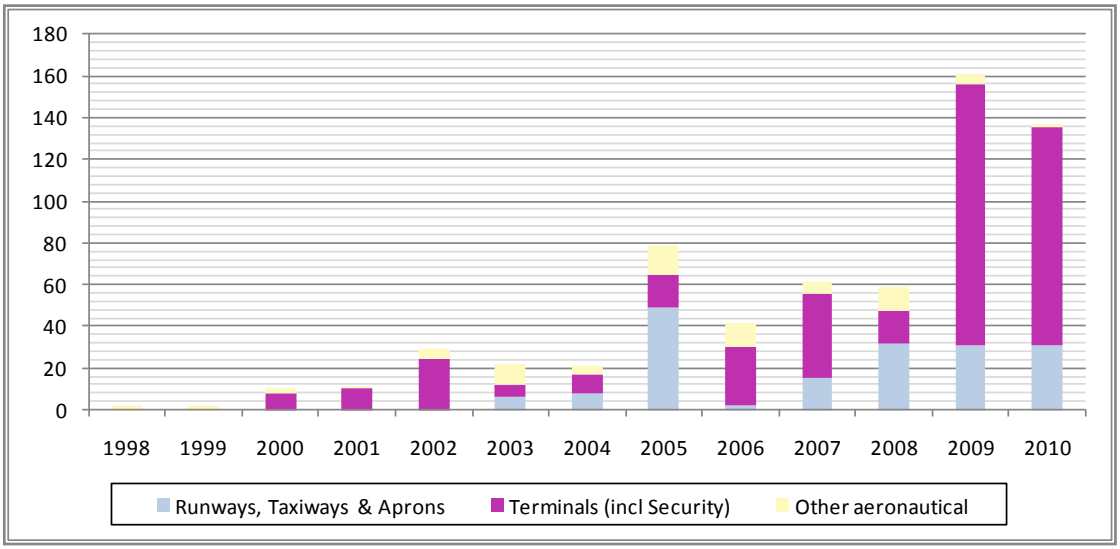

Table 11: Investment in aeronautical and non-aeronautical assets at Melbourne Airport
Source: Melbourne Airport

The following table provides a breakdown of Melbourne Airport's assets at the in 5 year intervals from 2000 to 30 June 2010 (the last audited balance date).

	2000 ($m)	2005 ($m)	2010 ($m)
Aprons, Runways and Taxiways	236	275	294
MA Operated Terminals	84	103	371
Services	5	5	43
Roads	24	32	45
Land	52	49	47
Other	28	10	33
Total Aeronautical Assets	429	474	833
Non Aeronautical Assets	296	345	322
Investment Property	0	0	871
Goodwill	600	577	668
Total Assets	1325	1396	2694

Table 1.2: Composition of assets as at 30 June

Table 12: shows that capacity of a number of terminal elements has expanded since 2000

	2001			2006			2010		
	T2	T3	T4	T2	T3	T4	T2	T3	T4
Check-in desks	72 +16 service desks	22 +8 electronic kiosks	n/a	72 +16 service desks	36 +14 electronic kiosks	n/a	92 +16 service desks	38 +14 electronic kiosks	10
Security screening points	2	3	n/a	5	4	n/a	6	5	2
Baggage Reclaim Units	4	2	n/a	4	3	n/a	5	3	1
Outwards immigration desks	18	n/a	n/a	18	n/a	n/a	24	n/a	n/a
Inwards immigration desks	26	n/a	n/a	26	n/a	n/a	37	n/a	n/a
Departure lounge seating	1800	-	n/a	2263	-	n/a	2721	-	-
Parking stands serviced by aerobridges	10	11	n/a	11	11	n/a	13	11	n/a
Parking stands not serviced by aerobridges	4	n/a	n/a	5	9	n/a	4	9	5

Table 12: Composition of assets at 30 June 2011
Source: Melbourne Airport (2011)

As far as runway assets are concerned, Melbourne Airport is likely to be required the next runway in the next ten years and this will be addressed in the next Melbourne Airport Master Plan. Current runway capacity is between 30 and 70 movements per hour depending on weather conditions and the mix of aircraft using the runways. In good weather, simultaneous operations are possible for certain categories of aircraft. There are no restrictions on runway use for environmental reasons.

As shown in Table 13, runway utilisation has increased since 2000, although it is interesting to note, that although we are a curfew free airport, aircraft movements between midnight and 5 am have remained relatively unchanged.

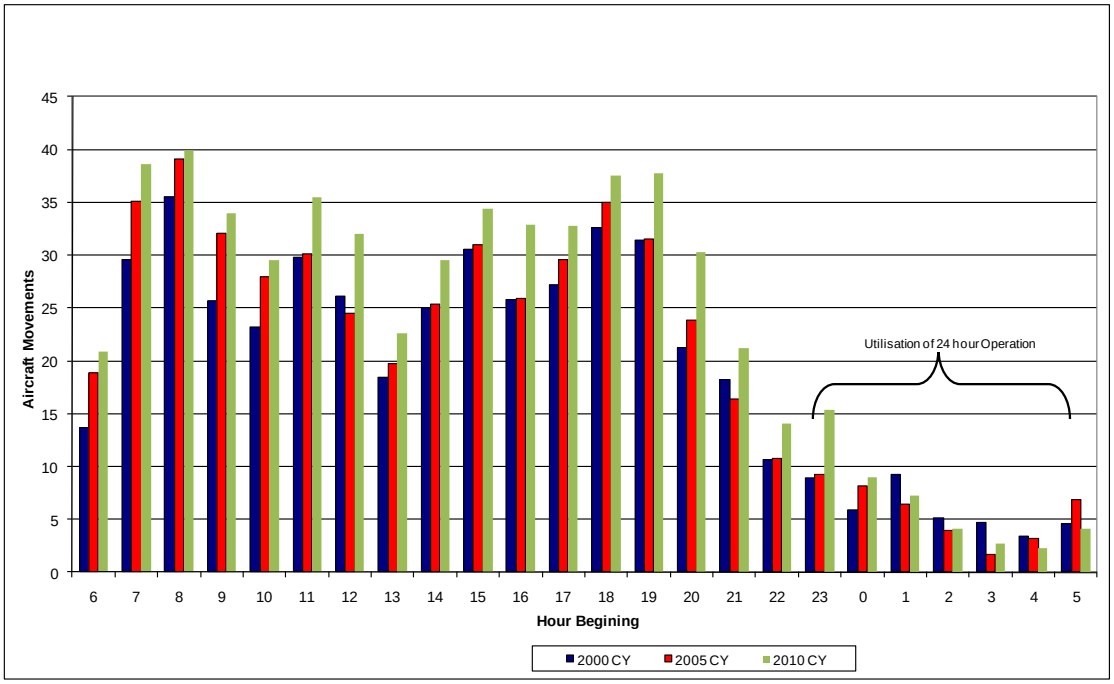

Table 13: Composition of assets at 30 June
Source: Melbourne Airport

As Table 14 below indicates, in addition to significant and ongoing capital investment since privatisation, airports have also demonstrated a commitment to strong cash investment in the replacement and maintenance of capital assets. Of its average annual aeronautical revenue of $1.3m, Melbourne Airport has reinvested an average of 79% of that cash back into its aeronautical assets.

Financial Year	2010 $'000	2009 $'000	2008 $'000	2007 $'000	2006 $'000	2005 $'000	2004 $'000	2003 $'000	2002 $'000
Revenue	211,989	197,113	187,435	159,623	144,357	137,066	121,055	100,477	65,689
Less: Cash Expense	79,060	72,518	70,049	64,192	56,994	55,064	48,214	41,744	40,801
	132,929	124,595	117,386	95,431	87,363	82,002	72,841	58,733	24,888
Less: Capital Expenditure	136,729	160,982	83,691	60,565	42,190	70,555	19,659	22,508	29,988
BENEFIT /(COST)	-3,800	-36,387	33,695	34,866	45,173	11,447	53,182	36,225	-4,100

Table 14: Composition of assets at 30 June 2011
Source: Melbourne Airport (2011)

1.5 Quality

Airports contracts contract with airports to deliver agreed service levels to meet the needs of the airline customers or passengers. Failure to meet agreed service level targets has the potential to impact financially on airports. The measurement of the quality of airport services is highly subjective and will differ between passengers as well as between airlines depending upon their business models and target customer market. It is on this basis that comparisons between airports are difficult.

Services provided to airlines by airport will differ according to the preferred service model of that airline. Melbourne's Terminal Four which is currently home to LCC Tiger Airways for example offers a more austere service consistent with the airlines focus on providing low fares to their customers, whilst a common user terminal such as the international Terminal Two offers a broader range of services and amenities to meet a variety to airline service expectations from international LCC to full service legacy airlines.

Ultimately the level of quality that an airport provides will depend on the specific needs of its airline customer and the level of service they in turn wish to offer their customers, the passenger. For example LCC operating aircraft such as the A320 or B737 often prefer not to use aerobridges to move passengers to and from the aircraft.

Passenger experience at airports is surveyed by the administration of a questionnaire which asks passengers to rate the various attributes of their airport experience against a scale. The reliability of drawing comparisons between airports which may adopt differing methodologies is highly problematic.

Melbourne Airport adopts a methodology established by one of its former shareholders BAA to monitor the quality performance of its airports and as such is in a position to make meaningful comparisons against a range of airports using the same survey methodology.

Accurately measuring airline perceptions poses a number of methodological issues, in particular the disparate sample size between passengers and airlines. Whilst Melbourne Airport surveys thousands of passengers every year, the ACCC in its annual report relies on the survey responses of less than a quarter of the airport's 25 international airlines and 4 domestic carriers. Beyond statistical deficiencies of this kind, it is inevitable that such a small sample size is capable of being influenced by the bias of a particular individual who may not in fact reflect the views of the airline concerned.

The most recent ACCC report into the quality of service revealed that Melbourne Airport's overall ratings for international and domestic terminals were satisfactory and rated second of all the monitored airports, closely behind Brisbane who were rated first. Though this represented an improvement on the rating of the previous year, Melbourne Airport's overall quality rating has been consistently positive since the time of the last PC Inquiry.

1.6 Profitability

Central to this Inquiry is not whether airports have been or will continue to represent profitable investments for their shareholders but rather whether airports are setting prices at a level which exceed the efficient costs of production in relation to those parts of their business where they possess market power. In the case of Australia airports this relates primarily to airports' provision of aeronautical services.

Information utilised by the ACCC in its annual reporting which deals with asset returns only depicts a part of the broader picture. High returns on assets may reflect that an airport is at a particular point in its capacity cycle or has a large future capital investment program in circumstances where current average costs are well below long run incremental costs. Low returns on the other hand might point to the presence of significant surplus aeronautical capacity.

Given the above it is clear that airports will experience different levels of return at different terms in their investment cycle. Persistent differences in the level of returns reflecting levels of efficiency in airport design and operations, the nature of the markets served and airport management competency can also be expected.

As can be seen in Table 15 Melbourne Airport's return on capital employed is broadly consistent with those comparable airports overseas.

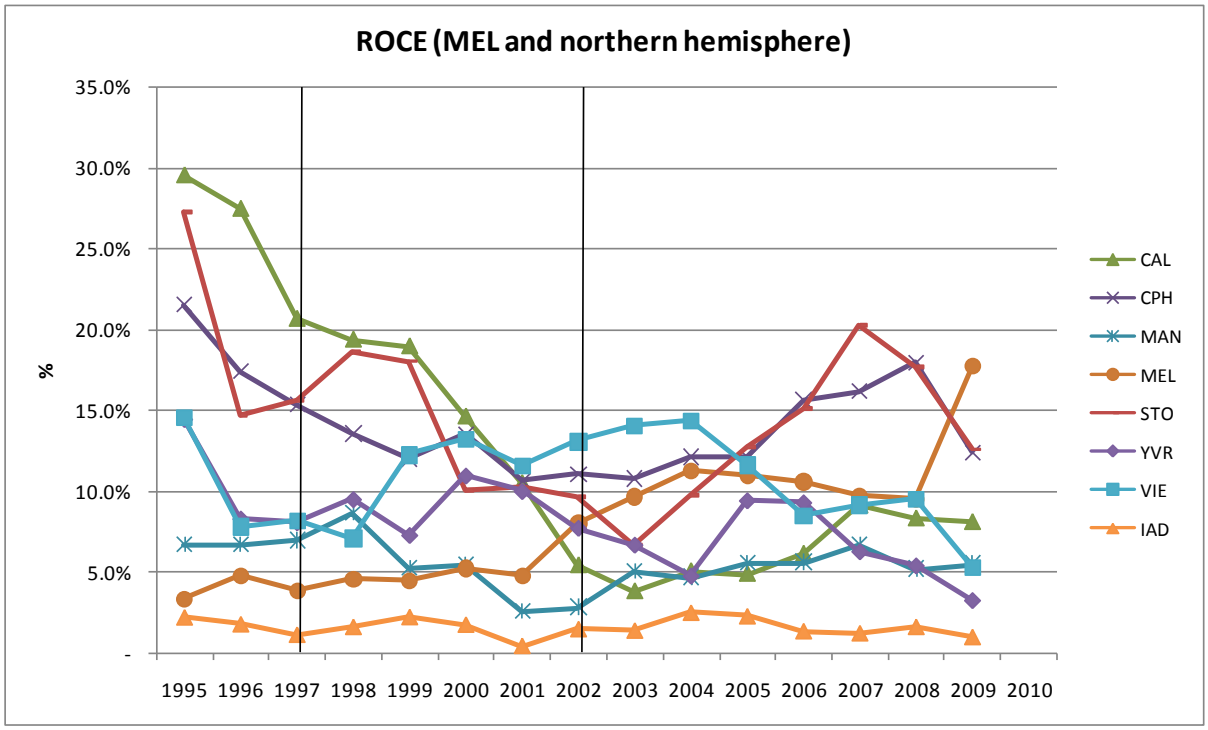

Table 15: Return on capital employed at selected airports
Source: LeighFisher (2011)

The recent significant increase experienced by Melbourne Airport reflects a substantial reduction in its long-term liabilities.

1.7 Prices

There are four basic ways in which airports can price discriminate:

1. Passenger based charges - assuming that ability or willingness to pay is reflected by the load factor of the aircraft concerned, such charges can be considered to be a form of price discrimination at the aircraft level.

2. Marketing and other incentive arrangements - by targeting particular carriers or market segments, demand will be stimulated by lowering total airline costs.

3. Lower chargers for differential service quality - the most common, which is not relevant to Melbourne Airport, is to charge a lower price (however structured) where passengers move between the terminal and the aircraft via bus rather than an aerobridge.

4. Allocation of joint and common costs - an airport may elect as a strategic component of its pricing strategy to seek relative higher returns in some broad market segments than others. For example an airport may have a very domestic base but is seeking to grow its international business. To encourage growth it may structure its price so

that domestic activities make a larger contribution to joint common costs relative to international ones while still targeting its overall cost of capital and each segment covering its own avoidable costs.

Airlines have historically resisted airport efforts to price discriminate and indeed certain International Civil Aviation Oraganisation (ICAO) conventions prohibit airport price discrimination that favours home international carriers over foreign carriers irrespective of whether such conduct is efficient.

The capacity of airports to price discriminate is limited to the level of individual flights. It is simply not feasible for an airport to price discriminate at the passenger level as far as aeronautical services are concerned. However it is clear those airlines can, and do effectively price discriminate at the passenger level and that the airlines' ability to do so is sufficient to ameliorate the welfare impacts of a significant proportion of any increase in aeronautical charges, especially if such increases are small compared to ticket prices. Further, it is clear that whatever price discrimination airports can undertake does not materially impact economic welfare in a negative way.

Evolution of Aeronautical prices at Melbourne Airport

When the lease for Melbourne Airport was granted in July 1997 the following charges were in place:

- A landing charge for all aircraft of $5.72 per tonne MTOW;
- A CTFR recovery charge of $0.44 per tonne MTOW; and
- An international terminal charge of $4.07 per tonne MTOW

Domestic terminal services were provided under leases granted to Qantas and Ansett. International check-in desks were provided under an arrangement that effectively guaranteed the airport a fixed income irrespective of volume. This pricing structure remained in place until price controls were removed in 2002. Prices varied according to the CPI-X price cap provisions, NNI pass through and the Government's decision to allow a one-off price increase in October 2001 as a result of the collapse of Ansett in September 2001 which Melbourne Airport deferred to 1 January 2002. Added to these initial prices, as a result of the NNI arrangements were:

- A cost recovery charge for international passenger screening in July 1999 of $0.79 per departing passenger;
- A cost recovery charge for international checked bag screening in June 2000 of $1.65 per departing passenger; and
- A charge for the use of the Domestic Express Terminal in December 2000 of $1.50 passenger.

The security recovery charges varied in accordance with actual costs and passenger throughput.

After the price increases were approved by the ACCC for Sydney Airport in 2000, it is clear that over time, passenger based prices for international services would become the norm. It

was also expected this trend to continue through to domestic services. At the time Melbourne Airport had a number of discussions with airlines and their representatives on the issue of charging structures. But given the proximity of review of price controls conducted by the Commission in 2001 and the amount of time and effort that would be involved in getting the ACCC to approve any restructuring, Melbourne Airport decided to defer restructuring until it became clear what would be the future of price regulation arrangements.

Melbourne Airport fundamentally restructured its prices on 1 July 2002. This was done as part of its overall settlement with the airlines. It put aeronautical services onto a proper commercial footing and its prices on a sustainable path. The prices - both their structure and their levels - put in place on 1 July 2002 were not, nor have subsequently been, objected to by airlines. This price structure continues today. Table 1.4 shows the prices established in 2002 and the current prices for the services described:

	1 July 2002	1 July 2006	1 July 2010
International passenger charge	$10.00 per passenger	$11.12 per passenger	$13.69 per passenger
Domestic passenger charge for terminals not operated by Melbourne Airport	$3.00 per passenger	$3.38 per passenger	$3.46 per passenger
Domestic passenger charge for terminals operated by Melbourne Airport	$6.30 per passenger	$7.16 per passenger	$8.25 per passenger
Landing charge for freighters	$6.00 per tonne MTOW	$6.63 per tonne MTOW	$7.43 per tonne MTOW
Freight parking charge	$25.00 per 15 minutes	$27.64 per 15 minutes	$31.87 per 15 minutes
Airport passenger security recovery charge	$0.27 per departing passenger	$0.10 per departing passenger	$0.25 per departing passenger
Airport security recovery charge non RPT aircraft	$0.59 per tonne MTOW	$1.27 per tonne MTOW	$0.27 MTOW
International passenger screening recovery charge	$1.87 per departing passenger	$3.00 per departing passenger*	$4.13 per departing passenger*
Domestic terminal screening recovery charge for domestic terminals provided by Melbourne Airport	$0.42 per departing passenger	$1.36 per departing passenger*	$2.76 per departing passenger*

* Checked baggage screening added

Table 16: Melbourne Airport Aeronautical Prices
Source: Melbourne Airport (2011)

Service provision for car parking across the monitored airports can differ significantly. For example whilst all Melbourne Airport short term car parking is located undercover, some airports do not offer covered areas and some long term car parking facilities are located within walking distance of the terminal whilst others are serviced by frequent shuttle services which result in airports incurring greater operations costs. Despite the differences, the below table demonstrates that car parking at Melbourne Airport broadly reflects those charges levied at other monitored airports and indeed in some instances is significantly below other airports for example in relation to four hours in the short term car park and in the one and seven day brackets in the long term car park.

Airport	Short-term car parking				Long-term car parking	
	1 hour	4 hours	8 hours	24 hours	1 day	7 days
Adelaide	$4.00	$14.00	$26.00	$30.00	$25.00	$70.00
Brisbane	$13.00	$22.00	$50.00	$50.00	$35.00	$140.00
Melbourne	$12.00	$36.00	$50.00	$50.00	$29.00	$77.00
Perth	$5.40	$9.80	$35.00	$35.00	$16.00	$80.00
Sydney	$15.00	$52.00	$52.00	$52.00	$25.00	$122.00

Table 17: Airport car parking prices as at 30 June 2010
Source: ACCC Airport monitoring report 2009-10

1.8 Operations cost comparisons

Information is generally available on the prices charged by individual airports. It is possible to combine this information with the operational characteristics of the aircraft (principally its weight and seating capacity) and assumptions about load factors and in some cases parking times and check-in desk use to calculate the cost of an aircraft turn around or the cost of a turnaround per passenger.

Table 18: Total charges for eight aircraft types at the regional sample of 9 airports (SDRs)
Source: Leigh Fisher (2011)

Within this sample, Melbourne airport is ranked lowest, with total charges a little more than half of those at the most expensive airport.

Relative levels of airport charges may be influenced by many factors, including ownership structure and the competitive and regulatory environment in which they operate. The sample of airports in this study is relatively homogenous in these respects, and this being so, a relatively close (inverse) relationship between the size of the airport in passenger throughput terms and its charge levels might be expected. This is because the high level of fixed costs in airport operations will tend to mean that small airports need to charge more than large airports in order to achieve adequate levels of cost recovery.

Against this background, it is not particularly surprising to find Adelaide and Cairns among the most expensive of the Australian airports, since they are the smallest within this sample in terms of passenger numbers. Brisbane's position is affected by significant levels of capital expenditure in recent years, as discussed in Section 6 which have put pressure onto charge levels. The disparity between the levels of charges at Sydney and Melbourne is at first sight surprising, given that Melbourne's traffic levels are around 24% lower than those at Sydney, but relative levels of capital expenditure at the two airports in recent years are also likely to have influenced these results.

Within the sample, the most significant shift in rankings has occurred in the case of Brisbane, which ranked in eighth position out of nine when we carried out our analysis in 2006, but is in second position in this analysis. The levels of Brisbane's Passenger Service Charge per passenger for the International Terminal have increased by a little over 50% since that for 2007/2008.

Airport charges indices

This approach usually involves calculating the charges for a standard range of
services (irrespective of whether they are provided by the airport or other agencies) for a number of aircraft types using common assumptions similar to the approach above. These are then averaged in some way (either via a fleet mix assumption or simple averaging) and converted to a common currency. The index values may be sensitive to exchange rate movements which have nothing to do with airport costs.

The most prominent index is that prepared by LeighFisher (formerly TRL) for international charges. There is no generally used index for domestic charges. Melbourne Airport has commissioned a report from LeighFisher to include the major international airports in Australia and New Zealand in its index.

The following chart shows that Melbourne Airport has the lowest charges (which include an Aviation rescue & fire fighting and terminal navigation of any airport in Australasia. Melbourne charges ranks (from highest to lowest) 45th out of the 58 airports in the TRL report.

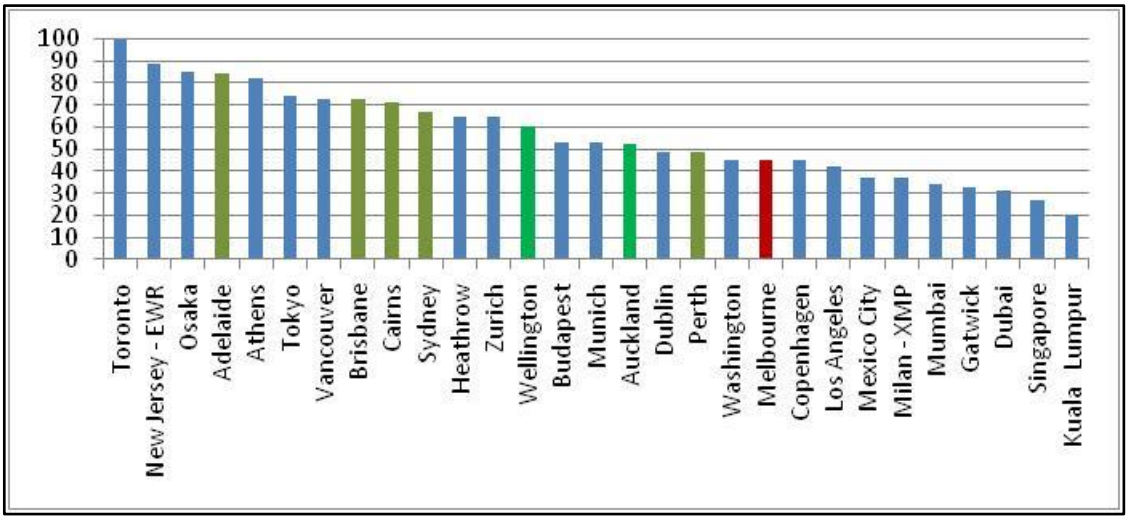

Table 19: Index of International Charges for Selected Airports
Source: LeighFisher (2011)

The limitations of this approach include inclusion of aircraft that do not, and in some cases cannot, use a particular airport and that the fleet mix used for the averaging will only coincide with that using any given airport by coincidence. Further, the indices represent the cost incurred by airlines using a specified bundle of services rather than those levied by airports themselves.

1.10 Ground Transportation and Car Parking

Forecourt Access

There are a wide range of ground transportation options for accessing Melbourne Airport.

1. Private vehicles using the kerb for pick-up/drop-off
2. Private vehicles using airport provided short and long term car parks
3. Privately operated buses servicing off-airport car parks
4. Private vehicles using airline provided valet car parks
5. Taxis
6. Private limousine hire cars licensed by the Victorian Taxi Directorate
7. On-airport car rental operations
8. Skybus
9. Oribtal Smart Bus
10. Metropolitan public bus services
11. Privately operated buses servicing regional centres
12. Courtesy buses operated by hotels, universities and other organisations
13. Tour coaches
14. Off-airport rental operations.

All of these transportation modes, with the exception of private vehicles using the kerb for pick-up/drop off and currently public buses, pay to access the airport. Private vehicle pick-up/drop off is the main form of access to the airport by mode share.

It is a Melbourne Airport policy that parties that obtain a commercial benefit from access to the forecourt should contribute to the cost of providing and maintaining those facilities. The access charges applied to commercial operators are summarised in the Table 20.

Kerbside Access Charges	Seat Capacity (max)	Cost per seat
1. Private vehicle pick-up/drop off – no charge		
2. Metropolitan public bus – no charge		
3. Taxi access charge - $1.32 per collection	4	$0.33
4. Limousine hire car access charge - $3.00 per 30 minutes per collection	4	$0.75
5. Commercial vehicle / Van up to 10 seats - $4.00 per collection	10	$0.40
6. Commercial vehicle / Van with trailer up to 10 seats - $6.00 per collection	10	$0.60
7. Small bus 10 – 24 seats - $6.00 per collection	24	$0.25
8. Large Bus more than 24 seats - $12.00 per collection	48	$0.25

Table 20: Kerbside access charges for Melbourne Airport
Source: PwC (2011)

The charges are applied on an equitable basis to all commercial users who rely on and derive commercial benefit from the infrastructure provided by the airport and from its investment in management of the congestion that is expected at the entrance of any major destination. They represent a relatively small proportion of the total costs of the particular access mode to the end user.

The standard terms of access for the different ground transportation modes are clearly signposted at the terminal precinct and provided to third parties. Where operators wish to negotiate commercial agreements in relation to access, the terms of such bilateral agreements replace the standard terms.

Car Parking

Car parking is provided on site by Melbourne Airport. Off-airport car parking is provided by third parties.

Melbourne Airport operates a range of public car parking products:

- Short term multi story car park opposite the terminal complex (STCP)
- Multi Level Long Term Car Park (MLLTCP)
- Business Car Park (Bus CP)
- Express Car Park (Express CP)
- Long Term Car Park. (LTCP)

The prices for Melbourne Airport car parking services reflect the proximity of the individual car parks to the terminal as well as service levels. They also take into consideration the capital investment made in relation to each car park and the amenity / service levels associated with each product.

The services provided by airport car parking sites have a high amenity value in the same way that car parking at CBD locations has high amenity value and embody a commensurate locational rent. The businesses of commercial car parks in the CBD are similar to car parking services provided at the airport in that the businesses are standalone basis.

Airport	Short-term car parking				Long-term car parking	
	1 hour	4 hours	8 hours	24 hours	1 day	7 days
Adelaide	$4.00	$14.00	$26.00	$30.00	$25.00	$70.00
Brisbane	$13.00	$22.00	$50.00	$50.00	$35.00	$140.00
Melbourne	$12.00	$36.00	$50.00	$50.00	$29.00	$77.00
Perth	$5.40	$9.80	$35.00	$35.00	$16.00	$80.00
Sydney	$15.00	$52.00	$52.00	$52.00	$25.00	$122.00

Table 21: Comparison of airport car parking rates with Melbourne CBD rates
Source: PwC (2011)

Off-airport car parks offer prices that are competitive with, and in many instances lower than, prices for on-airport car park stays, particularly in relation to medium and long-term stays. The 14 private operators in the airport vicinity on which Melbourne Airport has obtained information provide a total capacity of 10,950 bays.

This compares to the long term car parking capacity at the airport of 15,896 bays (comprising the capacities of the long term car park, of 12,500 bays and the multi-level long term car park, of 3,396 bays).

Table 22 shows the expansion of car parking capacity at Melbourne Airport. It is clear that rather than holding back supply to maximise rent from existing car park capacity Melbourne airport continues to invest in car parking capacity.

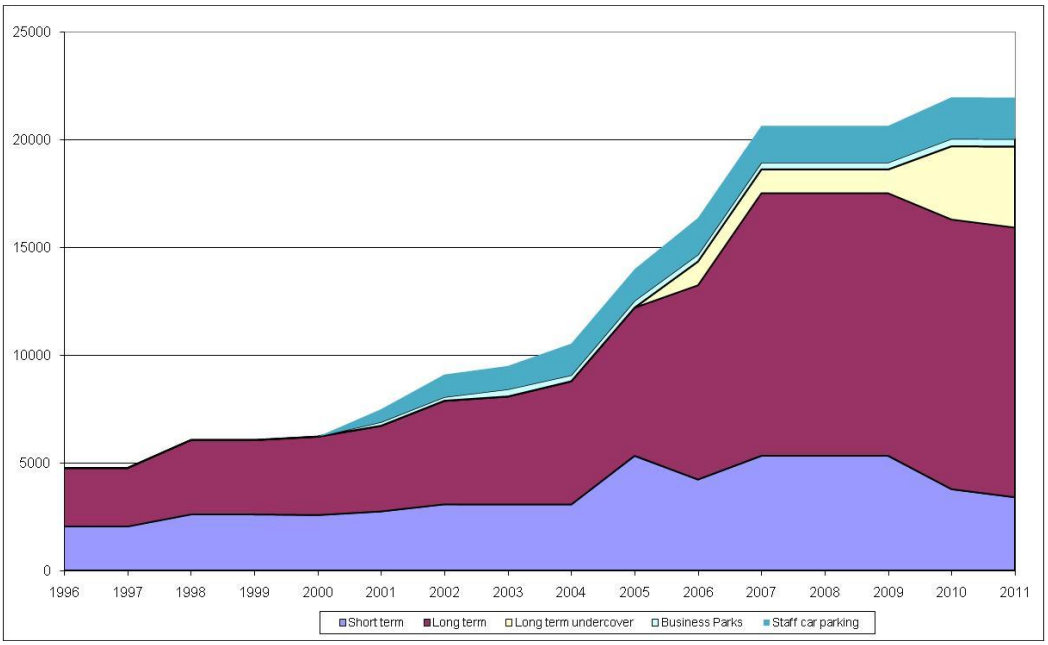

Table 22: Car park capacity at Melbourne Airport
Source: PwC (2011)

2. ECONOMIC VALUE OF MELBOURNE AIRPORT

This chapter describes the economic value of the airport in terms of employment generated, investment and contribution to the Victorian and Australian economy.

In this chapter we set out the benefits of the airport in terms of direct and indirect employment and its contribution to the Gross State Product of Victoria is established. The GSP impact of the airport was calculated by Sinclair Knight Merz in its 2008 economic impact study[7] which also sets out the value of Melbourne Airport's curfew-free status.

The 2008 Economic Impact of Melbourne Airport Study produced by Sinclair Knight Mertz is an update of a 2003 Economic Impact of Melbourne Airport Study.

The 2003 study was jointly commissioned by the Victorian Government (through the Department of Industry, Innovation and Development) and Melbourne Airport in 2001. The 2008 study was independently commissioned by Melbourne Airport in 2007 to track progress and to measure the ongoing impact of the Melbourne Airport on the local, state and national economy.

The 2008 study estimated the impact to the economy, measured in terms of employment generation and to GSP of Melbourne Airport defined as the activity of business and other operations located within the precincts of Melbourne Airport and their associated off-site operations. As such, in addition to Melbourne Airport itself, the study encompasses:

- Transport operations which use the airport (eg freight forwarders);
- Various Government services (eg customs and police); and
- Other activities located at the airport (such as retail outlets, car rental operations),

  within the airport precinct.

The 2008 direct economic contribution of activities within this precinct was calculated to be $526.8 million on GSP of $250 billion. The precinct was estimated to employ 12,524 persons (10,965 Full Time Equivalent (FTE) employees).

Melbourne Airport's ability to operate 24 hours a day, 7 days a week is a powerful and significant competitive advantage compared with other large Australian airports, such as Sydney, which is bound by noise curfews between 11pm and 6am. Having the ability to operate through the night time hours also provides greater flexibility in scheduling flights from Melbourne to match available landing slots at key overseas destinations, such as Heathrow, therefore increasing the attraction of Melbourne as a destination and launch point for international travel. For airlines the status of Melbourne Airport being curfew free substantially lowers airline operating costs by increasing efficiency of aircraft utilisation and reduces fuel consumption on arrival.

[7] The Economic Impact of Melbourne Airport, Sinclair Knight Merz, April 2008.

This contributes to lower costs for all users due to increased asset utilisation.

The study also determined the value of this curfew-free status of the airport to be $309 million in relation to broader economic impacts within the state, and that it added 4,642 jobs in the State – these values being for 2008.

The calculation of these economic impacts was determined by general equilibrium modelling conducted by Sinclair Knight Merz (SKM). To obtain 2010 values would ideally require conducting a new general equilibrium modelling exercise. However, an approximate value of the economic impact of the airport for 2010 can be determined by simply escalating the 2008 values to 2010 using the escalation in the Victorian GSP over that time. This is a rough approximation only, and is likely to represent a conservative escalation basis given that the 2003 study determined, based on historical data, that the productivity gains of the airport were markedly higher than the gains made in Victoria overall. Applying this escalation to the 2008 means that the airport precinct would make a direct economic contribution of $542 million and that the airport's curfew-free status is worth $318 million to the State in 2010. It is emphasised that these are rough approximations and that determining these values by simple escalation ignores material structural and operational changes that have taken place at the airport since 2008.

In the study, Sinclair Knight Merz summarised the key strengths of the airport as follows:

- the ability of the airport to operate 24 hours per day, 7 days per week without any curfews;
- its lack of physical capacity constraints (both external and internal);
- the relatively low rate of general aviation activity at Melbourne Airport, which conserves runway capacity for scheduled aircraft movements;
- the high standard of road transport links to Melbourne CBD and industrial regions to Melbourne's northwest and southeast; and
- the strong capital developments commitment, and historic spend on maintaining and upgrading facilities.

SKM also recommended that Local, State and Federal Governments should continue to support Melbourne Airport by:

- ensuring its ability to operate without a night time curfew;
- controlling development around the airport, to ensure urban growth in the area remains sympathetic to the airport's long term operations;
- continuing to support other general aviation airports within the Melbourne basin, to reduce runway congestion at Melbourne Airport;
- continuing to support the development of complementary road and rail infrastructure to the airport, which will improve:
    - the attractiveness of the airport as a freight hub; and
    - its attractiveness as an easy airport for passengers to access and use; and
- continuing to support tourism to Melbourne, via direct and indirect promotion of Melbourne and other Victorian tourism destinations to international markets.

3. PLANNING AND OPERATIONS OF MELBOURNE AIRPORT

This chapter provides information on the effectiveness of Melbourne Airport's planning and operations. Melbourne Airport works very closely with Government at all levels to ensure that there is strategic planning for future operations, both aeronautical and ground transportation. It also sets out the details of Melbourne Airport's major investment commitments.

3.1 Planning

Issue 25.1 Are planning and development regulations working effectively?

Response

Melbourne Airport plays a crucial role in the local, state and national economy and transport system. Consequently Melbourne Airport's day to day operations and long-term planning have always involved working closely with the Commonwealth, State and Local Governments and key stakeholders to ensure that operations and planning are integrated with existing systems, policies and future plans.

Airports are required to develop Master Plans every five years which outlines their vision for an Airport's medium and long-term future development of the airport asset. It includes plans for transport access and other key developments such as internal road networks and terminal buildings. Extensive consultation processes ensure that all levels of government, key stakeholders and the wider community are involved in the development of the Master Plan. These plans are approved by the Commonwealth Minister for Infrastructure and Transport.

While a Master Plan outlines an airport's 20 year strategic vision for the future, depending on the value and scale of a development, it may also be necessary for an airport to prepare a Major Development Planning (MDP). This legislated process requires Commonwealth planning approval for specific developments which trigger certain thresholds identified in s.89 of The Act. This process involves working with State and Local Governments and the local community and ensures that interested parties have an opportunity to put their views on major developments on the airport site.

In addition to Commonwealth legislative requirements, the State Government also has land use controls around Melbourne Airport, now known as Melbourne Airport Environs Overlay. This overlay incorporates improved and enhanced provisions specifically for Melbourne Airport in accordance with the outcomes of the Melbourne Airport Environs Strategy Plan.

Despite the legislated requirements for consultation the great majority of airports go beyond what is required to engage effectively with their local communities and to ensure sustainable outcomes. In 2010 for example, Melbourne Airport in conjunction with Hanrob, proposed to develop a state of the art dog and cat boarding facility on airport land in the vicinity of a residential area. Melbourne Airport wrote directly to residents to advise them of the proposal and to seek feedback prior to commencement of construction. The Airport subsequently held a number of meetings with representative groups of residents to discuss their concerns in

relation to the proposal and ultimately agreed to changes to the proposal to better serve residential amenity. The project ultimately enjoyed the full support of residents. Sustainable development which protects the primary aeronautical function of airports is essential and is supported by early and meaningful engagement with relevant stakeholders.

With the exception of the Commonwealth's Master Plans and Major Development Plans, much of the integration with other levels of Government has been informal and included quarterly meetings with governments, at minimum twice yearly briefings with relevant state governments and public briefing sessions. These informal working relationships have led to input into our Ground Transportation Plan for example.

The 2009 Aviation White Paper now require airports to establish a Planning Coordination Forum and Community Aviation Consultation Group. These two groups have recently been established at Melbourne Airport, formalising existing networks and processes to facilitate two way communications between key stakeholders.

These forums present an opportunity for the sharing of information and better integration of on and off airport planning and to promote consistency with community, expectations, rather than decision making authorities. However, these new bodies and other informal networks rely on the good faith of all parties to allow Melbourne Airport to prosper and grow for the benefit of the wider community in line with broader planning policies and frameworks. This reliance on good faith may provide uncertainty for all parties when difficult issues are being explored.

Overall, our experience is that the current planning framework does not have serious systemic problems. Where poor outcomes have occurred, they have more to do with poor decision making than fundamental problems with the Airports Act.

Issue 25.2 Can 'excessive' or 'inappropriate' economic development at airports impinge on effective transport linkages to and from airports, or might such development facilitate better transport linkages?

Response

As highlighted above, Melbourne Airport works closely with Local, State and Commonwealth Governments to manage on and off airport development and to manage linkages with other transport systems. This long-term planning process mitigates against the risk of excessive or inappropriate development.

The Master Plan and MDP process outlined above, ensure that all levels of Local, State and Commonwealth Governments are engaged in the process. These plans are approved by the Commonwealth and it also oversees the alignment of all relevant policies.

Supporting our Master Plan, is the Melbourne Airport Ground Transportation Plan. This plan outlines how the airport aims to grow responsibly through providing appropriate and sustainable ground transport options so that Melbourne Airport can meet the expectations of the predicted increasing numbers of airport passengers, our growing staff and future airport

developments. The plan has been developed with reference to key stakeholder strategies such as Melbourne 2030 and The Victorian Transport Plan and demonstrates the alignment of transportation policies.

Finally, given Melbourne Airport's role as a critical piece of state and national infrastructure and approach to business, it would be against Melbourne Airport's long-term interests and objectives to create excessive or inappropriate economic development that would impinge on efficient transport systems.

Issue 26.1 What mechanisms exist at airports to coordinate with local and state governments on planning issues?

Response

As stated above, Melbourne Airport works closely with Local, State and Commonwealth Governments on planning and transport issues. This occurs through formal processes including Master Plans, MDPs, Ground Transportation Plans and the Planning Coordination Forum and Community Aviation Consultation Group (CACG), see above.

We also work with State Government in the development of transport options for Melbourne Airport. Airport Rail is an example of this. Melbourne Airport recognises the benefits of having rail access and has provided for potential rail access on in successive Master Plans. The public demand and forecasts now indicate that rail access could be feasible. We are therefore committed to work with the State Government and relevant local governments to conduct a feasibility study on the possibility of a rail link.

Issue 26.2 Can more be done by airports and governments to better coordinate planning of transport options?

Response

As sated above, airports work closely with governments at all levels to coordinate the planning of transport options. We also meet regularly with ground transportation providers to ensure an integrated, competitive transport services are provided at the airport.

It is important that all agencies and bodies involved act with good faith to ensure that an integrated transport model is adopted.

Issue 26.3 Will recent changes to legislation to impose additional requirements on airport Master Plans (such as ground transport plans) help to alleviate past problems?

Melbourne Airport released its Ground Transport Plan (GTP) in June 2009. The GTP is based on the Melbourne Airport Master Plan 2008, the Melbourne Airport Environment Strategy 2008 and is consistent with the requirements of the Victorian Planning Provisions and the Victorian State Government's *Victorian Transport Plan* and metropolitan planning strategy *Melbourne 2030*. This plan, endorsed by the Victorian Government and Hume City Council and seeks to support improved accessibility via all modes of transport to the airport; to

promote the safe, secure, efficient and environmentally responsible use of the airport; and to consider the infrastructure needs both on and off airport land to ensure the sustainable growth of the airport and the north west region of Melbourne.

The newly establish Melbourne Airport Planning Coordination Forum (PCF) which consists of representatives from organizations including the State Departments of: Business Innovation; Planning and Community Development; Transport and VicRoads as well as the Commonwealth Department of Infrastructure and the City of Hume, will formalise the strategic partnerships between Melbourne Airport and Commonwealth, State and local planning authorities which have always been in place. The PCF will serve to further facilitate robust and ongoing dialogue between participants to ensure early communication about growth and capacity of on and off airport networks with a view to supporting a greater level of integration between the two.

3.2 Capital Investment

Melbourne Airport has invested $1 billion in airport facilities since privatisation and the annual investment amount has increased since the repeal of the heavy handed price cap regime which applied to airport services until 2002. It will also invest approximately $1 billion in infrastructure development projects over the next 5 years. Capital investment by Melbourne Airport since privatisation, and the estimate of future capital investment over the next 5 years, is shown in Table 23 below.

Year	1998	1999	2000	2001	2002	2003	2004
Total capex additions($m)	80.1	19.6	21.0	24.3	42.4	46.9	38

Year	2005	2006	2007	2008	2009	2010	2011-14
Total capex additions($m)	114.9	81.7	83.8	139.7	205.0	189.0	*1,000*

Table 23: Infrastructure Investment
Source: Melbourne Airport (2011)

It should be noted from the table above that average annual capital expenditure under the period of the heavy handed price cap regime was $37.5 million, in contrast to the average rate since price caps were removed in 2002, of $112.4 million.

This indicates that the heavy handed regulation may have had the effect of constraining investment - in contrast to the current light handed regime, which has facilitated growth in investment.

During the first Airline Services Agreement, which was entered into between the airport and airlines and covered the period 2002 to 2007, the airport had the intention of spending $165 million but, in fact, spent over $195 million. The current 5 year agreement indicative spend was $430 million and, as at 31 December 2010, the airport had spent approximately $500 million. It is forecast that by the end of this current agreement, the airport will spend around $700 million. These ASA amounts quoted relate to aeronautical services which account for around 60% of the capital expenditures at the airport as shown in the table

above. Airlines have also been consulted and actively involved and provided input into Melbourne Airport's capital plans presentations, meetings and formal / informal discussions.

The capital expenditure outcomes under the ASA show that Melbourne Airport reviews services and often goes above what is set in the ASA. A recent example of this is expenditure of approximately $60 million on bag reclaims, gates and check in counters.

4. MONITORED SERVICES

This chapter analyses the supply of aeronautical services and car parking services.

In relation to aeronautical services, the services considered in this submission are international passenger services, domestic passenger services and freight services.

In relation to car parking services, these are considered in the context of the range of modes of ground transport. It is possible for substitution to occur across all of the services that may be used to access the airport.

4.1 Market for Aeronautical Services

Regulation of aeronautical services at Melbourne Airport occurs under the CC Act (under Part VIIA Prices Surveillance) and the Airports Act.

Under Part VIIA of the CC Act, the Minister may direct the ACCC to monitor the prices, costs and profits of an industry or business. Direction 29 made under section 95ZF of Part VIIA requires the ACCC to monitor the prices, costs and profits relating to the supply of aeronautical services and facilities by the five airport operators specified in the direction. These airports include Australia Pacific Airports Corporation Limited (Melbourne Airport).

Direction 29 refers to Part 7 of the Airports Regulations, which defines aeronautical services as those services and facilities at an airport that are necessary for the operation and maintenance of civil aviation at the airport. The definition (in Regulation 7.02A) further categorises aeronautical services and facilities as aircraft-related or passenger-related.

Aircraft-related services and facilities include: runways, taxiways, aprons, airside roads and airside grounds; airfield and airside lighting; aircraft parking sites; ground handling (including equipment storage and refuelling); aircraft refuelling; airside freight handling and staging areas essential for aircraft loading and unloading; and navigation on an airfield.

Passenger-related services and facilities include: public areas in terminals, public amenities, lifts, escalators and moving walkways; necessary departure and holding lounges and related facilities; and aerobridges and buses used in airside areas.

Aircraft-related services and facilities for the purposes of the quality of service monitoring arrangements under Part 8 of the Airports Act (through Regulation 8.01A) comprise a subset of the aircraft-related services and facilities from Regulation 7.02A.

Airlines also provide services and facilities under domestic terminal leases (DTLs), which pre-dated the sale of the airport leases. At Melbourne Airport, the Qantas domestic terminal (T1) is occupied and operated by Qantas under a DTL which is not subject to the price and quality of service monitoring regime. The Qantas terminal at Melbourne Airport processes approximately 12 million passengers each year, accounting for 45% of all passengers using Melbourne airport each year.

The market power that airports possess in relation to aeronautical services arises for 3 reasons:

- strong economies of scale (at least up to short term capacity limitations) combined with sunk capital costs;
- the planning approval difficulties that would be encountered in establishing a new airport; and
- the level of sunk costs (terminals, route development costs etc) that individual users – particularly airlines - have in relation their consumption of services at the airport.

The issue of countervailing airline market power is central to this argument and is discussed below.

As set out in section 7.8 below, aeronautical services in Australia can be characterised as exhibiting high levels of productive efficiency, high quality and low prices.

The ability of users to substitute the services of one airport for another is a key issue in determining the extent of any market power of the individual airports.

In this regard, it is reasonable to present that there are differences between international and domestic passenger services and freight services, as discussed below in relation to the issue of countervailing power.

Overtime, major airports have developed a strong understanding of the different airlines that they serve. Aeronautical services at Melbourne Airport are provided not just in the context of airlines needs in Melbourne or Victoria but as a component of international airlines and long haul domestic services which encompass Tasmania, South Australia, the Australian Capital Territory and southern New South Wales and potentially New Zealand; Sydney for Europe and Asia; and Western Australia for America. Melbourne Airport vigorously competes in relation to all transport services, which do, or conceivably could, involve the airport.

It should also be noted that airline network planners, when determining where to place aircraft fleet, can be expected to consider what other international destinations can be reached by the aircraft they are looking to place. This means that there can be some competition between airports on a global basis. For example, an Asian international airline looking to deploy and large, long range aircraft such as a Boeing 747 or Airbus 380 on a long haul route could conceivably consider Australia, Canada or Dubai as a destination. In this context, there could be competition between the potential destination airports. Recently, Melbourne Airport and Sydney Airport were both vying to be a destination of a new Indian Airways service.

The airports also have to manage the risks of investing into fixed infrastructure. Airlines have the ability to withdraw from airports. Airlines that have withdrawn from Melbourne Airport include British Airways (March 2006), Austrian (March 2007), and Viva Macau (2010).

The table below shows the change of services that have occurred at Melbourne over the last four years:

Financial Year	Additional Services	Reduced Services
2006-2007	• Jetstar launching services to Bangkok (3 per week), Bali (2 per week) and Honolulu (2 per week) from December 2007. • China Eastern increasing from 5 per week to 7 per week to Shanghai via Sydney. • Garuda introduced 3 per week direct Melbourne Bali services instead of flying via Sydney or Brisbane.	• Austrian ceased 3 per week services March 2007
2007-2008	• Cathay Pacific increasing services to Hong Kong from 14 per week to 21 per week from October 2007. • Korean Air launching 3 services per week to Seoul from October 2007. • Thai Airways increasing Melbourne- Bangkok services from 12 per week to 14 per week. • Qantas increasing Hong Kong services from 7 per week to 10 per week. • Qantas launching 2 per week Melbourne-Shanghai services. •	• Jetstar cancels 2 per week Honolulu services.
2008-2009	• Etihad launching daily services to Abu Dhabi. • Air Asia launches 3 per week services in November 2008, and 7 per week services in March 2009. • Emirates launching third daily service to Dubai. • Qantas launching 2 per week A380 services to Los Angeles on existing daily service. • Pacific Blue launches 6 per week services to Auckland from September 2008 • Air China increases from 4 services per week to 5 services per week. • China Eastern introduces 2 direct Melbourne – Shanghai services of its daily services via Sydney. • China Southern increasing from 3 services per week to Guangzhou via Sydney, to 2 per week Melbourne direct. • Vietnam Airlines increased from 3 to 4 services per week to Hanoi. • Philippine Airlines increased from 5 per week to daily services. • Garuda Airways introduced 3 services per week to Jakarta to add to existing 4 per week Bali services.	• Qantas decreases Hong Kong services from 10 per week to 7 per week. • Qantas cancelled 2 per week Melbourne-Shanghai services.
2009-2010	• Qatar launching daily services to Doha. • Vietnam Airlines increasing services to Hanoi. • The Virgin Blue Group adding 3 services per week to Los Angeles, 2 per week to Johannesburg, 1 per week to Phuket and increasing services to Denpasar, Christchurch and Nadi. • AirAsia X increasing services to Kuala Lumpur to 11 services per week. • Singapore Airlines deploying A380 services on one of its triple daily MEL-Singapore services. • China Southern increases from 2 to 3 services per week direct to Guangzhou. • Viva Macau launching two services per week to Macau from December 2009	• Viva Macau suspends 2 per week services to Macau.

Table 24: Melbourne Airport - New/Additional and Reduced International Air Services
Source: Melbourne Airport (2011)

Passenger Perspective

Melbourne Airport, like its competitors, is sensitive to passenger needs and requests. Some requests will have a positive revenue outcome, such as trolleys. Others simply improve passenger amenity - such as baby change rooms.

Importantly, it should be recognised that Melbourne Airport's service contract with passengers is limited and that in most cases, passengers' service contract will be with other parties at the airport such as the airlines, retailers and border agencies. The service compact between Melbourne Airport and passengers is generally limited car parking services and ground transportation services.

Other more costly services need to be assessed against the breadth of demand, who will bear the cost of the service and who will provide the service – porterage is an example of such a service. Travelers are also sensitive to the quality of service provided in retail outlets, car parks and so on – in the sense that if they have a poor experience, they will quickly bring it to the attention of the airport or airline concerned. That said, there is little evidence to suggest that the quality of airport experience is critical in determining which airports passengers use – this decision is left up to the airlines.

It should however be noted that in the case of Melbourne Airport, its quality of service monitoring ratings have been consistently high. Melbourne Airport monitors such quality of service attributes as the cleanliness of bathrooms and the queuing time for security screening. Melbourne Airport monitors quality of service measures in order to support appropriate management of aeronautical assets, to encourage discretionary spending and to enhance its reputation as a world class infrastructure facility.

The ACCC suggests that an airport could use its market power – at least in the short term – to increase its profit by driving quality for passengers down. This, however, ignores two factors: one, that the airport has service level agreements with airlines that would not permit this; and two, that high levels of customer satisfaction drive greater turnover of discretionary expenditure in airports, which is profitable.

In order to realise these opportunities, Melbourne Airport needs to offer a value proposition to airlines which competes favourably with other international and domestic airports for the establishment of new services or expansion of existing networks. This is done by Melbourne Airport by pricing and investment decisions that reduce the cost of operations through Melbourne relative to other route options without reducing quality.

Airline Perspective

Melbourne Airport's relatively low aeronautical prices provide it with a distinct commercial advantage over other airports. In addition to the benefits conferred by Melbourne Airport's curfew free status and single terminal precinct, international airlines commencing services

to Australia also identify this as a primary factor in their decision making when commencing new services or expanding existing services. Other buying factors are as follows:

- Availability of infrastructure: airlines are concerned that they have sufficient access to gates, aerobridges, boarding lounges and other facilities. In addition, the certainty to land in a timely manner and not being turned away as a result of a curfew benefits airlines by reducing fuel burn;

- Turn-around times: airline profitability is fundamentally linked to capital utilisation which is directly related to the proportion of time aircraft spend in the air. Access to infrastructure is an issue here, along with congestion of aircraft movement areas and efficiency of ground handling and air traffic control services;

- Passenger processing: the time taken to process passengers through check-in and the border agencies is an important contributor to reducing turn-around times;

- Market development assistance: much of the growth in international services has been due to new international carriers. Market development is expensive and is often recognised as a barrier to entry to new carriers. Melbourne Airport has been in active partnership with the Victorian Government in developing routes both to and from Melbourne; and

- Ability to integrate into Northern Hemisphere schedules: international airline scheduling into Australia, especially from Europe, is determined by scheduling constraints in the Northern Hemisphere. The curfew free operation of Melbourne Airport is a key competitive advantage.

4.2 Countervailing Power of Airlines

Even in markets where an airport may have market power, airlines possess significant countervailing market power. The consumers of these services are to a large degree highly organised corporations with multinational reach and significant political power. It is recognised that not all carriers will have these characteristics, but it is reasonable to present that the carriers covered by the current Airline Services Agreement (ASA) negotiated between the airport and the Board of Airline Representatives of Australia (BARA) have significant bargaining power. This, in part, will stem from the fact that BARA negotiates on their behalf on a block basis with the airport.

The development and agreement of the ASA is evidence of the commercial negotiation process working effectively in a light handed regulatory environment. The 2007 ASA negotiations ran over a 15 month period. During this period, there were countless meetings, emails and written correspondence with airlines and BARA covering all components of the ASA, including principles, airfield conditions of use and pricing. This process was in keeping with the timings agreed in the preceding ASA. It is also noted that in 2007, Melbourne Airport was the first airport in Australia to give binding commitments in relation to service quality and that these have the potential to impact financial outcomes for the airport.

Under the current ASA process, Melbourne Airport continues to work closely with airlines and BARA. This is evidenced by an 18 month timeline for the process being tabled and accepted by airlines in December 2010.

As noted in Chapter 3 above, Melbourne Airport reviews services and often goes above what is set in the ASA. A recent example of this is expenditure of approximately $60 million on bag reclaims, gates and check in counters. In the last ASA negotiations, the Airlines requested a CAT IIIb, a runway landing instrument, and consequently this was installed at Melbourne Airport.

Any market power enjoyed by Melbourne Airport turns into a disadvantage vis-à-vis the airlines in negotiations given that much of the airlines' investment in servicing Melbourne is mobile. Melbourne Airport's value add is derived largely from the services of fixed sunk investments. Melbourne Airport has nowhere else to take its business to enhance its negotiating position with host governments and/or if it were to become unviable to provide its service from Melbourne. Further, because Melbourne Airport's aeronautical services revenue is usage-based, the airport faces volume risk where airlines' actual throughput varies from the throughput assumptions used in determining their commercial agreements with the airport. Recovery of assets in over 40 years signifies potential obsolesce risk.

In negotiating commercial agreements with Melbourne Airport on the capacity, quality and price of aeronautical services and facilities, airlines have bargaining power through the existence of Avalon Airport (currently in relation to domestic services). The role of Avalon Airport in this regard was commented on by the Australian Competition Tribunal (ACT) in its 2005 review of the decision by the Parliamentary Secretary to the Treasurer to declare airside services at Sydney Airport.[8] In the review decision, the ACT considered, in effect, that a significant countervailing power would exist where an airline can create a credible threat to withdraw from negotiations because they have alternative avenues for supply of aeronautical services. In this regard, the ACT raised the example of Jetstar and its discussions with Melbourne Airport in the light of Jetstar having entered into agreements for aeronautical services at Avalon Airport. In relation to this, the ACT made the following observation:

> "This experience of Jetstar showed that where an airport, such as Melbourne Airport, is operating in a competitive market, the environment for negotiating terms is enhanced. …"[9]

Although an aspect of the ACT decision was found by the Federal Court in 2006 to have been based on an irrelevant consideration, the analysis by the ACT of other matters, such as on constraints on the exercise of monopoly power was not interfered with by the Federal Court.[10]

[8] Australian Competition Tribunal, Virgin Blue Airlines Pty Limited [2005] ACompT 5.
[9] Australian Competition Tribunal, Virgin Blue Airlines Pty Limited [2005] ACompT 5, [392].
[10] Federal Court of Australia, Sydney Airport Corporation Limited v Australian Competition Tribunal [2006] FCAFC 146.

It's noted that Avalon Airport has a lesser capacity and does not currently provide all of the services and facilities that are provided at Melbourne Airport. This means that the extent of the competitive tension that can be applied by airlines in negotiations with Melbourne Airport - through existence of the alternative airport at Avalon - will differ between airlines. These competitive tensions, and the nature of competition from Avalon Airport, can however be expected to change over time. It is noted that at present Avalon doesn't just provide competition in the Low Cost Carrier (LCC) market and that it faces no barriers to delivering higher levels of service to target the full range of domestic services.

Although currently only domestic carriers are able to use Avalon Airport (Avalon has plans to develop an international terminal), international carriers may have a greater ability to switch to other capital cities than domestic carriers. This would provide international carriers with an additional basis of countervailing power into the future.

International Passenger Services

Market power depends on the availability of substitutes. The power of Melbourne Airport is mitigated by the potential for international carriers to fly to other international ports that have domestic links to Melbourne. Principal among these is Sydney and to a lesser extent Brisbane, but Adelaide and Canberra may also be able to facilitate some of the international services currently operating through Melbourne.

As noted above, international airline network planners, when determining where to place aircraft fleet, can be expected to consider what other international destinations can be reached by the aircraft they are looking to place and that in this context, there can be some competition on a global basis between international airports.

In negotiating service agreements with the airports, the majority of international airlines are members of BARA (with the exception of some Chinese carriers) and negotiate as a block with the airports. This provides the member airlines with bargaining power in relation to the negotiations and is a source of countervailing power to any market power that the airports may possess.

Domestic Passenger Services

In addition to the potential option of Avalon Airport, there may also be capacity for domestic airlines to bypass Melbourne Airport. For example, where passengers travelling to and from Tasmania going to Adelaide, Perth, Queensland and Canberra will, for the foreseeable future, need to change planes in either Sydney or Melbourne. Similarly, there are a number of options for connections to and from Perth and Darwin and services from northern Queensland can overfly Brisbane and indeed Sydney to service markets in south-eastern Australia. There is also an increasing number of direct services from regional ports to final destinations for example Launceston to Brisbane and Hobart to Adelaide.

Freight Services

Approximately 85% of all freight arriving at Melbourne Airport arrives in the hold of passenger aircraft, so freight services have a high dependency on the supply of passenger services.

In the case of dedicated freight services, these are impacted by the same sorts of issues that impact passenger aircraft – access to infrastructure and good handling agents, being able to be operated at any time of day and so on. This is because what really drives the provision of freight services is the known availability of high value cargo. It is this preparedness to move, coupled with a general availability of airport capacity that gives airports little market power in relation to freight services.

It is our view that whatever market power airports possess is countered by strong commercial customers in the form of airlines. If this countervailing power does not balance whatever power airports may have then the residual balance is likely to be sufficiently small not to warrant regulatory intervention especially when the clear commercial incentive to grow airport business is taken into account.

Issue 17 Have there been changes in the overall market power enjoyed by any of the price monitored airports and if so why? For example, do Avalon and Gold Coast airports materially reduce the market power of Melbourne and Brisbane Airports?

Response

This issue is dealt with in section 4.2 on the countervailing power of airlines. That section highlights observations by the ACT in its 2005 review of the Sydney Airport declaration, on the constraint that exists to the market power of Melbourne Airport as a result of competition from Avalon Airport.

The role performed by Avalon Airport demonstrates competition within the airports sector and provides airlines with bargaining power in their negotiations with Melbourne Airport on commercial agreements on the capacity, quality and price of aeronautical services and facilities.

Melbourne Airport has gained and lost customers to Avalon. Competition from Avalon has particularly affected Melbourne Airport's market power in relation to domestic passenger services, which is discussed further in relation to Issue 18.1 below. For example, both Tiger and Jetstar have moved flights from Melbourne Airport to Avalon Airport and vice versa.

Issue 18.1 What are the constraints on the airports' market power?

Response

The constraints are mainly in the form of substitute airports for the provision of aeronautical services. The key alternative option to Melbourne Airport is Avalon Airport, but because Avalon has a lesser capacity and does not provide all of the services and facilities as at

Melbourne, the ability of an airline to use Avalon in place of Melbourne will differ between the different airlines (international and domestic passenger services and freight services).

Domestic carriers are more capable of using Avalon Airport than international carriers as Avalon does not as yet have an international terminal. International carriers, however, are likely to have a greater ability to switch to other capital cities than domestic carriers - this provides international carriers with an important basis of countervailing power. The basis to constraints on Melbourne Airport's market power in relation to the different aeronautical services as follows:

- *In international passenger services, the power of the airport is mitigated by the potential for international carriers to fly to other international ports that have domestic links to Melbourne i.e. Sydney and to a lesser extent, Brisbane, Adelaide and Canberra;*

- *In domestic passenger services, domestic carriers may have an ability to bypass Melbourne, such as where passengers to and from Tasmania from Adelaide, Perth, Brisbane and Canberra need to change planes in either Sydney or Melbourne (and also have a clear general basis to bypass Melbourne Airport and use Avalon Airport); and*

- *In market for freight, freight service operators seem to be willing to change airports. This appears to reflect that their businesses are driven primarily by the task of delivering imports to Australia rather than to any particular location or the carriage of export freight from a specific location. This preparedness to move, coupled with a general availability of airport capacity, gives airports little market power in relation to freight services.*

Issue 18.2 Do the airlines have countervailing power in dealing with the airports, especially smaller airports?

Response

The basis of the countervailing power of airlines in dealing with the airports (and specifically, Melbourne Airport) is set out in section 4.2 and is also explained in the responses to Issues 17 and 18.1.

As noted, the constraints are mainly in the form of substitute airports for the provision of aeronautical services, but other constraints are also material. The basis of market power of Melbourne Airport is also a point of disadvantage in its negotiations with the airlines given that much of the airlines' investment in Melbourne is mobile while the airport's value added is derived largely from the services of fixed sunk investments. Melbourne Airport has nowhere else to take its business.

Airlines possess countervailing power to the airports in that they are in most cases large, highly organised entities, often with a multinational reach and political influence. This means they have the ability to undertake legal proceedings and media campaigns, or to lobby for regulation of airports, to support their negotiations with airports or otherwise to deter misconduct of airports.

Given the lesser importance of a small airport to a network carrier's operations, all other things being equal, such a carrier would be able to create a more credible threat to withdraw from access negotiations with a small airport than a large airport. Accordingly, such carriers could be expected to possess a material countervailing power in the case of small airports. The same could be expected where the airline negotiating with the small airport is a low cost carrier operating out of a capital city hub. The situation will differ according to the airport concerned, but overall, it could be expected that airlines would have a material countervailing power to the market power of small airports. This is illustrated by the withdrawal of daily Tiger Airways services between Melbourne and Launceston which commenced in November 2007 but were subsequently discontinued in August 2010. As a result of this withdrawal Tiger Airways no longer provides any services to Launceston.

Issue 19.1 If monitoring was to continue, should some airports be removed from, or added to, the list of monitored airports?

Response

Melbourne Airport considers that Adelaide and Perth airports should be removed from the airports subject to the price and quality of service monitoring regime. It is Melbourne Airport's view that these airports do not warrant regulatory intrusion because there is no evidence that they have abused whatever market power they may have and they do not have sufficient incentive to do so. In this regard, it is also noted that the ACCC acknowledged in its 2009/10 monitoring report that Perth Airport's response to quality of service, together with moderation in price increases had lessened the likelihood that Perth had used its market power, and that its car parking prices were not likely to be excessive.

Issue 19.2 If airports are removed, would the second tier self-administered scheme, or some other web-based self-reporting regime for the major airports, suffice?

Response

The existing regulatory regime has generally met its objectives. This 'light handed' regulatory regime has not impeded investment in airport facilities and, under the regime, Melbourne Airport has been able to achieve significant productivity, quality of service and economic efficiency gains over the monitored period. Melbourne Airport supports the continuation of the current regime, with potential amendments to remove Adelaide and Perth airports from regime coverage (as per the response to Issue 19.1). Melbourne Airport's concerns regarding the regime relate to how the monitoring results in some cases are being interpreted and applied. These matters are discussed in section 7.1. Melbourne Airport suggests that the quality of service monitoring arrangements should be undertaken on a self-administered basis, where the airports (and also other relevant service providers) would continue to undertake quality of service monitoring in meeting customer needs and would report these publicly. This reporting will also include financial information currently published by the ACCC.

Issue 20.1 Are the definitions of aeronautical services appropriate in reflecting market power in particular services?

Response

Melbourne Airport supports the current definition of aeronautical services under Part 7 of the Airports Regulations made under the Airports Act.

Issue 20.2 Should some services be excluded or others included?

Response

It is important that the definitions ensure that other services are not included in the definition of aeronautical services – whether such services are provided to non-airline consumers or provided to airlines in the context of strong competition.

If there are specific concerns about the pricing conduct of airports in relation to such services, then these should be monitored explicitly and separately from those services provided solely to airlines.

In addition, if it is determined that there is a requirement for such monitoring, this does not, of itself, mean that such services should be included within the definition of aeronautical services.

The inclusion of these services in the definition of aeronautical services could be taken to imply that the Government is of the view that the revenues and costs associated with these services should be taken into account in the setting of airline charges. If so, this would, in effect, constitute implementation of single-till pricing. The single-till approach is not consistent with the COAG Agreement because it involves the consideration of costs and revenues not involved with the production of aeronautical services.

4.3 Ground Transport Services

At Melbourne Airport, there are a wide range of options for access to the airport using public roads (provided by the airport on its leased premises and other parties to the airport boundary). The ground access options in relation to the airport are set out in Table 25 below.

Personalised Options	Scheduled or group options
1. Private vehicles using the kerb	8. Skybus
2. Private vehicles using airport provided long and short term car parking	9. Orbital Smart Bus
3. Privately operated buses servicing off-airport car parking	10. Metropolitan public bus services
4. Private vehicles using airline provided valet car parking	11. Privately operated buses servicing regional centres
5. Taxis	12. Courtesy buses operated by hotels, universities and other organisations
6. Private limousine hire cars licensed by the Victorian Taxi Directorate	13. Tour coaches
7. On-airport car rental operations	14. Off-airport car rental operations

Table 25: Ground access options in relation to Melbourne Airport
Source: PwC (2011)

Of the transportation access modes in Table 25 above, all modes apart from private vehicles using the kerb for pick-up/drop-off and currently public buses, pay for the access they enjoy to the services provided by the airport.

It is Melbourne Airport's policy that parties which obtain a commercial benefit from access to the forecourt should contribute to the costs of providing and maintaining those facilities.

As noted above, private vehicles accessing the terminal for pick-ups/drop-offs do not pay access fees. In this case, the vehicles must be attended at all times and the maximum length of stay for a pick-up or drop-off is 1 minute. The mode share percentages in relation to transport access to the airport are provided in Table 7 of Chapter 8. As shown in that table, the predominant mode of access is by private vehicle (35% for pick-up/drop-offs at the terminal, plus 27% for private vehicles plus use of car parking at the airport). Approximately 15% mode share relates to private vehicles using off-airport car parks, 14% involves taxis/hire cars and 9% involves bus travel.

In setting prices, Melbourne Airport considers the costs it incurs in providing services, the amenity provided by the service and the relativity of prices for airport services with competing services. Pricing for car parking and terminal access services also seeks to efficiently manage access to the kerb in front of the terminal complex and to give effect to the safe and efficient flow of traffic in the forecourt area.

To better understand its customers, Melbourne Airport in 2010 performed web-based research of Victorian passengers, involving a sample size of 956 customers. The findings of the research are that airport customers need to feel in control and to have certainty in getting to their flight on time in order to consider any particular mode of ground transport.

Other factors such as price, convenience and distance to the terminal are secondary and tend to be a consideration only after the customer is comfortable that the preferred mode will get them to their flight on time. Customer preferences in relation to ground access options, established from Melbourne Airport's 2010 research, are shown in Table 26 below.

Mandatory (Time Control Factors)
Need to have time control over the journey to their flight Need to feel comfortable than a mode of transport will get them to their flight Will not consider an alternative if they are not confident
Other Factors (in order of importance)
1. Price 2. Ability to easily manage luggage 3. Walking distance 4. Don't want to leave car at origin of journey 5. Personal security, also security of car 6. Effort to get from car to terminal 7. Parking undercover 8. Comfort of using own car

Table 26: Hierarchy of Customer Behaviour
Source: PwC (2011) from Melbourne Airport information

From Melbourne Airport's research, for shorter stays, in relation to the other factors above, there tends to be a lesser emphasis on the price factor and on security and safety factors. This is considered to reflect a high proportion of business travelers opting for shorter stays.

It is, however, difficult to generalise individual user behavior, and particular users can evidence different behaviour according to the context eg they may use a taxi for business trips and the long term car park for family trips.

Overall, a premium value, and a high weight by mode share is attached to service modes that are tailored to individual usage (that is, the services 1 to 7 in Table 26), which offer similar levels of flexibility and timeliness (i.e. around 20 minutes journey time between the airport and the CBD). There will also be ranking between these tailored service modes. For example:

- private vehicles, in many cases, will offer the greatest control over the journey to the flight; and
- in the absence of a private vehicle option, or for various factors where a private vehicle is not convenient, a taxi/limousine may represent the option which offers greatest control over the journey.

Within the private vehicle options, kerbside pick-up/drop-off and short term car parking represent highly substitutable sub-options. This will reflect the high level of amenity offered by short term car parking at the airport, which given close proximity of the short term car park to the terminals, can be considered to be similar to the amenity provided by kerbside pick-up/drop-off.

In many cases, rental vehicles will rank below the private vehicle and taxi options discussed above, given transaction times in contacting for the service and also the additional costs of the service in relation to other modes. It is noted that there will be circumstances where rental vehicles are cost-effective against other modes (eg where the rental vehicle is hired to allow the user to visit multiple locations in the city or elsewhere).

As can be noted from Table 26, after time control factors, cost tends to be the next important factor in relation to users' ground access mode preferences. The cost factor will influence user preferences in relation to the ranking of individual services in the grouping of 1 to 7 in Table 26 above and also in relation to preferences for such individually tailored services relative to the (typically less expensive) scheduled or grouped services. That is, more cost-sensitive users may prefer a scheduled bus service instead of a personalised hired service, even though the bus service may present a materially longer journey time and may offer a lower level of amenity than the personalised hired service.

Accordingly, based on their particular preferences, users will rank the same list of options differently and may apply different factors in arriving at their selections. Further, the mode selection by an individual user may differ according to the context (eg taxi for business, long term car park for private, as commented above).

The findings of Melbourne Airport's research are that most people use multiple modes and that demographic/situational factors are not the major drivers of mode selection. It is possible for substitution to occur across all of the services that may be used to access the airport, although there may be particularly strong substitution effects between like services eg private vehicle pick-up/drop-off and private vehicle combined with the short term car park; and private vehicle combined with the long term car park or with off-airport car parks serving the airport. It is also interesting to note, that customers are reporting a relatively high level of service. Melbourne Airport's QSM from July to December 2010 the overall standard of facility of all car parks a standard of 3.93 out of a possible 5.

Melbourne Airport Car Parking product	Overall standard of facilities
All Car parks	3.93
Short-term car park	3.95
Long-term (uncovered) car park	3.97
Multi-level long-term car park	3.82

Table 27: QSM: Overall standard of facility of Melbourne Airport Car Parks
Source: Melbourne Airport (2011)

5. REGULATION OF MELBOURNE AIRPORT

This chapter sets out the general regulatory mechanisms applying to Melbourne Airport. Essentially, these comprise the monitoring of prices, costs and profits of aeronautical services and car parking services under the prices surveillance provisions of the Competition and Consumer Act 2010; and the quality of service monitoring of airport services and facilities under the Airports Act 1996 and the Airports Regulations 1997.

The monitoring arrangements under the CC Act and under the industry-specific legislation above can be characterised representing a light handed regulatory regime. This is because the relevant regulatory agency, the ACCC, is empowered only to monitor the performance of the regulated services and regulated service providers. It does not have the power to determine aspects of the performance of the service providers, such as in the area of pricing. Light handed regulation is consistent with the fact that Melbourne Airport faces competition and countervailing power in relation to the services which it provides. The light handed approach has encouraged investment and promoted efficiencies.

The case of the declaration of airside services at Sydney Airport provides evidence that the access regime in Part IIIA of the CC Act may be used by an airline to facilitate access to aeronautical services. An access seeker's use of Part IIIA may however be constrained by the uncertainty and the potential duration of its declaration and arbitration processes.

In promoting an environment where commercial negotiations continue to drive airport investments, while ensuring that airlines, passengers and the community in general have confidence that airports do not overcharge for their services, in this chapter Melbourne Airport also suggests a framework to apply to the resolution of disputes between the airport and airlines. The process suggested by Melbourne Airport includes the fall-back mechanism of a formal inquiry under Part VIIA and the possibility of declaration under either Part IIIA (binding arbitration by the ACCC) or Part VIIA (prices notification).

5.1 Prices Surveillance

Under Part VIIA, Prices Surveillance, of the CC Act, the Minister may direct the ACCC to monitor the prices, costs and profits of an industry or business.

Aeronautical Services and Facilities

On 28 June 2007, the Parliamentary Secretary to the Treasurer issued Direction 29 under section 95ZF of Part VIIA, which directs the ACCC, from 1 July 2007, to monitor the prices, costs and profits relating to the supply of aeronautical services and facilities by:

- Sydney Airport Corporation Limited (Sydney Kingsford Smith Airport);
- Australia Pacific Airports Corporation Limited (Melbourne Airport);

- Brisbane Airport Corporation Pty Limited (Brisbane Airport);
- Adelaide Airport Limited (Adelaide Airport); and
- Westralia Airports Corporation Pty Limited (Perth Airport).

Direction 29 refers to Part 7 of the Airports Regulations 1997, which defines aeronautical services as those services and facilities at an airport that are necessary for the operation and maintenance of civil aviation at the airport. The definition further categorises aeronautical services as aircraft-related or passenger-related, as discussed in section 4.1 above.

Airport operators provide most of its services in conjunction with others such as contractors and government agencies. These partnerships in addition to the interaction with customers can impact the overall service levels. Importantly, at Melbourne Airport the Qantas domestic terminal (T1) is occupied and operated by Qantas under a DTL which is not subject to the price and quality of service monitoring regime. Passengers processed through the Qantas terminal constitute approximately 45% of all passengers arriving and departing Melbourne Airport on an annual basis.

For the purposes of the monitoring regime under Direction 29, non-aeronautical services and facilities are those supplied by an airport operator that do not fall within the definition of aeronautical services and facilities in Part 7 of the Regulations. Non-aeronautical services and facilities would include retail outlets, hotels, corporate parks, car parking and factory outlets.

Car Parking Services

On 7 April 2008, the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs issued Direction 31 under section 95ZF of Part VIIA of the CC Act, which directs the ACCC, from that date, to monitor the prices, costs and profits relating to the supply of car parking services by the five specified airports.

Accounts, Statements and Reports

Part 7 of the Airports Act 1996 provides that airports specified in the Airports Regulations 1997 (currently the five specified airports) must prepare and provide to the ACCC, accounts, statements and reports as required by the Regulations.

Sections 141 - 143 of the Act provide that audited accounts and statements prepared in accordance with the Regulations (which may adopt with or without modification AASB accounting standards) must be prepared and lodged with the ACCC by these airports.

Section 145 of the Act provides that these airports must also prepare and provide to the ACCC reports required by the Regulations or by the ACCC if a power to require a report is conferred on it by the Regulations.

Sections 143A and 145A of the Act empower the ACCC to publish reports, statements and accounts provided to it in accordance with these requirements.

The Regulations specify a range of aircraft-related and passenger-related services and facilities for which financial reports and financial statements are to be prepared and defines financial statements and financial records to be those as required by the Corporations Act 2001. The required financial reports must separately show costs and revenue in relation to the provision and use of these services and facilities.

In contrast with Part 8 of the Airports Act relating to quality of service, under Part 7 of the Act, the ACCC is not empowered to monitor and evaluate the accounts, statements and reports it receives.

Quality of Service Monitoring

The ACCC regulates the quality of service of the monitored airports through the Airports Regulations 1997 made under Part 8 of the Airports Act.

Under section 152 of the Act, the airport services and facilities subject to quality of service monitoring are only those that are provided by the airport itself, or by another person under an agreement with the airport.

Section 155(1) of the Act provides that the ACCC has the function of monitoring and evaluating the quality of those aspects of airport services and facilities as are specified in the Regulations. The services and facilities represent the passenger-related and aircraft-related services as set out in Regulation 8.01A of the Regulations.

The remaining provisions of section 155 of the Act include the following:

> "(2) The monitoring and evaluation of an aspect specified for the purposes of subsection (1) must be against the criteria determined by the ACCC in writing in relation to the aspect.
>
> (3) Before determining criteria under subsection (2), the ACCC must consult the Department and the Department administered by the Treasurer."

Accordingly, section 155 of the Act and Regulation 8.01A, in effect, provide that:

- where services at an airport are provided by anyone other than the airport operator or their subcontractor, they are not subject to quality of service monitoring;

- while it is the Government that determines which airports are to be monitored and which services offered by them are to be monitored, it is the ACCC that determines the criteria by which those services are to be measured with the only constraint on its discretion being the requirement that it first consult the Minister's Department; and

- the ACCC has discretion in deciding the methodology it uses to monitor those criteria in respect of those services.

This contrasts with the legislative position in respect of financial reporting and price monitoring, where the Act and Regulations combine to impose on the ACCC an obligation to abide by recognised accounting standards.

5.2 Infrastructure Access

Part IIIA of the CC Act establishes a regime for the provision of third party access to essential services provided by natural monopoly infrastructure. The Part IIIA regime is not specific to any particular industry or type of infrastructure.

The access regime involves three key processes:

- a Ministerial declaration that services provided by the facility should be subject to rights of access;

- commercial negotiation of the terms and conditions (including price) of access to the declared services; and

- to the extent commercial agreements cannot be reached, the arbitration of disputes by the ACCC.

The Ministerial declaration is preceded by an application by the access seeker to the National Competition Council (NCC) for a recommendation to the Minister that a declaration should be made. The NCC will assess the application based on criteria set out in Part IIIA of the CC Act including whether: access would promote competition in any market; the facility is uneconomical to duplicate; the facility is of national significance having regard to its size and importance to the national economy; and access to the facility would not be contrary to the public interest.

The Minister must then decide whether or not to declare the facility on the basis of the same statutory criteria considered by the NCC. The access seeker and the facility owner both have a right to apply to the Australian Competition Tribunal for review of the ministerial decision.

Part IIIA as effective deterrent to potential misconduct

Melbourne Airport's customer service focus means that it prefers to negotiate outcomes with users based on commercial principles. These principles are made by the Government relating to airport conduct, including the current review principles and others that might apply in the future. Such arrangements are incorporated into Melbourne Airport's Airline Services Agreement entered into with the airlines.

Negotiation of commercial agreements with users has been an efficient and effective means of establishing charges, terms and conditions of access to aeronautical services. If such

negotiations and agreements cannot be concluded in an efficient, timely manner, this can adversely affect Melbourne Airport's business and can affect the ability of users to receive the services and facilities they require. Melbourne Airport is also conscious that it is a guardian of public infrastructure under its lease with the Commonwealth and must plan for future generations beyond the life of the lease. The potential for uncertainty in relation to the Part IIIA declaration process, of the timeframe for ultimately arriving at an arbitration under Part IIIA and the likely cost associated with these processes means that Melbourne Airport has a strong incentive to avoid invoking Part IIIA through engaging in misconduct. Melbourne has always considered the threat of regulation as an important factor in its commercial discussions and as a result has always been very open about its aeronautical pricing, which is based on regulatory principles established under the former price capping regime.

Declaration of Airside Services at Sydney Airport

On 1 October 2002, Virgin Blue applied for declaration of airside services at Sydney Airport pursuant to Part IIIA. The NCC recommended to the Minister that the airside services should not be declared, on the basis that access would not promote an increase in competition in a market and that access would be contrary to the public interest. The Minister decided not to declare the airside services and Virgin Blue applied to the ACT for a review of that decision. The ACT sets aside the Minister's decision, holding that increased access to airside services would promote competition and any costs of regulation arising from such a decision were not of such weight that increased access would be contrary to the public interest.

Sydney Airport appealed the ACT's decision to the Federal Court and although an aspect of the ACT's decision was found to have been based on an irrelevant consideration, the ACT's decision was not interfered with by the Federal Court.

The Government has since amended the Part IIIA access regime, inserting a new objects clause in order to clarify the regime's object and scope and requiring that a service can only be declared if it would promote a "material increase" in competition in a market.

Issue 12 Has the Federal Court's interpretation led to Part IIIA becoming the operative regulatory instrument for the major airports or has the threat of potentially easier recourse to Part IIIA 'conditioned' negotiations between airports and airport users, or has it had little impact?

Response

The case of the declaration of airside services at Sydney Airport is evidence of the access regime in Part IIIA of the CC Act being used effectively to facilitate access. Part IIIA serves not only as an available remedy for airlines or other access seekers but also, potentially, a deterrent to misconduct by airports. An access seeker's use of Part IIIA may however be constrained by the uncertainty and the potential duration of its declaration and arbitration processes.

Melbourne has always considered the threat of regulation as an important factor in its commercial discussions and as a result has always been very open about its aeronautical pricing the current decision did not change our position because it confirmed a position that we fully understood.

Issue 13 Have recent legislative changes (in 2006 and 2010) addressed concerns that Part IIIA could supplant price monitoring as the operative regulatory instrument?

Response

The amendments to the Part IIIA access regime (the insertion of a new objects clause in order to clarify the regimes object and scope and requiring that a service can only be declared if it would promote a "material increase" in competition in a market) have not been tested and it is uncertain whether the potential for declaration has materially changed for major Australian airports.

Once a service is declared under Part IIIA, access seekers have a right to negotiate access to the service. The negotiation process involves private negotiations between the access seeker and access provider. Where access agreements are entered into they are registered with the ACCC. If parties are unable to agree on access arrangements or pricing, disputes may be arbitrated by the ACCC. Access arbitrations are conducted in accordance with specified criteria which include the objects of Part IIIA, the legitimate business interests of the access provider and the direct costs of providing access to the service. It is Melbourne Airport's view that Part IIIA constitutes an effective dispute resolution mechanism where price monitoring discloses an abuse of market power by an airport operator.

5.3 Dispute Resolution

Background

As set out in the PC's Issues Paper,[11] in the 2006 airport services inquiry, the PC recommended that the Government be required to make an explicit response to the ACCC's monitoring reports. The PC's recommended arrangement would have entailed the responsible Minister publicly indicating that either no further investigation of conduct was warranted, or that an airport would be asked to 'show cause' as to why further investigation into its conduct should not take place. Such a process would trigger a defined process in those instances where the ACCC's reporting indicated that airports may have misused their market power.

In the recent National Aviation Policy White Paper, the Government announced that the 'show cause' process recommended by the PC would not be introduced.

In its Issues Paper, the PC suggests an alternative approach, which is to require that commercial negotiations between the airports and their customers encompass processes for resolving disputes, such as independent commercial mediation and arbitration — for

[11] Economic Regulation of Airport Services, Productivity Commission Issues Paper, January 2011, p 19.

example, a legislative requirement to the effect that, once a party has notified a dispute, commercial mediation/arbitration is triggered. [12]

It is firstly emphasised that in response to the above developments, it is Melbourne Airport's view that commercial agreements between airports and airlines are the best way to establish aeronautical prices, terms and conditions.

Melbourne Airport's experience and we believe that of our airline customers (at least in their dealings with the APAC airports – Melbourne Airport and Launceston Airport), is that commercial agreement can be reached over the capacity, quality and price of aeronautical services and facilities. The agreements provide a commercial dispute resolution process, which as a fall-back, provides for binding arbitration for the life of the agreement.

As set out in 7.8 of this submission, the aeronautical service charges at Melbourne Airport (which represent a key subject of and outcome from, the negotiations in relation to commercial agreements with airlines) were found by Management Consultants (LeighFisher) to be the lowest amongst the 5 capital city airports for which aeronautical services are monitored under Direction 29 (and are the lowest amongst the 9 Australian and New Zealand airports in the sample used by LeighFisher).

In section 7.1, in responding to the PC's Issue 2.3, we set out how, in negotiating commercial agreements with airlines, Melbourne Airport applies a Weighted Average Cost of Capital (WACC) and cost of service approach as agreed to by the ACCC under the former price cap regime.

The LeighFisher Benchmarking Study also found that aeronautical service charges at Melbourne Airport compare favourably with the charges applied by 58 international airports. These positive price outcomes and Melbourne Airport's strong performance in relation to the range of operational and financial indicators assessed by LeighFisher, indicate that the current contractual basis to determining aeronautical charges, service quality and capacity is effective in arriving at efficient outcomes. It has also facilitated the significant capital investment in airport facilities, as shown in Chapter 3, particularly since the conclusion of the heavy handed price cap regulatory regime in 2002.

Issue 21.1 Is the existing range of remedies effective in deterring misuse of market power?

Response

The efficient pricing outcomes and the strong operational and financial performance at Melbourne Airport in relation to aeronautical services – where the LeighFisher Benchmarking Study regards cost and staff productivity and profitability outcomes at Australian airports to represent industry best practice – are consistent with the outcomes of strong competition and are not indicative of any misuse of market power.

[12] Economic Regulation of Airport Services, Productivity Commission Issues Paper, January 2011, p 12.

The ACCC has significant investigation and enforcement powers in relation to section 46 of the CC Act. It could be argued that these powers form an effective regulatory deterrent.

In addition, the potential for declaration under Part IIIA of the CC Act also serves not only as a deterrent to misconduct by airports but as a readily available remedy for airlines or other relevant parties.

Should the Government wish to adopt a dispute resolution process, the approach must firstly encourage commercial negotiations. Should this fail, a timed approach (as per the proposed approach outlined in section 5.3 of this submission) should be adopted.

Issue 21.2 Are these remedies effective 'punishment' for misuse of market power?

Response

As per our response to Issue 21.1 above, Melbourne Airport considers section 46 of the CC Act to provide appropriate safeguards in relation to the misuse of market power.

Issue 22.1 What impact does the lack of a 'show cause' process have on ensuring appropriate pricing and investment outcomes for aeronautical services?

Response

It is Melbourne Airport's view that the existing basis of providing aeronautical services under commercially negotiated agreements has proven to be efficient and effective and has provided the airport with appropriate foundation for long term investment in airport infrastructure.

It is Melbourne Airport's view that the existence of a show cause process threatens investor certainty, as the 'trigger' mechanisms of such processes and other aspects of regime design, will inevitably provide incentives for either airports or airlines to engage in strategic conduct to avoid normal commercial processes and outcomes. As presented above, it is Melbourne Airport's view that commercial agreements between airports and airlines represent the best way to establish aeronautical prices, terms and conditions. Reiterating comments made by both airport operators and airlines in relation to the draft show cause assessment developed by the Department of Infrastructure and Transport that such processes would also be resource and time intensive to establish and maintain.[13] These comments have been borne out by the experience since 2006 of the development and consideration of draft proposals in this regard. Melbourne Airport supports the National Aviation Policy White Paper wherein the Government announced that the 'show cause' process would not be introduced:

> *"In light of the concerns expressed by stakeholders regarding the draft guideline, the Government is not proposing to introduce the annual 'show cause' assessment at this time. The Government is sensitive to any potential impact a show cause*

[13] That such comments were made by airlines and airports is noted by the Productivity Commission on page 20 of its Issues Paper, Economic Regulation of Airport Services, January 2011.

assessment could have on airports' ability to attract capital, particularly because of the impact of the global financial crisis on investor confidence and access to finance, now is not the time to introduce this. However, should the ACCC monitoring report or other evidence indicate that an airport warrants further investigation for its pricing behaviour, the Minister retains the discretion to recommend a formal inquiry under the Trade Practices Act."[14]

The Minister's has a unilateral right to declare service under Part IIA or Part VII if the Government is disposed to this power. An annual statement only creates an annual problem that will create unnecessary and counter productivity lobbying each and every year, and an annual media cycle that could damage the relationship between the Government, airlines and airports.

Dispute Resolution

The agreements that Melbourne Airport has entered into with its airline customers cover a wide range of matters. It is open to airlines to seek to have dispute resolution processes in the contracts they negotiate with airlines. All contracts in place are subject to formal dispute resolution mechanisms. Those which are not subject to dispute resolution are typically related to decisions taken by the airport in relation to operational or regulatory issues, or which may impact on the amount of capital shareholders are required to commit. In particular, all issues in relation to the setting of prices during the life of the agreements are subject to agreed dispute resolution.

For all practical purposes, it is unlikely that airlines will enter into agreements unless they contain adequate dispute resolution mechanisms. However, it is not the settling of disputes within agreements that is of policy concern. Rather, it is those situations where the differences between the parties are so intractable that no agreement can be reached or that airlines, whilst continuing to pay for services believe the conduct of the airport concerned is outside the Principles laid down by the Government.

Further, it is Melbourne Airport's view that the absence of a formal (executed) agreement between an airport and its airline customers is not of itself a justification for policy intervention.

There will be times where some airlines agree and some do not about issues involving the provisions and pricing of common use services and facilities. There will be times where an airport for its own legitimate business reasons pursues a course of action (within the bounds of the Principles) which will have differential impacts on its customers and possibly detrimental impacts on some. These should only be of concern if they impact significantly on the conditions of competition between airlines. In such cases where the purpose is to damage competition, or an airport has an understanding with another airline, it is Melbourne Airport's strong view that these are issues rightly dealt with under Part IV of the CC Act.

[14] National Aviation Policy, White Paper: Flight Path to the Future" December 2009, page 180.

Melbourne Airport considers the access regime in Part IIIA of the CC Act to represent an adequate "last port of call" for the resolution of intractable disputes. These provisions are much more efficacious and accountable than the notification procedures in Part VIIA which, even if applied, may not be able to achieve a satisfactory resolution of the dispute. The Sydney Airport case discussed in section 4.2 illustrates this where Part IIIA can lead to:

- airlines have had to wait too long to discover whether they will gain access to arbitration; and

- there is significant uncertainty as to whether an airport fully compliant with the government's review Principles will not be declared.

This situation is unsatisfactory for all concerned. Melbourne Airport remains a supporter of price monitoring but believes that the interests of all parties will be better served by the establishment of an industry specific dispute resolution mechanism consistent with the Principles.

The development of an "industry specific" regime for airports actually represents the development of a more robust prices monitoring regime. The principles applied and the lessons learned, could, in turn, be used in adopting lighter forms of regulation in other industries, especially those which are vertically separated. The proposed regime need not be concerned with an airport denying access for a number of reasons including:

- the vertically separated nature of the aviation industry means the incentive to deny competitors access to facilities does not exist;

- in the presence of significant surplus capacity in at least one airport infrastructure element and passenger related non-aeronautical revenues, airports have a strong incentive to maximise passenger throughput which is incompatible with denying access; and

- The airports can be considered to be entities with a degree of market power. Conduct with the purpose of affecting competition in downstream services (in particular air travel services) would breach section 46 of the CC Act. If an airport had an understanding with one particular airline, or group of airlines, it may also run afoul of the cartel conduct regime in Division 1 of Part IV or the general prohibition on anticompetitive agreements in section 45 of the CC Act.

Further, Melbourne Airport believes that a competent airport operator could avoid declaration by demonstrating that declaration would not lead to increased competition in another market but still pursue pricing policies that contravene the Principles. Such an outcome would seriously undermine the credibility of the regime given:

- the level of the investment commitment of Melbourne Airport and others in the next decade;

- the legitimate interests of airlines to have access to dispute resolution when the Principles are not adhered to; and

- the uncertain nature of the current jurisprudence,

It is desirable that a clear mechanism leading to arbitration is provided.

In promoting an environment where commercial negotiations continue to drive airport investments, while ensuring that the community has confidence that airports do not overcharge for their services, Melbourne Airport suggests the framework below to apply to the resolution of disputes between airports and airlines. This framework seeks to address the issues that the show cause proposals have sought to cover.

Proposed Approach to Dispute Resolution

The approach below to deal with disputes between airports and airlines is proposed as a 'fall back' mechanism in the absence of the parties agreeing a different approach. The approach would ultimately lead to a formal inquiry under Part VIIA and the possibility of declaration under either Part IIIA (binding arbitration by the ACCC) or Part VIIA (prices notification). It has a known and relatively certain timeframe while ensuring that airports comply with the pricing principles outlined by the Government (the Principles) and is not subject to spurious complaints.

Our recommended process would involve the Minister in the process of determining whether an airport should be exposed to a formal inquiry or arbitration by the ACCC. In addition to reducing timeframes available under Part IIIA and increasing certainty this proposal:

- will reduce gaming from both sides;

- can deal with price and non-price issues;

- will encourage commercial rather than regulatory settlement; and

- potentially provide an arbitrated outcome to a dispute.

A dispute arises if an airline, or group of airlines, has not been able to reach a commercial agreement with an airport and believes that an airport is proposing to pursue (or is pursuing) a course of action that is inconsistent with the Principles.

The process would commence by the airline writing to the Minister of the conduct of concern. The complainants would also be required to provide a copy of this letter to the airport concerned. Such a letter (and/or accompanying materials) must set out to the Minister's satisfaction:

- Evidence that the complainants have engaged in serious good faith negotiations that have no reasonable prospect of reaching an acceptable outcome;

- The particular matters in dispute and how they constitute a contravention of the Principles; and

- A proposed resolution of the dispute that would be acceptable to the complainants including a demonstration of how such a resolution is consistent with the Principles. The complainant will need to evidence that such a counter offer has been put to and rejected by the airport concerned.

Within 14 days of receipt of such a letter, the Minister would confirm that the airport concerned had received a copy. The Minister would ask the airport to advise of any other customers who would have a legitimate interest in the matter and in particular who would be disadvantaged by the proposed resolution. During this period the Minister would also need to be satisfied that the complaint contains all the relevant information, the counter offer is capable of acceptance and is not vexatious.

Once the Minister is so satisfied the airport concerned will have 21 days to respond in writing to the complaint, accept the airline counter offer or submit the matters in dispute to commercial arbitration. Other affected commercial parties would be invited to provide a view during this period. If the airport concerned accepts the counter offer or is prepared to enter into binding commercial arbitration on the matters of concern (and obviously subject to the Principles) and if this is acceptable to the complainant, then the Minister will not proceed with the complaint.

Having received the views of the airport and other affected parties, the Minister would have a further 21 days to determine if there is prima face evidence that the proposed conduct may contravene the Principles, the complainants have acted in good faith and the dispute is unlikely to resolve itself. If the Minister believes any of these are not the case, there will be no further action. If, on the other hand, the Minister was satisfied on each of these grounds an inquiry under Part VIIA would be ordered.

The inquiry would be directed to consider the conduct proposed by the airport. The inquiry would be directed to have regard to:

- The Principles;

- Only those matters in dispute except to the extent any others are relevant to consideration of the matters in dispute;

- The extent to which the counter offer complies with the Principles; and

- The impact that acceptance of the both the proposed conduct and the counter offer would have on the interests of the commercial interests of parties not subject to the dispute.

As a matter of law, by effect of Part VIIA, the airport will not be able to increase prices during the inquiry. Given the potential for subsequent ACCC involvement under Part IIIA,

such an inquiry should be conducted by another body such as the National Competition Council.

The inquiry will be directed to report within 90 days. In accordance with part VIIA, a copy of the report will be sent to the airport when it is sent to the Minister. If the report concludes that the Principles have not been contravened, no further action will be taken. If the report concludes that the Principles are likely to be contravened then the airport has 28 days to accept the counter offer of the airlines, come to some other agreement with the airlines or submit to binding commercial arbitration. In any case, the report would be published 28 days after receipt by the Minister.

If the dispute remains unresolved or not subject to commercial arbitration, then the Minister will declare the aeronautical services (as defined in the Regulations) of the airport concerned for the purposes of Part VIIA and impose prices notification for a period of time and at least until the next scheduled review.

Neither the inquiry process nor the prices notification contained in Part VIIA can ultimately compel an airport to change its conduct or stop an unjustified price increase, only delay them. Further, there are a range of potential areas of dispute between airports and airlines that do not involve prices that procedures under Part VII could simply not address – in its 2006 report, the PC identified these as the major area of concern when it came to the potential abuse of market power by some airports.[15]

An alternative to the Part VIIA actions would be to amend the Airports Act as to enable the Minister to declare the aeronautical services of the airport concerned for the purposes of Part IIIA and thereby give the complainants the option of binding arbitration by the ACCC, in a similar way that section 192 of the Airports Act did until it expired and was repealed. Legislation would be required to do this and also to ensure that the ACCC, in conducting any subsequent arbitration, is required not to make any decision that is inconsistent with the Principles. Otherwise it would conduct the arbitration in accordance with the arbitration provisions of Part IIIA.

It is noted that decisions up to the point of declaration under Part IIIA are not currently subject to merits review although decisions would be subject to the normal processes of the ADJR Act. Decisions by the ACCC in arbitration are subject to merit review by the ACT. This is deliberate. At all times up until declaration which would lead to the possibility of arbitration by the ACCC the airport concerned may accept either the counter offer or commercial, rather than regulatory, dispute resolution.

In the event the airport elects to accept the counter offer or commercial arbitration – arbitration subject to the Principles – and the complainant refuses then the process is terminated. This is designed to ensure that the process is not gamed by airlines – it is difficult to conceive of reasons other than gaming why airlines would prefer arbitration by the ACCC over binding commercial dispute resolution.

[15] Productivity Commission (2006, p xvii)

Issue 22.3 Would there be benefits in a requirement for independent commercial arbitration and if so, how could this be effected?

Response

Melbourne Airport believes that the existing process currently provides airlines and other third parties the opportunity to resolve disputes with Airports. This includes dispute resolutions clauses in all of our ASAs. Should this be altered, we would recommend legislative changes that would alter the process and timing of when a Minister and arbitration committee would become involved.

The dispute resolution framework proposed by Melbourne Airport above provides for an airline to write to the Minister with a complaint and, once the Minister determines that the complaint contains all the relevant information in relation to the matters in dispute, how they constitute a contravention of the Principles and that any counter offer is capable of acceptance and is not vexatious, the airport concerned would have 21 days to respond in writing to the complaint, accept the airline counter offer or submit the matters in dispute to commercial arbitration.

If the airport concerned accepts the counter offer or is prepared to enter into binding commercial arbitration on the matters of concern (and obviously subject to the Principles) and if this is acceptable to the complainant, then the Minister will not proceed with the complaint.

If those conditions are not met and the Minister determines that the proposed conduct may contravene the Principles, the Minister would then order an inquiry under Part VIIA of the CC Act, which would be conducted by a body such as the NCC.

If the dispute remains unresolved, or not subject to commercial arbitration, then the Minister would declare the aeronautical services (as defined in the Regulations) of the airport concerned for the purposes of Part VIIA and impose prices notification for a period of time and at least until the next scheduled review.

Issue 22.4 Are there any public interest reasons for such arbitration to be conducted by the ACCC?

Response

The dispute resolution framework proposed by Melbourne Airport includes an alternative option where the Airports Act is amended to enable the Minister to declare the aeronautical services of the airport concerned for the purposes of Part IIIA and thereby give the complainants the option of binding arbitration by the ACCC (in a similar way that section 192 of the Airports Act did until it expired and was repealed).

Under such an option, legislation would be required to do this and also to ensure that the ACCC, in conducting any subsequent arbitration, is required not to make any decision that is

inconsistent with the Principles. Otherwise, it would conduct the arbitration in accordance with the arbitration provisions of Part IIIA of the CC Act.

There may be a public benefit from this option, in comparison to the Part VIIA process described above and in the response to Issue 22.3 above, given that neither the inquiry process nor the prices notification contained in Part VIIA can ultimately compel an airport to change its conduct or stop an unjustified price increase, only delay them.

An arbitration under Part IIIA of the CC Act would, however, bind the parties and decisions by the ACCC in arbitration are subject to merit review by the ACT, as noted above.

6. QUALITY OF SERVICE MONITORING

This chapter sets the views of Melbourne Airport on the quality of service monitoring arrangements. We wish to emphasise that, even if there was not a regulatory requirement for monitoring, Melbourne Airport would continue to undertake quality of service monitoring as it assists in improving services and creates transparency.

The rationale for the original introduction of quality of service monitoring reflected a concern that, under the former regulatory regime of price caps, an airport operator could reduce the quality of its services as a means of increasing its profit margin. Once price caps were removed in 2002, however, this rationale in effect disappeared.

In the present situation, where airports are not price controlled, airports have every commercial incentive to offer airlines the quality of service they desire for themselves and their passengers. Given that airlines are able to negotiate and mutually agree a reasonable price for providing service at the airline's desired standard, it is reasonable to present that there is no longer a regulatory need for quality of service monitoring.

Melbourne Airport conducts regular Quality of Service Monitor Surveys in respect of all operations on Airport. We run the following 3 QSM surveys:

- Domestic and International Passengers managed by APAC – 12,000. The sample reflects the breakdowns of travellers by factors such as country of origin;
- Car Park: 5,000 people annually; and
- Retail: 5,000 people annually.

The QSM surveys measure satisfaction levels by asking passengers to rate the facilities and services they have used during their journey through the airport, using a 5 point scale ranging from Excellent (5) to Extremely Poor (1).

As each comment on the rating scale is allocated a number, an "Average Score: can be obtained for each facility and service monitored, and these scores provide Melbourne Airport with measures of the degree of satisfaction.

Comparisons between scores for particular facilities and services are also possible, thus indicating those areas which are most successful in meeting passenger requirements and those which require the most attention. By examining results for previous months, Melbourne can also monitor trends and the gradual improvement in standards of facilities on- airport, as the information Melbourne Airport has gathered in acted upon by Airport Management.

The QSM is the guide by which the Airport performance is measured. Airport Management is targeted to improve or maintain average scores to a pre-set level, thus ensuring that the service Melbourne Airport has gathered is acted upon by Airport Management.

Melbourne Airport suggests that the quality of service monitoring arrangements should be undertaken on a self-administered basis using the existing QSM process. This approach

would enable airline customers and passengers alike to compare publically available information between airports in order to make informed choices, would accurately reflect the prevailing situation at each airport, and would be administered so as not to confuse customers and passengers through the use of arbitrary rankings that do not take account of the circumstances of the individual airlines.

6.1 Regulation

The ACCC regulates the quality of service of the monitored airports through the Airports Regulations made under Part 8 of the Airports Act.

Section 155 of the Airports Act and Regulation 8.01A, in effect, provide that:

- where services at an airport are provided by anyone other than the airport operator or their subcontractor, they are not subject to quality of service monitoring;

- while it is the Government that determines which airports are to be monitored and which services offered by them are to be monitored, it is the ACCC that determines the criteria by which those services are to be measured with the only constraint on its discretion being the requirement that it first consult the Minister's Department; and

- the ACCC has absolute discretion in deciding the methodology it uses to monitor those criteria in respect of those services.

This contrasts with the legislative position in respect of financial reporting and price monitoring, where the Act and Regulations combine to impose on the ACCC an obligation to abide by recognised accounting standards.

From the perspective of the travelling public, the present system of monitoring does not effectively monitor and evaluate the quality of their airport experience given that the current arrangements are:

- limited to services provided by the airports and their subcontractors (that is, it ignores a significant proportion of the services provided to travellers eg in the case of T1 as noted below); and

- the current methodology does not generate results that accurately assess or promote improvement in the quality of the services that are monitored.

There is no monitoring of any services provided by airlines or their subcontractors in the airport lease operated terminals - for example, while airports may make check-in desks available, it is airlines that decide how many desks to staff. Quality of service monitoring at Melbourne Airport is not relevant to a Qantas domestic passenger arriving at or departing from T1 which is leased and operated by Qantas and comprises of 45% passengers.

6.2 Proposal

Given that the original rationale of curbing inappropriate exercise of market power has now been superseded, there is no compelling reason why quality of service monitoring should be:

- prescribed by regulation; or
- undertaken by the competition regulator.

A process whereby quality of service monitoring is undertaken on a self administered and reported basis could feasibly apply, given that Melbourne Airport would undertake monitoring in any event to in meeting the needs of its customers. The self-administered arrangements proposed by Melbourne Airport comprise the following:

- quality of service monitoring to cover the present range of aircraft related services and facilities but also a wider range of passenger-related services and facilities, whether these are provided by the airport operator or another party (service providers in this case would include the airlines and border agencies);
- the monitoring to be undertaken by the individual service providers, who would separately liaise with the Department of Infrastructure and Transport on the development of their methodologies;
- monitoring to be transparently and readily available to travellers; and
- airports to publish their monitoring results on their own web-sites and include links to the web-sites of other relevant service providers.

In the interests of ensuring that the public is better informed, changes to the present system are required. In that case, in addition to key components from the self-administered arrangements proposed above, Melbourne Airport's proposed amendments to the regulated arrangements would include the following:

- the methodology used to monitor the relevant services and facilities being designed for and tailored to, the circumstances of the individual airport;
- the Regulations, or other relevant instrument, should specify the services to be monitored but also the monitoring criteria; and
- the monitoring methodology being designed to meet minimum professional standards.

Issue 10.1 How responsive have the monitored airports been to users' service needs and preferences?

Response

As noted in Chapter 6, the capacity, quality and price of aeronautical services and facilities provided by Melbourne Airport are determined by commercial agreement between the airport and its airline customers. Under such arrangements, ACCC's monitoring does not influence the quality of services provided by Melbourne Airport. The service needs and preferences of these users have been met and will continue to met, by the airport on the bases as agreed with the airlines.

A recent example of the airport's responsiveness to user needs related to Tiger specifically requesting particular facilities to meet their low cost objectives and targeted profile. In turn Melbourne Airport has provided these level of facilities, limiting the ability of the airport to use these facilities for future customers going forward. Also, through the last ASA negotiations, the airlines requested a CAT IIIb, a runway landing instrument, which was consequently installed at the airport.

Melbourne Airport is sensitive to passenger needs and requests. However, the full range of travel-related services provided to travelers is not monitored. The example cited above relates to the services provided by border agencies to international travelers: these services would form a significant part of the travel experience of those travelers. Similarly, there is no monitoring of services provided by the airlines or their subcontractors in the airport lessee operated terminals. Importantly, quality of service monitoring at Melbourne Airport is not relevant to a Qantas domestic passenger arriving at or departing from T1, which is leased and operated by Qantas.

We note that travelers will also be sensitive to the quality of service provided in retail outlets and other facilities in the terminals, in the sense that if they have a poor experience, they will quickly bring it to the attention of the airport or airline concerned. Melbourne Airport is responsive to users' service needs and preferences in these cases where the matter is within the airport's powers and responsibility to address.

Issue 10.2 Are there any significant quality problems for services under the control of the airports that are not being addressed?

Response

Melbourne Airport is not aware of any systemic issues in relation to the services provided under its control which, in the main, comprise the services and associated quality standards as specified in contracts entered into between the airport and the airlines.

Melbourne Airport supports quality of service monitoring (and proposes the self-administered scheme above) as a basis of bringing any such problems to light.

We have some crowding issues at Melbourne Airport due to unanticipated passenger growth specifically through the GFC period which is being corrected with new investment currently underway. But this is not systematic and under heavy handed regulation it is likely that we would have had a much longer lead team to find negotiate a through the regulator if forecasts proved to be understated.

Issue 10.3 Have necessary new investments been made in a timely fashion?

Response

In order to remain competitive and to attract airline services it is necessary for Melbourne Airport to have capacity to manage demand as passenger increases.

Melbourne Airport seeks to provide capacity it does not, and cannot, wait for facilities such as car parks to overflow before creating the required capacity and is unable to pursue new airline business if capacity constrained. To this effect, Melbourne Airport has committed to substantial capacity expansions to aeronautical and non-aeronautical facilities over the next 5 years, to the value $1.0 billion. In addition Melbourne Airport, has invested ahead of its contractual commitment to airlines. These actions are consistent with the airport responding to user needs in a timely manner.

Issue 10.4 How does the quality of service at the monitored airports compare with comparable international airports?

Response

As set out in the response to Issue 6.2, the conclusion arrived at by LeighFisher in its Benchmarking Study is that the Australian airports are generally the most efficient in cost and staff productivity terms and derive the lowest levels of revenue from their airline users. They are also the most profitable airports in the 12 airport sample used by LeighFisher. In this regard, LeighFisher states that "Within this sample, therefore, they may be regarded as representing industry best practice."

This finding by LeighFisher is particularly relevant to Melbourne Airport which, by most metrics measured by LeighFisher in this context, is generally the best performed of the Australian airports.

Issue 11.1 How robust are the survey techniques in indicating quality of service?

Response

In relation to the matter of methodology, Melbourne Airport notes the expert research papers that were commissioned by Sydney Airport. Those papers highlight actual or potential inadequacies in the statistical methodology that has been adopted by the ACCC in the exercise of the discretion allowed to it under section 155(2) of the Act. While agreeing with the ACCC Chairman's response that the role of the ACCC is not to engage in an "academic exercise", Melbourne Airport nevertheless believes it is important that, if it is to

continue its present monitoring role, the ACCC's approach should be methodologically sound. If it does not, there can be no adequate assurance that the results will not mislead the public about the standard of the services they receive.

In Melbourne Airport's view, the findings from the independent expert reviews are relevant:

- *The level of detail reported in the ACCC report is not sufficient to allow a reader to determine whether the research methods used to collect and analyse the findings are robust, reliable or valid;*

- *Some of the underlying methodology is open to challenge on the basis that there is insufficient detailed documentation. The key considerations are around the design of the sample, the survey instrument, survey methodology and procedures, response to the survey and sample sizes of each sub-group;.*

- *The evaluation based on averaging the results of ordinal scale may not be appropriate. The design of the questionnaire required the respondents to rate their satisfaction of airport services and facilities in a Likert scale and the evaluation assumes that there is an equal spacing of the values entered as between each category. Different conclusions may be drawn if the survey is performed with a differential spacing of the numerical values of the scale;*

- *Statistical information should be provided to assist the reader to understand and interpret the survey results across each sample group across different locations and points-of-time – this would require information on the sample size, standard error and confidence intervals.*

- *Similar issues relate to the process of combining responses obtained from different surveys of different population into an overall measure. Furthermore some of ACCC data comparisons do not compare like to like. For example, Melbourne Airport is the only monitored airport to [MA to provide] category, yet this is not highlighted in the research. Melbourne Airport introduced this product following market research conducted in 2009.*

Melbourne Airport supplies the ACCC with our Quality Service Monitoring (QSM) data. The QSM encompasses a sample size of 1,200 each month comprising of (travelers, car park users and retail). QSM measures satisfaction levels by asking passengers to rate the facilities and services they have used during their journey through the airport, using a 5 point scale ranging from Excellent (5) to Extremely Poor (1). Airport Management is targeted to improve or maintain average scores to a pre-set level, thus ensuring that the service Melbourne Airport offers to passengers is constantly being enhanced.

Issue 11.2 How useful is quality of service monitoring given the differentiation between DTLs and common user facilities, and how would this affect international comparisons?

Response

As we have noted in the body of the submission, there is no monitoring of any services provided by airlines or their subcontractors in the terminal. Quality of service monitoring at Melbourne Airport is not relevant to a Qantas domestic passenger arriving at or departing from T1, which is leased and operated by Qantas and accounts for 45% of all passengers at Melbourne Airport..

To address the fact that the full range of travel-related services provided to travellers is not monitored, we have suggested in section 4 that the quality of service monitoring regime should cover, not only the present range of aircraft related services and facilities, but also a wider range of passenger-related services and facilities, whether these are provided by the airport operator or another party (service providers in this case would include the airlines and border agencies).

Where passenger-related services and facilities are provided by different parties at the airports being compared and the comparison is based only on those charges levied by the airport operators, this can affect some aspects of international comparisons. The research conducted by LeighFisher accounts for these nuances.

7. PRICES, COSTS AND PROFITS MONITORING

This chapter sets out the views of Melbourne Airport on the operation of the monitoring regime for prices costs and profits in relation to aeronautical services and car parking services

This chapter provides a particular focus on car parking services, given that the ACCC has adversely commented on results from the monitoring of the car parking services at Melbourne Airport. Car parking prices at Melbourne Airport reflect the locational rent associated with the proximity of the individual car parks to the terminal complex and are consistent with the objective of efficient management of access and vehicle flows in relation to the constrained space at the terminal forecourt and terminal precinct.

Further, in the face of concerns expressed by the ACCC is relation to the relatively high proportion of airport revenue derived from car parking services at the airport, we demonstrate that Melbourne Airport's high proportion of revenue from car parking is a consequence of its low average revenue in relation to aeronautical services combined with the high number of car parking bays at the airport, relative to other monitored airports. The latter, in turn, represents a response by the airport to users' preferred modes of accessing the airport. The preferred modes involve the use of private vehicles. This is a function of the large distance of Melbourne Airport from the CBD, distance from the population base and the security and flexibility provided by private vehicles in the context of the curfew-free operation of the airport. It is also important to note that the majority of passengers come from the south and east of CBD, while the airport is to the north and west and that, for many Victorians, the CBD does not represent an end point but a transit point.

Importantly this chapter contains the key findings on the international comparison of airport pricing and efficiency from the LeighFisher Benchmarking Study which is provided as Attachment 1. The key findings of the study are that:

- Melbourne Airport's prices are the lowest within a sample of 9 airports in Australia and New Zealand;
- Melbourne Airport's prices compare favourably against a wider sample of 58 international airports; and
- the Australian airports are generally the most efficient in cost and staff productivity terms and derive the lowest levels of revenue from their airline users. Within a 12 airport international sample, they may be regarded as representing industry best practice.

7.1 Regulation

Part 7 of the Airports Act 1996 provides that airports specified in the Airports Regulations 1997 (currently the five specified airports) must prepare and provide to the ACCC, accounts, statements and reports as required by the Regulations.

The Regulations specify a range of aircraft related and passenger-related services and facilities for which financial reports and financial statements are to be prepared and defines financial statements and financial records to be those as required by the Corporations Act 2001. The required financial reports must separately show costs and revenue in relation to the provision and use of these services and facilities.

In contrast with Part 8 of the Airports Act relating to quality of service, under Part 7 of the Act, the ACCC is not empowered to monitor and evaluate the accounts, statements and reports it receives.

The following directions, however, have been made under section 95ZF of Part VIIA of the CC Act:

- Direction 29, effective from 1 July 2007, which requires the ACCC to monitor the prices, costs and profits relating to the supply of aeronautical services and facilities at the five specified airports; and

- Direction 31, effective from 7 April 2008, which requires the ACCC to monitor the prices, costs and profits relating to the supply of car parking services and facilities at the five specified airports.

The ACCC has issued a specification of its information requirements in relation to Part 7 of the Airports Act and Part VIIA of the CC Act. It has also issued guidelines for its quality of service monitoring.

Section 95G(7) of the CC Act provides that in exercising its powers and performing its functions under Part VIIA, the ACCC must, subject to any directions given under section 95ZH, have particular regard to the following:

(a) the need to maintain investment and employment, including the influence of profitability on investment and employment;

(b) the need to discourage a person who is in a position to substantially influence a market for goods or services from taking advantage of that power in setting prices;

(c) the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.

The ACCC has issued guidelines in relation to how it interprets the requirements of section 95G(7) for the purposes of assessing price notifications ("Statement of approach to assessing price notifications", June 2009).

The origins of section 95G(7) are from the Prices Surveillance Act 1983. Section 95G(7)(c), for example, which relates to the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by

relevant industrial tribunals, appears to be out of step with the current industrial relations environment.

On an annual basis, the ACCC releases a combined report of its monitoring of the prices, costs and profits and quality of service relating to the supply of aeronautical services and facilities and of car parking services and facilities, at the five monitored airports.

Airports incur additional expense in preparing the separate financial accounts and statements required for the purposes of Part 7 of the Airports Act. Because those reports and statements follow the accounting standards and requirements of the Corporations Act, this additional expense is less than it would be if different standards and requirements were prescribed. Accordingly, if separate financial reporting in respect of aircraft related and passenger-related services and facilities is to continue, this correlation with the Corporations Act standards and requirements should be maintained.

Airports also incur additional expense in meeting the information requirements of the ACCC in respect of its role under Part VIIA of the CC Act. As long as the ACCC does not change the nature of its information requirements greatly over time, this additional cost can be contained.

The direct costs of complying with the ACCC's financial monitoring requirements and the nature of the information required to be made available to the ACCC do not, of themselves, present material issues to Melbourne Airport.

Melbourne Airport's concerns about the monitoring of prices, costs and profits relate to interpretations made by the ACCC in relation to the outcomes from the monitoring data.

Issue 7.1 What are the compliance and administration costs associated with fulfilling the regulatory obligations imposed by the price and service quality monitoring system?

Response

The direct costs of complying with the ACCC's financial monitoring requirements and the nature of the information required to be made available to the ACCC do not, of themselves, present material issues to Melbourne Airport. Melbourne Airport's concerns about the monitoring regime relate to way in which the ACCC has interpreted the results from monitoring and how it has communicated its interpretations.

Issue 1.2 What is the ability of airports to vary prices year on year given many have long term contracts with airlines?

Response

Melbourne Airport's ability to vary prices is limited in that aeronautical prices are as agreed in the airport's contracts with airlines and may only change on basis prescribed by the contracts. For example, security charges are an agreed 'pass through' cost. Despite the fact

that Melbourne Airport is not required to do so, it is always looking for ways to reduce costs for airlines. Recently, for example, Melbourne Airport, security pricing efficiencies have recently been achieved and passed onto the airlines.

Issue 1.3 Is price monitoring providing a constraint on aeronautical charges at the major airports?

Response

The light handed monitoring regime, which has applied since 2002, was intended to constrain the misuse of market power by the airports, while greatly reducing regulatory intrusion into their commercial dealings with airlines and other customers. As noted by the PC in its 2006 inquiry report into airport services,[16] the light handed regime replaced a price cap regime that was widely acknowledged to have put various hurdles in the way of new investment, diverted management resources to dealing with the regulator and impeded the development of commercial relationships between airports and airlines.

At the time of the 2006 inquiry, the PC considered there to be a range of market and regulatory factors that would also assist in limiting the misuse of market power by airports. The factors considered by the PC in 2006 continue to constrain the exercise of any market power held by the airports and, because of developments since 2006, the effect of these constraints has increased over time. The factors considered included:

- *perceived scope for airlines to exercise some countervailing power (airlines – specifically domestic carriers – have greater bargaining power than in 2006 in their negotiations with Melbourne Airport, given that airlines may also have the aeronautical service supply option of Avalon Airport);*

- *the option for airlines to seek declaration of airports under the Part IIIA national access regime where commercial agreements cannot be reached (the 2006 Federal Court decision and subsequent amendments to the regime by the Government may have rendered Part IIIA a more 'accessible' regulatory instrument); and*

- *incentives for airports to hold down aeronautical charges so as to increase passenger throughput and thereby boost non-aeronautical revenues.*

At 2006, it was expected that commercial negotiations would generally be the basis for establishing prices and terms and conditions of access for aeronautical services. This has proven to be the case since 2006 as commercial agreements have increasing provided for airports and airlines to negotiate and mutually agree prices and terms and conditions for access to aeronautical services. Accordingly, aeronautical service prices and terms and conditions tend to be governed by contract, reducing the need for external monitoring of such commercial matters.

[16] Inquiry Report, Review of Price Regulation of Airports Services, No. 40, 14 December 2006, page 42.

Issue 2.1 Has the need to adjust the previous FAC's pricing legacy been fully accommodated?

Response

It is Melbourne Airport's view that the FAC's pricing legacy been fully accommodated. However it should be noted that current prices do not reflect the cost of new capacity as the pricing is still based in Melbourne's case on an asset value at 1997, which assumes a Greenfield development, with all of the efficiencies that includes and that any new build will be subject to a range of constraints imposed by building on an operating airfield with the impacts of Brownfield development and the costs of inflation from the 1997 to building costs.

Issue 2.2 Has the price monitoring regime promoted efficient investment and facilitated commercially negotiated outcomes?

Response

Under the commercial agreements between the airport and airlines, airports have every commercial incentive to offer airlines the quality of service and facilities that they desire for themselves and their passengers. The commercial agreements between the airport and airlines have promoted efficient investment and commercial outcomes.

The light handed approach to regulation has allowed for efficient investment. This is demonstrated by the agreed timeframe of the T2 $330 million expansion. Following the development of the terminal, passenger numbers increased from 4.5 million in 2007 to 5.5 million in 2010, providing economic benefit to the whole Victorian economy.

Issue 2.3 How would it compare relative to counterfactuals of explicit price regulation, or no regulation?

Response

As shown in Chapter 3, Melbourne Airport's average annual capital expenditure under the period of the heavy handed price cap regime was $37.5 million, in contrast to average annual capex since price caps were removed in 2002, of $112.4 million. This difference in capital investment outcomes is indicative of the adverse effects of explicit price regulation relative to light handed regulation (as currently in place) or indeed of no regulation.

In negotiating commercial agreements with airlines, the airport broadly applies the Weighted Average Cost of Capital methodology established under the former price cap regime. The WACC is applied to the written down line-in-the-sand value of existing assets and the current cost of new assets being created. This determines the return on capital component, which is added to the return of capital (depreciation) and operating costs to determine the total costs of the services to be recovered. This approach to pricing has been accepted by the airlines in their last two commercial agreements with the airport.

Under explicit price regulation, this would involve the airport in negotiations not only with the airlines but with the regulator. The outcome of such a process is likely to be additional constraint on airport pricing than if negotiation was only with one entity/group of entities. A constraint on pricing would also represent a constraint on the recovery of capital costs. Such an outcome could reduce the willingness of financiers to provide funding to the business (or increase the cost of those funds) due to the perceived risk associated with another party i.e. the Regulator involved, which is necessary to meet the existing and future capital expenditure demands of airlines and passengers.

Without regulation, we do not consider the outcome would be materially different than at present, given that the basis of determining charges, terms and conditions and capital investment in relation to aeronautical services is commercial agreement.

Issue 2.4 Does the information emerging from the price monitoring process assist commercial negotiations between airports and their customers?

Response

Publication of the outcomes of the monitoring results would provide airlines with the opportunity to compare prices/average revenues across airports and to determine their positions in access negotiations accordingly.

Issue 4.1 How adequate are the data in the ACCC's price (and quality) monitoring reports for judging the effectiveness of the monitoring regime?

Response

Melbourne Airport's concerns with the ACCC approach is not in relation to the data collected or the results of the data as shown in the tables in the ACCC report but in relation to unqualified and, in some cases unsubstantiated, statements by the ACCC in relation to the monitoring results. This has important consequences in terms of how comments are utilised by third parties such as consumers and the media. In turn, this can mislead the public and other stakeholders.

Issue 4.2 Are the regulatory accounts provided by the airport operators sufficient to reveal monopoly pricing and rates of return?

Response

In its 2009/10 monitoring report, the ACCC notes that the Melbourne Airport EBITA (earnings before interest, tax and amortisation) on average tangible non-current assets for aeronautical services was 12.6% in 2009/10 and, over the whole reporting period (2005/06 to 2009/10), this measure was relatively stable.

These results, as based on Melbourne Airport's regulatory accounting data, are not sufficient to reveal monopoly pricing and rates of return, given that the asset base used is a regulatory accounting value (which is a value accepted by Melbourne Airport for the purposes of the

monitoring regime) that does not reflect the economic value of the assets concerned. The asset value should reflect the net realisable value of the assets and this should include the value of goodwill as discussed in section 7.6. Further, the data reported by Melbourne Airport and analysed by the ACCC does not cover all of the economic costs of providing services. Such costs can be considered to comprise:

- *the operating expenses incurred providing the services;*
- *an allowance for depreciation of the capital assets;*
- *a return on capital assets; and*
- *a return on the land occupied by the assets.*

Data on the first two items are gathered by the ACCC, but the return on capital assets determined by the ACCC is not calculated as an economic value (as based on generally accepted WACC principles) and the return on land is not accounted for by the ACCC in an economic sense. Without data on the economic value of all of such items, it is not possible to determine whether prices or average revenues exceed total costs, or indeed, whether they are sufficient to reveal monopoly pricing and rates of return.

Issue 4.3 Are there material gaps or limitations in that data and can they be practically remedied?

Issue 4.4 What other data sources should the Commission use in its assessment of the price (and quality) monitoring regime?

Response

In relation to these Issues 4.3 – 4.4 See our response to Issue 4.1 above

Issue 5.1 Are the ACCC's monitoring methodologies appropriate?

Response

Melbourne Airport has addressed this issue in its response to Issue 11.1.

The ACCC's key metrics for prices, costs and profits monitoring relate to prices (aeronautical revenue per passenger), proportion of revenue from aeronautical services versus car parking services operating margins, rate of return (return on equity [profit after tax divided by total shareholder equity] and return on assets [EBITA on aeronautical assets]) and changes in such measures over time.

Outputs in relation to each of these measures have limited meaning without a proper consideration of all relevant costs and the characteristics of the individual airport concerned such as the MLLTCP.

The ACCC's key observations and interpretations are listed in "Key points" sections within its report. In the "Key points" the ACCC's statements are made on an unqualified basis. However, elsewhere in the report, important qualifications are made. These qualifications need to be read alongside the ACCC's statements made in the "Key points" and include the following:

> "Some indication about the airports' performance can be made based on observations from the monitoring results over time within the context of the airports' market power, as well as the incentives and ability to use that market power.
>
> However, the monitoring results do not provide conclusive evidence as to whether or not the airports are earning monopoly rents. A more detailed evaluation of the airports' performance, which is beyond the scope of monitoring and would include comparison with an economically efficient benchmark, would be required to make more definitive findings. Nevertheless, by providing a greater level of transparency to the airports' performance in this way, monitoring seeks to discourage airport operators from exercising their market power."[17]
>
> "Importantly though, the above observations do not consider the extent to which the airports are potentially using their monopoly position at the expense of users. This is because the overall ratings for quality of service do not provide the most reliable indicator of whether or not an airport has provided quality of service at an efficient level. Importantly, passengers' perceptions of airports' quality of service can be influenced by the services also provided by airlines and border agencies. Therefore, airline survey results can provide a better indication of whether or not an airport has provided quality of service at a satisfactory level."[18]

Accordingly, conclusions reached by the ACCC need to be interpreted with care. As shown in the quotes from the ACCC report above, this is recognised by the ACCC. However, the "Key points" and some public statements by the ACCC are not so qualified. This is illustrated by the ACCC's comments on car parking prices in the "Key points" on page 1 of the report and in the media release of the ACCC of 7 February 2011, as discussed section 7.1(a) below.

Issue 5.2 Is there adequate consultation with the monitored airports?

Response

Melbourne Airport's concerns with the ACCC approach is not in relation to the data collected or the results of the data as shown in the tables in the ACCC report but in relation to unqualified and, in some cases misinformed, statements by the ACCC in relation to the monitoring results. This has important consequences in terms of how comments are picked-up by third parties such as consumers and the media. In turn, this can mislead the travelling public. Although the ACCC has provides Melbourne Airport with a copy of the Melbourne Airport chapter of the draft monitoring report prior to the report release, Melbourne

[17] Page viii.
[18] Page viii..

Airport's inputs and explanations of the monitoring results have not been incorporated in the final report.

While we appreciate receiving the monitoring report prior to release, we would also welcome the opportunity to receive the analysis of the comparative chapters. For the process to be transparent, we would also like the opportunity to have our response incorporated into the report. Unfortunately in the past when we have provided feedback on the monitoring report, or factual corrections or inputs are not included.

As noted above, the simple outputs from the ACCC's monitoring have limited meaning without a proper consideration of all relevant factors. These will include consideration of:

- *the relevant costs;*
- *the particular characteristics of the airport being assessed;*
- *the purchase costs of the assets, which in the case of Melbourne Airport, is reflected in the amount for goodwill*
- *the cyclical nature of capital investment and how this affects performance results; and*
- *the approach that the company takes to funding capital investment.*

These factors are discussed below. The discussion below highlights the need for care to be taken before reaching conclusions of airport performance based simply on the metrics in the ACCC report. It also highlights some deficiencies in relation to some of the financial measures used (in relation to accounting for goodwill) and the need to take into account the efficient funding approach adopted by Melbourne Airport.

7.2 Car Parking and Monopoly Profits

Prices alone do not reveal the existence of, or the misuse of, market power without a proper consideration of the underlying costs and of the other factors as noted above. The summary of the "Key points" of the report set out on page vii (also contained on page 57) however contains an unqualified contention that Melbourne Airport is earning monopoly profits:[19]

> "Information provided to the ACCC as a part of the monitoring program indicates that car parking prices at Melbourne Airport are of particular concern.
>
> – Melbourne Airport appears to have reduced the ability of off-airport parking and private bus operators to compete with its own car parking services. For example, the airport appears to impose excessive access levies and controls the available space for those operators. This can lead to increased demand for on-airport parking, which brings about higher prices paid by consumers and allows Melbourne Airport to earn monopoly profits."

[19] ACCC, *Airport monitoring report 2009-10*, p.vii.

In relation to Melbourne Airport's "access levies and control [of] the available space" Melbourne Airport wishes to emphasise that the space in front of the terminal complex is a finite resource, creating natural constraints that must be managed. Melbourne Airport's prices for airport car parking and for forecourt access are set according to constraint management objectives (to manage traffic flows in the terminal forecourt and to provide a safe, secure and efficient operating environment for all users), to reflect the premium, convenience-basis to particular services and to provide efficient long term storage options (in the case of the long term car park).

There is no basis for the statement made above, or the virtually identical contention that appeared in the media release posted on the ACCC website.[20] As the ACCC acknowledges, prices alone are 'far from conclusive'. The claim above attracted significant media attention that presented Melbourne Airport in a distinctly unfavourable light.

The adverse, and avoidable, consequence of these shortcomings is that the public is frequently provided with the wrong impression about the airport's performance and are constrained in their ability to make informed choices about their ground transport access to Melbourne Airport.

Issue 9.1 Has the pricing behaviour of airports indicated the use of market power in car parking?

Response

The prices for airport car parking are set according to constraint management objectives (to manage traffic flows in the terminal forecourt) and to reflect the locational rent associated with the proximity of the individual car parks to the terminal complex. The costs to users of the different ground access options at the airport are materially different. For example, compared to use of a private vehicle plus a short stay in an airport car park, a taxi could be a relatively expensive option and a bus a low cost option. The cheapest option in many cases will be private vehicle pick-up/drop-off at the terminal forecourt. This mode is not charged to access the forecourt, and represents the main form of ground access to the airport. There is a high level of substitutability between the different ground access modes at the airport and car parking prices at the airport compare favourably to the general level of prices at commercial car parks in the Melbourne CBD (which similarly reflect a locational rent). On these bases, the pricing behaviour of Melbourne Airport does not indicate the use of market power in car parking.

We note public comments made by the ACCC to the effect that CBD car parks are not an appropriate comparator to airport car parks. Melbourne Airport considers them to be appropriate comparators given that CBD locations are generally the only other locations in Victoria that supports stand-alone multi story car parks.

[20] ACCC Media Release, *ACCC issues annual report on airport performance*, 7 February 2011. Available at: <http://www.accc.gov.au/content/index.phtml/itemId/971558>.

(This Issue 9.1 and Melbourne Airport's response to this issue above is also set out in Chapter 8 of this submission)

7.3 Car Parking Revenues

In the "Key points" of Chapter 3 of the 2009/10 monitoring report dealing with car parking, the ACCC makes the following comments about Melbourne Airport's car parking revenues:

> "Car parking revenue at each airport ranged from $13.7 million (Adelaide Airport) to $103.9 million (Melbourne Airport).
>
> Melbourne Airport reported the highest car parking revenue as a share of total airport revenue of 20.7 per cent, whereas Adelaide Airport reported the lowest of 9.2 per cent.
>
> Information provided to the ACCC indicates that car parking prices at Melbourne Airport are of particular concern. It is less clear if car parking prices are excessive at the other monitored airports."[21]

The implication of the above quotation that Melbourne Airport's car parking prices are excessive is not supported by any analysis in the ACCC's report and is not supported by an analysis of the basic data in relation to car parking at Melbourne Airport, which is set out below.

The above ACCC comments on Melbourne's car parking revenue as a share of the total airport revenue are also generally reflected in the ACCC's submission to the current PC inquiry.[22] The ACCC similarly raises issues about kerbside access prices, terms and conditions in its submission to the PC inquiry which were also raised in its 2009/10 monitoring report. The issues raised by the ACCC in relation to kerbside access are commented on in section 7.4 below.

We note also that consistent with the issue of unqualified statements by the ACCC which have been picked-up by the media, the following comments were made in the Melbourne Age of 26 February 2011 under the heading "Anger at the terminal":

> "Melbourne, while rated more favorably, faces criticism of its parking monopoly, which earns 20 per cent of the airport's annual revenue."

The report by PricewaterhouseCoopers (PwC) on Car Parking Services Benchmarking, which is provided at Attachment 2 to this report, analyses competition between different modes of ground transport in relation to Melbourne Airport and concludes that there is competition within all modes of ground transport. It also analyses the basis to Melbourne Airport's 20%

[21] ACCC, Monitoring Report 2009/10, Price, financial performance and quality of service monitoring, page 57.

[22] Submission to the Productivity Commission's inquiry into the economic regulation of airport services, March 2011, page 29.

revenue contribution from car parking services. The PwC analysis of this issue is summarised below.

Of the five major airports covered by ACCC monitoring, Melbourne Airport is furthest from the CBD. This fact combined with the dispersed nature of the Melbourne population means that the main forms of ground access in relation to the airport involve private vehicles (62%, or 77% when private vehicle use of off-airport car parking is taken into account). It also means that demand for car parking at the airport is high relative to other airports (particularly where also off-airport car parks that serve the airport are factored-in). This, in turn, is reflected in high car parking capacity Tables at Melbourne. Table 28 below shows the car parking capacity, car parking revenues, expenses and revenue yield per bay at the monitored airports.

Measure	Melbourne	Adelaide	Brisbane	Perth	Sydney
Passenger Numbers (m)	26.3	7.2	19.3	10.5	34.9
Car parking bays	22,412	3,085	9,610	11,526	12,148
Bays per million passengers	852	428	498	1,098	348
Car parking revenue	$104m	$14m	$58m	$33m	$95m
Revenue yield, per bay/day	$12.70	$12.17	$16.56	$7.92	$21.45

Table 28: Revenue Yield per Car Park Bay – Monitored Airports
Source: PwC (2011)

The data from Table 28 shows that the Melbourne Airport revenue yield from car parking is 15.8% below the average yield across the other monitored airports. In addition, Melbourne Airport provides 852 car parking bays per million passengers, compared to 506 car parking bays per million passengers across the other monitored airports. In addition, Melbourne Airport provides car parking for peak periods (specifically in relation to the 4 holiday peak demand period) which means that, in providing an appropriate level of amenity to users, the airport incurs additional capital costs.

Accordingly, based on the data in Table 28, as sourced from the ACCC monitoring report, Melbourne Airport's high proportion of revenue from car parking is a consequence of the number of car parking bays provided at the airport. This, in turn, represents a response by the airport in relation to users' preferred modes of accessing the airport, which involve the use of private vehicles.

Importantly, the high proportion of revenue from car parking is also a reflection of the fact that Melbourne Airport's aeronautical revenue per passenger is the lowest of the monitored airports. The summary of the "Key points" in the ACCC's 2009/10 monitoring report contains the following comment:

> "… Melbourne Airport had the lowest aeronautical revenue per passenger and is now ranked second behind Brisbane Airport for overall quality of service."[23]

In relation to the comment by the ACCC above, it should be noted that Melbourne Airport's revenue includes terminal operating costs in relation to around 65% of passengers, whereas the revenue of Brisbane Airport includes operating costs for around 25%, due to the operations of domestic terminal leases for all but 1 million domestic passengers.

Melbourne Airport's analysis of the issues above illustrate that outputs from the ACCC's monitoring have limited meaning without a proper consideration of the different characteristics of each of the monitored airports.

In the light of the potential for misinterpretation of the results, and for a misleading impression to be created about the airport's performance, Melbourne Airport suggests that if the current monitoring basis is continue, the ACCC should be obliged to consult with Melbourne Airport on the relevant section(s) of its draft monitoring report and, if requested by Melbourne Airport, to include our comments on the conclusions being made by the ACCC.

7.4 Kerbside Charges, Terms and Conditions

Charges and terms and conditions for forecourt access are focused on efficiently managing access to the kerb in front of the terminal complex and on giving effect to the safe and efficient flow of traffic in the forecourt area. The access charges applied to the different commercial users of the forecourt area (private vehicle pick-ups/drop-offs do not face access charges) are set out in Table 7 of Chapter 8.

Consistent with this, taxis for example are provided with a high level of access and vehicle pick-up/drop-off zones are arranged so that vehicles of equivalent sizes are grouped together.

The access charges applied by Melbourne Airport to vehicles using the forecourt are moderate. This is illustrated by the four points below:

- Melbourne Airport applies charges on an equitable basis to all commercial users who rely on and derive commercial benefit from the infrastructure provided by the airport and from its investment in management of the congestion that is expected at the entrance of any major destination.

- The main access mode to Melbourne Airport is by private vehicle pick-up/drop-off in the forecourt, this mode of transport does not attract a charge.

- In addition to providing for private vehicle pick-up/drop-off zones, Melbourne Airport provides disabled pick-up/drop-off zones in front of the terminals, which provide for short stay parking.

[23] ACCC, Monitoring Report 2009/10, Price, financial performance and quality of service monitoring, page vii.

- Currently, access by public buses is also not charged.

- As shown in Table 7 i.e. in Ch 8, the Melbourne Airport taxi pick-up charge is $1.32. This is the lowest of the taxi pick-up charges applied by the monitored airports (the Melbourne charge compares to $3.00 at Sydney and Brisbane and $2.00 at Adelaide and Perth). The charge applied reflects the additional infrastructure provided to taxis such as dedicated corralling areas and associated amenities.

- Melbourne Airport earns the same in revenue from ground transport, at around $0.22 per passenger, as the other monitored airports., as shown in Table 29

- In all cases, ground transport access charges levied by Melbourne Airport represent a relatively small proportion of the total costs of the particular access mode to the end user. For example, the taxi access rate of $1.32 compares to the total cost to a user of a taxi journey from the airport to the CBD which, depending on the specific CBD destination, will be around $50. The charges levied on other operators that are slightly higher than the taxi rate would generally be amortised by the operators of those services across the number of passengers their vehicles would be carrying.

Measure	Melbourne	Brisbane	Perth	Sydney
Passenger numbers (m)	26.3	19.3	10.5	34.9
Ground transport revenue[1] ($m)	5.8	4.2	1.7	8.9
Ground transport revenue/passenger	$0.22	$0.22	$0.16	$0.26

[1]Revenue considered includes access fees for taxi, bus, rail and private limousine hire.

Table 29: Airports Ground Transportation Revenue
Source: ACCC Airport Monitoring Report 2009-10

The standard terms of access for the different ground transportation modes are clearly signposted at the terminal precinct and provided to third parties. Where users wish to negotiate commercial agreements in relation to such access, the terms and conditions of such bilateral agreements replace the standard terms.

The ACCC raises a number of issues in its monitoring report, and in its response to the PC issues paper, in relation to access charges terms and conditions applied by Melbourne Airport and by airports in general. The comments below are contained in the monitoring report, but similar issues are, in effect, raised in the ACCC's submission to the PC.

In relation to each comment by the ACCC, we provide a direct response to the issue raised by the ACCC:

> "Melbourne Airport appears to have reduced the ability of off-airport parking and private bus operators to compete with its own car parking services. For example, the airport appears to impose excessive access levies and controls the available space for those operators. This can lead to increased demand for on-airport parking, which

brings about higher prices paid by consumers and allows Melbourne Airport to earn monopoly profits."[24]

Response

The access charges applied by Melbourne Airport compare favourably with the charges applied by the other monitored airports and the amount of charge represents a small proportion of the total charge levied by operators of ground transport services. (the example above is of the taxi rate of $1.32 applied to a taxi fare to the CBD for an all-up cost to the traveler of around $50). Importantly, the main form of ground access, private vehicle pick-up/drop-off, is not charged. The access terms and conditions apply in order to safely and efficiently manage access and traffic flows in the constrained space in front to the airport terminals.

> *"The monitoring results suggest Melbourne Airport has reduced the ability of off-airport parking and private bus operators to compete with its own car parking services (section 3.5.3). For example, the airport appears to impose excessive access levies and controls the available space for those operators. This can lead to increased demand for on-airport car parking, which brings about higher prices paid by consumers and allows Melbourne Airport to earn monopoly profits. It is less clear if car parking prices are excessive at the other monitored airports."*[25]

Response

The availability of forecourt access to ground transport operators is limited by the finite amount of kerb space available directly in front of the airport terminals. With well in excess of 27,000[26] *vehicles movements into and out of Melbourne Airport's forecourt each day, it is necessary to balance the needs of all user groups to ensure safe, equitable and efficient movement in that area.*

As outlined above, it is clear that charges imposed on commercial users of the forecourt represent a small proportion of the total charge levied by operators for example; the airport charge constitutes 2.6% of the total cost of a taxi from the airport to Melbourne's CBD. An off airport car parking operator charging between $22 and $45 for a two day stay will pay only $4.00 to transport up to ten people to the airport terminal at a total cost per passenger of 40 cents.

Access agreements began in 1998. At the time they were negotiated with providers and industry. As a result they varied considerably. Now consistent equitable rates are applied to all commercial operators accessing the forecourt. We provide clear documentation to

[24] ACCC, Monitoring Report 2009/10, Price, financial performance and quality of service monitoring, page vii. A similar statement is made on page 57 and also on page 28 of the ACCC's submission to the PC inquiry.
[25] ACCC, Monitoring Report 2009/10, Price, financial performance and quality of service monitoring, page 65.
[26] Melbourne Airport Ground Transportation Plan

providers on these charges. Our Ground Transportation Frequently Asked Questions is an example of this. Please see Attachment 3.

> *"It was also claimed that some airports place unreasonable restrictions on the ability of off-airport car parking operators to both advertise on airport land and erect signage at collection point areas. Further, these operators claimed that infringement notices issued by airport staff at kerbside areas are a harsh way of enforcing restrictions and have become an inevitable cost of doing business at the airport. Finally, some airports require off-airport parking and private bus operators to pay a substantial bond payment as a condition of the licence agreement."*[27]

Response

Melbourne Airport provides extensive way-finding signage both inside and immediately outside its terminals and permits operators to dwell inside the terminals holding their own signage to direct customers to their service. Well signed fixed zoning of the forecourt also enables ground transport operators to communicate with their customers in advance to advise of a meeting point.

The Airports (Control of On-Airport Activities) Regulations 1997 identify the application of Australian Road Rules in relation to the landside of an airport and permit airport operators to issue an infringement notice where a person contravenes those rules for example by stopping in a bus or taxi zone, parking in a clearway or no parking area or parking for longer than indicated. As a matter of standard operating procedure, traffic management issue verbal warnings to individuals contravening the applicable Road Rules and allow time for the individual or operator to remedy the situation before ultimately issuing an infringement notice.

Infringement notices are a well accepted method utilised by municipal councils and private asset operators alike to manage finite car parking infrastructure and are designed to ensure equitable access for all users both private and commercial as well as a safe operating environment. Revenue generated by infringement notices, not including administrative costs incurred by the airport operator, is remitted to the Commonwealth under the parking infringement notice scheme.

Melbourne Airport does not require ground transport operators to pay a bond in order to access the terminal forecourt. Any operator may purchase a casual parking ticket on arrival in the forecourt. Commercial operators who choose to enter into a bilateral agreement with the Airport pay a nominal bond which is held as security against usage and repaid at the conclusion of the agreement.

> *"Significantly, off-airport parking and private bus operators commented that some airports have only introduced airport charges in the last five years or so. Since then, it was claimed that levies have risen significantly at some airports, and off-airport*

[27] ACCC, Monitoring Report 2009/10, Price, financial performance and quality of service monitoring, page 69.

parking and private bus operators' fear that levies will continue to increase in the near future." [28]

Response

Commercial users accessing the airport's forecourt require access agreements.
Within the last 2 years a review of the Melbourne Airport forecourt identified that a significant number of commercial users had not paying the applicable access charges. As a result a number of operators who may not have previously paid for access are now doing so. At that time, Melbourne Airport took the opportunity to recalibrate prices to ensure that the level of charges was equitable for all commercial users of the forecourt.

In the monitoring report, the ACCC also makes comments in relation to the comparatively high percentage of Melbourne Airport's revenue derived from car parking services, relative to the five other monitored airports. On the basis of its observation in this regard, the ACCC makes assertions about car prices being excessive. Specific issues raised by the ACCC in relation to this issue, and Melbourne Airport's explanation of the basis of its car parking revenue weight, is provided in section 7.3 of this submission.

In its letter to Melbourne Airport, Sydney Airport and Brisbane Airport of 29 March 2011, the PC notes that airports generally have contended that their terms and conditions for access by competitors to on-airport car parking are not onerous. The PC invites these airports in their submissions to respond to the ACCC's findings, including whether the airports made their views known to the ACCC, and if so, how were they acted on.

Response

While Airports receive a copy of the chapter pertaining to their operations in advance of the public release of the annual ACCC price monitoring report, they do not receive the analysis contained in the comparative chapters which tend to contain the majority of statements cited above. This means that airports are not in a position to comment on the conclusions of the ACCC prior to the report being made public.
Prior access to the analysis and conclusions of the ACCC would support a more transparent and indeed robust process, as would the opportunity to have our response to the assertions of the ACCC incorporated into the report. Unfortunately, in the past, when we have provided feedback on the monitoring report, or factual corrections or inputs, these have not always been included. For example, the ACCC continue to report on operations that are outside of the airports control such as outbound government inspection and check-in times. Melbourne Airport has highlighted this concern with the ACCC, but it is yet to be addressed.

7.5 Capacity Cycles

The key financial metrics will have a tendency to fluctuate from year to year – including in response to macroeconomic conditions. In some years passenger numbers will be greater than expected and will lift aeronautical revenues and, potentially, operating margins. In

[28] ACCC, Monitoring Report 2009/10, Price, financial performance and quality of service monitoring, page 69.

others, passenger numbers may be less than those anticipated at the time of negotiating commercial agreements. Similarly, airports will be at a different point of their investment cycles in each year. For these reasons, yearly fluctuations are less relevant than trends over longer periods.

At a theoretical level, measured return on assets should be negatively correlated with the availability of surplus capacity. As capacity tightens the level of returns assuming prices are fixed will rise and then drop when capacity is augmented. Over time, level of returns on a year by year basis can be expected to fluctuate around the long run cost of capital. If above-WACC returns are not allowed when capacity is short it is likely that the cost of capital may actually be forced up.

At a practical level, there are a range of capacity elements at airports which become constrained at different times and which have different incremental cost profiles.

7.6 Treatment of Goodwill

The asset bases used for monitoring by the ACCC exclude the value of goodwill.

For the reasons set out below, Melbourne Airport does not believe that the ACCC's approach to excluding goodwill (from the non-aeronautical asset base) is appropriate.

When airports were sold by competitive tender, the prices that were paid for major airports exceeded the written down value, and even the Depreciated Optimised Replacement Cost (DORC) value, of the assets concerned. The difference between the price and the physical asset value is accounted for as goodwill.

Under the current guidelines, the goodwill is not allocated to either the aeronautical or non-aeronautical business segments. The ACCC justifies its focus on tangible assets as the goodwill (formerly referred to as lease premiums) because it "could reflect the expectation of future price and profit increases that take advantage of the airport's market power".[29] The ACCC has not provided evidence to support this assertion.

An alternative explanation is that airports had reasonable expectations under the tariff basket price cap regime of increases in earnings from volume growth and increased efficiency in the production of aeronautical services. Further, many airports were sold with significant parcels of underdeveloped industrial land. It was also clear that in virtually all cases under consideration there were significant terminal retailing and car parking opportunities available.

In adopting this approach the ACCC is effectively saying that airports are not entitled to earn returns on the full purchase price of their assets. Despite the reasons set out above, Melbourne Airport accepts there being no goodwill allocated to the starting aeronautical asset base. However, goodwill should not be simply assumed away by the ACCC because of unfounded propositions about the market power of airports (discussed in section 4).

[29] ACCC (2006, p12)

It may be convenient for the ACCC to remove the goodwill from the non-aeronautical business segment as simply has the effect of artificially inflating returns. This in turn enables inferences to be made in relation to the market power in non-aeronautical areas, especially car parks. It may also add to arguments for a widening of the monitoring framework. It is interesting to speculate what view the ACCC would take on goodwill if it was regulating on a single till basis – that is, whether it would seek to deny airports the right to earn a return on the total purchase price of the airport.

Issue 3 Has the 'line in the sand' for asset valuations been effective or have airports, airlines or other users encountered problems with this approach?

Response

Melbourne Airport's total aeronautical asset base used for the regulatory accounts matches the line in the sand aeronautical asset base values required by the ACCC. Melbourne Airport is accepts there is no goodwill allocated to the starting aeronautical asset base.

Melbourne Airport does not, however, believe that the ACCC's approach to excluding goodwill from the non-aeronautical asset base is appropriate. The airport operators are entitled to earn returns on the full purchase price of their assets as based on reasonable expectations at the time of sale. As noted above, these expectations related to increases in earnings from volume growth and increased efficiency in the production of aeronautical services under the tariff basket price cap regime and to opportunities available in relation to industrial land, terminal retailing and car parking. The value of goodwill (formerly referred to as lease premiums) should be included in the airport's asset values, though incorporation into the non-aeronautical asset base, in addition to the value of tangible assets.

Again Melbourne is concerned with reporting and analysis as the ACCC continues to compare returns from the different airport and this despite its knowledge that different airport have revalued assets at different time up to the line in the sand date and that Melbourne Airport has the not revalued aeronautical assets at any time subsequent to purchase. The ACCC' although has information makes no qualification of reference to the impacts that these may have on its reporting.

7.7 Approach to Funding Investment

The transition from price regulation to the current light-handed monitoring regime for the major Australian airports was facilitated by the airports adhering to a standard pricing methodology agreed between the airports and the ACCC. The current regime provides for negotiation of commercial agreements around a methodology that is clear to both the airports and airlines. The methodology involves pricing based on the written-down value (line in the sand) of existing assets plus capital investments required over a period of time or as it occurs (and as agreed). Pricing is a matter for commercial negotiation between the airports and airlines: how closely the final prices reflect the theoretical prices is a matter for determination between the parties.

There are clear incentives for airports to continue to seek funding for investment as it occurs, while airlines argue for recovery of capital costs once the asset is commissioned.

An argument against funding as investment occurs is that it is economically inefficient because it means users pay for assets they are not yet able to use and current users cross-subsidise future airport users. This argument is not supported theoretically or practically. Alfred Kahn in his statement to the NZ Commerce Commission in 2001 noted several substantive points relevant to this argument, including that congestion costs are unequivocally part of the short run marginal costs that economic efficiency requires to be reflected in price and a surrogate measure of these congestion costs is the long run incremental costs of relieving that congestion, or holding it within efficient limits.

The current approach adopted in setting user charges at airports of funding as investment occurs, works precisely the way Kahn suggests, in that charging for capital expenditure projects is based on long run incremental costs (based on a return on assets, return of assets [depreciation] and marginal operating costs). Under these arrangements, the airport essentially sets user charges to allow existing assets to earn an appropriate return on investment, but to also allow new discrete projects to earn that same return by charging an increment to the base charge. This is essentially the NNI methodology agreed to and applied during the initial regulatory period. Specifically, the ACCC noted in its April 2000 Position Paper:

> "The necessary new investment guidelines allow the Commission to pass through the costs associated with a necessary new aeronautical investment. Such an approach could include incremental operating or maintenance expenditures that flow from the new capital expenditure. This approach is consistent with that taken by the Commission in its Adelaide multi- user integrated terminal decision and its BACL draft decision"[30]

The approach referred to by the ACCC with regard to the "BACL draft decision" embodies the 'funding as investment occurs' approach which is consistently applied by Melbourne Airport to capital expenditure projects. Consistent with the view of the ACCC, the main advantages of this approach are that it provides a smooth transition to higher prices and enables the risks of a project to be shared between the parties that ultimately benefit from it - being the airport owners through returns on the asset and the airlines through availability of additional capacity.

The International Civil Aviation Organisation (ICAO) Airports Economic Manual advises:

> "pre-funding[31],[32] should only be applied where aircraft operators will benefit by the provision of needed, improved or lower cost service which could not otherwise be

[30] ACCC, New Investment Cost Pass Through, Position Paper, April 2000
31 ICAO uses "pre-funding" to describe both the "funding before investment occurs" and "funding as investment occurs" approaches.
[32] ICAO does note that 'pre-funding' should only be used for capital projects that are advanced in the capital planning stage and not as a sinking fund for unidentified projects

provided because regular sources of financing are insufficient and it is not possible or it is too costly to access capital markets".[33]

The 2009 edition of ICAO's Policies on Charges for Airports and Air Navigation Services[34] states that "pre-funding" may be applied where it is the most appropriate means of financing long-term, large-scale investment, provided that the following safeguards are in place:

- effective and transparent economic oversight of user charges and the related provision of services, including performance auditing and "benchmarking" (comparison of productivity criteria against other similar enterprises);
- comprehensive and transparent accounting, with assurances that all aviation user charges are, and will remain, earmarked for civil aviation services or projects;
- advance, transparent and substantive consultation by airports and, to the greatest extent possible, agreement with users regarding significant projects; and
- application for a limited period of time with users benefiting from lower charges and from smoother transition in changes to charges than would otherwise have been the case once new facilities or infrastructure are in place.

There are a number of examples of airports globally that collect charges for funding of investment as allowed by the above guidelines. These include:

- many Canadian airports including Montreal, Ottawa and Vancouver airports, which charge an Airport Improvement Fee;
- some airports in the UK including Newquay Cornwall and Norwich International Airports, which charge an Airport Development Fee;
- Delhi International Airport which charges an Airport Development Fee; and
- commercial airports controlled by public agencies in the USA are permitted to charge a Passenger Facility Charge which is used to fund approved projects that enhance safety, security, or capacity; reduce noise; or increase air carrier competition.

In conclusion, the principle of funding as investment occurs remains valid and appropriate in the context of Australian airport development activity. It has been successfully applied since privatisation to capital expenditure projects with accepted recognition by users. Further, it has been an agreed component in setting aeronautical charges in Australian airports and has been conceptually agreed to by the ACCC.

[33] ICAO, *Airports Economic Manual*, Second Edition, 2006, p. ATT 6-1.
[34] Pre-funding is defined by the ICAO as *"Partial or complete financing of an airport or air navigation facility project through charges levied on users prior to completion of the facility concerned"*. This includes both the "funding before investment occurs" and "funding as investment occurs" approaches.

7.8 Efficiency of Aeronautical Services – International Comparisons

LeighFisher Management Consultants (LeighFisher) was asked by Melbourne Airport to carry out a benchmarking review of aeronautical charges and operational and financial performance of Australian airports. LeighFisher's report to Melbourne Airport, Melbourne Airport Performance and Charges Benchmarking Study, February 2001 (LeighFisher Benchmarking Study), is provided as Attachment 1 to this submission.

The LeighFisher evaluation of aeronautical charges involved identifying all of the charges used to recover the infrastructure and environmental costs associated with the arrival at, and departure from, an airport by a sample of 8 different aircraft types, carrying a typical passenger load on an international flight. The charges taken into account are landing charges, aircraft parking charges, passenger-related charges and terminal navigation charges. The aggregate charges are determined in the domestic currency in relation to each airport and are then converted into Special Drawing Rights (SDRs) and presented in numerically ranked indices.

Aggregate charges for aeronautical services are determined for 9 Australian and New Zealand airports. This group comprises: in relation to Australian airports, the 5 capital city airports for which aeronautical services are monitored under Direction 29, plus Cairns airport; and in relation to the New Zealand airports, the airports of Auckland, Christchurch and Wellington. The aggregate aeronautical charges at each airport are calculated for 2010/11 and are also contrasted to the aggregate charges determined for these airports in respect of 2005/06, as determined by LeighFisher in 2006, in connection with its work in relation to the previous PC inquiry into aeronautical services.

The Melbourne Airport aeronautical service charges in relation to landings and take-offs by the 8 different aircraft types are the lowest within the 9 airport sample and are around half the level of those of the most expensive airport in the sample, Adelaide Airport. The ranking of the airports in absolute terms in SDRs, and indexed against the highest ranking airport, Adelaide, is shown in Table 30 below (also in section 1.8) represents Table 1 of the LeighFisher Benchmarking Study.

Table 30: Total charges for eight aircraft types at the regional sample of nine airports (SDRs)

Source: LeighFisher (2011)

In relation to the ranking of the charges shown in Table 30 above, LeighFisher comments that it is not surprising to find Adelaide and Cairns among the most expensive of the Australia airports, since they are smallest within the sample in terms of passenger numbers.

The position of Melbourne Airport in relation to the other airports in the sample has remained consistent over time. This is shown in Table 31 below, which also represents Table 5 of the LeighFisher Benchmarking Study.

	Ranking position in 2006	Ranking position in 2011
Adelaide	1	1
Brisbane	8	2
Cairns	3	3
Sydney	4	4
Wellington	2	5
Auckland	5	6
Christchurch	6	7
Perth	7	8
Melbourne	9	9

Table 31: Sample airport ranking positions in 2006 and 2011

Source: LeighFisher (2011)

In addition to the 9 airport sample above used to assess aggregate aeronautical charges, the LeighFisher Benchmarking Study introduces the airports from this sample into the index of charges contained in the 2010 edition of Review of Airport Charges, in order to put the Australian and New Zealand charges into a broader context. The sample of 50 airports included in this publication already contains Sydney, which ranks 8th position in the sample (that is, the 8th most expensive airport in terms of aeronautical charges). If Melbourne Airport is added to the sample, it would rank in 27th position.

Table 32 below shows the index of charges, including the 8 additional airports from the Australia-New Zealand sample used above. This expands the index of charges sample to 58.

Indexing is based on the most expensive airport in this sample, Toronto. Table 32 below is Table 7 from the LeighFisher Benchmarking Study. Within this combined sample, the Melbourne Airport aeronautical charges rank in 32nd position out of 58. The most expensive of the airports from the Australia-New Zealand sample, Adelaide, ranks in 4th position.

	AIRPORT	SDRs	Index	Passengers 000s (Source: ACI)	
				International	Total
1	Toronto	62,184	100	17,638.3	30,368.3
2	New Jersey-EWR	55,067	89	10,617.1	33,399.2
3	Osaka	52,639	85	9,351.6	13,448.3
4	Adelaide	52,423	84	516.2	6,933.9
5	Athens	51,031	82	10,029.8	16,135.2
6	Tokyo	45,730	74	30,894.5	32,135.2
7	Vancouver	45,209	73	7,499.1	16,176.5
8	Brisbane	45,110	73	4,116.1	18,885.8
9	Cairns	44,445	71	508.0	3,519.5
10	New York-JFK	44,122	71	21,899.7	45,915.1
11	Frankfurt	41,730	67	44,520.7	50,615.6
12	Sydney	41,530	67	10,644.8	32,997.7
13	London-LHR	40,658	65	60,651.3	65.907.9
14	Zurich	40,402	65	21,280.5	21,879.1
15	Moscow	38,995	63	9,846.3	14,708.2
16	Paris-CDG	38,208	61	53,032.5	57,812.0
17	Wellington	37,108	60	622.0	5,100.9
18	Vienna	35,533	57	17,383.6	18,058.1
19	Amsterdam	35,431	57	43,520.7	43,523.1
20	Berlin	33,054	53	7,538.9	14,154.9
21	Budapest	32,814	53	8,060.9	8,060.9
22	Brussels	32,811	53	16,770.4	16,771.5
23	Munich	32,758	53	23,347.2	32,628.8
24	Auckland	32,167	52	6,488.9	13,300.4
25	Beijing	31,160	50	14,098.4	65,372.0
26	Dublin	30,486	49	19,849.3	20,484.3
27	Perth	30,355	49	2,792.1	10,057.4
28	Johannesburg	29,570	48	8,153.8	17,446.2
29	Prague	28,463	46	11606.2	11,608.1
30	Dusseldorf	28,436	46	13,470.9	17,754.6
31	Washington	28,118	45	6,246.4	23,073.7
32	Melbourne	27,961	45	5,206.2	25,127.5
33	Copenhagen	27,804	45	17,620.4	19,622.2
34	Warsaw	27,783	45	7,472.8	8,300.0
35	Miami	27,351	44	15,970.4	33,886.0
36	Bangkok	26,624	43	28,834.6	39,044.9
37	Lisbon	26,560	43	11,070.2	13,241.6
38	Los Angeles	26,184	42	15,100.9	56,520.8
39	Seoul	25,754	41	28,080.5	28,459.8
40	Oslo	24,432	39	9,442.9	18,069.9
41	San Francisco	23,859	38	8,321.1	37,224.3
42	Mexico City	23,241	37	8,150.7	24,243.1
43	Stockholm	23,141	37	12,114.3	16,063.5
44	Milan-MXP	22,733	37	14,308.7	17,349.6
45	Madrid	22,168	36	29,066.1	47,951.0
46	Helsinki	21,167	34	10,236.5	12,609.0
47	Mumbai	20,918	34	7,628.8	24,371.5
48	Rome	20,834	34	26,852.6	33,415.1
49	Jeddah	20,702	33	9,832.5	15,921.8
50	London-LGW	20,662	33	28,699.0	32,369.9
51	Cancun	20,317	33	8,150.7	11,191.6
52	Dubai	19,129	31	40,104.1	40,104.1
53	Singapore	16,661	27	36,089.0	36,089.0
53	Hong Kong	14,467	23	44,979.1	44,979.1
55	Sao Paulo	13,849	22	8,458.9	21,684.8
56	Kuala Lumpur	12,557	20	19,401.7	29,398.5

Table 32: Worldwide airport charges Index 2010
Source: LeighFisher (2011)

To provide an additional perspective on aeronautical prices, LeighFisher also performs an assessment of airports based on aeronautical revenue per passenger between the similarly-sized airports of Auckland, Brisbane, Calgary, Copenhagen, Manchester, Perth, Stockholm, Sydney, Vancouver, Vienna and Washington Dulles.

Accordingly, this sample comprises 4 Australian airports (representing the capital city airports for which aeronautical services are monitored under Direction 29, less Adelaide Airport), plus 8 international airports. This 12 airport sample differs from the samples used for the aeronautical price comparisons above. LeighFisher's analysis covers the period of 15 years by the 12 airports and, for ease of presentation, divides the results into 2 categories: Melbourne and the southern hemisphere airports (ie the 4 Australian airports, plus the Auckland airport); and Melbourne and the northern hemisphere airports (ie Melbourne, Auckland, Calgary, Copenhagen, Manchester, Stockholm, Vancouver, Vienna and Washington Dulles, representing 8 airports).

The revenue measure used is the revenue earned by the airports from landing charges, aircraft parking charges and passenger-related charges. The data used cover the period 1995/96 to 2009/10.

In relation to Melbourne and the southern hemisphere airports, over the period, real reductions in prices were balanced by overall revenue terms by increases in passenger numbers.

In relation to Melbourne and the northern hemisphere airports, an upward trend in aeronautical revenue per passenger is evidenced at most airports, with the European airports generating higher levels of revenue, while Melbourne Airport consistently produced lower levels than this sample, with the exception of Washington Dulles, where aeronautical revenues per passenger declined in some recent years. The results in relation to this sample of airports are shown in Table 33 (also in section 1.8), represents the Table on page 18 of the LeighFisher Benchmarking Study.

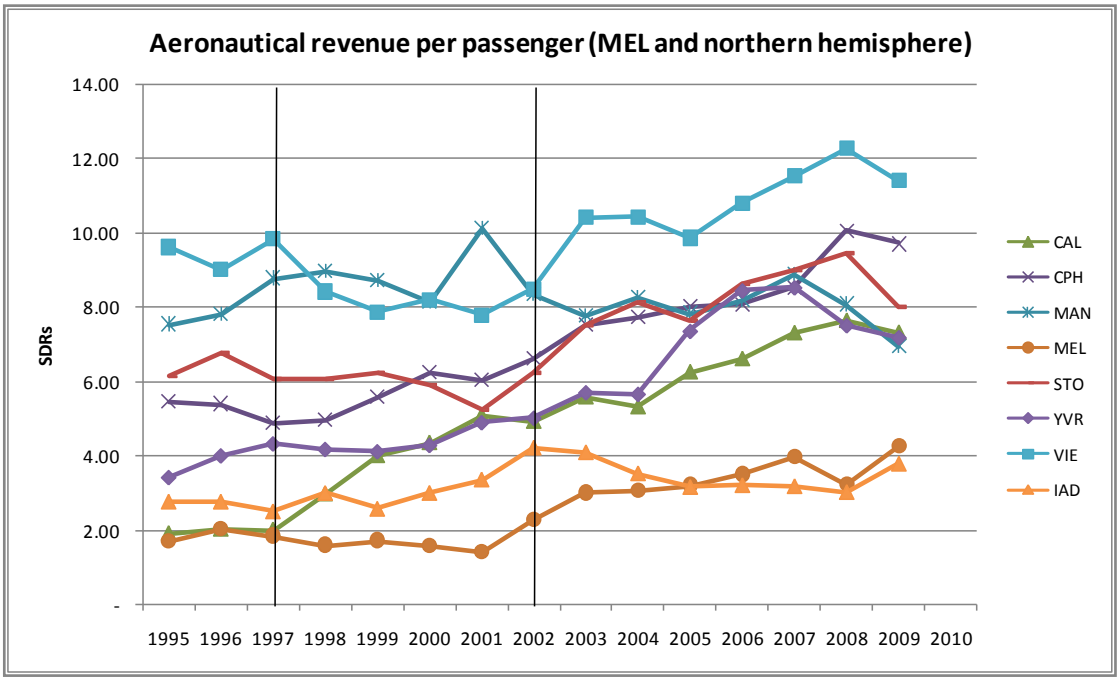

Table 33: Aeronautical revenue per passenger for selected airports (SDRs)
Source: LeighFisher (2011)

LeighFisher present that there has been an upward trend in income from aeronautical charges at Australian airports since price regulation was replaced by price monitoring. This however, in large part is an outcome of material escalation in the AUD value relative to SDRs over the last decade. Nevertheless, on average, the northern hemisphere airports derive almost 40% more revenue from aeronautical charges on a per passenger basis compared with those in the southern hemisphere. Also, Melbourne Airport's aeronautical revenue per passenger was over 20% lower than the southern hemisphere average in 2009/10.

Issue 6.1 How do recent charges for aeronautical services at the price monitored airports compare with those at comparable international airports?

Response

The Melbourne Airport aeronautical service charges are the lowest within the Australia-New Zealand 9 airport sample used by LeighFisher (which covers the 5 capital city airports for which aeronautical services are monitored under Direction 29), and are around half the level of those of the most expensive airport in that sample, Adelaide Airport.

By adding the 9 Australia-New Zealand airports used above to the 50 international airports used for the index of charges contained in the 2010 edition of Review of Airport Charges, Melbourne Airport aeronautical charges rank in 32nd position out of the extended sample of 58 airports (Sydney Airport being already in the 50 airports used in the 2010 publication).

Accordingly, Melbourne Airport's aeronautical charges are low relative to such charges applied by airports it can be reasonably compared against.

It is noted that a number of airports included in the broader sample are subject to price control, or to more onerous regulation than price monitoring as occurs pursuant to Direction 29. For example, Vienna was subject to a formula based on passenger numbers and Copenhagen was subject to a number of price freezes. There is also the different motives of these airports. Not all airports are responsible to shareholders to provide a return on investments. Many airports for example are government agencies are responsible for promoting tourism for local development. Given the strong competitive position of Melbourne Airport's aeronautical charges against those applied by other airports, it seems unlikely that better price outcomes at Melbourne could be achieved by more stringent regulation. In fact, based on the strong performance evidenced by the airport in this regard, additional regulation is unlikely to achieve a better outcome than has occurred under the current light handed monitoring regime and accordingly, there would not be a public benefit from additional regulation, as the costs of such regulation would exceed the benefits.

In addition to price and average revenue benchmarking of Melbourne Airport to other airports, LeighFisher also assessed the costs, profitability (in terms of EBIT and EBITDA margins) and productivity of Melbourne Airport relative to other airports.

LeighFisher's approach to assessing these matters is consistent with its approach to assessing aeronautical revenue per passenger between the 12 similarly sized airports (including Melbourne Airport). That is, the same 12 airports are used and 15 year timeframe is applied as in the revenue per passenger assessment and, for ease of presentation, results are divided into 2 categories: Melbourne and the southern hemisphere airports (5 airports, including Melbourne); and Melbourne and the northern hemisphere airports (8 airports, including Melbourne).

In terms of total costs per passenger, in the sample comprising Melbourne and the southern hemisphere airports, Melbourne's total costs per passenger were the lowest in the sample in all years with the exception of 1995, 2001 and 2003 (when total costs at Brisbane were slightly lower). This is shown in Table 34 below, which also in Section 1.8.

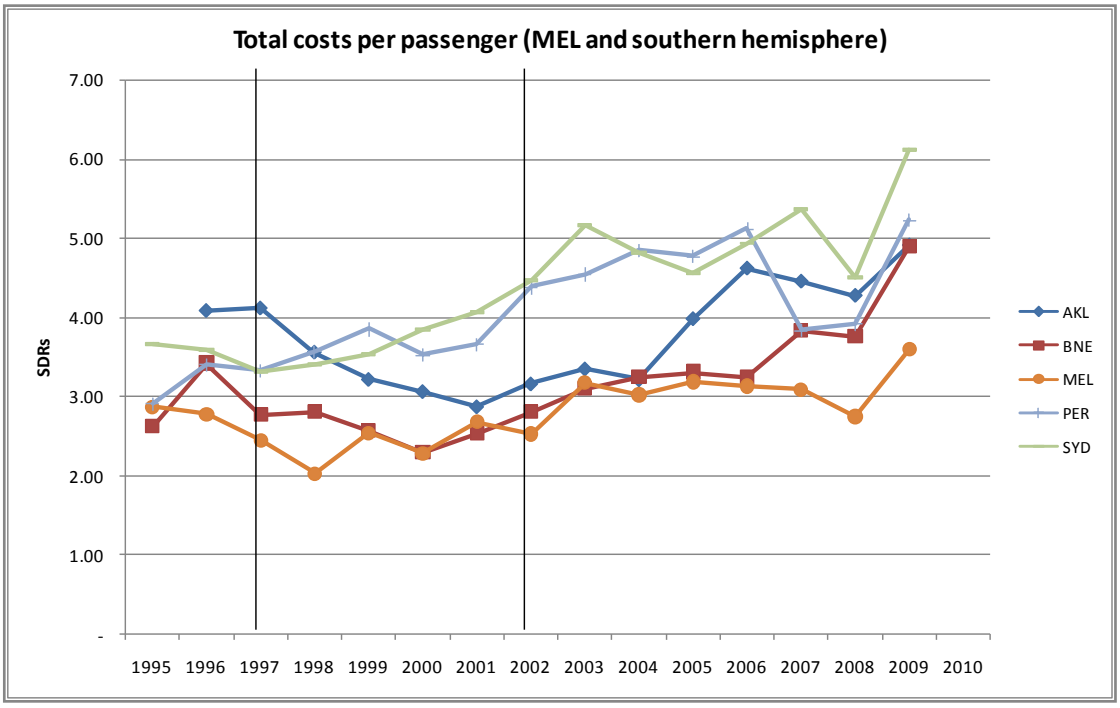

Table 34: Total costs per passenger for selected airports (SDRs)
Source: LeighFisher (2011)

Further, also in terms of total costs per passenger, in the sample comprising Melbourne and the northern hemisphere airports, cost levels at Melbourne have been significantly below the cost levels for all other airports, except Calgary and Vancouver – and that is only in respect of the initial years of the study period (ie 1995 and 1996).

In terms of staff costs per passenger, since the airport performance benchmarking began, Australian airports have had conspicuously lower staff costs (and staff numbers) than airports in almost all other parts of the world, with the Canadian airports coming closest to matching the Australian performance levels.

As observed by LeighFisher, in general, there has been an upward trend in staff productivity as measured by passengers per airport employee among the southern hemisphere airports (ie comprising 4 Australian airports plus Auckland Airport). On average, staff productivity rates at the southern hemisphere airports are more than 3 times greater than at the northern hemisphere airports. There is no evidence that this disparity can be explained by different levels of outsourcing. Melbourne Airport's productivity is also around 50% higher than the average of the southern hemisphere sample.

Other findings by LeighFisher in relation to the 12 airport sample on costs, profitability and productivity are that the southern hemisphere airports:

- on average, derive a higher return on capital employed than the northern hemisphere airports. Melbourne Airport has outperformed its peers in relation to this measure in recent years; and

- have consistently outperformed northern hemisphere airports in terms of EBIT and EBITA margins.

Issue 6.2 What conclusions can be drawn from international comparisons of airport performance?

Response

The conclusion arrived at by LeighFisher in relation the cost, profitability and productivity performance of the Australian airports in the 12 airport sample is as follows:

> *" …it appears that the Australian airports are generally the most efficient in cost and staff productivity terms and derive the lowest levels of revenue from their airline users. They are also the most profitable airports in the sample. Within this sample, therefore, they may be regarded as representing industry best practice."*

This finding by LeighFisher in relation to the 4 Australian airports covered by the relevant sample (the airports for which prices are monitored pursuant to Direction 29, less Adelaide Airport) is particularly relevant to Melbourne Airport which, by most metrics measured by LeighFisher in this context, is generally the best performed among the Australian airports. As Australian airports are considered to represent industry best practice in relation to the cost, profitability and productivity metrics above (and as further specified in the LeighFisher Benchmarking Study provided as Attachment 1 to this submission), there would appear to be little benefit (and there are likely to be some costs) from imposing additional regulation on the monitored airports in relation to these metrics.

7.9 General Monitoring Issues

Issue 14.1 At a broad level, is there value in continuing the monitoring of aeronautical services and/or parking prices?

Response

Melbourne Airport considers there to be benefit from continuing a monitoring regime .to ensure public disclosure of service levels and airport service. In relation to aeronautical services, this gives airlines opportunity to compare prices and other information across airports and to determine their positions in access negotiations accordingly. It also allows the disclosing airports to compete by comparison. In relation to car parking services, Melbourne Airport fully discloses its prices, terms and conditions for these services and considers monitoring of these services to be consistent with the full disclose objective. As discussed in relation to other issues concerning the monitoring framework, Melbourne Airport's concerns about the current monitoring regime relate to the ACCC's interpretation of monitoring results, rather than the monitoring regime per se.

Issue 14.2 Is there evidence that the current light-handed approach has not been successful in addressing market power concerns, and if so, what alternatives are available?

Response

The process of negotiation of commercial agreement agreements has lead to investment in airport facilities and in Melbourne Airport being able to achieve significant productivity, quality of service and economic efficiency gains over the monitored period. The light handed regulatory regime has facilitated these developments in that it has not placed hurdles in the way of new investment, or diverted management resources, or otherwise impeded the development of commercial relationships between airports and airlines.

Issue 14.3 Is both price and service quality monitoring needed?

Response

Melbourne Airport does not consider both price and service quality monitoring to be needed. We note, however, that there can be benefits associated with such a regime, which are discussed generally in our response to Issue 14.1. Melbourne Airport supports the continuation of price and service quality monitoring.

Issue 15.1 Should there be a fixed duration for any future period of price monitoring?

Response

Melbourne Airport considers a regulatory period of 5 years to represent a reasonable balance between industry and user needs in relation to both long-term certainty and flexibility in order to deal with material changes in circumstances.

Issue 15.2 Are further prescheduled reviews necessary?

Response

Melbourne Airport does not consider a further prescheduled review to be required, as market based mechanisms provide sufficient protection against misuse of any market power held by the airports.

Issue 16.2 Could the number of indicators be reduced? In some areas, would more information be desirable?

Response

Melbourne Airport's response to this issue is similar to that in relation to Issue 7.1. That is, Melbourne Airport's concerns about the operation of the current monitoring regime do not relate to the nature of the information required to be made available to the ACCC, but to the way in which the ACCC has interpreted the results from the monitoring and how it has communicated its interpretations.

Issue 16.3 Do reports need to be produced annually?

Annual reporting of results is considered appropriate but little value in ACCC's commentary if the information is made public and given then no positive value in commentary as it is currently presented.

Response

While monitoring is in place, annual reporting of results is considered appropriate.

Issue 22.2 Is there a better approach to developing a 'show cause' process or an alternative trigger process?

Response

In section 5.3 of this submission, Melbourne Airport sets out an alternative trigger process to that reflected in the 'show cause' proposals.

Issue 23.1 Do concerns about the potentially adverse effects of more heavy handed price regulation on investment militate against its reintroduction?

Response

As noted by the PC in its 2006 inquiry report into airport services, the current light handed regime replaced a heavy handed price cap regime that was widely acknowledged to have put various hurdles in the way of new investment, diverted management resources to dealing with the regulator and impeded the development of commercial relationships between airports and airlines.

The light handed regime was intended to constrain the misuse of market power by the airports, while greatly reducing regulatory intrusion into their commercial dealings with airlines and other customers. Melbourne Airport does not support a return to more heavy handed forms of regulation, which could 'unwind' benefits created by the light handed regime, particularly in terms of its facilitation of commercial agreements on prices, terms and conditions of access to aeronautical services.

Issue 24.2 Should potential links between airports (such as Canberra and Sydney or Melbourne and Avalon) be examined?

Response

While Melbourne Airport does not have a view on whether the PC's inquiry should deal with this issue, it wishes to state that it supports the Commonwealth investigation into high speed rail between capital cities taking into account the airports.

7.10 Proposal

As discussed in this Chapter 7, Melbourne Airport's experience to date with the prices, costs and profits reporting framework has far from ideal. The explanatory power of the financial metrics reported by the ACCC in its monitoring reports is limited, which means that great care needs to be taken before conclusions are reached and reported. In relation to the ACCC's 2009/10 monitoring report, facts contained in the detailed body of the report do not support the contentions that the ACCC makes in its summary sections.

If the eventual conclusion of the PC and the Government is that there remains a need for such regulation, in the interests of ensuring that the public is better informed about the inferences that should be properly drawn from the monitoring of airport financial data, it is recommended that the legislation should be amended so that the ACCC is obliged to:

- consult with Melbourne Airport (and the other airports) on the relevant section(s) of its draft monitoring report; and

- if requested by the airport, include the airport's comments on the conclusions being made by the ACCC.

8. CAR PARKING SERVICES

This chapter examines car parking services in relation to Melbourne Airport. It sets out the key findings from the Car Parking Benchmarking Study by PricewaterhouseCoopers in relation to the car parking services provided at the airport, and their comparison to car parking services in other locations, including car parks in proximity of the airport, but outside the airport boundary (off-airport car parks).

The PricewaterhouseCoopers Car Parking Benchmarking Study is provided as Attachment 2 of this submission.

The demand for ground access services is a derived demand in that it is dependent on the primary demand for aeronautical services. The efficiency of ground access services and, in general, the value placed on a service by users will reflect the extent to which that service provides the user with time control over the journey to their flight.

Pricing of car parking at the airport and attendant charging for terminal forecourt access is focused on efficiently managing access to the kerb in front of the terminal complex and giving effect to the safe and efficient flow of traffic in the forecourt area. Consistent with this approach, taxis are provided with a high level of access to the forecourt and vehicle pick-up/drop-off zones are arranged so that vehicles of equivalent sizes are grouped together. In addition to providing for private vehicle pick-up/drop-off zones, Melbourne Airport provides disabled pick-up/drop-off zones in front of the terminals, which provide for 15 minute parking. Private vehicles are not charged for access to the forecourt and are subject to a maximum length of stay of one minute.

Issue 27.1 What transport options exist at the major airports in Australia?

Response

The ground access options in relation to Melbourne Airport are set out in Table 23 of section 4.3 above.

Issue 27.2 Are these reliable, frequent and cost effective services?

Response

The available ground transport services reflect relatively high distance between the airport and the Melbourne CBD. The links between the airport and the CBD are by road access. The most cost effective ground access modes are private vehicle pick-up/drop-off (for which the airport applies no charge) and public buses (a one-way journey to the city is $5.80). The availability of taxis and hire cars at the airport and express buses (eg SkyBus) means that, in addition to the private vehicle access mode, there is a generally high frequency of services amongst the modes serving the airport.

Issue 27.3 Are they integrated into the suburban transport network?

Response

The ground access at the airport is via road access. Public buses at the airport are integrated into the metropolitan bus network. All other modes with the exception of regional Victorian bus services are integrated into the suburban transport network. In addition, Melbourne Airport has made provision for future rail access to the airport by reserving an access corridor for this purpose. Melbourne Airport will continue to work with the State Government in evaluating rail access options.

Issue 27.4 To what extent are they used relative to private cars?

Response

See our response to Issue 8.1.

Mode share information collected by the airport shows that on-airport car parking is not the dominant mode of ground transport. 27% of passenger mode share relates to private vehicles combined with airport car parking. The predominant form of access to the airport is private vehicle kerbside pick-up/drop-off, at 35% mode share. The mode shares are illustrated in Table 35.

The mode share information for Brisbane Airport and Sydney Airport in Table 1 below is from the ACCC Monitoring Report 2009/10. The mode share for Melbourne Airport is from Melbourne Airport's 2010 web-based research of Victorian passengers.

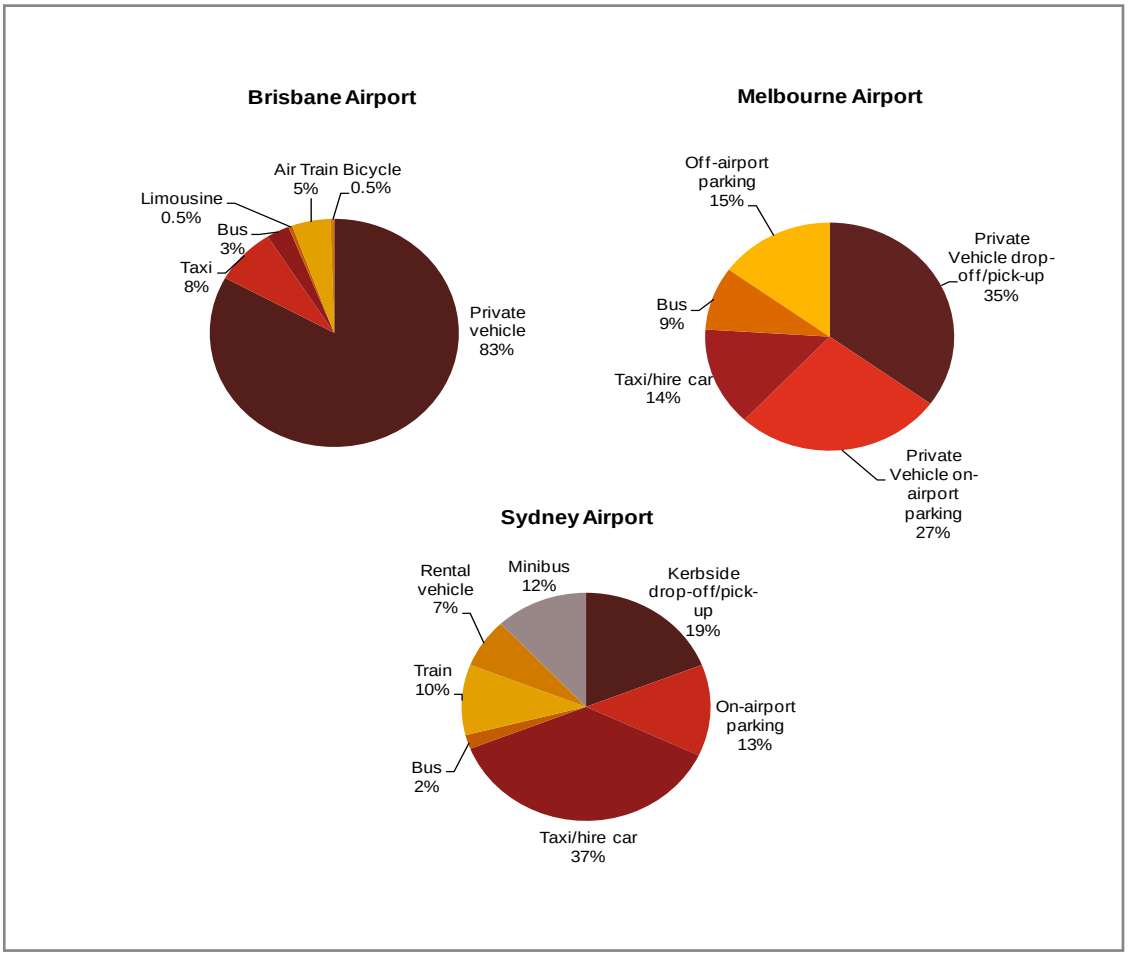

Table 35: Passenger Mode Share for Access to Airports
Source: PwC (2011), from Melbourne Airport and ACCC data

Issue 8.1 What percentage of passengers use the airport's car park facilities?

Response

The percentage mode share of private vehicles using the on-airport car parks is 27%, as shown in Table 35 above. This includes staff car parking.

Issue 8.2 What is the level of competition from other sources of transport?

Response

The level of competition is evidenced in the mode share data provided in Table 35 above. The main form of ground access to the airport is private vehicle pick-up/drop-off at the kerb in front of the terminal complex, at 35% mode share. This is followed by off-airport car parking at 27%, while taxis/hire cars also evidence material mode shares of 15% and 14% respectively.

It is Melbourne Airport's policy that parties that obtain a commercial benefit from access to the forecourt should contribute to the costs of providing and maintaining those facilities. Private vehicles accessing the terminal for pick-ups/drop-offs, however, do not pay access fees. In this case, the vehicles must be attended at all times and the maximum length of stay for a pick-up or drop-off is 1 minute. Currently public buses do not pay access fees. The access charges applied by the airport are set out in Table 36. A discussion of these charges and the associated terms and conditions of access is provided in section 7.4 above.

Kerbside Access Charges	Seat Capacity (max)	Cost per seat
1. Private vehicle pick-up/drop off – no charge		
2. Metropolitan public bus – no charge		
3. Taxi access charge - $1.32 per collection	4	$0.33
4. Limousine hire car access charge - $3.00 per 30 minutes per collection	4	$0.75
5. Commercial vehicle / Van up to 10 seats - $4.00 per collection	10	$0.40
6. Commercial vehicle / Van with trailer up to 10 seats - $6.00 per collection	10	$0.60
7. Small bus 10 – 24 seats - $6.00 per collection	24	$0.25
8. Large Bus more than 24 seats - $12.00 per collection	48	$0.25

Table 36: Access Fees at Melbourne Airport
Source: PwC (2011) from Melbourne Airport data

The access fees represent a relatively small proportion of the ultimate mode cost to users of the service. The cost per user of different transportation options (based on maximum load assumptions) is shown in the table above.

Issue 27.5 Is there evidence that land transport service providers (such as taxis, shuttles, off-airport car parking providers) are impeded unduly in gaining access to airports?

Response

There is no evidence that land transport service providers are being impeded unduly. Charges and terms and conditions for forecourt access are focused on efficiently managing access to the kerb in front of the terminal complex and on giving effect to the safe and efficient flow of traffic in the forecourt area. Consistent with this, taxis are provided with a high level of access and vehicle pick-up/drop-off zones are arranged so that vehicles of equivalent sizes are grouped together. In addition to providing for private vehicle pick-up/drop-off zones, Melbourne Airport provides disabled pick-up/drop-off zones in front of the terminals which provide 15 minute parking.

Issue 27.6 Are charges and conditions of access to airports (e.g. convenient pick-up and drop-off points) appropriate?

Response

The basis of the charges and general conditions of access is provided in Table 36 above. The charges and terms and conditions of access are clearly signposted at the terminal precinct and all standard terms are published on the Melbourne Airport website. In a number of cases, users (eg SkyBus and other commercial bus operators) have bilaterally agreed to different terms.

Issue 27.7 Is there a need to monitor such terms and conditions?

Response

There is no need to monitor the access terms and conditions. The standard terms of access for the different ground transportation modes are clearly signposted at the terminal precinct and are published on the Melbourne Airport website. Where users wish to negotiate commercial agreements in relation to such access, the terms and conditions of such agreements simply replace the standard terms. Given this, Melbourne Airport does not consider there to be a clear basis for monitoring these terms and conditions – the standard terms, because they are public anyway, and the agreed terms, because they are confidential.

Importantly, there is no discrimination in relation to the charges, terms and conditions applied to different commercial users by vehicle size or by reason for journey or destination.

There is a high level of substitutability between different modes of ground transport. In assessing substitutability, PwC evaluated different timeframes in relation to short term, medium term and long term access.

For short term stays, PwC shows that there is direct substitutability between services and particularly between private vehicle kerbside pick-up/drop-off and private vehicle access combined with short term car parking. The airport generally applies low rates compared to CBD benchmarks and also in comparison to rates applied by off-airport car parks serving the airport, for shorter term car park stays. The low short term rates applied by Melbourne Airport are consistent with its objective of reducing congestion of the constrained kerbside space in front of the terminal complex.

The relative costs of the key short term options are shown in Table 37 below.

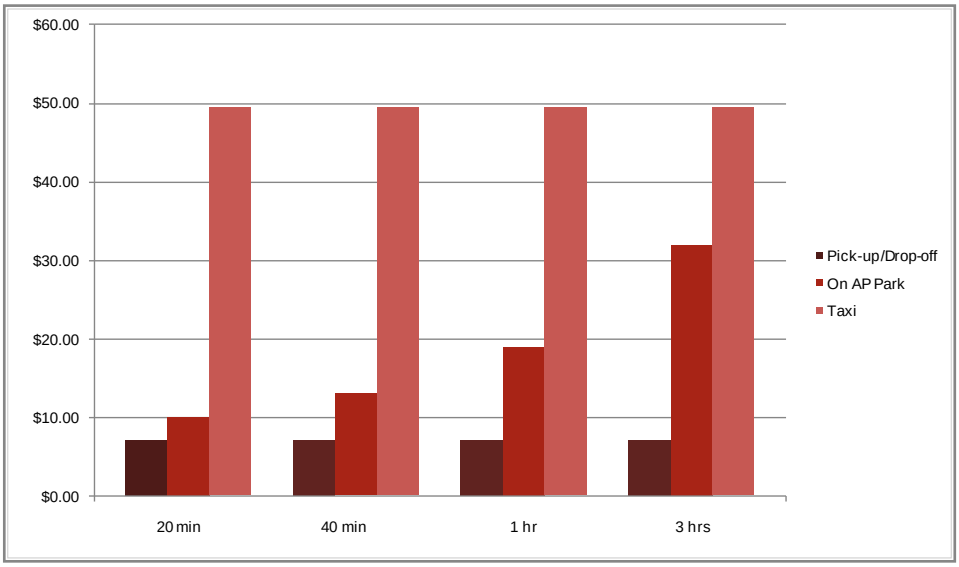

Table 37: Comparison of Key Access Options – Short Term (Single Journey)
Source: PwC (2011)

Monopolistic behaviour in relation to short term car parking could, for example, involve pricing up to substitute services and potentially toward the costs of taxi access, given that taxi costs to users are, in large part, fixed by regulation (taxi costs to users of the airport comprise costs based on the regulated rates fixed by the Victorian Taxi Directorate, plus access charges applied by the airport and passed through by taxi operators to their customers). The information in Table 37 above indicates that such a strategy has not been adopted by the airport.

In the case of medium term stays, a greater level of substitution is likely to apply between on-airport and off-airport car parking given similarities between the services offered and the charges applied in relation to such options in the medium term. Further, although it remains a low cost access option (in terms of direct costs to the vehicle operator), private vehicle pick-up/drop-off may not be feasible in a wide range of cases (given that reliance on this option would involve 2 return trips to the airport within the medium term timeframe).

Generally, in the case of medium term stays (3 to 24 hours), parking at off-airport sites becomes increasingly cost-competitive with car parking at the airport. The mode cost of private vehicle transport (and assuming a return journey between the airport and the CBD) plus a 24 hour stay in the long term car park is calculated to be $43: this compares to the range of costs associated with such private vehicle transport, plus a 24 hour stay in on off-airport car park serving the airport, of $23 (lowest cost car park option) to $49 (highest cost option).

As the length of the stay increases beyond 24 hours, not only off-airport car parking, but fixed cost options, such as taxis and buses, may become more attractive to users. The latter options become more attractive because they are not affected by the duration of the stay (or the timing of the outbound and inbound legs of a passenger's return flight). As the bus options involve a low nominal cost to users relative to the costs of personalised

transportation options, for long term stays, there may also be substitution from personalised transportation options to buses, both private and public.

The value attached to individual car parking services reflects their proximity to airport terminal complex and as such, the services embody a locational rent. Given the value and utility of the on-airport car parking sites located near the airport terminals and customer preference for timeliness and time control in relation to ground access services, it would be inefficient for these sites to be allocated to less productive uses, or to uses that are critical to meeting customer needs.

The services provided by car parking sites have a high amenity value in the same way that car parking at CBD locations has a high amenity value and embodies a commensurate locational rent. In the case of commercial car parks in the CBD, prices are determined by the general process of competition between car parking operators in the city centre.

For medium term and long term stays, in particular, Melbourne Airport faces direct competition from off-airport car parks (in addition to general competition from other modes). Melbourne Airport car parking prices in this medium to long term context are, on average, higher than off-airport rates, reflecting the greater amenity value and locational rent associated with the proximity of airport car parks to the terminal. For short term stays, the airport car parking rates, in addition to reflecting locational costs, also seek to position short term car parking as a cost effective alternative to private vehicle pick-up/drop-off (this is in order to assist managing traffic flows in the constrained space of the terminal forecourt).

As set out in Table 38 below, the locational value reflected in on-airport car parking charges is less than that reflected in CBD commercial car park rates.

Timeframe	20 min	40 min	1 hour	3 hours	8 hours	1 day	2 days	3 days	7 days
Melbourne Airport Car Parks									
short term car park	$3	$6	$12	$25	$50	$50	$100	$150	*$350*
multi-level long term car park	$3	$6	$12	$25	$50	$50	$95	$139	$139
long term car park	$10	$10	$10	$10	$29	$29	$46	$69	$77
business car park	$50	$50	$50	$50	$50	$50	$100	$150	*$350*
express car park	$3	$6	$12	$25	$50	$50	$100	$150	*$350*
Melbourne CBD*									
Highest	$20	$20	$20	$60	$86	$86	$172	$258	$602
Lowest	$3	$10	$10	$30	$35	$35	$70	$105	$245
Average	$15	$17	$17	$49	$65	$65	$130	$194	$454
* Covered parking, not including earlybird rates									

Table 38: Comparison of airport car parking rates with Melbourne CBD rates
Source: PwC (2011)

The information in Table 38 above is consistent with car parking prices being set based on the factors described above. The generally lower prices at Melbourne Airport relative to the Melbourne CBD commercial car parks are not indicative of the use of market power in car parking.

Melbourne Airport has expanded its car parking capacity by 23% over the monitored period since 2005/06, in excess of the growth in passengers passing through the airport. These additions to capacity have been made in a timely manner in response to user demand and to provide better quality products to compete with off-airport parking and other modes of ground transport.

In addition, Melbourne Airport has developed a range of enhancements to the airport forecourt to allow better traffic management such as the development of taxi holding areas and trials of Victorian Government Smart bus having access near the front of the terminals. Such initiatives are being undertaken with collaboration with the Victorian Government in an effort to reduce congestion across the road network.

Melbourne Airport plans to invest approximately $76 million over the next five years to increase car parking capacity. The key projects include a 37% increase in long term uncovered parking bays and a new multi-level car park. In contrast to the past and future investments by Melbourne Airport in car parking capacity, it can be presented that monopolistic behaviour in relation to a service could involve limiting or restricting its capacity in order to maximise earnings from the service. This is not the case for Melbourne Airport which has expanded capacity in response to user needs.

Issue 8.3 Are off-site car parks a real source of competition to the airport car parks?

Response

Off-airport car parks offer prices that are competitive with, and in many instances lower than, prices for on-airport car park stays, particularly in relation to medium term and long term stays at which they are targeted.

A material level of capacity is provided by off-airport operations. The 14 private operators in the area of the airport on which Melbourne Airport has obtained information provide a total capacity of 10,950 car parking bays. Table 39 shows the geographic proximity of these competitors to the airport.

This compares to the long term car parking capacity at the airport of 15,896 bays (comprising the capacities of the long term car park, of 12,500 bays and the multi-level long term car park, of 3,396 bays). This is a foundation for competition between on-airport and off-airport car parks.

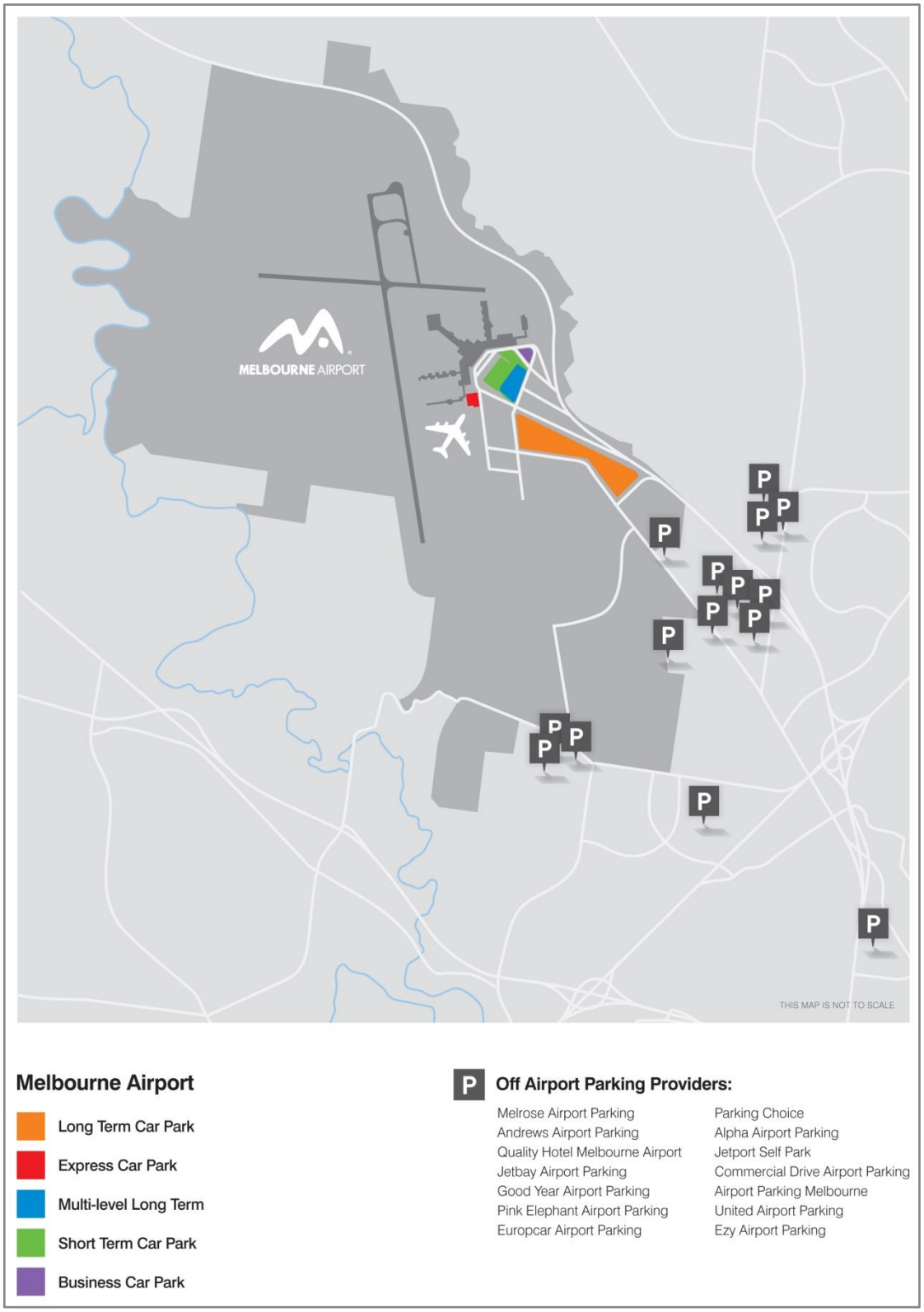

Table 39: Location of off-airport car parks
Source: Melbourne Airport

Issue 8.4 Is there evidence that airports are influencing the level of competition from alternative transport modes?

Response

It is not apparent that the airport is influencing the level of competition from alternative transport modes. There are material differences in the cost and amenity to users of the different modes of ground access (users choose between modes based on their particular preferences and generally place the highest store on modes that provide time control over their journey time to their flight: this is evidenced in a high level of access being based on private vehicles) and the airport does not have market power in relation to ground transport..

The airport's services (car parking, kerbside access) are components of a broader range of ground access options. Importantly, the main form of ground access at the airport, private vehicle pick-up/drop-off, is not charged.

Issue 9.1 Has the pricing behaviour of airports indicated the use of market power in car parking?

Response

The prices for airport car parking are set according to constraint management objectives (to manage traffic flows in the terminal forecourt) and to reflect the locational rent associated with the proximity of the individual car parks to the terminal complex. The costs to users of the different ground access options at the airport are materially different. For example, compared to use of a private vehicle plus a short stay in an airport car park, a taxi could be a relatively expensive option and a bus a low cost option. The cheapest option in many cases will be private vehicle pick-up/drop-off at the terminal forecourt. This mode is not charged to access the forecourt, and represents the main form of ground access to the airport. There is a high level of substitutability between the different ground access modes at the airport and car parking prices at the airport compare favourably to the general level of prices at commercial car parks in the Melbourne CBD (which similarly reflect a locational rent). On these bases, the pricing behaviour of Melbourne Airport does not indicate the use of market power in car parking.

We note public comments made by the ACCC to the effect that CBD car parks are not an appropriate comparator to airport car parks. Melbourne Airport considers them to be appropriate comparators given that CBD locations are generally the only other locations in Victoria that supports stand-alone multi story car parks.

(This Issue 9.1 and Melbourne Airport's response to this issue above is also set out in section 7.2 of this submission)

Issue 9.2 Do the price increases reflect monopoly rent, locational rent (e.g. accounting for the opportunity cost of alternative uses of land dedicated to car parking), or both?

Response

Car parking prices and forecourt access charges reflect the locational rent associated with the amenity of the service provided to users. The amenity value will reflect the benefit the proximity and value to users, based on the location of the car parking facilities and kerbside access near to the airport terminals. Melbourne Airport's market research shows that users place greatest value in ground access services that provide them with time control over the journey to their flight.

Issue 9.3 Are monopoly profits evident for short-term, long-term, or all forms, of parking?

Response

Car parking prices at the airport are generally below prices at commercial car parks in the Melbourne CBD, which similarly reflect a locational rent. They are also competitive with prices applied by off-airport car parks serving the airport in relation to short term stays. Off-airport operations will not be subject to the planning and development processes of the Airports Act and other regulatory arrangements applying to airports. Car parking prices are determined in the competitive context of the broader ground access market.

Issue 20.3 What is the market power of the major airports in relation to car parking prices?

Response

This question is closely related to the issue raised at Issue 9.1 above. Because of the substitutability of the different ground access modes at the airport, Melbourne Airport has limited market power in relation to car parking prices.

9 CONCLUSION

Melbourne Airport welcomes the opportunity to contribute to this inquiry by the Productivity Commission and to respond to the particular issues raised by the Commission's Issues Paper. In this submission, we have sought to respond to each issue raised by the Commission which is relevant to Melbourne Airport.

In responding to the issues raised by the Commission, we also provide comment on recent views about the financial and operating performance of the airport as published in the ACCC's 2009/10 monitoring report. Similar issues have also been raised by the ACCC in its submission to the Commission's inquiry.

On 29 March 2011, the Commission wrote to the Chief Executive Officers of Sydney, Melbourne and Brisbane Airports to invite submissions to respond to the ACCC's views. Accordingly, in addition to providing responses to the Commission's issues, this submission also addresses comments made by the ACCC in relation to the monitored services of Melbourne Airport.

Melbourne Airport's financial and operating performance has been judged to be sound, and in a number of areas, as representing industry best practice by objective research conducted by a recognised expert in the field of airports performance.

The expert concerned, Peter Mackenzie-Williams of LeighFisher Management Consultants, formerly of the UK Transport Research Laboratory, has developed the widely recognised aviation benchmarking publications *Airport Performance Indicators* and *Review of Airport Charges* over a period of over twenty years.

The findings of the research conducted by Peter Mackenzie-Williams are that Melbourne Airport:

- has the lowest aeronautical charges amongst 9 airport Australia-New Zealand sample used in the research study; and

- is amongst the best performers based on a broader sample of 12 international airports across a range of financial and operating performance indicators.

The research also found that Australian airports generally are the most efficient in cost and staff productivity terms and derive the lowest levels of revenue from their airline users. The research report comments that the Australian airports within the broader sample, and Melbourne Airport in particular, evidence industry best practice.

We consider it important for the airport to make a contribution to the inquiry in the light of our view that the current light handed regime has served the industry well and that any move to adoption of a more heavy handed arrangements could unwind the benefits that have accrued since the privatised of the airports, as evidenced by the performance results as commented on above.

Aeronautical services

In relation to the airport's monitored aeronautical services, there are important factors which place the airport's services within a competitive environment.

There is competition between airports for new airline services and there is incentive to win new and additional services given that commercial benefits are derived by airports through increased throughput.

Airlines are able to chose between airports, particularly where they are international carriers looking to deploy long range aircraft (Melbourne Airport's competitors may be airports in Australia and overseas in this context).

Importantly, domestic carriers have the option of using Avalon Airport in serving the Victorian market. Also, Avalon could also be used by international carriers in future. Competition from Avalon Airport was not a factor at the time of the last Commission inquiry.

These factors mean that airlines have countervailing power in relation to Melbourne Airport in their negotiation of access prices, terms and conditions for aeronautical services.

Therefore, market power that may exist is constrained, leaving limited rationale for applying conventional regulation (that is, where it is generally used as a surrogate for competitive market forces, where these are weak or absent).

Further, aeronautical service prices, terms and conditions are set by commercial agreement:

- the charging principles in relation to the commercial agreements are those established under the former regulatory regime and agreed to be the ACCC; and

- the terms of the commercial agreements apply to the provision of aeronautical services to the airlines. These terms apply in place of terms that may be prescribed by regulation.

Accordingly, the benefits that have arisen in terms of industry performance derive from the current contractual framework and while this framework has its foundations in regulatory principles, the airport and airlines are able to negotiate different terms to those that may be otherwise prescribed.

In relation to most airlines using Melbourne Airport, the airport's negotiations are with the airlines as a block, through the Board of Airline Representatives of Australia. This process provides another source of countervailing power of the airlines in relation to Melbourne Airport.

Car parking services

Car parking services provided at the airports are part of a broad suite of access options and the circumstances and characteristics of the different airports have a significant impact on the financial and operating performance their respective car parking services.

Private vehicles provide the main form of access to Melbourne Airport due to the geography of the population base served by the airport and the location of the airport relative to the CBD (of the five major airports subject to monitoring, Melbourne Airport is furthest from the CBD).

The main mode of access is private vehicle pick-up/drop-off at the terminal forecourt. Such private vehicle access is not charged by Melbourne Airport.

Car parking charges at the airport reflect the locational rent associated with the proximity of the car parks to the terminal and high value placed on accessibility by users. This is similar to commercial car parks in the CBD. Car parking prices at the airport are generally below those of equivalent commercial car parks in the Melbourne CBD.

Users generally have options in being able to substitute between transportation modes (hence there are competitive tensions between the modes).

The ACCC makes adverse comments on car parking prices at Melbourne, apparently on the basis of observing a higher percentage of revenues from car parking at Melbourne than at other airports. However, this is a simple consequence of Melbourne's low average revenues on aeronautical services (this is noted by the ACCC in its monitoring report), the effects of mode choice for ground transport as based on the distance of the airport from the main population centre and that the airport has sought to meet user requirements by providing a high number of car parking bays on a per passenger basis.

On the related issue of kerbside access, on which ACCC has also made comment, Melbourne Airport's charges, terms and conditions are determined based on the objective of managing the safe and efficient flows of traffic at the front of the terminal complex, which represents a finite, constrained space.

Such access charges only apply to entities that commercially benefit from accessing the terminal. The charges applied represent a notional amount in the context of the costs of the land journey concerned. For example, the taxi access charge applied by the airport (which is the lowest of the taxi access charges applied by the monitored airports) would amount to less than 5% of the cost of a taxi fare from the airport to the CBD.

The charges, terms and conditions are made available to commercial operators and are signposted at the terminal. Commercial operators seeking to access the terminal can also bilaterally agree to different charges, terms and conditions with the airport.

Recommendations

Quality of service monitoring

A process whereby quality of service monitoring is undertaken on a self administered and reported basis could feasibly apply, given that Melbourne Airport would undertake monitoring in any event as required under its commercial agreements with the airlines, and in meeting the needs of its customers more generally. The self-administered arrangements proposed by Melbourne Airport comprise the following:

- quality of service monitoring would cover the present range of aircraft related services and facilities but also a wider range of passenger-related services and facilities, whether these are provided by the airport operator or another party (service providers in this case would include the airlines and border agencies). This would be based on the airport's current QSM process;

- the monitoring would be undertaken by the individual service providers, who would separately liaise with the Department of Infrastructure and Transport on the development of their methodologies;

- the results of the monitoring would be transparently and readily available to travellers; and

- the airports would publish their monitoring results on their own web-sites and include links to the web-sites of other relevant service providers.

In the interests of ensuring that the airline sector and the community more generally is better informed, changes to the present system are required. In addition to key components from the self-administered arrangements proposed above, Melbourne Airport's proposed amendments to the regulated arrangements would include the following:

- the methodology used to monitor the relevant services and facilities being designed for and tailored to, the circumstances of the individual airport;

- the regulations, or other relevant instrument, should specify the services to be monitored but also the monitoring criteria; and

- the monitoring methodology being designed to meet minimum professional standards.

Prices, costs and profits monitoring

The explanatory power of the financial metrics reported by the ACCC in its monitoring reports is limited, which means that great care needs to be taken before conclusions are reached and reported.

Melbourne Airport's concern with current monitoring arrangements for prices, costs and profits is not with the way in which the data is obtained, but relates to how the data is being

interpreted by the ACCC without appropriate consideration of the characteristics and circumstances of each airport. A consultative process between the regulatory agency and the airports is proposed as means of overcoming problems that have arisen in relation to the interpretation of monitoring results.

If the eventual conclusion of the Commission and the Government is that there remains a need for continued regulation based on monitoring, in the interests of ensuring that the aeronautical sector and the community is better informed about the performance of the monitored airports, inferences should be properly drawn from the financial data collected. To this effect, it is recommended that the ACCC should be obliged to:

- consult with Melbourne Airport (and the other airports) on the relevant section(s) of its draft monitoring reports; and

- if requested by the airport, include the airport's comments on the conclusions being made by the ACCC.

Attachment 1 Melbourne Airport Performance and Charges Benchmarking Study, February 2011, LeighFisher Management Consultants

Attachment 2 Car Parking Benchmarking Study, March 2011, PricewaterhouseCoopers

Appendix 3 Ground Transportation Frequently Asked Questions