March 2001

Submission to the Productivity Commission from Adelaide Airport Limited

Inquiry into Price Regulation of Airport Services

Response to Issues Paper

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Executive Summary

The principal issue to be considered by the Productivity Commission is whether aeronautical services should continue to be subject to price regulation. For Adelaide Airport Limited (AAL), this rests on whether AAL commands market power and the extent to which AAL is able to abuse that market power.

Adelaide Airport submits that despite an apparent monopoly position as the only airport for international and interstate air travellers to and from Adelaide, AAL should not be subject to specific price regulation because:

- For a significant product market (international arrivals and departures) Adelaide Airport competes against other mainland capital city airports and this places a competitive constraint on AAL's ability to vary aeronautical charges. Adelaide Airport has only a 1.6 percent share of this market compared to 15.6 percent at Brisbane Airport and 10 percent at Perth Airport (Chapter 2 of this submission).

- Adelaide Airport Limited is not able to abuse any market power that it may have in the domestic market as AAL's main customers, Qantas and Ansett, hold significant countervailing market power. Put simply, Qantas and Ansett are much more important for Adelaide Airport than Adelaide Airport is for Qantas and Ansett. This unequal bargaining power means that AAL has no ability to extract 'economic rents' from airlines (Chapter 2).

- Despite the fact that airport regulation is designed to protect the travelling public, aeronautical charges are not a material component of ticket prices paid by passengers, so the effect on consumer welfare of these charges is insignificant and probably less than the transaction costs involved in administering the regulation. Furthermore, savings that have been achieved via regulation have not been passed on by the airlines to the end-consumer. In contrast, charges levied by Air Services Australia and Australian customs (over which AAL has no control) are a much greater burden on travellers. The most significant influence over consumer welfare, however, is ticket prices charged by the major airlines. The entry of Virgin Blue and Impulse into the domestic airline industry, if they succeed, will lead to substantial improvements in consumer welfare many orders of magnitude greater than the effects of regulating airport charges. In fact, fares have fallen by up to 50 percent on Adelaide routes where new competition has been introduced; namely Adelaide-Sydney and Adelaide-Brisbane (Chapter 3).

- Even if Adelaide Airport Limited did possess market power, conduct by firms with market power is already regulated by the *Trade Practices Act (1974)* (TPA), most notably Part IIIA (which provides for third party access to essential services in certain circumstances) and s.46, which prohibits the misuse of market power. Only in very special circumstances are the general provisions of the TPA inadequate to regulate the conduct of firms with market power and these circumstances certainly do not apply to Adelaide Airport (Chapter 4).

- Finally, prices regulation along with the monitoring of non-aeronautical prices and the requirements for approval of Necessary New Investment proposals impose an unnecessary, expensive, and cumbersome administrative and regulatory burden on AAL (Chapter 5).

Chapter One

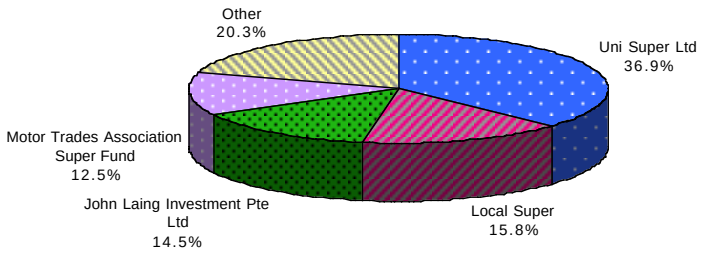
Introduction

1.1 Background

Adelaide Airport is owned and operated by Adelaide Airport Limited (AAL), which took over its operation from the Federal Airports Corporation (FAC) in May 1998 during the Governments sale of the Phase II airports. AAL paid $362 million for a 50-year lease (with an option for a further 49 years) of Adelaide Airport and Parafield Airport. AAL is made up of four key shareholders, three of which are Australian super funds (Figure 1).

Figure 1

KEY SHAREHOLDERS IN ADELAIDE AIRPORT LIMITED



Source: Adelaide Airport Limited, *Annual Report 1999-00*.

Adelaide Airport is the fourth largest domestic airport, but only the sixth largest international airport in Australia. It handled over 4 million passengers in the 1999-00 financial year. A comparative growth rate in passenger throughput at the major airports is provided in the table below.

Table 1

AIRPORT GROWTH AT CAPITAL CITY AIRPORTS SINCE PRIVATISATION

Airport	1997/98	1999-00	97/98 to 99/00 Percentage Growth
Sydney	20,975,038	23,036,892	9.83%
Melbourne	13,759,990	15,119,800	9.88%
Brisbane	9,701,611	10,528,904	8.53%
Perth	4,618,510	4,880,939	5.68%
Adelaide	3,937,230	4,284,920	8.83%
Darwin	1,010,197	1,056,247	4.56%
Canberra	1,820,573	1,968,690	8.14%
Hobart	850,942	908,647	6.78%

Source: Austats and Adelaide Airport Limited.

Since taking over operations of Adelaide Airport, AAL made a net loss before tax of $13 million in 1998-99, and a net loss before tax of $6.9 million in 1999-00. Whilst AAL's financial performance has been improving, it is yet to earn a profit and is yet to make a "reasonable rate of return" on capital invested.[1]

The current regulatory regime results in significant compliance costs, including administration, numerous liaisons with regulators and the preparation of submissions, accounts, or proposals for consideration by the ACCC. AAL estimates that compliance and administrative costs associated with airport regulation are approximately $50,000 per annum.

This review is both timely and important as the Productivity Commission has the potential to recommend changes that remedy the unnecessary costs and burdens imposed on AAL, which are associated with the current regulatory oversight of aeronautical services.

1.2 Price regulation of airport services

Australia's 'core regulated' airports are currently subject to prices regulation under the *Prices Surveillance Act (1983)* (PSA). The eleven privatised core regulated airports are those airports with significant 'regular passenger traffic' and include the three Phase I airports (Brisbane, Melbourne and Perth) and eight of the Phase II airports (Adelaide, Alice Springs, Canberra, Coolangatta, Darwin, Hobart, Launceston and Townsville). Price regulation for these airports under the PSA comprises a CPI-X price cap on 'declared aeronautical services', prices monitoring of 'aeronautical related services', and special provisions for necessary new investment at airports.

In practice, the majority of AAL's revenue from regulated aeronautical services comes from a charge based on the tonnage of landed aircraft, a terminal charge for international passengers, and a charge per passenger fees for baggage and security screening.[2] In the future, Adelaide Airport will also receive money from the regulated Passenger Facilities Charge (PFC) to pay for the capital cost and the incremental operational costs of the new Multi-User International Terminal (MUIT).

It is interesting to note that while Sydney Airport dominates airport services in Australia (see Table 1 above) it is not subject to the same price controls or regulatory system, which governs aeronautical services at the privatised airports. Yet, in many ways, the regulatory regime appears to be aimed at regulating market power issues that only arise at Sydney airport, such as congestion, capacity constraints, and excess demand.

1.3 Objectives of price regulation

The Department of Transport and Regional Development outlined the intentions of price regulation arrangements for airports at the time the measures were being implemented:

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[1] Adelaide Airport Limited, *Annual Report 1999-00*.

[2] There are other fees which airports levy on airlines — for example, parking charges — but these are very small relative to the revenue raised from the landing charge. The fee for security screening is mandatory and does not allow AAL to recover the full cost of providing that service, particularly administration costs.

"Pricing oversight arrangements are intended to promote operation of airports in as an efficient and commercial a manner as possible … The arrangements should also aim to protect airport users from any potential abuse of market power by airport operators. Market power stems from the fact that airports have natural monopoly characteristics".[3]

Prices regulation is based on the assumption that airports are monopolies, and thus have market power. Following the privatisation of airports, it was suggested that the ability of airports to exploit market power through excessive pricing could create sub-optimal market outcomes. Consequently, prices regulation was introduced to restrain excessive prices.

1.4 Review of price regulation

At the time these price regulation measures were introduced, the Commonwealth Government outlined a review of such arrangements after a period of 5 years:

"**The review will be based on the premise that the price cap applied to aeronautical charges during the first five years will no longer operate**. In its place, the review will aim to develop arrangements targeted at those charges where the airport operator has most potential to abuse market power… Beyond the central issue of market power, it is not intended that the review place further obligations on airport operators in respect of pricing".[4]

The principal concern of this review is determining whether airports should be subject to continued price regulation at all. This in turn rests on whether AAL commands market power and to what extent AAL is able to abuse this market power through excessive pricing.

[3] Department of Transport and Regional Development (1996), *Pricing Policy Paper*, p. 1.

[4] Ibid, p. 8.

Chapter Two

Market Power

AAL accepts that to a degree, AAL's geographical location grants it some potential market power, at least in relation to domestic and regional air services. The 1.2 million residents of Adelaide have few other choices of transport mode to travel to or from Adelaide, unless they are prepared to use road or rail. However, the relevant issue for consideration by the Productivity Commission is the degree to which AAL is capable of abusing this potential market power. AAL submits that it has no scope to misuse its potential market power.

Qantas and Ansett currently dominate the domestic airline market in Australia. This dominance is even more pronounced for Adelaide as Virgin Blue provides only a very limited service to/from Adelaide and Impulse does not currently service Adelaide. International travel to and from Adelaide Airport also tends to be dominated by Qantas and Ansett, directly or indirectly though alliances with other airlines, such as Star and Oneworld. Qantas and Ansett accounted for nearly 90 percent of AAL's total passenger throughput for the 1999/00 financial year and above 90 percent if airline alliances and partners are taken into account.

Airlines command an advantage over AAL, in terms of bargaining power, which allows them to largely dictate commercial negotiations. In essence, airlines have sufficient countervailing market power to negate any market power that AAL might possess.

2.1 The Market for Airline Services in Adelaide

In the context of a firm with market power, the relevant market is often defined as the smallest area over which a monopolist (or monopsonist) could exercise a significant degree of market power.[5] The process of establishing the market boundaries starts with the product, geographic and functional areas of supply covered by the firm and is extended to include all those sources, and potential sources, of close substitutes, which limit the exercise of a significant degree of market power.

In relation to the provision of an airport service, it is important to determine the relevant geographic dimension of the market. The ACCC has outlined a number of factors important in determining this:

- the convenience to customers of accessing alternative sources of supply;
- the costs of switching to alternative sources of supply; and
- the costs of transportation or access to the alternative sources of supply.[6]

In the case of Adelaide Airport, there are two distinct markets in which AAL competes: the domestic/regional market, and the international market. AAL also has a general aviation market but it should be noted that there are a number of general aviation airfields in and around Adelaide, thus ensuring that AAL has no monopoly power in regards to this market.

[5] ACCC (1999), *Merger Guidelines*, p. 33.
[6] Ibid, p. 37.

Domestic market

Adelaide Airport is primarily a domestic facility, with approximately 94 percent of passengers travelling domestically or regionally. Interstate travel to Melbourne, Sydney, Brisbane and Perth accounts for 87 percent of the domestic traffic, with the Melbourne and Sydney routes accounting for approximately 60 percent. Reflecting the airport's role as a hub for regional flights within South Australia and for flights between Australia's eastern seaboard and Western Australia, approximately 15 percent of domestic passengers are transit passengers and the remaining 85 percent are origin and destination passengers.[7]

The structure of the airline market in Adelaide is quite different to many capital cities in eastern Australia as the Adelaide market is serviced almost entirely by Qantas and Ansett, whereas major airports in eastern States are serviced by two additional domestic carriers — Impulse and Virgin Blue (see Table 2 below).

Table 2

CURRENT DOMESTIC AIRLINE SERVICE, BY CAPITAL CITY[a]

Capital city	Airline			
	Qantas	Ansett	Impulse	Virgin Blue
Adelaide	✈	✈		✈
Brisbane	✈	✈	✈	✈
Canberra	✈	✈	✈	
Darwin	✈	✈		
Hobart	✈	✈	✈	
Melbourne	✈	✈	✈	✈
Perth	✈	✈		
Sydney	✈	✈	✈	✈

[a] Airlines which currently provide domestic service to each capital city (at March 2001).

Source: The Allen Consulting Group.

Impulse has indicated it has no immediate plans to service the Adelaide market. Virgin Blue does offer a service to Adelaide — approximately 35 flights a week from Sydney and Brisbane — but this service has only recently commenced and is still very limited compared to Qantas and Ansett. Consequently, Qantas and Ansett dominate air services to and from Adelaide and constitute the majority of aeronautical revenue for AAL (see section 2.2). It should also be noted that all except one of the regional airlines operating in South Australia are currently owned by, or allied to, either Qantas or Ansett.

International market

In terms of international passengers for all Australian Airports, the five top airlines for the year ended June 2000 were:

- Qantas (25.5 percent);
- Air New Zealand (10.5 percent);

[7] Standard & Poor's (2000), *Analysis: Adelaide Airport Ltd.*, p. 4.

- Singapore Airlines (10.1 percent);
- Malaysia Airlines (5.9 percent); and
- British Airlines (4.7 percent).

Given that Qantas and British Airways form part of Oneworld airline alliance, and Air New Zealand and Singapore Airlines form part of the Star alliance, then it is fair to say that the transportation of international passengers is dominated by two airline alliances made up of Qantas and the owners of Ansett (Air New Zealand and Singapore Airlines).

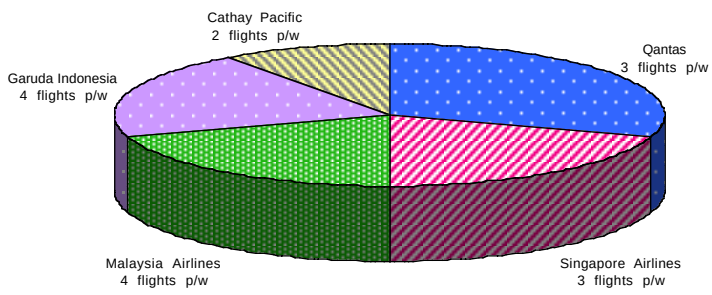
For Adelaide Airport, market concentration for direct international flights is slightly less pronounced. Of the 16 international flights per week to Adelaide, Qantas provide three and the remainder are provided by four other carriers — Singapore Airlines, Malaysia Airlines, Garuda Indonesia and Cathay Pacific (Figure 2).[8] As mentioned above, Singapore Airlines is aligned with Ansett via the Star alliance, and Cathay Pacific is aligned with Qantas via the Oneworld airline alliance. This leaves 8 flights per week being provided by airlines not aligned with Ansett or Qantas (Malaysia Airlines and Garuda Indonesia). If, as has been speculated, Malaysia Airlines aligns with Qantas and Oneworld, then this would reduce non-aligned flights to 4 international flights per week.

It should be acknowledged that domestic flights into and out of Adelaide are often a substitute for international flights. In fact, over 50 percent of all international traffic from Adelaide first travel domestically to Sydney, Melbourne or Brisbane before departing Australia (almost exclusively carried by Ansett and Qantas).

AAL has a strong commercial preference for direct international flights. However, the relative bargaining power of AAL compared to the carriers is reflected in the fact that Ansett and Qantas mainly use their domestic network to feed international passengers to and from Adelaide via another major airport.

Figure 2

INTERNATIONAL AIRLINE SERVICE TO ADELAIDE AIRPORT, BY MARKET SHARE[a]



[a] Airlines which currently provide international service to Adelaide Airport (at June 2000).

Source: Adelaide Airport Limited

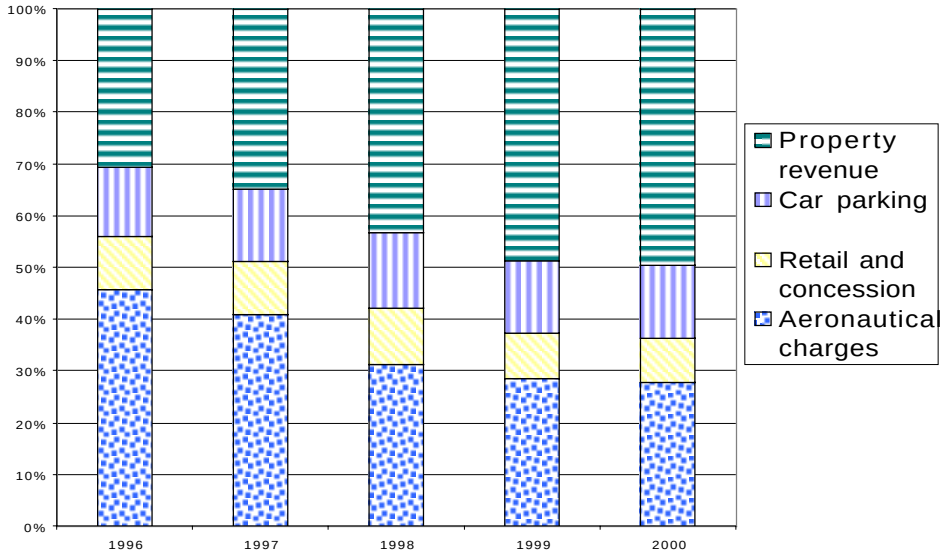
[8] Ibid, p. 6.

2.2 Adelaide Airport's Revenue Base

Adelaide Airport has a relatively diversified revenue base for which there has been a significant compositional change in recent years. AAL's reliance on property revenue has increased substantially since 1996, while there has been a corresponding decline in revenues from aeronautical charges over that time (Figure 3).

Figure 3

ADELAIDE AIRPORT LIMITED'S REVENUE MIX, 1996-2000[a,b]



a The figures for the year 2000 are estimates. b Property revenue figures include recharge property service costs.

Source: Adelaide Airport Limited.

However, despite the decline in the proportion of Adelaide Airport's revenue coming from aeronautical charges, this still comprised almost 30 percent of the airport's revenue base in 2000, and is expected to remain at about 20 percent of total revenue after fiscal 2003.[9] [10] In relation to aeronautical charges, Adelaide Airport relies heavily upon the two main domestic carriers, Qantas and Ansett, for much of its revenue from this source.

Qantas and Ansett alone, and their regional airlines, currently contribute about 75 percent of aeronautical revenues at Adelaide Airport (or approximately 23 percent of total current revenue). Further, total property income at Adelaide Airport made up almost half of the airport's entire revenue in 1999, of which about 50 percent was due to payments from Qantas and Ansett towards the domestic terminal leases. In total, more than half of AAL's total revenue is sourced from Qantas and Ansett.

[9] Ibid, p. 7.

[10] These figures do not include the revenue that will be raised via the introduction of the PFC to fund the new terminal, as this revenue is solely to fund the Multi-user International Terminal's (MUIT) capital cost.

Revenue raising opportunities depend, ultimately, on people moving through the terminal. The flow of passengers accounts for most of this and Qantas and Ansett are the dominant carriers. Therefore AAL's revenue is significantly influenced by decisions made by the airlines, as those decisions not only affect aeronautical revenue but also changes in passenger volumes impact on non-aeronautical revenue, eg car parking, retail and commercial concessions — especially in the proposed new terminal.

2.3 Airport Competition

Adelaide Airport faces fierce competition from other major city airports for direct international passengers (see Table 3 below). However, AAL has always struggled to attract new airline services as those services have traditionally gone to Sydney, Melbourne, Brisbane or Perth before consideration is given to Adelaide. Emirates is a recent example. In addition to their current services to Sydney and Melbourne it is now considering adding services to Perth or Brisbane but not Adelaide Airport. In fact, despite Adelaide Airport being a relatively under serviced airport, Emirates has expressed no short-term interest in serving the city.

It should also be noted that Adelaide remains the only major capital city without direct flights to Australia's largest overseas market, New Zealand. All New Zealand-bound passengers must transit via another Australian Airport.

Table 3

ADELAIDE AIRPORT'S COMPETITORS WITH SIMILAR POPULATIONS

Capital City	Population	Direct Asian & European flights per week	Population per Direct Flight
Adelaide	1.2 million	17	70,600
Perth	1.3 million	100	13,000
Brisbane	1.2 million	65	24,600

Source: Adelaide Airport Limited.

In the face of airport competition, coupled with the introduction of the passenger charge to fund the new MUIT, AAL will face strong downward pressure on airport charges if AAL wants to attract new airline services. This has led AAL to offer discounts on aeronautical services to new international and domestic carriers to diversify AAL's revenue base and to enhance passenger volumes. For example, discounts of between 20 and 50 percent on landing charges have been offered to new international airline services to operate at Adelaide Airport. This is a better outcome for the travelling public than that dictated by the price cap regime and it highlights that competitive pressure is sufficient to ensure AAL does not abuse any market power that it may theoretically possess.

It should also be noted that AAL competes for airfreight services. At present, more than 68 percent of airfreight from South Australia is trucked to Melbourne and Sydney Airports. This in part is due to the fact that Melbourne Airport is not subject to flight curfews whereas Adelaide Airport is only allowed to operate for 16 hours per day.[11] AAL needs to ensure appropriate infrastructure and accompanying charges are sufficiently competitive to attract South Australia's airfreight back to Adelaide Airport.

[11] See the *Adelaide Airport Curfew Act 2000* which came into effect on 27/8/00.

2.4 Countervailing Market Power of Airlines

Countervailing power exists where a supplier (or buyer) faces a buyer (or supplier) with market power or a credible threat of vertical integration (or other form of bypass) or direct importing. In such cases, the ability of the firm to increase (decrease) prices may be constrained.[12]

AAL's major customers, Qantas and Ansett, are much larger businesses than AAL, with Qantas having a market capitalisation of over $4.4 billion and Ansett with assets valued at over $3.6 billion. In contrast, AAL is a small organisation made up of a number of institutional superannuation investors and has net assets worth around $36 million. The ability for AAL to dictate negotiations to Qantas or Ansett is limited, particularly given the resources and strong negotiation skill base available to the airlines.

For example, negotiations between AAL and the airlines on relinquishing their domestic terminal leases and signing new leases for space in the proposed new Multi-User Integrated Terminal (MUIT) in Adelaide have yet to be finalised, despite several years of negotiations. As part of the negotiations for the MUIT, Qantas and Ansett have taken the opportunity to use their market power to lever out concessions on a wider range of unrelated matters.

This imbalance in regulatory power is exacerbated by the fact that the international airlines that service Adelaide are highly concentrated with significant cross ownership arrangements and airline alliances such as Star and Oneworld.

Furthermore, it is not in AAL's interest to try and abuse any theoretical market power that it may have as AAL's revenue is dependent on passengers and passenger throughput. This in turn is dependent on the airlines and their ability to grow passenger traffic. Therefore, AAL has a commercial imperative in satisfying the commercial needs of the airlines rather than creating an acrimonious commercial relationship.

However, it must be stated that the current regulatory system works against facilitating commercial solutions. The need to negotiate and reach commercial agreements is limited under the current system, as airlines are able to use the regulatory regime to enhance their market power. Commercial pressure can be brought to bear on AAL as negotiations are delayed while the airlines wait or lobby the regulator for an outcome that is in their favour. For example, the current criteria for the Necessary New Investment (NNI) regime afford one airline an effective right of veto on any new investment that may be necessary for other carriers. Currently, commercial negotiations on the Multi-User Integrated Terminal (MUIT) with all airlines need to be concluded even if one carrier has no interest in a competitor gaining additional necessary capacity. This gives the disinterested party the ability to try to extract a wide range of other concessions from the airport for totally unrelated issues in order to gain their approval for the new investment.

Finally it should be noted that, in contrast to other major airports, Adelaide Airport is small, does not have air space capacity constraints like Sydney, and has a greater reliance on aeronautical revenues than other airports. Thus it is suggested that price regulation of Australian airports should be considered on a case-by-case basis and for AAL regulation is unnecessary.

[12] Op cit, p. 51.

2.5 AAL's Ability to Increase Aeronautical Charges

The initial aeronautical charges that are used in the price cap were inherited by AAL from the Federal Airports Corporation (FAC); that is, the Government predetermined the charges prior to privatisation. Since the introduction of the price cap, charges at Adelaide Airport have been falling by CPI minus four percent each year.[13]

However, the basis on which the FAC (the Government) set the initial aeronautical charges was arbitrary and in no way reflected the true cost of providing aeronautical services at Adelaide Airport. As part of the FAC's move to location and service specific pricing prior to privatisation, the FAC's activity based costing model identified that cost recovery for aeronautical services at Adelaide Airport would require charges of $12 per tonne (in 1997/98 dollars and pre-GST). However, the FAC did not raise aeronautical charges to this level before privatisation and compared to AAL's current charges totalling $6.19 per landed tonne including GST, the FAC's estimate is nearly double the amount that is currently allowed by regulation.[14]

As mentioned before, AAL has yet to make a profit and mandated reductions in aeronautical charges that were artificially low to start with have contributed to AAL's poor financial performance.

Should aeronautical services be deregulated, it is not unreasonable to expect that AAL would try and reach an agreement with the airlines to move charges some way towards recovering the cost of providing those services. However, it is highly likely that the airlines would use their countervailing power to limit any attempt by AAL to increase charges, even if the basis for negotiation was AAL trying to obtain a 'reasonable rate of return' on its investment.

2.6 Why does AAL want Deregulation?

A logical question for the Productivity Commission to ask is what would AAL gain from deregulation if AAL has no or limited market power and hence no or limited ability to increase aeronautical charges through commercial negotiation?

In answering this question it should be noted again that the current regulatory oversight of airports imposes a number of restrictions and costs on AAL. These costs inhibit the genuine commercial development of Adelaide Airport.

Deregulation would allow AAL to operate and manage its business unfettered by unnecessary and cumbersome government oversight. It would eliminate a major obstacle to reaching competitive commercial agreements with the airlines and it would reduce the regulatory risk for both airports and airlines.

Furthermore, deregulation would allow AAL and airlines to pursue innovations and improvements to airport facilities and services to the travelling public, such as the new MUIT, without the hindrance or distraction of regulatory oversight.

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[13] Charges have been falling by CPI minus four percent on average. In practice though, charges were not reduced in 1999 but were adjusted in 2000 to bring them into line with an average reduction of CPI-X.

[14] Detailed spreadsheet modelling by the FAC can be provided to the Inquiry if necessary.

Also, it must be restated that prices regulation along with prices monitoring and the oversight of agreements for Necessary New Investment imposes a significant compliance cost on AAL. Prices oversight imposes an administrative burden on AAL and requires significant government resources to manage. The Productivity Commission should recommend that this unnecessary burden be removed.

Chapter Three

Current Charges and their Significance

Adelaide Airport has historically been a price-taker rather than a price-maker with respect to aeronautical charges. In part, this has reflected the airport's attempts to keep prices down in order to attract greater domestic and international traffic relative to the larger airports in the eastern seaboard cities including Melbourne and Sydney.

In comparison to other airports, Adelaide Airport's landing charges are the lowest charges across all Australian airports in terms of international passengers and the lowest in terms of domestic charges, with the exception of Sydney (Table 4 and see Appendix A for a more detail).[15] Compared to international standards, these charges are amongst the lowest in the world.

Table 4

AERONAUTICAL CHARGES PER TONNE, EFFECTIVE FROM 01/07/2000

City	Domestic	Variance to Adelaide	City	International	Variance to Adelaide
Adelaide	$5.05		Adelaide	$6.19	
Sydney	$3.20	-$1.85	Darwin	$7.17	$0.98
Perth	$5.45	$0.40	Perth	$7.50	$1.31
Melbourne	$5.72	$0.67	Brisbane	$8.77	$2.58
Brisbane	$5.77	$0.72	Melbourne	$9.89	$3.70
Darwin	$6.06	$1.01	Sydney	$11.87	$5.68

Source: Adelaide Airport Limited.

3.1 Factors Restraining Aeronautical Charges

Whilst aeronautical charges are not, if at all, a major factor in the choice of destination by airline passengers, they are a factor in an airline's consideration of airline operations and air routes, particularly international flights. Aeronautical charges for Adelaide in 1999-00 were $9.9 million. Any reduction in these charges that the airlines can obtain will directly translate to their improved financial performance. This is all the more important in a highly competitive environment with Impulse and Virgin Blue operating as discount domestic airlines.

[15] It should be noted though Sydney Airport has proposed a change to the basis on which their aeronautical charges are to be calculated. If accepted by the ACCC, Sydney's charges will almost double, thus leaving Adelaide Airport as the lowest cost airport in terms of aeronautical charges.

Demand for services at airports that have constrained access or enjoy strategic importance such as Sydney or Melbourne (and to a lesser extent Brisbane) is likely to be substantially more price inelastic compared to Adelaide Airport. Major airlines would need substantial disincentives not to fly to those destinations. However, Adelaide does not enjoy such advantages over Sydney or Melbourne and therefore needs to maintain low aeronautical charges relative to other airports so as to encourage the airlines to maintain and enhance passenger and aircraft volumes. This is important because profit will be driven by passenger volume rather than price changes as the majority of airport revenue (and the area for greatest potential growth) is non-aeronautical revenue, which in turn is driven by passenger volumes.

In fact, as part of the drive to increase business and passenger throughput, agreements have been reached with international airlines to land their international flights in Adelaide. Similarly, negotiations are being held with the new domestic airlines to introduce services to new destinations from Adelaide.

3.2 Materiality of Aeronautical Charges

The issue of whether or not Adelaide Airport has the potential to abuse market power must be considered in the light of whether aeronautical costs are material to the end consumer; that is, the travelling public.

The average cost of aeronautical charges per passenger trip to and from Adelaide Airport during 1999-00 was approximately $2.70. Based on current airfares for the more frequently travelled routes, namely Adelaide-Sydney and Adelaide-Melbourne, aeronautical charges (if fully passed through to the travelling public)[16] represent around 2-3 percent of a domestic airline ticket and less than 1 percent of international tickets.

By way of contrast, charges levied by Air Services Australia (ASA) are almost twice the level of charges set by AAL. So whilst the Government, via the Productivity Commission, reviews price regulation of airport services, it is interesting to note that charges levied on behalf of the Government owned Air Services Australia impose a much higher burden on airlines and the public.

The current methodology used to allocate ASA's costs is not transparent, largely arbitrary and varies significantly from airport to airport (they use location-specific pricing). For AAL, ASA charges are twice as high as Brisbane and nearly three times as high as Melbourne. Further, whenever ASA lowers the charges, the cost disadvantage faced by AAL increases as the differential between other airports increases in relative terms. Also, AAL does not receive any rent or income to compensate for the land that ASA occupy at the Airport site. Thus the incidence of ASA's charges falls particularly heavily on AAL.

It should also be noted that customs charges on international passengers (departure taxes) are $30 per passenger and approximately 5 times more than the proposed domestic passenger facilities charge for the new terminal.[17] Furthermore, AAL is not allowed to collect revenue for the provision of accommodation for customs' offices. The Productivity Commission should consider the relativity of the various charges and consider the impact that unregulated charges have on consumer welfare.

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[16] That is, an assumption that the price elasticity for aeronautical services is zero. This is an assumption which is likely to overestimate the pass through to passengers.

[17] These charges can be quickly and arbitrarily changed as is evidenced by the recent proposal to increase the charge to address the foot and mouth epidemic.

3.3 Impact of Price Regulation on Aeronautical Charges

In total, the ACCC has claimed that price regulation is expected to reduce the real price for aeronautical services by between 4 and 22 percent over five years.[18] Given that aeronautical charges represent less than 3 percent of the total domestic ticket price, price regulation is expected to lead to reductions of around 0.12 percent to 0.66 percent over the initial five-year regulatory period. The relevance of this is that, even at the high-end, (for example, a 22 percent reduction in charges), the regulatory regime will have an almost negligible impact on prices paid by the end consumers and the travelling public.

However, this assumes that savings generated by capping aeronautical charges are passed on to customers. In fact, this is rarely if ever the case. For example, when Qantas and Ansett eventually move from the current terminal at Adelaide Airport to the new terminal, they will save a substantial amount per year in direct lease and associated costs. There has been no statement or evidence from the airlines that they intend to pass any of this saving on to customers. In contrast, the airlines have insisted that the new passenger charge to fund the capital expenditure of the terminal must appear separately on the airline ticket. So whilst airlines want customers to know exactly how much the new terminal is costing, they do not want to advise or pass on their own savings.

In contrast to the impact of price capping, the introduction of new competition between airlines — particularly for domestic air routes — has led to significant price reductions for air tickets. As part of its monitoring activities, the ACCC and the former Prices Surveillance Authority concluded that average airfares for domestic air travel fell by around 20 percent between 1990 and 1996, and where Qantas and Ansett faced direct competition with former domestic airline Compass, airfares were around 32 percent below pre-deregulation levels in December 1991.[19]

Most recently, Impulse and Virgin Blue have introduced discount domestic air services to and from most major capital cities. For Adelaide, since Virgin Blue started flying between Adelaide-Sydney and Adelaide-Brisbane prices for those services have fallen dramatically (see Appendix B). By way of example, Qantas's cheapest 21-day advance purchase tickets are now 44 percent cheaper than those on offer before Virgin Blue started to fly to Adelaide. Virgin Blue's fully flexible (full economy) fares cost only around 50 percent of the Qantas equivalent full economy, fully flexible fare. These reductions far exceed the benefit associated with aeronautical price caps.

Thus, whilst price regulation requires administration by the ACCC, and potentially periodic regular review by organisations like the Productivity Commission, and results in significant compliance cost and regulatory burden on the Adelaide Airport, it ultimately only impacts on less than 1-3 percent of the cost of airline ticket prices. The potential impact of regulation is clearly not material, especially given the relatively high compliance and administrative costs associated with the regime.

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[18] ACCC (March 2000) *Aviation*, taken from ACCC's web site at www.accc.gov.au.

[19] ACCC (March 2000) *Aviation*, taken from ACCC's web site at www.accc.gov.au.

Chapter Four

Existing Price Regulation Arrangements

AAL believes that regulatory oversight via the *Prices Surveillance Act 1983* (PSA), which is used to regulate the aeronautical charges of airports, is unnecessary as there are other price regulation mechanisms to keep in check any market power that AAL may have, namely the *Trade Practices Act 1974* (TPA).

Conduct by firms with market power is regulated by a number of provisions in the TPA, including Part IIIA (which provides for third party access to essential services in certain circumstances) and section 46 of Part IV, which prohibits the misuse of market power. The TPA prohibits certain types of market conduct, which might damage or curtail competition. It is aimed at firms acting, individually or in collusion, to enhance or abuse their market power in an anti-competitive manner.

Given that the Government's original objective in relation to prices regulation of aeronautical charges was to ensure no abuse of market power, AAL believes that it is inappropriate to continue specific regulatory oversight and impose additional costs on AAL when the general provisions of the TPA provide ample scope for checking market power.

4.1 Part IIIA of the Trade Practices Act

Under Part IIIA of the TPA, third-party access to the services of certain essential facilities of national significance can be afforded in prescribed circumstances. Part IIIA is intended to apply to the services provided by 'essential facilities' when commercial negotiations fail to secure access to the services provided by the facility.

Part IIIA is intended to facilitate competition in related markets upstream or downstream of the essential facility by allowing potential competitors to access the facility. In providing for access to essential facilities, Part IIIA results in regulation of the terms and conditions (including prices) for use of the facility. Part IIIA has been applied to essential facilities, which are both vertically integrated and vertically separated. Therefore, if specific price regulation was unregulated for AAL, there would still be scope for other controls or remedies via the TPA should commercial negotiations between airports and airlines fail.

4.2 Part IV of the Trade Practices Act

In addition to the provisions of Part IIIA, Part IV of the TPA prohibits a range of anti-competitive trade practices, including the misuse of market power (s. 46). Section 46 prohibits a business with a substantial degree of market power from taking advantage of that power for the purpose of:

- eliminating or substantially damaging a competitor;
- preventing the entry of a person into any market; or
- deterring or preventing a person from engaging in competitive conduct in any market.

Section 46 prohibits two key forms of anti-competitive conduct:

- predatory pricing — where a firm substantially under-prices its goods or services to weaken or bankrupt a competitor; and
- refusal to deal — where a firm refuses to supply a good or service to a competitor.

To the extent that AAL is able to abuse any market power that it may have, Part IV of the TPA provides a further check. This is particularly relevant given that the rationale for price regulation is not to limit competitive businesses from negotiating commercial fees and charges but rather to ensure that any airport that holds market power does not abuse that market power.[20] As such, it would seem that Part IV of the TPA satisfies that objective without the necessity of specific price caps.

4.3 Deficiencies in the Prices Surveillance Act

In addition to overlap between the PSA and the TPA, AAL believes that the PSA has a number of other deficiencies. This is a view consistent with Productivity Commission findings from its recent *Legislation Review of the Prices Surveillance Act 1983*:

> "Assessed against general principles of good policy-making, the PSA fails on a number of counts. The objectives of the PSA are unclear and potentially conflicting. There is no requirement under the Act for the Minister to initiate a public review prior to the application of the Act. This has meant that in a number of instances the reasons for applying the provisions of the PSA are unclear. In today's more competitive economic environment, the absence of a requirement to conduct an independent investigation of potential pricing problems and to evaluate all alternative policy responses, could lead to the PSA being applied inappropriately. The deficiencies in the PSA give rise to uncertainty about how the Act may be applied in the future. The absence of a requirement for a public assessment of the problems that supposedly lead to the use of the PSA also has the potential to reduce transparency and accountability in government decision-making."[21]

The lack of clear objectives, discretionary nature, and inconsistent application, all suggest that the PSA can generate significant regulatory risk and uncertainty for all airports. The conclusions of the Productivity Commission review add further to the argument that the general provisions of the TPA are sufficient to promote competition and commercial outcomes between airports and its customers.

4.4 Industry Specific Versus General Regulation

In contrast to what AAL believes is appropriate for airport regulation, there are some industries which are also governed by industry specific regulations, such as telecommunications, electricity, and gas. These industries tend to have unique characteristics for which general economic regulation is not sufficient. However, in AAL's view, AAL does not possess those characteristics.

For example, the Government considers that the general provisions of the TPA are not sufficient for the telecommunications industry and therefore regulates telecommunications under industry specific legislation (*Telecommunications Act 1997*) and via industry specific provisions in the TPA (Parts XIB and XIC).

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[20] The Pricing Policy Paper by Department of Transport and Regional Development (1996) stated that price regulation would only continue to apply to those charges where the airport has the most potential to abuse market power.

[21] Ibid, p. 57.

Table 5 provides a comparison between the rationale for specific regulation in telecommunications and AAL. Table 5 is not provided to highlight that AAL is different to telecommunications companies, quite obviously it is, but rather to highlight that the circumstances that justify industry specific regulation are not present for AAL.

Table 5

CONTRAST BETWEEN TELECOMMUNICATIONS AND AIRPORTS

Telecommunications[22]	*Response from AAL*
• The industry is a complex, horizontally and vertically integrated industry.	• AAL is not vertically integrated and operates a relatively straight-forward, simple business, which is in direct competition with other airports.
• The telecommunications industry is developing from a monopoly structure to greater competition, with relatively small entrants compared to the incumbent.	• Airport industry structure was set in the late 1990s. There is no need to protect new entrants.
• The Government's objective of not imposing undue administrative burdens on industry participants may require effective enforcement backstops to provide a strong disincentive for the dominant incumbent to use its market power to stifle competition.	• AAL believes that the countervailing power of Qantas and Ansett are more than sufficient to provide a check on market power. If not the general provisions of the TPA are also available.
• Anti-competitive cross-subsidies by the incumbent from non-competitive markets to markets in which competition exists or is emerging are a particular threat to the establishment of a competitive environment.	• AAL does not receive cross subsidies.
• Due to the fast pace of change in the industry and the volatile state of the industry, anti-competitive behaviour can cause particularly rapid damage to competition.	• The market for airport services is relatively stable and airport facilities do not exhibit the same rapid technological change as telecommunications.
• There is considerable scope for the incumbent to engage in anti-competitive conduct because competitors in downstream markets depend on access to networks or facilities controlled by the incumbent. The access regime is intended to facilitate 'any-to-any connectivity' and the Government's commitment to promote the diversity of carriage and content services available to end-users.	• There are very limited opportunities for AAL to engage in anti-competitive behaviour. Even if it did, the TPA would govern AAL's activities.

[22] ACCC (2000), *Submission to the Productivity Commission Review of Telecommunications Specific Competition Regulation*, p. 15.

In short, Adelaide Airport does not exhibit unique characteristics (such as those which are reflected by the market for telecommunications) that warrant any industry specific regulations.

4.5 Final Comment on Existing Price Regulation Arrangements

The TPA is specifically designed to address market behaviour and the misuse of market power. Under Part IIIA of the TPA, airport services can be declared and, where negotiation fails, the ACCC can set prices. Particular airport services were declared at Melbourne international airport from August 1997 until 9 June 1998 (thereafter subject to section 192 of the Airports Act) and at Sydney international airport for a period of five years from 1 March 2000. Further, airport operators can submit undertakings, which specify prices subject to ACCC approval. In addition to Part IIIA, airports are also regulated under section 46 of Part IV, which prohibits the misuse of market power. Consequently, there is no rationale for continued prices regulation of aeronautical services at Adelaide Airport under the PSA.

Chapter Five

Conclusion

In conclusion, AAL submits that despite an apparent monopoly position as the only airport for international and interstate air travellers to and from Adelaide, AAL should not be subject to specific price regulation because:

- Competitive pressure from other airports for international flights and airfreight provides a sufficient competitive constraint on AAL's ability to vary aeronautical charges.
- The countervailing power of AAL's main customers, Qantas and Ansett, means that AAL has little, if any, market power to extract 'economic rents' from airlines.
- The effect on consumer welfare of prices regulation is insignificant and probably less than the transaction costs involved in administering regulation.
- Airline competition has had a much greater impact on the prices of air tickets than aeronautical prices regulation
- Part IIIA and section 46 of the *Trade Practices Act (1974)* are more than sufficient to regulate the commercial activities of AAL. Industry specific regulation is unnecessary.
- Prices regulation along with the monitoring of non-aeronautical prices and the requirements for approval of Necessary New Investment proposals impose an unnecessary, expensive, and cumbersome administrative and regulatory burden on AAL.

Finally, it should be reiterated that AAL faces a different commercial environment to that faced by other capital city airports. AAL's location specific circumstances highlight the need for a case-by-case examination of the necessity for continued prices regulation. Such an approach should result in the Productivity Commission also concluding that there is no justification for continued specific price regulation of AAL's operations.

Appendix A

Table A1

BOEING 737 SERIES 400 AIRCRAFT
DOMESTIC MOVEMENT

Charges	Landing
Alice Springs	$412.08
Darwin	$412.08
Brisbane	$392.36
Melbourne	$388.96
Perth	$370.60
Adelaide	**$343.40**
Sydney	$217.60

maximum take off weight 68 tonnes

Source: Adelaide Airport Ltd

Table A2

BOEING 747 SERIES 400 AIRCRAFT INTERNATIONAL MOVEMENT

Charges	Landing	Terminal	Total
Sydney	$1,260.80	$3,415.98	$4,676.78
Melbourne	$2,253.68	$1,642.98	$3,896.66
Brisbane	$2,273.38	$1,182.00	$3,455.38
Perth	$2,147.30	$807.70	$2,955.00
Alice Springs	$2,387.64	$437.34	$2,824.98
Darwin	$2,387.64	$437.34	$2,824.98
Adelaide	**$1,989.70**	**$449.16**	**$2,438.86**

Maximum take off weight 394 tonnes
Source: Adelaide Airport Ltd.

Appendix B[23]

Pre-Competition prices as at 3 July 2000

QANTAS	
Adelaide – Sydney (Return)	
Business Class	$1,180.74
Full Economy	$874.94
21 day advance purchase	$412.94

QANTAS	
Adelaide – Brisbane (Return)	
Business Class	$1,656.60
Full Economy	$1,225.40
21 day advance purchase	$533.50

Post-Competition Prices as at 19 March 2001

QANTAS	
Adelaide – Sydney (Return)	
Business Class	$1,200.54
Full Economy	$894.74
21 day advance purchase from	$229.24
Specials* from	$201.74

* Minimum stay and subject to availability

QANTAS	
Adelaide – Brisbane (Return)	
Business Class	$1,656.00
Full Economy	$1,225.00
21 day advance purchase from	$297.00
Specials* from	$220.00

* Minimum stay and subject to availability

VIRGIN BLUE	
Adelaide – Sydney (Return)	
Fully Flexible	$454.00
Standard	$236.00
Specials from**	$198.00

VIRGIN BLUE	
Adelaide – Brisbane (Return)	
Fully Flexible	$598.00
Standard	$296.00
Specials from**	$218.00
Route launch specials from**	$144.00

** Subject to availability.

[23] Source Adelaide Airport Limited