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

Response to Draft Report
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1 INTRODUCTION

1.1 The Australian Airports Association (AAA) is a non-profit organisation founded in 1982 which represents the interests of over 185 airports Australia-wide, from local country community landing strips to major international gateway airports. There are a further 85 corporate members representing aviation stakeholder companies and organisations providing goods and services to airports.

1.2 The Charter of the AAA is to facilitate co-operation among all member airports and their many and varied partners in Australian aviation, whilst maintaining an air transport system that is safe, secure, environmentally responsible and efficient for the benefit of all Australians.

1.3 All airports who fall within the scope of the Productivity Commission's terms of reference are members of the AAA.

1.4 In April 2011 the AAA made a submission to the Commission and has subsequently had lodged a supplementary submission on 26 July 2011.

1.4 As the AAA indicated in its first submission, no two airports are the same, and no two negotiations between airport operator and airline are the same. Further, it is clear that the nature of regulation of airports is of vital importance to all airports. Accordingly, many AAA members have made their own individual submissions to the Commission. Those submissions confirm the significant diversity that exists in airport operations, the markets in which they operate and the relationships that exist between airports and their customer airlines in relation to how they agree price and non-price terms relating to the provision of airport services.

1.5 To a considerable degree, this further submission by the AAA again reflects a broad consensus among AAA members. It is nevertheless possible that some of the content of this submission might differ materially from the submissions made to date by individual airports. In such circumstances this further AAA submission does not purport to replace the positions already communicated to the Commission by individual airports.

2 PURPOSE OF THIS SUBMISSION

2.1 The Commission released its Draft Report in relation to the inquiry into the Economic Regulation of Airport Services on 22 August 2011.

2.2 On the same day the AAA publicly welcomed that Draft Report. In a media release issued at that time the AAA said:

> *The Productivity Commission Draft Report into the Economic Regulation of airport services has it right when it recommends that the scope of airport monitoring should not be expanded, according to the Australian Airports Association (AAA).*
>
> *AAA Executive Director Caroline Wilkie said given their significance to the Australian economy, it is essential that the economic regulation of airports is no more intrusive than it needs to be, and that it operate on a settled basis without the potential for fundamental change.*

"The AAA welcomes the finding that there is insufficient evidence to suggest the scope of monitoring for our major airports should be expanded and that there are no trends to suggest the misuse of market power.

"Australia's airports already operate within a highly monitored environment and have a network of mature, flexible and mutually beneficial commercial arrangements with their airline partners," Ms Wilkie said.

"Market failure has not occurred – commercially negotiated agreements between airports and airlines are both widespread and long-term in their duration.

"Airports are commercially motivated to ensure that their airline partners develop and expand routes and frequencies.

"Airports continue to invest to cater for growing passenger numbers, to improve the quality of services offered to customers and to enhance the quality of the services they offer.

"Since 2001-02 airports have invested more than $3.5 billion in aeronautical infrastructure alone.

"There is also some $9 Billion in investment in the pipeline at our major airports.

"Large investments will need to be made to keep pace with expected passenger growth which it is estimated will increase by 250 per cent by 2029-30.

CAR PARKING AND LAND TRANSPORT ACCESS

"The draft PC report confirms that airports have invested reasonably in car parking facilities in response to growing demand.

"It is a challenge to deliver major transport infrastructure in line with demand-a challenge faced by airports and governments alike.

"Off airport modes of transport including public transport and off-airport car-parking provide steady competition to airport car-parking.

"However there is an urgent need for some states-in particular New South Wales-to deliver better transport options to our airports".

2.3 At the same time, however, there are a number of aspects of the Draft Report that are of concern to the AAA and on which it wishes to comment.

2.4 This submission therefore deals with the following matters:

- the proposed "show cause" mechanism;
- guidelines on commercial negotiation;
- coverage of airport price monitoring;
- quality of service monitoring;
- possible extension of the pricing principles to other airports; and
- off-airport infrastructure funding.

3 THE PROPOSED "SHOW CAUSE" MECHANISM

3.1 The Draft Report proposes that:

> *The Australian Competition and Consumer Commission (ACCC), on publication of its monitoring reports, should be empowered to issue a direction that an airport has six weeks to show cause why its conduct should not be subject to scrutiny under a Part VIIA price inquiry.*
>
> *To issue a show cause direction, the ACCC must form a view that there is prima facie evidence that an airport has, over time, demonstrated a consistent pattern of achieving aeronautical returns in excess of a reasonably expected band of outcomes, having regard to price paths, the quantum and timing of investment and how that bears on quality outcomes and market conditions.*
>
> *Where the ACCC is dissatisfied with an airport's response to a show cause direction, it shall recommend that the relevant competition Minister invokes a Part VIIA inquiry. If the Minister initiates a Part VIIA price inquiry, the review body would draw on the monitoring reports and also take evidence and consult with the airport operator and its customers. In forming a view about an airport's exercise of market power, the review should examine:*
>
> - *whether airport charges have consistently been set at a level higher than would be justified on the basis of costs, investment requirements and changes to service quality;*
> - *how non-price terms and conditions are treated in agreements and how rights to vary such terms are set; and*
> - *the extent to which consultation mechanisms allow for the reasonable provision of (two way) information.*
>
> *The review body must be guided by the 'Pricing Principles'.*

3.2 The AAA's primary position has hitherto been, and remains, that a "show cause" mechanism is not necessary.

3.3 This is because, as noted in the AAA's previous submissions to the Commission:

- when read carefully the ACCC's monitoring reports make it clear that the ACCC has no evidence that any airport has in fact abused whatever market power it may have. The ACCC reports simply speculate that it is possible that an airport might possibly do so;
- it is a well established first principle in Australia that economic regulation should only be put in place where there is adequate evidence of market failure. In particular, the accepted test of relevance in the present circumstances is that regulatory intervention is only justified:
  - where there is an unacceptably high degree of unconstrained market power;

- where there is either clear evidence of abuse of that power, or strong reason to believe that such abuse is probable;

- where the degree of intervention is proportional to and no greater than is reasonably necessary to prevent or resolve that abuse; and

none of those criteria are met in the present circumstances; and

- the existing forms of regulation in Parts IIIA, VIIA and IV of the Competition and Consumer Act and the provisions of the Commonwealth leases together form a recognised, credible and effective constraint on the improper exercise by an airport of whatever degree of market power it may have. Minimal recourse has been had to any of those forms notwithstanding their clear efficacy. This necessarily casts doubt on why a show cause mechanism would be necessary to guard against the exercise of market power that has never been found or seriously alleged to have been abused.

3.4 The AAA is particularly concerned that the imposition of new regulation such as the proposed show cause mechanism may well have an adverse impact on the ability of airports to gain timely access to the very significant new funding they will require in order to proceed with the major capital investments that are widely acknowledged as necessary over the coming years. The Commission has rightly acknowledged that the light-handed regulatory regime has been a major factor in ensuring that the major investment of the preceding years has been able to proceed. Great care needs to be taken, therefore, to ensure that future investment is not placed at risk by any new regulation.

3.5 If, contrary to the AAA's primary position, a show cause is to be introduced, the AAA makes the following observations on the Commission's draft recommendation:

- first, the show cause mechanism should apply only to those airports that are price monitored;

- second, the proposal that *the ACCC must form a view that there is prima facie evidence that an airport has, over time, demonstrated a consistent pattern of achieving aeronautical returns in excess of a reasonably expected band of outcomes, having regard to price paths, the quantum and timing of investment and how that bears on quality outcomes and market conditions* is not only suitably balanced and appropriate but should also be specifically set out in legislation so that the ACCC is given proper parliamentary guidance and is suitably constrained in its exercise of the proposed power. It would be quite inappropriate for any lower hurdle to be set for the triggering of so significant a process as that proposed;

- third, to avoid any unwarranted inhibition on investment capital, the ACCC's decision to issue a show cause notice, the airport's response to it and any subsequent ACCC recommendation to the Minister should all be undertaken on a confidential basis - only a decision by the Minister to initiate a Part VIIA inquiry should be a matter of public record; and

- fourth, if the Minister decides to institute a Part VIIA price inquiry, that inquiry should not be undertaken by the ACCC. This is because, in the very process of reaching the conclusion that a show cause notice should be issued and that the response to it is unsatisfactory, the ACCC will undoubtedly be perceived to have reached so settled a view that, without suggesting any impropriety on its part, it would be unable to bring an unbiased mind to the substance of the

Part VIIA inquiry. That inquiry should instead be conducted by a completely independent body such as the Productivity Commission.

3.6 The AAA believes that each of these safeguards would be essential to moderate to a reasonable level the potential threat to new investment funding from the introduction of new regulation in the form of a show cause mechanism.

4 GUIDELINES ON COMMERCIAL NEGOTIATION

4.1 The Commission states in its Draft report that it:

> *is seeking information on whether guidelines on matters that could improve commercial negotiation — such as information on whether existing assets are being deployed efficiently prior to new investment and processes to facilitate effective service level agreements — should be:*
> - *devised by the Productivity Commission and incorporated into the Pricing Principles, or*
> - *encapsulated within a new voluntary industry code — a committee comprising representatives from the Australian Airports Association, the Board of Airline Representatives of Australia, the Regional Aviation Association of Australia, Qantas, and Virgin Australia (and possibly with guidance from the Australian Competition and Consumer Commission) could be tasked with this.*

4.2 This extract essentially raised two issues:

- should the current Pricing Principles deal with any additional price-related matter; and

- are any additional guidelines on other matters required to improve commercial negotiations.

4.3 As to the first of these issues, the AAA acknowledges that a central element in the successful achievement of the objectives of the current regulatory regime has been the Government's airport Pricing Principles and that these principles have been modified by the Government from time to time, including in response to past recommendations of the Commission.

4.4 The Government's Pricing Principles have provided guidance to airports and airlines in relation to the Government's expectations of the parties and the desired outcomes from the Government's perspective. A key feature of these principles has been that they are high level, and importantly, they are not overly prescriptive. This is both necessary and appropriate having regard to the Government's key policy objectives in relation to airport operation, development and pricing.

4.5 Notwithstanding the past success of the Pricing Principles in helping airlines and airports to transition to mutually agreed commercial agreements, the AAA opposes any extension of them to deal with further price-related issues. In the AAA's view, the need for such an extension has not been made out, especially in circumstances where agreements between airports and airlines are already widespread and long-term in nature.

4.6 As to the second issue, the AAA believes that no such guidelines are required (whether in the Pricing Principles or in a separate document such as a code of conduct).

4.7 As noted above, it is established principle that there should be regulatory intervention only where there is adequate evidence of market failure. In the present context this means that it would have to be established that there is little prospect of the parties being able to resolve the issues they face in the negotiation process without regulatory intervention and that that intervention did not carry an unacceptable risk of regulatory failure.

4.8 Experience clearly demonstrates that market failure has not occurred. Commercially negotiated agreements between airports and airlines are both widespread and long-term in their duration. In these circumstances where airports routinely have entered into long-term commercial agreements with airlines seeking such, it is difficult to see what further regulatory intervention could achieve. In the AAA's view, the formulation of codes of conduct or guidelines would carry an unacceptable risk of regulatory error. While negotiations around such agreements between airports and airlines have often been keenly debated and detailed, this is simply an indication of an ordinary commercial market involving participants with closely aligned degrees of bargaining power. There is no reason to assume that guidelines of the type mentioned would alter that dynamic.

4.9 The Commission has given only two examples of the type of matter that might be covered by such guidelines - *information on whether existing assets are being deployed efficiently prior to new investment and processes to facilitate effective service level agreement.*

4.10 So far as the AAA is aware, there is no evidence that bilateral and multilateral negotiations between airports and airlines have been rendered ineffective by any absence of *information on whether existing assets are being deployed efficiently prior to new investment*. The practical position is that, unless an airport is prepared to provide sufficient information to satisfy its airline clients that new investment is required, it will not gain their agreement to any price increase necessary to recoup that investment. Airlines simply refuse to pay increased charges that they have not agreed - indeed there are even examples of airlines failing to pay increased charges that they have agreed.

4.11 In relation to *processes to facilitate effective service level agreement*, the AAA believes that experience to date demonstrates that any attempt to develop such guidelines would be either unnecessary or futile.

4.12 In a significant number of cases, airlines and airports have already mutually agreed service levels and guidelines would thus be unnecessary. These agreed levels relate to the particular issues that the individual airline regards as of importance to it, and they often vary on an airport-by-airport or airline-by-airline basis. Because commercial considerations dictate that service levels are not uniform, they would not easily fit into any set of pre-determined criteria that might be included within guidelines.

4.13 In relatively few cases, service levels have not been agreed. However, the reasons for this need to be understood. It is the AAA's understanding that, in these cases either:

- the airline has not sought to negotiate service levels despite the airport's preparedness to do so - some airlines simply do not see service level agreements as relevant to their particular business model; or

- the airline has stated a desire for service levels to be included in its agreement with the airport but has been unable or unwilling to specify the service levels it seeks; or

- the airline, having specified its desired service level and that having been agreed by the airport, has been unwilling to agree to pay the increase in airport charges that would be necessitated by implementation of that service level.

In such cases, the existence of guidelines of the type proposed would not advance matters and their development would thus be futile.

4.14 If, contrary to the view expressed above, any such guidelines were to be required, the AAA is of the very firm view that they should be devised by the Productivity Commission in active and detailed consultation with all affected parties (and be of a very limited nature - see paragraph 4.16 below).

4.15 The alternative proposal of a voluntary code of conduct formulated by a committee comprising *representatives from the Australian Airports Association, the Board of Airline Representatives of Australia, the Regional Aviation Association of Australia, Qantas, and Virgin Australia* would be unworkable. First, the AAA has neither the authority nor the capacity to embark on such an exercise as all individual airport members quite properly reserve the right to deal individually with matters such as this, given their potential impact on commercial viability. Second, the proposed composition of the committee would see airports substantially outnumbered and there could be no reasonable expectation of a consensus outcome.

4.16 Finally, if guidelines of this nature are to be prepared, they must be strictly confined to processes designed to facilitate the negotiation of service level agreements, and should not intrude into the substance of such agreements. The content of any service level agreement must remain a matter for commercial negotiation between the airport and the airline concerned. It would be completely inappropriate for a regulator to effectively impose contractual terms upon either party, particularly having regard to the price-premium that particular service standards or compliance requirements may command. As the AAA has previously stressed, no two airports are the same and different airlines can seek different levels of service at the same airport, or the same airline can seek variable levels of service at different airports. As a result, such guidelines would necessarily have to be generic and high-level - which necessarily calls into question their potential value.

5 COVERAGE OF AIRPORT PRICE MONITORING

5.1 The Draft Report recommends that price monitoring should continue until June 2020 at each of Adelaide, Brisbane, Melbourne, Perth and Sydney airports.

5.2 Given that the rationale for price monitoring lies in the Commission's assessment of the degree of market power held by airports, the AAA believes that the case for inclusion of Adelaide (already accepted by the Commission as marginal) cannot be sustained. Adelaide Airport has completed its major new investment program and has entered into long term agreements with its airline customers. It has, in effect, contracted out of whatever market power it might have had. As such, it is in a markedly different position to the other airports concerned.

5.3 The AAA therefore urges the Commission to amend its draft recommendation to exclude Adelaide Airport from the coverage of price monitoring.

6 QUALITY OF SERVICE MONITORING

6.1 The AAA refers the Commission to the comments made in its supplementary submission in relation to quality of service monitoring. In summary, in that submission the AAA, while noting that the second tier airports already operate under a different self-administered regime, suggested that for the price monitored airports:

- an appropriate regime for quality of service monitoring and public reporting does not require involvement of the ACCC; and

- a credible option for the Commission to recommend is that the AAA develop (at its cost) for approval by the Minister a survey form (along the lines of the internationally accredited Airports Council International (ACI) airports service quality survey) that would be adopted at all airports currently the subject of formal monitoring, and the results of which would be published on the websites of both those airports and the AAA.

6.2 If the Commission does not favour this option and believes that the ACCC should remain involved, the AAA would support the following propositions for quality of service monitoring at the price-monitored airports:

- a passenger survey methodology based on the ACI Airports Service Quality information should be adopted - the AAA and affected member airports wish to register their strong interest in participating in the development of that methodology;

- the views of airlines should no longer be surveyed by the ACCC;

- airports should instead periodically publish statistics on what proportion of their airline agreements contain service level standards and on the proportion of times those standards are met;

- airports should not be required to publish either the specific service level standards they have agreed with their airline customers, the compliance rate for each such standard, or the consequence of any non compliance - this is because:

    - these are all properly commercial-in-confidence matters between the airport and each of its airline customers individually;

    - agreed service levels vary between airlines to meet the requirements of those individual airlines and thus there is no need for cross-airline comparisons, which may in any event be meaningless because of the different service criteria agreed;

    - service levels sought by airlines generally relate to issues of significance to their operational needs rather than directly to passenger impact, and thus there is no need for, and would probably be little interest in, public dissemination; and

    - the non-compliance consequences agreed between airport and airline already provide sufficient incentive for airlines to honour what they have agreed; and

- the views of border authorities should no longer be surveyed by the ACCC, because of their unique position.

7 POSSIBLE EXTENSION OF THE PRICING PRINCIPLES TO OTHER AIRPORTS

7.1 In the Draft Report the Commission states:

> *The Commission seeks information on the potential costs and benefits of extending the Pricing Principles to regional airports. How might the principles be applied, and is the problem of sufficient magnitude to warrant any potential enforcement mechanisms?*

7.2 Notwithstanding the past success of the Pricing Principles in helping airlines and price-monitored airports to transition to mutually agreed commercial agreements, the AAA opposes any extension of the them to any airport other than those currently subject to price monitoring and, particularly, to any of the regional airports. The rationale that was seen to justify the introduction of the Pricing Principles in respect of the largest price-monitored capital city airports simply does not apply in respect of the smaller regional airports.

7.3 In this regard the AAA notes that:

- the suggestion that any regional airport has market power capable of abuse in its dealings with airlines, and particularly the larger airlines, is simply fanciful - indeed, in many cases, airports are served by only one RPT carrier and are already extremely highly motivated to maintain those services in the best interests of their local community;

- there is no evidence whatsoever to suggest that any regional airport has abused, or even attempted to abuse, market power;

- there has been no proper examination of the reasons underlying any increases in prices charged by regional airports;

- the AAA nevertheless expects that such price increases as have occurred will be reasonably attributable to a variety of readily identifiable and properly justifiable issues, including:

    - airports simply seeking to recover the significant costs imposed on them by the Commonwealth's extension of the various aviation security or safety regimes such as checked-bag screening, or increased AirServices Australia charges as an airport grows and moves into a higher charging code;

    - airports seeking to recover the cost of other new capital works provided for the benefit of their airline customers and passengers - for example, the significant capital expenditure that can be required to attract and retain RPT services; and

    - airport owners, often local government authorities, seeking to place loss-making public utilities onto a more commercially tenable footing.

7.4 Indeed, the AAA suggests that there would be a very real prospect that application of the pricing principles to many regional airports, rather than constraining airport pricing, would see major increases in aviation charges. By way of comparison, it notes that the ACCC approved a price increase of nearly 100% for Sydney Airport when the Commonwealth decided to place aviation charges at that airport onto a commercial footing before proceeding to sell the airport. The AAA reasonably anticipates that many government owned regional airports are similarly operating at significantly less than commercial pricing levels.

8. OFF-AIRPORT INFRASTRUCTURE FUNDING

8.1 The Commission's Draft Report notes that:

> *The Commission seeks views on whether an airport should contribute to the cost of infrastructure outside its boundary as a result of future on-airport non-aeronautical development.*
>
> *If funding is viewed as necessary, the Commission also requests information regarding:*
> - *the basis for funding such infrastructure including the benefits*
> - *the form of funding (such as upfront financial contributions, rate payments or land transfers)*
> - *the method of calculating contributions and how the contributions would relate to existing developer charges levied by local governments*
> - *how such funding would align with the conditions under which airport leases were granted.*

8.2 The AAA believes that it is, and should be reinforced by the Commission to be, properly the responsibility of State and Local Governments (and to some extent potentially the Commonwealth) to fund and provide public transport networks, and particularly the road systems that service the community's residential and commercial developments. There is no justification for adopting special rules for airports. Airports have already taken on the role of providing major infrastructure that was previously the responsibility of Government (and have met that role far more actively than Government ever did), and care needs to be taken not to place their capacity to continue to do so at risk by seeking to expand the scope of their responsibility.

8.3 Airports exist to facilitate transportation of people and goods for the benefit of the wider community. In so doing, they facilitate residents and businesses in the more efficient conduct of their personal and commercial affairs. In this sense they are no different to any other commercial enterprise and they should be treated in the same way as other private sector commercial developments.

8.4 Airport operators quite properly provide on-airport road systems but there should be no expectation that they will provide off-airport road systems. Like other commercial property developers, they may on occasion be required to contribute to the costs of providing infrastructure for the necessary boundary inter-connection between on-airport and off-airport road systems (such as traffic lights and "slip" lanes), but the need for and level of any such contribution should be assessed on a case-by-case basis.

8.5 While there have been occasions on which individual airport operators have agreed to make a contribution to road networks beyond the airport boundary point of inter-connection, these should not be regarded as any form of precedent for any rule of general application but simply as reflective of special circumstances then prevailing in the individual case.

8.6 It is also important to note that the Government has only relatively recently made significant changes to the Major Development Plan and Master Plan provisions of the *Airports Act 1996* so as to require increased levels of consultation between airports and State and Local Government authorities in relation to ground transport issues and, in particular, integration between on-airport and off-airport transport networks. Care should be taken to allow these amendments to be tested before any further regulation of airports is contemplated.