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

*6 July 2011*

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# Executive Summary

Adelaide Airport Ltd (AAL) provides the following additional information to the Commission in respect of its earlier submission 7 April 2011.

In its earlier submission AAL contended that airlines had strong countervailing power, in support of this, AAL provides details of the pricing negotiations conducted in respect of a new pricing agreement in 2007. AAL agreed a price with some of its customers which was lower than its modelling suggested due principally to a concession on the level of traffic forecast for the term of the agreement. Prices were further reduced 11 months later after one airline decided not to meaningfully engage in negotiations until April 2008.

AAL also provides details of its optional pricing and discounts which are offered to airlines by which AAL encourages growth and demonstrates a willingness to participate in traffic risk with its customers.

AAL has provided comparisons of its prices with the other Australian capital city airports where, despite being disadvantaged by high Airservices Australia location specific charges and much lower traffic volumes, it has the 3rd lowest charge for both International and Domestic total charges.

Melbourne Airport recently commissioned a "Performance and Charges Benchmarking Study" in which it alleged that AAL had the highest charges for International services. AAL refutes this and using publicly available information on pricing has confirmed its charges to be below that charged by Brisbane and Sydney.

The contents of this submission supports AAL's contention that airlines have a strong countervailing power and that this constrains AAL from any abuse of market power. In addition AAL's pricing is achieved through meaningful negotiations with its customers, is cognisant of changing economic conditions and shows a willingness to share in risk with its customers, this is not the approach of a monopoly business intent on flexing its market power.

# Aeronautical Pricing

## Pricing Negotiations

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

- When airport charges at Adelaide Airport were negotiated in 2002, the negotiated pricing was 28% below the cost-based prices being sought by AAL. At the end of that agreement in 2007 the negotiated outcome for the next 5 years was 25% below AAL cost-based prices. One airline did not finalise price negotiations for 12 months which was well after agreement had been reached with all other domestic airlines. Subsequently a lower price was agreed and this reduction passed on to all domestic airlines in line with the terms of AAL's commercial agreements with some airlines. It should be noted that the dissenting airline continued to access Adelaide Airport during that time and only paid the pre-increase charges until agreement was reached. No action was taken by AAL to recover the underpayment during the course of the year, nor was any attempt made to refuse access on the grounds of the substantial "arrears" accumulating in AAL's books.
- In 2011, the Passenger Facilitation Charge (PFC) for the use of Adelaide's new Terminal (T1) was reset under very prescriptive terms and conditions of a formal long term agreement; here, even though the calculation under the terms of the agreement yielded a 26% decrease in price, a further 2% decrease was negotiated with the airlines.
- In the 2007 landing charge negotiations, AAL conceded to a Compound Annual Growth Rate (CAGR) for domestic passengers of 5.1% over the 5 year term of that agreement. So far, the CAGR for the first 4 years of the agreement (based on latest forecasts) is 4.3%. Current forecasts suggest that passenger growth and revenue will fall substantially short of the expectations assumed in the pricing agreement.

The pricing negotiations in 2007 were somewhat protracted and difficult.

Negotiations began in May 2007, AAL providing a pricing report and traffic forecast prepared by Access Economics.

Pricing was agreed with two airlines in early May 2007 with a final sign off in September. International and Regional airlines had also been involved in discussions and had also agreed. Another airline did not meaningfully engage until April 2008 and continuing negotiations were not finalised until August 2008. The lower outcome agreed with that airline required AAL to provide credits to its other customers in line with the revised agreement and in adherence to agreements with them which provided for them to be on "terms no less favourable".

AAL has foregone some increases in landing fees;

- notably the 1 July 2008 CPI price increase foregone as a response to requests from airlines for some relief due to the peculiar economic circumstances arising from the global financial crisis ; and
- the 1 July 2011 CPI price increase has been reduced by approximately 1% below the contractually entitled level, due to the headline rate of inflation for March 2010 to March 2011 being considered to incorporate 'lumpy' items.

AAL offers airlines a choice of charging basis, per passenger or per landed tonne. This choice enables airlines to accept or pass to the airport traffic risk. One Airline has elected to change from a per pax basis to a landed tonne basis during this pricing period after using a per pax basis during its start-up thus passing traffic risk during start-up to Adelaide Airport and then reducing costs once it had consolidated its position.

Allowing airlines this choice of pricing opens AAL to a risk on airline efficiency. Pricing is initially set so that the airport is ambivalent to whichever method is chosen. Airlines have increased load factor efficiency since the negotiation of the Landing Fee arrangement, resulting in lower landing fee income for the airport for airlines which have elected to be charged on a per landed tonne basis compared to that assumed at the time of the pricing negotiations.

**Pricing shift - airline has elected to be charged on a landed tonnes basis.**

| | | | | |
|---|---|---|---|---|
| A | Current price per pax 2010/11 price list | | 4.49 | |
| B | Current price per tonne 2010/11 price list | | 14.76 | |
| C | Ratio | = B/A | 3.29 | |
| D | Current ratio passenger to landed tonnes for airlines electing to be charged on a landed tonnes basis 2010/11 | | 3.68 | |
| E | Equivalent price per pax now | = B x D | 4.01 | |
| F | Reduction in price achieved by better aircraft loading | = A- E | 0.48 | per passenger |

In order for AAL to maintain a competitive position in attracting airlines to set up local bases and attracting direct services to wanted destinations, AAL has had to ensure through commercial negotiation a pricing structure and incentive offering that is attractive without recourse to any perceived market power.

AAL offers significant incentives to airlines to open new routes, offer discounted fares and generally grow traffic.

AAL offers the following incentives:

- 100% discount on landing charges for new services for a period of up to 5 years.
- 50% discount on landing charges for new services on previously incentivised routes for a period of 1 year.
- 100% discount for each passenger for landing charges where the fare charged is below $30 provided that the aircraft is based in Adelaide and does a minimum of 6 sectors each day to/from Adelaide. This discount is capped at 50,000 passengers per annum.

- A discount is provided for each passenger in excess of a year on year growth threshold as follows;
    - 50% of landing charge per passenger for growth exceeding 6% and up to 15%.
    - 100% of landing charge per passenger for growth in excess of 15%.

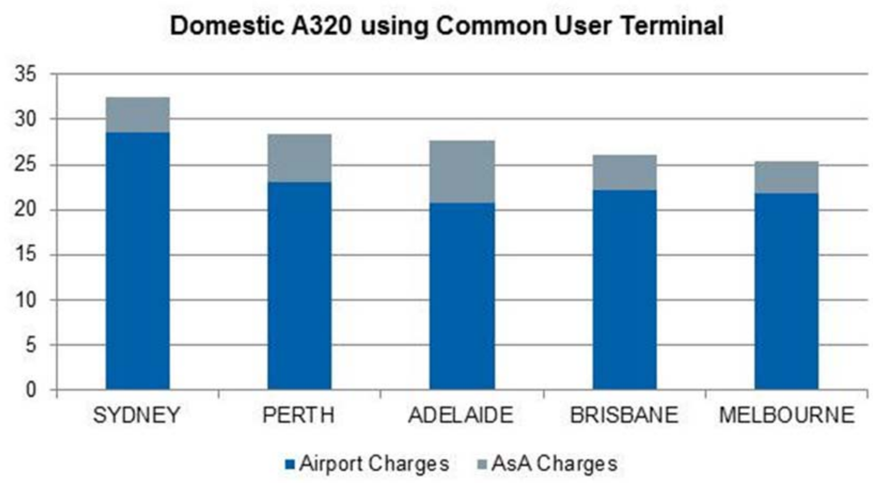
An Airline may only claim one discount for a passenger, route incentive or low fare incentive. Incentivised passengers are excluded for the purpose of calculating growth incentives.

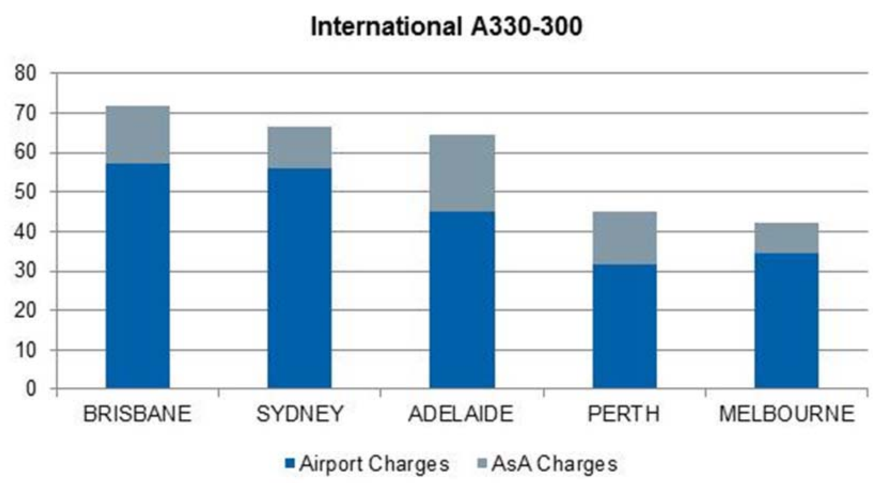
Other incentive measures may be introduced, the above does not represent the limit of what AAL may offer from time to time.

Where airlines elect to be charged on a per tonne basis, growth discounts are earned on passenger growth, the discount is calculated on actual passengers carried and actual landing charges paid.

## Adelaide Compared To the Other Major Capital City Airports

The following graphs illustrate AAL's pricing outcomes compared to the other major capital city airports.




These graphs have been prepared using the following parameters and assumptions;

- current prices for each airport which have been sourced from their websites.
- Melbourne Airport mandated security charges for their terminals are available only on application, it has been assumed that they are equal to an average for Sydney/ Brisbane.
- Published common user terminal charges have been used as a proxy where airlines use their own terminal facilities.
- Adelaide permits domestic airlines to elect the basis of charging each year (per passenger or per landed Tonne (MTOW).
- Current proportion of traffic charged on an MTOW basis at Adelaide is 52%.

The Graphs illustrate;

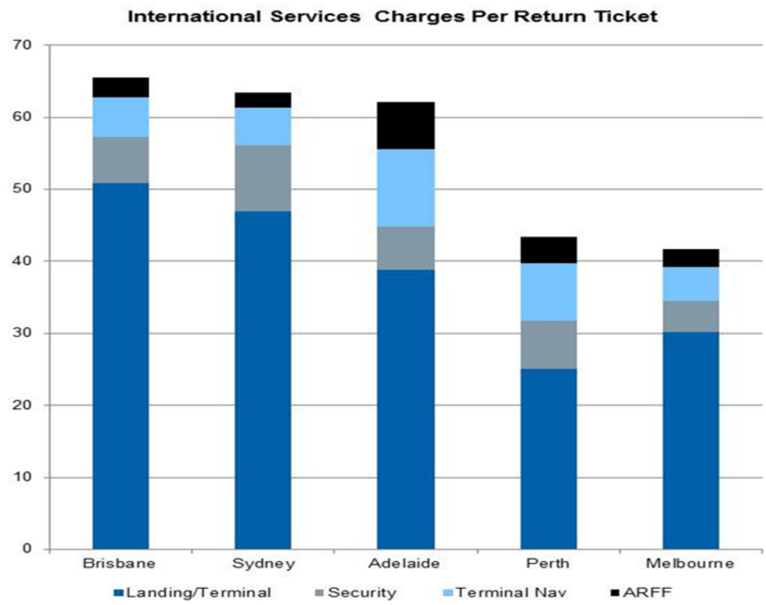
- AAL's total charges are 3rd lowest of the capital city airports for both International and domestic services.
- For domestic services, AAL's airport charges are the lowest for services using common user terminal facilities.
- AAL's competitive position is disadvantage by Airservices costs which are not within its control. This acts as a further constraint on any abuse of perceived market power.

Considering AAL's much lower volumes, its pricing is competitive with the larger airports.

## Melbourne Airport Performance and Charges Benchmarking Study

The following graph repudiates the allegation in the Leigh Fisher report on behalf of Melbourne Airport that AAL is the most expensive capital city airport in respect of total airport charges.

This graph has been prepared using the same aircraft sample as set out in table 1 and table 4 in that report. Current prices for each airport have been sourced from their published prices on each of their websites.




AAL airport charges are $5 to $10 less than Sydney and Brisbane per return ticket.

AAL is 3rd highest for total charges of the capital city airports.

AAL security costs are the 2nd lowest of the capital city airports.

AAL is severely disadvantaged through Airservices Australia location specific charges for Adelaide which are the highest of the capital city airports.

Car parking charges in Adelaide generally are much lower than other Australian Capital cities other than Perth.  Adelaide Airport car parking is closely aligned with CBD prices and compares favourably the longer the term.

AAL's total airport charges including car parking support the contention that it does not abuse any market power it may have.