Australian Government

Department of Infrastructure and Transport

Productivity Commission

Inquiry into the Economic Regulation of Airport Services

Submission

April 2011

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1. Executive Summary

Major airports are critical gateway infrastructure facilitating the movement of people and goods to, from and within Australia, and as such have a direct impact on national productivity.

Since their privatisation commencing in 1997, Australia's major airports have continued to invest in, improve and operate aeronautical infrastructure to meet steady growth in the aviation market. They have been able to finalise negotiations for commercial agreements with the airlines on airport charges notwithstanding the inevitable tensions from time to time. The airports have delivered relatively efficient pricing, high levels of productivity and operational efficiency in international terms while maintaining reasonable levels of quality of service. They have also weathered the recent global financial crisis in reasonably robust shape.

This success can be seen in part as testimony to the underlying soundness of the current Private Public Partnership model for Australia's major airports. Indeed, compared to approaches in most other countries, Australia's leased airport arrangements remain at the cutting edge of models utilizing the private sector to enhance and grow transport infrastructure and services. This outcome has largely been achieved under the current so-called `light touch' price monitoring regime that has been in place since 2002. The Department supports a continuation of the light touch approach price monitoring but suggests that the experience since 2006 points to areas where the quality of service monitoring arrangements in particular could be enhanced.

Given the success of the major airports in meeting the key objectives of privatisation, there may be submissions that continued price and quality of service monitoring is no longer needed and that relationships between airports and airlines could be said to be mature enough to ensure responsible and commercially rational outcomes without such oversight. The Department considers that the transparency provided by the monitoring process continues to provide valuable information for the commercial parties involved, the travelling public and governments. Airlines continue to express dissatisfaction from time to time with the quality of particular services provided by some airport operators, but nevertheless airlines have, as far as the Department is aware, been able to settle long term commercial contracts on pricing and service levels. And airlines have not, at least in the period since the last Productivity Commission Inquiry in 2006, sought the active intervention of the ACCC in these negotiations.

Airlines do continue to suggest that the major airports enjoy more market power in these negotiations and that recourse to compulsory arbitration mechanisms should be considered. The Department is yet to see convincing evidence that the current approach is not working in terms of pricing and quality of service outcomes. It believes a move away from the current approach which is based on commercial negotiation with a safety net through the access provisions of Part IIIA of the *Competition and Consumer Act 2010*, could potentially introduce much greater regulatory uncertainty, lead to delays in reaching commercial agreements and act to dampen investment in airport infrastructure.

However, as the major airports are critical pieces of national transport infrastructure with some natural monopoly characteristics, it is important that the Commonwealth, as the airport lessor, and airport customers including the airlines, travelling public and transport providers,

continue to have access to sufficient financial and other performance data to maintain a degree of airport lessee accountability and transparency in return for the very long term leasehold arrangements they enjoy.

The Department is also conscious that, while investment has kept pace with the demands of steady growth in aviation services over the last decade, continued growth will raise demands for a new level of investment in major infrastructure development. The most prominent current example is the advanced proposal for a new parallel runway at Brisbane Airport. These kinds of major investments in future capacity raise a range of new issues, including the need to finance work years before the benefits of the project become available. It is important that the regulatory arrangements are effective in monitoring the emergence of such new issues and the success of the parties in dealing with them on a commercial basis.

The Department supports the continuing of the current regulatory arrangements with external price monitoring for the five major airports – Sydney, Melbourne, Brisbane, Adelaide and Perth. The Department will continue to work with second-tier airports on the implementation of self-reporting arrangements in accordance with the direction outlined by the Government in the National Aviation Policy White Paper.

The Department recommends that the Commission consider the need for some broadening of the scope of the current monitoring and reporting regime to meet a wider range of stakeholder expectations. The current arrangements for quality of service monitoring have developed largely as an adjunct to price monitoring, in particular to ensure that the operators are not inflating returns through running down the aeronautical assets and consequently the standard of service provided. As foreshadowed in the White Paper, the Government sees value in going beyond purely checking for the exercise of airport monopoly power and windfall gains to provide a more transparent and meaningful picture of airport performance over time for the travelling public. The Department believes some specific enhancements could be made to the current monitoring regime to improve its validity and reliability and to increase its value as a tool to achieve transparency. These enhancements could include price monitoring approaches that take account of the long term nature of capital investment in aeronautical facilities, more rigorous survey methodology, the introduction of regular benchmarking against comparable overseas airports, and extending quality of service monitoring to more fully capture the passenger experience at airports including in domestic terminals leased by the airlines.

The Inquiry Terms of Reference also call for the Commission to consider land transport facilities providing access to the airports. Landside connections to airports including access roads and public transport connections impact on airport and city efficiency and productivity as well as passenger experience. There are a number of factors which contribute to the complexity of planning for and funding the investment required to provide efficient connections. These include the range of parties involved (Commonwealth, State and local governments and the airport operators at least) and the levels of traffic around the airport which is unrelated to airport activities. The Government has stated its support for more integrated ground access planning on and around airports and has initiated a range of measures to encourage Federal, State and local governments and public and private transport providers to work together towards this end. A major challenge will be how to fund the investment identified as necessary through these processes. The Department considers that investment programs across the three spheres of government need to recognise the economic benefits which flow to communities from the efficient operation of major airports and the detriment to productivity that congestion or other impediments to access cause.

2. Background

The Inquiry Terms of Reference ask the Productivity Commission to examine:

- aeronautical services and facilities provided by airport operators;
- passenger-related aeronautical services and facilities provided by major airline tenants;
- the quality and effectiveness of land transport facilities providing access to the airports;
- the effectiveness and appropriateness of the current monitoring arrangements; and
- improvements to and the future role of the monitoring regime.

The Commission, in undertaking its assessment, is to examine and, where practicable, quantify, the economy wide costs and benefits and distributional impacts of the economic regulation regime. The Commission will also provide international comparisons of the performance of the airport operators.

The Productivity Commission conducted reviews of the economic regulation of leased airports in 2001-02 and 2006-07.

In June 2001 the Department (then the Department of Transport and Regional Services) submitted to the Commission that the experience with the administration of the prices oversight arrangements at that time, which included price capping and price notification, suggested that the regulatory approach adopted was not working as intended and that an alternative approach was required to achieve efficient outcomes for air travel.

There was little evidence at that time to support an argument that any of the major airport operators had actually abused any market power they may have possessed. There was also little evidence to suggest that this was because of the existence of the aeronautical price caps. The Department noted that there was growing evidence that airlines had a degree of countervailing power that, together with various market forces, would be sufficient to warrant a shift in approach to any future regulation to reduce the significant economic distortions being created under the regulatory regime current at that time. Moreover, even in the absence of countervailing power, it was not clear that airport operators had an incentive to abuse any power since it was in the interests of airports to grow airline services and maximise passenger numbers to generate business growth.

It was suggested that a higher level view be taken in the regulation of prices for airport services. The Department's preferred model was to encourage a market outcome with commercially negotiated agreements being formed under 'umbrella' regulatory arrangements which could take the form of prices and services monitoring. Coupled with that could be strengthened requirements for information reporting to allow more detailed and transparent cost attributions to be made for 'aeronautical services' and meaningful productivity comparisons under benchmarking.

In its July 2006 submission the Department advised the Commission that, in its view, the objectives for price regulation, as stated in the then Government's Pricing Policy Paper released prior to the first airport sales in 1997, remained relevant.[1]

[1] Department of Transport and Regional Development (1996), *Pricing Oversight Guidelines*, Canberra.

The Department considered that the then pricing regulatory regime had delivered benefits for air services in Australia, particularly with regard to the level of aeronautical infrastructure development undertaken to keep pace with increasing demand. Airports had, for example, invested in new or significant upgrades to airport terminals and increased airside capacity to provide for more and larger aircraft. This development was facilitated by commercial negotiations between the major airport operators and their airline customers.

The Department also advised the Commission that it considered that the airport pricing regulatory regime had been a successful model in most respects and should continue. The price monitoring components (i.e. the financial reporting requirements of the *Airports Act 1996* and the data reporting requirements of the then *Direction 27* made under the then *Trade Practices Act 1974*) provided an important control on abuse of market power.

3. Policy and Regulatory Context

The National Aviation Policy White Paper, released on 16 December 2009, outlines the Government's policy settings and long term approach towards its aviation objectives:

- Giving the industry the certainty and incentives to invest for the long term;
- Maintaining and improving Australia's excellent safety record;
- Giving proper consideration to the interests of travelers and users of airports; and
- Better managing the impact of aviation activities on communities and the environment.

The Government recognizes that Australia's airports are a major component of the national transport infrastructure and make a significant contribution to Australia's overall economic prosperity. Efforts should be made to ensure the aviation industry generally, and Australian airports specifically, continue to provide access to national and international services and infrastructure that meets the broad range of passenger needs and expectations.

The White Paper notes that a degree of regulatory oversight is required to minimise the potential misuse by airports of their market power, the capacity for airports to provide services below community expectations or to neglect the maintenance of essential national infrastructure.

The Government also recognises that regulatory stability is important for airports as they make long-term investment decisions. The current Productivity Commission review of Australia's airport economic regulatory regime will give the Government an opportunity to consider the most appropriate form for the future economic regulation of airports.

One of the Government's key policy initiatives in the National Aviation Policy White Paper is the improvement of the planning regime at Australia's airports to facilitate better integration and coordination with off-airport planning schemes and improve the airport operators' consultation and engagement with the community and other stakeholders. To achieve this, the Government introduced a suite of reforms including amendments to the *Airports Act 1996.* These amendments include:

- strengthening the requirements for airport Master Plans to include ground transport plans, detailed information on non-aeronautical developments, and analysis of the impact of proposed developments on the community and on local and regional economy;

- ensuring better alignment of on-airport developments with State, Territory and local planning schemes;
- restructuring the triggers for Major Development Plans including capturing proposed developments with a significant community impact;
- requiring sensitive developments (e.g. residential dwelling; community care facility; pre-school, primary, secondary, tertiary or other educational institution; hospital) to undergo more rigorous regulatory scrutiny; and
- integrating the Airport Environment Strategy into the Master Plan requiring only one public comment period for the combined document.

In addition to the above reforms, the Government has required the establishment of Planning Coordination Forums (PCFs) for all main capital city passenger airports and Community Aviation Consultation Groups (CACGs) for all Commonwealth-leased airports except Mt Isa and Tennant Creek airports. The PCFs act as a vehicle to lead constructive dialogue between the airport operators and representatives from all tiers of Government (Commonwealth, State, Territory and Local) on matters such as Master Plans, proposed on-airport developments, regional planning initiatives and the like. The CACGs facilitate communication and engagement between airport operators, the community, government, airport users and other stakeholders. Currently, PCFs and CACGs are established on a non-legislative basis.

Leased federal airports are subject to legislation including the *Airports Act 1996* and regulations. The aircraft-related or passenger-related services and facilities that are subject to monitoring by the ACCC are defined by Regulation 7.02 of the Airports Regulations 1997.

As businesses operating within Australia, airports are subject to the provisions of the *Competition and Consumer Act 2010* (formerly the *Trade Practices Act 1974).* This legislation has a focus on anti-competitive behavior and limits the opportunity to use market power to restrain competition. Where airport operators and users (such as airlines) are not able to reach commercial agreement on the terms and conditions for use of, and price paid for, airport facilities, users may resort to Part IIIA of the Act to seek access to these facilities. The Department believes that such action should only be seen as a last resort, and that reaching an agreed outcome through commercial negotiation is preferable. The ACCC's annual monitoring of airport pricing behavior and quality of services is conducted in accordance with Part VIIA of the *Competition and Consumer Act 2010*.

Importantly, airports are also subject to lease conditions. The decision to sell long term leases of 50 years, with an option for a further 49 years, rather than freehold title, reflects the strategic importance of airports as critical national infrastructure and the need for appropriate long term public interest protections. The leases require the airport lessee, for example, to develop the airport at its own cost and expense having regard to:

a) the actual and anticipated future growth in, and pattern of, traffic demand for the airport;

b) the quality standards reasonably expected of such an airport in Australia; and

c) good business practice.

Airport operators must ensure that they meet the aviation safety and security requirements set out by the Civil Aviation Safety Authority (as set out in the *Civil Aviation Act 1988* and Civil Aviation Safety Regulations 1998) and the Office of Transport Security (OTS).

OTS is the Australian Government's security regulator of the Australian transport industry and primary adviser on transport security policy. The purpose of the OTS is to provide

expert advice and regulatory oversight for the Australian Government by taking a risk-based approach that continuously enhances security in Australia's transport system. The OTS approach to regulation is to ensure industry compliance with the law and regulations by effecting changes in industry participant behaviour towards their regulatory obligations.

OTS has responsibility for the *Aviation Transport Security Act 2004* and associated regulations. Australia utilises a multi-layered aviation security regime to prevent acts of unlawful interference with aviation. Security at Australian airports is commensurate with current threat levels, with the cost to airports of meeting mandated security standards passed through to passengers through arrangements with airlines.

4. Investment in Aeronautical Infrastructure

The long term leasing of federal airports provided the opportunity for a more responsive and individually tailored approach to investment in airport infrastructure to meet increasing passenger numbers and other market changes such as the emergence of low cost carriers and changing aircraft types. The results have seen private airport operators bringing significant new investment to enhance and maintain a key part of our national transport infrastructure.

The operators of the major airports leases sold in 1997 and 1998 committed to undertake a total of $700 million of capital expenditure at the airport sites over the first 10-year period of the airport leases. All airports met this requirement within the specified timeframe and in some cases, well before the ten year period elapsed. Sydney Airport was not leased with an infrastructure undertaking, as it had been subject to considerable investment in aeronautical facilities, terminals and freight facilities in the lead up to the 2000 Olympic Games.

Since 2006, the major airports have completed, or have currently under way, some $2 billion of capital works projects, most directly related to aeronautical activity (Table 1). This indicates that airports are continuing to invest in new aeronautical and major infrastructure to meet the growing demand for services.

Table 1 – Major Airport infrastructure projects completed and commenced from 2006

Airport	Projects	Value ($ million)
Adelaide	Multi level Car Park and Plaza	85
Brisbane	Northern Access Road	220
	International Terminal	340
Canberra	New terminal	140
Gold Coast	New terminal	100
Hobart	Terminal upgrade	26
Melbourne	New international terminal	330
Sydney	International Terminal	500
	Runway end safety areas	100
	New car park	65
	New infrastructure for the A380	128
	T2 upgrades Pier A apron works	11.5
Townsville	Terminal upgrade	12.5
Perth	Aviation infrastructure	212

Source: various sources, including airport annual reports and Departmental administrative records

Some of these investments reflect changes in the aviation industry, including the developing low-cost carrier market and the introduction of new aircraft types, such as the Airbus A380 in 2007. These new aircraft have the potential to move greater numbers of passengers. However, the higher number of passengers embarking and disembarking places additional

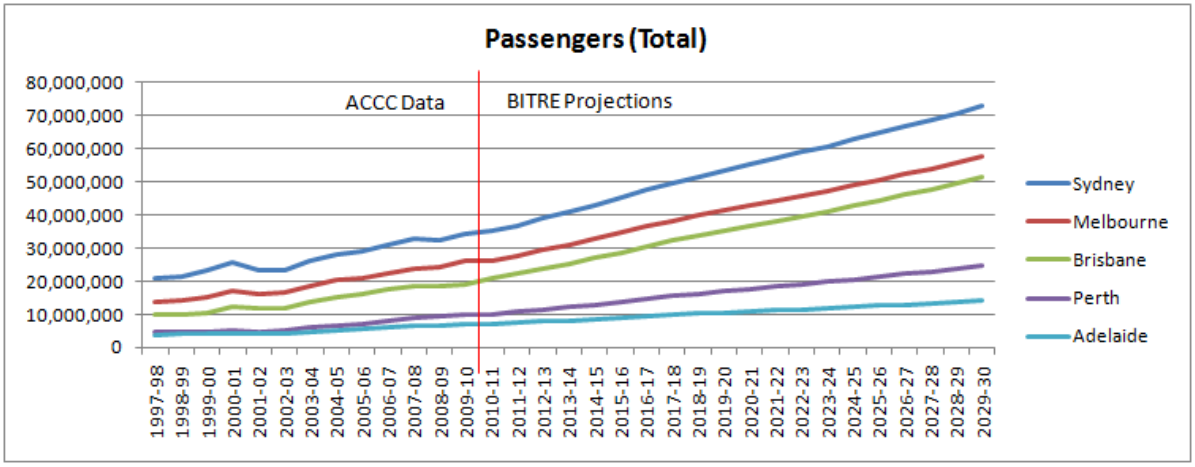
pressures on airport terminal and passenger movement facilities such as car parks and airport access roads.

The Airbus A380 is substantially larger than the Boeing 747-400 and has the capacity to disembark more than 500 passengers, and more than 800 in an all-economy configuration.[2] Sydney, Melbourne and Brisbane airports, following negotiations with airlines, increased runway, taxiway and apron capacity to provide for the new aircraft which is 35 per cent heavier than the Boeing 747-400ER, installed new aerobridges to service the three access doors, improving turnaround times and passenger comfort and have redesigned terminal spaces to cater for increased passenger movement. These airports were ready for the A380 from the commencement of commercial services in 2007 when the aircraft's inaugural commercial flight landed in Sydney from Singapore.

The Department notes that Adelaide Airport's Terminal 1 has the capacity to service A380 aircraft and that plans are in place to expand capacity at Perth Airport that includes facilities for this aircraft as part of a $500 million terminal upgrade.[3] Major new aircraft types, such as the Boeing 787 Dreamliner, are also expected to emerge in the near future. While new aircraft types offer gains in efficiency of airline operations, they are also likely to raise new requirements in aspects such as apron and parking space.

Airports need to plan for continued growth and investment. Chart 1 below shows that passenger numbers at the five largest Australian airports increased by an average 5 per cent per annum over the last 31 years, and will continue to increase annually by 4.2 per cent, from 98.3 million to 220 million passengers in 2030.

Chart 1: Number of passengers at the five major airports (ACCC and BITRE data)



Source: ACCC Airport Monitoring Reports and BITRE Research Report 117

The Government, as a condition of airport leases, requires airports to develop the airport to manage the growing demand for aviation services. Major Australian airports have advised the Department of investment intentions of around $4.3 billion for the next five years (representing approximately 30 per cent of expected airport total revenue) and $4.5 billion for the five years after that to address the projected growth. Table 2 below lists known major projects for a number of the leased federal airports.

That airports are investing such amounts in new infrastructure is an indication of financiers' and shareholders' confidence in the operation of Australia's major airports. Airports active in the US market report that Australian airports are held in high regard as investments. Brisbane

[2] Airbus (2011), http://www.airbus.com/aircraftfamilies/passengeraircraft/a380family/a380-800/

[3] Perth Airport (2010),"$500 million redevelopment for Perth Airport". Media Release 25/11/2010

Airport recently raised $400 million in the US private placement market in 10, 12 and 15 year fixed rate bonds. These longer terms are not available in the Australian market.

Table 2 – Planned airport infrastructure developments[4]

	Projects	**Value ($ million)**
Brisbane	Works over next 5 years, including a new parallel runway	2,000
Canberra	Future development of the new terminal, taxiway and navigational aids	180
Darwin	Terminal expansion	30
Hobart	Works to 2029 include: extension of parallel taxiway; apron overlay and expansion; terminal expansion; extension of road network; and new car parking	492
Melbourne	New apron, terminal expansions and possible third runway planned 2011-2015	1,000
Perth	Terminals and infrastructure in the next three years (including a $120 million new domestic terminal)	500
Sydney	New capital works	1,000

Source: Airport Master Plans, Departmental administrative records

The Australian Government has recently moved to support the airports' future investment and capacity to borrow in domestic and overseas markets for future infrastructure development by agreeing to extend the tripartite deeds between the Commonwealth, the airport lessee companies, and their senior financiers to cover the full 50 year airport lease period. These deeds, which were initially signed for 20 years, provide financiers with greater security in the unlikely event that an airport lease had to be terminated by the Commonwealth.

While the primary role of the leased federal airports is to deliver their core aviation business, airport operators have also realised business opportunities through investing in non-aviation infrastructure on parts of airport sites not reserved for aviation.[5] These non-aeronautical land use and commercial developments form an important long-term element of airports' overall budgetary strategies.

Investment in non-aeronautical opportunities at airports pre-dates privatisation. To meet an undertaking of the government of the day that the establishment of the Federal Airports Corporation (FAC) would not lead to higher airport user charges, the FAC actively encouraged the growth of revenues from non-aviation activities. Within six years of its formation the FAC increased the proportion of income from non-aeronautical activities from 50 per cent of total revenues to 60 per cent.[6] In 2009-10, the percentage of non-aeronautical

[4] Information on forward infrastructure planning is publicly available through airports' 20-year Master Plans, available at:

Sydney	http://www.sydneyairport.com.au/SACL/Master-Plan.html
Melbourne	http://www.melbourneairport.com.au/About-Melbourne-Airport/Planning/Master-Plan.html
Brisbane	http://bne.com.au/corporate/current-publications
Perth	http://www.perthairport.com/default.aspx?MenuID=344
Adelaide	http://www.adelaideairport.com.au/corporate-and-community/community#s_adelaideairportmasterplan_collapsible
Gold Coast	http://www.qldairports.com.au/publications/airport-master-plans/
Canberra	http://www.canberraairport.com.au/air_planning/masterPlan09.cfm
Hobart	http://hobartairport.com.au/corporate/master-plan-2/
Darwin	http://www.darwinairport.com.au/property/master-plan

[5] National Aviation Policy White Paper, page 156

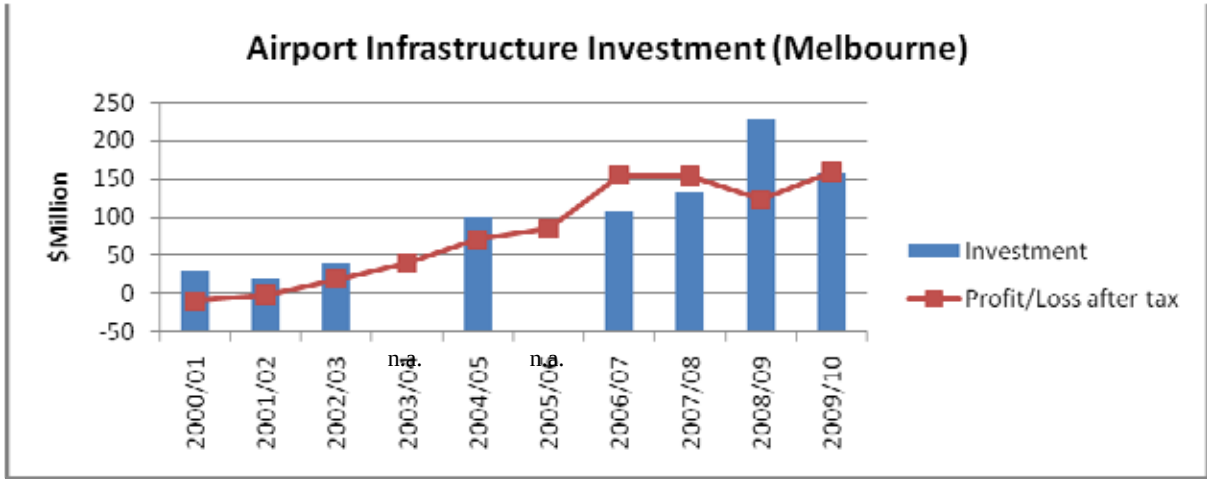
[6] Eames, J 1998, *Reshaping Australia's Aviation Landscape. The Federal Airports Corporation 1986-1998*, Focus Edgecliff, p63.

revenue for the five major Australian airports, as reported by the ACCC, was 53 per cent of airports' total revenue.[7]

Airports continue to invest in non-aeronautical infrastructure and commercial opportunities to diversify and reduce exposure to aviation industry fluctuations. Airports advise that the income streams from the non-aeronautical operations are also critical for financial institutions as lending security and to support continued investment into the future.

There is some indication that investment levels at airports have risen as airports' profits have risen. For example, Chart 2 indicates that at Melbourne Airport, a rise in profits in recent years has been accompanied by an increase in capital expenditure.

Chart 2: Airport investment in infrastructure and profit after tax 2001-2010



Source: ACCC Annual Airport Monitoring Reports and APAM Annual Reports
Note: 2003-04 and 2005-06 investment data not available

To date, it appears that airports have had sufficient income streams and borrowing potential to deliver infrastructure for future development. However, major step-change investments, where costs are significant and long repayment timeframes are needed, are likely to be an important test of the privatized approach to airport infrastructure funding. An example is the proposed parallel runway at Brisbane Airport, which will require an investment of over $1 billion. It is important that Australia's airport system allows for such significant one-off investments. A key issue is the extent to which current airport users, particularly airlines in the case of a new runway investment, should contribute to the significant investment costs, and the timing of that contribution.

After privatisation, a 'dual-till' system of financial reporting was established under which revenues and costs for aeronautical activities are assessed separately from those for non-aeronautical activities. Aeronautical charges should reflect the real costs of providing aeronautical services and disregard other income the airport may make through non-aeronautical services. Some stakeholders have suggested changes to the definition of aeronautical infrastructure. The Department has not seen any persuasive case presented to change the 'dual till' approach to airport financial monitoring and reporting.

[7] In 2009-10, the percentage of non-aeronautical revenue to total revenue for each airport was Sydney 46%, Melbourne 58%, Brisbane 57%, Perth 65% and Adelaide 44%.

5. Commercial Negotiations between Airports and Airlines

Pricing arrangements for aeronautical services and facilities offered by airports to customers, particularly major customers such as airlines, are best agreed through commercial negotiations between the parties undertaken in good faith. The establishment of commercial agreements is consistent with the Aeronautical Pricing Principles as amended following the Commission's 2007 Report. The Department continues to support these principles. The objectives of price regulation of airport services, as stated in the original pricing guidelines, are:

> *"Pricing oversight arrangements at airports post-leasing have been designed to achieve an appropriate balance between public interest and private commercial objectives.*
>
> *Pricing oversight arrangements are intended to promote operation of the airports in as an efficient and commercial a manner as possible. Pricing is fundamental to the efficient use of airport infrastructure. It is in the interests of airport users in particular, and the national economy in general, that commercially-driven decisions be made about maintaining existing airport infrastructure, and building new infrastructure.*
>
> *The arrangements should also aim to protect airport users from any potential abuse of market power by airport operators. Market power stems from the fact that airports have natural monopoly characteristics.*
>
> *It is the Government's intention to step back from setting prices at individual, privately-leased airports; and to provide a framework in which – over time – airport operators and their customers are encouraged to negotiate directly, and resolve prices rather than involve the Government of the day".*

The Aeronautical Pricing Principles are at Attachment A.

While prices for aeronautical services have increased since privatisation, the Department notes that these have been negotiated with the airlines and reflect significant investment in aviation infrastructure as outlined in the previous section of the Submission. These agreements fix prices and services between airports and participating airlines for periods that typically range from three to five years and in some cases as long as 15 years.

The Department is aware that these commercial agreements have evolved to become increasingly sophisticated, for example often including clauses to deal with risk sharing and other matters of contention. This is a positive outcome, although the Department is aware that some airlines remain concerned about their ability to overcome the market power of the larger airports, and believe there is room for greater transparency about the underlying assumptions of the building block pricing models.

The risks faced by airports and airlines are both related (in areas such as movements in passenger demand) and different (for example, in the timing of investment and ensuing charges to meet anticipated increases for aeronautical facilities). Maintaining the symbiotic balance between airports and major customers is currently managed through commercial negotiation.

The experience to date is that disagreements on access to airport services and facilities are eventually resolved through commercial negotiations, despite sometimes difficult negotiations. For example, in October 2010 Jetstar and Darwin International Airport reached agreement on services after an extended period of negotiation.

While the Department supports commercial negotiations as the best means of setting efficient aeronautical charges, should negotiations fail it is still possible for airlines and other airport users to seek arbitration through the National Access Regime in Part IIIA of the *Competition and Consumer Act 2010*. Part IIIA establishes a legal regime to facilitate third party access to services of certain facilities such as airports that are considered critical to competition in related markets. However, as noted in the National Aviation Policy White Paper, access to Part IIIA is not designed to replace commercial negotiations, but to enhance incentives for negotiation and provide a means of access on reasonable terms and conditions where negotiations fail.[8]

The *Competition and Consumer Act* sets out mechanisms by which access can be obtained to infrastructure services, including declaration and arbitration processes. As evidenced by the October 2002 application for the declaration of aeronautical services at Sydney Airport, such processes can be lengthy and expensive. But the successful conclusion of negotiations after the declaration (without needing recourse to final arbitration by the ACCC) indicates the value of the Part IIIA processes where serious differences exist.

The Department believes that the resort to external arbitration and determination through a body such as the ACCC should not be too easily accessed, to avoid undermining the commercial negotiation process. The *Competition and Consumer Act* and the ACCC do, however, provide an effective backstop should negotiations fail.

A "show cause" process has been proposed in the past for where there is prima facie evidence of serious pricing misbehaviour by an airport. The Government stated in the National Aviation Policy White Paper that it is not proposing to introduce the annual 'show cause' assessment at this time.[9] However, should the ACCC monitoring report or other evidence indicate that an airport warrants further investigation for its pricing behaviour, the Minister retains the discretion to recommend a formal inquiry under the *Competition and Consumer Act*.

6. Benchmarking the Performance of Australian Airports

An analysis of airport performance with comparable international benchmark airports would be a useful addition to the price monitoring analysis that the ACCC performs each year for our major airports. There are two main reasons for this:

- the ACCC monitoring is limited in that there are only 5 monitored Australian airports and comparisons are necessarily limited as well; and
- commentators have pointed out that while price monitoring may assess whether prices reasonably reflect costs, it does not assess whether airports are under investing.[10]

Airport performance in Australia can be assessed against comparable international airports through measures such as passenger and aircraft movements, revenues and costs per passenger and capital expenditure and returns on investments. These measures can give regulators a broader picture of airport performance. There are acknowledged difficulties in making these comparisons, caused by a number of factors, including variation in: ownership structures; labour costs and work practices; aircraft mix; the proportion of international passengers; the type of airlines using the airport; and airport size.

Taking the last point, Table 3 shows that in relation to passenger numbers, Sydney Airport is closest in size to Canada's Toronto Airport, London's Gatwick, Newark in the USA and

[8] National Aviation Policy White Paper, p. 176.
[9] National Aviation Policy White Paper, p. 180.
[10] For example, P Forsyth "Light-handed regulation of Australia's Airports" *The Melbourne Review Vol. 3 No. 1* May 2007

Munich in Germany. Melbourne and Brisbane Airports cater for approximately the same number of passengers as Stansted, however, the latter airport's focus on low cost carriers provides another significant point of difference between airports and highlights the potential difficulty in comparing like with like.

Table 3: Comparing Australian and International Airports

2009 Passengers (million)	Australian Airports	Overseas Airports
30-50	Sydney	Gatwick, Toronto, Newark, Munich
20-30	Melbourne	Paris Orly, Copenhagen, Dublin, Stansted
10-20	Brisbane	Auckland, Vancouver, Manchester, Vienna, Montreal
5-10	Perth, Adelaide	Luton, Edinburgh, Nice, Calgary, Christchurch, Wellington
3-5	Gold Coast, Cairns, Canberra	Liverpool, Newcastle (UK), Aberdeen, Ottawa
Less than 3	Hobart, Darwin	Glasgow Prestwick, Cardiff, Queenstown (NZ)

In its 2006 report, the Productivity Commission stated that by international standards, cost levels at the major Australian airports appear to be low and productivity performance high.

The Commission's reference to productivity performance has recently been corroborated by the Air Transport Research Society (ATRS) in its 2010 Airport Benchmarking Report.[11] In this report, Sydney and Brisbane are identified as low cost airports, and the report notes that the average revenue raised per passenger is lower in Australia/NZ than in Asia or Europe - US$16 for Australia/NZ airports, US$17 for Asian airports, US$28 for European airports. The lower revenue raised at Australian airports compared to Europe could reflect higher airport productivity in Australia, as well as other factors such as weather advantages, where European airports need to spend more to deal with inclement weather (eg snow storms).

In comparison, US airports have an average passenger charge of US$11. This reflects the difference in airport ownership and financial structures. US airports are largely owned and operated by city or county governments which may provide some services, maximum prices may be restricted at US airports, and US airports may be eligible for government infrastructure grants rather than needing to raise the funds themselves.

The ATRS, recognising that airport performance is affected by a range of internal and external factors, has developed a Residual Variable Factor Productivity measure to assess operating efficiency after removing the effect of variables beyond managerial control. The measure identifies Sydney Airport as the second most efficient after Hong Kong in the Asia-Pacific region for airports handling more than 15 million passengers. Brisbane and Melbourne were rated third and fourth respectively. Perth Airport was named second most efficient in the region of the smaller airports, with Adelaide eighth of the ten smaller airports.

Jacob's Consultancy ranks 50 of the world's major airports, including Sydney, Melbourne, Brisbane and Perth, against 35 measures of airport performance.[12] The data are mainly from the year ended December 2008, before the Global Financial Crisis impacted greatly on global aviation. For Perth, Melbourne and Brisbane airports, the analysis is for the year ended June 2009.

The analysis of the Jacobs Consultancy data (Table 4 below) shows the four largest Australian airports (the only Australian airports in the sample) have:

[11] Air Transport Research Society (2010), *Airport Benchmarking*, summary available at http://www.atrsworld.org/airportawards.html
[12] Jacob's Consultancy, Airport Performance Indicators 2010

- below average aeronautical revenue per passenger;
- around average non-aeronautical revenue per passenger;
- among the lowest operating costs per passenger;
- above average operating profit per passenger;
- average to good returns on capital employed; and
- average to above average capital expenditure per passenger.

Table 4 – Performance Measures for Australian Airports, using common currency units for comparison

Indicator	Sydney	Melbourne	Brisbane	Perth	Average of 50 Airports
Aeronautical revenue per passenger	6.90	4.17	5.03	4.75	7.61
Non-aeronautical revenue per passenger	6.17	5.10	5.34	6.35	6.20
Operating costs per passenger	1.93	1.99	2.56	3.03	4.58
Operating profit per passenger	7.27	5.75	5.53	6.05	3.81
Capital expenditure per passenger	6.73	5.08	10.05	6.69	6.36
Return on capital employed	6.60	9.50	6.0	12.2	7.20

Source: Jacobs Consulting Airport Performance Indicators 2010

The units of comparison are derived currency units to allow for comparison between airports. This information depicting a range of performance measures, including for a number of international airports, is at Attachment B.

Against these financial and productivity measures major Australian airports fare comparatively well. However, different measures are needed to assess quality of service and there are other sources for this. The ACCC carries out annual airport quality of service monitoring for the five monitored Australian airports, however this monitoring has limitations and should be extended and enhanced (see Section 7). As well as the ACCC monitoring, there are international quality of service comparisons available through Skytrax and the Airport Council International (ACI) data.

The most recent ACCC Airport Monitoring Report for 2009-10 shows that the five major airports had overall quality of service ranking between satisfactory and good. Apart from Adelaide, where the ranking rose considerably after the opening of its new terminal in 2005, the rankings have been maintained over each of the last five years.

This result is consistent with the Skytrax online survey of airports. Sydney is the only Australian airport with an official Skytrax rating – 3 stars out of a possible 5. International airports with a 3-star rating include London Heathrow and Dubai International. Other Australian airports do not yet have sufficient responses to receive an official rating, although a star rating for Melbourne Airport is currently under analysis. [13]

However, it is possible to calculate average customer ratings for the other major Australian airports from admittedly small samples. The average customer ratings for the four other major Australian airports are Adelaide and Brisbane 3.5, Melbourne 3 and Perth 2.5 out of a maximum of 5.

[13] http://www.airlinequality.com/Airports/apt_forum.htm

Brisbane Airport was named as the eighteenth best airport across the globe by travellers in the 2010 Skytrax World Airport Awards, with no other Australian airports in the top 25 airports. In the Skytrax 2011 Airport Awards, Gold Coast was placed second and Brisbane third in the Australia/Pacific section. No Australian airport featured in the 2010 ACI awards for quality of service.

From this analysis, it is reasonable to conclude that Australian airports are providing at least a satisfactory to good service in international terms and at reasonable levels of charging. In assessing this performance it needs to be remembered that many overseas airports receive significant government subsidies.

In the key points from its 2006 report, the Productivity Commission concluded:

> *"Price monitoring, as part of a light handed regulatory approach, has delivered some important benefits.*
>
> - *It has been easier to undertake the investment necessary to sustain and enhance airport services in the face of growing demand for air travel.*
> - *Airports' productivity performance has been high by international standards, and service quality has been satisfactory to good.*
>
> *Moreover, though it is too early to fully judge the effectiveness of the light handed approach in constraining airport charges, price outcomes to date do not appear to have been excessive."*[14]

The comparative international analysis above shows that the last five year period of the current regulatory regime has not produced significant changes from these conclusions on investment, productivity, service quality and pricing outcomes.

7. Price and Quality of Service Monitoring

The provision of transparent regular information on pricing and the quality of airport services remains critical to the success of the current model of economic regulation. It ensures airlines and other customers of the five largest airports have information on airport's relative performance. It also ensures the Government and community are properly informed about the performance of significant elements of our national transport infrastructure. However, as foreshadowed in the White Paper, the Government is concerned that the current formal monitoring process may be too narrow in its focus to meet the varying expectations of it.

Price Monitoring

The broad objective of price monitoring is to assist the competitive process by allowing airport customers and the community to scrutinise prices and market outcomes and to provide evidence to support claims of unjustifiable price increases. Scrutiny of the potential receipt of monopoly rents by airports, along with the threat of re-regulation, is an appropriate deterrent to the abuse of market power.

The current ACCC price monitoring regime addresses part of the overall objective, as it focuses strongly on seeking evidence of improper use of market power by analysis of aeronautical revenues, costs and margins. It delivers a picture of how well airports manage their operational costs and revenues, but does not provide the same focus on total airport costs, including the costs of borrowing, and how these translate into prices. The Department

[14] Productivity Commission 2006, *Review of Price Regulation of Airport Services*, page xii

believes that the Productivity Commission could examine how these elements could be included in the price monitoring by the ACCC to gain a more comprehensive picture of airport costs and revenues.

Further, the Department supports price comparisons not only in absolute terms, but through benchmarking Australian airports against comparable overseas airports. As noted in Section 6 above, Australian airports do not appear to have high costs compared to many similar airports in other countries, nor do they appear to make excessive profits per passenger. The average return on assets for Australian and New Zealand airports, at 9.6 per cent, is comparable to European airports (11.7 per cent) and Asia/Pacific airports (9.0 per cent).[15]

Such an approach could also note when the Australian financial model reflects significant differences with other countries. For example, while Australian airports have high operating margins compared to airports around the world, our major airports also must raise their capital in the private market and service the debt that was incurred to purchase the airport leases, as well as for capital upgrades and new construction.

At the time of the 2006 Inquiry, there had been some debate about airport valuations and how these could affect price setting for aeronautical fees. The adoption of the 'line-in-the-sand" valuations after the Inquiry has proved effective in reducing disputation while allowing for appropriate valuation of new infrastructure. The Department supports the continuation of this approach. One related element which also can be controversial is the definition of a reasonable rate of return. While the Department believes that the appropriate level of airport returns should be part of the commercial agreement process, the Commission could use its experience with other industries to provide comment and guidance on the concept of a reasonable rate of return as applicable to airports.

Quality of Service Monitoring

The Department also supports continued monitoring and reporting of the quality of service provided by the major airports. Monitoring the quality of service that airports provide to airport customers gives assurance to airport users, and to the Australian Government, that airports are not reducing standards in order to maximise profits and also provides information on service standards that support pricing negotiations and capital investment proposals.

However, it is recognised that the current approach to quality of service monitoring gives, at best, a limited view of how well airports serve the travelling public. The current arrangements for quality of service monitoring have developed largely as an adjunct to price monitoring, in particular to ensure that the operators are not inflating returns through running down the aeronautical assets and consequently the standard of service provided. As indicated in the White Paper, the Government sees value in going beyond purely checking for the exercise of airport monopoly power and windfall gains to provide a more transparent and meaningful picture of airport performance over time for the travelling public. In accordance with this, the Department believes some specific enhancements could be made to the current monitoring regime which may improve its validity and reliability and increase its value as a tool to achieve transparency.

Some airports claim the results of their own customer satisfaction surveys are not always reflected in the overall scores published by the ACCC. It would be preferable for the quality of service monitoring to reflect a wider perspective on airport performance to better

[15] Air Transport Research Society (2010), *Airport Benchmarking*, Section 6.3.5

encompass the experience of passengers and other airport users as they utilise the airport facilities.

The Department acknowledges there will be a significant challenge in broadening the monitoring regime in collecting and interpreting the results. Possibly, enhanced monitoring could include quantitative and qualitative information on such things as:

- Passengers' experiences throughout the airport;
- Airports' consideration of and outcomes from complaints on landside and airside matters;
- The delivery of contracted services;
- Parking and transport options;
- Landside congestion and delays; and
- Legal compliance with health and safety regulations, accidents and environmental management.

A high priority should also be to update and refresh the monitoring system to reflect contemporary issues and technological changes. For example, the number of self-help terminals for check-in and seat allocation may become more important than the number of traditional check-in counters as technology improves the way that people interact with airports and airlines. Airports with advanced technologies for passenger processing may be providing a better quality of service without it being measured in current systems.

Some areas of the airports are currently excluded from the quality of service monitoring regime. These areas are the leased Qantas terminals (Sydney T3, Melbourne T1, Brisbane and Perth T2) and the Virgin Blue terminal at Brisbane. The leases for these areas will expire in 2018 and 2019. We estimate that the current ACCC survey methodology does not cover 40 to 50 per cent of total domestic passengers, and the Department believes a comprehensive monitoring regime that includes the terminals leased by Qantas and Virgin Blue would provide stakeholders with a more definitive view of airport overall performance.

Supporting the price and quality of service monitoring currently carried out by the ACCC for the five largest airports in Australia (Sydney, Melbourne, Brisbane, Perth and Adelaide) is a voluntary monitoring and reporting scheme being implemented by the 'second tier' airports (Darwin, Hobart, Canberra and Gold Coast). This self-administered scheme was supported in the National Aviation White Paper and is in the final stages of implementation.[16] For this reason the second tier arrangement was excluded from the terms of reference for the Inquiry. The Government also encourages other airports not covered by the self-administered scheme to conduct customer/passenger satisfaction surveys and to publicly disclose the results on their websites. Ultimately, airport customers would benefit if these approaches evolved into a nationally consistent scheme for airport quality of service monitoring.

By publishing the monitoring results each year and highlighting issues of concern, the current monitoring system does raise public awareness of airport pricing and provides the opportunity for airport operators to respond to stakeholder concerns, including issues raised by the ACCC.

[16] National Aviation Policy White Paper, p. 179

8. Landside Access and Ground Transport

Landside ground transport connections are vital in getting passengers, visitors, employees and freight to and away from the airport. The landside connections to the airport, including the external and internal traffic conditions, impact on airport efficiency and productivity as well as the passenger experience. The United Kingdom (UK) has recognised that "improving the passenger experience across the end-to-end journey and understanding where the pinch points exist are essential to maintaining and improving the UK's competitive position". [17]

In addition to growing numbers of air travellers, developments such as retail centres and commercial and industrial developments mean that increasing numbers of workers and members of the public are accessing airports on a regular basis. This has sparked investment in transport networks and car parking on the airport site.

Car parking is an essential element of airport infrastructure allowing access to flight and other airport services. Because of this, the ACCC monitors prices, costs and profits for car parking services at the five major airports in accordance with Government policy. Income from car parking is an important component of income for airports, ranging from nine per cent of total airport income in Adelaide to 21 per cent in Melbourne [18].

The major concern with car parking on airports is that in the absence of viable alternatives, airports can charge monopoly rents. Car parking at airports is relatively expensive but comparable in price to other high value locations such as the city central business district. On-airport car parks also face competition from off-airport car parks. However, unlike CBD areas, airports are generally not served well by frequent and affordable public transport.

At airports such as Sydney where on-site development capacity is increasingly constrained, alternative forms of transport to and from the airport become more important, as does the transport network used for airport access. Other forms of landside passenger access apart from private vehicle parking include:

- Private drop off and pick up;
- Taxis;
- Private and public buses; and
- Trains.

The significance of different forms of access varies with airports. The various means by which passengers travel to and from airports is at Table 6. In Sydney, passenger drop-off represents 19 per cent of all passenger access, with taxis providing 37 percent. In Perth, numbers are similar, with about 25 per cent of passengers dropped off and 35 per cent arriving in taxis. However, other passenger transport splits across airports are significantly different. In Sydney, passengers using train (11 per cent), bus (2 per cent) and mini-bus (possibly from an external car park, 12 per cent) make up 25 per cent of passengers, compared to 4 per cent using mass public transport in Perth.

[17] UK Department for Transport (2009), *Improving the Air Passenger Experience*, p 2
[18] ACCC Airport Monitoring Report 2009-10

Table 6 – Passenger mode share for access to Sydney, Melbourne and Brisbane Airports

	Private vehicle – on-airport parking, kerbside drop-off and pick-up and rental car (%)	Off-airport parking (%)	Taxi, hire car or limousine (%)	Bus or minibus (%)	Train (%)
Sydney (2006)	49	Not known	25	14	11
Melbourne (2009)	61	8	17	14	-
Brisbane (2009)	83	Not known	8.5	3	5
Perth (Domestic Terminal 2009)	54	6	33	4	
Canberra (2009)	56	Not known	30	14 (includes hire, rental cars and buses)	-

Source: ACCC 2009-10 Airport Monitoring Report, Airport Ground Transport Plans and Airport Master Plans

All airports can influence the costs of alternatives to on-airport car parking by, for example, imposing levies on them or restricting access to airport terminal facilities. Airports are often criticized for moving drop-off and pick-up points well away from terminals, but airports often point to security and traffic congestion as legitimate reasons for doing so.

The ACCC has noted that if sufficient access for modes of transport representing substitutes for car parking is provided on reasonable terms and conditions, the ability of airports to impose charges above efficient levels for car parking would be limited.[19] Further, a shift away from private transport would reduce congestion in the road networks in and around airports as well as reducing the environmental impact of airport-related travel. While it is unlikely that a very high proportion of air passengers would choose to use public transport, because of issues with luggage, timing etc, public transport could be a viable choice for airport employees and could make an appreciable difference to peak hour congestion. A majority of the 12,000 employees at Sydney Airport currently travel by car as other forms of transport are not readily available.[20]

One of the potential barriers to increasing public transport is that some of the major airports charge some type of access fee for private and public transport that act as substitutes for private car access to the airport. These include access fees for taxis, but these fees partly reflect the costs of providing facilities provided for taxi drivers while they wait at the airport. Brisbane Airport, for example, has undercover car parks, a kiosk and showers for taxi drivers.

Sydney, Brisbane and Melbourne airports charge landside access levies for private bus and mini-bus operators, the latter including those bringing in passengers who park in off-airport car parks. Some airports have indicated they will also charge for access to the terminal area for public transport vehicles.

There is a need for access to public transport at airports and airports should consider incentives for such transport to better serve the needs of passengers, visitors and employees. Airport operators should not levy fees for kerbside access to buses or other public transport that are not directly related to the reasonable costs of special purpose facilities provided by the airport. Such policies are likely to encourage more public transport and private bus operators that would:

[19] ACCC (2010), *Airport monitoring report 2008-09*, page 72

[20] SACL 2006 Sydney Airport Ground Travel Plan p. 11

- help reduce traffic congestion around airports, when car access is nominated as a key limit to growth by the airport operators themselves;
- provide opportunities for passengers to spend more time and money for retail spending at the airport; and
- help airport carbon reduction strategies.

More integrated transport planning between the airports and all levels of government also has a role in improving land access. The Commonwealth recognises that states have primary responsibility for land use and transport planning, although planning responsibility for airports and their surrounds is split between the Commonwealth and state, territory and local governments. Furthermore, transport infrastructure linking airports and their communities is controlled by both government and private interests. This makes integration and coordination a challenge for airports, their customers and governments.

The National Aviation Policy White Paper recognised the need for improved planning at our airports to facilitate better integration and coordination of planning and support continued investment both in air transport infrastructure and land transport links. A priority for the Australian Government, outlined in the White Paper, is "to ensure that the airport planning system is properly integrated with the off-airport transport planning system and contributes to a coordinated transport system that supports our cities' broader economic productive capacity and avoids imposing unnecessary social and economic costs".[21]

To this end, it is important the states and territories give priority to transport planning into and around airports, and to invest in infrastructure where necessary to support the efficient operation of the airports.

Despite the split responsibilities, there have been some good examples of cooperation and integration in planning around airports. Brisbane Airport's Northern Access Road project was planned and delivered through the joint efforts of the airport and the Commonwealth, state and local governments involved. Adelaide Airport has worked with the South Australian Department of Transport, Energy and Infrastructure to produce an Adelaide Airport Access Study to meet access requirements for the next 20 years. Perth Airport is working closely with the Australian and Western Australian Governments to plan for a major upgrade to the arterial road network around Perth Airport to underpin the expansion of the airport. Ground access plans have been published by Sydney and Melbourne Airports outlining current arrangements and future needs. Cooperative approaches could act as models for other jurisdictions.

The Australian and NSW Governments are also currently working together on a Joint Study of aviation capacity for the Sydney region. The Joint Study will consider the short and long term aviation infrastructure and supporting surface transport requirements of the Sydney region, and identify strategies and locations to meet future needs. It is anticipated that the report will be completed in mid 2011. Since the release of the White Paper, the Department has also been working with airports, state and territory and local governments, and communities, to establish airport Planning Coordination Forums and Community Aviation Consultation Groups.

These forums and the outcomes of the joint study on aviation capacity in Sydney should improve consultation and planning outcomes at and around airports. A major challenge will be how to fund the investment identified as necessary through these processes. The Department considers that investment programs across the three spheres of government need

[21] Aviation White paper pages 156-157

to recognise the economic benefits which flow to communities from the efficient operation of major airports and the detriment to productivity that congestion or other impediments to access cause.

Attachment A

Aeronautical Pricing Principles[22]

The pricing principles relating to prices for aeronautical services and facilities (as defined in Part 7 of the *Airports Regulations 1997*) provided by airports are:

a) that prices should:

(i) be set so as to generate expected revenue for a service or services that is at least sufficient to meet the efficient costs[23] of providing the service or services; and
(ii) include a return on investment in tangible (non-current) aeronautical assets, commensurate with the regulatory and commercial risks involved and in accordance with these Pricing Principles;

b) that pricing regimes should provide incentives to reduce costs or otherwise improve productivity;

c) that prices (including service level specifications and any associated terms and conditions of access to aeronautical services) should:

(i) be established through commercial negotiations undertaken in good faith, with open and transparent information exchange between the airports and their customers and utilising processes for resolving disputes in a commercial manner (for example, independent commercial mediation/binding arbitration); and
(ii) reflect a reasonable sharing of risks and returns, as agreed between airports and their customers (including risks and returns relating to changes in passenger traffic or productivity improvements resulting in over or under recovery of agreed allowable aeronautical revenue);

d) that price structures should:

(i) allow multi-part pricing and price discrimination when it aids efficiency (including the efficient development of aeronautical services); and
(ii) notwithstanding the cross-ownership restrictions in the *Airports Act 1996*, not allow a vertically integrated service provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher;

e) that service-level outcomes for aeronautical services provided by the airport operators should be consistent with users' reasonable expectations;

f) that aeronautical asset revaluations by airports should not generally provide a basis for higher aeronautical prices, unless customers agree; and

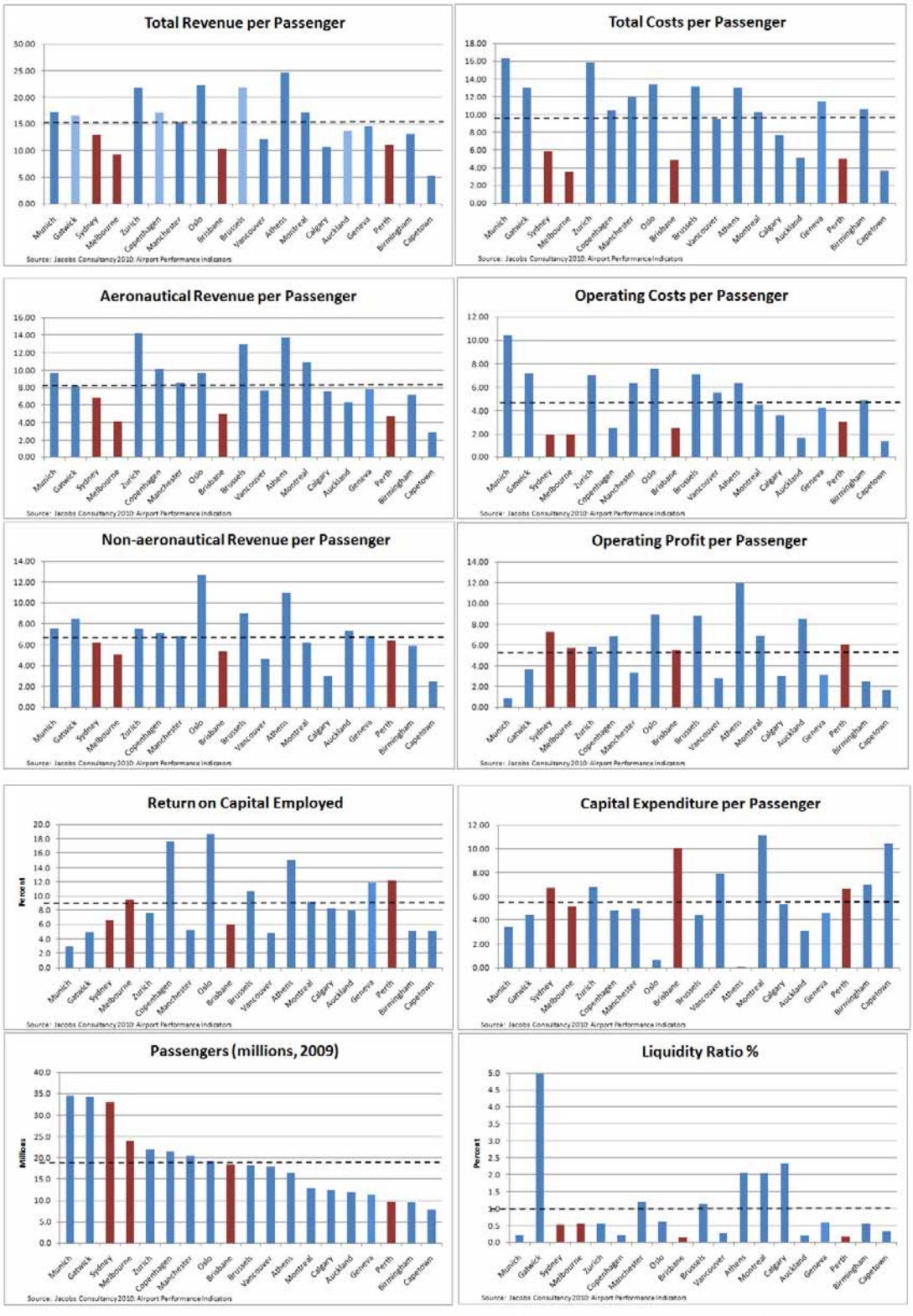
[22] These Principles were implemented as amended in 2007.

[23] For the purpose of determining aeronautical prices through commercial negotiations, these should be long-run costs unless another basis is acceptable to the airports and their customers.

g) that at airports with significant capacity constraints, peak period pricing is allowed where necessary to efficiently manage demand and promote efficient investment in and use of airport infrastructure, consistent with all of the above Principles.

Attachment B

Airport Performance Measures



Except where indicated, the Y axis units are a special currency value created by Jacobs Consulting to provide for comparisons between countries. See "Airport Performance Indicators 2010" for details.

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