



Productivity Commission Inquiry into the Economic Regulation of Airports

ACCC submission in response to the
Issues Paper

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Executive Summary

Airports are critical pieces of infrastructure that provide for services that both enrich people's lives and drive economic growth. Australian airports now provide for over 150 million airline passengers each year.

In Australia, providers of key infrastructure services with natural monopoly characteristics similar to those exhibited by the major airports are typically regulated to ensure that they will not exploit their market power to the detriment of consumers. This is not the case with Australia's major airports.

The airports of Sydney, Melbourne, Brisbane and Perth operate under a limited monitoring regime. Effective monitoring regimes can influence behaviour if the monitored companies consider that reporting of undesirable behaviour, such as high prices or declining service quality, could be met with regulation. This threat of regulation may have constrained behaviour in the past when the airports were first privatised. However, we do not consider that the current regime is effective in constraining behaviour. Moreover, any remaining threat of regulation will be further diminished if the Productivity Commission recommends against regulation in its fourth review of this nature.

The ACCC recognises that airports provide a range of services, including aeronautical, car parking and landside access services. The degree of market power they hold in the supply of those services can vary. As a result, different regulatory approaches may be appropriate for different services. It is therefore important to ensure that the elements of a regulatory approach are fit-for-purpose and that the benefits outweigh associated costs.

The ACCC notes that the monitored airports have significantly raised aeronautical charges to airlines over time. Revenue per passenger is a useful proxy for showing movements in airport charges. Over the last decade, revenue per passenger has increased in real terms by 59 per cent at Perth Airport, 36 per cent at Brisbane Airport and 31 per cent at Melbourne Airport. Sydney Airport's revenue per passenger has increased at a more subdued rate over this time (15 per cent). However, Sydney still maintains the highest revenue per passenger of the four airports with the airport almost doubling its charges just before it was privatised in 2002. The increases across the four airports over the last decade represent an additional \$1.3 billion in payments from airlines.

Despite these significant increases in charges, only Perth Airport has materially improved its overall quality of service. The ratings for the other airports have been settled over this period, typically between the high end of 'satisfactory' and 'good'.

The ACCC considers that high aeronautical charges imposed by airports need to be addressed by a more effective regulatory regime. In the past, the Productivity Commission has not been sufficiently concerned with airport charges to recommend regulation because it has taken the view that such charges simply represent an economic transfer from airlines and passengers to airports, with no reduction in output. The ACCC considers that transfers in monopoly pricing have significance and would need to be examined carefully. In any case, the ACCC considers that the total economic welfare loss due to high airport charges is likely to be higher than previously considered by the Productivity Commission.

The Productivity Commission may wish to consider whether airlines would be better positioned to negotiate with airports if airlines were provided with additional information. This could be supported by the ACCC having the ability to create record-keeping rules for airports as it does in telecommunications.

The ACCC considers that commercial negotiations would be further supported if the parties are provided with a fall-back option of seeking arbitration. This would address the imbalance in bargaining power between monopoly airports and airlines, particularly small airlines. Arbitration could be undertaken by a commercial arbitrator to ensure that outcomes are reached in a more timely manner.

The ACCC considers that monitoring the performance of the major airports in relation to aeronautical services should continue alongside an arbitration regime. Monitoring would support commercial negotiations, help to assess whether the arbitration regime is achieving the desired results, and continue to provide stakeholders with information on the airports' quality of service. An ability to make record-keeping rules would enable the ACCC to make improvements to the way it monitors the various activities of the airports.

An alternative to establishing an arbitration framework backed by greater information disclosure would be to enhance the existing monitoring regime in a similar manner to that previously undertaken in New Zealand. One of the key limitations of the current monitoring regime is that, despite the major Australian airports being highly profitable compared with other airports and sectors, the ACCC cannot be conclusive about whether the airports are making excessive profits. In contrast, the New Zealand Commerce Commission is able to conduct more conclusive reviews of prices charged by the major airports because it has been able to implement an extensive set of rules regarding matters such as how the major airports value their assets, calculate depreciation, and allocate costs. While this approach offers some appeal, the ACCC considers that a regime based on information disclosure and commercial negotiations with recourse to arbitration is likely to lead to better outcomes for national welfare.

Given some of the second-tier airports such as Adelaide and Canberra potentially hold significant market power, the current inquiry provides an opportunity for the Productivity Commission to consider whether other major airports should be subject to similar types of regulatory oversight as the four monitored airports.

Airports continue to hold significant market power as the only providers of car parking on airport grounds. Car parking revenue has grown significantly at each of the four monitored airports over the last decade. The operating profit margin across the four monitored airports was 64 per cent in 2016–17. A study of international car parking prices also found that short term car parking prices at airports in Australia and New Zealand are higher at every duration compared with the average price at airports in both the Asia Pacific and the world.

The airports provide landside access services to operators of various transport modes including taxis, hire cars and off-site car park operators. While revenues from these services are much smaller than those for aeronautical and car parking services, there have been concerns about airport behaviour in this area. The four monitored airports earned a combined revenue of \$47.9 million from landside activities in 2016–17, up 97 per cent in real terms since 2009–10. Further, charges and access arrangements that airports set for landside access services can have some impact on the level of competition for the airports' own car parking services.

While having concerns about airport market power in car parking and landside access services, the ACCC does not recommend stronger regulatory oversight for these activities beyond the current monitoring arrangements. Unlike for aeronautical services, there does not appear to be a more effective approach to regulating these services. Further, monitoring and advising consumers may be more effective in relation to car parking than aeronautical services because there are some ground transport options available and the reporting of high parking prices may encourage consumers to more carefully consider alternative ways to get to and from the airport. The government could provide a formal direction to the ACCC to

monitor landside access services, as this currently occurs on an informal basis and available data is limited.

Sydney Airport is required to notify the ACCC of any proposed increases in prices for regional air services. It is likely that this obligation has helped to achieve the government's goal of protecting regional air services at the airport. Prices for regional air services have been held constant in nominal terms since 2001. This equates to a fall of 31 per cent in real terms.

However, subjecting only part of the services provided by the airport to price regulation may impact on the efficient operation of Sydney Airport, which is capacity-constrained. The efficiency impact will become more relevant over time as the airport has to find a way to cater for an estimated doubling of passengers between now and 2033.

Sydney Airport also faces operational restrictions in the form of hourly aircraft movement caps and curfews to limit noise impacts. These restrictions have likely increased the challenge associated with managing congestion at the airport and brought forward the need to build a new airport at Western Sydney. The government could periodically review these restrictions to ensure they are not unnecessarily impacting on the efficient operation of the airport, especially considering the technological developments that continue to reduce the level of noise from aircraft.

The lack of competition in the supply of jet fuel likely results in airlines paying excessive prices for a key cost input. However, the complexity of the problem means that there is not an obvious solution. The Productivity Commission may wish to consider the merits of open access arrangements at the various bottlenecks along the supply chain. However, any decision regarding open access arrangements would need to balance the need for more competitive pricing with the need for further investment in facilities. The government could also seek to take action now to help prevent some of these issues emerging at the Western Sydney Airport.

List of recommendations to the Productivity Commission

1. The ACCC submits that the Productivity Commission consider, based on market power, whether any other airports such as Adelaide and Canberra should be subject to similar types of regulatory oversight as the four monitored airports.
(Page 18)
2. The ACCC submits that the Productivity Commission consider whether airlines would be better positioned to negotiate with airports if they were provided with additional information. This could be supported by the ACCC having the ability to create record-keeping rules for airports as it does in telecommunications.
(Page 36)
3. There should be access to arbitration if airports and airlines cannot reach commercial agreement on terms and conditions. The imbalance in bargaining powers of monopoly airports and airlines, particularly small airlines, could be reduced if both parties had recourse to arbitration. This would promote commercially negotiated outcomes that better represented the interests of both airports and airlines.
(Page 39)
4. Commercial arbitration, where the arbitration of an access dispute is done by an independent commercial arbitrator rather than the regulator (similar to arrangements under Part 23 of the National Gas Rules), could lead to more timely dispute resolution.
(Page 39)
5. The ACCC monitoring of aeronautical services should continue in order to support commercial negotiation and to provide the government and stakeholders with information on a key infrastructure sector, including aspects of performance not related to aeronautical charges. This monitoring would be supported by the ability for the ACCC to make record-keeping rules.
(Page 40)
6. The ACCC should continue to monitor car parking services and inform consumers of the range of alternatives for getting to and from the airport. This monitoring would be supported by the ability for the ACCC to make record-keeping rules.
(Page 51)
7. The consideration of landside access issues could be improved by the Australian Government formally directing the ACCC to monitor landside access services.
(Page 55)
8. Operational restrictions that apply to Sydney Airport, such as the hourly aircraft movement caps, should be reviewed periodically to ensure they remain appropriate, so as to reflect technological advances that reduce aircraft noise. This would provide policy makers with opportunities to consider whether the operational restrictions are fit-for-purpose in balancing all relevant policy objectives, including operating efficiency and noise management.
(Page 57)
9. The Australian Government could take action to promote competition in the future supply of jet fuel at the new airport in Western Sydney. This includes setting aside land for a future jet fuel pipeline and implementing appropriate open access arrangements at the joint user hydrant installation (JUHI) facilities.
(Page 59)

1. Introduction

The ACCC welcomes the opportunity to contribute to the Productivity Commission's review of the economic regulation of airports.

1.1. Role of air transport

Air travel has become an essential component of modern life. It enables people to explore the country or the world, brings people living in regional areas closer to the services offered in major cities, and helps drive economic growth.

Airports play a fundamental role in air travel. Australia contains over 100 airports dotted across the country, from small regional airports such as Ceduna in South Australia with 25,000 passengers each year, to major airports like Sydney Airport, which caters to over 43 million passengers each year.

Australian airports now cater to over 150 million passengers each year. This represents a doubling of the number of passengers served, compared to when the airports were privatised around two decades ago.

The demand for global air travel in particular has continued to grow, with international passenger movements increasing by 34 per cent over the five years to 2016–17. International travel now represents one in every four passenger movements. The rate of domestic passenger growth was relatively modest at 9 per cent over the same period¹. Rates of change have varied across different airports, with Western Australia impacted by decreased demand from the mining sector, while other areas have continued to experience increased demand.

Given the significant role that airports play in driving economic growth and community wellbeing, it is important that the regulatory regime for the airports is designed to balance the interests of airports, airlines, passengers and broader stakeholders.

1.2. The ACCC's role in relation to airports

The ACCC has two specific roles in relation to the regulatory oversight of airports:

- The ACCC conducts annual price and service quality monitoring of the four major airports (Brisbane, Melbourne, Perth and Sydney airports) under Part VIIA of the *Competition and Consumer Act 2010* (CCA) and Part 8 of the *Airports Act 1996* (Airports Act). This includes monitoring the provision of aeronautical and car parking services at those airports.
- The ACCC also has a role in assessing proposed price increases for regional air services at Sydney Airport under the Part VIIA price notification regime (in the CCA).

More broadly, the ACCC would be responsible for conducting arbitration of any disputes that arise in relation to access to services that have been declared under the National Access Regime (Part IIIA of the CCA), although no airport services are currently declared.

The ACCC also enforces compliance with the general competition and consumer provisions of the CCA. Like other companies, airports are subject to these provisions.

This submission will draw from the ACCC's experience in administering these functions and its role in the economic regulation of other key infrastructure sectors such as telecommunications, rail and water.

¹ Bureau of Infrastructure Transport and Regional Economics, *Airport Traffic Data*, 2018.

1.3. Structure of this submission

This submission will consider the provision of aeronautical, car parking and landside access services separately because the competitive environment, including the sophistication of the counterparties, is different in each.

The structure of the rest of the submission is as follows:

- Chapter 2 provides an overview of the airport regulatory regime in Australia.
- Chapter 3 discusses the limitations of the ACCC's current monitoring role.
- Chapters 4, 5 and 6 focus on the regulation of aeronautical, car parking and landside access services supplied at the major airports.
- Chapter 7 discusses issues related to regional air services at Sydney Airport.
- Chapter 8 considers issues around operational restrictions imposed at Sydney Airport.
- Chapter 9 considers competition issues associated with jet fuel supply at airports.

2. Overview of the regulatory regime

2.1. History of airport regulation

Airport regulation in Australia has undergone significant changes over the past two decades, accompanied by the transition of airports from government to private ownership and operation.

Prior to privatisation between 1997 and 2002, the airports were owned and operated by the government owned Federal Airports Corporation (FAC). Recognising the need to address their market power, the FAC's aeronautical charges were declared by the government under s. 21 of the *Prices Surveillance Act 1983*. The declaration required the FAC to notify the ACCC's predecessor, the Prices Surveillance Authority, prior to raising its aeronautical charges.

When the major airports were being privatised, the government implemented a transitional regulatory framework. It was designed to limit the potential for the airports to exercise their market power, and consisted of:

- a price cap on 'aeronautical' services on the major airports (except Sydney Airport²);
- an airport specific access regime (provided in s. 192 of the Airports Act) that operated under the National Access Regime (under Part IIIA of the CCA);
- monitoring of prices, costs and profits of 'aeronautically-related' services; and
- transparency provisions, including quality of service monitoring and accounts reporting requirements (under Airports Act and *Airports Regulations 1997* (Airport Regulations)).

Following the privatisation of the majority of the major airports, in December 2000 the Australian government asked the Productivity Commission to undertake an inquiry into airport price regulation. The 2002 Productivity Commission inquiry took place in the aftermath of the 11 September 2001 terrorist attack in the United States as well as the collapse of Ansett Australia. These events saw demand for air travel falling significantly and some airports were under financial pressure as a result. Recognising this, the government had already removed price caps on some of the regulated airports prior to the 2002 Productivity Commission inquiry.

In this context, the Productivity Commission recommended the introduction of a monitoring regime, which applied from 1 July 2002. Monitoring replaced price caps (with the exception of those that applied to regional air services at Sydney Airport). Under the new regime, the ACCC was required to monitor Sydney, Melbourne, Brisbane, Perth, Adelaide, Canberra and Darwin airports. As monitoring was a relatively new approach to the regulation of airports at the time, the regime was subject to a probationary period of five years, followed by a further Productivity Commission review.

The government also agreed with the Productivity Commission that airports should only be subject to the National Access Regime once the airport-specific access regime (provided under s. 192 of the Airports Act) had expired. Consequently, s. 192 of the Airports Act was repealed on 6 September 2003 by the *Civil Aviation Amendment Act 2003*.

The next two Productivity Commission inquiries (in 2006 and 2011) found that the monitoring regime had worked well and there was no apparent need for further regulation. As a result, monitoring has been retained until 2022.³ However Darwin and Canberra airports were

² Sydney Airport was subject to the price notification regime under the Part VIIA of the CCA.

removed from the monitoring regime following the 2006 inquiry, and Adelaide Airport was removed following the 2011 inquiry.

2.2. The ACCC's airport monitoring regime

2.2.1. Overview

Since 2002, aeronautical services at a number of major airports have been subject to the ACCC's monitoring regime. The ACCC is currently required to monitor the prices, costs and profits related to the supply of aeronautical services and facilities by Brisbane, Melbourne, Perth and Sydney airports under Part VIIA of the CCA.

Under Part 8 of the Airports Act, the ACCC is also required to monitor the quality of services and facilities at the four major airports, which include a range of aeronautical services.

Further under the Airports Act and Airports Regulations, the monitored airports are required to prepare financial reports which separately show the financial details in relation to the provision of aeronautical and non-aeronautical services.⁴

In 2008, the government formally directed the ACCC to monitor the prices, costs and profits of providing car parking services at the airports under the monitoring regime, along with the quality of these services.

The ACCC's monitoring role in relation to aeronautical services relates only to those terminals that are owned and directly operated by the airports. Domestic terminals that are leased to and operated by domestic airlines are not subject to the ACCC's monitoring regime. These terminals are the Qantas domestic terminals at Sydney (until it was purchased by Sydney Airport in 2015), Melbourne, Brisbane and Perth airports, as well as the Virgin Australia terminal at Brisbane Airport.

Under the current airport monitoring regime, price and quality of service information is collected from the monitored airports and airlines. The airports are required to provide the ACCC with their regulatory accounts and quality of service information within 90 days after the end of the financial year.

- For aeronautical price monitoring, the airports provide annual regulatory accounting statements that include income statements, balance sheets and statements of cash flows. Information on prices, costs, and asset values are also provided;
- For car parking price monitoring, the airports provide information on car parking spaces, prices (drive-up and online rates), revenues, costs and profits. The ACCC also collects some limited information on landside access charges and revenues for alternative transport modes such as taxis, off-airport car parking and ride-share services;
- For quality of service monitoring, the ACCC uses information from passenger surveys, airline surveys and objective performance indicators that reflect the service quality provided by the monitored airports. To evaluate services, the ACCC uses a five-point scale: very poor (1–1.49), poor (1.50–2.49), satisfactory (2.50–3.49), good (3.50–4.49), and excellent (4.5–5).

Passenger surveys are arranged by each airport and may differ in their coverage and detail. These surveys provide information consistent with the requirements of the regulations and ACCC guidelines. The airports also provide objective data related to the number or size and usage of various airport facilities.

³ Australian Government, *Australian Government response to the Productivity Commission inquiry into the Economic Regulation of Airport Services*, 2012.

⁴ Regulation 7.03 of the *Airports Regulations*, Subs. 141 (2) of the *Airports Act 1996*.

Airline surveys are conducted by the ACCC. Responses are typically reviewed and submitted by the airlines' head offices to allow for the results to account for commercial negotiations and reduce the potential for bias.

The ACCC publishes the above information in its annual airport monitoring reports. These reports focus on trends over time in the key indicators of prices, costs, profits and quality of services. A range of price monitoring indicators are used, including (but not limited to):

- average aeronautical revenue per passenger as a proxy for average prices for aeronautical services;
- operating profit margins;
- return on assets measures as indicators of profitability.

Quality of service indicators are published in the monitoring reports on a service-by-service basis. Indicators include the average ratings given by passengers and airlines, as well as objective data measures. The quality of service indicators that are published in the reports are aggregated to derive an overall quality of service rating for each of the monitored airports. The airports are then ranked relative to each other based on these overall ratings.

The airports are provided with opportunities to comment on relevant sections of the reports to ensure accuracy of the data. The ACCC incorporates these comments into the reports, particularly where they provide a possible explanation for changes in indicators.

2.2.2. Comparison with other infrastructure services

The ACCC and the Australian Energy Regulator (AER) regulate a number of infrastructure services including electricity, gas, telecommunications, rail, bulk water and wheat ports. Airports do not face the same level of regulatory oversight, despite this important sector exhibiting strong natural monopoly characteristics. Indeed, monitoring is the most light-handed of the suite of regulatory tools available.

Under the regulatory regime for telecommunications, the ACCC has the power to declare certain telecommunications services where it is in the long-term interests of end-users to do so. Once a service is declared, the ACCC can set regulated terms and conditions of access, including prices. There are currently 11 declared communications services including those provided by the National Broadband Network (NBN). The ACCC also has the power to make record-keeping rules to specify what information regulated firms must keep and provide to the ACCC.

In relation to rail, the ACCC has a role in assessing access undertakings submitted by the Australian Rail Track Corporation (ARTC) in relation to its 'Interstate Rail Network' and the 'Hunter Valley Rail Network' in New South Wales. With respect to the Hunter Valley Access Undertaking, ARTC is required to provide information to the ACCC on an annual basis to demonstrate its compliance.

The ACCC also has legislated functions regarding enforcement, price setting, monitoring and reporting in water markets. Under the *Water Charge (Infrastructure) Rules 2011*, the ACCC can approve or determine certain regulated charges in the Murray-Darling Basin.

The AER regulates electricity networks and gas pipelines. The regulatory framework is set out in the National Electricity Law and the National Gas Law. Some gas pipelines that are not subject to certain regulations are instead subject to the recently established information disclosure/commercial negotiation regime under Part 23 of the National Gas Rules. The regime requires pipeline operators to disclose information to facilitate commercial negotiation, in addition to providing access to arbitration if parties cannot reach commercial agreement.

2.3. The National Access Regime

Airport services could potentially be regulated under the National Access Regime, which is provided for by Part IIIA of the CCA. The regime can be applied to infrastructure services with monopoly characteristics, which also meet certain criteria.

Potential access seekers can apply to have a service declared under the regime. The assessment of whether a service should be declared is made by the National Competition Council (NCC). The NCC makes its recommendation to the designated Minister, who then makes a decision on whether the service is declared. Once declared, access seekers can seek arbitration by the ACCC if they are unable to reach agreement with the provider of the service. The Minister's decision on declaration and the ACCC's determination on the arbitration are both subject to review.

To date there have been at least four cases where airport users have made an application to the NCC to have services declared under the Part IIIA.⁵ Two resulted in airport services being declared for a specified period. However, no airport services are currently declared under the National Access Regime.

⁵ See Arblaster, 'Negotiate-arbitrate regulation of airport services: Twenty years of experience in Australia', *Journal of Air Transport Management* 51, 2016. Table 2, p. 30.

3. Limitations in ACCC monitoring

This section considers limitations in the ACCC's monitoring of airport performance.⁶ A key limitation is that the information collected under the monitoring regime does not enable the ACCC to make conclusive assessments about whether the airports are earning excessive profits. The more conceptual issue of whether monitoring acts as a constraint on the airports exercising market power in relation to aeronautical services is explored in section 4.3.

3.1. Inability to make conclusive assessments about whether airports are earning excessive profits

A key limitation of the existing monitoring regime is that the data collected does not allow the ACCC to conclusively assess the appropriateness of airport profitability.

This is mainly because the various indicators and measures the ACCC uses to report on prices, costs and profits are based on historical accounting data. While the ACCC can make some observations about trends and movements in these indicators and can also make some comparisons across the monitored airports, it is not possible to conclusively determine whether the airports have been operating efficiently or whether their rates of return are consistent with the degree of risks they face.

As discussed later in the submission, monitoring has shown that airport prices and costs have been generally increasing while profitability (i.e. return on assets and operating profit margin) remains high. However it is very difficult to interpret these results in terms of whether prices are consistent with efficient long-run costs of providing the service.⁷

Another important limitation associated with monitoring is that reporting periods are typically much shorter than the life of airport assets (e.g. runways), which can be in service for decades. It is therefore difficult to estimate the long-term economic rate of return on investment using monitoring data alone.

The ACCC presents the following profitability measures on an annual basis in its airport monitoring reports:

- 'operating profit margin' represented by earnings before interest, tax and amortisation (EBITA) as a percentage of revenue
- 'return on assets' represented by EBITA as a percentage of the value of tangible non-current assets.⁸

While these indicators can shed light on some aspects of the airports' performance, they reflect accounting rates of return, which rely on book values of investment and accounting profits. As a result, they can be affected by non-cash items such as bad debts and depreciation and do not take into account the time value of money.

The appropriate approach for analysing monopoly profits is by using an economic rate of return. This is because an economic rate of return is what provides signals to entry and exit for firms and resources, and therefore should be used when assessing whether a monopoly is making excessive profits.⁹

⁶ ACCC, *Airport Monitoring Report 2016–17*, 2018, pp. 189–190.

⁷ This principle forms part of the government's Aeronautical Principle Principles and is also generally adopted in regulation of other natural monopoly industries (for example this forms part of Part IIIA pricing principles in s44ZZCA of the CCA).

⁸ See a discussion of various profitability measure in the *ACCC Airport Monitoring Report 2016–17*, 2018, p. 184.

⁹ An economic rate of return above the cost of capital is produced by output restriction under monopoly. For more details, see Fisher and McGowan, 'On the misuse of accounting rates of return to infer monopoly profits', *The American Economic Review*, 1988.

This approach would involve adopting the concepts of Internal Rate of Return (IRR) or net present value (NPV). NPV is the present value of all discounted cash flows associated with a project. IRR is the discount rate that equates the net present value of all cash flows from the project to the initial capital cost.

As economists Franklin Fisher and John McGowan noted, accounting rates of return do not necessarily correspond to economic rates of return. They concluded that 'examination of absolute or relative accounting rates of return to draw conclusions about monopoly profits is a totally misleading enterprise.'¹⁰

In order to overcome the limitations above, the ACCC would require information on the airports' efficient long-run costs. This includes data on the economic valuation of airport assets. In sectors where regulators have a direct price setting role, asset valuation (or regulatory asset base) is typically established through a process involving stakeholder consultation and specialist technical engineering advice. Such processes can be data intensive and costly and are not possible without strong information gathering powers.

In addition, there needs to be an ability for the regulator to make upfront rules about matters including how airport assets should be valued and how costs should be allocated between various airport services.¹¹ While the ACCC has prepared some high-level guidelines (airport price monitoring and information reporting guidelines)¹² about how it expects the airports to prepare data, it does not have explicit power under the current monitoring regime to make rules. In contrast, under the information disclosure regime in New Zealand, the NZCC has the power to determine 'input methodologies', which prescribe the rules that airports should adhere to when disclosing information. The merits of introducing a similar approach in Australia are considered in section 4.4.

3.2. Other limitations in the ACCC monitoring

A number of other challenges in producing the monitoring reports are explored below.

First, the monitoring regime explicitly excludes terminals that are directly operated by airlines under domestic terminal leases. This means that four of the fifteen terminals at the major airports are excluded in the quality of service findings and the financial data for aeronautical services. These excluded terminals are the Qantas terminals in Melbourne, Brisbane and Perth, and the Virgin terminal in Brisbane.¹³ This has also created challenges for the way that some financial measures are calculated.

For example, the ACCC calculates revenue per passenger by dividing aeronautical revenue by total passenger numbers for each airport. The airports provide the ACCC with the number of passengers travelling through any of their terminals, but are only required to report aeronautical revenues that relate to terminals that they directly operate. This means that per-passenger revenue figures in the airport monitoring reports may understate the true values. However, this issue is expected to disappear over the next few years as the leases expire and the airports have direct operational responsibility for all terminals.¹⁴

¹⁰ Fisher, F. M., McGowan, J. J., On the misuse of accounting rates of return to infer monopoly profits, *American Economic Review*, Vol. 73, No. 1, March 1983, p.91.

¹¹ The ACCC currently adopts a 'line-in-sand' approach for airport assets following the 2006 Productivity Commission inquiry. The 'line in the sand' values reflect the airports' tangible (non-current) aeronautical assets as at 30 June 2005 which may have included revaluations in asset values booked prior to that date. Any 'line in the sand' asset base figure that is applied for monitoring purposes should not necessarily be regarded as an appropriate asset value for any other regulatory decision the ACCC may be required to make.

¹² ACCC, *Airport prices monitoring and financial reporting guideline*, 2009.

¹³ The Qantas domestic terminal at Sydney Airport had been excluded prior to 2015–16 as it had previously been operated under a domestic terminal lease.

¹⁴ ACCC *Airport Monitoring Report 2016–17*, April 2018, Box 2.3.1, p. 31.

Another challenge is associated with the small number of responses received from airlines to the ACCC's airline satisfaction survey. Typically the ACCC receives around 8–10 responses to its airline survey. This may affect the reliability of airline ratings. Furthermore, as each airline's rating is weighted equally, the views of a single small airline may have an impact on the ratings that is disproportionate to its size.

Objective indicators (e.g. size of gate lounges, number of toilets) used in service quality monitoring can also create challenges. In calculating the overall service quality rating for an airport, we combine objective indicator ratings with passengers' and airlines' satisfaction survey results to produce a single overall quality of service rating for each monitored airport.

However, unlike passenger and airline ratings which are scores out of five, ratings for objective indicators are calculated against a set of benchmarks based on the average value of each objective measure across four monitored airports. This means that a lower rating for objective indicators does not necessarily indicate a drop in an airport's performance. Rather it could be due to an improvement in the average performance of the other airports.

Importantly, it should also be noted that the ACCC monitoring data does not involve benchmarking of efficiency or service quality with other airports. We recognise that benchmarking can provide useful information on the relative financial and service quality performance of the monitored airports. However there are inherent difficulties in benchmarking airports in different countries on a 'like for like' basis. Further, it is likely to be a resource intensive process if it is conducted as part of annual reporting.

4. Aeronautical services

4.1. Airport market power in the supply of aeronautical services

The four monitored airports of Sydney, Melbourne, Brisbane and Perth have a significant degree of market power in the supply of aeronautical services due to their natural monopoly characteristics. Aeronautical services, in general, consist of aircraft movement services and facilities such as runways, taxiways and aprons, as well as passenger movement facilities such as terminals, aerobridges, check-in and baggage handling facilities.

The ACCC considers that this market power may be resulting in greater economic harm than that considered by the Productivity Commission in its past reviews of airport regulation. Furthermore, the ACCC submits that the Productivity Commission could closely examine the distributional consequences of monopoly airport charges.

4.1.1. The extent to which the monitored airports have market power

There is typically only a single major airport in each capital city in Australia. This is for a number of reasons:

- Firstly, it is difficult to find an appropriate location for an airport. It requires a lot of land, away from tall structures than may impede flight paths, but close enough to the relevant population centre and effective transport links;
- Secondly, airports exhibit high economies of scale, which means that larger airports can operate more efficiently than smaller airports. The economies of scale are associated with high sunk costs in much of the airport infrastructure;
- Thirdly, airports are also associated with significant network effects. This means that both airlines and passengers benefit from having all flights arriving and departing at the same location.

The concerns associated with market power are greatest in relation to the four monitored airports of Sydney, Melbourne, Brisbane and Perth. These airports hold very high degrees of market power because airlines cannot realistically withhold a significant number of services from these airports/cities. Furthermore, the large size of these airports and the high numbers of passengers flying through these airports mean that market power at these airports is likely to result in more harm than at other airports (see Table 4.1). The strong market power of these four airports has been recognised by the Productivity Commission as a policy concern.¹⁵

Table 4.1 Passenger volumes at the ten largest airports in Australia

Airport	Total passengers (year ended May 2018)	International passengers (% of passengers at the airport)
Sydney	43,984,128	37%
Melbourne	36,222,293	30%
Brisbane	23,229,932	25%
Perth	12,428,319	35%
Adelaide	8,267,131	12%
Gold Coast	6,547,640	16%
Cairns	4,974,130	14%

¹⁵ Productivity Commission, *Economic Regulation of Airport Services Inquiry Report*, 2011, p. XLVI.

Canberra	3,172,775	3%
Hobart	2,591,925	0%
Darwin	2,054,402	12%

Source: Bureau of Infrastructure, Transport and Regional Economics

However, within this broader assessment of market power for these airports, there can exist some elements of limited competition. For example, there is likely to be some limited competition between Brisbane, Sydney and Melbourne airports in relation to international airlines (particularly those seeking to enter the Australian market). However the scope of competition is likely limited to new airlines looking to establishing a route and is likely to decline significantly once new services have been introduced and investments have been made such as promotions, scheduling and fleet purchasing.

Some limited competition may also exist in the south eastern region of Queensland where Brisbane, Gold Coast and Sunshine Coast airports are located within reasonably close proximity of each other. It may be feasible for a small percentage of passengers, most likely to be tourists planning to visit more than one of the destinations, to consider flying into or out of one of the other airports in the region if airfares or scheduling made it favourable to do so. Sydney Airport is also expected to face some limited competition when Western Sydney Airport (WSA) commences operation in 2026. However, the vast majority of passengers have no choice but to fly directly to the airport located closest to their destination.

Airlines have limited countervailing power

A firm may have limited ability to exercise its market power if its customers have strong countervailing power. However, airlines have little if any countervailing power to constrain the major airports' market power.

The degree of airline countervailing power is dependent on the credibility of the threat of airlines withdrawing or significantly reducing services from an airport. Because the major airports are in the major population centres and face little or no competition, the majority of the airlines are unlikely to have the choice of leaving or significantly reducing services to those airports.

Among the airlines operating at the major airports, Qantas Group (Qantas) is likely to have the highest degree of countervailing power given its size and its significant market share of the Australian aviation market. Qantas is estimated to account for around 60 per cent of the domestic airline market.¹⁶ However, even Qantas is likely at some disadvantage in negotiating with the major airports (particularly the four monitored airports). This disadvantage reflects the inability of Qantas to credibly threaten to withdraw or significantly reduce services at any of the monitored airports. Not only does it need to be able to offer its customers the ability to fly to all the main population centres in Australia, but these airports represent a significant component of the airline's overall operations. Furthermore, the three major airports of Sydney (23 per cent of Qantas seat capacity¹⁷), Melbourne (16 per cent) and Brisbane (14 per cent) also play a key role within its trunk network.

For other smaller airlines, countervailing power is likely to be virtually non-existent. This is because they contribute a relatively small component of the airports' operations.

¹⁶ CAPA, 'Australia domestic airline market outlook: Qantas Group reins in capacity as Virgin continues growth', April 2015.

¹⁷ These percentages are based on the airline's annual one-way seat capacity. See <https://www.anna.aero/2016/10/20/qantas-is-averaging-30-percent-passenger-share-in-its-top-international-markets/>, viewed on 3 September 2018.

4.1.2. The extent to which second-tier airports are likely to have market power

A second tier of airports, which consist of Adelaide, Gold Coast, Cairns, Canberra, Hobart and Darwin are not currently subject to ACCC monitoring (some of them self-report certain information publicly). Adelaide, Canberra, and Darwin airports were initially subject to ACCC monitoring but were later excluded from monitoring.¹⁸

Some of these airports are likely to have a considerable degree of market power. For example, Adelaide Airport has significance for airlines as the fifth largest airport in Australia, catering to over 8 million people each year. Furthermore, it is likely to benefit from market power as a result of hosting overwhelmingly domestic rather than international flights. As discussed earlier, international air services can benefit from some very limited competition between airports. Adelaide Airport caters to 7.2 million domestic passengers in 2017–18, which is not far behind the 8.1 million domestic passengers at Perth Airport.

Canberra Airport may also have some market power. Although it provides for just 3.2 million passengers in a year, only 3 per cent of those are international. It is also likely to have market power due to its large share of less price sensitive business passengers who need to travel to Canberra.

The ACCC considers that the current inquiry provides an opportunity to have a fresh look at whether market power held by some of these second-tier airports represents a policy concern, which would need to be addressed by regulatory oversight.

Recommendation 1:

The ACCC submits that the Productivity Commission consider, based on market power, whether any other airports such as Adelaide and Canberra should be subject to similar types of regulatory oversight as the four monitored airports.

4.1.3. The extent to which regional airports have market power

There are a large number of small airports serving regional and remote communities in Australia. Regional airports only account for a very small share of the total air travel market given that the ten largest airports in Australia account for around 90 per cent of passenger traffic.¹⁹ However, regional airports play an important role in their communities. Many regional airports are owned and operated by local councils.

Regional airports are unlikely to be able to exercise their market power due to the relatively strong countervailing power airlines may hold. This is because, as an airline is likely to have the option to reduce or totally withdraw services, it has strong bargaining power in negotiation with regional airports. However, this may not be the case for regional airports that serve as regional hubs for airlines.

4.1.4. Harm associated with airports exercising market power

As noted earlier, at least the four monitored airports have a significant degree of market power. However the presence of market power does not, in itself, justify regulatory intervention. It is important to assess the size of the economic harm that might arise from

¹⁸ The rationale for excluding these airports from monitoring was considered by the Productivity Commission in its previous inquiries.

¹⁹ Bureau of Infrastructure Transport and Regional Economics, *Airport Traffic Data*, 2018.

market power and compare that harm to the potential costs of regulation. It is therefore necessary to be clear about the nature of the economic harm associated with misuse of market power.

This section explores:

- why the potential economic harm from the misuse of airport market power might be greater than previously considered under the Productivity Commission's traditional economic framework;
- why the Productivity Commission may be overlooking the harm associated with airlines and other airport users being unwilling to make sunk investments; and
- why the equity and distribution issues associated with airport market power should be carefully examined.

Assessment of economic harm using the Productivity Commission's traditional economic framework

Although there are a range of non-price distortions that might be associated with market power²⁰, economic textbooks tend to focus on one primary harm associated with market power: the tendency for a firm with market power to reduce output and increase the price for the service above the marginal cost. The resulting reduction in total economic welfare is known as the deadweight loss.

The Productivity Commission has explicitly adopted this framework in its past reviews of airport regulation.²¹ It has determined that if airport charges make up only a relatively small component of downstream air transport services, modest increases in airport charges would likely have negligible impact on the decisions of airport users (airlines, freight forwarders, or the travelling public).²² In this framework an increase in airport charges that does not affect the decisions of airport users has no overall impact on economic welfare. Such an increase in charges is said to result in a mere wealth transfer with no efficiency consequences. This is particularly the case if airlines can effectively price discriminate, spreading the cost of airport charges efficiently amongst airline customers according to their willingness to pay.²³

Using this framework the Productivity Commission has, in its previous reviews of airport regulation, concluded that the economic harm (the deadweight loss) is not sufficiently large as to outweigh the potential distortions caused by regulation. Disputes over airport charges are merely a 'distributional tussle' with no consequence for overall economic welfare and therefore no need for regulation:

'To the extent that an airport can extract some rent, the effect would be confined to a relatively small escalation of a small component of a ticket price. Accordingly, the Commission reaffirms its view that, overall, disputes principally revolve around distribution tussles between airports and airlines. And while distributional issues are front and centre for them, the Commission's focus is on outcomes for the Australian community'.²⁴

²⁰ In addition to effects related to the price, a firm with market power might have the willingness and ability to over or under-supply quality, or to over or under-invest in quality. A firm with market power may also be less efficient ('x-inefficiency') than a firm in a competitive market. Productivity Commission, 2011, pp. 70–71.

²¹ See, for example, Productivity Commission, *Price Regulation of Airport Services*, 2002, p. 83; Productivity Commission, 2011, p. 70.

²² See, for example, Productivity Commission, 2011, pp. 72–73, "In practice, airport charges make up such a small proportion of total airfares that even large increases in these charges are unlikely to have significant welfare effects, and will largely represent a 'distribution' between airlines and airports"; Productivity Commission, 2011, p. 95.

²³ Productivity Commission, 2011, p. xlix and p. 72, "The extent to which airlines can price discriminate against passengers ... reduces the welfare effects of an increase in airport charges".

²⁴ Productivity Commission, 2011, p. xxviii.

The ACCC notes that the Productivity Commission may wish to consider broadening its economic framework in assessing the harm from airport market power (discussed below). However, even if the traditional framework were to be strictly applied in this review, there are reasons why one may argue that the deadweight loss is higher than previously considered.

The first reason is that while airport charges may, on average, reflect a small proportion of average airfares (especially international airfares), we consider that airport charges are likely to reflect a material proportion of certain airfares, especially in the case of low-cost fares and fares offered by low-cost carriers (LCCs).

Average aeronautical revenue per passenger has increased by more than 30 per cent in real terms over the last decade at three of the four major airports, including by 61.8 per cent in just six years at Perth Airport. In contrast, the ACCC observes that the average best discounted airfares have fallen by 41.4 per cent in real terms over the last decade.²⁵ For example, some economy fares offered by LCCs for weekend one-way trips from Sydney to Melbourne are as low as \$69. This means that airport charges could potentially account for 30–40 per cent of the airfare.²⁶ It is therefore reasonable to conclude that airfares would have fallen even further were it not for the increase in airport charges. In this context there is a risk that airport charges may have an impact on the take-up of low-cost seats and the volume of low-cost services.

This risk is supported by submissions to a recent Senate Committee inquiry into regional air services by both Qantas and Virgin, which state that high airport charges have a significant impact on their businesses.²⁷ Both airlines submitted that airport charges were one of the most significant cost items behind fuel charges. Qantas said that the business model for a LCC like Jetstar (which is a part of Qantas Group) relies on stimulating travel that would not have otherwise occurred except for the lower price point. Both Qantas and Virgin submitted that in contrast to certain market segments, people travelling for leisure have elastic demand and there is significant scope to boost demand and passenger volumes through price discounting.

In that regard, Qantas said that high airport charges can significantly impact the ability of the airline to maintain frequency and capacity, while offering low fares and stimulating travel. For example, it claims that high airport charges were the sole reason that Jetstar does not fly to Canberra, which is otherwise a market with sufficient scale to support LCC services. While there could be other commercial reasons why Jetstar does not fly to Canberra, it is likely that the level of airport charges is an important factor for LCCs when considering whether particular routes are commercially viable due to their business models.

Another reason why the deadweight loss from airport market power may be higher than previously considered is that, in practice, there are limits on the ability of airports to price discriminate. For example, policies set by the International Civil Aviation Organization (ICAO) recommend that airports set charges on the basis of maximum take-off weight (MTOW), independent of, for example, the route flown by the aircraft, the time of day, or the identity of the carrier.²⁸ To our knowledge, airports have not chosen to set airport charges as a percentage of the fare paid by each passenger, or to set different charges for different origin-destination fares. These limits on price discrimination may limit the ability of an airport to price discriminate effectively, and may therefore lead to a positive deadweight loss. The

²⁵ Bureau of Infrastructure, Transport and Regional Economics, *Domestic Air Fare Indexes (CPI adjusted)*, 2018.

²⁶ Data on fare prices are obtained from www.webjet.com.au on 30 August 2018. Calculations are based on ACCC's monitoring data.

²⁷ Virgin, Qantas, submissions to the Inquiry into the operation, regulation and funding of air route service delivery to rural, regional and remote communities, 2018.

²⁸ ICAO, *Policies on Charges for Airports and Air Navigation Services*, Ninth edition, 2012: "States are encouraged to incorporate the four key charging principles of non-discrimination, cost-relatedness, transparency and consultation with users into their national legislation, regulation or policies".

Productivity Commission has, in the past, argued that such limitations on price discrimination should be removed.²⁹

We invite the Productivity Commission to consider both the impact of higher airport charges on demand for and supply of LCC services, as well as the extent to which airports use price discrimination.

The economic harm associated with the potential chilling effect of market power on sunk investment by airlines and other airport users

The ACCC considers that the economic framework adopted by the Productivity Commission in its past reviews of airport regulation may be incomplete and therefore may underestimate the potential for economic harm and the case for regulation.

Specifically, we are concerned that the Productivity Commission's economic framework overlooks the importance of airport users making sunk investments to get the most out of airport services. If, as we suggest, it is important for airlines and other airport users to make investments in reliance on airports then the failure to make such investments may be another form of deadweight loss and therefore an important source of economic harm.³⁰

Economists Johannes Fuhr and Thorsten Beckers identified the following sources of sunk investment by airlines in reliance on airports:

- Site-specific investments, particularly investments associated with scheduling (e.g. the acquisition of slot rights and bilateral traffic rights), together with investments in maintenance and training facilities.³¹
- Marketing and brand investments. These investments are important for both hub-and-spoke carriers at a hub airport, and also for a low-cost carrier (which they refer to as a 'value based airline' or VBA):

*'Investment in brand building in the catchment area of the base airport is considered a substantial sunk cost. The success of the VBA business model is rooted primarily in lower unit costs due to employment of one single, large aircraft type, the high productivity of resources and personnel, and the omission of complexity-driven services. In order to attain a high seat load factor, VBAs must mobilize sufficient demand through lower prices and significant advertising expenditures in the respective catchment area. The value of such mobilized demand through the establishment of local 'low-cost brands' at the catchment as well as at the route level causes the VBA to value a continuing relationship with its base airport supplier.'*³²

²⁹ For example, Productivity Commission, 2002, p. 376: "A multi-product monopoly ... should be encouraged to set prices to minimise efficiency losses ... Generally this means that markets/customers with relatively inelastic demand should bear a greater share of common, fixed costs than do those with more elastic demand". See also Productivity Commission, 2012, p. 331. The Productivity Commission has also argued that one of the undesirable features of regulation is a tendency to limit the scope for price discrimination (Speech by Gary Banks, 'The baby and the bath water', 2002).

³⁰ This argument is set out in Biggar, Submission to the Productivity Commission Inquiry into the Economic Regulation of Airports, 2011; Biggar, D., "Why regulate airports? A re-examination of the rationale for airport regulation", *Journal of Transport Economics and Policy*, 2012; and Biggar, D., "Is Protecting Sunk Investments by Consumers a Key Rationale for Natural Monopoly Regulation?", *Review of Network Economics*, 8(2), June 2009.

³¹ Johannes Fuhr and Thorsten Beckers expressed this as follows: "A far greater source of quasi-rents is rooted in the optimization of the hub-and-spoke flight schedule. These quasi-rents originate through a mixture of *human capital asset specificity* in the scheduling process itself (Langner, 1995) and *site specificity* through grandfathered slots and bilateral traffic rights. Flight schedules are planned around the hub airport and are continuously optimized through a trial-and-error procedure in order to determine which (new) destinations are profitable or which combination of aircraft rotations result in the highest asset productivity. In this revolving scheduling process, slots and international traffic rights are taken into account as constraints. In consequence, the cost of switching a hub airport within a fully developed schedule will be extremely high." Johannes Fuhr, Thorsten Beckers, 'Vertical governance between airlines and airports – A transaction cost analysis', *Review of Network Economics*, 1 December 2006.

³² Johannes Fuhr, Thorsten Beckers, 'Vertical governance between airlines and airports – A transaction cost analysis', *Review of Network Economics*, 1 December 2006.

In addition to airlines, other airport users, such as freight forwarders, also need to make sunk investments in reliance on an airport. For example, a freight forwarder may seek to make a sunk investment in a warehouse close to an airport in order to benefit from efficiencies in the logistical supply chain.

It is commonly recognised that airports are a key driver of local economic development.³³ A 2013 study found that half of the Fortune 500 companies were headquartered within ten miles of a hub airport. Many of the businesses that choose to locate in proximity of an airport do so in reliance on access to air transport services. These businesses must make a sunk investment in their location.

Like all sunk investments, these investments by airlines and airport users are subject to the threat of hold-up: the risk that, once sunk, the airport will raise the airport charges to take for itself some or all of the value of that investment. This threat of hold-up may deter airport users from making valuable complementary investment(s), which could be a major source of economic harm.

There are mechanisms that some airlines or airport users can use to protect their investments, such as entering into long-term contracts with airports or through vertical-integration. Airports and airlines do, occasionally, enter into long-term arrangements, such as long-term leases for terminals. In addition, from time to time airports will subsidise sunk investment of airlines by, for example, contributing to marketing costs. In addition, some airlines or airport users may have a credible threat to withdraw services. This is a form of countervailing power, which they could exercise if the airport sought to increase its charges.

However, even if some options such as long-term contracts are available to airlines, they are almost never available to broader users of air transport services. Airlines are, to some extent, insulated from the impact of higher airport charges as they can pass the higher charges on to their customers. However, their customers (both business and leisure travellers) can seldom pass on those higher costs downstream.³⁴

For these reasons, the ACCC considers that there remains a risk that airlines and other airport users will be reluctant to make important investments out of fear that airports will subsequently raise its airport charges. In the long term this will lead to a failure to adequately develop the air transport industry in Australia.

This risk can be envisaged in relation to the new Western Sydney Airport. The Australian Government is in the process of establishing a new airport at Badgerys Creek. The new airport is to form the heart of a new 'aerotropolis' to be called the Greater West City, 'featuring universities, high-tech industries, convention centres, produce markets, hotels, and even sport stadiums'³⁵.

As noted earlier, for an industry or airline to be located in proximity of the Western Sydney Airport, that industry or airline will have to incur sunk investments in new factories, facilities, logistics and staff. Those investments are subject to the threat of hold-up. There will likely be some companies that will not be prepared to make those investments without some assurance as to the long-term path of aeronautical charges for the use of the Western Sydney Airport.

³³ See, for example, the Productivity Commission's list of non-aviation developments in the vicinity of capital-city airports in Productivity Commission, 2011, table 2.4, page 16. This list includes many distribution, warehousing and freight forwarding facilities which are presumably directly reliant on the airport.

³⁴ The extent to which businesses will be able to pass on charges depends on the extent to which their rivals are exposed to the same charges. Trade-exposed sectors, for example, will not normally be able to increase their prices in response to an increase in domestic airport charges.

³⁵ Nick Tabakoff, 'Badgerys Creek airport: "Aerotropolis" will be known as Greater West City', *Daily Telegraph*, 18 October 2016.

Another scenario would be where a major airline develops a new route from, for example, Melbourne to a major city in Asia. Let us assume that the airline invests heavily into acquiring bilateral traffic rights and promoting that route to the public, and the route subsequently turns out to be highly profitable for the airline. Subsequently, Melbourne Airport recognises that this and substantially increases the airport charges for this service. Under the Productivity Commission's analytical framework, such an increase in the charge for an inelastic service has little or no impact on efficiency and should be encouraged. However, the potential for an airport to unilaterally raise its fees is likely to undermine the incentive of the airline to invest in the first place. It is likely that some airlines have recognised the potential for an airport to take some or all of the resulting rent of a new service and have therefore decided not to invest.

The ACCC considers that providing airlines with access to arbitration can act as an effective long-term restraint on the growth of prices at major airports, thereby protecting airport users against the threat of hold-up and facilitating long-term investment in the use of air services.

The ACCC considers that it is important to consider the impact of policy recommendations on the investment decisions of airlines and airport users, and to seek input from airlines and airport users as to the importance of these considerations. Some form of countervailing restraint on airports is considered essential to achieve efficient ongoing investment by airport users in the development of air services.

Equity and distribution arguments should be carefully examined

The ACCC considers that equity and distribution arguments should be carefully examined for policy relevance.

Conventional public analysis considers both the efficiency and the distributional consequences of regulation. For example, the 2001 Nobel Prize winner, Joseph Stiglitz has stated:

'Having identified a number of alternative programs, the next step in the analysis is to evaluate them. This entails identifying the efficiency and distributional consequences of the program and assessing the extent to which alternative programs can meet the objectives of public policy'.³⁶ (emphasis added)

In several of his recent papers,³⁷ Stiglitz discussed the causes of the increasing inequality in the world, and specifically identified increased market power as one such force:

'A monopolist who overcharges for her or his product takes money from those whom she or he is overcharging and at the same time destroys value.'³⁸

In particular, we believe that competition regulators should be concerned about monopolies earning excessive profits by way of overcharging consumers for reasons that include issues of distribution and equity. The concern for consumer welfare is consistent with the view of Adam Smith who wrote:

'Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to only so far as it may be necessary for protecting that of the consumer'³⁹

³⁶ Stiglitz, J., *Economics of the Public Sector*, 1988, p. 242.

³⁷ Stiglitz, J. *Wealth and income inequality in the twenty-first century*. Presented at the 18th World Congress of the International Economic Association, Mexico City, 2017.

³⁸ Stiglitz, J. *Rethinking Capitalism*, 2016, p. 141.

³⁹ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776.

This explains why regulators are typically asked to make decisions that protect and consider consumers' long term interests. For example, the key objective in some of the regulatory regimes in relation to infrastructure services discussed in section 2.2.2 such as telecommunications, electricity and gas specifically require regulators to make decisions in the long term interests of consumers.

There are also many examples overseas where regulators are asked to focus on consumer interest. In the case of New Zealand's regulation of airports for example, 'the purpose ... is to promote the long-term benefit of consumers by promoting outcomes that are consistent with outcomes produced in competitive markets'.⁴⁰

In relation to this review of airports, the Productivity Commission could consider whether any transfer to the shareholders of airports is from airline shareholders or the travelling public. If it is the latter, then that may raise further concerns about the harm from airport market power. With the growth in incomes and the fall in airfares over the last decade, air travel is no longer the reserve of the wealthy but is accessible to all segments of the Australian population.⁴¹ It is therefore likely that people on low incomes are accounting for a higher proportion of the travelling public and therefore contributing to any transfer to the shareholders of the major airports.

The ACCC acknowledges that the Productivity Commission has explicitly considered distributional effects in the context of airport regulation in the past and urges it to continue to do so.⁴²

4.2. Performance of the monitored airports in providing aeronautical services

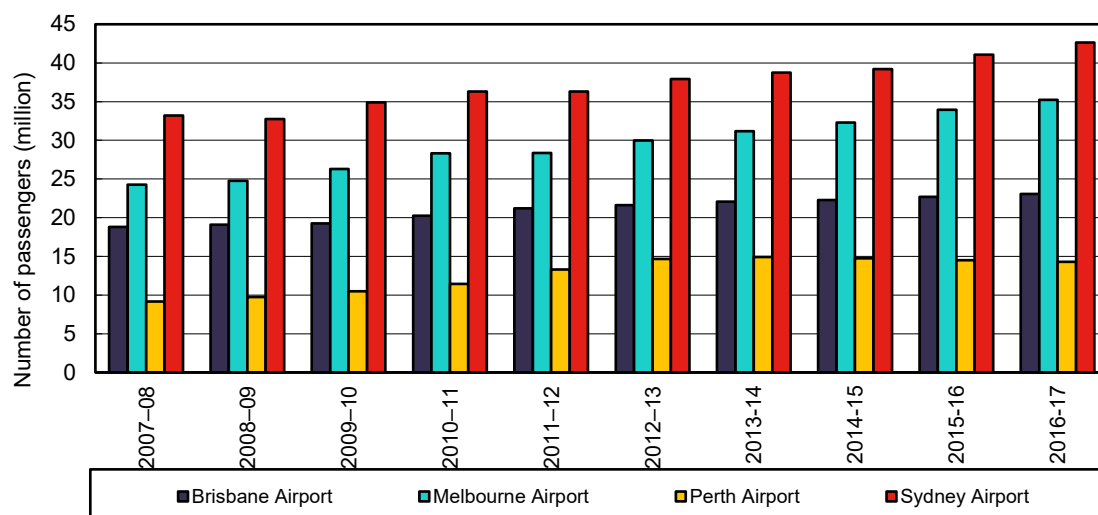
Total passengers for the monitored airports have increased by 34.9 per cent over the last decade to 115.2 million. Perth Airport grew the most with 55.6 per cent, followed by Melbourne (45.2 per cent), Sydney (28.5 per cent) and Brisbane (22.7 per cent) airports. Sydney has remained the largest airport with 42.7 million passengers in 2016–17, followed by Melbourne (35.2 million), Brisbane (23.1) and Perth (14.3 million).

⁴⁰ The *New Zealand Commerce Act 1986*.

⁴¹ For example: "The worldwide emergence of low-cost carriers (LCCs) has revolutionized travel, brought affordable air transport within economic reach of large segments of the population, and massively expanded the market for air travel. ... Since 2000, the LCC market has virtually exploded, covering dense networks across international markets. Presently, around 128 airlines are defined as LCCs, representing over 26 percent of all globally available seats in May 2012", Schlumberger and Weisskopf, 'Ready for Takeoff? The Potential for Low-Cost Carriers in Developing Countries' World Bank Group, 2014.

⁴² Productivity Commission, 2011, pp. 85–86; Productivity Commission, 2002, p. xxix.

Figure 3.1: Volume of passengers: 2007–08 to 2016–17

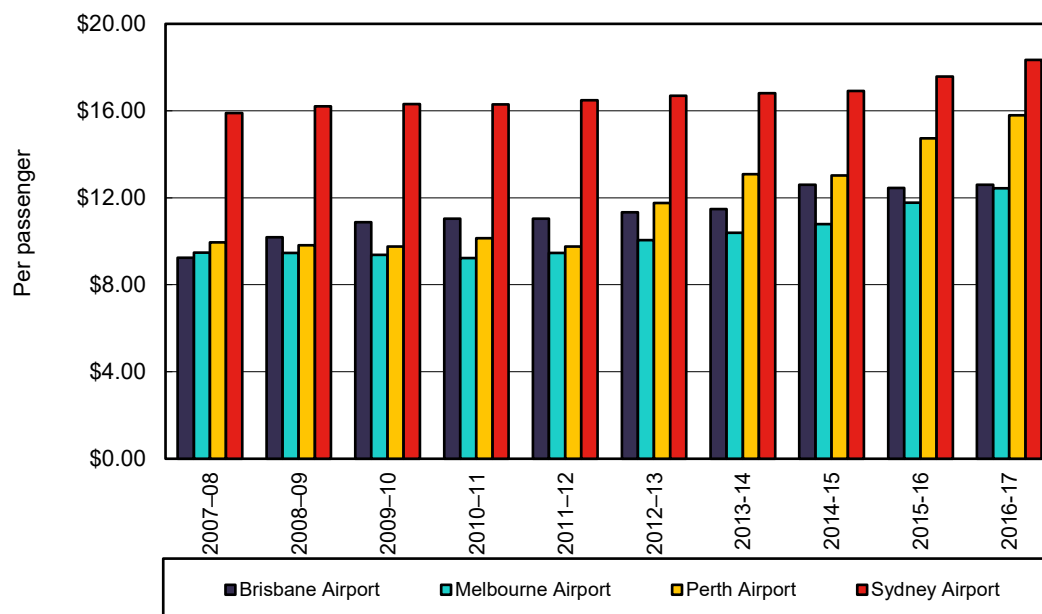


Source: ACCC, *Airport Monitoring Report 2016–17*, 2018.

Revenue per passenger is a useful proxy measure of the various aeronautical charges applied by airports. Figure 3.2 shows the growth in average aeronautical revenue per passenger over the last decade for the four airports. Most notably, Perth Airport has increased its revenue per passenger by 61.8 per cent in real terms in just six years. Brisbane Airport has grown revenue per passenger by 36.3 per cent over the decade, while Melbourne Airport recorded a 31.4 per cent increase. Sydney Airport’s revenue per passenger has increased at a more subdued rate over this time (15 per cent). However, Sydney still maintains the highest revenue per passenger of the four airports as a result of the airport almost doubling its rates just before it was privatised in 2002.⁴³ The increases in revenue per passenger in real terms represent an additional \$1.3 billion in payments from airlines over this period.

⁴³ Sydney Airport sought an increase of around 130 per cent in some of its aeronautical charges under the Part VII price notification regime in 2000. In 2001, the ACCC decided to object to the proposed increase but not to oppose a smaller increase (i.e. 97 per cent).

Figure 3.2: Aeronautical revenue per passenger in real terms: 2007–08 to 2016–17



Source: ACCC, *Airport Monitoring Report 2016–17*, 2018.

Despite the increases in average revenue per passenger, only Perth Airport has improved its overall quality of ratings during this period (discussed below). Airfares have also declined over the same period with average best discounted airfares have fallen by 41.4 per cent in real terms over the last decade.⁴⁴

These increases, combined with greater patronage, have resulted in substantial growth in aeronautical revenue at the monitored airports. Aeronautical revenue has grown by between 48.2 per cent (Sydney Airport) and 147.1 per cent (Perth Airport) over the ten years.⁴⁵ Sydney Airport has consistently collected significantly higher aeronautical revenue than other airports.⁴⁶ Sydney Airport has often generated double the aeronautical revenue of the next highest airport (Melbourne Airport).

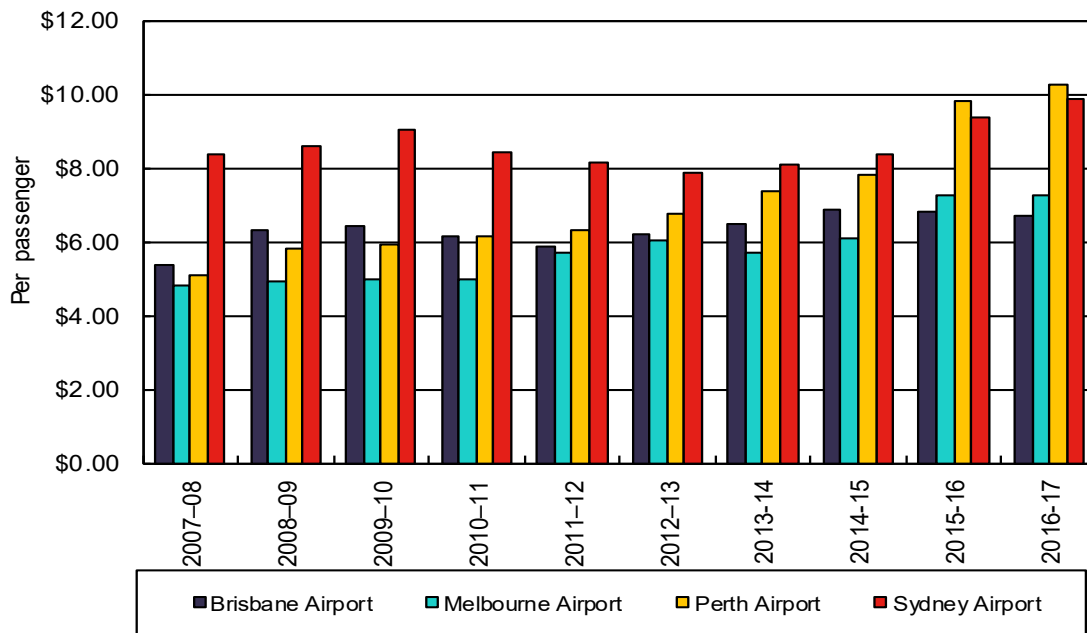
It is clear that some proportions of the higher aeronautical charges is to cover rising costs instead of profit margins. Figure 3.3 shows that the aeronautical operating costs per passenger have risen by 102.2 per cent at Perth Airport over the past decade, followed by 51.6 per cent at Melbourne Airport. Given that passenger growth over this time should have enabled the airports to benefit to some extent from economies of scale, there is a question as to whether the airports have sufficient incentives to keep costs down.

⁴⁴ Bureau of Infrastructure, Transport and Regional Economics, *Domestic Air Fare Indexes (CPI adjusted)*, 2018.

⁴⁵ ACCC, *Airport Monitoring Report 2016–17*, April 2018, p. 30.

⁴⁶ Sydney Airport has a higher proportion of international passengers than some of the other airports, which has likely contributed to its higher average aeronautical revenue per passenger.

Figure 3.3: Aeronautical operating costs per passenger in real terms: 2007–08 to 2016–17

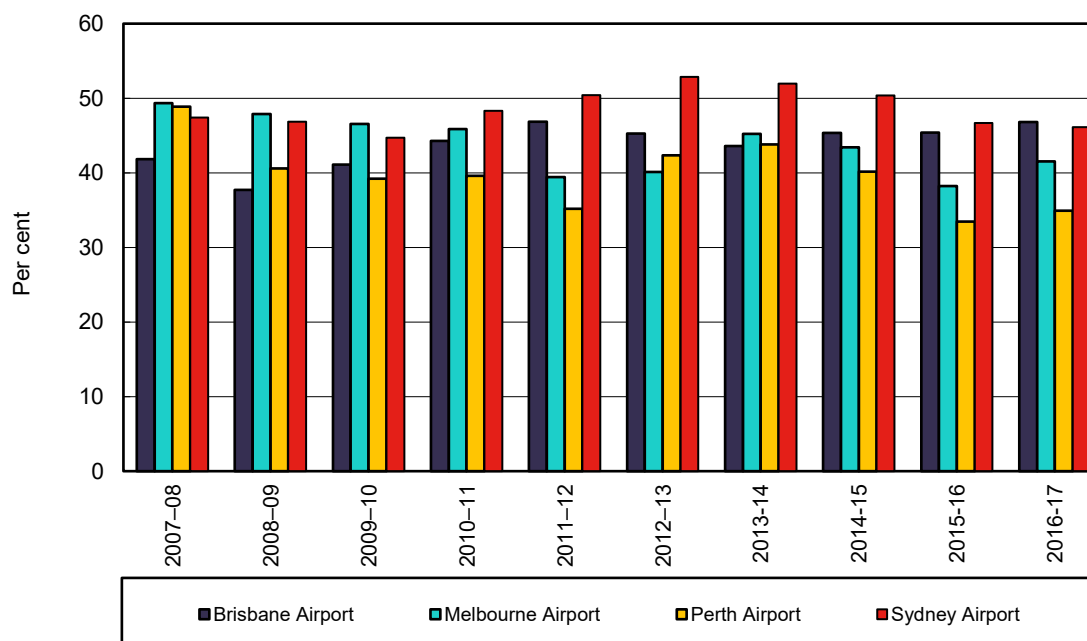


Source: ACCC, *Airport Monitoring Report 2016–17*, 2018.

Note: 'Operating costs' represents all costs (including depreciation) before taxation, interest and amortisation.

High aeronautical charges have enabled the monitored airports to consistently earn high operating profit margins in aeronautical services. Figure 3.4 shows that the average operating profit margins across the four airports have typically been around 40–50 per cent over the last decade. Operating profit margins are defined as earnings before interest, taxation and amortisation (EBITA) as a percentage of revenue. However, the ACCC cannot be conclusive about whether airports are earning excessive returns (see Chapter 3).

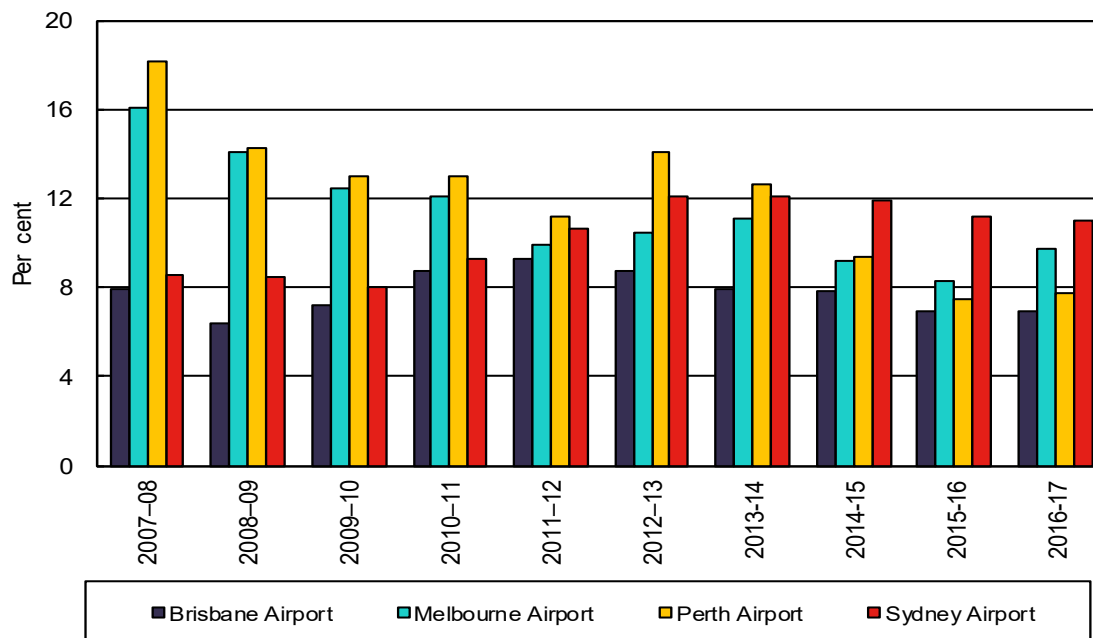
Figure 3.4: Aeronautical profit margins in real terms: 2007–08 to 2016–17



Source: ACCC, *Airport Monitoring Report 2016–17*, 2018.

Return on assets is defined as EBITA as a percentage of average total tangible aeronautical non-current assets. The four airports have typically earned a return on assets of around 8–12 per cent (Figure 3.5). The decline in recent years reflects the expansion in asset bases to meet growing passenger numbers.

Figure 3.5: Return on aeronautical assets: 2007–08 to 2016–17



Source: ACCC, *Airport Monitoring Report 2016–17*, 2018.

There are a number of ways to measure profitability. Studies employing alternative methods have also found that the airports are earning substantial profits. A study by the Grattan Institute shows that on average, nearly half of returns earned by airport operators in Australia were ‘super-normal’ profits.⁴⁷ Return on equity (14.4 per cent) was about twice the cost of equity (8.0 per cent) between 2010–11 and 2015–16. Airports had the third highest returns of the nine industries categorised as natural monopolies. The study also found that, of industry sectors that earned super-normal profits, airport operations had the second highest average mark-up (20 per cent).

There is some evidence suggesting that Australian airports’ revenue per passenger and profits are high by international standards. A study by Frontier Economics on behalf of Airlines for Australia and New Zealand found that the average EBITDA margins of the four Australian monitored airports were around 67–82 per cent between 2008 and 2015, compared to 53 per cent for non-Australian airports.⁴⁸

The growth in patronage has required airports to continue to invest. Total aeronautical investment at the four monitored airports was in excess of \$7.0 billion between 2007–08 and 2016–17.⁴⁹ Figure 3.6 shows that Melbourne, Brisbane and Perth airports’ investment has fluctuated over the last decade. The ACCC raised some concerns earlier in the period about

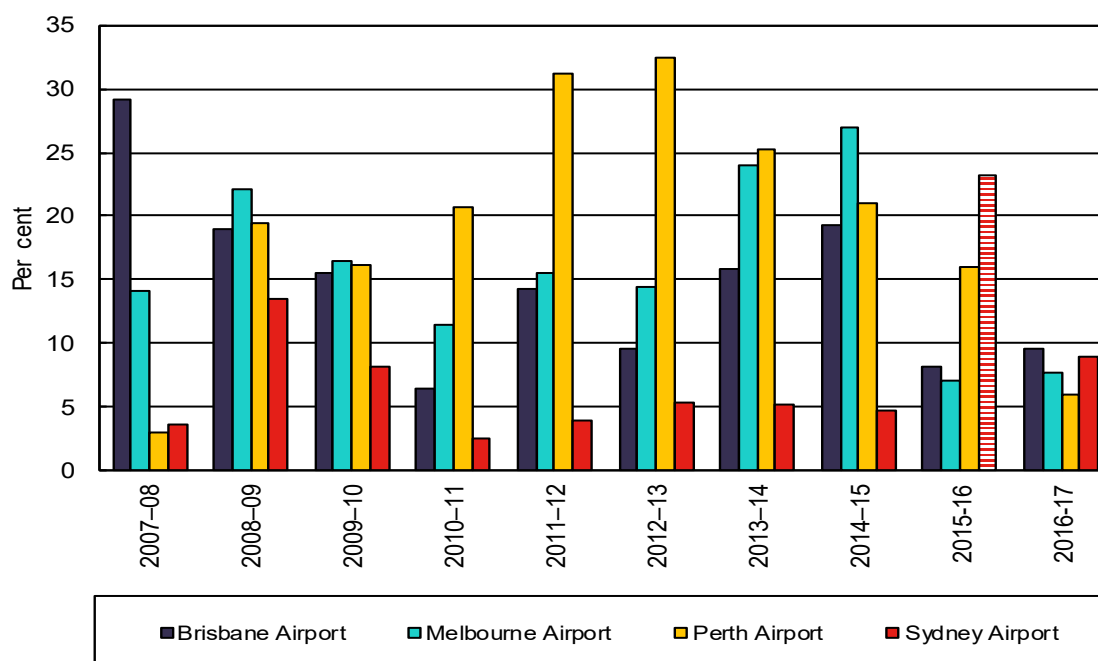
⁴⁷ Minifie, J., Chisholm, C., Percival, L. *Competition in Australia Too little of a good thing?* Grattan Institute Report No. 2017, 12 December 2017, pp. 21, 32–33, 39. Chart data (Figure 4.4, p.33) are available at the Grattan Institute’s webpage, <https://grattan.edu.au/report/competition-in-the-australian-economy/>, viewed on 20 August 2018.

⁴⁸ Airlines for Australia and New Zealand, *The performance & impact of Australia’s Airports since privatisation: A preliminary report prepared by Airlines for Australia & New Zealand*, 2018, pp. 9–10.

⁴⁹ ACCC, *Airport monitoring report 2016-17*, 2018, p. 38.

whether the monitored airports had been slow to respond to passenger growth with their investment.

Figure 3.6: Additions as a percentage of tangible non-current assets for aeronautical services: 2007–08 to 2016–17⁵⁰



Source: ACCC, *Airport Monitoring Report 2016–17*, 2018.

Sydney Airport invested at the lowest rate of the four airports in most of the ten years. One of the few years in which it did not trail the other airports was 2015–16 when its investment largely consisted of a payment to Qantas as part of the airline’s handing back of the lease for the T3 terminal. This relative lack of investment raises some concerns about underinvestment at Australia’s largest airport. However, it may also reflect the greater external constraints that Sydney Airport faces with respect to increasing capacity, including the operational restrictions (e.g. maximum 80 aircraft movements per hour, curfew) and a relatively small piece of land.

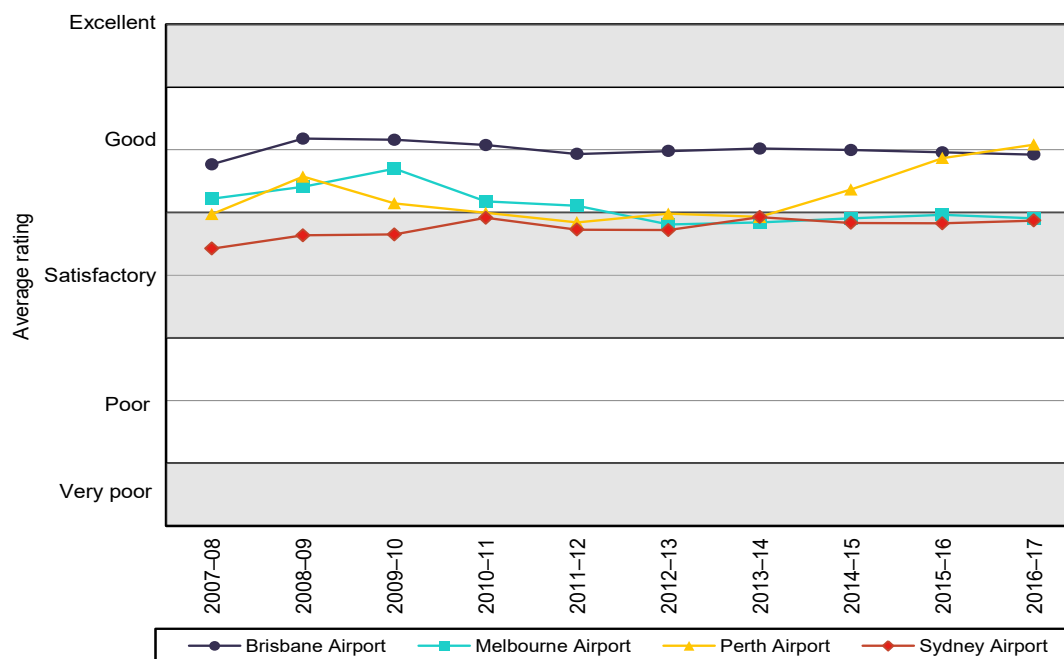
Various measures suggest that the monitored airports appear to be managing the growing challenge of congestion at present. In particular, ACCC monitoring shows that various ratings for the ‘availability’ of airport services and facilities remain relatively stable despite passenger growth. Capital expansion by the airports may also have contributed to a recent improvement in on-time arrival performance by airlines.⁵¹ Furthermore, three of the four airports are in the process of building or planning a new runway.

Despite all monitored airports significantly increasing revenue per passenger, only Perth Airport recorded any notable improvement in overall quality of service ratings (see Figure 3.7). The overall rating for the airports have generally remained between ‘satisfactory’ and ‘good’.

⁵⁰ Sydney Airport’s investment in 2015–16 includes its purchase price of the Qantas domestic terminal (T3).

⁵¹ Bureau of Infrastructure, Transport and Regional Economics, *Domestic airline on-time performance monthly reports*, June 2017.

Figure 3.7: Overall quality of service rating: 2007–08 to 2016–17



Source: ACCC, *Airport Monitoring Report 2016–17*, 2018.

Brisbane Airport has consistently achieved a ‘good’ rating in overall quality of service over the past decade. Perth Airport’s service quality improvements in the past few years coincide with significant investments in the terminals and now place it as the highest rated of the four airports. Sydney and Melbourne airports’ service ratings have remained relatively stable over the past few years, sitting slightly below the threshold for ‘good’.

The overall rating draws on survey results from airlines and passengers, as well as objective performance measures. Airports have typically been rated more highly by passengers than airlines. In particular, passenger ratings are typically ‘good’, while airlines have typically rated airport performance as ‘satisfactory’.

Another aspect of the quality of service offered by the airports are service level agreements with the airlines. While service level agreements with airlines appear to improve each time a new agreement is negotiated, there is still some way to go for them to provide sufficient accountability on the airports to ensure their service level is fit for purpose.⁵²

4.3. The regulatory regime with respect to aeronautical services

The current airport regulatory regime does not provide an effective constraint on the major airports’ ability to exercise their market power. While the combination of ACCC monitoring and Productivity Commission reviews may have provided some inherent threat of regulation in the past, the threat has diminished significantly following three successive inquiries in which the Productivity Commission has recommended against regulation. In addition the National Access Regime has generally proven ineffective for airlines due to its costly and lengthy processes as well as it not being a suitable tool for dealing with monopoly pricing issues.

⁵² The development of service level agreements over time is discussed in the ACCC 2015–16 Airport Monitoring Report.

4.3.1. Any credible threat of regulation has diminished following successive inquiries recommending against regulation

Periodic inquiries into airport regulation by the Productivity Commission is a key part of the current monitoring regime. They are intended to provide some checks on the effectiveness of the regime and in turn some constraint on misuse of market power by the monitored airports.

While this arrangement might have provided some constraint in the past, it is much diminished today. The credibility of threat from a Productivity Commission inquiry has diminished each time an inquiry recommended no action.

In particular, following the introduction of the monitoring regime the two Productivity Commission inquiries (in 2006 and 2011) reaffirmed the view that monitoring was an appropriate measure despite concerns raised by a range of stakeholders (including the ACCC) about the deficiency of the regime.

The ACCC is therefore concerned that there is a perception that the likelihood of a Productivity Commission inquiry recommending any remedies other than monitoring is low.

In addition, the Productivity Commission's previous view that high airport charges are unlikely to lead to significant deadweight loss and in turn the need for regulation further reinforces this perception (discussed in detail in section 4.1.3).

If the current inquiry by the Productivity Commission concludes that the current monitoring regime is sufficient (and there is no need for additional remedies) to address the concern about the monitored airports' market power, the credibility of threat of regulation is likely to be significantly diminished. In that event, continuing to monitor in the current form may in fact be counterproductive because it creates a false impression for government and the public that airports face some regulatory constraint.

4.3.2. Monitoring data does not enable the detection of monopoly pricing and profits

A key question of the current Productivity Commission inquiry is whether the current monitoring regime is suited to identifying abuse of market power by the airports.⁵³

As discussed in section 3.1, data collected by the ACCC under the current monitoring regime is insufficient to enable the ACCC to make any conclusive judgement about whether the price levels observed for the monitored airports are reasonable or reflect monopoly profits. This inherently weakens any credible threat of regulation associated with the monitoring regime.

The limitation of the monitoring regime is primarily because it is based on accounting data. For example, to measure profitability, the ACCC is limited to using 'operating profit margin' and 'return on assets'. These are accounting measures which are not well suited to analysing monopoly profits.

The ACCC has discussed the deficiency resulting from relying on accounting data in the past.⁵⁴ There appears to be a general recognition of this limitation. For example, academic Margaret Arblaster commented:

"the information provided in price monitoring reports cannot provide an adequate assessment of airport performance on its own. Price and quality of service monitoring

⁵³ The Productivity Commission, *Economic regulation of airports – issues paper*, 2018, p.14.

⁵⁴ ACCC, *Airport Monitoring Report 2016–17*, 2018, p. 186.

*provide indicative information but do not permit an assessment of whether airports are economically efficient or whether they have used their market power.*⁵⁵

4.3.3. Part VIIA price inquiries unlikely to provide additional benefits alongside monitoring and Productivity Commission inquiries

Under Part VIIA of the CCA, the ACCC also has the ability to recommend to the Minister that it undertakes a Part VIIA price inquiry. The Productivity Commission previously noted that a Part VIIA price inquiry was yet to be used in relation to the airports.⁵⁶

There are a number of reasons why the ACCC has not chosen to recommend a pricing inquiry, despite holding concerns about airport market power. The ACCC considers that a Part VIIA price inquiry is unlikely to be more effective in constraining the airports' market power than price monitoring and Productivity Commission inquiries. Because price inquiries also operate under Part VIIA of the CCA, they do not provide much improved information gathering power than current monitoring. Indeed, the ACCC is likely to run into the same type of data challenges in conducting a price inquiry as it does in its airport monitoring.

Without any obvious benefits, the significant cost burdens associated with a price inquiry on the industry and the ACCC is unlikely to be justified. Furthermore, the ACCC cannot initiate a price inquiry. It can only recommend that to the Minister, who can decide whether a price inquiry will be conducted. Even if an inquiry is conducted, the government may or may not accept its recommendations.

It should be noted that while the ACCC has been directed by the government in the past few years to conduct a number of price inquiries (e.g. electricity supply and prices inquiry, gas inquiry 2017–2020, dairy inquiry etc.), they primarily relate to areas where the ACCC does not have an ongoing direct monitoring role.⁵⁷

4.3.4. The National Access Regime has proven ineffective for airlines

As discussed in section 2.3, airports (including the monitored airports) are subject to a generic access regime i.e. National Access Regime under the Part IIIA of the CCA. However, the regime appears no longer to be seen by airlines as a viable tool.

The National Access Regime is not a viable tool for airlines

The National Access Regime is intended to serve as a back-up mechanism where access seekers can seek access to a monopoly infrastructure by way of ACCC arbitration if they fail to reach agreement with an infrastructure operator through negotiation. However, arbitration is only available when a relevant service has been declared.

Part IIIA declaration processes are subject to merits and judicial reviews and can be lengthy and arduous.⁵⁸ The recent declaration of Port of Newcastle took two years to complete and went through a number of appeals (to Australian Competition Tribunal and Full Federal Court).⁵⁹ Following the recent amendment to the Part IIIA declaration criteria, Port of Newcastle has applied to the NCC in July 2018 seeking that the declaration be revoked.⁶⁰

⁵⁵ Arblaster, M., *Reform of economic regulation under Part VIIA of the Competition and Consumer Act 2010- Submission to the Review of Competition Policy*, June 2014, p. 8.

⁵⁶ Productivity Commission, 2011, p. XXXIV.

⁵⁷ Information on the inquiries the ACCC is conducting is available on the ACCC website.

⁵⁸ For example, s. 44K of the CCA provides that the minister's decision on declaration is subject to review by Australian Competition Tribunal.

⁵⁹ Clayton Utz, 'Federal Court confirms access is straightforward in Port of Newcastle case - for now', 2017.

⁶⁰ National Competition Council, 'Consideration of possible recommendation to revoke declaration of service at the Port of Newcastle', 2018.

Despite the revocation process, arbitration by the ACCC, which was notified by Glencore Coal Pty Ltd on 4 November 2016, is currently underway.

In relation to airport related services, there has been only one case to our knowledge where services have been declared under Part IIIA since the airports were privatised.⁶¹ In 2007, Virgin Blue succeeded in having domestic airside services at Sydney Airport declared for a period of five years. However the entire process (including multiple appeals) took nearly five years to complete.⁶²

Airlines have in the past expressed the view that Part IIIA is not a viable tool for them because the threshold for declaration is high and the process can be lengthy and costly with great uncertainty. For example, Qantas considered that Part IIIA is an inappropriate solution and is “a crippling time consuming and burdensome process”.⁶³

The ACCC also considers that Part IIIA is ineffective in facilitating airlines’ negotiation with the major airports. In particular, its onerous declaration requirements and costly processes likely present a significant barrier for small airlines.

Importantly, following the Competition Policy Review (Harper Review) the government recently introduced some changes to the CCA including Part IIIA and its declaration criteria. In its submission to the Exposure Draft Consultation on Competition Law Amendments, the ACCC noted that “the likely effect of adopting the ‘with or without declaration’ test rather than the ‘with or without access’ test is to raise the threshold for declaration”. The ACCC is not alone in holding the view that the changes to the declaration criteria (a) have likely raised the threshold for declaration.⁶⁴

The recent application to the NCC by the Port of Newcastle to revoke the declaration of its services made prior to the changes further suggests that there is indeed a perception that the declaration threshold is now higher under the new criteria.

Having said that, the ACCC notes that the question of how the new threshold should be interpreted is yet to be tested by courts.

The National Access Regime is not the best tool for addressing airport monopoly pricing

Part IIIA is not best suited to addressing airport monopoly pricing as the regime is originally intended for addressing access issues in vertically integrated industries.

Trying to explain the origin of the regime, the Harper Committee noted:

‘The Hilmer Review recommended introducing competition into those industries by separating them into their contestable and natural monopoly elements. As the contestable elements required access to the natural monopoly elements, the Hilmer

⁶¹ Some freight related services were declared at Melbourne Airport in 1996 and Sydney Airport in 2002. See Arblaster, ‘Negotiate-arbitrate regulation of airport services: Twenty years of experience in Australia’, *Journal of Air Transport Management* 51, 2016, pp. 27–38

⁶² In October 2002, Virgin Blue applied to the National Competition Council (NCC) to have domestic airside services at Sydney Airport declared under Part IIIA. The NCC recommended against declaration, which was accepted by the Minister. Following appeals to Australia Competition Tribunal, the services were declared in 2005 for a period of five years (expiring in December 2010). The Tribunal’s decision was appealed to the Federal Court in 2006 by Sydney Airport. In October 2016 the Full Federal Court dismissed the appeal. Sydney Airport applied for leave to appeal to the High Court, which was dismissed in March 2007. Arbitration did not commence until February 2007. In May 2007, Virgin Blue withdrew its notification to arbitration following resolution of the disputes.

⁶³ ACCC, *Airport Monitoring Report 2015–16*, p. 17.

⁶⁴ See a note from Herbert Smith Freehills - Amendments to Competition and Consumer Act 2010 (Cth):

<https://www.herbertsmithfreehills.com/latest-thinking/amendments-to-competition-and-consumer-act-2010-cth>, viewed on 16 August 2018. Also see a note from Clayton Utz - Significant changes proposed to the National Access Regime, <https://www.claytonutz.com/knowledge/2017/may/significant-changes-proposed-to-the-national-access-regime>, viewed on 16 August 2018.

Review recommended introducing a single national access regime to regulate that access.'

The Harper Committee went on to say:

'Part IIIA of the CCA was originally enacted to provide a common framework for access to infrastructure within each of those industries. However, it soon became clear that each industry had distinct physical, technical and economic characteristics and that it was preferable to address access issues on an industry-by-industry basis. Distinct access regimes have subsequently emerged.'

The ACCC agrees with that assessment. Because operators of the airports are typically not vertically integrated into the provision of airlines services,⁶⁵ they are unlikely to have an incentive to block access to airlines. Therefore the issue concerning airports is primarily an issue of monopoly pricing rather than access.

The Harper Committee observed that:

*'while to some extent, Part IIIA can be used as a means of addressing monopoly pricing at airports, that is not its original objective and its processes are cumbersome and not well suited to that function.'*⁶⁶

4.4. Options for a more effective regulatory regime

Given that the current monitoring regime is not effective in constraining the major airports' ability to exercise their market power, there is a need to consider alternative remedies.

The ACCC submits that the Productivity Commission consider whether commercial negotiation can be further facilitated by providing airlines with better access to information. This would be supported by giving the ACCC powers to make record-keeping rules. Furthermore, airlines should be provided with a more direct access to arbitration (rather than having to go through the Part IIIA declaration process) to reduce the imbalance in bargaining powers of airlines and monopoly airports. Moreover, using a qualified commercial arbitrator (similar to that under the gas regime under Part 23 National Gas Rules) to conduct these arbitrations, instead of the ACCC, may help result in timely outcomes.

4.4.1. Information disclosure can address information asymmetry between airlines and airports in negotiation

A key objective of the government is to encourage airlines and airports to develop mature commercial relationships through negotiation (as stated in the terms of reference for the inquiry). In order for airlines to negotiate effectively with the airports, they need to have access to necessary information. This is particularly important for smaller airlines as they are likely to have less capacity to gather information when compared to larger airlines.

It is therefore important that the Productivity Commission considers whether information asymmetry is limiting the airlines' ability to negotiate with the airports and if that is the case, what additional information would be needed to facilitate negotiation.

The gas regime under the Part 23 of the National Gas Rules provides an example of how information asymmetry between a monopoly operator and its customers can be addressed through incorporating a mandatory information disclosure requirement in a negotiate/arbitrate model.

⁶⁵ There is an element of vertical integration in the airports' provision of car parking services as these services compete to some degree with other modes of transport for which the airport provides landside access service.

⁶⁶ Australian Government, *Competition Policy Review – Final Report*, 2015, p.428.

The ACCC understands that the airports do voluntarily provide information to airlines as part of airline agreement negotiation. For example, Perth Airport appears to have conducted its recent airline agreement negotiations on a transparent basis with information available online to interested stakeholders.

However it is unclear whether the information provided by the airports is sufficient for the airlines. For example, airlines have raised concern that there is insufficient information in relation to cost/benefit analysis for capital projects proposed by the airports.

The Productivity Commission could consider whether airlines would be better positioned to negotiate with airports if they were provided with additional information.

One option for addressing information asymmetry in negotiation is providing the ACCC with broader power to make record-keeping rules

One option for addressing the issue of information asymmetry is to provide the ACCC with the ability to make rules about what type of information the airports must keep and disclose. This can be implemented by giving the ACCC the power to make record-keeping rules (RKR) for the monitored airports similar to the arrangement in telecommunications. This could be applied by amending the Airports Act.

The information disclosed under RKR could be used to support commercial negotiation. Further it could also be used to provide the ACCC with the ability to collect the data required for assessing airport prices and profits.

As noted, the ACCC currently has similar power to make RKR in some other areas including telecommunications and Australia Post (under the *Australian Postal Corporation Act 1989*).

The process of making RKR generally involves consultation with stakeholders. Airlines' input on what information would be useful to facilitate their negotiation with the airports would be particularly useful in that regard. It is also likely that the ACCC may need to engage specialist advice in areas such as asset valuation and cost allocation to inform its processes.

Such a process is likely to take some time and may initially be costly. However the ACCC will be able to draw on its significant experience in setting up and administering firm/industry-specific RKR.

Moreover, once established, the ongoing administration costs of an enhanced disclosure regime are unlikely to be over-burdensome.

Finally, the ACCC's RKR powers can also provide the flexibility for the ACCC to regularly assess the ongoing need for RKR and amend and revoke RKR when necessary. For example, in telecommunications the ACCC recently revoked its Regulatory Accounting Framework RKR that used to underpin an extensive reporting framework for relevant businesses.

While this ability to make RKR would primarily be used to support information disclosure to facilitate commercial negotiations between airlines and airports, it may also be useful for improving the ACCC's monitoring activities. This could relate to the monitoring of aeronautical, car parking and landside access activities. RKR can assist in this regard despite the airports generally taking a cooperative approach to the ACCC seeking further information on occasions.

Recommendation 2:

The ACCC submits that the Productivity Commission consider whether airlines would be better positioned to negotiate with airports if they were provided with additional information. This could be supported by the ACCC having the ability to create record-keeping rules for airports as it does in telecommunications.

4.4.2. Access to arbitration would help to address the imbalance in power in commercial negotiations

Given the lack of credible threat under the current monitoring regime, the ACCC considers that information disclosure should be backed with access to arbitration for airlines if they cannot reach commercial agreement with the airports. This would provide appropriate constraint on the airports' market power. Moreover the threat of arbitration can also help achieve the government's objective of facilitating commercial negotiations between airports and airlines.

Arbitration provides a credible threat against misuse of market power by the airports

As discussed in section 4.1, while the major airports have a high degree of market power in the supply of aeronautical services, airlines generally do not have sufficient countervailing power. This imbalance in bargaining power is likely resulting in airline agreements with less favourable terms and conditions of access than would be the case in a more competitive airport environment. It is likely that many airlines may simply accept the airport's proposed terms and conditions on a take-it-or-leave-it basis.

While mandatory information disclosure by the airports can reduce information asymmetry to some extent and facilitate commercial negotiation, it needs to be backed by recourse to independent arbitration should commercial agreement not be reached. The threat of arbitration provides a credible threat against misuse of market power by the airports. This in turn can incentivise the party with stronger bargaining power to negotiate in good faith with the party with weaker bargaining power to reach agreement.

Airlines generally support a negotiate/arbitrate regime

The airline industry in general has been supportive of a negotiate/arbitrate regulatory regime. In their joint submission to the Productivity Commission's 2011 inquiry, Qantas, Virgin Blue (now Virgin), Board of Airlines Representatives of Australia (BARA), and Regional Aviation Association of Australia (RAAA) advocated for introduction of binding arbitration carried out by an independent party.⁶⁷

Following the Harper Review, Qantas stated that commercial negotiations have tended to be difficult and protracted, despite the existence of the National Access Regime and the monitoring regime. Qantas proposed that airports be deemed to be declared under the National Access Regime by the government, avoiding the delays, costs and uncertainty of seeking declaration through the National Competition Council.⁶⁸

Virgin said that 'the current regulatory regime is not effective in guaranteeing the efficient operation of the Australian aviation industry or in providing incentives for airports to efficiently price services while addressing the imbalance in negotiating power between airports and airlines'. Virgin advocated for the adoption of a negotiate/arbitrate access model

⁶⁷ Qantas Group, Virgin Blue, and Board of Airlines Representatives of Australia, and Regional Aviation Association of Australia joint submission to the 2011 Productivity Commission Inquiry into Airport Regulation, April 2011, p. 4.

⁶⁸ Qantas Group, *Qantas Group submission on Harper Review Recommendations*, 2015.

for airports, with declaration under Part IIIA remaining as a safeguard until such a model is implemented.⁶⁹

A negotiate/arbitrate regime for airports is unlikely to lead to a large number of arbitrations

A concern around a negotiate/arbitrate regime is that arbitration can potentially become the default mechanism for determining terms and conditions instead of commercial negotiation. The Productivity Commission raised this issue in the context of the former access regime for telecommunications, noting that ‘under the access regime for telecommunications, the ACCC has conducted nearly 100 arbitrations in the five years to 2009–10’.⁷⁰

The ACCC considers that such outcomes are unlikely for airports and airlines. The outcome in telecommunications should not be considered as a natural result of negotiate/arbitrate regimes per se. The history of arbitrations there is likely due to the fact that Telstra was vertically integrated and was competing with access seekers in downstream markets. In that setting, Telstra could potentially benefit from protracted arbitration processes and therefore likely had less incentive to reach agreement.

This is unlikely to occur in an airport context as airports in Australia are not generally characterised by vertical integration and are therefore unlikely to have an incentive to block or delay access by airlines.⁷¹

On that point, the Harper Committee noted that:

*‘The regulatory issue that arises in respect of airports is generally one of monopoly pricing rather than access. Although airports are bottleneck facilities, their operators are not vertically integrated into upstream and downstream markets. Hence, they have limited incentive to reduce competition in dependent markets’.*⁷²

The Productivity Commission’s concern about a negotiate/arbitrate regime leading to excessive use of arbitration is not borne out by the ACCC’s experience. There are some examples of success in application of negotiate/arbitrate regimes both in Australia and overseas. In particular, during the five year period when cargo handling and domestic airside services were declared at Sydney Airport, no ACCC arbitrations arose,⁷³ which suggests the threat of arbitration was an important factor in negotiation.

Moreover when airport services at Sydney Airport were declared, the prospect of arbitration by the ACCC appeared to be a key driver in facilitating a commercial settlement between Virgin Blue and Sydney Airport in 2007.⁷⁴ Similarly, the threat of arbitration also appeared to have incentivised Glencore Grain Pty Ltd and GrainCorp to resolve their disputes regarding access to GrainCorp’s port terminal services in 2010.⁷⁵

The Productivity Commission previously said ‘expedited access to arbitration by the ACCC at the contract formation stage could fundamentally undermine light-handed regulation’ and that ‘it is difficult to conceive how provision for ACCC arbitration would provide both airports and airlines with strong incentives to engage in genuine commercial negotiations’.

⁶⁹ Virgin Australia, *Virgin Australia Airlines – submission on the Competition Policy Review Final Report*, 2015.

⁷⁰ Productivity Commission, *Inquiry into airport regulation – final report*, 2011, p. XL.

⁷¹ There are some limitations on airport ownerships. s. 44 of the Airports Act includes a 5 per cent limit on airline ownership of airports

⁷² Australian Government, *Competition Policy Review – final report*, 2015, pp. 427–428.

⁷³ Productivity Commission, *Inquiry into airport regulation – final report*, 2011, p. 203.

⁷⁴ ACCC, *Submission to Productivity Commission Inquiry into the Economic Regulation of Airports*, March 2011, p. 23.

⁷⁵ The wheat access undertakings accepted by the ACCC in 2009 incorporated a publish-negotiate-arbitrate model based on the provisions in Part IIIA. See a discussion in ACCC’s submission to the Productivity Commission’s review of the National Access Regime, 2013.

It is unclear why provision of arbitration by an independent regulator would automatically lead to arbitrations as neither party involved in a dispute can anticipate the outcome of an arbitration. In that sense, it is 'risky' for a party to go to the arbitrators unless it considers the outcome it would face otherwise is totally unacceptable (in that case arbitrations are likely to lead to more efficient outcomes). The risk factor should therefore encourage the parties to reach a commercial agreement that is mutually acceptable.

As noted above, during the period when cargo handling (2000–2005) and domestic airside services (2005–2010) were declared at Sydney Airport, no ACCC arbitrations ever arose. The Productivity Commission previously considered that the reason for lack of recourse to arbitrations was mainly because "the previous declarations operated concurrently with commercial agreements, which already had dispute resolution mechanisms."⁷⁶

It is unclear what type of resolution mechanisms were available at that time when airport/airline commercial negotiation was still in a less mature phase. Even if there were some basic provisions for dispute resolution for the incumbent users, it is not inconceivable to envisage scenarios where new users tried to negotiate access outside existing agreements. The fact that not one single arbitration by the ACCC occurred clearly shows that the concern that arbitration may become the default option is unwarranted.

Indeed, drawing from a wide range of international experience, Professor Stephen Littlechild observed that:

'Elsewhere in the world, evidence continues to accumulate that parties in a regulatory framework are willing and able to negotiate settlements to the extent that they are allowed to do so. These parties effectively have the ability to trigger regulatory arbitration simply by declining to reach agreement. Nonetheless, they have not in general found it necessary or advantageous to do this.'

...there is increasing international evidence – from other sectors in the US, Canada, and the UK – that access to dispute resolution tends to facilitate commercial negotiations rather than undermine them'.⁷⁷

A negotiate/arbitrate regime is a light-handed and flexible regulatory solution

A negotiate/arbitrate regime is a light-handed form of regulation. This is because terms and conditions can continue to be determined through commercial negotiation without any external involvement such as that by a regulator. This is in contrast to other forms of regulation where a regulator may be asked to determine prices upfront and assess whether the provider of the service is operating efficiently and investing prudently.

A negotiate/arbitrate regime can also provide flexibility if there is uncertainty regarding the level of market power of the infrastructure provider. In the event that the major airports do not possess significant market power, then the airports and airlines can continue to commercially negotiate terms and conditions without regulatory interference and the recourse to arbitration will not be used. This minimises the potential for harm from regulatory overreach.

In fact, this flexibility means that the recourse to arbitration could even be used by airports in the event that airlines have strong countervailing power. Some airports have told the ACCC that it is possible for Qantas to have strong countervailing power. They have said that this countervailing power can be used in relation to airport charges. They have also said that

⁷⁶ Productivity Commission, Inquiry into airport regulation – final report, 2011, p. 202.

⁷⁷ Stephen Littlechild, 'Australian airport regulation: Exploring the frontier,' *Journal of Air Transport Management* 21, 2012, pp. 60–61.

Qantas has sought to protect its dominance in the airline industry by attempting to prevent an airport from undertaking investment to grow capacity for new airlines. If an airline was able to have such significant market power in certain circumstances, then it may be that the airports themselves will be able to benefit from seeking recourse from arbitration when commercial agreement could not be reached. This could also benefit airlines that were looking to secure new slots at the relevant airport.

Recommendation 3:

There should be access to arbitration if airports and airlines cannot reach commercial agreement on terms and conditions. The imbalance in bargaining powers of monopoly airports and airlines, particularly small airlines, could be reduced if both parties had recourse to arbitration. This would promote commercially negotiated outcomes that better represented the interests of both airports and airlines.

Commercial arbitration can lead to effective and timely resolution of disputes

The ACCC considers that a preferred model of providing arbitration is using commercial arbitration. An example of that model is the Part 23 gas regime for regulating non-scheme⁷⁸ gas pipes (under the Part 23 of the National Gas Rules), which was adopted following the Vertigan Review.⁷⁹

Commercial arbitration involves arbitration by an accredited commercial arbitrator rather than the regulator. It has the advantage of being able to focus on commercial principles with the expectation that arbitration should be completed within relatively short timeframes. Furthermore, arbitrators' decisions can be made binding (not subject to reviews or appeals). This approach is likely to provide a more effective and timely resolution of disputes.

Moreover, commercial arbitration appears to address some of the Productivity Commission's concern associated with having regulators conduct arbitration. In particular, commercial arbitration can be confined in both coverage and factors to take into account, with the impact of decisions confined to the parties. The Productivity Commission noted that 'commercial arbitration can thus neutralise market power, without the added cost that precedent set under arbitration by the regulator could introduce'.⁸⁰

The ACCC notes that use of commercial arbitration would require the establishment of a new regime, and therefore could not be implemented by the government deeming airport services to be declared under Part IIIA.

Recommendation 4:

Commercial arbitration, where the arbitration of an access dispute is done by an independent commercial arbitrator rather than the regulator (similar to arrangements under Part 23 of the National Gas Rules), could lead to more timely dispute resolution.

Issues to consider when implementing a negotiate/arbitrate framework

In designing a suitable arbitration regime, it is important to consider the nature of existing commercial negotiation to ensure that the regime can encourage parties to reach negotiated outcomes and is also capable of dealing with the type of disputes likely to arise.

⁷⁸ Non-scheme pipelines are distribution and transmission pipelines that are not subject to either 'full' or 'light' regulation.

⁷⁹ Australian Energy Regulator (AER), *Non-scheme Pipeline Arbitration Guide: National Gas Law and Rules Version 1*, September 2017, pp. 31–32.

⁸⁰ Productivity Commission, 2011, p. 213.

It appears that while the price caps were removed a long time ago, airport charges at some airports continue to be set on a whole-of-airport basis with reference to the building block model (BBM) methodology. For many airlines bilateral negotiations appear to occur largely after a headline price (list price) has been agreed to, with their scope largely limited to addition or removal of certain service components.

This potentially raises a number of questions. One issue is how bilateral arbitration should be used to deal with issues that can potentially affect third parties. For example, given how airport charges are set, they are likely to reflect an airport's capital program which affects many airlines. If one airline does not agree with prices and seeks an arbitrated outcome, should that outcome also apply to other airlines that use the same type of services and face the same charges?

Further as noted above, an incumbent airline may try to avoid capital projects being undertaken to expand capacity, which may lead to new entrants and increased competition. In that event, there may be a need for arbitrators to consider the needs of other airlines and passengers in addition to the parties in dispute.

One way to potentially address these types of issues (in the context of commercial arbitration) is by incorporating some guidelines on how arbitrations should be conducted and what matters arbitrators should consider. As an example, the guidelines can include a requirement that consideration should be given to overall efficiency in operation of an airport.

Another question to consider is to what extent an arbitration decision should be publicly disclosed. A greater degree of disclosure can potentially help lower the impact of information asymmetry and promote more equitable outcomes. While it may also lead to more airlines seeking arbitration, it is also possible that public disclosure of prices may instead simply set the commercial rate for other airlines and therefore remove the need to go to arbitration. Airlines, however, may be concerned about having their arbitrated agreement made public.

4.4.3. Monitoring of aeronautical services should continue

The ACCC considers that there should be an ongoing role for monitoring of aeronautical services for a number of reasons.

First, monitoring data could potentially be used to support commercial negotiation and help reduce information asymmetry between airlines and the airports. It can also potentially be useful for arbitration processes.

Monitoring will also ensure that the government continues to be sufficiently informed about a key infrastructure industry, especially as that monitoring could be used to assess the effectiveness of the introduction of arbitration arrangements.

Furthermore, monitoring covers a broader array of airport performance than just aeronautical charges, including airport quality of service, passenger-related services, car parking services and landside services.

Monitoring would be further supported if the ACCC had the ability to create record-keeping rules for the airports as it does in telecommunications (see section 4.4.1).

Recommendation 5:

The ACCC's monitoring of aeronautical services should continue in order to support commercial negotiation and to provide the government and stakeholders with information on a key infrastructure sector, including aspects of performance not related to aeronautical charges. This monitoring would be supported by the ability for the ACCC to make record-keeping rules.

The information disclosure regime in New Zealand provides an alternative approach

The information disclosure regime in New Zealand, which operates under Part 4 of *the New Zealand Commerce Act*, represents an alternative approach. It applies to the three major international airports in New Zealand (Auckland, Wellington and Christchurch), as well as relevant electricity networks and gas pipelines.

Under that regime, the New Zealand Commerce Commission (NZCC) has the ability to specify a rigorous and transparent framework for reporting of key economic variables to enable assessment of airport profitability. The airports are required to publicly disclose financial and performance information annually and after an airport sets or changes prices. The NZCC undertakes a review of the airports' prices once they have been set.

The NZCC has established a set of 'input methodologies' for airports to follow in their reporting. They cover areas such as cost allocation, asset valuation, tax and cost of capital. The input methodologies provide a set of comprehensive and rigorous methodologies, rules and processes, which underpin the NZCC assessment of airport historical and future excess profitability. Following its recent review of the input methodologies, the NZCC now requires airports to disclose a forward-looking profitability indicator that enables the NZCC to directly assess airport targeted rate of return.⁸¹

It is worth noting that New Zealand had a similar monitoring framework to the current regime in Australia for its airports in the past. That regime was found ineffective in constraining their airports' market power, which led to the enhanced information disclosure being introduced by the New Zealand government in 2008.⁸²

The New Zealand regime is essentially a form of shadow pricing regulation. This type of approach can enable the regulator to review efficiency of airport prices and appropriateness of their rates of returns. Following introduction of the regime, the NZCC reviewed the prices set by the airports and found that Wellington Airport prices would generate excessive returns. This has likely led to Wellington Airport eventually lowering its prices.⁸³

While this shows that the regime has had some success, it is likely that the timing of the event has contributed to the success. The NZCC's review of Wellington Airport's prices was undertaken shortly after the introduction of the regime and it is likely that the perceived risk of regulation if airports failed to respond to NZCC's findings was relatively high at that time.

It is however unclear whether this type of threat is sustainable in the long term. The NZCC recently questioned the appropriateness of Auckland Airport's pricing for the five year period from 1 July 2017 as its targeted return was higher than NZCC's benchmark WACC.⁸⁴ Whether this would lead to a response from Auckland Airport may provide some indication of the long-term viability of the regime.

An approach similar to the New Zealand regime is likely to be quite intrusive and costly to set up. It initially took the NZCC two years to set up its input methodologies, and three years for associated court appeals. The complexity of the process is evident by the length of documents: over 1 000 pages for the NZCC reasons document, court records of 50,000

⁸¹ The New Zealand Commerce Commission 2016, IM review – final reasons paper, p. 902.

⁸² Ministry of business, innovation & employment, New Zealand Government 2014, Effectiveness of information disclosure regulation for major international airports, p. 4.

⁸³ New Zealand Commerce Commission 2015, *Media release – Commission releases final report on Wellington Airport's revised pricing*, 30 June 2015.

⁸⁴ New Zealand Commerce Commission, 'Commission concerned Auckland Airport's profits may be too high', media release, 26 April 2018

pages, and 657 pages for the merits appeal decision.⁸⁵ Therefore it is important to balance the potential benefit of this approach with its associated costs when assessing its merits.

4.4.4. Price notification regime under Part VIIA of the Competition and Consumer Act

Price notification under Part VIIA of the CCA provides a framework of ex ante price regulation. Previously applied to the airports, the price notification regime (along with price caps) was removed when the monitoring regime was introduced (with the exception of regional air services at Sydney Airport).

Currently, the price notification regime applies to three businesses: Australia Post, Airservices Australia, and Sydney Airport in relation to its regional air services.

The regime applies to services declared by the Minister and once a service is a declared, a proposed price increase needs to be notified to the ACCC and is subject to a 21 day price freeze period. The ACCC is required to make a decision on whether it objects to the price increase. While an objection by the ACCC does not prohibit a price increase under the regime, it is very rare for a business to go ahead with an increase if objected by the ACCC.⁸⁶

The ACCC's approach to assessing a price notification focuses on efficiency of prices in the sense that they should not generate more revenue than what is required to cover efficient cost of supplying the service. This is explained in detail in "Statement of regulatory approach to assessing price notifications under Part VIIA of the *Competition and Consumer Act 2010*" (available on the ACCC's website).

As a form of price control, the price notification regime can be an effective tool for constraining the ability of a monopoly to exercise its market power. For example, under the regime five-year pricing paths have been developed for Airservices Australia for its monopoly air traffic control services and aviation rescue and firefighting services.

However, having its origin in the *Prices Surveillance Act 1983* as a tool for controlling inflation, the price notification provisions have essentially remained unchanged from that time. The legislative criteria governing the operation of the regime therefore may not be best suited to the policy objective today. For example, subs. 95G(7)(c) requires the ACCC to give regard to 'the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.' This criteria is now less relevant given there has been a movement away from centralised wage fixing to agreements negotiated at the enterprise level.⁸⁷

The regime is also likely to be less effective in promoting commercial negotiation between airports and airlines when compared to the negotiate/arbitrate approach. Being a cost-based approach, it is also less effective in providing incentives for efficient operation.

The ACCC therefore considers that the Part VIIA price notification regime will not be as effective as a negotiate/arbitrate regime in terms of achieving the government's objectives.

⁸⁵ Sue Begg (Deputy Chair, NZCC), presentation to the Regulatory Policy Institute conference, 2014.

⁸⁶ Arblaster, *Reform of economic regulation under Part VIIA of the Competition and Consumer Act 2010- Submission to the Review of Competition Policy*, June 2014, p. 4

⁸⁷ ACCC, Statement of regulatory approach to assessing price notifications under Part VIIA of the *Competition and Consumer Act 2010*, 2017, p.12.

5. Car parking services

5.1. Airport market power in the supply of car parking services

The price of car parking at airports, and the associated profits, has been of particular concern to the public over many years. This is because unlike aeronautical charges, it is very apparent to consumers how much they pay for the service.

In response to these concerns, the government directed the ACCC to begin monitoring the car parking operations of the monitored airports in 2008.

As the sole provider of car parking services on airport land, each major airport holds significant market power with respect to these services.

There are a variety of modes of transport for getting to and from the major airports. Aside from parking at the airport, consumers may be able to choose to park at a nearby independent carpark, travel by taxi, hire-car, ride-share, train or bus. To some degree, each transport mode competes with the others including the airport's car parking operations.

However, not all transport modes will be realistic options for an individual consumer depending on their circumstances. In addition to the price sensitivity of passengers and the cost and convenience of alternatives, many other factors could also limit a consumer's options, such as the reason for travelling, or time of day. For example, public transport, taxi or ride-share may not be considered reasonable options for price sensitive travellers who live at a distance from a CBD, and have relatively few affordable transport options for travel to and from an airport. Thus the competitive constraints on an airport's car parking services are more limited than they seem.

Airport market power is likely to be greatest in the supply of short-term (defined as less than 24 hours) car parking that is closest to airport terminals, compared to that at some distance from the airport (i.e. require shuttle bus transportation). This is because all four of the monitored airports are also serviced by a number of independent car parking operators that provide some level of competition to the long-term parking services provided by each airport (i.e. more than one day). In addition:

- the convenience of short-term parking is hard to substitute;
- many motorists may be less price sensitive (e.g. business travellers), meaning that prices for short-term car parking are relatively inelastic compared to longer parking durations;
- motorists may be less willing or able to consider offsite carparks which require taking a shuttle bus;
- motorists who choose to park for shorter durations are less likely to pre-book online to get a discount; and
- any premium paid for short-term parking is going to seem less detrimental to the motorist because the excessive rate is paid for a shorter timespan (1–2 hours) compared to long-term parking services (e.g. more than 24 hours).

5.1.1. Distinguishing between locational and monopoly rents

There are two types of economic rents that airport operators can incorporate when setting prices for car parking: locational rents and monopoly rents. Airports charge customers different rates to account for factors such as length of stay and the type of car parking used. To some degree, these prices reflect value of the land; that is, the convenience of parking within a short walk from airport terminals and the willingness to pay for that convenience. Of

course, another reason for the different prices between different car parks is the need for airports to manage growing demand for space near the terminal entrances. These are referred to as locational factors.⁸⁸

It is efficient for prices to be set with consideration of locational factors. However, airports still have the ability to raise prices above efficient levels (i.e. collect revenue in excess of locational rents, referred to as monopoly rents), particularly for services where they possess significant market power. Although a number of factors suggest that airport car parking prices reflect monopoly rents, it is difficult to form conclusions on whether this is the case.

A number of structural characteristics can be identified that provide airports with an ability to potentially earn monopoly rents from car parking. These include the following:

- there are effective barriers to entry to on-airport car parking that arise from airports' control over landside access to terminal facilities (see section 4 for more details on landside access);
- airports have a considerable amount of discretion in determining the conditions under which alternatives to its car parking services compete (such as allocation of kerbside space);
- levies imposed by the airports on competing modes are not regulated; and
- airports have direct control over the number of car parking spaces that are supplied in close proximity to terminals.

5.2. Performance of the major airports in providing car parking services

In addition to the structural characteristics outlined in Section 5.1 that point to an ability for airports to earn monopoly rents from car parking, an assessment of car parking prices and profits over the ten years to 2016–17 also suggests this to be the case. In particular:

- Real-prices paid for car parking services have increased significantly (see Tables 5.1 and 5.2).
- Furthermore, although expenses per car parking space have increased, car parking services continue to generate significant EBITA operating profits for all of the four monitored airports, with profit margins ranging between 59 per cent (Perth and Brisbane) and 63 per cent (Sydney) in 2016–17.

While all airports offer short-term at-terminal and long-term at-distance parking, each also offers a range of products and services in between. For some airports, this offering has broadened to include premium services such as valet car parking and 'guaranteed space' allocations. Most airports also offer promotions that can be accessed online, such as for off-peak periods. In comparing prices and profits, it is important to consider that these configurations vary between airports, and that locational factors will also vary in each city.

⁸⁸ Peter Forsyth, 'Locational and monopoly rents at airports: creating them and shifting them', *Journal of Air Transport Management*, Volume 10, No. 4, 2004.

5.2.1. Airport car parking prices and profits

Car parking prices

As noted in Section 5.1, market power is greatest for short-term car parking services that are within short walking distance from airport terminals. The expenses for providing short-term car parking can differ from long-term car parking, with the former typically being more capital intensive (e.g. in the case of multi-level car park near terminals). These and many other factors can influence the prices airports charge for these products.

Table 5.1 presents a selection of short-term car parking prices in 2016–17. It shows that prices increased across all durations at all airports in real terms over the decade. Prices increased the most at Perth Airport with prices essentially doubling or more across all categories over the decade. Despite these increases, Perth Airport remains the cheapest of the four airports. Brisbane Airport has also become much more expensive over the last ten years, with prices for all durations shown increasing by at least 30 per cent.

Melbourne Airport decreased its car parking charges across all selected short-term categories over the past year, but were the most expensive for 1 to 2 hours of parking at \$29. Sydney Airport had the most expensive car parking prices for the remaining categories despite greater fluctuations in prices over the decade.

Table 5.1 Selected prices for short-term, at-terminal car parking (in 2016–17 prices) – Brisbane, Melbourne, Perth and Sydney: 2016–17^{(a)(b)}

	Price in 2016–17	1 year change	10 year change
Brisbane			
30 minutes to 1 hour	\$16.00	4.9%	30.5%
1 to 2 hours	\$20.00	3.5%	35.9%
2 to 3 hours	\$25.00	2.4%	45.6%
3 to 4 hours	\$27.00	2.1%	37.6%
Melbourne			
30 minutes to 1 hour	\$15.00	-1.7%	1.9%
1 to 2 hours	\$29.00	-1.7%	31.4%
2 to 3 hours	\$29.00	-26.9%	18.2%
3 to 4 hours	\$39.00	-21.7%	6.0%
Perth			
30 minutes to 1 hour	\$12.60	37.6%	97.6%
1 to 2 hours	\$18.00	36.1%	109.7%
2 to 3 hours	\$21.00	37.6%	114.1%
3 to 4 hours	\$24.00	34.8%	117.5%
Sydney^(a)			
30 minutes to 1 hour	\$18.50	7.0%	4.8%
1 to 2 hours	\$26.50	4.2%	7.8%
2 to 3 hours	\$35.60	5.8%	8.1%
3 to 4 hours	\$59.50	-1.7%	20.6%

Source: ACCC, *Airport Monitoring Report 2016–17*, 2018.

Notes: (a) Price changes have been calculated based on drive-up rates (b) Data for the following car parks was used in this table: ParkShort (Brisbane), T123 (Melbourne), T1/T2 and T3/T4 short term car parks (Perth), P1/P2/P7 (Sydney).

In addition to reducing short-term car parking prices in real terms during 2016–17, Melbourne Airport reduced many at-terminal drive-up prices by up to 20 per cent in early 2018.⁸⁹ It also delivered a broader range of products that reflect a range of needs. These include budget options for short-term parking (meet and greet) that are cheaper than the at-terminal option and are accessed using a shuttle bus service; and premium/valet options to cater to the high end consumer market.

⁸⁹ Gardiner, E, 'Melbourne Airport slashes terminal parking fees by up to 20 per cent', 26 February 2018, *Herald Sun*, 2018.

Table 5.2 presents a selection of long-term car parking prices in 2016–17, represented by open-air car parks that are located at some distance from terminals and require shuttle bus transportation. It shows that over the ten-year period, price increases were smaller compared to short-term parking. This may reflect the competitive pressure that independent car parking operators (and other transport modes to some degree) are likely to be placing on these services.

Despite this, prices at all airports still increased in real terms across a majority of long-term parking durations over the past decade. In Perth and Sydney, these price increases occurred across all long-term parking durations, while at Melbourne these increases occurred at stays of 2 to 3 days and 6 to 7 days.

Table 5.2 Selected listed prices for long-term, at-distance car parking (in 2016–17 prices) – Brisbane, Melbourne, Perth and Sydney: 2016–17^{(a)(b)}

	Price in 2016–17	1 year change	10 year change
Brisbane^(c)			
1 to 2 days	\$33.00	-24.5%	n/a
2 to 3 days	\$53.00	-17.3%	n/a
3 to 4 days	\$73.00	-13.5%	n/a
6 to 7 days	\$93.00	-1.7%	n/a
Melbourne			
1 to 2 days	\$49.00	-1.7%	-0.1%
2 to 3 days	\$69.00	-1.7%	12.5%
3 to 4 days	\$75.00	-1.7%	1.9%
6 to 7 days	\$99.00	-1.7%	17.0%
Perth			
1 to 2 days	\$50.00	0.3%	19.9%
2 to 3 days	\$73.00	1.1%	16.7%
3 to 4 days	\$93.00	11.5%	35.4%
6 to 7 days	\$126.00	7.7%	44.7%
Sydney			
1 to 2 days	\$64.00	1.5%	49.1%
2 to 3 days	\$77.00	2.3%	28.1%
3 to 4 days	\$92.50	1.1%	17.9%
6 to 7 days	\$140.00	0.5%	4.7%

Notes: (a) Calculated based on drive-up rates for open-air car parks (b) Data for the following car parks is used in this table: Airpark (Brisbane), Long term car park (Melbourne), T1/T2 and T3/T4 long term car parks (Perth), Blu-Emu (Sydney) (c) Brisbane Airport did not have a comparable car park in 2007–08 (Airpark opened during 2015).

It should be noted that data in the above table shows listed prices, and in recent years there is a growing trend towards customers pre-booking their parking online to access cheaper rates, particularly for those using long-term, at-distance car parking options. In 2016–17, this accounted for between 24 per cent (Perth) and 83 per cent (Brisbane) of total long-term car parking revenue. In 2016–17, online prices for at-distance car parking were around 22 per cent cheaper than listed prices on average across the four airports that are subject to ACCC monitoring, depending on duration and type of service.

Benchmarking car parking prices

Car parking prices in Australia and New Zealand, particularly for short-term parking, appear to be higher than other countries. An international car parking prices study conducted by Mercurius Group⁹⁰ in 2016 found that on average, short-term car parking prices at airports in Australia and New Zealand are higher at every duration compared to the average price charged at airports in the Asia Pacific region and the world. In particular, Australia and New Zealand's prices for the first hour of parking were almost double the average of the Asia-Pacific region. Prices for long-term car parking close to terminals however, were more consistent with global averages.

Benchmarking also suggests that airport car parking has been a strong driver of industry growth. A report on car parking in Australia prepared by IBIS World⁹¹ shows that airport parking accounts for over one-third of industry revenue and is the most profitable industry segment. This is expected to continue as air passenger movements are projected to increase.

Airport car parking profits

The four major airports combined made \$280 million in operating profit (EBITA) from car parking operations in 2016–17 from revenues of just \$436 million. This equates to an operating profit margin of 64 per cent.

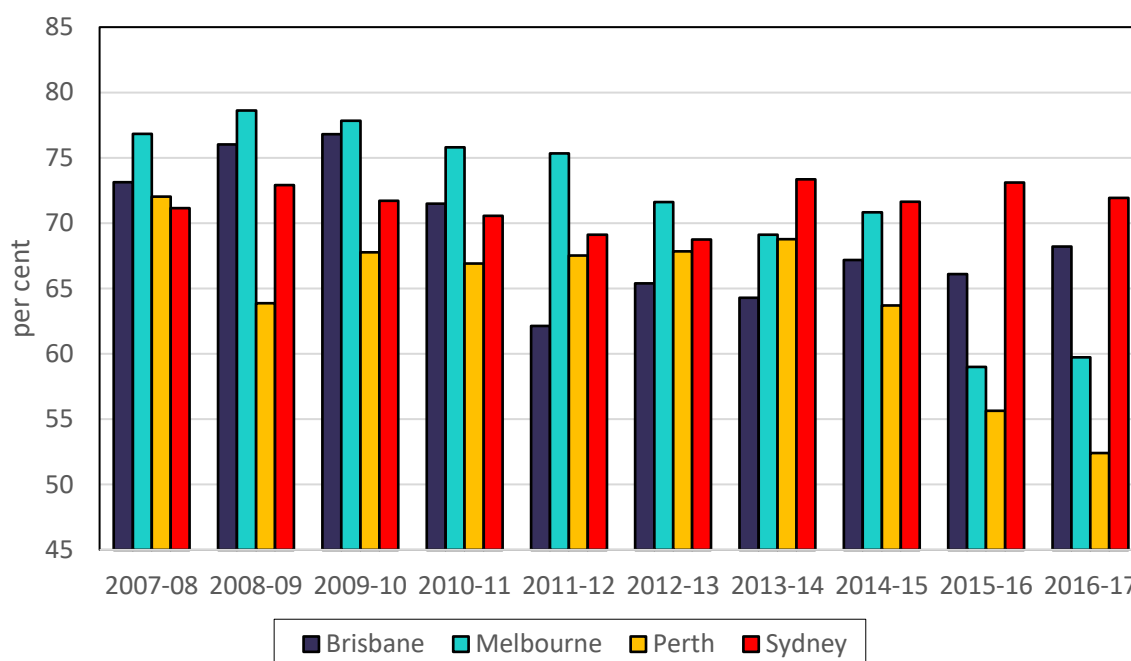
Car parking continues to contribute positively to the total profitability of airports, and total car parking revenue and operating profits continue to grow significantly at all four of the monitored airports. However, with the exception of Sydney Airport, profit margins as a percentage of revenue have been trending down over the last decade. This is largely attributable to a significant increase in operating expenses at Brisbane, Melbourne and Perth airports over the period.

Figure 5.1 shows that Sydney Airport reported the highest operating profit margin from car parking in 2016–17, at 71.9 per cent. This has been the case since it overtook Melbourne Airport in 2013–14. Perth Airport had the lowest reporting profit margin of 52.4 per cent, which represented a 3.2 per cent drop from 2015–16.

⁹⁰ The Mercurius Group, *The Airport Car parking Study, 2016: The Definitive Guide to Airport Car Park Pricing and Management – Asia Pacific Edition*, 2016.

⁹¹ IBISWorld, *IBISWorld Industry Report S9533: Parking Services in Australia*, 2016.

Figure 5.1 Airport car parking operating profit as a percentage of car parking revenue (before tax), 2007–08 to 2016–17



Source: ACCC, *Airport Monitoring Report 2016–17*. 2018

Airport investment in car parking facilities

The monitored airports have made significant investment in car parking facilities in the past decade. Total airport car parking spaces have increased by 66.2 per cent to nearly 83,000. The number of car parking spaces has grown the most at Perth Airport (157.2 per cent), while the smallest growth occurred at Melbourne Airport (32.9 per cent).

Growth in throughput of the car parks has been more modest. The total number of car trips across the monitored airports increased by 18.1 percent over the past decade to nearly 12 million in 2016–17. Throughput growth was highest at Sydney (40.3 per cent), while Melbourne actually saw its throughput decline by 4.8 per cent.

Some of the investment made by the airports represents part of their broader programs to improve terminal services and streamline traffic flow within the airports. For example, Melbourne Airport has built a new multi-level facility near the new T4 terminal, which provides integrated transport services including car parking. This is complemented by significant works to streamline the road network within the airport.

5.3. The regulatory regime with respect to car parking services

5.3.1. The effectiveness of the current regulatory regime

Similar to aeronautical services, airports do not face price regulation in relation to their car parking operations. Instead, the ACCC has been directed by the government to monitor airport car parking prices, costs and profits as part of the monitoring regime.

There are a couple of reasons why monitoring could potentially be more effective in constraining airports from exercising market power in relation to car parking than it is for aeronautical services.

Unlike for aeronautical services, car parking services are provided directly to the consumer. This means that there is much greater potential for strong public interest, with car parking prices and profits typically receiving most of the media attention associated from the monitoring reports. .

Monitoring may be somewhat more effective in relation to car parking is because people have some degree of choice of how they get to or from the airport. Media exposure of high car parking prices may therefore encourage people to give greater consideration to other transport modes instead of parking at the airport. For this reason, the ACCC explored the potential savings for people choosing to park at one of the independent car park operators located nearby each airport in its 2016–17 monitoring report.

A possible indication of the influence of the monitoring of car parking occurred in early 2018 when Melbourne Airport announced a reduction in its car parking prices just prior to the release of the last monitoring report.⁹²

Despite this, the four monitored airports have continued to generate high profit margins from car parking services, which suggests that the monitoring regime does not provide an effective constraint on the ability for the major airports to exercise their market power. This may be because there is not an ideal regulatory solution (see section 5.3.2) even if a government wanted to act.

As with aeronautical services, it is clear that airports possess market power in the provision of car parking services, but it is difficult to determine the extent to which this occurs. Car parking information collected for the ACCC monitoring report is less detailed than what is collected for aeronautical services. For example, asset values are not provided for car parking services, although it is noted that there are challenges with providing information at this level of detail. Furthermore, monitoring does not provide conclusive evidence about whether airports are earning monopoly rents. It is also difficult for the ACCC to determine conclusively whether adequate investment is undertaken and airports are not inefficiently delaying investment. This issue has been raised in previous monitoring reports as well as in the ACCC's submission to the 2011 Productivity Commission inquiry.

5.3.2. Options for a more effective car parking regulatory regime

There are a number of regulatory solutions that could be considered to address concerns about airport market power in car parking, but each of them has potential constraints.

Unlike for aeronautical services, a regulatory solution based on a negotiate/arbitrate regime would likely not work for car parking because it would not be possible for individual motorists to enter into negotiations with the airport over parking prices.

A price cap limiting increases in prices could be implemented using the price notification regime under Part VIIA of the CCA. However, this is unlikely to be workable because of the wide range of prices and services offered by an airport. Prices paid will depend on the motorist's choice of car parking product (e.g. at terminal or at distance, valet), duration, time of day, whether the parking was booked online, and if so, how far in advance the booking took place. Airports have a certain degree of efficiency in setting their prices to reflect these dynamics. A price cap may also limit airports from restructuring prices regularly between different car parking products, which can assist with managing demand for limited forecourt space. However under the Part VIIA price notification regime, any proposed increases to the price of a product or price-setting for a new product will trigger the need to notify the ACCC for an assessment.

⁹² Gardiner, E., 'Melbourne Airport slashes terminal parking fees by up to 20 per cent', *Herald-Sun*, 26 February 2018.

A revenue cap on car parking could also be considered. However, limits would need to be sufficiently flexible to not only enable the airport to collect more revenue in response to new car parking infrastructure, but also incentivise investment when necessary. For example, if revenue did not reflect the value of car parking land, there would be the risk that airports may be incentivised to reallocate land to other uses. Similar to price caps, a revenue cap represents a relatively strong form of regulation, which is unlikely to be warranted at this stage given the presence of alternative transport modes at airports.

It is worth considering whether the airports' market power in car parking could instead be addressed by supporting competition from other transport modes. For example:

- Recourse to arbitration could be provided to landside access seekers if they could not agree to appropriate terms and conditions with the airport. However, this would still have significant challenges given that, unlike airlines, independent car park operators are unlikely to have adequate resources to negotiate with airports.
- A price notification regime could be introduced to help ensure that alternative transport operators could access the airport on reasonable terms and/or prices.

Both of these options are examined further in the following section. However, it is unclear whether any reduction in access charges for transport modes (including off-site car parking operators) would materially reduce the market power of airports in car parking.

Given these factors, the ACCC supports the continued monitoring of car parking services. This monitoring could include some improvements to the information collected, including more detailed data about expenses (for example distinguishing between the costs of providing short and long-term parking). A new ability to create record-keeping rules for airports may assist in this regard (see section 4.4.1).

The ACCC's monitoring could also continue to highlight alternative transport modes that offer some competition to airport car parking. The ACCC can also use its competition law powers under Part IV of the CCA should the airports act in a way towards alternative transport operators that substantially lessens competition.

Recommendation 6:

The ACCC should continue to monitor car parking services and inform consumers of the range of alternatives for getting to and from the airport. This monitoring would be supported by the ability for the ACCC to make record-keeping rules.

6. Landside access services

6.1. Airport market power in the supply of landside access services

Airports are responsible for providing landside access services. These services relate to the pick-up, drop-off and waiting areas required by taxis, independent car park operators and other transport modes as well as the road network within airport precincts that facilitate vehicle movements to and from those areas.

The major airports possess monopoly power in the provision of landside services and it would be very difficult for each transport mode to operate effectively without dedicated access to facilities. Furthermore, the airports also compete to some degree with the transport operators through the supply of the airports' own car parking operations.

The combination of market power and vertical integration creates a significant risk that the airports will charge monopoly prices and/or provide substandard facilities (e.g. location, signage). Businesses that require landside access do not have countervailing power to negotiate reasonable terms and prices.

6.2. Performance of the major airports in providing landside access services

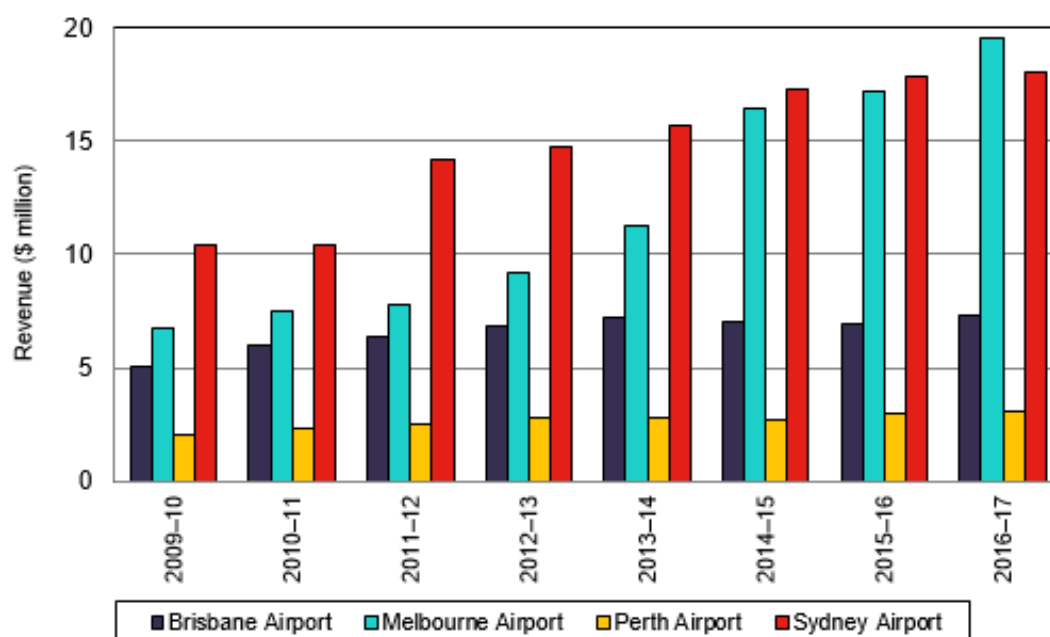
Concerns that airports are using their market power in relation to landside access services have grown over recent years with significant increases in both prices and revenue.

Demand for landside access from transport modes has increased significantly since the ACCC started monitoring these services in 2009–10, with a smaller proportion of people choosing to park at the airports. Across the four monitored airports, passengers have increased by 27 per cent over the seven year period to 2016–17, while car park throughput only grew 21 per cent. The take-up of Uber and other ride-share services has resulted in a significant shift in transport behaviour and the need for dedicated pick-up and drop-off zones in each of the airport's forecourt areas.

Over that period, there have also been significant increases in revenue generated from landside access fees. In 2016–17, the four monitored airports earned a combined \$47.9 million in revenue from landside access, up 97 per cent in real terms since 2009–10. Most notably, Melbourne Airport increased its landside revenues by 188 per cent over this period, while Sydney Airport increased its revenues by 74 per cent.

Figure 6.1 shows total landside revenue collected at each of the monitored airports in each year since the ACCC began collecting this information in 2009–10.

Figure 6.1 Total revenue for landside services in real terms – Brisbane, Melbourne, Perth and Sydney: 2009–10 to 2016–17



Source: ACCC, *Airport Monitoring Report 2016–17*

Note: Excludes revenue from car rental operators.

Aside from growth in the number of vehicles demanding landside access, increased access charges have also contributed to increased revenue. For example, taxis at Melbourne Airport are paying over 130 percent more in real terms per pick-up than they did in 2009–10 (\$3.60 compared to \$1.50 in 2009–10), while private cars and ride-share services paid \$4.00 and \$4.40 per pick-up in 2016–17 respectively. These charges are likely passed directly to the consumer.

While Perth Airport is the only airport that does not currently charge buses (including those run by off-airport car parking operators) for access, fees imposed on private cars have increased by 75 per cent (in real terms) since 2009–10.

The ACCC received a number of complaints in 2018 about airport access charges for landside transport operators including hire cars (i.e. limousines) and car rental providers. In particular, the ACCC received complaints from hire car operators about both the magnitude of increases in the fees charged by Sydney Airport and the nature of the airport’s contract terms.

6.3. The regulatory regime with respect to landside access services

6.3.1. The effectiveness of the current regulatory regime

There is currently no regulatory regime in place for landside services. Although the ACCC Airport Monitoring Report has been presenting some information on landside services every year since 2009–10, there is no formal direction in place to do so, which means that information is provided by the four monitored airports on a voluntary basis. This is different from aeronautical services and car parking, where the government has specifically directed the ACCC to monitor these services at the monitored airports.

This has implications for the level of information we seek from the airports and how much attention it is given in the report. This could in turn influence how much of a threat the

monitored airports feel from direct regulation should they take advantage of their market power in setting their access prices, terms and conditions.

Overall, it is difficult to determine the degree to which the increases in landside access charges reflect airports' market power, vertical integration incentives, or some elements of peak pricing for management of growing demand for limited forecourt space. In its 2002 report, the Productivity Commission noted that market power for landside access services was high, 'pricing access to ease congestion may be efficient, assuming the airport operator does not constrain artificially the availability of kerb-side roads'.

To address some of these concerns, the last Productivity Commission inquiry recommended that:

'The price monitored airports should be required to publish on their websites the general prices and terms and conditions of access for transport operators and provide this material to the Australian Competition and Consumer Commission as part of their reporting obligations for monitoring. This should not preclude airports and their customers from being able to agree to vary these general conditions to suit their particular circumstances.'

This recommendation was accepted by the government⁹³, and has resulted in the publication of comprehensive pricing information on the websites of the four monitored airports.

The ACCC faces similar issues with respect to information provision under the current monitoring regime. This has affected the consistency, comparability and interpretability of information that is received. For example, revenue information is mostly provided, but price and expense information is less consistent and asset values are not provided at all. Airports have previously advised that there are difficulties in allocating expenses and assets for landside access services. This means that the ACCC cannot report conclusively on profitability, or whether adequate investment is undertaken to ease congestion and justify changes in prices, terms and conditions.

The challenge in collecting information is also affected by other factors such as the low survey response rates from landside operators, and the difficulty in collecting comprehensive information on the full range of prices that each airport sets in the provision of landside services.

In addition to the monitoring regime, the ACCC has some existing tools for addressing certain behaviour by airports in relation to these services. These tools include provisions to protect small businesses from unfair contract terms⁹⁴, as well as anti-competitive conduct provisions under Part IV of the CCA if their behaviour leads to a substantial lessening of competition.

6.3.2. Options for a more effective regulatory regime

The ACCC considers that it is appropriate for the supply of landside access services by the monitored airports to continue to be monitored for the time being, rather than regulated. While rising prices and revenues are a growing concern, landside access revenue comprised of between 2 and 4 per cent of total revenue in 2016–17. This indicates that the scale of any problem related to landside access services is likely to be much smaller compared to aeronautical services (between 36 and 43 per cent of total revenue in 2016–17)

⁹³ Australian Government, *Australian Government Response to the Productivity Commission Inquiry into the Economic Regulation of Airport Services*, 30 March 2012.

⁹⁴ However, the ACCC has argued that these provisions have significant limitations and need to be strengthened to adequately protect small businesses. See ACCC, 'Major changes needed to get rid of unfair contract terms', media release, 31 August 2018.

or car parking services (between 9 and 14 per cent of total revenue in 2016–17). This makes it less likely that any stronger forms of regulation will result in a net benefit.

There are also ways to improve the monitoring of landside access services. As discussed above, a formal direction from the government for the ACCC to monitor landside services would enable the ACCC to seek further information from the airports. It would also show the airports that the government is somewhat concerned about this issue and will be watching for any reports of undesirable behaviour.

There are also ways to improve on the quality of information that is currently collected under the ACCC monitoring regime. For example, the ACCC could request more specific pricing data in relation to off-airport car park operators (e.g. prices charged to stop for 15 minutes) so that these prices can be monitored over time. Airports currently do not provide this data. While each airport has various and complex pricing structures depending on factors such as the length of time taken to drop-off/pick up, and which terminal, this should not affect their ability to publish this information on their website, or provide it to the ACCC.

As noted in the ACCC's submission to the 2011 Productivity Commission inquiry, the Master Plan process is another useful tool to ensure airports are planning for future car parking and landside access services that benefit competing modes of transport. As part of this process, meaningful consultation with landside access operators could improve transparency of investment and funding decisions.

If landside access prices continue to grow into the future, and therefore the possible harm of airport market power in this area, the government may wish to consider stronger regulatory oversight. One option would be to subject the landside access services of the major airports to the price notification regime under Part VIIA of the *Competition and Consumer Act 2010*. This would require the airports to notify the ACCC of any proposed increase in prices. The ACCC would then conduct an assessment as to whether the price increases are reasonable. The ACCC decision is not binding, however companies do not typically proceed with the price increase if the ACCC has objected. This tool is already used to regulate Airservices Australia and regional air services operating at Sydney Airport.

Recommendation 7:

The consideration of landside access issues could be improved by the Australian Government formally directing the ACCC to monitor landside access services.

7. Protection of regional air services at Sydney Airport

Regional air services provided at Sydney Airport are declared under Declaration No 94 (under the CCA) and are therefore subject to price regulation by the ACCC under the price notification regime under Part VIIA of the CCA.⁹⁵

Sydney Airport is required to notify the ACCC of any proposed increase in price to this service. The ACCC must then determine whether it objects to the proposal. While this decision is not binding, it is very rare for a company to proceed with a price increase if the ACCC has objected. Sydney Airport has always acted in accordance with the ACCC's decisions.

In the terms of reference for the current inquiry, the Australian Government stated its commitment to maintaining access to Sydney Airport for regional communities. Instead of seeking views on the merits of the applicability of the price notification regime to regional services at Sydney Airport, the government asked the Productivity Commission to look at any unintended consequences of the arrangements.

It is likely that the price notification regime has helped to achieve the government objective in relation to regional air services. Prices for regional air services have remained constant in nominal terms, and therefore fallen in real terms by 31 per cent since 2001.⁹⁶ This compares with a real increase in average aeronautical revenue per passenger of 34 per cent since 2001–02 across the airport as a whole. As a result the differential in airport charges for regional air services and regular air services has substantially widened over time.

As discussed in chapter 3 of this submission, the ACCC considers that regulatory oversight is necessary to constrain the ability of a major airport like Sydney Airport to exercise its market power. However, applying regulatory control to only part of the services at the airport is likely to have efficiency implications, particularly given that Sydney Airport is capacity-constrained.

The ACCC therefore considers that when evaluating the appropriateness of the measures implemented to protect regional air services, in addition to their effectiveness in achieving the government's policy objective, the impact of these measures on the efficient use of airport capacity should also be considered.

⁹⁵ The Declaration took effect on 1 July 2016 and ceases on 30 June 2019. It replaces Declaration No 93 of 27 May 2013.

⁹⁶ Sydney Airport notified a proposed price increase in 2010. The ACCC decided to object to the proposed increases. The ACCC's decision is available on its website.

8. Operational restrictions at Sydney Airport

Sydney Airport faces a number of operational restrictions imposed by the government, which are intended to limit the impact of aircraft noise.

Sydney Airport is one of four airports in Australia (along with Adelaide, Gold Coast and Essendon), and the only one among the monitored airports, with a curfew on aircraft operations. It is also the only Australian airport with a cap on aircraft movements.

In particular, the *Sydney Airport Curfew Act 1995* prohibits all aircraft from taking off or landing at Sydney Airport during the curfew period between 11pm and 6am. Under the *Sydney Airport Demand Management Act 1997* (Cth), Sydney Airport also has a maximum movement limit of 80 aircraft movements (take-offs or landings) per hour.

These restrictions have likely contributed to the challenge of congestion at Sydney. This challenge is expected to continue to grow with the airport forecasting passenger numbers to double between now and 2033.⁹⁷

Capacity challenges at Sydney Airport can have significant implications for investment decisions. They were likely a key reason for the New South Wales and Federal governments to commit \$5.3 billion in equity to the construction of Western Sydney Airport.

The ACCC therefore considers that the operational restrictions should be reviewed periodically to ensure they remain appropriate and do not impact unnecessarily on the ability for airports to operate efficiently. Such reviews would be particularly useful given technological advances that have significantly reduced the level of noise emitted from aircraft.

Recommendation 8:

Operational restrictions that apply to Sydney Airport, such as the hourly aircraft movement caps, should be reviewed periodically to ensure they remain appropriate, so as to reflect technological advances that reduce aircraft noise. This would provide policy makers with opportunities to consider whether the operational restrictions are fit-for-purpose in balancing all relevant policy objectives, including operating efficiency and noise management.

⁹⁷ Sydney Airport, *Master Plan 2033*, pp. 12–13.

9. The supply of jet fuel

The lack of competition in the supply of jet fuel likely results in airlines paying excessive prices for a key cost input. However, the complexity of the problem means that there is not an obvious solution.

Jet fuel is a key cost input for airlines, often representing over 40 per cent of an airline's operating costs. The Board of Airline Representatives of Australia (BARA) said in 2014 that its members—international airlines—purchase over \$4 billion of jet fuel annually.⁹⁸

The lack of competition in jet fuel is well recognised. The National Competition Council (NCC) stated in 2012 that the market associated with the supply of jet fuel at Sydney Airport was not effectively competitive.⁹⁹ The Competition Policy ('Harper') Review final report from 2015 said that competition in jet fuel should be a focus of reform efforts in the aviation sector.¹⁰⁰

BARA said in 2014 that there were three suppliers of jet fuel at Brisbane Airport and two suppliers at Sydney and Melbourne airports. There was only a single supplier at Perth Airport.

In addition to competition concerns, there have also been issues related to the availability and reliability of supply of jet fuel. Due to shortages in the supply of jet fuel, there were a number of instances of fuel rationing at Melbourne Airport during 2015 and 2016. At Sydney Airport, the NCC found that airlines generally received only one or two bids to an invitation to tender for the supply of jet fuel because of supply and capacity constraints.¹⁰¹

The lack of competition is due to a number of bottlenecks along the jet fuel supply chain. The key elements of the supply chain are:

- *Off-airport jet fuel storage facilities*

Importers of jet fuel require off-airport storage tanks to allow the fuel to settle and be tested before it is transferred to the airport. The storage tanks are typically owned and operated by the existing suppliers of jet fuel.

- *Transferring the jet fuel to the airport*

Jet fuel is most effectively delivered to airports via dedicated pipelines. Pipelines are very expensive to build and existing pipelines are owned and controlled by individual companies or joint ventures of companies that supply jet fuel at the airport. Jet fuel is increasingly being transferred to airports by trucks given capacity constraints with the pipelines.

- *Airport storage and distribution*

At the airport, there is a need for both storage and infrastructure for supplying the fuel to the aircraft. This infrastructure—known as the joint user hydrant installation (JUHI)—is typically operated by a joint venture of companies supplying the jet fuel. These companies invest in and operate the infrastructure under lease from the airport.

While it may be possible that a new entrant may be able to overcome the challenges associated with any one of these elements of the supply chain, the need to have appropriate access at all three makes it very difficult for a company to enter the market. This provides

⁹⁸ Board of Airline Representatives of Australia (BARA), *A competitive supply of jet fuel at Australia's major international airports*, December 2014, p. 3.

⁹⁹ National Competition Council, *Jet fuel supply infrastructure at Sydney Airport: Final recommendations*, 2012, p. 25.

¹⁰⁰ Australian Government, *Competition Policy Review Final report*, 2015, p. 206

¹⁰¹ National Competition Council, *Jet fuel supply infrastructure at Sydney Airport: Final recommendations*, 2012, p. 25.

the existing suppliers of jet fuel with significant market power. It also means that there is unlikely to be a simple solution to the problem.

BARA explored one solution in 2011 when it sought declaration of jet fuel supply infrastructure services at Sydney Airport under the National Access Regime. However, the Minister accepted the recommendation of the NCC that both the pipeline and JUHI services should not be declared. The NCC considered that capacity issues with the facilities meant that declaration would not increase competition.

Since that time, BARA has suggested other solutions. These have included the Australian Government deeming jet fuel services to be declared under the National Access Regime, airport procurement of competing facilities, and airports using the expiry of JUHI leases to implement open access arrangements.

The Productivity Commission could consider all options. In doing so, it will also need to balance the need for more competitive pricing with the need to encourage further investment in facilities. The ACCC understands that new leases have been secured with JUHI operators, but it is not clear whether these have led to more competitive arrangements. There may also be a role for government given the importance of the availability of reliable and competitive supply of jet fuel for tourism and the broader economy.

Some of the issues with the supply of jet fuel at airports are the result of legacy matters. The Australian Government should ensure that it avoids some of these challenges as it constructs the new airport at Western Sydney. This includes setting aside land for a future jet fuel pipeline, as well as implementing appropriate open access arrangements at the JUHI facilities.

Recommendation 9:

The Australian Government could take action to promote competition in the future supply of jet fuel at the new airport in Western Sydney. This includes setting aside land for a future jet fuel pipeline and implementing appropriate open access arrangements at the joint user hydrant installation (JUHI) facilities.