Brisbane Airport Corporation Pty Ltd

Submission to the Productivity Commission's Inquiry into Economic Regulation of Airport Services

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11 The Circuit, Brisbane Airport Qld 4007 | PO Box 61 Hamilton Central, Queensland 4007 Australia
T: +61 (0)7 3406 3000 | F: +61 (0)7 3406 3111 | E: info@bne.com.au | W: www.brisbaneairport.com.au
ACN: 076 870 650 | ABN: 54 076 870 650

Executive Summary

The current light-handed regulatory pricing regime originally proposed by the Productivity Commission in 2002 and endorsed in 2007 has been an outstanding success by any measure. In support of this statement our submission highlights the successes of the regulatory regime which in summary are:

Investment

1 Brisbane Airport Corporation is 81% owned by Australian superannuation and similar funds. Airport privatisation has resulted in superannuation funds investing in infrastructure (both equity and debt funding) which has been a goal of successive Australian Governments. Feedback from shareholders and investors is that the current regulatory environment and certainty of return on investments are crucial to their decision to enter this infrastructure asset group.

2 Significant capital investment has occurred under the current regime. Investment at Brisbane Airport in both aeronautical and non-aeronautical infrastructure in the 8 years from 2002 to 2010 has been substantial ($929 million) including:

(a) Domestic long term multi-level car park expansion - $28 million;

(b) International terminal undercover car park - $37 million;

(c) International terminal expansion - $320 million;

(d) New major road access to terminals relieving significant congestion - $220 million; and

(e) Central Parking Area, Stage 1, taxi area - $47 million;

This compares with investment of $116 million in total in the 5 years ended 2002 when airport charges were regulated by the ACCC.

3 Projects currently underway include:

(a) Domestic Common User Satellite expansion, completed March 2011 - $45 million;

(b) Domestic undercover car park, staged completion to early 2012 - $190 million;

(c) Domestic terminal pedestrian access project and road improvements, late 2011/early 2012 - $43 million;

(d) International apron expansion, by 2012 - $29 million;

(e) Domestic apron expansion, staged to 2014 - $77 million; and

(f) Central Parking Area future stages to 2014 - $27 million.

4 Over the next 10 years from 2010 including the projects currently underway, investment is expected to be around $2.6 billion of which $1.3 billion is for the proposed parallel runway. This project is believed to be the first major runway funded by the private sector in the world.

5 This level of investment is unlikely to have occurred under Government ownership or under a strict regulatory pricing environment, where the process of the ACCC setting a regulated price is time consuming and expensive.

6 Any investment carries a certain degree of risk. For infrastructure companies like airports, one of the key risks is regulatory risk – changes to the pricing framework and therefore revenue. The comments in this submission from Standard & Poor's and Moody's demonstrate this point. Regulatory uncertainty is a major barrier to investment in infrastructure around the world.

Growth

7 Jobs on airport have grown from 4,700 when the airport was privatised to 17,000 today and are expected to grow to 50,000 by 2029 (refer Brisbane Airport Master Plan 2009).

8 Passenger numbers at Brisbane have grown from 10.2 million in 1998 to 19.1 million for the year ended June 2010, and are expected to grow to 45.1 million by 2029 (refer Brisbane Airport Master Plan 2009).

9 Brisbane Airport directly contributed an estimated $3.2b in output to the South-East Queensland economy in 2008 (refer Brisbane Airport Master Plan 2009).

Airline Pricing Structure

10 Aeronautical investment has taken place in full consultation and with the agreement of the major airlines using Brisbane Airport under two 5 year Aviation Service & Charges Agreements commencing 1 July 2002.

11 The significant improvements in airport/airline relationships that have developed and matured is in the large part, due to the stable pricing framework (aeronautical/non-aeronautical definition, valuation of assets, building block pricing model, pricing as investment occurs etc.) that has evolved as "shadow regulation" through the earlier ACCC and Productivity Commission involvement. Airlines and airports understand the boundaries for commercial negotiation of prices for complex infrastructure, often with a mix of aeronautical and non-aeronautical uses.

12 Airlines at Brisbane Airport have supported the use of five-year pricing agreements which have given them certainty as to investment in capacity and to pricing. Brisbane Airport has also welcomed this type of agreement as it has been instrumental in maintaining investment level credit ratings, securing investment and debt funding. Risks have been shared between the parties and there has been regular consultation on progress of the investment program. It is now understood from airlines that they wish to change this arrangement in respect of the

proposed runway investment at Brisbane Airport due to the time and cost profile of the project.

The airlines may propose to the Productivity Commission that airport charges should only increase when facilities are available for use as opposed to the current framework where price increases as investment occurs. This is only one element of a complex pricing framework, which includes assets being valued at historic cost for pricing purposes. Infrastructure assets are developed and built over long periods and are long-life assets, and therefore to make the significant up-front capital investment both debt providers and shareholders need to receive a return as the investment is made. BAC does not see the need for any change to accepted guidelines on pricing and would prefer to continue to negotiate this directly with the airlines. If the Productivity Commission sees the need to change one element then a complete review of acceptable pricing framework should be undertaken, which would certainly have the effect of delaying investment, until there was clarity.

13 It should be noted that ultimately it is the passenger, not the airline, that helps to fund infrastructure through increases in airfares as investment occurs, as airport charges are passed directly to the passenger and are clearly stated on ticket prices.

Quality of Service

14 Brisbane Airport has been the highest rating airport for Quality of Service for the last seven years under the ACCC's monitoring. Price and profit monitoring of airport services has revealed no evidence of excessive prices or profits.

15 There has been no dispute with the airlines in relation to Quality of Service at any time since the airport was privatised in 1997.

16 Indeed there has only been one dispute with the airlines under the agreements. This concerned the phasing of prices in response to a changed profile of investment during one period and was resolved by negotiation at management level without the need to use dispute resolution procedures set out in the agreement (which would involve CEOs of each organisation meeting and then independent mediation).

Car Parking

17 BAC considers that car parking prices are commercial and fair, allowing continued ongoing investment. The attached report from KPMG on Brisbane Airport's significantly improved car parking and ground transport facilities demonstrates that BAC's prices and profits in this area are not excessive given the high level of investment.

18 ACCC's allegation that BAC may have deliberately deferred investment in domestic car parking capacity to enable it to put up prices is incorrect, and ignores the recent debt crisis that has held back investment around the world. BAC was already investing in an international terminal expansion ($320 million) and major new roads to the airport ($220 million) in 2007 when debt markets around the world collapsed. In response, BAC's shareholders agreed to cancel proposed distributions effectively injecting the equivalent of

more than $200 million in equity to strengthen BAC's balance sheet and maintain its investment grade credit rating, thereby enabling it to raise debt to fund planned infrastructure.

19 In early 2010 after the major road project was completed and recovery from the GFC was evident, BAC approved the new car park project and commenced the extensive consultation needed for the changes to the road system near the domestic terminal with those affected, including negotiations with Airtrain. The project now underway will provide significant additional capacity sufficient for many years under current growth expectations. This additional capacity will provide BAC with the opportunity to meet demand as well as to compete more effectively with the growing off-airport car park market. This is a significant project and is being delivered in a framework that ensures that shareholders and investors are satisfied and that will provide consumers with convenient and efficient parking facilities.

Competition

20 Brisbane Airport's market power is significantly less than almost all of the major airports in Australia due to competition from Gold Coast Airport and, to a lesser extent, Sunshine Coast Airport. All Queensland airports share high exposure to tourist markets. International and domestic growth at Gold Coast Airport has been higher than Brisbane over the last few years, following their investment in new terminal facilities targeted specifically at lower cost carriers. Jetstar International have chosen to focus on Gold Coast Airport, rather than Brisbane. This is evidenced by the number of international destinations serviced by Jetstar at the following airports:

- Sydney 6
- Melbourne 6
- Gold Coast 5
- Brisbane 1

In this competitive environment it is hard to justify Brisbane Airport and Gold Coast Airport being treated differently from a regulatory perspective. This places Brisbane Airport at a comparative commercial disadvantage.

21 The success of the current regime is reinforced by the fact that airlines in Australia and the region are amongst the most profitable and financially stable in the world. No major Australian airline has got into financial difficulties since deregulation of airport prices in 2002. In 2001, Ansett collapsed and before that Compass Airlines twice. Since 2002 Tiger and Strategic Airlines have entered the domestic market. The number of international airlines flying to Australia continues to increase.

Conclusion

22 Whilst there could be minor improvements to the ACCC's monitoring role, any significant changes to the current light-handed approach that involve more (not less) economic regulation is almost certain to result in reduced investment. Stability in relation to pricing and investment returns is critical to any major investment in long-term infrastructure of this nature.

23 BAC takes its role as a good corporate citizen very seriously and its behaviour is consistent with its own high standards. Given the increased competition with Gold Coast Airport, it is difficult to see why Brisbane Airport should be subject to any specific price or profit monitoring. The processes in the Competition and Consumer Act 2010 would appear to be sufficient to enable airlines to take action if they are concerned about abuse of market power. The threat of re-regulation by the Government, if there is evidence of abuse of market power, is sufficient to control the behaviour of Brisbane Airport.

Contents

1 Introduction

This submission is Brisbane Airport Corporation's (BAC's) formal response to the Productivity Commission's (the Commission's) request for submissions to its inquiry into the economic regulation of airport services (the 2011 Review).

In preparing our response, we have been cognisant of the Government's objectives, as set out in the Terms of Reference for the 2011 Review:

> *"The Commission is to report on the appropriate economic regulation of airport services, including the effectiveness of the price and quality of service monitoring, in achieving the following objectives:*
>
> - *promoting the economically efficient and timely operation, use of and investment in airports and related industries;*
> - *minimising unnecessary compliance costs; and*
> - *facilitating commercially negotiated outcomes in airport operations."*[1]

The Commission's Issues Paper requests further information on a range of issues. In general, this submission focuses on the particular issues of most concern to BAC.

This chapter provides information on Brisbane Airport and its operating environment leading up to this review. The remainder of this submission is structured as follows:

- Chapter 2, which addresses the Commission's specific questions about the current price monitoring regime for aeronautical services and facilities and the outcomes under that regime;
- Chapter 3, which addresses the Commission's specific questions about the car park price monitoring regime;
- Chapter 4, which addresses the Commission's specific questions about the quality of service monitoring for both aeronautical services and facilities and car parking;
- Chapter 5, which discusses BAC's preferences for future regulatory arrangements; and
- Chapter 6, which addresses the Commission's specific questions about the transport linkages at the airport.

The supporting appendices include a copy of a report into car park and landside access at Brisbane Airport that BAC commissioned KPMG to undertake (Appendix A) and a listing of the Commission's specific questions with cross references to the sections in this submission that address each question (Appendix B).

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

1.1 Brisbane Airport

Brisbane Airport is Australia's third largest airport and represents the primary international and domestic gateway into the state of Queensland. In 2009/10, more than 19 million passengers passed through the Airport. The 10.6 million passengers for the recent December 2010 half year represented growth of 7.2% on the previous corresponding period. Since privatisation in 1997, total passengers have grown from 10.2 million to 19.1 million in 2009/10.

Brisbane Airport is located 15 kilometres from the central business district of Brisbane and occupies approximately 2,700 ha (6,672 acres). It has no curfew and therefore the benefit of 24 hour operations.

BAC acquired the 50 year Airport Lease from the Commonwealth of Australia in 1997, covering land and fixed assets, with an option to extend for a further 49 years. BAC owns and operates the international terminals, the common-user domestic terminal, runways, and general aviation facilities. It also owns the domestic terminal, approximately 80% of which is under long-term leases to Qantas and Virgin Blue expiring in 2018. Other airport services, such as air traffic control, customs, quarantine, and immigration, are the responsibility of the Commonwealth Government.

Brisbane Airport is one of Australia's largest airports in area with a network of nine integrated and master planned development precincts with approximately 1,000 ha (out of 2,700 ha in total) suitable for commercial development. BAC is one of the largest commercial landholders in Queensland.

Brisbane Airport services eight domestic airlines and in 2009/10 recorded domestic passengers of 14.9 million, flying to or from 44 domestic locations. Brisbane Airport services 26 international airlines flying direct to or from 31 international destinations and in 2009/10 had international passengers of over 4.1 million.

BAC's vision for Brisbane Airport is to be world-best and the preferred choice for passengers, airlines and businesses. The BAC vision goes beyond the traditional role of the airport, as simply a place to catch a plane, and instead recognizes the way in which the sustainability of aviation, investment, industry, commerce and tourism revolve around integrated and well-planned transport nodes.

Brisbane Airport's strategic location, its curfew free 24-hours a day, 7 days a week operations, its modern infrastructure, its proximity to Asia-Pacific economies, its extensive landmass and decades of visionary planning by all levels of government, positions it well to capitalise on its many advantages.

The Airport is, in itself, now a major business centre, with the offices, infrastructure, facilities, public transport and general amenities of a typical commercial centre. Jobs on airport have grown from 4,700 when the Brisbane Airport was privatised to 17,000 today. Brisbane Airport will increasingly play a vital role within a multi-modal transport nexus of integrated land, sea and air transport connections.

BAC's operations are diverse and comprise four main business segments:

- Aeronautical and Government Mandated Security Operations (aeronautical services and core airport infrastructure);
- Retail and Advertising;
- Parking and Transport Services (car rental concessions, car park facilities and ground transport arrangements); and
- Property Rental Income and Development.

BAC is 81% owned by Australian superannuation and similar funds.

1.2 Investment in services and facilities

The regulatory framework has undergone significant modification since the privatisation (commencing in 1997) of the major airports in Australia. BAC's behaviour towards new investment in services and facilities has been influenced by changes in regulation, although its investment strategy has ultimately been one that allows the corporate vision to be achieved.

Significant investment has been undertaken since Brisbane Airport was privatised. More notably this has amplified since the commencement of the second Aviation Services and Charges Agreement (ASCA) in 2007, with $929 million invested in aeronautical and non-aeronautical infrastructure in the eight years from 2002 to 2010, compared to investment of $116 million in total in the 5 years ended 2002 when airport charges were regulated by ACCC.

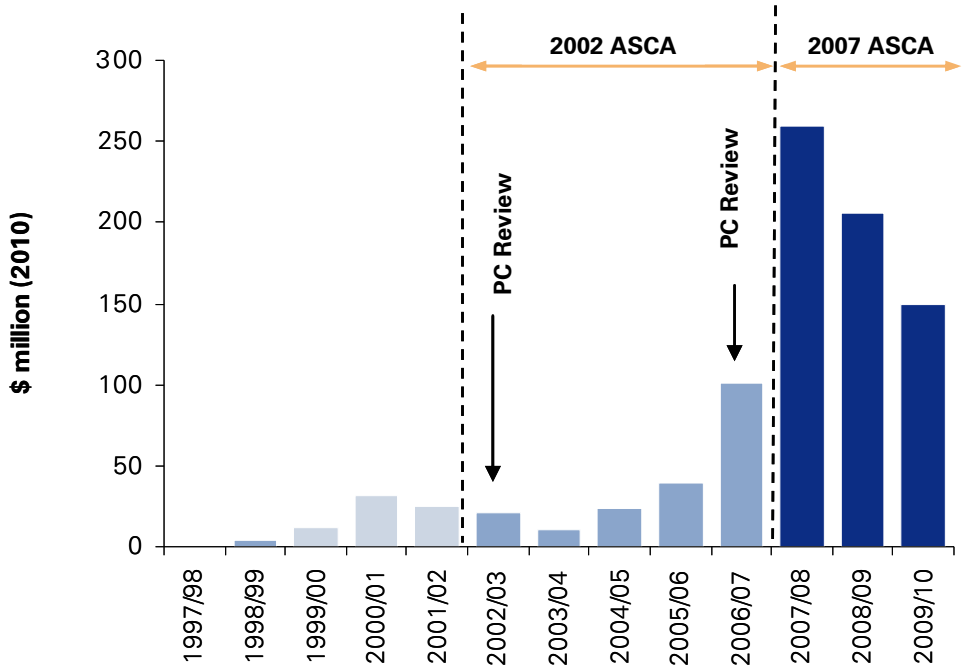
This outcome is consistent with the Government's response to the Commission's 2002 review, in which it stated that the light-handed regulatory framework would:

> *"…provide airports with greater scope to undertake efficient aeronautical investment…"*[2]

Figure 1 below displays the growth in new aeronautical services and facilities investment since the privatisation of Brisbane Airport. For the purpose of assessing the upward trend in investment, three five-year cycles have been identified reflecting the Commission's reviews and subsequent changes in the regulatory framework, and the commercial agreements negotiated between BAC and its airline customers. These are defined as the periods 1997/98 to 2001/02; 2002/03 to 2006/07; and 2007/08 to 2011/2012.

[2] Minister for Transport & Regional Services and Treasurer, *Productivity Commission Report on Airport Price Regulation*, Joint Press Release, 13 May 2002.

Figure 1 Real Annual Capital Investment in Aeronautical Services at Brisbane Airport (2010 dollars)



Source: ACCC Annual Price Monitoring Reports, RBA

The trend in investment at Brisbane Airport reflects the vision that the Commission articulated when it first recommended a light handed regulatory framework for Australian airports. As predicted, the light handed framework has facilitated investment and, in the case of aeronautical investment specifically, this has been agreed with airlines through commercial negotiations.

Other key points with regards to investment activity at Brisbane Airport include:

- Between 1997/98 and 2001/02 real capital expenditure on aeronautical facilities and services totalled $74 million ($2010). During this period, BAC was subject to CPI-X price cap regulation, with price increases for new investment subject to approval by the ACCC through a necessary new investment (NNI) process. However, the onerous and lengthy NNI process ultimately delayed investment at the airport. BAC submitted just three NNI applications during the price cap period, identifying the process to be difficult and time-consuming.

- During BAC's first commercially negotiated ASCA commencing in 2002, capital expenditure escalated to a total of $194 million ($2010). This is more than double the amount invested under the period of price cap regulation. BAC's hefty capital expenditure in aeronautical services since the removal of price cap regulation provided capacity for the growing passenger numbers, improved the quality of service for passengers and the respective airlines, and enhanced the efficiency of operations.

- In just the first three years of the second ASCA (third cycle), investment in additions was almost ten times that of the first cycle, at $615 million ($2010). This was consistent with BAC's forecast, set out in our submission to the 2006 review, that capital expenditure under the second ASCA would grow at a considerably higher rate compared with expenditure under the first agreement. The main expenditure items in the second regulatory period included the International Terminal Building expansion, the Northern Access Road Project and the preliminary stages of the New Parallel Runway.

- It is important to note that the upward trend in investment since the removal of heavy-handed regulation is reflective of long-run efficient investment commitments.

- Capital expenditure forecasts for coming years is even greater and further demonstrates that BAC is committed to substantial investment in aeronautical facilities and services to meet demand.

Airport privatisation and the light-handed regulatory framework has resulted in superannuation funds investing in infrastructure which would simply not have occurred to the same extent under a heavy-handed regulated pricing framework.

More details of the effectiveness of the price monitoring regime in facilitating services and facilities investment, as well as capital expenditure forecasts, are provided in chapter 2.

1.3 Quality of services

Brisbane Airport has consistently ranked highly on the overall level of quality of services provided at the airport, as well as the quality of car parking, compared to the other price-monitored airports. The ACCC price monitoring reports indicate that, amongst the five price-monitored airports, Brisbane Airport ranked:

- highest for overall quality of service at the airport every year since 2002/03, and was the only airport with a rating above "Good" (rating of 4.15, on a scale of 1-5 with 4 representing a rating of "Good") for 2009/10;

- highest for car parking availability in 2009/10 with a rating of 3.94 (just below "Good"); and

- second highest for "time taken to enter the car park" in 2009/10, with a rating just above "Good".[3]

Further information on quality of service at Brisbane Airport is provided in Chapter 4 in response to the Commission's specific questions.

1.4 Aviation Services & Charges Agreement (ASCA)

The first Brisbane Airport ASCA, in operation from 1 July 2002 to 30 June 2007, followed the replacement of heavy-handed price cap regulation with the light-handed price and quality monitoring regime. In anticipation of regulatory change, BAC underwent extensive negotiation and consultation with airport users and appointed an external advisor (KPMG) prior to the Commission's final report for the 2002 review of airport pricing, to scope the terms of the agreement. BAC currently operates under its second five-year ASCA, effective from 1 July 2007 to 30 June 2012, which applied the same process as the first agreement. A copy of the 2007 ACSA is available on BAC's website (see http://bne.com.au/corporate/fees-charges).

For the negotiations on the 2007 ASCA, BAC also used the building block methodology as the basis for determining maximum allowable aeronautical charges. This is consistent with the approach historically applied by the ACCC for NNI decisions and with the regulatory principles currently used by the Australian Energy Regulator (AER). The building block model determines the allowable revenue for aeronautical services as per accepted regulatory principles, with BAC then negotiating with the airlines to reach agreed charges. The terms of the agreement, which are the outcomes of these commercial negotiations, are provided on the BAC website. The 2007 ASCA provides airlines with fixed prices for the five years of the agreement[4], while BAC bears the risks associated with variations in actual capital expenditure, inflation and demand from the forecasts used in the building block model.

BAC consults extensively with airport users on airport development needs and effectively translates this into prices. Further, the revenue model and demand forecasts are provided to the airport users as part of the negotiations, thereby providing transparency of the methodology used.

BAC believes that dispute resolution should be a matter for services agreements between the airports and the users, as would be the case in any commercial agreement between two parties. The 2007 ASCA has a clear dispute management processes in place. The process outlined in clause 22 of this agreement is as follows:

1 Referral to management committee;

- If the parties are unable to resolve an issue within 14 days, either party may refer the issue to the Management Committee, generally comprising two senior executives of each party.

2 Management Committee meets;

- The Management Committee must meet at least twice within 14 days of having the issue referred to it.

3 Failure to agree;

[4] Subject to some exclusions. For example, major projects that still have some uncertainty as to timing and scope may be excluded from the pricing agreement, with aeronautical charges specific to those projects negotiated subsequent to the ASCA.

- If the issue remains unresolved for 60 days after the Management Committee has met, either party may refer the issue to the Chief Executive Officers (CEOs) of the parties.

4 Referral to CEOs; and

- The CEOs must meet within 14 days of the issue being referred and discuss the issue in good faith with a view to resolving the issue.

5 Independent Mediation.

- If the issue is unresolved 60 days after the CEOs have met, then the parties agree that the issue will be referred for independent mediation under the rules for mediation used by the Australian Commercial Disputes Centre in Brisbane, Australia.

There has only been one dispute between BAC and the airlines under the agreements and that was resolved by negotiation at management level without the need to use dispute resolution procedures set out in the agreement This dispute resolution mechanism is available to either party and agreed to by both parties in the ASCA.

BAC has recently initiated discussions with airport users for the next Aviation Services and Charges Agreement, scheduled to commence on 1 July 2012. We have again applied the commonly accepted regulatory principles to determine indicative charges for negotiation purposes.

Given the success and effectiveness of the current arrangements, BAC is keen to see the continuation of a light-handed regulatory framework.

2 Current price monitoring regime

This chapter provides responses to specific questions about the current price monitoring regime for aeronautical services and facilities.

2.1 Basis for aeronautical charges

The Commission is seeking feedback on the outcomes under the current price monitoring regime. Specifically, the Commission seeks responses to the following questions:

> *Is there evidence that the price monitored airports have increased charges by more than could be justified on the basis of costs, new investment requirements, and/or other enhancements to service quality? What is the ability of airports to vary prices year on year given many have long term contracts with airlines?*

Current charging basis

BAC sets prices for their aeronautical services based on commercial negotiations with the respective airlines. These negotiations generally follow the process described below.

1 As a starting point for these negotiations, BAC estimates the charges by using a building block model, applying the methodology which was previously adopted by the ACCC, and which is currently used by the Australian Energy Regulator (AER). Before any capital expenditure is undertaken, BAC undertakes extensive consultation with the airlines to agree on the necessity, scope and scale of the investment and the proportion of the investment which should be classified as aeronautical and thus included in the aeronautical asset base.

2 BAC engages an independent advisor to estimate the required rate of return. This analysis is conducted in line with regulatory best practice, and often relies on precedents from Australian regulators for individual parameters.

3 BAC then provides the building block model to the airlines, rather than just providing the prices calculated by the model. In this model, most of the capital expenditure is described on a project by project basis, with the only exception being minor works which are commonly grouped together.

4 Face-to-face meetings are then held between BAC and the major users to walk through the analysis undertaken.

5 Initial feedback is then sought from the major users.

6 BAC then invites all major users for a one day workshop where BAC and the users can openly discuss any aspect of the pricing methodology used.

7 After this workshop, BAC finalises the inputs into the building block model.

8 Finally, from these indicative prices, BAC can finalise the negotiations with the airlines.

This process has resulted in agreed prices for aeronautical services that are lower than that estimated by the building block methodology.

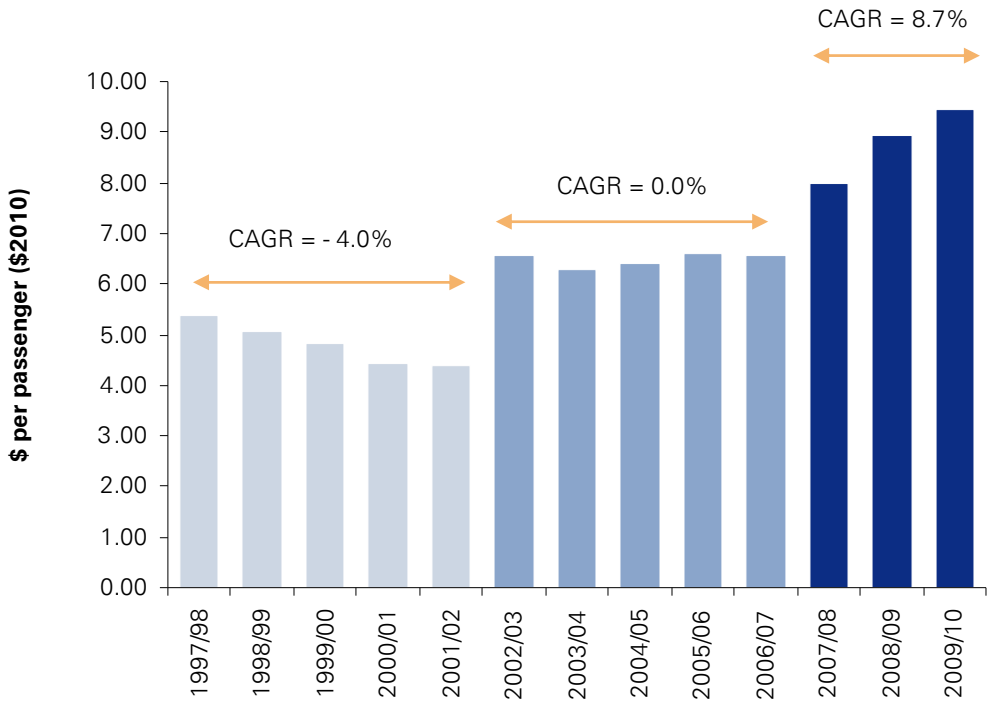
Therefore, in relation to the whether BAC has increased charges by more than can be justified on the basis of costs and investments, it is clear that this is not the case as the current charges are lower than what can be justified by the building block model for the given asset base (and the asset base has been agreed to by the airlines and so cannot be claimed to be excessive).

Additionally, these charges are negotiated for a five-year pricing period, similar to many price regulated entities. Thus, BAC is very limited in the ability to vary prices on a year-to-year basis.

Despite current charges being lower than that required to earn a reasonable return, the ACCC price monitoring reports often quote a high figure for the increase in aeronautical revenue per passenger since 2001/02. For example, the ACCC submission to this inquiry states that aeronautical revenue per passenger has increased by 154% since 2001/02. BAC believes this is misleading as it includes the adjustment from the inefficiently low prices inherited from the FAC to prices that more accurately reflected the cost of service provision. Furthermore, the price increase needs to be considered in light of the investments made by BAC.

The following chart presents the real average aeronautical revenue (i.e. aeronautical revenue per arriving and departing passenger) from 1997/98 to the present.

Figure 2 Real Average Aeronautical Revenue, 1997/98 – 2009/10 (2010 dollars)

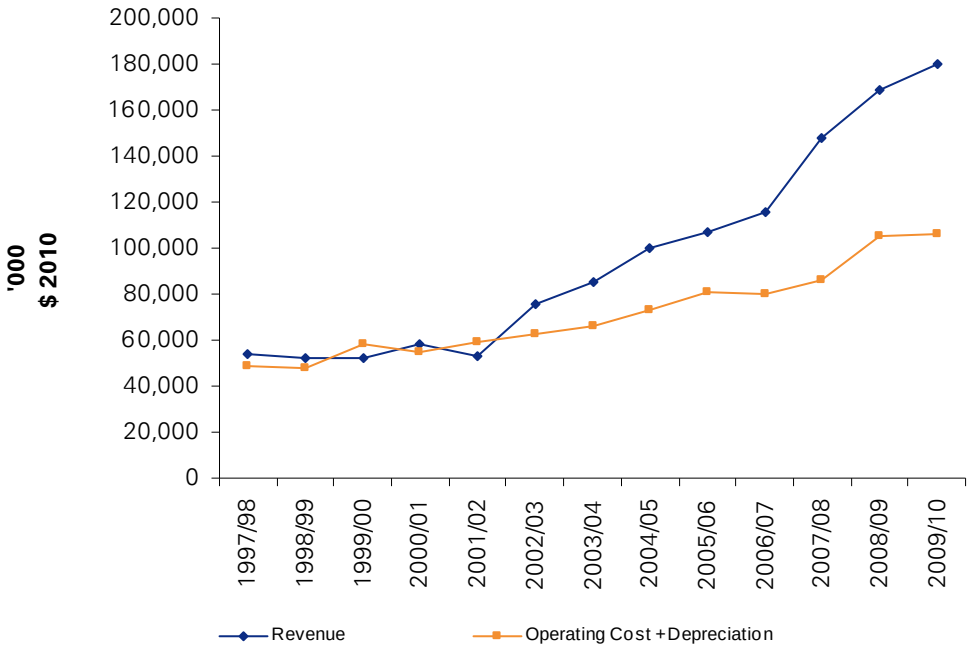


Source: ACCC Annual Price Monitoring Reports

It has been accepted by the Commission and the ACCC that the prices during the price cap period (1997/98 – 2001/02) were inefficiently low, and therefore BAC had the opportunity to increase prices to more cost reflective levels as part of the second regulatory period (2002/03 to 2006/07). The price path that BAC negotiated with the airlines at that time was below the charges that were justified based on the building block modelling and provided for annual CPI increases only.

BAC agreed a price path approach where the price gradually increased to reflect full cost pricing over a longer period to minimise price shocks on passengers. This is illustrated by the figure below which shows the total aeronautical costs and revenues at BAC from 1997 to the present.

Figure 3 Real Aeronautical Revenue and Cost, 1997/98 – 2009/10 ('000 2010 dollars)



Source: ACCC Annual Price Monitoring Reports, RBA

As shown above, the margin between the revenue and costs (operating cost plus depreciation, excluding return on assets) was very small or negative during the period following privatisation, reflecting the inefficiently low FAC prices and consequently the low rate of return achieved by BAC. Over time, prices have moved closer to achieving a commercial rate of return and this is reflected in the increasing margin between revenue and costs.

In addition to accepting a lower rate of return, BAC also took on the commercial risks under the agreements negotiated with the airlines. Specifically, the prices agreed with the airlines for the current agreement are fixed for the agreed capital expenditure program, with no review triggers

for changes in, for example, demand and inflation. Thus, BAC bears all the risks of a demand shock under the current agreement, and indeed there has been a number of industry shocks in the period since deregulation, including the Bali bombings, the war in Iraq, the SARS epidemic, the GFC and more recently the natural disasters in Australia, New Zealand and Japan.

Pricing principles

BAC is cognisant that the airlines are seeking to adopt alternative pricing principles in light of the scale of major aeronautical investment at Brisbane Airport commencing in the next pricing period (i.e. commencing 1 July 2012). Specifically, the airlines are seeking to have the investment in the New Parallel Runway at Brisbane Airport recognised in the aeronautical asset base when it is commissioned. Under the current pricing principles adopted and previously agreed with the airlines, capital expenditure is incorporated into the aeronautical asset base as it is incurred.

An outcome of the transition from price regulation to the current light-handed regulation and price monitoring regime for major Australian Airports has been clarity around acceptable pricing methodology. A benefit of the current regime is that it allows commercial negotiation and agreements around a framework which is clear to both airports and airlines. Amongst other parameters, this building block approach allows an outcome where pricing is based on (effectively) historic written-down asset values (line in the sand) plus capital investment as it occurs (and as agreed). Importantly, pricing is a matter for commercial negotiation between airports and their users, and how closely final prices reflect theoretical prices is a matter for determination between those parties.

The issue of when capital expenditure is recovered from airport users may be contentious, as there are clear incentives for airports to continue to seek for "funding as investment occurs" whilst there are also clear incentives for airlines to argue for recovery of capital costs once the asset is commissioned.

The main argument against "funding as investment occurs" is that it is economically inefficient because it means that users are paying for assets that they are not yet able to use and current users of the airport are cross-subsidising future airport users. This argument is not supported theoretically or practically. Alfred Kahn[5] 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 suggested, in that charging for capital expenditure projects is based on long run incremental costs (including return on asset, return of asset and marginal operating expenses). The airport essentially sets users charges that allow existing assets to earn a fair return on investment, but also new discrete projects to earn that same return

[5] Alfred E. Kahn was a well respected regulatory economist who excelled in both academia and government. Roles which he held include the Chairman of Civil Aeronautics Board (CAB) in America, Professor of Political Economy at Cornell University and Special Consultant to National Economic Research Associates. He was also the author of *The Economics of Regulation*.

by charging an increment to the base charge, where this is agreed with the airlines. This is essentially the same "Necessary New Investment" methodology agreed to and applied during the initial regulatory period post-privatisation. Specifically, the ACCC noted in its April 2000 Position Paper:

> *"A criticism levelled at the Commission's draft position paper is that the definition it proposed biases investment decisions of airport operators to capital rather than operating or maintenance expenditure. The view was expressed that the Commission's approach anticipated only capital expenditure and only in a single period. The Commission does not maintain such an approach should be adopted."*

and

> *"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"*[6]

The approach referred to by the ACCC above with regard to the "BACL draft decision" has been the same "funding as investment occurs" approach consistently applied to all capital expenditure projects at Brisbane Airport. Consistent with the view of the ACCC, the main advantages of "funding as investment occurs" are that it:

- allows for a **smoother transition of prices** – by allowing prices to gradually increase as work is undertaken on the capital expansion, it allows the prices to build up steadily over the time period of the construction. If the asset is only added to the asset base for pricing purposes upon completion there could be a sudden, and significant, increase in prices. A smoother transition to higher prices allows customers to gradually adapt to the higher prices; and

- allows for **risk sharing** – "funding as investment occurs" enables the risks of the project to be shared between those parties that ultimately benefit from the project, i.e. the airport owners through returns on the asset and airlines through availability of additional capacity.

There are numerous jurisdictions that accept this principle as an appropriate methodology for setting airport charges, including the United Kingdom. For example, in their submission to the 2003 price review, BAA applied for funding as investment was incurred for a major new investment, namely Terminal 5 at Heathrow. Whilst key users objected to this approach, the CAA noted that it and the Competition Commission have both *"… come independently to the view that prices need to be able to rise at Heathrow to fund the investment programme"*.[7] The Competition Commission maintained that *"some addition to revenue while assets are being constructed remains necessary to secure funding for a major project and / or reduce the costs of*

[6] ACCC, New Investment Cost Pass Through, Position Paper, April 2000
[7] Civil Aviation Authority, *Economic Regulation of BAA London Airports (Heathrow, Gatwick and Stansted) 2003 – 2008*, CAA Decision, February 2003, p. vii.

financing".[8] Furthermore, it noted that an allowance for a return on investment during the course of construction:

- was desirable to avoid volatility in prices, which airlines have previously indicated they disliked; and

- reflected what would be expected to occur in competitive markets, with pressure on prices as capacity constraints arise.

In addition, the International Civil Aviation Organisation (ICAO) *Airports Economic Manual* advises that:

> *"… pre-funding[9,10] should only be applied where aircraft operators will benefit by the provision of needed, improved or lower cost service which could not otherwise be provided because regular sources of financing are insufficient and it is not possible or it is too costly to access capital markets".*[11]

Further, the 2009 edition of *ICAO's Policies on Charges for Airports and Air Navigation Services* also allows for "pre-funding".[12] Specifically, it states that "pre-funding" may be applied where it is the most appropriate means of financing long-term, large-scale investment, provided the following safeguards are in place:

1 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);

2 Comprehensive and transparent accounting, with assurances that all aviation user charges are, and will remain, earmarked for civil aviation services or projects;

3 Advance, transparent and substantive consultation by airports and, to the greatest extent possible, agreement with users regarding significant projects; and

4 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:

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[8] Competition Commission, *BAA plc: A report on the economic regulation of the London airport companies (Heathrow Airport Ltd, Gatwick Airport Ltd and Stansted Airport Ltd)*, 2002.
[9] ICAO uses "pre-funding" to describe both the "funding before investment occurs" and "funding as investment occurs" approaches.
[10] 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
[11] ICAO, *Airports Economic Manual*, Second Edition, 2006, p. ATT 6-1.
[12] 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.

- 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 (PFC) 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 for both small and large 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. It is not appropriate to suggest alternative arrangements just because the scale and scope of various new projects being contemplated are more substantial than previously considered.

The airlines often refer to the current approach of "funding as investment occurs" as "pre-funding", consistent with ICAO's definition of the term. However, BAC believes this may be misleading, as it is not seeking to have investments funded before any outlays are made.

BAC also notes that this is only one element of a complex pricing framework, which includes assets being valued at historic cost for pricing purposes. Infrastructure assets are developed and built over long periods and are long-life assets, and therefore to make the significant up-front capital investment both debt providers and shareholders need to receive a return as the investment is made. BAC does not see the need for any change to accepted guidelines on pricing and would prefer to continue to negotiate this directly with the airlines. If the Commission sees the need to change one element then a complete review of acceptable pricing principles should be undertaken, which would certainly have the effect of delaying investment, until there was clarity.

2.2 Legacy FAC prices

As noted above, the FAC prices that applied when the airports were first privatised were insufficient to provide a reasonable rate of return. The Commission is now seeking to understand whether this pricing legacy is still affecting pricing:

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

When the airports were leased to private operators in 1997, the previous Federal Airport Corporation (FAC) prices were used as the base for the first five-year price cap period. No asset revaluations were undertaken at this time and so the charges bore little resemblance to the underlying value of the assets utilised by the airlines. Furthermore, the FAC starting prices did not take into account the existence of inefficient cross subsidies between the profitable non-

aeronautical activities and the (at that time) non-profitable aeronautical activities, as well as the cross subsidies between airports as a result of the FAC's network approach to pricing. The Commission recognised this issue in the 2002 review, stating:

> *"the starting prices for the price caps were not adjusted by the FAC or the regulator to remove economically inefficient cross subsidies and hence are unlikely to be a good basis for efficient pricing"*[13]

This problem was further exacerbated by the ACCC selecting inappropriate X-factors during the first regulatory period, inconsistent with advice provided to it.[14]

Therefore, at the commencement of the second regulatory period in 2002, the airports were allowed to revise up their charges to make them more reflective of the asset base and operational expenditure requirements. Whilst some airports made this change instantaneously at the beginning of the pricing period, BAC agreed a five-year price path that applied a relatively modest initial price increase and gradually lifted charges thereafter to minimise price shocks to consumers.

In the third regulatory period, BAC's charges are approaching levels that reflect the line in the sand asset values and true operational expenses, so that a reasonable rate of return is now being earned. This means that the impacts of the FAC pricing legacy have disappeared.[15]

2.3 Effectiveness of the price monitoring regime

BAC considers that the current regulatory regime has generally been successful in achieving the Commonwealth Government's stated objectives of:

- *"promoting the economically efficient and timely operation, use of and investment in airports and related industries;*
- *minimising unnecessary compliance costs; and*
- *facilitating commercially negotiated outcomes in airport operations."*[16]

The regulatory framework recommended by the Commission in 2002 and subsequently adopted by the Commonwealth Government has promoted efficient investment and facilitated commercial agreements between BAC and the airlines. However, there are some important improvements that could be made to minimise unnecessary compliance costs and improve the quality of the annual reporting on airport performance. Specifically, there are significant issues

[13] Productivity Commission 2002, *Price Regulation of Airport Services*, Inquiry Report, January, p.226.
[14] Further information on this matter was included in BAC's submission to the 2002 inquiry. See: BAC 2001, *Brisbane Airport Supplementary Submission to the Productivity Commission Review of Price Regulation of Airport Services*, 18 July 2001.
[15] BAC notes that there are still some non-aeroanutical contracts in place that it inherited from the FAC when it acquired Brisbane Airport in 1997, such as the domestic terminal leases.
[16] Productivity Commission 2011, *Economic Regulation of Airport Services*, Issues Paper, January, p.ii.

with the data and methodology used for both the price monitoring (see section 2.5) and quality of service monitoring (see section 4.3).

The Commission seeks responses to the following specific questions on the effectiveness of the price monitoring regime:

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

Has the price monitoring regime promoted efficient investment and facilitated commercially negotiated outcomes? How would it compare relative to counterfactuals of explicit price regulation, or no regulation? Does the information emerging from the price monitoring process assist commercial negotiations between airports and their customers?

Constraints on aeronautical charges

There are three key factors constraining the aeronautical charges at Brisbane Airport, namely:

- The threat of re-regulation. BAC is conscious that abuse of market power could lead the Government to return to price cap regulation;

- The countervailing market power of airlines. The oligopolistic nature of the airlines, especially in the domestic market, provides strong incentives for BAC to reach commercially negotiated arrangements. The threat of the airlines to increase their usage of rival airports, most notably the Gold Coast, is a very real threat to BAC; and

- Increasing competition from other airports, particularly Gold Coast Airport. In recent years, the average annual growth in domestic passengers using the Gold Coast Airport has been significantly higher than the growth rate for domestic passengers at Brisbane Airport. As a result, Gold Coast Airport is increasingly capturing a greater share of the South East Queensland market for domestic passengers. Similarly, Brisbane Airport competes with both Sydney, Melbourne and Gold Coast Airports for incremental international routes.

These constraints on BAC's pricing behaviour are discussed further in Chapter 5.

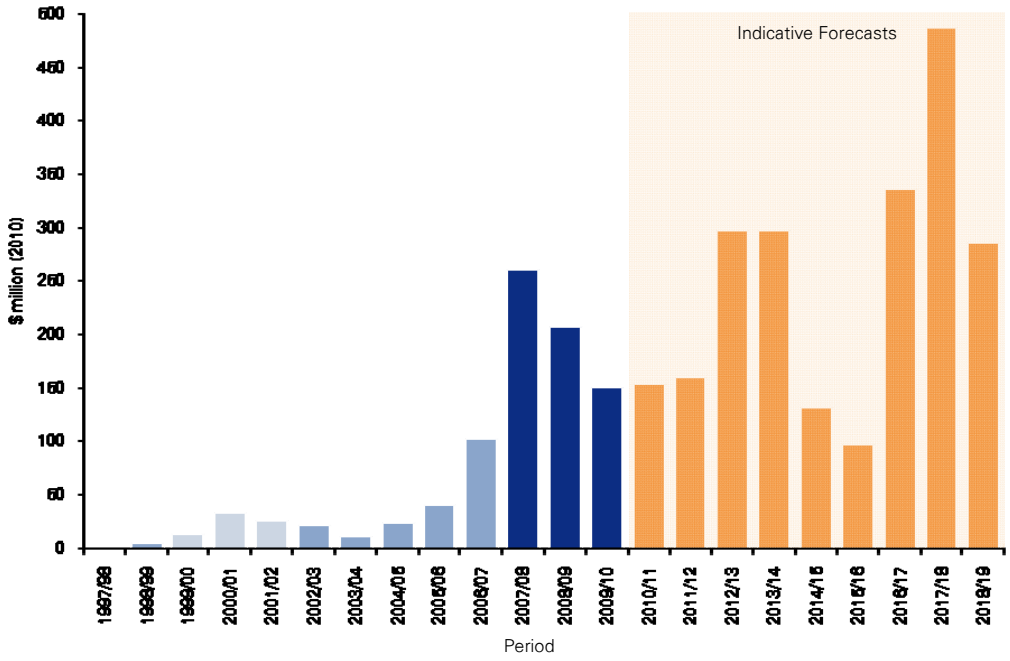
Promotion of efficient investment

There has been an efficient level of investment at the Brisbane Airport under the price monitoring framework. BAC undertakes extensive consultation with the impacted stakeholders, including the airlines, to determine the scope and scale of capital investment. This consultation also includes agreement on the proportion of the investment which can be classified as aeronautical and thus included in the aeronautical asset base. Therefore, BAC does not have the opportunity to 'gold plate' its provision of infrastructure.

The capital investments made by BAC represent sunk costs—that is, the cost is then fixed and the investment cannot be reversed. These investments are generally in long life assets, and have considerable lead times. The nature of these investments is such that BAC takes on demand risk, which means that it bears the risk of airlines changing their route selection. This adds further incentive for BAC to negotiate prices that are acceptable to the airlines.

The graph below shows the real capital investment in aeronautical facilities made by BAC in the years since privatisation. It can clearly be seen that investment by BAC in the period of price monitoring (2002 onwards) has exceeded that evident under the previous price cap regulation. Since 2006, this has increased further and is expected to continue with the development of the New Parallel Runway at Brisbane Airport. BAC is committed to continued efficient investment in the aeronautical facilities and services at Brisbane Airport.

Figure 4 Real Aeronautical Capital Expenditure at Brisbane Airport, 1997/98 – 2018/19 (2010 dollars)



Source: ACCC Annual Price Monitoring Reports, RBA, BAC

Facilitation of commercially negotiated outcomes

BAC has made a concerted effort to keep negotiations with its airline customers positive, which has had a large influence on the overall effectiveness of the regime in achieving its outcomes.

The ever present threat of the imposition of a heavier handed form of regulation is one reason why BAC runs an open and transparent negotiation process with the airlines quite apart from the fact that BAC sees such a process as good business practice regardless of regulatory status. Indeed, BAC's values are based on taking a commercially responsible approach to negotiations, as has been demonstrated in negotiations with the airlines to date. BAC is aware that abuse of market power could lead Government to a return to price cap regulation. The fact that BAC and the airlines have so far not had the need to the resort to independent mediation shows that these negotiations are able to reach a mutually satisfying conclusion for both parties, without any requirement for a heavier handed regime.

It is also important to note that BAC has recently commenced negotiations with the airlines for the next aviation services and charges agreement (to commence on 1 July 2012). BAC expects

that these negotiations will again result in an acceptable outcome for all parties without the need for independent mediation.

Usefulness of price monitoring information

BAC believes that the information presented in the price monitoring reports does little to facilitate commercial negotiations with the airlines. To date, BAC has successfully negotiated two 5-year agreements and, as detailed previously, this is an open and transparent process. By providing a copy of BAC's building block model to the airlines, the airlines have extensive details about the asset base, capital expenditure, asset base roll-forward, operating expenses, depreciation, WACC and demand forecasts on which BAC bases its negotiations. Thus, the rate of return used is known to the airlines.

Price monitoring reporting could be useful for demonstrating how actual capital expenditure, operating expenditure and demand have tracked the forecast used in the building block model, as variations in these would lead to changes in the actual rate of return earned.

However, the price monitoring reports confuse the matter by presenting information that is not relevant. For example, the ACCC reports on rates of return on and additions to, the statutory aeronautical asset base as well as the "line in the sand" asset values. This has previously caused confusion by readers of the report as assets in the statutory accounts may be revalued periodically in accordance with accounting standards. However, revaluations are not permitted for price monitoring purposes. Section 2.5 below provides further information about the concerns that we have with the price monitoring data and methodology.

2.4 Effectiveness of the "line in the sand" approach

The Commission is seeking feedback on the use of the "line in the sand" asset valuations under the current price monitoring regime. Specifically, the Commission seeks responses to the following questions:

> *Has the 'line in the sand' for asset valuations been effective or have airports, airlines or other users encountered problems with this approach? Should the line in the sand be extended to other airports? Is there a better alternative approach?*

BAC accepts that the "line in the sand" approach has merit in that it reduces the scope for disagreements in the negotiations between the airports and airlines. Conceptually however, BAC also recognises the approach puts added financial burden on the airports compared to airlines as it bears the replacement cost/risk that building and engineering production costs grow at rates greater than CPI over the life of the asset. Further, this introduces some confusion in the reporting of financial results from both the airlines' and other stakeholders' perspectives. This also results in increased costs for the airports as BAC is required to maintain two asset registers. BAC, like the other regulated airports, maintains a separate asset register for its statutory accounts in which it may revalue assets in line with Accounting Standards.

BAC's main concern about the use of the "line in the sand" methodology is how the line was drawn in the first instance. All airports were required to adopt the aeronautical asset values as

reported to the ACCC for 2004/05, irrespective of the asset valuation policies that may have been applied to arrive at those values. Thus, the asset valuation methodologies adopted for the line in the sand valuations differ between airports, depending on the valuation that was used in that year. BAC believes that a more equitable approach would have been to adopt a consistent valuation methodology across all the airports. The preferred valuation approach to adopt would have been the Depreciated Optimised Replacement Cost (DORC) approach. However, the proportion of the assets for which the initial line in the sand value is used is decreasing as more assets are added into the aeronautical asset base. Therefore, this issue has decreasing importance over time.

Regardless of the above, BAC does not have any significant issues with the use of the line in the sand approach at the moment. The confusion for key stakeholders arises predominantly from the reporting of rates of return based on both the values recorded in the statutory accounts and the regulatory accounts, and BAC would prefer to see the scope for this confusion minimised.

2.5 Price monitoring data and methodology

The Commission is seeking feedback on the adequacy of the current price monitoring methodology. Specifically, the Commission seeks responses to the following questions:

> *How adequate are the data in the ACCC's price (and quality) monitoring reports for judging the effectiveness of the monitoring regime? Are the regulatory accounts provided by the airport operators sufficient to reveal monopoly pricing and rates of return? Are there material gaps or limitations in that data and can they be practically remedied? What other data sources should the Commission use in its assessment of the price (and quality) monitoring regime?*
>
> *Are the ACCC's monitoring methodologies appropriate? Is there adequate consultation with the monitored airports?*

Direction No. 29 under the *Competition and Consumer Act 2010* defines the scope of the ACCC's role in the regulation of airport services as the monitoring of "*prices, costs and profits related to the supply of aeronautical services and facilities*" by the five major airports.[17]

The purpose of the ACCC's formal monitoring role is to identify whether airports are exerting market power in their dealings with airlines and other customers and earning monopoly prices or rates of return on aeronautical services and facilities.

Lack of analytical framework

In order to determine whether prices or rates of return for aeronautical services are excessive, the ACCC should:

- describe an analytical framework to establish what may or may not be efficient long run costs; and

[17] Commonwealth of Australia, Direction No. 29 under the *Trade Practices Act 1974*, now consolidated into the *Competition and Consumer Act 2010*.

- then undertake a comparison of airport prices and revenues within this framework and draw conclusions on this basis.

At a minimum this would require an understanding of comparable returns in similar sized airports in other jurisdictions. In carrying out such a benchmarking exercise, the ACCC would however need to take careful account of factors that could influence the rate of return earned such as risk profile, ownership structure, stage in investment cycle, regulatory regime, and level of competition faced.

Without an analytical framework guiding the analysis, the ACCC's report makes a number of inferences or conclusions without appropriate commentary or reference to what the analysis demonstrates in relation to efficient prices or returns. For example, the ACCC notes the monitoring results do not provide conclusive evidence as to whether or not the airports are earning monopoly rents, but then suggests the monitoring results point to one airport earning monopoly rents from services provided to airlines.[18]

A well thought out and expressed rationale for how the ACCC determines whether rates of return are excessive would assist readers to interpret the ACCC's findings. This should be supported by ACCC research into comparator businesses and broader contextual information, which is a current gap in the ACCC's monitoring reports.

Issues with reporting and methodology used

In addition to the lack of an analytical framework, a number of reporting and methodological issues previously raised by BAC in submissions to the Productivity Commission and ACCC continue to be problematic.[19]

Analytical period – The ACCC continues to produce misleading analysis by reporting price increases under the price monitoring regime from 2001/02 – the final year of the first regulatory period when prices bore no resemblance to what they should have been (see section 2.2). As noted in section 2.1, BAC introduced a staged approach from 2001/02 to increase its landing charges to reflect a fair return, given the inefficiently low prices which were prescribed in the first regulatory period. Whilst the ACCC continue to present the results in this manner, BAC's concern will persist with regards to the misleading impact that such a method produces. The most recent example of this is in the ACCC submission to the current Issues Paper, specifically in Box 2.1 on page 5 of that submission.

Scope of reporting - The ACCC notes that whilst it is not required to monitor non-aeronautical services, it considers it appropriate to report on total airport revenue, costs and profits due to difficulties in allocating costs and revenues between aeronautical and non-aeronautical services and the complementarity between services.[20]

[18] ACCC, *Airport monitoring report 2009-10: Price, financial performance and quality of service monitoring*, January 2011
[19] BAC is able to provide copies to the Commission of its previous submissions to the ACCC on this matter, if required.
[20] ACCC, Ibid, p. 10

BAC's submission to the 2006 Productivity Commission review of airport regulation highlighted the following flaws in the ACCC's reasoning:

- The "difficulties" argument is contradictory, as it suggests that the ACCC does not accept its own regulatory accounting guidelines. These are the guidelines used by the airports to undertake regulatory reporting; and

- The "complementarities" argument is irrelevant on the basis the Government has directed a "dual till" approach to airport regulation.

BAC again considers that the ACCC has presented on performance issues beyond its brief.

Profit measures - Return on equity calculations are acknowledged by the ACCC as being "of limited value". However it continues to be calculated and reported upon. Furthermore, commenting on return on equity for the airport as a whole is outside the scope of Direction No.29.

The cumulative effects of the lack of a proper framework and commentary on items outside of the ACCC mandate, is that the ACCC reports present an overly negative view of a system which is working well.

Minimising the compliance burden

Consistent with better regulation principles, the cost of regulation should not outweigh the benefits.

Preparing separate financial accounts and statements for submission to the ACCC is onerous, as demonstrated in section 2.7. Further, it is not apparent whether the ACCC effectively uses the additional detailed information it requests from airports. For example, BAC provides information about the rate of return on its car parking and landside access business, which is not included in the price monitoring report.

Consultation with airports

The ACCC provides BAC, and the other regulated airports, with extracts from the draft Price Monitoring reports prior to finalising and releasing the reports. However, the airports are not provided with the overview section of the report which details the majority of the ACCC's commentary. Further the airports are asked to comment specifically only on the factual accuracy of the information.

This approach deprives the airports of the opportunity to provide the ACCC with further insight into the interpretation of the factual results. Indeed, BAC has previously provided comments on the interpretation of the facts contained in the excerpts which BAC receives, however these comments are not reflected in the report, nor published in any form.

The ACCC commentary about Brisbane Airport potentially earning monopoly rents on its car parking business was excluded from the draft report provided to BAC. As a result of this, BAC

did not have the opportunity to provide comments to the ACCC about these claims until after the final report was published.

BAC believes that a more consultative approach to the reporting of these results would increase the robustness and reliability of the conclusions contained within the reports. Furthermore, additional explanatory commentary provided by airports should be included in the price and quality monitoring reports.

2.6 International comparisons

The Commission is seeking feedback on the use of international airports as comparators. Specifically, the Commission seeks responses to the following questions:

How do recent charges for aeronautical services at the price monitored airports compare with those at comparable international airports? What conclusions can be drawn from international comparisons of airport performance?

There are significant difficulties in drawing meaningful comparisons between Australian and international airports. These arise due to the different environments in which airports operate. Some key areas where airports typically differ include:

- Whether they operate on a single or dual till basis;
- Whether they are regulated and, if so, the form of regulation applied;
- The respective operating model (i.e. whether the airport has a mandate to earn a commercial return);
- The asset profiles (i.e. the age of the assets and hence the value of depreciation in the cost stack that makes up the charge);
- Whether the airports service predominantly origin and destination passengers or transit passengers;
- The size of the airport (i.e. number of passengers);
- The degree of competition evident in the individual airport's markets;
- Cost of labour;
- The health of the local economy; and
- The rate of passenger growth.

These differences make it extremely difficult to find a range of airports to compare the Australian airports with internationally. Comparing airports which do not align on at least the majority of the above characteristics is problematic, will likely result in misleading conclusions,

and is therefore considered to be of limited benefit. On the other hand, determining a group of airports which are sufficiently similar to the Australian airports on the above criteria might be beneficial in revealing the relative costs of each airport.

BAC therefore believes that there are only limited benefits in extending any comparisons undertaken to international airports, and that any comparisons which are undertaken would need to be carefully considered to ensure that they are like-for-like comparisons.

While international comparisons are of limited usefulness from pricing perspective, from an operational perspective international comparisons may provide useful information.

2.7 Price monitoring compliance costs

The Commission is seeking information on the cost of regulatory compliance. Specifically, the Commission seeks responses to the following question:

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

Compliance with the obligations under the price monitoring regime does impose costs on BAC, and the other regulated airport operators. These costs fall into a number of categories, including:

- Maintaining additional accounts;
- Completing the annual regulatory accounts and price monitoring templates for the ACCC;
- Responding to ACCC queries and draft reports; and
- Undertaking quality of service surveys.

Although it is difficult to quantify the cost of these activities as compared with the costs that would be required under an unregulated structure, our analysis indicates the costs amount to approximately $150,000 - $200,000 per annum, including internal staff, quality of service surveys and audit costs.

However, the regulator should be concerned with minimising unnecessary impositions on the airports, as this will inevitably flow through to higher prices for consumers. The ACCC should only be collecting information if it helps to inform the negotiations with the airlines, as outlined in section 2.5 of this submission. This will help to minimise the impost of the regulatory regime on airports, whilst not detracting from the outcomes.

3 Car parking price monitoring regime

This chapter provides responses to specific questions about the current price monitoring regime for car parking services and facilities. To inform our response to the Commission, BAC engaged KPMG to undertake a study into car parking and landside access at Brisbane Airport. KPMG's report is included at Appendix A.

3.1 Car parking services and facilities at Brisbane Airport

Passengers, staff and others needing to access the domestic and international terminals at Brisbane Airport have a wide range of options to choose from. Table 1 below provides a snapshot of the options and the providers of the relevant services.

Table 1 Transport options to and from Brisbane Airport

Transport Option	BAC	Other Providers[1]	
Car Parking – on airport (under cover and open air)	✓		
Car parking – off airport (with free shuttle)		✓	Gateway Airport Parking, Budget Airport Parking, Andrew's Car parking, Alpha Car Parking, Priority Parking, Portside Parking, Kingsford Smith Airport Parking.
Car parking – valet	✓	✓	Qantas
Free pick up & drop off		✓	Private vehicle
Rental Car – on airport		✓	Avis, Budget, Hertz, Europcar, Redspot, Thrifty
Rental Car – off airport		✓	Numerous (>20)
Taxi		✓	Black & White Cabs Yellow Cabs
Limousine / Hire Car		✓	Numerous (>100)
Train		✓	Airtrain
Public Bus (to Airport Village , Da Vinci Precinct and Aerotech Park) BAC Airport Village Bus (to International Terminal) BAC Inter-terminal Bus BAC Staff Bus	✓	✓	Translink (public buses) Carbridge (funded by BAC)
Private Buses & Shuttles		✓	Coachtrans (licensed), plus a variety of others
Walk / cycle	✓		

1. While some of the services are only provided by "Other Providers", it should be noted that BAC provides the infrastructure (e.g. roads, kerbsides, facilities) to enable the "Other Providers" to access the terminals.

The range of landside access options has changed significantly since Brisbane Airport was privatised in 1997. At that time, there was no undercover parking, only one off-airport car park operator, no Airtrain, no public bus, no Airport Village Shuttle and no dedicated walk / cycle track.

BAC has made significant investments in the quality and quantity of car parking. Total public car parking capacity has doubled from 3,546 car spaces in 1998 to 7,362 car spaces as at 6 April

2011. When the construction of new multi-level car park at the Brisbane Domestic Terminal is completed in early 2012, there will be 10,082 undercover public car parking bays and 139 at grade public car parking bays. Furthermore, the number of car rental bays will almost double from 584 today (4% undercover) to 1,018 in early 2012 (79% undercover). Further information about the quantum and timeliness of investment in car parking and landside facilities and services is provided in section 4.2.

Passengers and staff have a range of substitutes for airport parking to choose from and options that are differentiated by their convenience (i.e. overall travel time, number of transfers and proximity to points of origin and the terminals). The analysis undertaken by KPMG indicated a general trend of increasing cost with increasing convenience. The exception to this was free drop off and pick up, which incurs few costs but is highly convenient for the passenger.

3.2 Level of competition

The Commission is seeking feedback on the outcomes under the current price monitoring regime. Specifically, the Commission seeks responses to the following questions:

What percentage of passengers use the airport's car park facilities? What is the level of competition from other sources of transport? Are off-site car parks a real source of competition to the airport car parks? Is there evidence that airports are influencing the level of competition from alternative transport modes?

Market shares

KPMG estimated the relative market share of each transport mode in 2009/10 based on traffic counts provided by BAC, patronage data from Airtrain and estimates of the average occupancy of each mode. Their findings are set out in the following table. For comparison purposes, the table also shows the results of a study commissioned by BAC for the development of the 2009 Master Plan. However, KPMG notes the 2008 data includes all trips to and from the airport, whereas the KPMG estimates relate to airline passengers only.

Table 2 Transport mode market share estimates

Mode	Modal Share 2008[1]	Modal Share 2009/10 estimate Mid-point	Modal Share 2009/10 estimate Range
Private vehicle – drop off / pick up[2]	83%	**58%**	48% - 68%
Private vehicle – on-airport car park		**16%**	11% - 22%
Private vehicle – off-airport car park		**2%**	2% - 3%
Airtrain	5%	**9%**	n.a.
Taxi	8%	**9%**	6% - 11%
Private Bus	3%	**5%**	4% - 6%
Limousine / Hire Car	<1%	**1%**	0.5% - 1.5%
Other	<1%	Not estimated	n.a.

1. Includes passengers and staff. Source: BAC 2009 Master Plan
2. Includes car rental activity as this cannot be separately estimated.
3. Totals may not sum to 100% due to rounding.
Source: KPMG 2011

There is often a perception that a large proportion of passengers utilise the on airport car parks. However, KPMG's analysis suggests that less than one in five passengers uses the on-airport car parks. Furthermore, Airtrain and taxis both have a significant share of the market.

Competition from off airport car parking

While the market share of off-airport car park operators remains low, the number of operators has increased significantly. When Brisbane Airport was privatised in 1997, there was one off airport car park operator (Budget Airport Parking). There are now seven operators, with four of those having been established in the past three years.

Despite the low market share, BAC's pricing decisions at the International Terminal car park have been impacted by these off-airport car park operators. The throughput at the International multi level car park (MLCP) decreased in 2009/10. Subsequently, BAC decreased the prices at the International MLCP to $99 for seven days, which is comparable to the off-airport car park options.

This reactive behaviour is a function of the level of competition in the market. That is, the off airport car parks are a real source of competition for BAC.

Facilitation of competition

The KPMG report concludes that BAC has facilitated, rather than restricted, competition from alternative transport modes. This conclusion was based on the following observations:

- The alternative options available to passengers and staff have increased since privatisation and the market share of the alternative options have increased. For example, Airtrain commenced operations in 2001 and now accounts for almost one in 10 airline passengers;
- BAC provides comprehensive information regarding the alternative travel options on its website, including cost comparisons for bus, rail and train when users check car parking fees online;
- BAC provide high quality facilities for its competitors, including dedicated ground transport operators (GTOs) and taxi lanes and pick up areas in close proximity to each terminal. The facilities provided are also in the process of being upgraded further through the Domestic Terminal Access Project;
- BAC has invested in the Central Parking Area (CPA) to provide taxis and GTOs with a significant holding area which includes a canteen, prayer room, amenities and shade cloth;
- The fees charges by BAC to the GTOs represent only a small proportion of the total revenue that a GTO could expect to earn from a return trip to Brisbane Airport;
- BAC has made significant investments to facilitate land side access, much of which is classified as non-aeronautical and thus not recovered through aeronautical charges. For example, the CPA is 100% non-aeronautical and approximately $88 million of the $220 million Northern Access Road Project (NARP) was non-aeronautical; and
- BAC funds the staff bus, the terminal shuttle, the Airport Village bus and any infrastructure required to facilitate the operation of public bus services within the airport boundaries (e.g. bus stops).

These results are not indicative of a company attempting to hinder their competitors, but rather of a company which is actively promoting alternative options. With the increasing competitiveness of the Gold Coast Airport as an alternative to Brisbane Airport, BAC is even more focussed on providing a superior customer service experience, which involves facilitating easy and convenient land side access to the airport.

3.3 Pricing behaviour

The Commission is seeking feedback on the use of market power by airports in setting car parking charges. Specifically, the Commission seeks responses to the following questions:

Has the pricing behaviour of airports indicated the use of market power in car parking? 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? Are monopoly profits evident for short-term, long-term, or all forms, of parking?

Parking charges and rate of return

KPMG analysed the prices over the last 10 years at Brisbane Airport's car parks and found that:

- The charges for an eight-hour stay at the **domestic short term car park** had increased at a higher rate than shorter stays. The larger increase for the longer stay was a deliberate strategy by BAC to encourage use of the long term MLCP for stays of four or more hours, so as to free up capacity in the short term at grade car park. The cost of parking for fours hours at the short term MLCP is now the same as for parking for fours hours in the long term MLCP;

- Charges at the **domestic long term MLCP** over the past 10 years had increased modestly on a year-on-year basis;

  - During 2010, there has been increasing capacity constraints on certain days at the domestic parking facilities at Brisbane Airport. Economic theory suggests that congestion pricing could be applied to allocated constrained capacity during peak periods. Further, Economist Alfred Kahn presented a statement to New Zealand's Commerce Commission where he stated that efficient prices should "*include costs associated with the construction of additional capacity when and as those costs become reasonably predictable*"[21].

  - The fact that BAC has not increased prices in order to reduce congestion or to include costs associated with the new MLCP currently under construction indicates that BAC is not overcharging for these facilities, and indeed there may be a case that it is charging an inefficiently low price.

- Charges at the **international MLCP** had increased over the past 10 years for stays of one hour, four hours and one day, but had decreased for stays of seven days. The seven-day rate is now comparable to off airport car park charges;

- Increases at the domestic long term MLCP and the international MLCP seem reasonable given the change in quality of the service, from open-air at grade facilities to multi-story undercover facilities over this period;

- Brisbane Airport has low staff car parking charges compared to other price-monitored airports, for both standard and priority staff parking;

- Car parking charges at Brisbane Airport have been growing at a slower rate than charges for Brisbane CBD car parking. On average, CBD car parking charges for one hour, four hours and one day are now twice as high as the charges at Brisbane Airport;

[21] Kahn, A *Statement of Alfred E. Kahn On Behalf Of Auckland International Airport Ltd* August 10, 2001

- The rate of return[22] on BAC's car parking and land side access was 10.1% for 2009/10, which is reasonable.

Locational vs monopoly rents

KPMG notes that locational rents can be distinguished from monopoly rents in theory, but in practice there is no acceptable way to measure such a difference. A discussion on the theoretical concepts and the practical limitations is provided in an Appendix to their report.

However, KPMG concluded that the car parking charges at Brisbane Airport reflect locational rents rather than monopoly rents, on the following basis:

> *"There are viable, cost effective alternative solutions available to passengers to access the domestic terminal. One of those options is to park at the international car park and catch the terminal bus to the domestic terminal, which is $31 cheaper over a seven day period. However, a proportion of passengers still* ***choose*** *to park at the domestic car park, suggesting that they are willing to pay a higher price for this option. Given that passengers do have choices, and that these choices are viable alternatives, it suggests that BAC is earning a locational rent, rather than a monopoly rent, on its car parking facilities."*

[22] Rate of return = EBIT / total non-current assets

4 Quality of service monitoring

This chapter provides responses to specific questions about the current quality of service monitoring regime for both aeronautical and car parking services and facilities.

4.1 Service quality at Brisbane Airport

The Commission is seeking feedback on the quality of service outcomes under the current price monitoring regime. Specifically, the Commission seeks responses to the following questions:

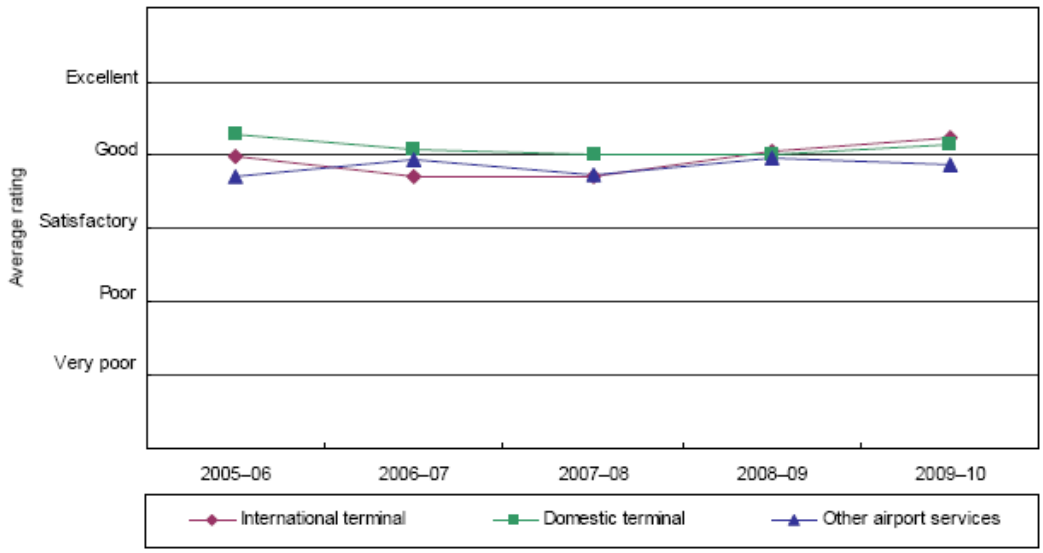
> *How responsive have the monitored airports been to users' service needs and preferences? Are there any significant quality problems for services under the control of the airports that are not being addressed? Have necessary new investments been made in a timely fashion? How does the quality of service at the monitored airports compare with comparable international airports?*

BAC considers the Quality of Service monitoring an important aspect of its business behaviour, and would undertake a similar level of monitoring were it not required by the ACCC. The outcomes from the monitoring are used by BAC to assist in forward planning.

4.1.1 Aeronautical services and facilities

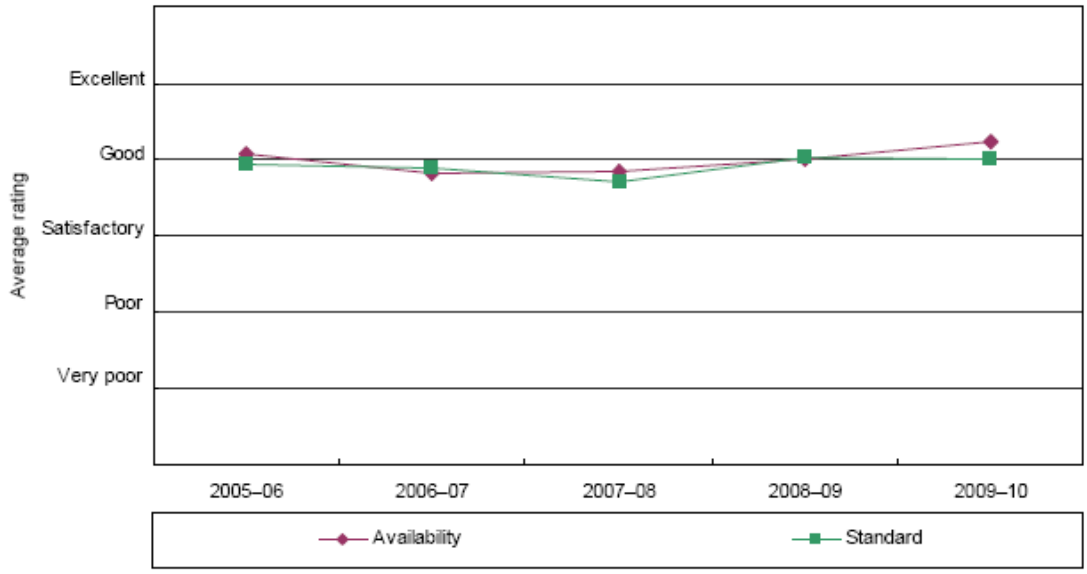
The most effective way to judge an airport's responsiveness to users' service needs is to examine the users' quality of service surveys. The following two figures show the users' overall satisfaction with the quality of services provided at Brisbane Airport. The ACCC's monitoring results include only data for the common user areas operated by BAC.

Figure 5 Brisbane Airport—overall quality of service ratings for international and domestic terminal services, and other airport services



Source: ACCC 2011

Figure 6 Brisbane Airport—overall quality of service ratings for availability and standard of airport services



Source: ACCC 2011

The satisfaction ratings for the Brisbane Airport are generally around the 'Good' rating. Furthermore, the results for the 2009/10 period ranged between 3.46 and 4.15 with Brisbane Airport receiving the highest rating.[23] BAC has consistently ranked high or highest amongst the price monitored airports.

These statistics also include some factors for which BAC is not directly responsible and so could result in misleading information. In BAC's case, we do not believe that removing the criteria over which BAC does not have direct control would materially change the outcomes from the quality of service monitoring.

These statistics show that generally the services provided by Brisbane Airport satisfy the needs and requirements of users, and indicate that there are no underlying quality problems with Brisbane Airport which need to be addressed. Furthermore, there have been no disputes with the airlines in relation to quality of service at any time since the airport was privatised in 1997.

The high satisfaction ratings for Brisbane Airport also indicate that necessary new investment has been undertaken in a timely fashion. To highlight this, BAC again draws attention to Figure 4 which shows the annual level of investment by BAC since privatisation in 1997. From this it is clear that investment has increased significantly since the lighter handed form of regulation was introduced in 2002.

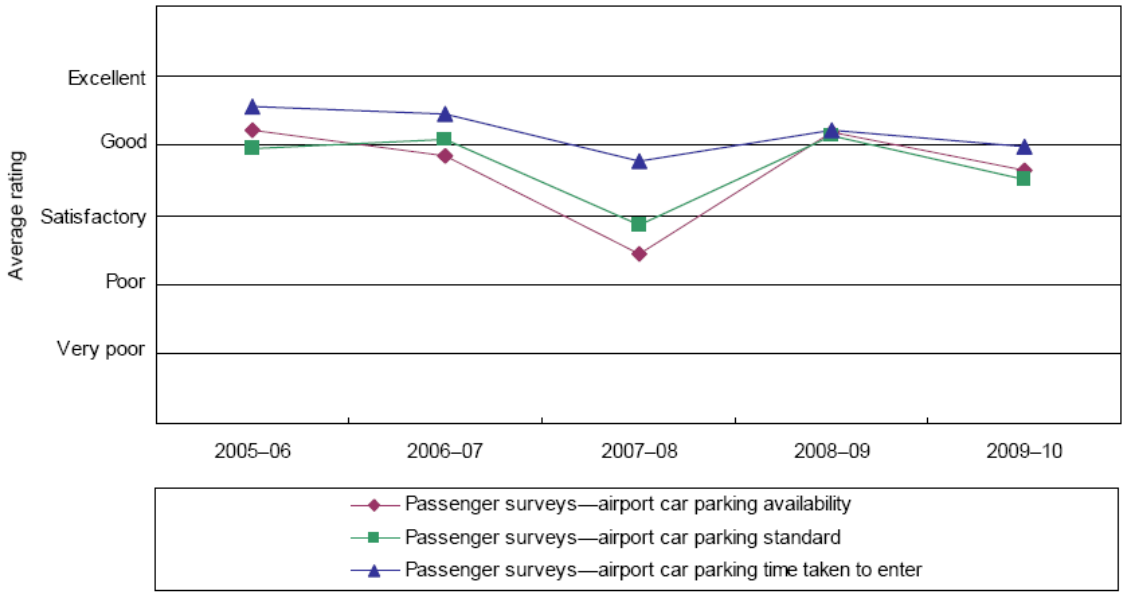
[23] ACCC 2011 *Airport Monitoring Report Price 2009-10 – Price, financial performance and quality of service monitoring* p40

4.1.2 Car parking

Domestic terminal car parking

BAC has generally ranked highest, or very high, on overall car parking quality of service relative to the other price-monitored airports. The exception was 2007/08 when the rating for car parking standard and car parking availability fell below "satisfactory", as shown in the graph below.

Figure 7 Brisbane Airport—domestic passenger survey ratings for car parking



Source: ACCC 2011

The drop in those two quality of service measures in 2007/08 can be explained primarily by congestion on Airport Drive at the Gateway Motorway roundabout which significantly impacted the convenience of on airport car parking during that period.

More recently, the less significant fall in the quality of service ratings in 2009/10 may be attributed to the current construction of the new MLCP at the domestic terminal. As the MLCP is being built on the site of the former short term car park, BAC has opened two temporary short term car parks at either end of the domestic terminal. While there is greater capacity at the temporary car parks, they are further away from the terminal but still within comfortable walking distance. BAC provides information relating to these temporary arrangements via both a newsletter and its website.

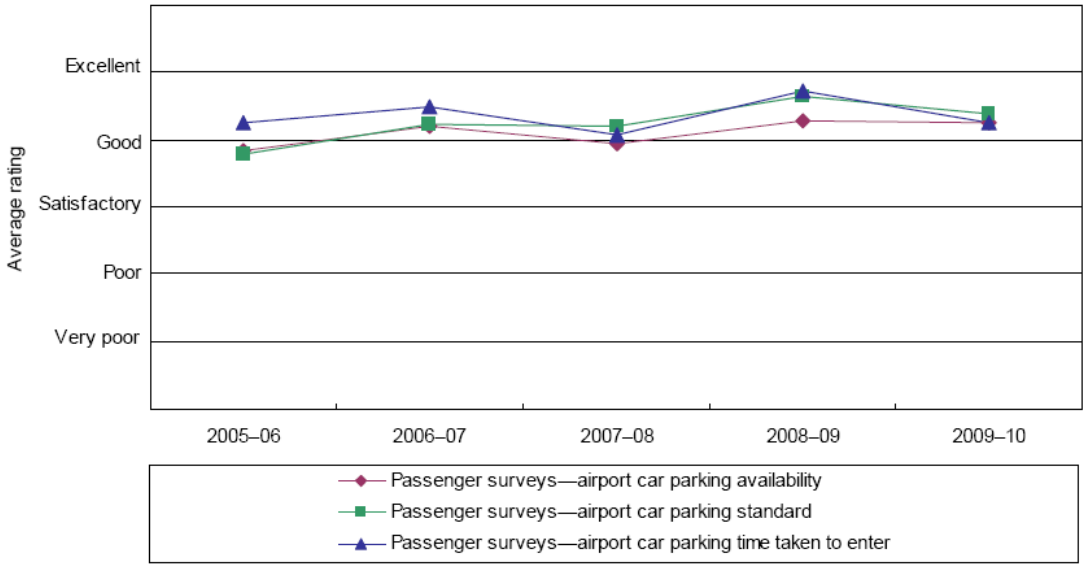
The generally high ratings for quality of service for the domestic terminal car parking and the quick recovery from the fall in quality of service ratings in 2007/08 show that BAC has been responsive to consumers' needs and preferences. This is further supported by the relatively small fall in quality of service ratings despite the use of temporary car parks for short term

parking. BAC is not aware of any significant quality problems that need to be addressed at the domestic terminal car parks.

International terminal car parking

The quality of service for the car parking at the international terminal has consistently ranked very highly on all measures reported by the ACCC – availability, standard and time taken to enter the car park. As shown in the following graph, the quality of service measures were generally rated between "Good" and "Excellent" over the past five years.

Figure 8 Brisbane Airport—international passenger survey ratings for car parking



Source ACCC 2011

The parking at the international terminal was impacted minimally by the construction of the international MLCP in 2006/07 (it opened in August 2007). While the international MLCP was built on the site of the existing at-grade car park, BAC was able to provide a temporary car park that was of similar quality, capacity and proximity to the existing one.

The above results demonstrate that BAC has been responsive to consumers' needs and preferences. BAC is not aware of any quality of service issues that need to be addressed.

4.1.3 Comparison with international airports

Similar to the issues raised in section 2.6, BAC notes that it is extremely difficult to undertake meaningful comparisons of quality of service with international airports. Aside from the issues of comparability of the airports, including variances in consumer expectations in different countries, a reliable comparison would require a similar set of data to be collected at international airports. This would require a degree of international cooperation unlikely to be realised. It would also impose significant extra costs on the international airports.

A comparison with publically available quality of service information on international airports would only have a limited benefit due to the differences in methodology used.

4.2 Timeliness of investments

The Commission is seeking feedback on the timeliness of investments at the price-monitored airports, specifically:

Have necessary new investments been made in a timely fashion?

BAC believes that the quality of service monitoring outcomes, as described above, demonstrate that BAC has been responsive to users' needs and has made necessary new investments in a timely fashion.

In total, BAC invested around $929 million on aeronautical facilities and landside access infrastructure at Brisbane Airport over the eight years from 2002 to 2010. Major projects included:

- Domestic long term multi-level car park expansion - $28 million;
- International terminal undercover car park - $37 million;
- International terminal expansion - $320 million;
- New major road access to terminals relieving significant congestion - $220 million; and
- Central Parking Area, Stage 1, taxi area - $47 million.

In addition, recently completed and current projects include:

- Domestic Common User Satellite expansion (completed March 2011) - $45 million;
- Domestic undercover car park staged (completion in early 2012) - $190 million;
- Domestic terminal pedestrian access project and road improvements (completion in late 2011 / early 2012) - $43 million;
- International apron expansion (completion by 2012) - $29 million;
- Domestic apron expansion (staged to 2014) - $77 million; and
- Central Parking Area future stages (staged to 2014) - $27 million.

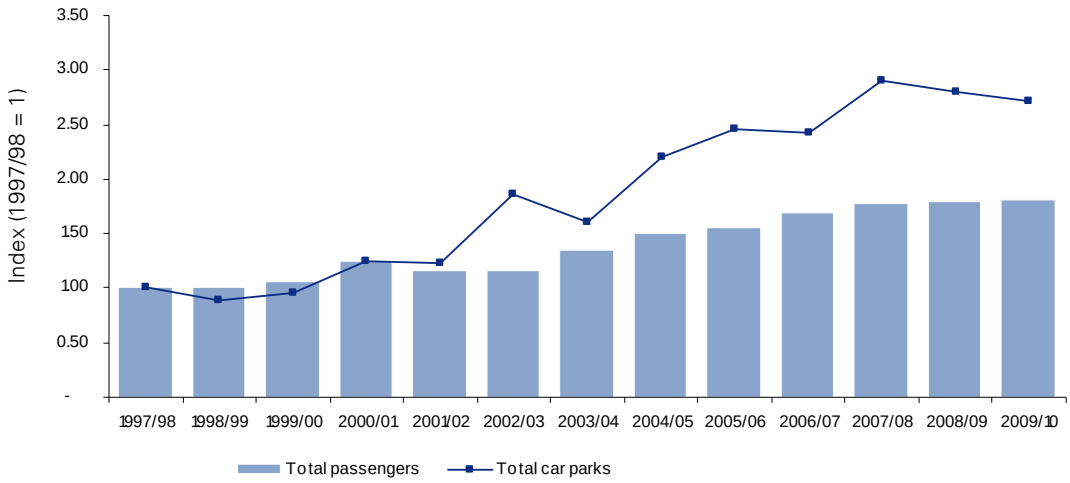
Investment by BAC is expected to be around $2.6 billion over the 10 years from 2010, including the recently completed and current projects shown above. This estimate also includes $1.3 billion for the proposed parallel runway, which is believed to be the first major runway funded by the private sector in the world.

In addition to the direct investments above, BAC has contributed the land corridor[24] across the airport for the duplication of the Gateway Motorway. In return for this contribution, the Queensland State Government funded the Gateway Motorway Northern Interchange, which provides access to the airport from the motorway. This outcome is a demonstration of BAC's view that partnering with key stakeholders, including airlines (e.g. transparent price agreement negotiations) and, in this case, the State government in terms of access, to improve outcomes for the wider aviation industry and our community catchment area equates to long term prosperity for BAC. This is in contrast to a monopolistic approach where the monopolist has no need to participate in such arrangements given the guaranteed demand and lack of other viable alternatives.

However, in the 2009-10 price monitoring report, the ACCC suggested that BAC *"has been slow to invest in parking capacity, which could also have the effect of pushing up airport car parking prices"* and noted that BAC had only recently undertaken substantial investments.[25] The ACCC failed to provide any support to substantiate these claims. KPMG concluded that the comment made by the ACCC is not justified, and is incorrect both in terms of investment timeliness and pricing impacts. The following discussion sets KPMG's findings on this matter.

The graph below shows the relative growth, on an index basis, in the number of car parks available at the airport and the growth in the number of passengers since 1997/98.

Figure 9 Passenger growth compared against growth in car park capacity



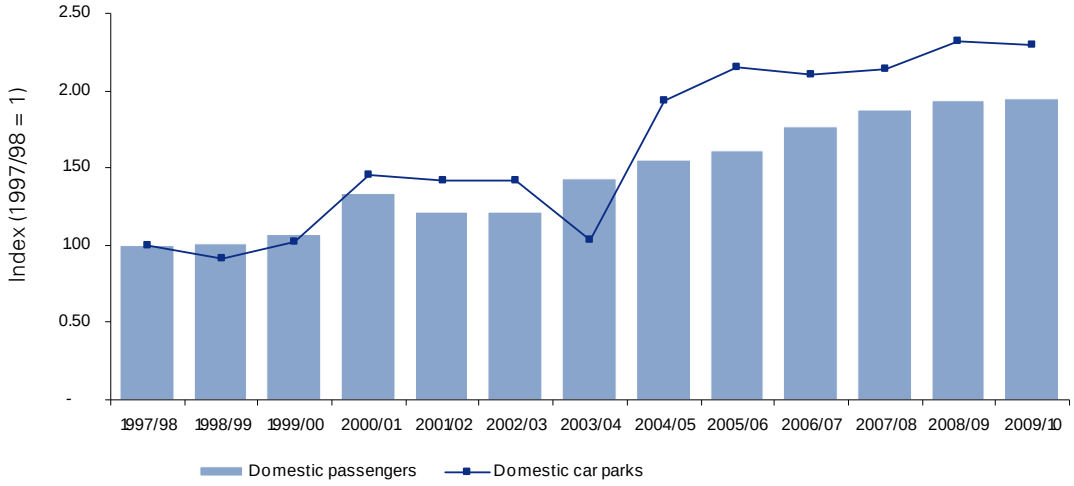
Source: BAC, ACCC Price Monitoring Reports

The above graph shows clearly that over the past 12 years, the growth in the number of car parks has outpaced the growth in passenger numbers. However, this graph shows all car parks available at the Brisbane Airport, including staff parking. As the ACCC comments relating to

[24] BAC contributed the corridor by surrendering a portion of its Airport Lease it purchased from the Commonwealth Government in 1997.
[25] ACCC 2011, *Airport Monitoring Report 2009-10: Price, financial performance and quality of service monitoring*, February.

delayed investment may have been directed to the domestic car parks, a similar graph has been produced for just domestic passengers and car parks, and this is shown below.

Figure 10 Domestic passenger growth compared to growth in domestic car park capacity



Note: the decrease in car park spaces in 2003/04 was due to the construction of the extension to the original MLCP and associated road and ground transport works at that time.
Source: BAC, ACCC Price Monitoring Reports

It can be seen that growth in total car parks at the domestic terminal has also outpaced growth in domestic passenger numbers since privatisation in 1997. This indicates that, on any measure, BAC has undertaken timely investment in car parking facilities at the domestic terminal.

The original Major Development Plan (MDP) for the short-term MLCP was approved by the Minister for Infrastructure, Transport, Regional Development and Local Government in October 2008. This envisaged a MLCP with 8 levels of parking, delivering 5,300 parking bays. However, it was subsequently discovered that the proposed design would not deliver the stated capacity:

> *"When the MLCP was conceived it was anticipated that up to 5,300 parking bays could be delivered by construction of an eight level multi-level car park. During the design development phase, which included detailed internal planning coupled with distribution of the various product mixes within the facility, it became evident that the final yield in terms of bay numbers was less than the number required and significantly fewer than included within the MDP submission."* [26]

Therefore, BAC submitted a revised MDP in January 2010 for a 9-level MLCP, which would deliver 5,276 car parking bays. The revised MDP was subsequently approved with conditions on 12 April 2010, and construction commenced that same month.

[26] Brisbane Airport Corporation Pty Ltd, 2010, *Minor Variation to the Major Development Plan – Multi-level Car Park*, 17 January. p.3.

The time between the original and revised MDP was also used by BAC to address the conditions that were attached to the original approval. The additional detailed work that was done during this period enabled BAC to commence construction of the short-term MLCP immediately upon approval. This planning period also coincided with the start of the global financial crisis which had a significant impact on the ability of BAC to source debt financing for the project. In late 2007, BAC was already investing in an international terminal expansion ($320 million) and major new roads to the airport ($220 million) when debt markets around the world collapsed. BAC's shareholders agreed to cancel proposed distributions and inject the equivalent of more than $200 million in equity to strengthen BAC's balance sheet and maintain its investment grade credit rating, thereby enabling it to raise debt to fund planned infrastructure.

Changes to the road system near the domestic terminal, an integral part of the project, also required extensive consultation with those affected, including negotiations with Airtrain.

The period between BAC initially identifying the need for the extra capacity, and thus submitting the original MDP, and commencement of construction of the facility is reasonable given the hurdles faced and overcome by BAC.

Furthermore, there were several options considered by BAC to maximise the capacity of the short-term MLCP, including underground levels. However, the soil conditions at Brisbane Airport made this a prohibitively expensive option. Control tower line of sight restrictions also limit the number of levels above ground that can be accommodated. Thus, the short-term MLCP is being built at the maximum possible capacity within the environmental, planning and economic constraints at the site.

The ACCC has contended that BAC deliberately delayed the investment in this MLCP in order to drive up prices in the short term. The above commentary shows that this was not the case. Additionally, the choice by the BAC to develop the largest possible car park for this current investment appears to be contradictory to the ACCC's assertion. The project now underway will provide significant additional capacity sufficient for many years under current growth expectations. This additional capacity will provide BAC with the opportunity to meet demand as well as to compete more effectively with the growing off-airport car park market. This is a significant project and is being delivered in a framework that ensures that shareholders and investors are satisfied and that will provide consumers with convenient and efficient parking facilities.

If BAC was prone to artificially restricting supply, it would follow that it would likely develop a smaller car park which would face capacity constraints in the foreseeable future. The fact that BAC did not go down this path adds credence to the argument that it is not been slow to invest in order to maximise prices in the short term.

BAC believes delaying investment is counter-productive for both car parking and aeronautical services, as it would have negative consequences for customer satisfaction (which would be reflected in the quality of service monitoring results) and there are viable alternatives for those customers to choose from.

4.3 Quality of service monitoring methodology

The Commission is seeking feedback on the methodology used to monitor quality of service outcomes under the current regime. Specifically, the Commission seeks responses to the following questions:

> *How robust are the survey techniques in indicating quality of service? How useful is quality of service monitoring given the differentiation between DTLs and common user facilities, and how would this affect international comparisons?*

Part 8 of the *Airports Act 1996* provides for the ACCC to monitor and evaluate the quality of certain aspects of airport services and facilities. Section 155 of the Act allows the ACCC to carry out this function on its own initiative, namely through specifying a set of criteria by which these monitored services are measured.

BAC generally supports the continuation of quality of service monitoring to facilitate a balance between service levels and aeronautical charges, and has ensured its quality of monitored services and facilities remain of a high standard. BAC notes the availability of the ACCC's *Airport quality of service monitoring guideline, October 2008* and associated quality of service monitoring templates (which incorporate the June 2009 regulatory amendments) that aim to assist airport operators meet their quality of service regulatory reporting requirements whilst minimising the compliance burden.

However, BAC maintains that the function of quality of service monitoring would be better managed by Government. Its role as the industry's technical regulator means it has a better understanding of the technical and operational aspects of airports, and is therefore better placed to set measurement criteria by which to evaluate these services.

With regard to the robustness of the survey methodology used by the ACCC to measure and report on quality of service, BAC considers this to be generally adequate with some scope for improvement. For example, surveys could be designed to capture information to help inform and deliver real service improvements to customers.

Like all performance measures, it is imperative to ensure there is fairness in the assessment and reporting processes. To this end, BAC highlights the importance of its service quality being assessed based only on measures over which it has control. For example, its role is to provide sufficient space and desks to process passengers, but it does not control the use of those desks (e.g. airlines decide how many desks to staff). BAC notes the ACCC has recognised the influence of factors outside the control of airport operators in the interpretation of its results, however there is scope for improvement in this area of the ACCC's methodology.

Similarly, there is scope to improve the level of consistency across a range of appropriate measures to facilitate more accurate and meaningful comparisons over time and across airports. One element of this is the current differentiation of service quality monitoring requirements between Domestic Terminal Leases (DTLs) and common user facilities. The current exclusion of service quality monitoring at DTL facilities means that an airport's overall quality of service assessment is not a true measure of the overall passenger's service experience, nor does it present an accurate assessment across all airports given the differing extent of common user facilities in each individual airport.

5 Future regulatory arrangements

This chapter provides responses to specific questions about the current regulatory regime for both aeronautical and car parking services and facilities.

5.1 Access arrangements

The Commission is seeking feedback on the impact of the Federal Court decision. Specifically, the Commission seeks responses to the following questions:

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

The 2006 changes to Part IIIA of the *Competition and Consumer Act 2010* (CCA) and the interpretation thereof effectively make it easier for airlines to seek airports to be declared, as well as making it easier for the airlines to seek arbitration, rather than negotiate openly with the airports. Theoretically this provides added incentive for the airports to reach a negotiated outcome with the airlines in a timely fashion.

BAC has seen no material impact from either the courts interpretation or the 2006 amendments of Part IIIA. Regardless of these changes in interpretation and legislation, the threat of declaration and potentially heavier handed regulation, has always been and will continue to be, real. This threat moderates the ability of BAC, and indeed all the regulated airports, to potentially abuse their market position in dealings with the airlines.

There are also other sections of the CCA which now place even more effective constraints on the pricing behaviour of airports. The most critical of these is Part VIIA which allows the Treasurer to place the responsibility for price setting in the hands of the ACCC without a declaration process. Unlike Part IIIA, the ACCC can act effectively as a price regulator once it is empowered to do so by the Commonwealth Treasurer. This mechanism contained in the CCA places an even higher threat towards the airport owners approach to access and pricing, and should be recognised as a real 'stick' in the airport-user negotiating framework. This is particularly so given what appears to be the low threshold from which this could be enacted (i.e. the discretion of the Commonwealth Treasurer) and that the airlines commonly lobby government representatives over pricing and investment decisions at airports. In addition to this, Part IV contains general provisions for the misuse of market power which can impose significant remedies on the airports if they are found to be in breach of the requirements.

However, BAC is concerned with any attempt to further lessen the hurdle required to escalate issues in the negotiation process to the ACCC. As outlined in Section 1.4, BAC already has in place, in its agreed dispute resolution mechanism, an independent mediation process should the need arise (recognising that it has not to date) and believes that this is the best approach for each airport. Assigning the ACCC as arbitrator would in essence re-instate price regulation as the airlines will no longer have an incentive to negotiate openly and fully. In addition, the burden

shifts to the airports and ACCC and there is no longer a genuine commercial negotiation process.

5.2 Future regulatory arrangements

The Commission is seeking feedback on the need for, and form of, continued regulation for Australian airports. Specifically, the Commission seeks responses to the following questions:

> *At a broad level, is there value in continuing the monitoring of aeronautical services and/or parking prices? 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? Is both price and service quality monitoring needed?*
>
> *Should there be a fixed duration for any future period of price monitoring? Are further prescheduled reviews necessary?*

Continuation of price monitoring

As outlined in this submission, BAC is generally satisfied with the outcomes under the price monitoring framework. BAC believes that there is scope to further lighten the regulatory framework, and would under no circumstances support a recommendation to move to a heavier handed form of regulation. Under these circumstances, BAC would support a recommendation to continue the regulation in its current form, albeit that the application of this framework could be improved to help reduce the regulatory burden on the airports whilst not detracting from the ability of the regulatory framework to encourage commercially negotiated outcomes and facilitate investment. These changes include:

- Only collecting information which is critical to inform the ACCC's price monitoring (Section 2.6);
- Developing an analytical framework for assessing whether returns are excessive and only reporting within that framework (Section 2.6); and
- Basing the quality of service monitoring only on factors over which the airports have direct control (Section 4.1.3), or extending the arrangements to include terminals under long-term lease to users so that they are monitored in a consistent fashion.

With regards to the price monitoring of car parking specifically, BAC is of the view that price monitoring is not strictly required due to:

- The number of competitors providing land side access to the terminals, including the high quality of facilities and reasonableness of access charges which BAC provide to these competitors;
- The continued strong performance of BAC's car parking facilities in quality of service surveys; and

- BAC's continued strong investment in car parking and land side access facilities and services.

These factors are evidence that price monitoring, or heavier handed forms of regulation, are not necessary for the airport car parking industry. However, BAC is willing to accept a recommendation for continuation of price monitoring, but will strongly resist any move towards price regulation of on-airport car parks.

Further, this Review could be considered part of the price monitoring regime in totality, and BAC question the need for such reviews to be continued into the future. The industry has now had three such reviews, and without pre-empting the findings of the current review, the Commission has essentially found that airports are monopoly infrastructure businesses that have the potential to exert market power but do not due to safeguard mechanisms and the countervailing market power of users. Such findings will undoubtedly continue, so long as these regulatory safeguards remain, and users continue to behave in a monopsony manner. Therefore, BAC is of the view these reviews should cease with this one, and only be triggered if the Commonwealth Treasurer is contemplating activating Part VIIA of the CCA.

Duration of price monitoring period

BAC considers that it is important that there should be fixed periods between reviews, if they are to continue. Having a fixed period prior to a review provides some certainty to the industry participants, including airport shareholders, that the regulatory regime will not change materially during the period. Additionally it provides the airports, airlines, Governments and other interested parties with an opportunity to provide input to enhance the regulatory regime on a regular basis.

Additionally, as discussed throughout this report, BAC strongly contends that commercially negotiated outcomes are working effectively and consequently believes there is less need for price regulation or monitoring. Therefore, BAC supports a recommendation to end price monitoring of airports.

5.3 Enhancements for future regulatory arrangements

The Commission is seeking feedback on potential improvements to the price and quality of service monitoring, should these arrangement continue. Specifically, the Commission seeks responses to the following questions:

> *If there is a further period of monitoring, are there opportunities to streamline arrangements to improve reporting, without compromising effectiveness? Could the number of indicators be reduced? In some areas, would more information be desirable? Do reports need to be produced annually?*

Opportunities to streamline arrangements

There are a number of opportunities available to streamline and improve the regulatory arrangements which are addressed in detail in previous sections of this submission. The most critical of these are:

- To develop an analytical framework to guide the ACCC analysis (as discussed in section 2.5); and
- For the ACCC to report only on issues over which they have jurisdiction (as discussed in section 2.5).

Data requirements

As previously discussed in Section 2.5, BAC believes that the ACCC should only collect information which it uses in its analysis and subsequently presents in its annual regulatory reports.

Frequency of ACCC reporting

The ACCC currently produces a full price monitoring report on an annual basis. BAC notes that there are considerable costs involved with this reporting requirement, both on the side of the ACCC and the airports. However, there are only limited benefits in producing the full report annually as BAC, along with most other airports, negotiates aeronautical prices over five year periods. Therefore, there appears to be scope to reduce the regularity of ACCC price monitoring reports to a five-year cycle.

However, there could still be value in preparing a much more streamlined annual report which could cover the quality of service reports, as well as car park price monitoring, if this is deemed to be required in the future. Both of these areas are far less onerous on both the ACCC and the airports, but can still provide the level of oversight required to ensure that economically efficient use of and investment in airports remains, whilst minimising unnecessary compliance costs.

5.4 Market power in aeronautical services

The Commission is seeking feedback on the airport's market power and countervailing factors. Specifically, the Commission seeks responses to the following questions:

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?

What are the constraints on the airports' market power? Do the airlines have countervailing power in dealing with the airports, especially smaller airports?

If monitoring was to continue, should some airports be removed from, or added to, the list of monitored airports? If airports are removed, would the second tier self administered scheme, or some other web-based self-reporting regime for the major airports, suffice?

Are the definitions of aeronautical services appropriate in reflecting market power in particular services? Should some services be excluded or others included?

Overall level of market power in aeronautical services and facilities

In BAC's submission to the Commission's Review in 2006, BAC describes market power as:

"… the actual ability of a firm (or group of firms) to raise and maintain prices above the level that would prevail under competition, resulting in reduced output and loss of economic welfare. The extent to which airports do possess market power, this will depend upon the degree to which they possess (natural) monopoly attributes, being:

- *Barriers to entry;*
- *Substitutability between air transport and other transport modes; and*
- *Existence of economies of scale and scope."*

BAC acknowledges that it carries natural monopolistic power but reiterates its view in the 2006 submission that that the mere existence of these attributes does not necessarily indicate that it has the ability to raise and maintain prices above the competitive price level. Further, BAC contends that there is little scope for airports to abuse their theoretical market power, and there is no evidence during the 13 years since privatisation to indicate that they have done so. This is due to:

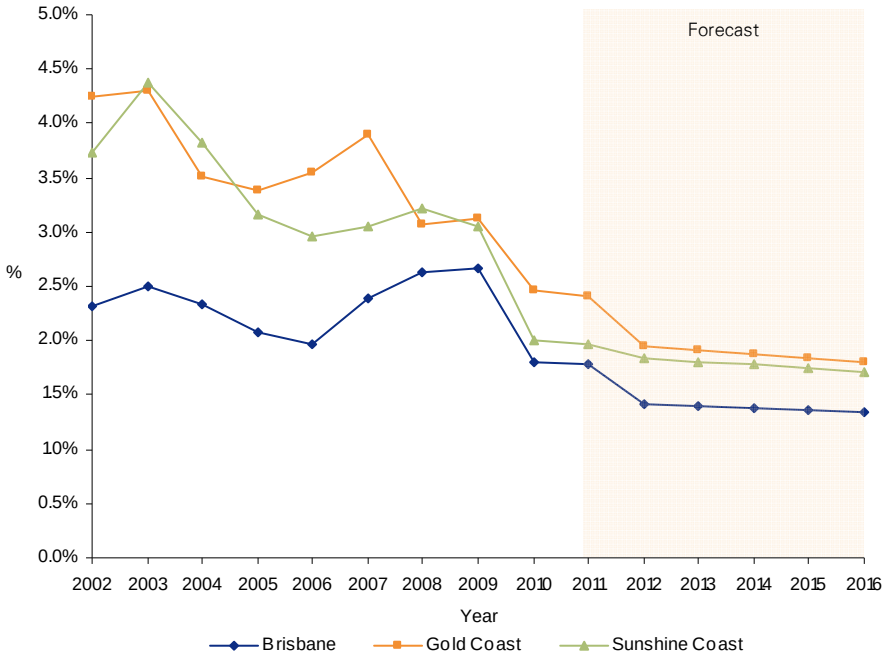
- Competition between individually operated airports in Australia, that takes the form of:
  - competition to attract new airline services (both passengers and freight);
  - competition for a role as a hub airport and for transfer between hubs;
  - competition between airports within urban areas, specifically for General Aviation users; and
  - competition for the provision of services at airports.
- Significant countervailing market power from the major users of airports;
- An airport's inability to withhold service; and
- The threat of 'big stick' regulation through the enabling of existing legislation, such as Part VIIA of the CCA, that allows greater involvement by the ACCC in what should be a commercial environment.

This section and the subsequent two sections discuss these indisputable market constraints and demonstrate through example how they suppress the use of what market power BAC naturally holds.

Brisbane Airport is not the sole option for airlines seeking to operate within the South East Queensland (SEQ) region and more broadly, across Queensland and Australia. It competes against a number of individual airports within the state, primarily the Gold Coast Airport which is subject to a self administered regulatory regime, as well as other unregulated, privatised regional airports, namely Ballina and Sunshine Coast Airport, for domestic services. BAC competes for some international services with Australia's other major airports as well as some regional airports (Sydney, Melbourne, Cairns and Gold Coast).

The figure below shows population growth in Brisbane, Gold Coast and the Sunshine Coast. The population growth in Brisbane has been consistently lower than that of the other two major population centres in SEQ. Therefore, the logical gateway may not be the Brisbane Airport for an increasing proportion of the SEQ population, which means that BAC needs to continue to compete in the broadest sense to attract airlines and passengers in the future.

Figure 11 Population growth in Brisbane, Gold Coast and the Sunshine Coast

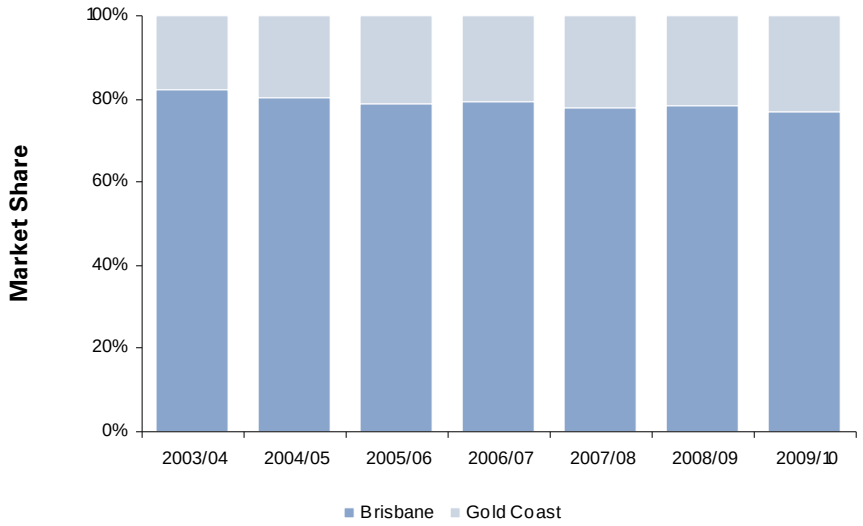


Source: Office of Economic and Statistical Research (OESR), Queensland Government

The degree of overall market power carried by BAC has certainly not increased since the previous Commission review in 2006. If there has been any change at all, its monopoly service provider status has declined over the last five years, largely due to the expanding market share

of Gold Coast Airport. As shown in the following chart, Gold Coast Airport's market share of domestic passengers has increased from 18% in 2003/04 to 23% in 2009/10.

Figure 12 Relative market share, Brisbane Airport and Gold Coast Airport



Source: BAC, Gold Coast Airport Monthly Statistics Report 2011 Feb.

Over this period, domestic passenger numbers at the Gold Coast Airport increased by 11% per annum, on average. This is twice the growth rate in domestic passengers numbers for Brisbane Airport over the same period. Thus, Gold Coast is increasingly capturing a greater share of the total number of domestic passengers arriving in, and departing from, South East Queensland.

The Gold Coast Airport's 2009 Master Plan is strategically focussed around providing an efficient, diverse and responsive land transport network. A major component of this is light rail, with its proposed network to extend to the Gold Coast Airport expected to be complete in the medium term and the provision of heavy rail in the longer term. On top of this, large investment in the other travel options is underway which will substantially increase accessibility to the airport, heightening its attractiveness and convenience to a broader population across SEQ, including residents of Brisbane City. For example, with the intensely competitive airline prices already offered at the Gold Coast Airport, coupled with a vast improvement in travel from the CBD, this is a genuine competitive threat for Brisbane Airport.

BAC notes that Jetstar International have chosen to focus on Gold Coast Airport rather than Brisbane. This is evidenced by the number of international destinations serviced by Jetstar at the following airports:

- Sydney 6
- Melbourne 6
- Gold Coast 5
- Brisbane 1

In this competitive environment it is hard to justify Brisbane Airport and Gold Coast Airport being treated differently from a regulatory perspective. This places Brisbane Airport at a comparative commercial disadvantage.

Further, an expanding network of secondary airports further increases airlines' countervailing market power when seeking to negotiate access to airports within the SEQ region. BAC is cognisant of how competitor airports are pricing their services and monitors (to the extent it can) its competitors' pricing strategies. This behaviour is inconsistent with that of a true monopolist, and demonstrates that BAC is limited to exercise the defined monopolistic power it naturally carries.

BAC also contends there has been real and escalating competition with Melbourne Airport for the international market in recent years. This competition has been focused on expanding and non-Sydney centric international airlines, like Etihad and Qatar airlines. Consequently BAC's behaviour in setting aeronautical charges for airlines has become even more competitive in nature (price taker) in an attempt to attract the airlines. This is a key example of the market constraint on BAC's ability to exercise monopoly power.

Finally, BAC's behaviour is also a good indicator of the fact that not only do airlines have other choices but the health of the aviation industry (i.e. BAC's customer base) is not guaranteed. Unlike a monopoly, demand is not guaranteed and BAC therefore places great emphasis on:

(a) building relationships with airlines (e.g. through transparent price negotiations and agreed dispute resolution mechanisms (see Section 1.4)); and

(b) contributing to the support structures around the airport necessary to enhance its population catchment (e.g. partnership with the State Government for the Gateway motorway project and ceding of leased land to the State Government for that purpose (see Section 4.2)).

BAC notes that airlines in Australia and the region are amongst the most profitable and financially stable in the world. No major Australian airline has experienced financial difficulties since deregulation of airport prices in 2002. In 2001, Ansett collapsed and before that Compass Airlines, twice. Since 2002, Tiger Airways and Strategic Airlines have entered the domestic market. The number of international airlines flying to Australia continues to increase.

It is not in BAC's interest to abuse its market power, as doing so is not conducive to developing a prosperous aviation industry in the long run. Therefore, BAC places great emphasis on building effective partnerships with all stakeholders.

Countervailing market power

The Commission in the 2006 review stated that the countervailing power of airlines which acts as a 'market' constraint on airports' behaviour is not as strong as was previously envisioned. BAC believes this power is held by airlines, and is both a past and continuing constraint on airport market power.

In particular, the potential for airlines to exercise countervailing power is more prevalent now in light of the recent and continuing increase in Gold Coast Airport's market share. With an increase in competitive tension amongst the two airports, the airlines carry more negotiating power. Therefore, BAC believes it is important to revisit/reiterate comments addressed in their previous submission and draw upon recent observations by the AAA concerning countervailing power of airlines as a market constraint.

BAC supports the AAA's viewpoint that the ability of Australia's major airports to misuse market power to the disadvantage of the airlines is generally a misperception. The restrictive nature of the long-term leases between BAC and their airline customers is indicative of this, despite a general stance by the airlines that airports are able to advantageously operate under their natural monopoly status. The leases impose considerable limitations on the potential for BAC to deny, or threaten to deny, airline access to operate at Brisbane Airport.

As reported in the 2006 Commission review, airlines continue to have the power to withdraw or reduce the number of services operated from any airport. The use of countervailing power held by international airlines by reducing the number of flights on certain routes has been a genuine and ongoing concern to BAC. BAC continues to be mindful of this in its negotiations with the airlines. Airlines also have flexibility with routes and an airline with spare capacity, (i.e. spare aircraft) has the ability to seek out the airport offering the best deal. This results in competitive behaviour between airports to determine who will provide the lowest price. This reduces the market power held by BAC. Moreover, competition with the Gold Coast Airport to offer airlines the best deal has intensified recently.

Definition of services

BAC, like all airports, has experienced a creeping of services into the definition of what constitutes an aeronautical service or activity, since privatisation. As can be seen through the table below, since privatisation eight service / activity categories have entered into the definition of aeronautical activities. The consequence of this activity creep has been a lowering of investment returns for BAC, as many of these commercial activities earn market returns greater than regulated returns – that is, the shifting of these services from non-aeronautical or aeronautical-related to aeronautical has resulted in a gradual cross subsidy in aeronautical charges akin to a single-till methodology.

Table 3 Definition of aeronautical services

Service Category	1997	Now
Runway, taxiways, aprons, airside roads/grounds	✓	✓
Airfield and airside lighting	✓	✓
Ground handling services and facilities (including equipment storage and refuelling)	×	✓
Aircraft refuelling services and facilities (including pipelines to and from the JUHI)	×	✓
Airside freight handling and long/short term staging areas essential for aircraft loading and unloading	×	✓
Airfield navigation services and facilities (including visual navigation aids)	✓	✓
Airside safety and security services (including rescue and fire-fighting services and perimeter fencing)	✓	✓
Environmental hazard control services and facilities	×	✓
Services and facilities to ensure compliance with environmental laws	×	✓
Aircraft lighting and emergency maintenance sites and buildings	×	✓
Public areas in terminals, public amenities, lifts, escalators and moving walkways	✓	✓
Departure and holding lounges, and related facilities (excluding club/business lounges)	✓	✓
Aerobridges (including nose-in guidance systems) and airside buses	✓	✓
Flight information and public address systems	✓	✓
Facilities to enable processing of passengers through customs, immigration and quarantine	✓	✓
Check-in counters and related facilities (including associated queuing areas)	×	✓
Landside terminal access roads and facilities (including lighting and covered walkways)	✓	✓
Security systems and services (including closed circuit surveillance systems)	✓	✓
Baggage make-up, handling and reclaim facilities	✓	✓
Office space and facilities in terminals or airside for airline staff	×	✓

BAC are most disappointed with this, given at the time of privatisation there was a clear definition of aeronautical and non-aeronautical that appeared to be workable and reasonable. Further, BAC's bid for Brisbane Airport was based on expectations of cash-flows as per these definitions. BAC's 2006 submission to the Commission highlighted the concerns about this shift in the definition, noting:

> *"any moves to change this now would be considered a breach of good faith"*

BAC has paid a significant premium to the Commonwealth Government for the non-aeronautical assets associated with Brisbane Airport, and any changes beyond the current definition would be considered inappropriate, unnecessary and unfair.

5.5 Market power in car parking services and facilities

The Commission is seeking feedback on airports' market power in car parking. Specifically, the Commission seeks responses to the following question:

What is the market power of the major airports in relation to car parking prices?

It is important to note that regardless of the level of market power BAC potentially holds in relation to car parking prices, there exists a number of practical market constraints that hinder its ability to misuse such power.

- Not only have the number of competitors increased significantly since privatisation, but the market shares of the competitors have increased over time. Subsequently, the market share of private vehicles has fallen (see Chapter 3 for further discussion).

- Comparatively, the market share of the alternative modes of transport is increasing. In particular the Airtrain nearly doubled its market share between 2008 and 2009/10 and this is expected to continue to grow in the future. Private buses too experienced a 50% market share increase over this period and the use of off-site parking facilities rose dramatically (up 140%).

- The number of off-airport car park operators has increased considerably from just one, when Brisbane Airport was privatised in 1997 to now seven operators, four of which were established in the last three years. BAC views these operators as a genuine and growing threat. This is evident in BAC's reactive behaviour of setting international terminal car parking prices at competitive rates to that of off-site parking. See Appendix A for further information.

- BAC does not behave like a company attempting to hinder its competitors, but rather as one which actively promotes and facilitates alternative options. BAC has provided the necessary infrastructure for all transport alternatives to operate and has fully integrated them into the transport/road network system. Further, BAC displays comprehensive information about the alternative travel options on its website and provides customers with cost comparisons of using the on-site parking facility with the alternative options.

Further detail regarding BAC's market power in relation to car parking prices and the various market constraints that restrain such market power is provided in chapter 3; section 4.1.2 and section 6.3 of this submission.

5.6 Deterrent to the use of market power

The Commission is seeking feedback on the effectiveness of deterrents to the potential misuse of market power. Specifically, the Commission seeks responses to the following questions:

> *Is the existing range of remedies effective in deterring misuse of market power? Are these remedies effective 'punishment' for misuse of market power?*
>
> *What impact does the lack of a 'show cause' process have on ensuring appropriate pricing and investment outcomes for aeronautical services? Is there a better approach to developing a 'show cause' process or an alternative trigger process? Would there be benefits in a requirement for independent commercial arbitration and if so, how could this be effected? Are there any public interest reasons for such arbitration to be conducted by the ACCC?*
>
> *Do concerns about the potentially adverse effects of more heavy handed price regulation on investment militate against its reintroduction?*

Effectiveness of existing remedies

Section 46 of Part IV of the *Competition and Consumer Act 2010* contains a prohibition on the misuse of market power. Penalties for contravention of Part IV are severe including not only damages payable to affected parties who bring a claim (such as airlines) but also substantial civil penalties (being the greater of $10 million, three times the benefit received or 10% of annual turnover).

These remedies have never been applied by the Federal Court in relation to airports. BAC contends that this demonstrates the effectiveness of the prohibition as a deterrent.

As suggested by the issues paper, the knowledge that a publically released report will highlight any potential misuse of market power is enough to constrain most airports. In addition to this knowledge, there is the threat of the declaration under the CCA and the imposition of a heaver handed regulatory regime.

Therefore, BAC is of the view that market dynamics, countervailing market power of airlines and regulatory instruments, including existing remedies, are effective in constraining the ability of the airports to misuse their market power.

Effect of lack of 'show cause' process

The lack of a show cause provision has not had a detrimental impact on pricing and investment at Brisbane Airport. Under the show cause provision recommended by the Commission in

2006, the Government would have been required to make an explicit response[27] to the ACCC Price Monitoring reports. It has already been shown that the ACCC Price Monitoring reports are misleading and therefore that the adoption of this "show cause" process would be functionally dependant on flawed analysis.

The lack of this provision has had no impact on BAC as we have always been able to reach a commercially negotiated outcome, indicating that the airlines do not have major issues with the pricing structures and levels at the Brisbane Airport. If BAC was attempting to misuse its market power under the current regulatory regime, the airlines could have exercised their rights under the ASCA to call in an independent mediator (a relatively simple and accessible option for airlines) or pursued court actions under Part IIIA or Section 46 of the CCA. They have not done so.

As further outlined below, BAC believes that the use of an independent mediator (contractually available to airlines using BAC pursuant to the ASCA) remains preferable to instating the ACCC as the arbitrator.

Threat of re-regulation

The threat of the imposition of a heavier handed form of regulation is a key incentive for BAC to ensure that agreements are reached with the airlines rather than relying on provisions in the CCA which appoint an independent arbitrator in the event of a dispute. Heavier handed regulation would result in a detrimental impact to the airports due to:

- Significantly higher costs being incurred in the price setting period than would be incurred throughout commercial negotiations;

- Significantly higher costs being incurred during the negotiations regarding necessary new investment; and

- The diminishing of control over pricing. (Under a commercially negotiated outcome, both parties have significant input into the structure and levels of the pricing, which will be diminished if the ACCC is tasked with price regulation).

This threat is important in all negotiations with the airlines as BAC, and the other regulated airports, realise the airlines could potentially instigate action which would lead to heavy handed price regulation.

Ensuring such a process is never revisited is very important for BAC. Simply, airport performance under previous ACCC price regulation was resource intensive, not effective and resulted in under-investment – essentially a poor outcome for airport owners, airlines and passengers, which BAC are keen to ensure does not happen again.

[27] This response would indicate either that no further action was required, or request that the airports that have been highlighted as possibly misusing market power show cause as to why further investigation is not warranted.

Impact of changing light handed regulatory regime

Any investment carries a certain degree of risk. For infrastructure companies like airports, one of the key risks is regulatory risk – changes to the pricing framework and therefore revenue. Regulatory uncertainty is a major barrier to investment in infrastructure around the world.

BAC receives credit and risk ratings from both Standard and Poor's and Moody's. Both of these agencies have highlighted the risks to BAC of a change from the current light handed regulatory regime.

The following except from Moody's Credit Opinion of BAC issued on 25 June 2010 shows the importance it places on the current regulatory regime on overall credit quality:

> *"Moody's rating for the Airport factors in light-handed regulatory oversight, with the company expected to generate a fair return on investment, within a reasonably certain framework. This framework is supportive of earnings stability. On the other hand any policy changes that would lead to increased uncertainty surrounding rate-setting or pressure to reduce pricing, could ultimately have a negative impact on credit quality.*
>
> *The Australian Government has adopted a light-handed regulatory approach for major Australian Airports since 2002. The approach has allowed price changes to occur without regulatory approval and for a fair return on capital. Pricing is monitored by the Australian Competition & Consumer Commission (ACCC) to ensure no abuse of market power and there are periodic reviews by the Productivity Commission.*
>
> *A review by the Productivity Commission in 2007 led to confirmation this arrangement will continue until 2013. However, recent developments – whereby the responsible Minister asked the Productivity Commission to expedite its review, originally scheduled for 2012 - suggest the Government could be open to the idea of tighter regulation and there appears to be an increased focus on car parking charges.*
>
> *The Airport relies on the current framework to develop pricing that supports the significant ongoing capital investment needed for upgrading and maintaining facilities, which by their nature are long-term assets. Moody's methodology for rating airports specifically factors in regulation / rate-setting as one of the criteria determining our ratings in the sector."*

Standard & Poor's arrive at a similar conclusion when it notes that:

> *"Negative pressure on the rating may arise if … [t]here were adverse changes to the existing light-handed regulatory regime"*[28]

These comments suggest that BAC's credit rating may be downgraded if a heavier-handed regulatory approach was adopted. This, in turn, would affect the price at which BAC would be able to source debt finance and its ability to fund future investment.

[28] Standard and Poor's 2011, *Global Credit Portal RatingsDirect Brisbane Airport Corp. Pty Ltd.* March 17, p4

Summary

BAC takes its role as a good corporate citizen very seriously and its behaviour is consistent with its own high standards. Given the increased competition with Gold Coast Airport, it is difficult to see why Brisbane Airport should be subject to any specific price or profit monitoring. The processes in the *Competition and Consumer Act 2010* would appear to be sufficient to enable airlines to take action if they are concerned about abuse of market power. The threat of re-regulation by the Government if there is evidence of abuse of market power, is sufficient to control the behaviour of Brisbane Airport.

6 Airport planning regulations and transport

This chapter provides responses to specific questions about the current planning regulations and transport linkages to the airport.

6.1 Scope

The Commission is seeking feedback on which major cities it should consider when addressing its Terms of Reference on airport planning and transport linkages. Specifically, the Commission seeks responses to the following questions:

> *The terms of reference request the Commission to focus on the provision of passenger transport services at and surrounding main passenger airports operating in Australia's major cities. Which major cities should the Commission focus on — those housing the five price and service monitored airports, all capital cities or some other combination? Should potential links between airports (such as Canberra and Sydney or Melbourne and Avalon) be examined?*

The issue of effective transport linkages and coordination of activities with state and local government planning authorities is not an issue that is unique to the price-monitored airports. Therefore, there is likely to be some benefit in the Commission considering this matter across a wider range of airports. However, BAC believes the issue of which specific airports to consider is a matter for the Commission to determine.

Regarding Brisbane Airport specifically, BAC believe it is appropriate to consider South East Queensland as a whole, as this represents the catchment area for Brisbane Airport. As the Gold Coast Airport and Sunshine Coast Airport both compete with Brisbane Airport, BAC believe it is appropriate to consider the potential links between the three airports. As noted previously, Gold Coast Airport has been increasing its market share of the domestic passengers. The level of competition from both the Gold Coast Airport and Sunshine Coast Airport will increase over time as transport linkages are improved.

6.2 Planning regulations

The Commission is seeking feedback on the effectiveness of planning regulations and coordination with planning authorities. Specifically, the Commission seeks responses to the following questions:

> *Are planning and development regulations working effectively? 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?*
>
> *What mechanisms exist at airports to coordinate with local and state governments on planning issues? Can more be done by airports and governments to better coordinate planning of transport options? Will recent changes to legislation to impose additional requirements on airport Master Plans (such as ground transport plans) help to alleviate past problems?*

There has been significant non-aeronautical economic development at Brisbane Airport since 1997/98. However, BAC has planned and undertaken this development in such a manner so as not to impinge on future aeronautical developments. The 2009 Master Plan for Brisbane Airport clearly identifies those areas that are required for future aeronautical development.

Furthermore, the commercial developments at Brisbane Airport have not impeded effective transport linkages. To the contrary, BAC takes a holistic view in its planning, with transport linkages being an integral component of the overall planning process.

BAC also has a history of working effectively with state and local government planning and transport authorities. For example, BAC has worked with Translink to introduce public bus services to the commercial and hangar precincts at the airport and are in regular discussions with Translink about further public bus services to and around the airport. BAC also worked closely with the state planning authorities to facilitate the duplication of the Gateway Motorway, which traverses the airport and provides a key access point for traffic inbound from the north and south, and the Airport Link, which provides the key access point for traffic originating from the west.

There are a number of relevant forums on transport and development that BAC participates in.

One of these is the Brisbane Airport Area Round Table (BAART), which includes executive level representatives from state and local government planning and transport authorities. BAART meets four to five times per annum to coordinate activities, and discuss current and future projects.

BAC is also an active contributor to the Australia Trade Coast (ATC) initiative, which is a joint initiative between BAC, the Port of Brisbane Corporation, the Queensland Government through the Department of Employment, Economic Development and Innovation and the Brisbane City Council. The vision of this organisation is "to share the commitment to creating a world-class, international gateway for business in Brisbane". To assist in achieving this vision, the ATC established an Infrastructure Working Group "to coordinate infrastructure planning for the region between the government and industry partners." Initiative from this Working Group have led to $600 million being invested in infrastructure development throughout the region in the past seven years, as well as the development of numerous studies to identify key issues for the region in the future.

Active participation in the ATC initiative underlines the commitment which BAC has to working with key stakeholders to plan and facilitate transportation in order to encourage growth in the Trade Coast region.

6.3 Transport options

The Commission is seeking feedback on the transport options at Brisbane Airport and the conditions of access for service providers. Specifically, the Commission seeks responses to the following questions:

> *What transport options exist at the major airports in Australia? Are these reliable, frequent and cost effective services? Are they integrated into the suburban transport network? To what extent are they used relative to private cars? 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? Are charges and conditions of access to airports (e.g. convenient pick-up and drop-off points) appropriate? Is there a need to monitor such terms and conditions?*

KPMG considered these questions in detail their report on car parking and landside access at Brisbane Airport, which is attached at Appendix A. Further details supporting the BAC response below can be found in that report.

Transport options at Brisbane Airport

As set out in section 3.1, there are a wide range of options for transport to and from Brisbane Airport. Furthermore, many of the services now available have been introduced since Brisbane Airport was privatised.

KPMG found that these services were generally reliable, frequent and cost effective, not withstanding that perceived cost effectiveness varies between passengers. Furthermore, these transport options are fully integrated into the suburban transport network. For example, the Airtrain provides a continuous service from the domestic and international terminals to the Gold Coast and tickets for this service can be purchased at any train station within the South East Queensland suburban rail network.

KPMG also found that on airport car parking accounts for less than one in five arriving and departing passengers. While free pick up and drop off accounts for more than half of passengers, the market shares of Airtrain (8.9%) and taxis (8.6%) were also significant in 2009/10. BAC expects that the market share of the Airtrain will continue to increase, given the growth in the popularity of this service in recent years. Furthermore, given the increase in the number of off airport car park operators in recent years, BAC also expects their share of the market to increase.

BAC fully supports and facilitates the growth of the alternative modes of transport.

Facilitation of access

The KPMG report concludes that BAC has facilitated, rather than restricted, competition from alternative transport modes. This conclusion was based on the following observations:

- The alternative options available to passengers and staff have increased since privatisation and the market share of the alternative options have increased. For example, Airtrain commenced operations in 2001 and now accounts for almost one in 10 airline passengers;

- BAC provides comprehensive information regarding the alternative travel options on its website, including cost comparisons for bus, rail and train when users check car parking fees online;

- BAC provides high quality facilities for its competitors including dedicated GTO and taxi lanes and pick up areas in close proximity to each terminal. The facilities provided are also in the process of being upgraded further through the Domestic Terminal Access Project;

- BAC has invested in the Central Parking Area (CPA) to provide taxis and GTOs with a significant holding area which includes a canteen, prayer room, amenities and shade cloth;

- The fees charges by BAC to the GTOs represent only a small proportion of the total revenue that a GTO could expect to earn from a return trip to Brisbane Airport;

- BAC has made significant investments to facilitate land side access, much of which is classified as non-aeronautical and thus not recovered through aeronautical charges. For example, the CPA is 100% non-aeronautical and approximately $88 million of the costs associated with the recent Northern Access Road Project (NARP) were non-aeronautical; and

- BAC funds the staff bus, the terminal shuttle, the Airport Village bus and any infrastructure required to facilitate the operation of public bus services within the airport boundaries (e.g. bus stops).

Monitoring of landside access terms and conditions

As described above the charges for access to the Brisbane Airport are very reasonable given the high quality facilities provided. The desire of BAC to provide excellent facilities for access to the airport is best highlighted by our investment in the CPA. This represents a significant capital investment for BAC and is being very well received by the current users.

BAC realise the importance of facilitating access to the airport as an input to our core business of the airport itself. As such, BAC actively supports its competitors in providing land side access to the airport, and therefore does not consider that there is a need to monitor the terms and conditions of providing access. This would simply add to the regulatory burden faced by the airport, and not provide any benefit to passengers, or GTOs.

A KPMG report on car parking and land side access at Brisbane Airport

Brisbane Airport Corporation

Car Parking and Land Side Access at Brisbane Airport

Final Report

April 2011
This report contains 47 pages
11228626_5

Executive Summary

The Commonwealth Government recently directed the Productivity Commission (the Commission) to commence an inquiry into the economic regulation of airports in Australia. In response to concerns raised by the Australian Competition and Consumer Commission (ACCC) about the potential for monopoly rents being extracted through car parking charges at the airports, the Terms of Reference for this inquiry requires the Commission to, amongst other things, examine the provision and quality of land transport facilities providing access to the airports.

To commence the inquiry, the Productivity Commission released an Issues Paper in January 2011 entitled *Economic Regulation of Airport Services*.

KPMG was engaged by Brisbane Airport Corporation Pty Ltd (BAC) to examine the car parking and land side access at Brisbane Airport, with a view to addressing the questions in the Productivity Commission's Issues paper.

Economic theory identifies various common market characteristics and behaviours employed by businesses who are attempting to extract monopoly rents. However, we have not found any of these characteristics in relation to car parking and land side access at Brisbane Airport. Rather, what we have found is that:

- There are a wide range of options for passengers and staff to access the airport facilities. Around 80% of passengers choose to access the terminals by one of these other means, which include private vehicle drop off / pick up, taxis, Airtrain, off airport car parking, buses / shuttles, limousines and hire cars;

- The alternative transport options are a real source of competition to BAC's car parking operations and this has been reflected in BAC's pricing behaviour. In 2009/10, BAC reduced long-term car parking charges at the international car park and these charges are now comparable to charges for off airport car parking;

- The number of off airport car park operators has increased significantly in recent years, suggesting there is competition and barriers to entry are low;

- BAC has facilitated, rather than restricted, competition from alternative transport modes. Furthermore, the fees charged to ground transport operators for passenger pick ups represent only a small proportion of the typical fares and are reasonable given the investments made by BAC;

- BAC has made significant and timely investments in car parking and landside access, with car parking capacity growing at a higher rate than passengers;

- This investment has led to significant improvements in the quality of services. When the airport was privatised in 1997, there were no undercover public car park spaces at Brisbane Airport. With the completion of the new Domestic Terminal multi-level car park, there will be 10,082 undercover public car parking bays and 139 at grade public car parking bays.

Furthermore, the number of car rental bays will almost double from 584 today (4% undercover) to 1,018 in early 2012 (79% undercover);

- BAC generally ranks high on quality of service and, in 2009/10, ranked highest for "car parking availability" and second-highest for "time taken to enter the car park" relative to the other price-monitored airports;

- Prices at CBD car parks in Brisbane, which also enjoy a locational advantage, have been increasing at a faster rate than the car parking charges at Brisbane Airport. Furthermore, parking at Brisbane Airport is now cheaper than parking at any of the privately owned car parks in the Brisbane CBD; and

- The rate of return earned by BAC on car parking and land side access is around 10%, which is not excessive.

These findings do not support the notion that BAC has abused its market power and is extracting monopoly rents. Rather, there are viable alternatives to the use of on airport car parks and BAC has actively facilitated competition from the alternative transport modes.

Contents

Inherent Limitations

This report has been prepared as outlined in the Scope Section. The services provided in connection with this engagement comprise an advisory engagement, which is not subject to assurance or other standards issued by the Australian Auditing and Assurance Standards Board and, consequently no opinions or conclusions intended to convey assurance have been expressed.

No warranty of completeness, accuracy or reliability is given in relation to the statements and representations made by, and the information and documentation provided by, BAC management and personnel consulted as part of the process.

KPMG have indicated within this report the sources of the information provided. We have not sought to independently verify those sources unless otherwise noted within the report.

KPMG is under no obligation in any circumstance to update this report, in either oral or written form, for events occurring after the report has been issued in final form.

The findings in this report have been formed on the above basis.

Third Party Reliance

This report is solely for the purpose set out in the Scope Section and for BAC's information, and is not to be used for any other purpose or distributed to any other party without KPMG's prior written consent.

This report has been prepared at the request of BAC in accordance with the terms of KPMG's engagement letter/contract dated 20 July 2010. Other than our responsibility to BAC, neither KPMG nor any member or employee of KPMG undertakes responsibility arising in any way from reliance placed by a third party on this report. Any reliance placed is that party's sole responsibility.

1 Introduction

1.1 Background

The Commonwealth Government recently directed the Productivity Commission (the Commission) to commence an inquiry into the economic regulation of airports in Australia. The Terms of Reference for this inquiry requires the Commission to, amongst other things:

- examine the provision and quality of land transport facilities providing access to the airports;
- consider whether the existing regime is effective in appropriately deterring potential abuses of market power by airport operators;
- consider the adequacy and arrangement for the control of planning, operation and service quality monitoring of land transport access to major airports; and
- have regard to the concerns raised by the Australian Competition and Consumer Commission (ACCC).[1]

The ACCC formally commenced monitoring airport car parking charges in 2008, with its first commentary appearing in the 2007-08 Airport Monitoring Report. At that time, the ACCC considered that *"the monitoring results and structural characteristics of airport car parking [were] consistent with charges reflecting an element of monopoly rent"*.[2] It has maintained this view without corresponding evidence to prove it in subsequent price monitoring reports.

To commence the inquiry, the Productivity Commission released an Issues Paper in January 2011 entitled *Economic Regulation of Airport Services*.

1.2 Scope

KPMG was engaged by Brisbane Airport Corporation Pty Ltd (BAC) to examine the car parking and land side access at Brisbane Airport, with a view to addressing the questions in the Productivity Commission's Issues Paper and establishing whether there is any basis to suggest that BAC has market power in this market and, if so, whether BAC has misused this market power.

In preparing this report we:

- Undertook a desktop review of relevant literature, including prior Productivity Commission inquiries into airport pricing in Australia and the ACCC's annual price monitoring reports;
- Completed primary research in a number of areas, including researching comparative prices;

[1] Productivity Commission 2011, *Economic Regulation of Airport Services*, Issues Paper, January.
[2] ACCC 2009, *Airport monitoring report 2007-08: Price, financial performance and quality of service monitoring*, March, p.37.

- Obtained relevant information from BAC, including operational data for its Parking and Transport Services business;
- Examined the available evidence to address the questions posed by the Commission in its Issues Paper; and
- Prepared a report (this document) setting out our findings and conclusions.

1.3 Structure of Report

This report is structured as follows:

- Chapter 2 sets the context by providing a brief history and current overview of car parking and land side access at Brisbane Airport;
- Chapter 3 examines the level of competition amongst the alternative land side access options and whether competition has been restricted or facilitated by BAC;
- Chapter 4 considers the quality of the car parking and land side access services provided by BAC, including the timeliness of investment;
- Chapter 5 examines car parking charges at Brisbane Airport and the returns to BAC; and
- Chapter 6 concludes with our assessment of the level of market power held and used by BAC.

2 Overview of car parking and land access at Brisbane Airport

This chapter provides an overview of the car parking and land side transport options at Brisbane Airport. Specific questions raised by the Commission are addressed in the subsequent chapters.

2.1 Car parking and land side access options

Passengers, staff and others needing to access the domestic and international terminals at Brisbane Airport have a wide range of options to choose from. Table 1 below provides a snapshot of the options and the providers of the relevant services.

Table 1 Transport options to and from Brisbane Airport

Transport Option	BAC	Other Providers[1]	
Car Parking – on airport (under cover and open air)	✓		
Car parking – off airport (with free shuttle)		✓	Gateway Airport Parking, Budget Airport Parking, Andrew's Car parking, Alpha Car Parking, Priority Parking, Portside Parking, Kingsford Smith Airport Parking.
Car parking – valet	✓	✓	Qantas
Free pick up & drop off		✓	Private vehicle
Rental Car – on airport		✓	Avis, Budget, Hertz, Europcar, Redspot, Thrifty
Rental Car – off airport		✓	Numerous (>20)
Taxi		✓	Black & White Cabs Yellow Cabs
Limousine / Hire Car		✓	Numerous (>100)
Train		✓	Airtrain
Public Bus (to Airport Village , Da Vinci Precinct and Aerotech Park) BAC Airport Village Bus (to International Terminal) BAC Inter-terminal Bus BAC Staff Bus	✓	✓	Translink (public buses) Carbridge (funded by BAC)
Private Buses & Shuttles		✓	Coachtrans (licensed), plus a variety of others
Walk / cycle	✓		

1. While some of the services are only provided by "Other Providers", it should be noted that BAC provides the infrastructure (e.g. roads, kerbsides, facilities) to enable the "Other Providers" to access the terminals.

The range of landside access options has increased significantly since Brisbane Airport was privatised in 1997. At that time, there was no undercover parking, only one off-airport car park operator, no Airtrain, no public bus, no Airport Village Shuttle and no dedicated walk / cycle track.

The following table summarises the indicative costs and relative convenience of the alternative transport options.

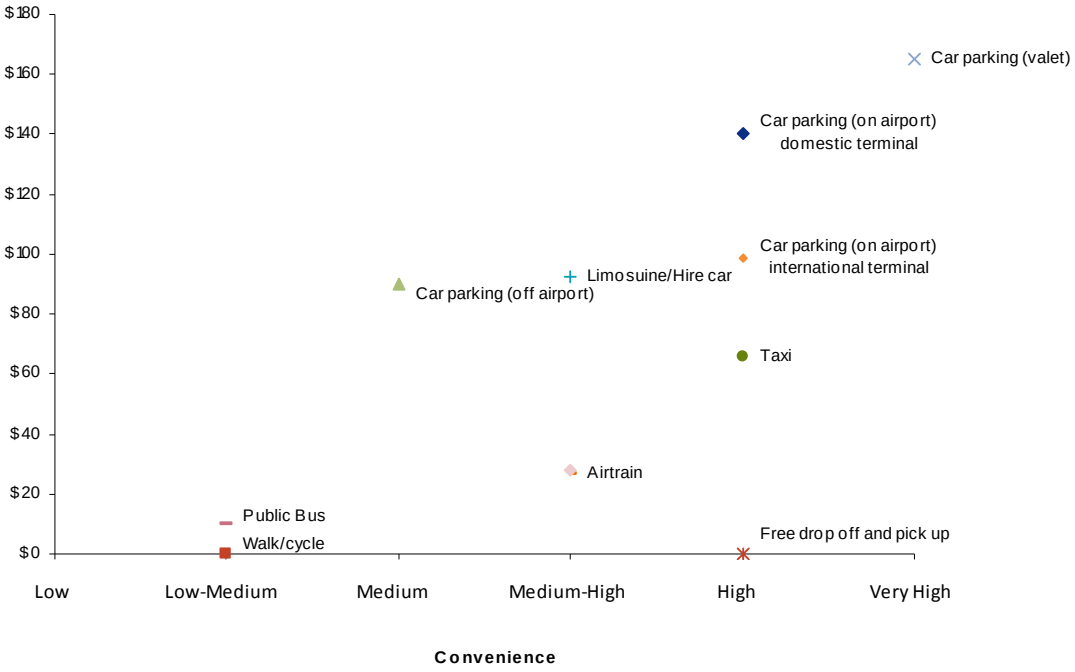
Table 2 Cost and convenience of transport options to and from Brisbane Airport

Transport Option	Indicative Cost [1]				Convenience	Comments
	1 hr	4 hr	1 day	7 days		
Car Parking – on airport Domestic Terminal	16	40	40	140	High	Proximity to terminal means it is effectively "door-to-door".
Car Parking – on airport International Terminal	16	30	30	99	High	Proximity to terminal means it is effectively "door-to-door".
Car parking – off airport (with free shuttle)	16-25	16-25	16-25	70-97	Medium	Need to allow extra time for shuttle transfer (~half hour). May need to book
Car parking – valet	38-63	50-63	63-65	165-263	Very High	Proximity to terminal means it is effectively "door-to-door".
Private vehicle (pick up & drop off)	Free[2]				High	Proximity to terminal means it is effectively "door-to-door".
Rental Car – on airport	From $29 per day[3]				Medium – High	Generally need to book to ensure a car is available.
Rental Car – off airport	Varies depending on type of vehicle.				Medium – High	Generally need to book to ensure a car is available. Only marginally less convenient than on airport rental due to the favourable positioning of the facilities provided by BAC.
Taxi	Varies depending on origin. ~$66 from CBD (return)				High	For trips to the airport, need to book or wait at a taxi rank. Waiting times are subject to taxi availability. Effectively "door-to-door".
Limousine / Hire Car	$80 – $185 from CBD (one-way)				Medium – High	Need to be booked beforehand. Effectively "door-to-door".
Airtrain	~$27 from CBD (return, adult) Staff: $25 per week (CBD)				Medium – High	Relative convenience depends on proximity of point of origin to the train network. The stations are at the terminals.
Public Bus Airport Village Bus Inter-terminal Bus Staff Bus	Public bus varies with origin. Airport Village Bus free to ITB, $5 to DTB on Inter-terminal Bus Staff Bus is free				Low – Medium	Less convenient for travellers with luggage, but may be convenient for staff. Requires at least one transfer, but the public bus is well integrated into the Brisbane bus and rail network as it includes a stop at Toombul Station, a major interchange hub in North Brisbane
Private Buses & Shuttles	Varies depending on origin. ~$28 from CBD (return, adult)				Medium – High	May need to be booked beforehand. Proximity to terminal means it is effectively "door-to-door".
Walk / cycle	Free				Low – medium	Not convenient for travellers with luggage, but may be convenient for staff.

1. Based on published prices as at February 2011.
2. Ignoring the financial costs (e.g. vehicle operating costs) and non-financial costs (e.g. opportunity cost of the driver's time).
3. This is based on the cheapest quote found for pick up and drop off at Brisbane Airport (Able Car Hire). This price also includes the benefit of having access to the car for the duration of the stay and so is not an exact comparator for the prices listed for the other land side access options.
Source: BAC, provider websites and http://www.brisbane-australia.com/brisbane-airport-transfers.html

The representation of this data graphically, as shown below, indicates a general trend of increasing cost with increasing convenience.

Figure 1 Price vs convenience for travel options to Brisbane Airport[3]



The notable exception to this general trend is the free drop off and pick up. However the costs for this option exclude the financial and non-financial costs (e.g. vehicle operating costs and the opportunity cost of the driver's time), and if these costs could be accurately quantified, would be more consistent with the general trend.

There are a range of factors that passengers and staff are likely to take into consideration when choosing between the various options available, including price, convenience and overall travel time. While cost and time are objective measures, the assessment of convenience is necessarily subjective as the perception of relative convenience depends on the passenger's specific circumstances. For example, there is a significant difference in the convenience of catching the Airtrain, for a young couple with no children living near a train station compared to family of four who don't live near a train station.

Further information on the car parking and land side access options and competition between them is provided in Chapter 3, while further information on public car parking charges and the rates of return to BAC is provided in Chapter 4.

2.2 Capacity, quality of service and investment

As at 6 April 2011, BAC provided 7,362 public car park spaces, comprising the following facilities:

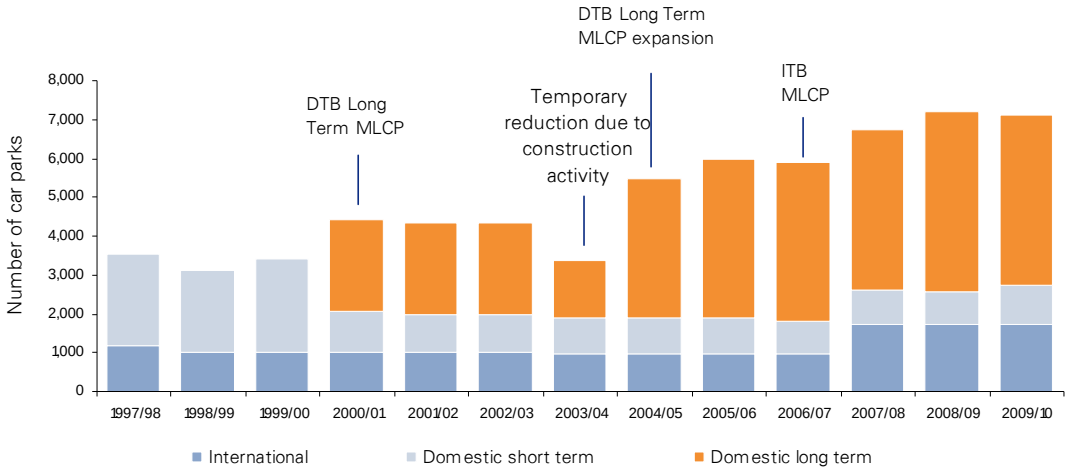
[3] This graphic excludes on and off airport car rentals as the prices for these options do not provide a fair comparison as the passenger using these options also gets the benefit of having access to the car, where the other options solely provide access to the airport.

- Domestic long-term Multi Level Car Park (MLCP) (4,410 spaces);
- Domestic short term at-grade car park (1,133 spaces);
- International short and long-term MLCP (1,740 spaces);
- International at-grade car park (79 spaces).

In addition, BAC also provides at-grade car parking for staff, at-grade and undercover parking for rental cars, free private bus holding areas and a shaded holding area for taxis.

BAC has made significant investments in the quality and quantity of car parking since Brisbane Airport was privatised. As shown in the following chart, total public car parking capacity has doubled from 3,546 car spaces in 1998 to 7,126 car spaces as at 30 June 2010.

Figure 2 Number of car parks available at Brisbane Airport



Note: the decrease in car park spaces in 2003/04 was due to the construction of the extension to the original MLCP and associated road and ground transport works at that time
Source: ACCC Price Monitoring Reports

As noted previously, there was no undercover car parking provided at Brisbane Airport in 1997. When the construction of new MLCP at the Brisbane Domestic Terminal is completed in early 2012, there will be 10,082 undercover public car parking bays and 139 at grade public car parking bays. Furthermore, the number of car rental bays will almost double from 584 today (4% undercover) to 1,018 in early 2012 (79% undercover).

In total, BAC has invested around $600 million on improving land side access and car parking facilities at Brisbane Airport over the past 14 years. Major projects include:

- Domestic long term MLCP extension - $28 million;
- International terminal MLCP - $37 million;
- Moreton Drive (Northern Access Road Project (NARP)) - $220 million;
- Central Parking Area (CPA) Stage 1 (Taxi area) - $47 million;

- Domestic short-term MLCP (current project) - $190 million; and
- Domestic Terminal Pedestrian Access Bridge and associated road improvements (current project) - $43 million.

In addition to the direct investments above, BAC has contributed the land corridor across the airport for the duplication of the Gateway Motorway. In return for this contribution, the Queensland State Government funded the Gateway Motorway Northern Interchange, which provides access to the airport from the motorway. BAC has also facilitated the construction of the Northern Link which flies over Airport Drive.

Brisbane Airport has consistently ranked highly on the overall level of quality of services provided at the airport, as well as the quality of car parking, compared to the other price-monitored airports. The ACCC price and quality of services monitoring reports indicate that, amongst the five price-monitored airports, Brisbane Airport ranked:

- highest for overall quality of service at the airport every year since 2002/03, and was the only airport with a rating above "Good" (rating of 4.15, on a scale of 1-5 with 4 representing a rating of "Good") for 2009/10;
- highest for car parking availability in 2009/10 with a rating of 3.94 (just below "Good"); and
- second highest for "time taken to enter the car park" in 2009/10, with a rating just above "Good".[4]

Further information on the car parking quality of service and the investments made by BAC are provided in Chapter 4.

[4] ACCC 2011, ibid.

3 Modal shares and competition

As noted in the previous chapter, there is a wide range of options for accessing the terminals at Brisbane Airport including:

- On-airport car parking;
- On-airport valet parking;
- Off-airport car parking;
- Private vehicle pick-up / drop-off
- On airport car rental;
- Off airport car rental;
- Taxis;
- Airtrain;
- Public bus;
- Shuttle buses and other GTOs; and
- Walking / cycling.

This chapter examines the modal share for passenger access to the terminal and addresses the Commission's questions about the relative use of the transport modes, frequency, reliability, cost-effectiveness and integration with the suburban transport network.

It also considers the behaviour of BAC toward the third party service providers.

3.1 Transport mode market shares

The market share of on-airport car parking relative to other forms of land side access can provide an indication of the level of competition from the substitutes. As the walking, cycling and public bus options are used primarily by staff working at the airport, these transport options are not considered in this section.

Issues Paper:

What percentage of passengers use the airport's car park facilities? (p.12)

What transport options exist at the major airports in Australia? To what extent are they used relative to private cars? (p.22)

BAC's 2009 Airport Master Plan included the findings from a study into the airport-wide transport mode market shares in 2008. It was estimated that the market share of private cars at that time was 83%, and that this would decrease over time in favour of public transport options. For the purpose of that study, private vehicles included those vehicles using on and off airport parking, on and off airport car rentals, as well as those using the free pick up and drop off facilities.

While the transport mode study provided useful insights for the development of the Master Plan, it was not prepared in anticipation of the Commission's review and thus:

- did not distinguish between the purpose of the access to the airport (i.e. passengers, staff and others); and

- did not specifically consider whether the private vehicles were parked at the public car park or used for kerbside drop-off / pick-up.

Therefore, KPMG has estimated the current modal shares on the best available information.

BAC Car Park

Total public car park throughput at Brisbane Airport was just over 2 million in both 2008/09 and 2009/10.[5] Assuming this throughput is primarily for the purpose of picking up or dropping off passengers and parking while away, and each car takes on average between 1 and 2 passengers[6], the number of passengers using the car park to access the terminal would be between approximately 2 million and 4 million. This represented approximately 11% to 22% of all domestic and international passengers (except domestic on-carriage) in 2009/10.

The estimate of 22% is likely to represent the upper limit of the market share of the public car park as not all throughput at the car park is related to travelling passengers (e.g. it is also used by couriers, persons attending on-airport business meetings, tradespersons, etc.).

Airtrain

[redacted].[7] This means that approximately [redacted] airline passengers accessed Brisbane Airport terminals via the Airtrain in 2009-10, representing a significant market share of approximately 8.9%.

Interestingly, Airtrain's market share is significantly higher than was forecast when the airport-wide transport mode study for the 2009 Master Plan was undertaken. Specifically, this study forecast that Airtrain's total airport market share would be only 5.8% by 2014, increasing to 8.8% by 2029.

[5] ACCC 2011, ibid.
[6] Estimate based on discussion with BAC.
[7] Patronage figures received from Airtrain via email, 21 March 2011.

Taxis

There were 1,100,810 taxi movements at Brisbane Airport in 2009/10.[8] Assuming each taxi carries 1 to 2 passengers, the number of passengers using taxis to access Brisbane Airport is around 1.1 to 2.2 million. This represents a market share of 5.7% to 11.4%.

This is consistent with the airport-wide transport model study included in the 2009 Airport Master Plan, which estimated that the market share for taxis was 8% overall (i.e. passengers, staff and other).

Off-airport car parking

In 2009/10, the off-airport car park operators undertook 90,500 shuttle bus trips between their operations and the Brisbane Airport terminals. These shuttle buses typically carry 5 to 11 passengers. Taking the average shuttle bus capacity (8 passengers)[9] and assuming 50% to 75% occupancy, this equates to 362,000 to 543,000 passengers per annum. This represents a modal market share of 1.9% to 2.8%.

Limousines and hire cars

There were approximately 127,000 limousine and hire car movements at Brisbane Airport in 2009/10.[10] Assuming each limousine or hire car carries 1 to 2 passengers, the number of passengers using limousines and hire cars to access Brisbane Airport is around 127,000 to 255,000 per annum. This represents a market share of 0.7% to 1.3%.

Private buses

In 2009/10, there were approximately 105,000 private bus movements at Brisbane Airport.[11] Assuming average bus sizes and occupancy ranging from 50% to 75%, this equates to 723,000 to 1.1 million passengers per annum using private buses to access Brisbane Airport. This equates to a market share of 3.8% to 5.6%.

Private vehicle (Free drop off and pick up/Car Rental)

By definition, the market share of free drop off and pick up and car rental is the total number of passengers less those who use an alternative mode of transport. Given the market shares for each of the alternative modes estimated above, it is estimated that the market share of free drop off and pick up and car rentals is in the order of 48% to 68%. This includes some car rental activity but this is not recorded and therefore cannot be separately estimated.

[8] Data provided by BAC
[9] KPMG conducted telephone interviews with seven off-site airport car parking operators in March 2011. Based on these discussions, KPMG estimated that eight passengers was the average shuttle bus capacity for off-site airport operators.
[10] Data provided by BAC
[11] Data provided by BAC

Summary

The following table summarises the market shares of the alternative modes of transport to the terminals at Brisbane Airport.

Table 3 Transport mode market share estimates

Mode	2008[1]	Modal Share 2009/10 estimate	
		Mid-point	Range
Private vehicle – drop off / pick up[2]	83%	**58%**	48% - 68%
Private vehicle – on-airport car park		**16%**	11% - 22%
Private vehicle – off-airport car park		**2%**	2% - 3%
Airtrain	5%	**9%**	n.a.
Taxi	8%	**9%**	6% - 11%
Private Bus	3%	**5%**	4% - 6%
Limousine / Hire Car	<1%	**1%**	0.5% - 1.5%
Other	<1%	Not estimated	n.a.

1. Includes passengers and staff. Source: BAC 2009 Master Plan.
2. Includes car rental activity as this cannot be separately estimated.
3. Totals may not sum to 100% due to rounding.

Source: BAC 2009 Master Plan, KPMG estimates

Private vehicles remain the preferred mode of transport to the airport terminals for passengers. However, the market share of private vehicles appears to be falling in favour of other transport modes.

The increasing market shares of the other transport options demonstrates that BAC faces competition for its car parking services.

3.2 Reliability, frequency and cost-effectiveness

Issues Paper:

Are these reliable, frequent and cost effective services? Are they integrated into the suburban transport network? (p.22)

The relative frequency, reliability and cost-effectiveness of the alternative transport options, as well as the degree to which they have been integrated into the suburban transport network, are measures which may be used to assess the extent to which the land side access options provide viable alternatives to on airport parking.

Table 4 following provides a snapshot of these respective qualities for the Airtrain, taxi, free drop off and pick up, off-site parking and private bus transport services.

Cost effectiveness is necessarily a subjective measure as this will be influenced by the specific circumstances of the passenger, such as disposable income, particularly for non-business travel. Furthermore, it is also dependent on the number of passengers travelling as a group. Therefore, for the purpose and simplicity of assessing the cost effectiveness of the options compared with on-site parking, four passenger groups have been identified: 'single person' and 'family of four' for both the CBD and Gold Coast (GC).

In addition, we have measured reliability as the degree of availability, punctuality and ease of access/attainability of the respective transport option, as well as the overall travel time to / from the airport. Due to the number of factors that influence overall reliability, this has necessitated a subjective assessment of reliability to some extent.

The table also shows the break-even point, which is a measure of the relative cost of using the on-site parking facility and any given alternative option. The price at which the alternative transport mode is equal to the price of the on-site parking is the break-even point. The corresponding time frame (i.e. number of days / hours) to stay at the on-site parking represents the break-even value of the two options. These values are based on the prices for the International MLCP car park (2009/10).

Table 4 Reliability, frequency and cost-effectiveness

Transport Mode	Reliability	Frequency	Passenger Group		Cost (return trip)	Break-Even Point	Transport Network Integration
Airtrain	*High* • 88% on time performance during peak[1]	• Every 15 minutes during peak periods • Every 30 minutes off-peak • Trains run between 6:00 and 20:00 o'clock	CBD	Single person	$28	4 hours	✓
				Family of four	$64 (children are free)	2 days	
			Gold Coast	Single person	$50-$60[3]	2 days	
				Family of four	$100-$120[3]	7 to 9 days	
Taxi	*Medium/ High* • Available as required	• Booking or queuing at a taxi rank required for trips to the airport • Potential queuing when leaving the airport	CBD[2]		~$50 - $66	2 days	✓
			Gold Coast[2]		~$95- $170	5 days to 7 days	
Free drop off and pick up	*High* • Available as required	• Maximum of 2 minute parking allowed per car. • Potential queuing during peak periods	All[2]		Minimal cost to passengers	N/A	
Off-site parking	*Medium/ High* • Pre booking for guaranteed parking	• Shuttle services run on demand	All[2]		From $16 (minimum rate for 1 day)	2 hours	✓
Private buses[4]	*Medium/ High* • Pre booking required subject to availability	• Licensed buses are required to meet all arriving flights	CBD	Single person	$30	5 hours / 1 day	✓
				Family of four	$76	3 days	
			Gold Coast	Single person	$87	4 days	
				Family of four	$214	18 days	

Notes:
1. A train is classified as 'not on time' if it arrives more than three minutes and 59 seconds after its scheduled arrival time. This figure is an average of the peak on time performance across the QR City network for the period 11/02/11 – 16/02/11 (this is the only available data). Data specifically for Airtrain on time performance was not available however it runs on the QR network and has six CBD stations on its route. Therefore this measure is a reasonable representation of the reliability of the Airtrain service.
2. No cost difference for 1 to 4 passengers, ignoring the cost of private vehicle.
3. The rate range depends on which of the six Gold Coast Airtrain stations the passenger is travelling to/from.
4. These prices are based on Coachtrans Australia prices for their private bus services.

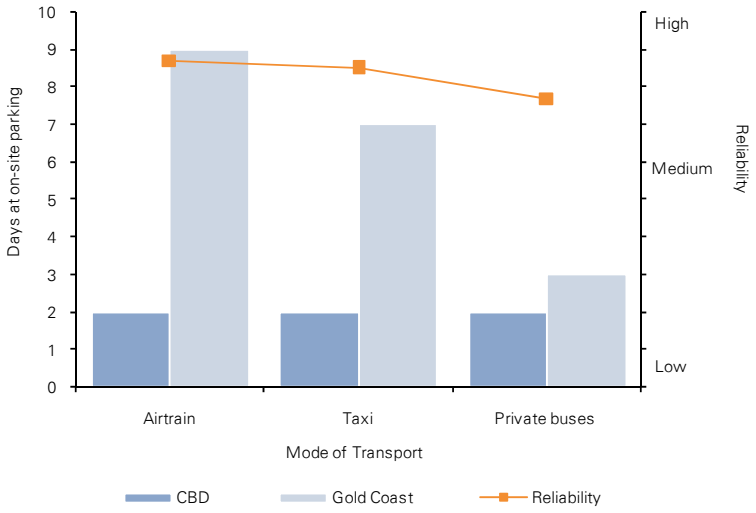
It is important to note that the ability to pay differs across demographic groups, which will influence the individual's assessment of the cost effectiveness of the transport options. A low-income earner travelling with a family of four will more likely place greater weight on the financial costs of the option than the non-financial costs (e.g. comfort, travel time) in assessing cost-effectiveness. For this type of passenger, off-site car parking, private buses or the Airtrain are likely to be cost-effective, having the lowest break-even points of (from) 2 hours, 2 days and 2 days respectively.

On the other hand, a high-income earner would more likely base their decision on other factors such as convenience, comfort and/or reliability. In this case, a taxi may be the most appropriate comparator to on-site parking regardless of the taxi having the highest break-even point of up to 7 days (to/from the Gold Coast).

When evaluating the cost effectiveness, it is important to consider the difference in travel time and other requirements or features of the various transport services. The Airtrain is not subject to unpredictable road traffic delays and takes a (relatively consistent) 20 minutes from the CBD to the airport. Comparably, this journey can take between 25 and 60 minutes by road transport modes namely taxi, car and bus, which are susceptible to variable traffic conditions. Further, some services have pre-travel time requirements, for example most off-site parking operators recommend being at their premises half an hour before needing to be at the airport. The relatively low break-even point is reflective of this requirement. Private bus operators provide customised pick-up from home or hotels for Gold Coast travellers. This personalised service is indicative in their high break-even point (for family of four).

Figure 3 below displays the degree of reliability and the break-even point for Airtrain, taxi and private buses transport options.

Figure 3 Reliability and break-even point for alternative options



The relative reliability of each transport option has been measured on a low, medium or high scale. The three transport modes (Airtrain, taxi and private bus) all exhibit strong reliability. For example, the consistent nature of the train network influences a high rating for Airtrain. However Airtrain's operating hours (6:00am to 8:00pm) restricts its availability to travellers, which has influenced an overall reliability rating to just below high. Comparatively, the 'on call' 24/7 nature of taxi services is indicative of strong reliability. A rating of medium to high has been assigned to taxi, due to its susceptibility to unpredictable road traffic delays (as noted previously). These conditions also apply for travellers using private buses and the on-site parking facility. This emphasises the competitive and attractive nature of the alternative transport services compared to on airport parking.

For the purpose of this analysis, the break-even point for the passenger group family of four has been used for both Airtrain and private bus. This allows for a more consistent assessment across the three options because a standard taxi services up to four passengers. The cost effectiveness for travelling to and from the CBD is equal across the three modes of transport with a break even value of two days stay at the on-site parking. The relatively low convenience ratings assigned to the Airtrain, taxi and private bus, compared to that of on-site parking (high convenience), is likely to be correlated with a low break-even value.[12]

For travel between the Gold Coast and Brisbane Airport, the Airtrain and taxi are less cost effective relative to on-site parking. However, private buses are a cost effective alternative to on-site parking.

Free drop off and pick up was not included in this analysis because no charges apply to use this facility, making this a cost effective alternative to on airport parking. As noted above, private vehicle costs (for example petrol) are excluded from this analysis. Off-site parking has also been excluded as this option is cheaper than on-site parking for all lengths of stays, and as such, a break even point cannot be calculated.

Integration into transport network

In response to the Commission's question of the degree to which the alternative options have been integrated into the transport network, it is evident that BAC has provided the necessary infrastructure and facilities to fully incorporate all services. A kerbside drop-off and pick-up location has been designated to each of the road services directly outside (or within close proximity to) the domestic and international terminals.

For the Airtrain, the airport stations are located directly outside the domestic and international terminals. The network has been fully integrated into the suburban Queensland Rail passenger network, which includes the Gold Coast. There are eight Brisbane suburban stations on the airport route, extending from Eagle junction to Park Road and six on the Gold Coast network. In addition, passengers are able to purchase tickets in advance from a variety of locations e.g. at the Airtrain booths located in BAC airport terminals or at any suburban station.

BAC also provides infrastructure for buses which are integrated into the greater Brisbane transport network. For example the bus service (308) which services Airport Village, stops at the interchange at the Toombul Station which is a major transport hub for North Brisbane.

[12] See section 2.1 for more details of the convenience ratings

3.3 Competitive constraints

Issues Paper:

What is the level of competition from other sources of transport? Are off-site car parks a real source of competition to the airport car parks? (p.12)

The modal share estimates presented in section 3.1 indicate that the market share of private vehicles for on-airport parking and passenger pick-up / set-down has decreased, while the relative use of private buses, taxi, and the Airtrain has increased. In particular, the market share of the Airtrain is now significantly higher than was anticipated in the 2009 BAC Master Plan given its low utilisation in the early years.

When Brisbane Airport was privatised in 1997, there was one off-airport car park operator (Budget Airport Parking). There are now seven, with four of those having been established in the past three years. This growth in the number of providers suggests that barriers to entry in the market are low, and it is a competitive market.

The combined market share of the off-airport car operators is relatively low. They nevertheless appear to have affected BAC's pricing decisions for the MLCP at the International Terminal.

The throughput at the International MLCP decreased in 2009/10. Subsequently, BAC decreased the price for a seven-day stay at the International MLCP from $115 in 2008/09 to $99, which is comparable to the off-airport car park options. This behaviour is not consistent with a monopolist using its market power to restrict supply and increase charges.

Given the growth in the number of providers and BAC's pricing decisions for the International MLCP, it appears that the alternative supply options act as effective competitors. BAC has successfully facilitated the competitive off airport parking options by providing fair access terms and conditions to these businesses.

3.4 BAC's behaviour

Issues Paper:

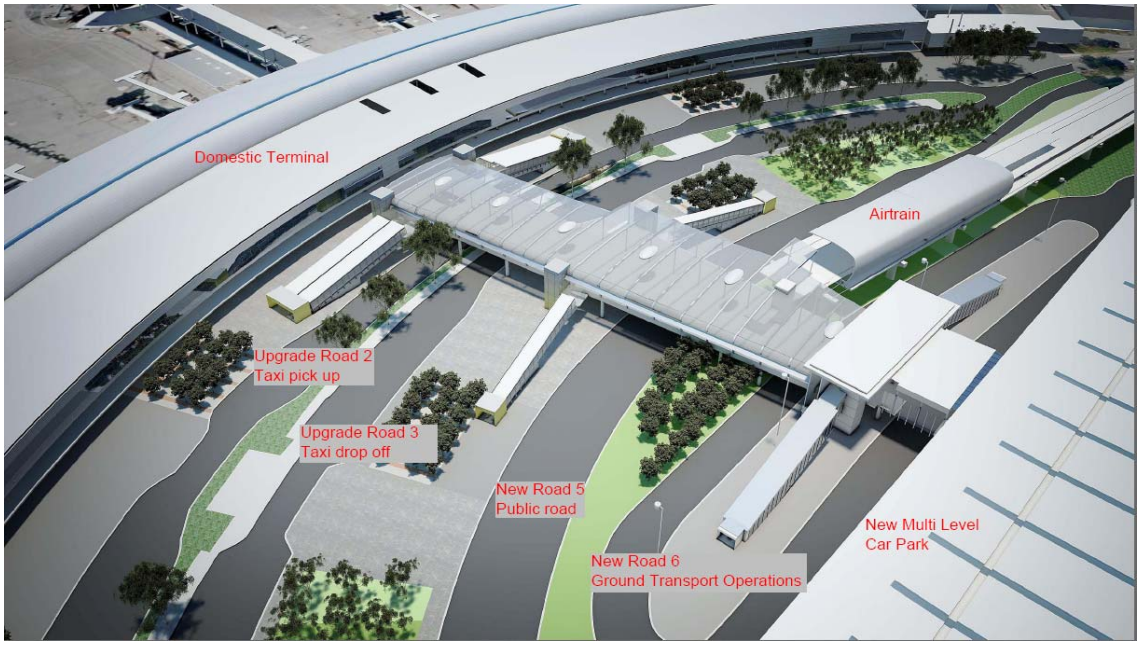
Is there evidence that airports are influencing the level of competition from alternative transport modes? (p. 13)

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? Are charges and conditions of access to airports (e.g convenient pick-up and drop-off points) appropriate? (p.22)

Facilities provided

BAC provides high quality facilities for all modes of transport including dedicated Ground Transport Operator (GTO) and taxi lanes and pick up areas in close proximity to each terminal. These facilities are also being upgraded further. As illustrated in Figure 4 below, the Domestic Terminal Access Project (DTAP) will provide significant benefits to taxis and GTOs.

Figure 4 Facilities available upon completion of the DTAP



With the completion of the DTAP in 2011/12, the two roads closest to the domestic terminal will be dedicated to taxi pick up and taxi drop off as well as limousine services, respectively. The third road from the terminal will be a public road providing for drop off, with pick up facilities located next to the existing long term MLCP. The final road between the Domestic Terminal and the car park will provide a significantly expanded area for GTOs. Thus, each alternative transport option, including the Airtrain, will have a drop off / pick up point that is closer to the terminal than BAC's car parking facilities.

At the International Terminal there are also dedicated taxi and GTO lanes. There are also free bus and taxi holding areas. In addition to this, the new Central Parking Area (CPA) provides taxis and GTOs with a significant holding area which includes a canteen, prayer room, amenities and shade cloth.

Fees and charges

The fees charged by BAC to taxis and other GTOs are shown in the table below, and compared to the overall fare for the respective transport options. It should be noted that the BAC fees are only for pick ups at the airport, with drop offs being free.

Table 5 BAC charges to taxis and GTOs

	BAC fee	Total average return fare[1]	Average Number of Passengers	Average revenue for operator for return trip	BAC fee as % of total GTO revenue
Taxi fee (to city)	$3.00	$58.00	n.a.	$58.00	5.17%
Taxi fee (to Gold Coast)	$3.00	$132.50	n.a.	$132.50	2.26%
Large bus (to city)	$11.50	$30.00 per pax	n.a.	$600.00	1.92 %
Large bus (to Gold Coast)	$11.50	$87 per pax	20	$1,740	0.66%
Medium Bus (to city)	$9.50	$30.00 per pax	20	$240.00	3.96%
Medium bus (to Gold Coast)	$9.50	$87 per pax	8	$969.00	1.36%

1. Mid-point of the cost estimates provided in Section 3.2 for a single adult travelling from the airport. Bus fares are taken from Coachtrans website (http://www.coachtrans.com.au/pricing.aspx)

The table above shows that the fees charged by BAC to the GTOs represent only a small proportion of the total revenue that a GTO could expect to earn from a return trip to the airport from the CBD. For travel between Brisbane Airport and areas further from the CBD (e.g. Toowoomba or the Gold Coast), the BAC fee represents an even smaller proportion of the total revenue earned by the GTO.

BAC provides significant infrastructure to enable land side access to the airport which is used by these GTOs. BAC needs to fund the non-aeronautical components of this investment through non-aeronautical charges, including from the fees charged to GTOs. In some instances, such as the taxi holding facilities, the aeronautical component of the capital and operating expenditure is 0%, which means that it needs to be fully funded from charges other than aeronautical charges. For example, the recent Northern Access Road Project (NARP) had a capital expenditure of approximately $220 million. BAC, in consultation with the airlines, allocated 60% of this cost to the aeronautical asset base, thus leaving 40% of the total capital cost ($88 million) to be recovered from other sources, including GTOs.

Additionally, BAC funds the staff bus, the terminal shuttle, the Airport Village bus and any infrastructure required to facilitate the operation of public bus services within the airport boundaries (e.g. bus stops).

Summary

It is therefore clear that BAC does not restrict access on non-price grounds, as they provide quality facilities to GTOs and other land side access options. It has also been shown that the individual charges are not restricting competition. This is evidenced by:

- The fact (as shown in Table 5) that the total BAC fees represent only a small proportion of the total fees charges by GTOs to passengers; and

- That there has been increasing competition in the market as shown in Table 3.

The fees charged by BAC are levied in order to recover the non-aeronautical costs of providing services and infrastructure for use by the GTOs.

It is also important to note that it is in the best interests of not only passengers and competitors, but also BAC to encourage higher uptake of alternative transport modes. BAC is unique among the price-monitored airports in that there is a significant distance from the airport boundary to the Domestic Terminal, which requires a significant investment in road infrastructure. Therefore, BAC has an incentive to reduce traffic and minimise congestion on these roads in order to decrease maintenance costs and requirements for expansion. Promoting public transport and other forms of group transport therefore has the potential to reduce BAC's costs in the longer term.

4 Quality of services and investment

As noted by the Commission, a potential indicator of the abuse of market power is the poor or falling quality of service, which may be brought about by delayed, or lack of, investment.[13] The Commission's questions about quality of service and timeliness of investment are addressed in this chapter.

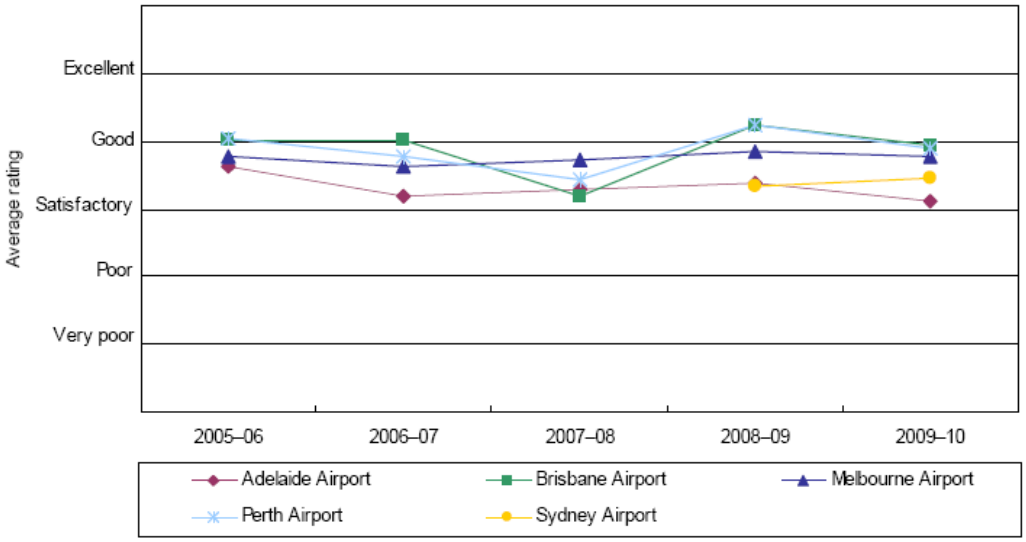
4.1 Quality of services

Issues Paper:

How responsive have the monitored airports been to users' service needs and preferences? Are there any significant quality problems for services under the control of the airports that are not being addressed? (p.14)

As noted previously, BAC has generally ranked highest, or very high, on overall car parking quality of service relative to the other price-monitored airports. The exception was 2007/08 when the ratings for car parking standard and car parking availability fell, in some instances to below "satisfactory", as shown in the following graphs. The reason for these falls in quality are predominantly due to congestion along Airport Drive which detracted from the overall convenience of parking at the airport.

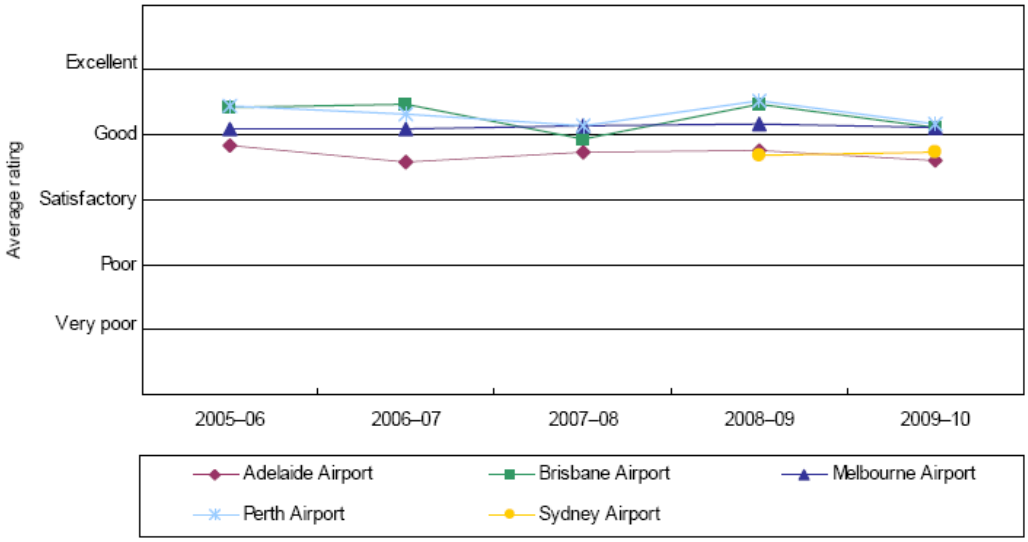
Figure 5 Comparison of quality of service –car park availability



Source: ACCC 2011

[13] Productivity Commission 2011, ibid, p.13.

Figure 6 Comparison of quality of service – time taken to enter car park

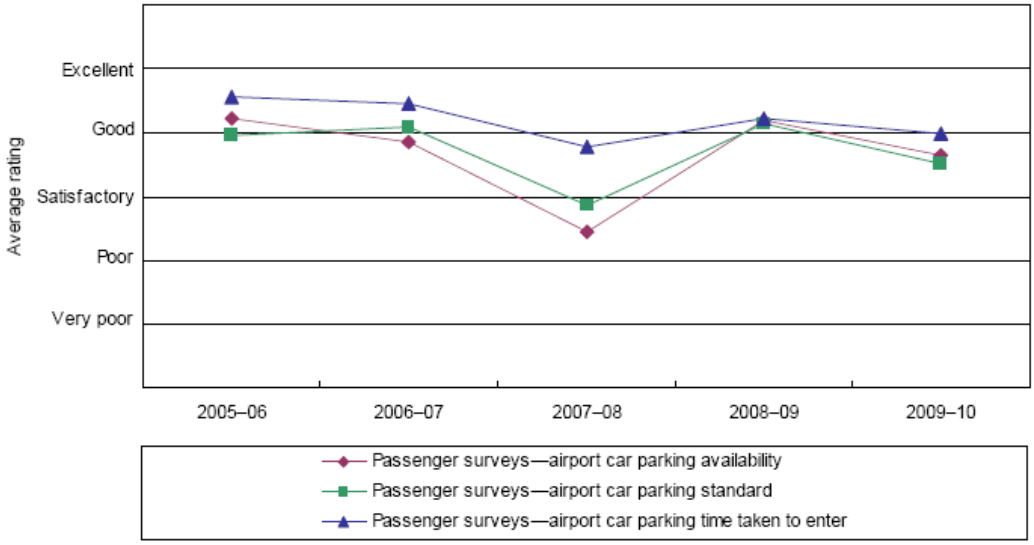


Source: ACCC 2011

4.1.1 Domestic Terminal car parking

Consistent with its overall ranking on quality of car park services, the quality of service at the Domestic Terminal car parks have achieved "Good" ratings for four out of the past five years. The exception was 2007/08 when the rating for car parking standard and car parking availability fell below "satisfactory", as shown in the graph below.

Figure 7 Brisbane Airport—domestic passenger survey ratings for car parking



Source: ACCC 2011

The drops in those two quality of service measures in 2007/08 can be explained primarily by congestion along Airport Drive which significantly detracted from the convenience of accessing the car parking facilities.

More recently, the less significant fall in the quality of service ratings to "Satisfactory" or better, in 2009/10 may be attributed to the current construction of the new MLCP at the Domestic Terminal. As the MLCP is being built on the site of the former short term car park, BAC has opened two temporary short term car parks at either end of the Domestic Terminal. While there is greater capacity at the temporary car parks, they are further away from the terminal albeit still within comfortable walking distance. BAC provides information relating to these temporary arrangements via both a newsletter and their website. Figure 8 below shows the locations of the temporary car parks.

Figure 8 Map of temporary parking arrangements at Domestic Terminal

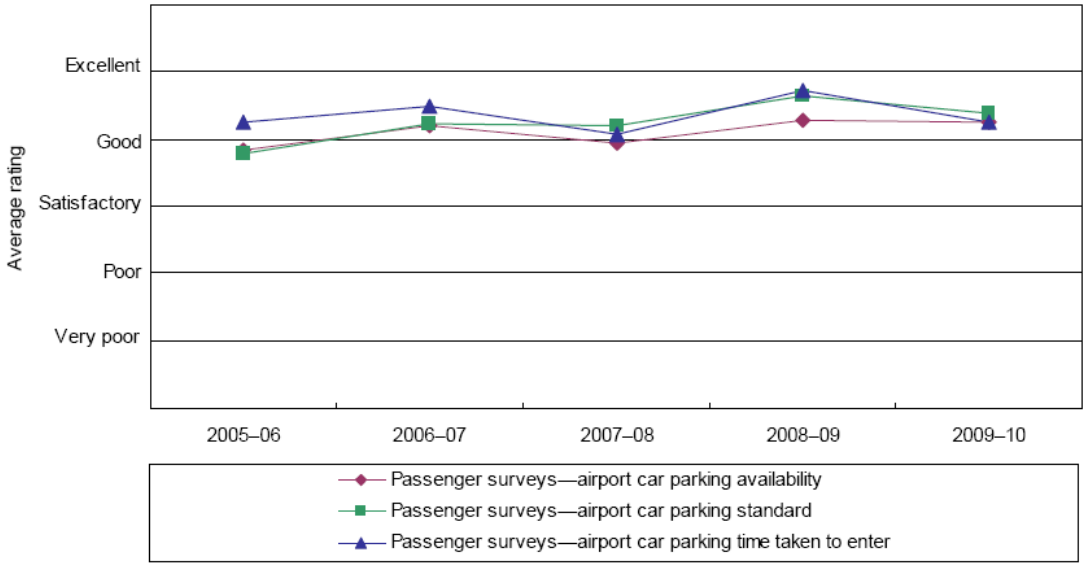
Source: BAC website (www.bne.com.au)

The generally high ratings for quality of service for the Domestic Terminal car parking and the quick recovery from the fall in quality of service ratings in 2007/08, suggest that BAC has been responsive to consumers' needs and preferences. This is further supported by the relatively small fall in quality of service ratings in 2009/10, despite the use of temporary car parks for short term parking. Furthermore, (based on the ACCC monitoring results) there does not appear to be any significant quality problems that need to be addressed by BAC.

4.1.2 International terminal car parking

The quality of service for the car parking at the international terminal has consistently ranked between "Good" and "Excellent" over the past five years, on all measures reported by the ACCC – availability, standard and time taken to enter the car park. This shown in the following graph.

Figure 9 Brisbane Airport—international passenger survey ratings for car parking



Source ACCC 2011

The parking at the International Terminal was impacted minimally by the construction of the international MLCP in 2006/07 (it opened in August 2007). While the International MLCP was built on the site of the existing at-grade car park, BAC was able to provide a temporary car park of similar quality, capacity and proximity to the existing one.

The above results indicate that BAC has been responsive to consumers' needs and preferences and there are no significant quality of service issues that need to be addressed by BAC.

4.2 Investment in services

Issues Paper:

Have necessary new investments been made in a timely fashion? (p.14)

As shown in the following table, BAC has undertaken significant investment in car parking and land side access since it was privatised in 1997. Notably, most of this investment occurred after the replacement of price regulation with price monitoring.

Table 6 BAC investment in car parking and land side access

Project	Description	Timeframe	Cost ($million)
Domestic Long Term MLCP	Initial development and extensions to the long term MLCP at the Domestic Terminal	2000 - 2006	41
International MLCP	New MLCP to address capacity requirements for both short and long term parking.	2007	37
Northern Access Road	Construction of new access road (Moreton Drive) for both the Domestic and International Terminals.	2006 – 2009	220
Central Parking Area	Stage 1 taxi holding bays	2010	47
Minor improvements works	Includes terminal roads, roundabout improvements and intersection upgrades	Various	10
Domestic Short Term MLCP[1]	New 9-level MLCP to address capacity requirements for both short and long term parking.	2010 - 2012	190
Domestic Terminal Pedestrian Access Bridge	Elevated walkway from short term MLCP (currently under construction) to Domestic Terminal to ease congestion on access roads in front of the terminal, and associated terminal face road improvements.	2011/12	43
Total			**578**

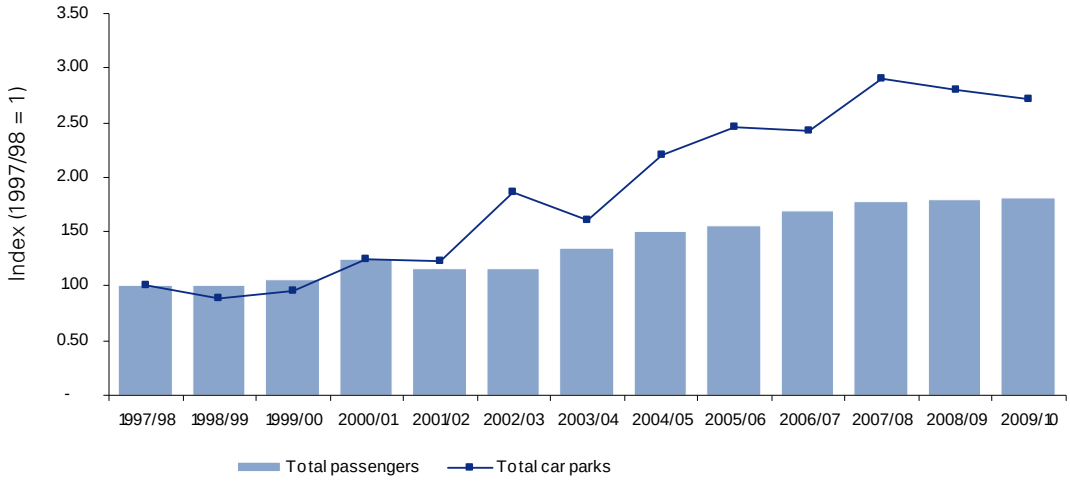
Source: BAC

In the 2009-10 price monitoring report, the ACCC suggested that BAC *"has been slow to invest in parking capacity, which could also have the effect of pushing up airport car parking prices"* and noted that BAC had only recently undertaken substantial investments.[14] Based on evidence presented in this report, these comments made by the ACCC regarding timeliness of investment and pricing impacts, are not justified.

The graph below shows the relative growth, on an index basis, in the number of car parking spaces available at the airport and the growth in the number of passengers, since 1997/98.

[14] ACCC 2011, *Airport Monitoring Report 2009-10: Price, financial performance and quality of service monitoring*, February.

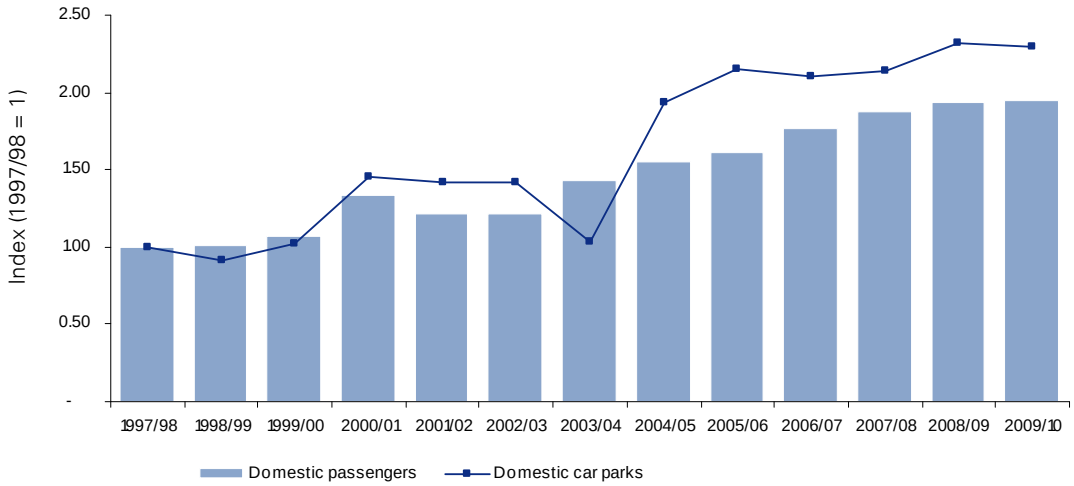
Figure 10 Passenger growth compared against growth in car park capacity



Source: BAC, ACCC Price Monitoring reports

The above graph shows clearly that over the past 12 years, the growth in the number of car parks has outpaced the growth in passenger numbers. However, this graph shows all car parks available at the Brisbane Airport, including staff parking. As the ACCC comments relating to delayed investment may have been directed to the domestic car parks and there have been no capacity constraints at the international terminal car parks, a similar graph has been produced for just domestic passengers and car parks, and this is shown below.

Figure 11 Domestic passenger growth compared to growth in domestic car park capacity



Note: the decrease in car park spaces in 2003/04 was due to the construction of the extension to the original MLCP and associated road and ground transport works at that time.
Source: BAC, ACCC Price Monitoring reports

It can be seen that growth in total car parks at the Domestic Terminal has also outpaced growth in domestic passenger numbers since 1997/98, the year that the airport was leased to BAC. This indicates that BAC has undertaken timely investment in car parking facilities at the Domestic Terminal.

The original Major Development Plan (MDP) for the short-term MLCP was approved by the Minister for Infrastructure, Transport, Regional Development and Local Government in October 2008. This envisaged a MLCP with 8 levels of parking, delivering 5,300 parking bays. However, it was subsequently discovered that the proposed design would not deliver the stated capacity:

> *"When the MLCP was conceived it was anticipated that up to 5,300 parking bays could be delivered by construction of an eight level multi-level car park. During the design development phase, which included detailed internal planning coupled with distribution of the various product mixes within the facility, it became evident that the final yield in terms of bay numbers was less than the number required and significantly fewer than included within the MDP submission."* [15]

Therefore, BAC submitted a revised MDP in January 2010 for a 9-level MLCP, which would deliver 5,276 car parking bays. The revised MDP was subsequently approved with conditions on 12 April 2010, and construction commenced that same month.

The time between the original and revised MDP was also used by BAC to address the conditions that were attached to the original approval. The additional detailed work that was done during this period enabled BAC to commence construction of the short-term MLCP immediately upon approval. This planning period also coincided with the start of the global financial crisis which had a significant impact on the ability of BAC to source debt financing for the project.

The period between BAC initially identifying the need for the extra capacity, and thus submitting the original MDP, and commencement of construction of the facility not only appears to be reasonable given the hurdles faced and overcome by BAC, but also prudent from a commercial perspective.

Furthermore, there were several options considered by BAC to maximise the capacity of the short-term MLCP, including underground levels. However, the soil conditions at Brisbane Airport made this a prohibitively expensive option. Control tower line of sight restrictions also limit the number of levels above ground that can be accommodated. Thus, KPMG understands that the short-term MLCP is being built at the maximum possible capacity within the environmental, planning and economic constraints at the site.

The ACCC has contended that BAC deliberately delayed the investment in this MLCP in order to drive up prices in the short term. The above commentary shows that this was not the case. Additionally, the choice by the BAC to develop the largest possible car park for this current investment appears to be contradictory to this contention. The demand forecasts for this new

[15] Brisbane Airport Corporation Pty Ltd, 2010, *Minor Variation to the Major Development Plan – Multi-level Car Park*, 17 January. p.3.

investment indicate the domestic MLCP will have significant spare capacity in the short term. If BAC was prone to artificially restricting supply, it would follow that it would likely develop a smaller car park which would face capacity constraints in the foreseeable future. The fact that BAC did not go down this path adds credence to the argument that it has not been slow to invest in order to maximise prices in the short term.

4.2.1 Future capacity investments

BAC has allocated 70 hectares of land along Moreton Drive (the main access road for both terminals) for future car parking. Referred to as the Central Parking Area (CPA), this area will provide parking for a large number of vehicles and will be divided between a taxi holding area, rental car overflow parking, GTO holding area, remote long term public car parking and remote staff parking.

The CPA is currently being developed in stages with the GTO and taxi holding areas completed in August 2010. The car rental head office and storage facilities are anticipated to open in July 2012, and the public and staff car parking capacity will be developed as required to meet future demand.

Unlike the existing car parks, the CPA is not within walking distance to either the Domestic or International Terminals and will require shuttle transfers when used for staff or public car parking. From a consumer perspective it will therefore be a similar product to the existing off-airport car parks. BAC anticipates that public and staff car parking at the CPA will initially be at-grade. Over the longer term, however, the 2009 Master Plan anticipates that the CPA will incorporate multi-level car park facilities.

Furthermore, BAC supports the future development of a third Airtrain station at the Airport Village precinct, which would provide a convenient and cost effective option for staff working in the commercial precinct around Airport Village. Future plans for plans for this precinct include a range of amenities and facilities including a bus interchange and integrated walking and cycling paths.

5 Car park pricing

In its recent price monitoring reports, the ACCC has pointed to the pricing behaviour of airports as an indication that some airports are abusing their market power and earning monopoly rents on car parking facilities and services. To address this, the Commission is seeking further information on the pricing behaviour and the form of rents earned by the airports.

> ***Issues Paper:***
>
> *Has the pricing behaviour of airports indicated the use of market power in car parking? 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? Are monopoly profits evident for short-term, long-term, or all forms, of parking? (p.13)*

We have considered these questions by first looking at the current and historical charges at the Brisbane Airport car parks, comparing them to car parking charges in Brisbane's CBD and then considered the rates of return earned by BAC on car parking and land side access.

5.1 Parking charges

We have analysed the price changes over the last 10 years at Brisbane Airport's car parks, and have found that:

- The charges for an eight-hour stay at the **domestic short term car park** had increased at a higher rate than shorter stays. The larger increase for the longer stay was a deliberate strategy by BAC to encourage use of the long term MLCP for stays of four or more hours, so as to free up capacity in the short term at grade car park. The cost of parking for fours hours at the short term at grade car park is now the same as for parking for fours hours in the long term MLCP;

- Charges at the **domestic long term MLCP** had increased modestly on a year-on-year basis over the past 10 years;

  - Throughout the previous year, there has been capacity constraints on certain days at the domestic parking facilities at Brisbane Airport,. Economic theory suggests that congestion pricing could be applied to allocated constrained capacity during peak periods. Further, Economist Alfred Kahn presented a statement to New Zealand's Commerce Commission where he stated that efficient prices should *"include costs associated with the construction of additional capacity when and as those costs become reasonably predictable"*[16].

  - The fact that BAC has not increased prices in order to reduce congestion or to include costs associated with the new MLCP currently under construction indicates that BAC is not overcharging for these facilities, and indeed there may be a case that it is charging an inefficiently low price.

[16] Kahn, A *Statement of Alfred E. Kahn On Behalf Of Auckland International Airport Ltd* August 10, 2001

- Charges at the **International MLCP** had increased over the past 10 years for stays of one hour, four hours and one day, but had decreased for stays of seven days. The seven-day rate is now comparable to off airport car park charges. KPMG notes that decreasing charges to match competitors' prices is not characteristic of a monopoly service provider; and

- Increases at the domestic long term MLCP and the international MLCP seem reasonable given the change in quality of the service, from open-air at grade facilities to multi-story undercover facilities over this period.

5.2 Comparison to CBD car parking charges

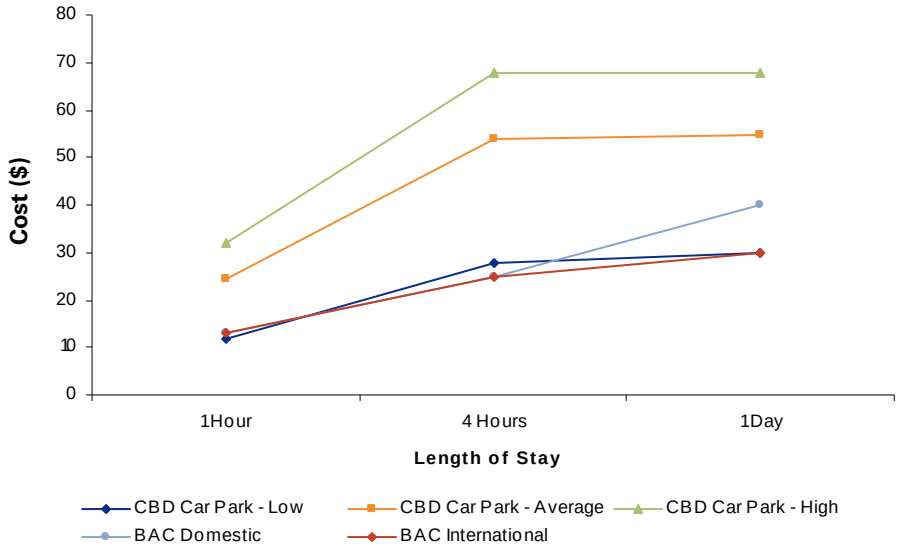
In its 2006 report, the Commission compared the car parking charges at the airports to CBD car parking charges to inform its assessment of whether increases in car parking charges reflected locational rent.[17] At that time, the Commission found that …

> *"… while car parking charges have increased at all airports since 2001, in some cases significantly, the increases have generally been no larger than at central city locations, and overall charges remain low. Though not by itself definitive, this comparative analysis suggests that constraints on the ability of airports to increase these charges have been influential."* [18]

The following chart compares car parking charges at Brisbane Airport with those at private car parks in Brisbane's CBD as at March 2011.

[17] Productivity Commission 2006, *Review of Price Regulation of Airports Services*, Inquiry Report No.40, 14 December 2006.
[18] Productivity Commission 2006, *Review of Price Regulation of Airports Services*, Inquiry Report No.40, 14 December 2006, p.117.

Figure 12 Prices for the long-term parking at the international car park facility from 2000 to 2010



Source: Wilson's Parking (www.wilsonparking.com.au); Secure Parking (www.secureparking.com.au); BAC (www.bne.com.au)

As shown above, the car parking charges at Brisbane Airport are considerably lower than the average charges for Brisbane CBD car parks.

In 2006, the Commission estimated that the differential between car parking at Brisbane Airport for one hour and parking at a Brisbane CBD car park was 25% (i.e. the CBD charges were 25% higher). In contrast, the data shown above for current car parking charges indicate that the differential is currently around 96% (i.e. it costs almost twice as much to park for one hour in the CBD compared to Brisbane Airport).

The increase in the differential indicates that CBD car parking charges have been increasing at a greater rate than the charges for BAC's car parks. This suggests that the increases in car parking charges at Brisbane Airport have been relatively modest, given the price increases at other car parks that also have a locational advantage.

5.3 Comparison to off-airport car park prices

The following table compares the prices charged at both on and off airport car park operators for stays of between one and 15 days.

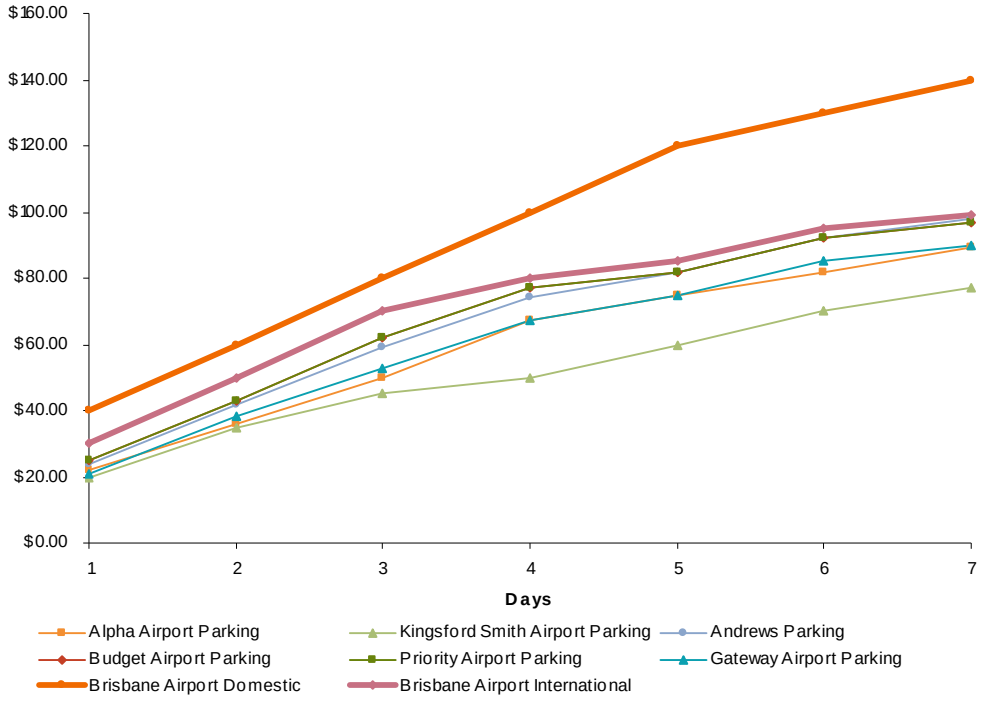
Table 7 Prices at on and off airport car park operators at Brisbane Airport

Days	Alpha Airport Parking	Kingsford Smith Airport Parking	Andrews Parking	Budget Airport Parking	Priority Airport Parking	Gateway Airport Parking	Brisbane Airport Domestic	Brisbane Airport International	Qantas Valet	BAC Valet
1	$22	$20	$24	$25	$25	$21	$40	$30	$63	$65
2	$36	$35	$42	$43	$43	$38	$60	$50	$88	$85
3	$50	$45	$59	$62	$62	$53	$80	$70	$123	$105
4	$67	$50	$74	$77	$77	$67	$100	$80	$158	$125
5	$75	$60	$82	$82	$82	$75	$120	$85	$193	$145
6	$82	$70	$92	$92	$92	$85	$130	$95	$228	$165
7	$89	$77	$98	$97	$97	$90	$140	$99	$263	$175
8	$93	$80	$104	$107	$107	$95	$150	$110	$120 thereafter	$10 thereafter
9	$99	$90	$111	$112	$112	$101	$160	$120		
10	$105	$95	$117	$117	$117	$107	$170	$130		
11	$110	$100	$123	$125	$125	$113	$180	$140		
12	$115	$105	$126	$133	$133	$118	$190	$150		
13	$120	$110	$132	$141	$141	$122	$200	$160		
14	$125	$115	$137	$149	$149	$127	$210	$170		
15	$5 thereafter	$120.00	$6 thereafter	$8 thereafter	$8 thereafter	$5 thereafter	$10 thereafter	$10 thereafter		

Source: BAC

The data for prices over one to seven days is represented in the following graph.

Figure 13Prices at on and off airport car park operators at Brisbane Airport

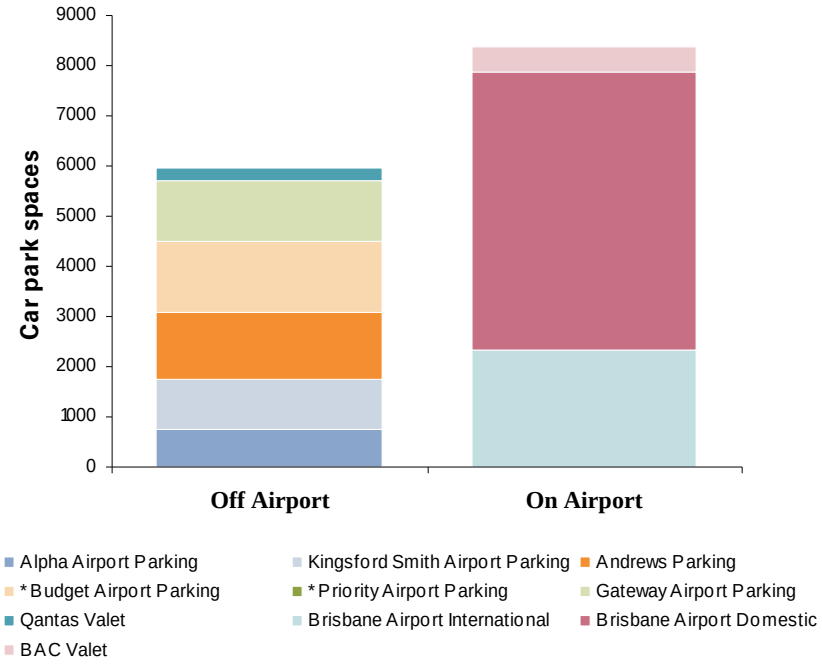


Source: BAC

Whilst the prices at both the international and domestic terminals are higher than those of the off airport car park operators, the variance in prices is not dramatic, especially at the international terminal. As explained in section 5.6 below, variances of this order of magnitude can be readily justified as locational rents, and do not reflect the misuse of market power.

The total number of parking bays provided by the off airport operators is significant as shown in the following graph.

Figure 14 Comparison of number of on and off airport car park spaces



Source: BAC

The number of off–airport car parking bays available and the fact that the number of providers is increasing indicates that this alternative to on–airport car parking has the potential to capture a significant share of the market for transport to and from Brisbane Airport.

5.4 Staff parking

The main staff car park is Staff Car Park No. 5 which is adjacent to the International terminal. A courtesy bus service, which is funded by BAC, provides transfers to the Domestic Terminal, running (no less frequently than) every ten minutes. There are also parking bays in the MLCP for priority staff parking (funded by BAC). As noted previously, additional staff car parking will be provided at the CPA the meet future demand. At the same time, BAC is actively promoting the Airtrain and the cycling/walking paths as viable alternatives for staff who work at the airport. BAC is also in discussion with Translink about further public bus services at

Brisbane Airport to facilitate staff access. This is in addition to the two Translink buses that currently service the commercial business and hangar precincts at the airport.

Comparison with other airports

[redacted]

5.5 Rates of return

The estimated rate of return on landside access facilities and services is estimated at 10.1% for 2009/10. This is based on total assets and has been calculated as follows:

[19] Perth Airport is not included as this data was unavailable.

Table 9 BAC Car parking and landside access return on assets, 2009/10

	Car Park Public	Car Park Staff	Car Park Total	Landside Access	Total
Total Revenue	53,918	4,225	58,144	8,736	66,880
Operating Expenses	6,783	2,954	9,737	2,441	12,178
EBITDA (Operating Margin)	47,135	1,272	48,407	6,295	54,702
Depreciation					6,933
EBITA					47,769
Amortisation					94
EBIT					**47,675**
Assets					
Tangible Assets					287,199
Intangible Assets					185,883
Total assets					**473,082**
Return on Assets (EBIT / Total Assets)					**10.1%**

Source: 2009/10 Information Templates as provided to ACCC

This estimate is based on all landside access facilities and services at Brisbane Airport, including public and staff car parking, GTO facilities and services, Ready Bays for car rental companies and the non-aeronautical component of access roads. Given the higher operating margin for car parking, it is expected that the rate of return for car parking would be higher, while the rate of return on other GTO operations would be lower. However, without a breakdown of assets by type of landside access option, it is not possible to estimate a rate of return for car parking specifically.

We also note that rates of return should be viewed over a period of time due to the lumpy nature of the investment at airports. In the case of Brisbane Airport, there will be a significant increase in the value of tangible car parking assets in 2011/12, when the new domestic MLCP becomes operational. The estimated cost of this project is $190 million, of which the vast majority is non-aeronautical. Therefore, the inclusion of this asset into the calculation will significantly reduce the estimated rate of return on landside access facilities and services.

The vanilla WACC for BAC's aeronautical business was estimated at 10.8% during the 2007 price negotiations which is higher than the return on asset of the car parking and landside access business. Whilst this is not a perfect comparator due partly to the different risk profiles of the two businesses, this comparison indicates that BAC's rate of return of its car parking and land side access is not excessive.

5.6 Locational vs monopoly rents

Locational rents can be distinguished from monopoly rents in theory (but not without serious questions), but in practice there is no acceptable way to measure such a difference. The following provides a condensed theoretical discussion of this point, while Appendix A presents a more detailed analysis.

Locational Rent Theory

Standard market power measures such as the Lerner Index (i.e. [P – MC] / P)[20] struggle to identify the abuse of significant/substantial market power (mainly due to identifying and measuring marginal cost (MC)). MC issues aside, they are of little use in breaking down the' P – MC' gap into locational, monopoly and other forms of economic profit or rent. Therefore, the ACCC appears to be making an understatement in its March 2011 submission in response to the Commission's Issues Paper, when it said: "*Distinguishing between location and monopoly rents is not an easy task."*

The question marks around the static theory of locational, monopoly and other rents due to market power are most strongly raised by the more dynamic and realistic theories from transaction cost economics and Austrian economics. The former suggests that some of these rents could be more appropriately characterised as reflecting the transaction costs associated with site-specific asset specificity and other transaction cost economising factors. Austrian economics goes further by suggesting that prices due to locational market power are because every supplier enjoys a locational monopoly to some degree and in fact these location specifics make it a different product all together in the minds of its customers. Thus, according to the economist Murray Rothbard in *Man, Economy, and State: A Treatise on Economic Principles* (2009) "*there is no theoretical criterion by which we can distinguish simple locational income to sites from alleged monopoly income to sites*".

In its 2002 report, the Productivity Commission stated that a 33% premium on airport parking compared with off airport competitors was "*likely…(to) largely reflect the greater convenience of parking closer to the airport. In other words, they may reflect locational more than monopoly rents"*.[21]

While the differential at Brisbane Airport is lower than this for the car park at the international terminal, it is somewhat higher for the car park at the Domestic Terminal. There are viable, cost effective alternative solutions available to passengers to access the Domestic Terminal. One of those options is to park at the international car park and catch the terminal bus to the Domestic Terminal, which is $31 cheaper over a seven day period. However, a proportion of passengers still **choose** to park at the domestic car park, suggesting that they are willing to pay a higher price for this option. Given that passengers do have choices, and that these choices are viable, cost-effective alternatives, it suggests that BAC is earning a locational rent, rather than a monopoly rent, on its car parking facilities.

[20] P = price, MC = marginal cost
[21] Productivity Commission 2002, *Price Regulation of Airport Services – Inquiry Report* 23 January 2002. p158

6 Summary and conclusions

Issues Paper:

What is the market power of the major airports in relation to car parking prices? (p.19)

Airports generally have at least some form of market power in the provision of land side access to their facilities. However, the existence of market power does not in itself mean that the airport will abuse its dominant position. Whilst prices for car parking on airport land will often be in excess of that of nearby competitors, this does not in itself imply the misuse of market power, as the higher prices are likely to be influenced by locational rents, rather than monopoly rents.

It is commonly acknowledged that it is very difficult to accurately measure the impact of locational and monopoly rents[22]. However, there are some indicators that may suggest if either, or both, of these sources of rent are being earned. These include:

- Whether there is sufficient competition in the market to constrain behaviour;
- Whether the airport restricts access by competitors;
- Whether the airport invests in capital improvements in a timely fashion to provide the desired level of service to customers; and
- Whether there is a legitimate reason for the airport charging higher prices, particularly due to scarcity of land.

6.1 Do the car parks face real competition from the alternatives?

As outlined in this report, there are a wide range of options for passengers and staff to access the Brisbane Airport. These include buses, trains, taxis, off airport parking, free pick up and drop off, as well as on airport parking. Our best estimates indicate the on airport car park's market share is up to 22%, with Airtrain and taxis combined accounting for a further 20%. While the market share of off airport car parks is currently relatively low, there is an increasing number of off airport car park operators, with four new operators commencing in the past three years. This suggests that this is a competitive market, with low barriers to entry.

These options combine to restrain the ability of BAC to earn monopoly profits on the provision of on airport parking. It has been shown that the competition, particularly from off airport parking, has had a marked affect on the behaviour of BAC in respect to the pricing at the long term international car park.

Further, given this competition has effectively forced the BAC to adjust their prices, this practically reveals that the competitive facilities are close substitutes for airport car parking.

[22] See for example the discussion in Appendix A and Forsyth 2004, 'Locational and monopoly rents at airports: creating them and shifting them', *Journal of Air Transport Management*, 10 (2004), pp. 51 – 60.

6.2 Has BAC restricted access by competitors?

A monopolist attempting to protect their monopoly position has a strong incentive to damage the viability of their potential competitors. The behaviour of BAC in dealing with alternative land side access providers suggests they do not use their position to disadvantage their competitors. For example, as outlined in the previous chapters:

- Access charges are reasonable given the quality of the facilities provided. For example, taxis are currently liable for $3 per pick up with free drop off. However, BAC has invested significant funds in taxi-related facilities as part of the CPA, including shaded holding areas, a canteen, prayer room and amenities. Furthermore, one of the lanes in front of the Domestic Terminal is currently dedicated to taxi pick-up and at the International Terminal there are dedicated taxi and GTO lanes. There are also free private bus and taxi holding areas. With the completion of the Domestic Terminal Access Project, the first two roads in front of the Domestic Terminal will be dedicated to taxi pick up and taxi drop off, respectively.

- BAC has made significant investments in access roads and facilities since privatisation. This investment is ongoing with the Domestic Terminal Access Project, which will result in dedicated roads and kerbside access for taxi pick up, taxi drop off, private pick up and drop off and GTOs (i.e. limousines, hire cars and buses). Each of these alternatives will have a dedicated road between the terminal and the short term MLCP.

6.3 Has BAC invested sufficiently to provide the required quality of service?

Whilst the ACCC suggested that BAC has been slow to invest in parking capacity as a deliberate ploy to increase prices, the findings in this report do not support that assertion. KPMG understands that BAC has aimed to maximise the capacity of the new MLCP within the environment, planning and economic constraints at the site. BAC has chosen to build a facility with significant initial excess capacity in order to minimise costs and passenger inconvenience.

In addition to this, it has been shown that the growth in car parking capacity at the airport, and particularly the Domestic Terminal, has exceeded growth in passenger numbers. This further suggests that BAC is not artificially withholding capacity.

Further evidence that the level of investment by BAC has been sufficient and responsive to passenger needs is the fact Brisbane Airport has consistently ranked highly in the quality of service surveys undertaken by the ACCC.

6.4 Is land close to the terminals scarce, justifying locational rents?

Locational rents are theoretically only able to earned if there is a genuine shortage of suitable parking options on site. Indeed, an airport artificially restricting car parking capacity, for example by delaying necessary capital investment, may be attempting to earn monopoly profits disguised as locational rents. However, it has been shown in section 6.3 above that BAC has

invested in extra capacity in a timely fashion and airport users are satisfied with the overall services provided by BAC in this area.

There is limited land available within walking distance of the Domestic Terminal, with land north of Moreton Drive set aside for future aeronautical facilities including the new parallel runway and the northern Domestic Terminal expansion. However, BAC has also earmarked a parcel of land between the existing long term MLCP and Moreton Drive for a third MLCP when demand justifies this expenditure. Similarly, BAC has earmarked a parcel of land next to the existing International Terminal MLCP for a future MLCP. Thus, while land around the terminals is limited, BAC has not artificially restricted the land available for non-aeronautical services and facilities.

6.5 Conclusions

The analysis completed in this report enables KPMG to conclude that BAC has not been earning monopoly rent for its car parking services. The major reasons behind this include:

- There are a number of viable cheaper alternatives which on airport car park users bypass, which indicates that the consumers have a willingness to pay for greater convenience, and hence the premium represents locational rents;
- These competitors hold significant market share, with our estimates of the on-airport car park's market share being between 11% and 22% only. While private pick up and drop off has the highest market share, the market shares for Airtrain (9%), taxis (6% - 11%) and private buses (4% - 6%) are also significant;
- That the prices charges by BAC to competitors for access to their facilities are reasonable given the significant level of investment by BAC and the quality of the facilities provided;
- That the growth in car park capacity has exceeded growth in passenger numbers; and
- BAC does not appear to have artificially restricted the availability of land for car parking near the terminals.

A Theoretical discussion on economic rents

In its Issues Paper, the Commission sought further information on whether car park *"price increases reflect monopoly rent, locational rent (eg accounting for the opportunity cost of alternative uses of land dedicated to car parking), or both"*.[23]

Locational rents can be distinguished from monopoly rents in theory (but not without serious questions and debate), but in practice there is no acceptable way to measure such a difference.

Measurement

Decades of trying to measure abuse of significant/substantial market power in the USA, Australia and elsewhere has been fraught with danger (much less trying to 'look under the hood' of market power at possible locational power). The **Lerner Index** for example tries to measure market power through the gap between price (P) and marginal cost (MC) – ie (P – MC) / P. MC for one is nearly impossible to measure precisely on an ongoing basis at a reasonable cost (assuming one can decide between short run and long run MC, or proxies like incremental or average variable costs). MC is also a major problem in measuring predatory pricing when price is supposedly below MC.

MC issues aside, market power measures such as the Lerner Index are of little use in breaking down the' P – MC' gap into locational, monopoly and other forms of economic profit or rent. Therefore, the following is quite an understatement by the **ACCC** in its March 2011 submission in response to the Commission's January 2011 issues paper: "***Distinguishing between location and monopoly rents is not an easy task.***"

Industrial Organisation Economics

A business earns an **economic rent** when it sells its product (ie good or service) for a price higher than average total cost (which includes a 'normal' rate of return). Positive rents imply that the business is earning more than is necessary to motivate it to continue to produce the product over the long run (it is earning an economic or super-normal profit). Economic profits result from the existence and use of market or monopoly power.

It should be firstly noted that under **competition law**, the terms of 'monopoly power' and 'market power' have tended to be used interchangeably – eg *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177. It is also worth noting that, under the anti-competitive conduct provisions of the *Competition and Consumer Act 2010 (Cth)*, the existence of market power is not illegal *per se* but only the misuse of such power to harm the competitive process. In terms of **industrial organisation (IO) economics** – of the standard neoclassical (static equilibrium) kind – 'monopoly power' is generally considered a subset of 'market power'. The former is the ability to keep prices above MC and restrict output for extended periods of time in the context of a monopoly market structure, whilst the latter is the ability to price above MC for any reason and in any context.

[23] Productivity Commission, 2011, *Economic Regulation of Airport Services*, Issues Paper, 25 January 2011.

Most of the reasons for the existence of **market power** are not monopoly in origin, such as success in taking entrepreneurial risks on input and transaction cost reductions, product innovation and differentiation, and even location selection and development. These successes create value (i.e. producer plus consumer surplus) at least in the shorter term. Some degree of market power is needed to capture the value created. This market power generally depends upon the '5 forces' of: market rivalry; product substitutes and complements; market entry and exit barriers; output buyer power; and input supplier power.

Significant **monopoly power** is relatively rare (especially as a monopoly means one supplier in a well defined market ... and in most cases needs government intervention to give it this monopoly in the longer term) and is generally considered 'bad' from both economic efficiency and social equity points of view. Some degree of market power is usually the norm in 'real world' markets and is considered by businesses and other informed persons as, if not desirable, then at least acceptable and necessary.

Locational rents arise out of the exercise of market (not monopoly) power due to scarce airport space or land, restricted physical access, etc. This is sometimes represented as a highly inelastic or even vertical supply curve. Locational rents accrue to a scarce factor of production (such as land). They do not involve the (dead weight) efficiency loss of monopoly that results from distorted supply and demand. The location rents reflect the value placed on scarce resources by consumers and provide signals for their efficient use. Thus, it does not matter who prices the scarcity in terms of economic efficiency. As long as a rent exists some party will capture it, such as an airport, the service provider located on or off the airport, or airport land owner.

Locational rents are considered to arise not from artificial, unproductive or anti-social conduct, unlike monopoly rents. The former do not generate dead weight losses of economic efficiency, unlike the latter.

Transaction Costs Economics

Market power can also be looked at through **transaction costs economics** approach. Car parking and land-side services are heavily influenced by transaction costs.

From the **customer's point of view** these costs are mainly driven by the time and effort of searching for alternatives, along with the agreement (formal and informal) in exchanging their patronage and payment for these services.

From a **service provider's point of view** these costs are mainly driven by: the degree to which a transaction is supported by transaction-specific investments (i.e. asset specificity); the uncertainty involved in the transaction; and the frequency or recurrence of the transactions. Asset specificity, in turn, is driven by the costs of: selecting and securing a location (i.e. site-specific investments); securing machinery, equipment and plant (i.e. physical asset-specific investments); and education, training and development of human resources (i.e. human asset-specific investments.

Obviously, **site-specific asset specificity** drives car parking and land-side services at airports. Thus, what may appear to be the generation of economic rent could actually be the accounting for the transaction costs to the exchange between airports and their customers.

Austrian Economics

The leading economists of the Austrian School strongly question the ability, or indeed need, to identify locational rents versus other economic rents. Murray N. **Rothbard** in "*Man, Economy, and State: A Treatise on Economic Principles*" (2009) had the following to say on **location monopoly**:

[D]ue to the eternal law of human action, and indeed of all matter,…only one thing can be in one place at one time. The retail grocer on Fifth Street enjoys a monopoly of the sale of groceries for that street; the grocer on Fourth Street enjoys a monopoly of grocery service for his street, etc. … Location is as specific to a firm or plant as ability is to a person.

Now, a good is homogeneous if consumers evaluate its units in the same way. And this homogeneity…must be in the minds of the consuming public, not in its physical composition. If a malted milk consumed at a luncheonette is the same good in the minds of consumers as the malted at a fashionable restaurant, then the price of the malted will be the same in both places. On the other hand…[a] consumer buys not only the physical good, but all attributes of a thing, including its name, the wrappings, and the atmosphere in which it is consumed. If most of the consumers differentiate sufficiently between food consumed in the restaurant and food consumed at the luncheonette, so that a higher price can be charged in one case than in the other, then the food is a different good in each case. A malted consumed in the restaurant becomes, for a significant body of consumers, a different good from a malted consumed at the luncheonette. … As long as the bulk of the consumers regard them as different goods, then they are different goods, and their prices will differ. Similarly, goods may differ physically, but as long as they are regarded by consumers as the same, they are the same good.

The same analysis applies to the case of location. Where the Fifth Street consumers regard groceries at Fifth Street as a significantly better good than groceries at Fourth Street, so that they are willing to pay more rather than walk the extra distance, then the two will become different goods. Groceries on Fifth Street may be higher in price than groceries on Fourth Street to the Fifth Street consumers. If so, it will be because the former is a different good to the consumers. … …the two are different goods by virtue of their difference in location. And there is no way of determining whether or not the price…on Fifth Street is a monopoly price or a competitive price or of determining what the competitive price might be. It certainly could not be the price charged by the other firm elsewhere, since these prices are really for two different goods.

There is no theoretical criterion by which we can distinguish simple locational income to sites from alleged monopoly income to sites. If all sites are purely specific in locational value, there is no sense to the statement that they earn a monopoly rent. *For monopoly price, according to the theory, can be established only by selling less of a good and thus commanding a higher price.* ***But all locational properties of a site differ in quality because they differ in location, and therefore there can be no restriction of sales to part of a site.*** *Either a site is in*

production, or it is idle. But the idle sites necessarily differ in location from the sites in use and are therefore idle because their value productivity is inferior. They are idle because they are submarginal, ***not because they are monopolistically withheld parts of a certain homogeneous supply****.*

Professor **Rothbard** and the other leading 'Austrians' strongly contend further that **monopoly** can only be a product, in theory and practice, of government intervention:

The only viable definition of monopoly is a grant of privilege from the government. It therefore becomes quite clear that it is impossible for the government to decrease monopoly by passing punitive laws. The only way for the government to decrease monopoly, if that is the desideratum, is to remove its own monopoly grants. The [competition] laws, therefore, do not in the least diminish monopoly.

[Competition] law…is couched in vague, indefinable terms, permitting the [regulator] and the courts to omit defining in advance what is a monopolistic 'crime' and what is not. Whereas Anglo-Saxon law has rested on a structure of clear definitions of crime, known in advance and discoverable by a jury after due legal process, the [competition] laws thrive on deliberate vagueness and ex post facto rulings. No businessman knows when he has committed a crime and when he has not, and he will never know until the [regulator], perhaps after another shift in its own criteria of crime, swoops down upon him and prosecutes. The effects of these arbitrary rules and ex post facto findings of 'crime' are manifold: business initiative is hampered; businessmen are fearful and subservient to the arbitrary rulings of [regulatory] officials; and business is not permitted to be efficient in serving the consumer. ***Since business always tends to adopt those practices and that scale of activity which maximize profits and income and serve the consumers best, any harassment of business practice by [a regulator] can only hamper business efficiency and reward inefficiency.***

It is vain, however, to call simply for clearer statutory definitions of monopolistic practice. For ***the vagueness of [competition] law results from the impossibility of laying down a cogent definition of monopoly on the market. Hence the chaotic shift of the [regulator] from one unjustifiable criterion of monopoly to another: size of firm, closeness of substitutes, charging a price too high or too low****…, etc. All these criteria are meaningless. An example is the criterion of substantially lessening competition.* ***This implicitly assumes that competition is some sort of quantity. But it is not; it is a process****, whereby individuals and firms supply goods on the market without using force.* ***To preserve competition does not mean to dictate arbitrarily that a certain number of firms of a certain size have to exist in an industry or area; it means to see to it that men are free to compete (or not) unrestrained by the use of force.***

B Cross reference of Commission's questions to BAC submission

The following table lists each of the questions raised by the Commission and provides a cross-reference to the section in the body of the submission where we have address that question. The table also notes where we have chosen not to respond.

Commission Issue	BAC Response
Is there evidence that the price monitored airports have increased charges by more than could be justified on the basis of costs, new investment requirements, and/or other enhancements to service quality?	Section 2.1
What is the ability of airports to vary prices year on year given many have long term contracts with airlines?	Section 2.1
Is price monitoring providing a constraint on aeronautical charges at the major airports?	Section 2.3
Has the need to adjust the previous FAC's pricing legacy been fully accommodated?	Section 2.2
Has the price monitoring regime promoted efficient investment and facilitated commercially negotiated outcomes?	Section 2.3
How would it compare relative to counterfactuals of explicit price regulation, or no regulation?	Section 2.3
Does the information emerging from the price monitoring process assist commercial negotiations between airports and their customers?	Section 2.3
Has the 'line in the sand' for asset valuations been effective or have airports, airlines or other users encountered problems with this approach?	Section 2.4
Should the line in the sand be extended to other airports? Is there a better alternative approach?	Section 2.4
How adequate are the data in the ACCC's price (and quality) monitoring reports for judging the effectiveness of the monitoring regime?	Section 2.5
Are the regulatory accounts provided by the airport operators sufficient to reveal monopoly pricing and rates of return?	Section 2.5
Are there material gaps or limitations in that data and can they be practically remedied?	Section 2.5
What other data sources should the Commission use in its assessment of the price (and quality) monitoring regime?	Section 2.5
Are the ACCC's monitoring methodologies appropriate?	Section 2.5
Is there adequate consultation with the monitored airports?	Section 2.5
How do recent charges for aeronautical services at the price monitored airports compare with those at comparable international airports?	Section 2.6
What conclusions can be drawn from international comparisons of airport performance?	Section 2.6

Commission Issue	BAC Response
What are the compliance and administration costs associated with fulfilling the regulatory obligations imposed by the price and service quality monitoring system?	Section 2.7
What percentage of passengers use the airport's car park facilities?	Section 3.2
What is the level of competition from other sources of transport?	Section 3.2
Are off-site car parks a real source of competition to the airport car parks?	Section 3.2
Is there evidence that airports are influencing the level of competition from alternative transport modes?	Section 3.2
Has the pricing behaviour of airports indicated the use of market power in car parking?	Section 3.3
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?	Section 3.3
Are monopoly profits evident for short-term, long-term, or all forms, of parking?	Section 3.3
How responsive have the monitored airports been to users' service needs and preferences?	Section 4.1
Are there any significant quality problems for services under the control of the airports that are not being addressed?	Section 4.1
Have necessary new investments been made in a timely fashion?	Section 4.1
How does the quality of service at the monitored airports compare with comparable international airports?	Section 4.1.3
How robust are the survey techniques in indicating quality of service?	Section 4.2
How useful is quality of service monitoring given the differentiation between DTLs and common user facilities, and how would this affect international comparisons?	Section 4.2
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?	Section 5.1
Have recent legislative changes (in 2006 and 2010) addressed concerns that Part IIIA could supplant price monitoring as the operative regulatory instrument?	Section 5.1
At a broad level, is there value in continuing the monitoring of aeronautical services and/or parking prices?	Section 5.2
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?	Section 5.2
Is both price and service quality monitoring needed?	Section 5.2
Should there be a fixed duration for any future period of price monitoring? Are further prescheduled reviews necessary?	Section 5.2

Commission Issue	BAC Response
If there is a further period of monitoring, are there opportunities to streamline arrangements to improve reporting, without compromising effectiveness?	Section 5.3
Could the number of indicators be reduced?	Section 5.3
In some areas, would more information be desirable?	Section 5.3
Do reports need to be produced annually?	Section 5.3
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?	Section 5.4
What are the constraints on the airports' market power?	Section 5.4
Do the airlines have countervailing power in dealing with the airports, especially smaller airports?	Section 5.4
If monitoring was to continue, should some airports be removed from, or added to, the list of monitored airports?	Section 5.4
If airports are removed, would the second tier self administered scheme, or some other web-based self-reporting regime for the major airports, suffice?	Section 5.4
Are the definitions of aeronautical services appropriate in reflecting market power in particular services?	Section 5.4
Should some services be excluded or others included?	Section 5.4
What is the market power of the major airports in relation to car parking prices?	Section 5.5
Is the existing range of remedies effective in deterring misuse of market power?	Section 5.6
Are these remedies effective 'punishment' for misuse of market power?	Section 5.6
What impact does the lack of a 'show cause' process have on ensuring appropriate pricing and investment outcomes for aeronautical services?	Section 5.6
Is there a better approach to developing a 'show cause' process or an alternative trigger process?	Section 5.6
Would there be benefits in a requirement for independent commercial arbitration and if so, how could this be effected?	Section 5.6
Are there any public interest reasons for such arbitration to be conducted by the ACCC?	Section 5.6
Do concerns about the potentially adverse effects of more heavy handed price regulation on investment militate against its reintroduction?	Section 5.6
The terms of reference request the Commission to focus on the provision of passenger transport services at and surrounding main passenger airports operating in Australia's major cities. Which major cities should the Commission focus on — those housing the five price and service monitored airports, all capital cities or some other combination?	Section 6.1

Commission Issue	BAC Response
Should potential links between airports (such as Canberra and Sydney or Melbourne and Avalon) be examined?	Section 6.1
Are planning and development regulations working effectively?	Section 6.2
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?	Section 6.2
What mechanisms exist at airports to coordinate with local and state governments on planning issues?	Section 6.2
Can more be done by airports and governments to better coordinate planning of transport options?	Section 6.2
Will recent changes to legislation to impose additional requirements on airport Master Plans (such as ground transport plans) help to alleviate past problems?	Section 6.2
What transport options exist at the major airports in Australia? Are these reliable, frequent and cost effective services?	Section 6.3
Are they integrated into the suburban transport network?	Section 6.3
To what extent are they used relative to private cars?	Section 6.3
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?	Section 6.3
Are charges and conditions of access to airports (e.g. convenient pick-up and drop-off points) appropriate?	Section 6.3
Is there a need to monitor terms and conditions	Section 6.3