



29 September 2011

The Commissioner
Economic Regulation of Airport Services
Productivity Commission
GPO Box 1428
CANBERRA CITY ACT 2601

Dear Commissioner,

**Productivity Commission Draft Report
Economic Regulation of Airport Services**

The RAAA and its Members

The Regional Aviation Association of Australia (RAAA) was formed in 1980 as the Regional Airlines Association of Australia to protect, represent and promote the combined interests of its regional airline members and regional aviation throughout Australia.

The Association changed its name in July 2001 to the Regional Aviation Association of Australia and widened its charter to include a range of membership, including regional airlines, charter and aerial work operators, and the businesses that support them.

The RAAA has 29 Ordinary Members (AOC holders) and 57 Associate/Affiliate Members. The RAAA's AOC members directly employ over 5,000 Australians, many in regional areas. On an annual basis, the RAAA's AOC members jointly turnover more than \$1b, carry well in excess of 2 million passengers and move over 23 million kilograms of freight. Annex A lists the Ordinary Members of the RAAA.

RAAA members operate in all States and Territories and include airlines, airports, engineering and flight training companies, universities, finance and insurance companies and government entities. Many of RAAA's members operate successful and growing businesses providing employment and economic sustainability within regional areas.

Some examples of RAAA members' presence in regional Australia is the REX hub in Wagga Wagga, SkyWest in WA, Sharp Aviation in Hamilton, Airnorth, Chartair and Vincent Aviation Northern Territory networks, West Wing Aviation in Mt Isa, Airlines of Tasmania in Hobart and Skytrans operations from Cairns, to name a few.

Serving regional aviation, and through it, the people and businesses of regional Australia

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RAAA Charter

The RAAA's Charter is to promote a safe and viable regional aviation industry. To meet this goal the RAAA:

- ➡ promotes the regional aviation industry and its benefits to Australian transport, tourism and the economy among government and regulatory policy makers;
- ➡ lobbies on behalf of the regional aviation industry and its members;
- ➡ contributes to government and regulatory authority policy processes and formulation to enable its members to have input into policies and decisions that may affect their businesses;
- ➡ encourages high standards of professional conduct by its members; and
- ➡ provides a forum for formal and informal professional development and information sharing.

The RAAA provides wide representation for the regional aviation industry by direct lobbying of Ministers and senior officials, through parliamentary submissions, personal contact and by ongoing, active participation in a number of consultative forums.

RAAA Response to the Productivity Commission draft report

The RAAA is disappointed that in its draft report, the Commission has not attempted to balance the competing interests within the aviation industry and has viewed all the issues through the prism of ensuring that airport investment continues to be strongly encouraged.

However, given the terms of reference, the Commission has focused, understandably, on the five major airports and their major customers - which are typically large, often international, airlines with considerable bargaining power. The Commission has also given considerable weight to the growth of low cost carriers and the small increase in competition between airports, and has concluded that only minor adjustments to the regulatory controls is justified.

In providing these comments, the RAAA is not attempting to address every issue, rather those that in the views of our members are those that most require a response. These comments should be read in conjunction with the three previous submissions made by the RAAA.

Different markets

The Commission has failed to understand that regional airlines and small to medium aviation entities are operating in an entirely different market to that of major domestic, international and LCC airlines. The economies of scale are different, the effect of price changes is different, the barriers to entry are different, and, importantly, the bargaining positions are very different.

The Commission has given weight to the small amount of competition that exists between major airports and yet this pales into insignificance in comparison with the amount of competition that exists between airlines within the different market segments that operate - regional, domestic and international.

Industry knowledge, market power and the breadth of regulatory controls

It is not clear why the Commission has accepted the views of the Department of Infrastructure and Transport over the views of the regulatory agency that is most knowledgeable about the aviation market. The ACCC has responsibility for overseeing the industry and is at the receiving end of complaints about airports – a much more informed position than that of the Department.

“Moreover, the airport regulatory regime, which is based on airport monitoring and the general provisions of Part III of the Competition and Consumer Act 2010, does not create an effective constraint on the major airports’ market power”. (Page 3 of the ACCC submission March 2011.)

It is also not clear how the Commission has determined the level of market power of the various airports, particularly as they relate to smaller and regional airlines and other aviation operators. This is a vital element in the Commission’s conclusion that the scope of the regulatory arrangements should not be extended.

The RAAA submits that monopoly behaviour and lack of competition is evidenced by the Commission’s own finding that airports have since 2002 enjoyed “substantial total price increases” during a time when airlines, operating in a very competitive market, have achieved substantial price decreases. The RAAA submits that the Commission has applied no real analysis to the conclusion that the regulatory arrangements should continue to apply only to the five major airports when, in fact, other airports exercise a high level of market power within their geographic region (particularly in respect of smaller operators) and, in some instances, abuse that market power when dealing with their customers.

The facts

The RAAA does not agree with some of the Commission's conclusions. In particular, its assessment that "Airports are passenger throughput-based businesses with long-term horizons whereas airlines typically operate with shorter horizons" (pXXXI). This conclusion shows how poor is the Commission's understanding of the aviation sector. We would submit that domestically and worldwide, airlines invest more money in capital and infrastructure and have longer lead-times and investment horizons than airports and yet they face greater risks and far less benign investment environments.

Further, whilst the conclusion that "Australian airports are complex, stand alone, multi product private entities, which investors generally regard as a class of assets with greater exposure to demand shocks than energy network infrastructure" may be correct, it completely ignores that airlines are considerably more complex entities than airports and have significantly greater exposure to demand shocks than airports. Fuel price changes, volcanic eruptions, SARS and September 11 all had far greater effects on airlines than on airports. Airports are effectively guaranteed a reasonable return on their assets – whether it is a record year for passenger numbers or a terrible year for passenger numbers.

Whilst airports have their complexities, most of the aviation related operational activity on airport is conducted by airlines and their third party contractors and providers, rather than by the airports themselves. It is airlines that are responsible for their ground handling, engineering, check-in and baggage handling arrangements. These all require different teams of people with different skills, and different regulatory and auditing requirements. In airlines, these tasks are sometimes outsourced, but they are still usually airline activities not airport activities. Airports are often responsible for security screening but security companies typically provide the screening services, and third party lessees conduct the retail outlets, etc. Airports are more akin to large shopping centres. They provide the infrastructure and are principally owners/ lessors – it is the airlines and their contractors and other third parties that operate, use and pay for the infrastructure. Typically airports are not nearly as complex as airlines and they are not subject to the same level of aviation regulatory controls to which airlines are subject.

For the purpose of assessing airport investor risks, the Commission has compared airports with energy infrastructure and has ignored the airport's customers, the airlines. The RAAA submits that the airlines are also part of the aviation industry's infrastructure. In order to understand the bargaining imbalance at airports and investor outcomes within the sector, the most important comparison should be between airlines and airports, and the Commission's assessment should have regard to the fact that airlines are not all operating in the same markets.

The Commission has principally focussed on the effect of aeronautical charges on an airline and concluded that “in practice, however, aeronautical charges typically have only a minor effect on airfares” (pXXVI). We do not agree with this assessment – particularly in the market our members are in. In addition, this conclusion ignores the other very important costs/ factors through which airports exercise their monopoly power (rent and lease conditions, access to the airport, staff car parking, etc) which tend to be significant factors for smaller aviation entities and regional airlines.

The RAAA submits that the Commission’s assessment of market outcomes since its last review in 2008 is inaccurate and does not adequately recognise the negative effect of the GFC on airlines. As highlighted in our previous submissions, this effect was not shared equally by airports which effectively pushed the downside risks to their customers – particularly their smaller customers. The unequal outcome is another example of the bargaining imbalance between airports and airlines, particularly regional airlines and smaller operators.

The Commission’s conclusion that failure to utilise processes under the Competition and Consumer Act (with all their attendant costs and risks) confirms that the regulatory system does not need adjusting, ignores the market environment during 2008-2010 and the fact that smaller operators are simply not able to access the processes due to the costs involved. During the GFC a number of smaller regional airlines failed and those that didn’t were reduced to basic survival mode. In these circumstances, there was little prospect of a small airline tackling aggressive airport behaviour through cumbersome and expensive legal channels .

Conclusion

It is deeply disappointing that the Commission prefers to ensure there are very generous returns for airport investors so that they keep investing, rather than support a competitive aviation sector in which the profits and risks are more evenly distributed. The Commission has not made a detailed assessment of airport market power and has ignored the various market segments in which RAAA members operate.

However, given that airports were privatised by government only some 10 years ago, perhaps this is predictable. No federal government, having sold most of the nation’s airport infrastructure to private interests (albeit on long term lease arrangements), would wish to contemplate the prospect of again assuming responsibility for that infrastructure should there be a failure of the new owners to properly invest. This and the commitments given to the new owners at the time of sale, may be a factor in the Commission’s preparedness to err on the side of the airports.

In our view the Commission's report and findings have contributed very little to the discussion about relationships between airports and their smaller and regional customers. This relationship continues to exhibit a significant imbalance in bargaining power leading to unfair outcomes that are inhibiting market growth and efficiency, and yet there appears to be no government or political appetite to recognise or address it. Over time, small to medium and regional operators will not thrive and will vacate the field either by choice or through failure. This has already been happening as highlighted by a reduction in operators from 53 in 1984 to 27 in 2008 (BITRE Report 115, Air transport services in regional Australia: trends and access) and will continue. This will leave only the major and international carriers with substantial market shares focused on key trunk routes, which will negatively impact regional communities and the services they receive.

The RAAA remains committed to its proposal that there should be an inquiry into regional aviation.

Responses to some of the requests for information

The Commission has sought views about whether an airport's ability to earn non-aeronautical revenue provides an incentive to constrain aeronautical charges, and if so, to what extent this currently occurs.

The RAAA does not believe that in practice an airport's ability to earn non-aeronautical revenue is an incentive to lower their aeronautical charges, particularly at the five largest airports where the pricing principles are applied. The pricing principles effectively authorise the airports to recover all of their costs plus a reasonable margin from their aviation customers, and non-aeronautical revenue effectively becomes icing on the cake. With the largest airports often obliged to maximise their revenues for shareholders, it is a reality of life that they will maximise them as much as they possibly can – whether the regulatory controls are based on a single till or dual till approach.

The Commission has sought information on whether new guidelines to improve commercial negotiation should be devised by the Productivity Commission or included in a new voluntary industry code devised by industry representative groups.

The RAAA is happy to participate in devising a voluntary industry code and sees some benefit to its members in such codes being adopted. It would be important that these codes extend more broadly, to airports that are not currently regulated, and that they address behaviour and pricing of all the services that are important to our members such as on-airport office and hangar rental, as well as traditional aeronautical services such as terminal pricing and aircraft parking. These codes may also assist in removing the differential that often exists in respect of pricing outcomes for larger airlines compared to their smaller and regional counterparts. An important aspect of any voluntary industry code would of course include a dispute resolution mechanism that minimises costs to all parties.

The Commission has sought views on whether the Pricing Principles should be extended to regional airports.

The RAAA cautions that whilst the pricing principles are valuable and can be helpful in price discussions with regional airports, the concept of complete cost recovery should not necessarily always be applied. It is perhaps not difficult to justify the position that city airports should be fully paid for by only those who use them, but in rural and regional centres with small passenger numbers and a need to encourage visitors and maintain airlinks for health, education and other reasons, passing on the full cost of airport services may not be the most optimal outcome. In small regional centres, the airport is more an essential piece of community infrastructure – similar to roads, schools, hospitals, the local football ground and the local pool. The newspapers are often delivered by overnight freight, health service deliveries such as blood and supplies arrive by air, and the mailbag and air ambulance services are also delivered or provided by airlines. Airfields and local terminals are also sometimes used for non aviation purposes. Most infrastructure in smaller centres draws on the community's general revenue base as well as user contributions, and the RAAA submits that in regional areas, this is an appropriate approach.

If the RAAA is appreciative of being able to respond to your draft report. If we can be of any further assistance in this matter please don't hesitate to contact me.

Regards

Paul Tyrrell
Chief Executive Officer

Annex A: RAAA Ordinary Members

