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25 July 2006

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Via email: airportpricing@pc.gov.au

Dear Ms Irvine

**Productivity Commission Inquiry into the Price Regulation of Airport Services
Submission by Canberra Airport**

Please find following Canberra Airport's submission to the Productivity Commission's Inquiry into the Price Regulation of Airport Services.

Canberra Airport thanks the Commission for the opportunity to provide this submission and we look forward to discussing its content with the Inquiry Team at the appropriate time.

Yours sincerely

Matthew Brown
Manager Aviation

The Case for Regulatory Change at Canberra Airport

**Submission to the Productivity Commission Inquiry
Price Regulation of Airport Services**

July 2006

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The Case for Regulatory Change at Canberra Airport

Overview

Canberra Airport was privatised in 1998 along with the other so-called “Phase II” airports that also included Gold Coast, Darwin, Alice Springs, Adelaide, Hobart, Launceston and Townsville airports – the majority of which are now non-price monitored airports. Unlike other Australian airports, Canberra Airport is a wholly owned family company with the shareholders having a direct involvement in the day-to-day running of the company.

Since privatisation, Australian airports have endured significant challenges; poor investment conditions, anticompetitive airline practices, unworkable customer relationships, airline failure (Ansett collapse, Impulse) and major downturns in passenger numbers (September 11, Iraq War, SARS, Asian crises). In the short period since the Productivity Commission’s 2002 Report, airports and their industry partners have also had to manage the impact of the ‘one-off’ transition from unsustainably low airport prices, the significant cost burden of additional security measures and record aviation fuel prices. At the same time a more positive outlook has emerged, with record passenger volumes, more discounted airfares, increasing airport and airline investment, and the continued success of two of the world’s most profitable airlines.

The ability of the industry to overcome these significant challenges and deliver positive outcomes can be attributed in no small part to the regulatory change that occurred in 2002 and, specifically, the resultant maturing in airport-airline commercial relationships. However, progress at some airports has been more pronounced than at others. In the case of Canberra Airport, progress has been somewhat slow. Increasingly, Canberra Airport is experiencing delays and uncertainty due to a regulatory framework that is diminishing in its relevance and instead becoming more effective at highlighting the inconsistencies in the treatment of comparable airports and the contrast between major airports and their smaller counterparts.

The following submission to the Productivity Commission’s Inquiry is therefore made in support of a change in the classification of Canberra Airport from a price monitored airport to a non-price monitored airport.

The Case for Regulatory Change at Canberra Airport

Introduction

The case for regulatory change at Canberra Airport is made on the basis of an assessment of the benefits against the costs of formal regulation, compared with the alternative framework that has been effectively implemented at other comparable small airports around Australia.

Canberra Airport advocates its reclassification from a monitored airport to a non-monitored airport on the grounds that:

1. The benefits of the monitoring framework are negligible and diminishing;
2. The costs of the monitoring framework remain significant; and
3. There are inconsistencies and anomalies in the regulatory treatment of Canberra Airport that need to be addressed.

The following sections provide a detailed discussion of these points.

1. Diminished Regulatory Benefits

While the monitoring regime supported the process of adjusting airport prices in a post-price cap regulatory environment, that process has now concluded and so too has the need for regulatory support. The monitoring regime has also overseen the maturing of airport-airline relationships from an adversarial to a more partnership-based approach that has provided for the negotiation of long-term commercial agreements covering the provision of aeronautical services by airports. These commercial negotiations have occurred under the influence of the dominant major airlines and the increasing competition faced by Canberra Airport for its share of the Canberra travel market. These issues are considered in more detail below.

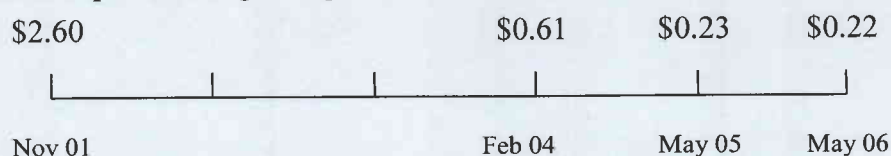
1.1 Price adjustment – a completed process

Following removal of the former price cap regulation, aeronautical charges at Canberra Airport increased, albeit on a fully justifiable basis. This in itself is not a cause for continued price regulation of Canberra Airport. During the current regulatory period commencing in July 2002, aeronautical prices at Canberra Airport have increased by approximately \$1, although it should be noted that a price adjustment of \$2.60 in November 2001 preceded the current regulatory period. In any case, increased prices at Canberra Airport are modest in comparison to the increased charges levied by airlines over the same period.

The timeline below demonstrates that the period of price adjustment at Canberra Airport has passed, with only modest increases (marginally in excess of CPI) since February 2004.

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Canberra Airport Landing Charge – Diminishing Price Increases (not adjusted for CPI)



The increase airport prices reflects the following:

- (i) The recovery of new investment costs (including costs relating to a 'necessary new investment' proposal that had been approved in draft form by the ACCC at the time of the removal of the price cap);
- (ii) Increases in costs attributable to government-mandated additional security measures;
- (iii) New infrastructure and services not previously provided by Canberra Airport (for example the RAAF Fairbairn infrastructure that has become accessible to civilian operations since 2003/2004); and
- (iv) The transition from an unsustainably low network price, that resulted in the recognised long-term underinvestment at Canberra Airport, to a location specific price.

In the case of (i), (ii) and (iii) above, the 'rules' for such recoveries were well established under the former price cap regime and Canberra Airport continues to adopt these established pricing principles in its commercial negotiations. In the case of (iv), it was appropriate that the transition occur under the current prices monitoring regime.

It is therefore reasonable to say that the process of 'setting the rules' in part justified the price cap regime, and the transition to location specific pricing arguably necessitated the prices monitoring regime. However, now that the rules have been set and the transition is complete, the need for regulatory 'support' for airport-airline negotiations is no longer required.

Key Point - *The prices monitoring regime supported the transition from inefficient airport pricing to location specific pricing. Following the adjustment in airport prices, there is no longer a need for annual price monitoring of airports.*

1.2 Maturing of airport-airline relationships

There has been a noticeable improvement in the working relationship between Canberra Airport and its airline partners since the introduction of the prices monitoring regime. This is evident at the basic commercial level where airlines contract airports to provide two types of services; airfield services and passenger terminal services.

In terms of airfield services, Canberra Airport has signed agreements with two of the three airlines that operate at the Airport. The third airline negotiated terms of an agreement and then elected not to enter into the arrangement, although it is currently complying with the terms that were negotiated.

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Canberra Airport's airfield agreements are long-term agreements spanning five (5) years. The agreements were negotiated on an entirely open-book process, with both major airlines taking up an offer to access a 'data room' with detailed information relating to Canberra Airport's revenues, operating expenditure, asset valuations, as well as historical and future capital expenditure. Airlines have obviously benefited from this high degree of transparency as it allows for a more detailed analysis of the Airport's cost base than afforded by the ACCC reports that have become superfluous in airport-airline negotiations.

It should be noted that Canberra Airport and the airlines did not agree on every issue during the negotiations on the airfield services agreements. There were differences of opinion in relation to passenger volumes, future capital expenditure and valuations. However, such differences of opinion represent a healthy level of disagreement typical of most corporate negotiations. Once there was a mutual recognition of the other party's business imperatives, the disagreements were largely overcome. Where disagreements persisted, they did not preclude the parties reaching agreement on key terms. That is, the parties agreed to disagree and then negotiated a deal.

In addition to the airfield services agreements, Canberra Airport is also establishing long-term agreements for the provision of terminal services to the airlines, in this case for a term of fifteen (15) years. The terminal deals have been developed with the close involvement of the airlines, particularly in relation to design, commercial and legal aspects as well as methods of delivery and service level agreements. The process is again transparent with an open-book approach to construction costs and the cost recovery framework, with periodic reviews and adjustments for passenger volumes and additional investment where necessary.

While the approach adopted by Canberra Airport in its negotiations is not dissimilar to that at other airports (and that advocated by the ACCC during the price cap regime), the effectiveness of the negotiation process has been validated by one major airline customer at Canberra Airport which has elected to make an early move from a position of outright control over its owned terminal facilities, to one where the **airport** provides the terminal facilities to meet the airline's long-term requirements.

The progress made by Canberra Airport and its airline partners on the abovementioned long-term agreements demonstrate that airport-airline commercial relationships are working at a 'primary function' level - that is, agreements are being reached on the terms of service provision and payment for services. However, more notable is the evidence of higher level airport-airline relationship building through partnership initiatives that engender goodwill and foster long-term (non-contractual) commercial relationships.

Following the negotiation of five-year airfield agreements and fifteen-year terminal agreements, supported by the development of higher level commercial relationships, there are negligible benefits to be gained from ongoing annual price monitoring of Canberra Airport.

Key Point – *With the provision of aeronautical services at Canberra Airport covered by long-term commercial agreements with airlines, as well as the evidence of the*

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development of high-level partnership relationships between airports and airlines, there are negligible benefits to be obtained from ongoing annual price monitoring.

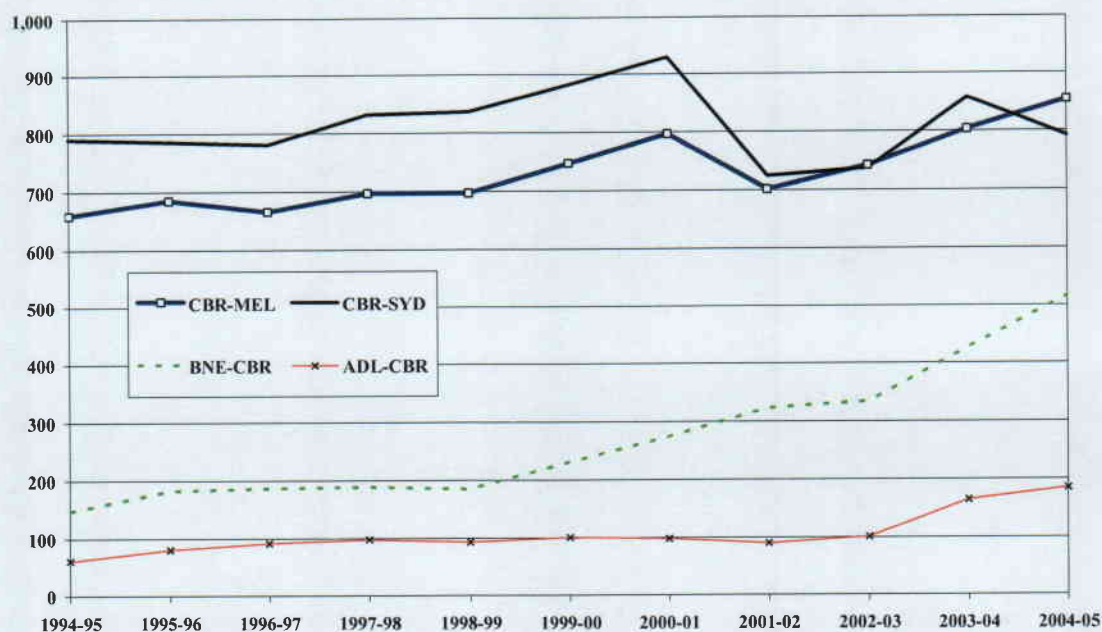
1.3 Increasing competition - modal and airport substitution

Figure 1 shows the number of annual passengers by the major routes at Canberra Airport.

Interestingly, since 2002 the passenger traffic on what was historically Canberra Airport's largest route, the Canberra-Sydney route, has fallen below the passenger traffic on the Canberra-Melbourne route. This trend is continuing in the data for 2005/2006, where passengers on the Canberra-Melbourne route are approximately 16% ahead of passengers on the Canberra-Sydney route.

Figure 1: Thousand passengers per annum on Canberra's major routes

Thousand passengers p.a. (top four routes)



The major factors driving the structural change on the Canberra-Sydney route have been Qantas' monopoly on the route and the increased modal competition from road transport due to the opening of the M5 East, M7 Orbital and various other road improvements around Sydney. Road improvements have significantly reduced travel time between Canberra and Sydney since 2000, with airport-to-airport travel time down to approximately 2.5 hours, and city-to-city travel time in less than 3 hours.

Numerous studies have established that air travel is only the preferred mode of travel on trips greater than three hours. On this basis, Canberra Airport is subject to effective modal competition from road travel on what is historically its largest route, Canberra-Sydney.

However, Canberra Airport experiences modal competition on routes beyond Sydney. Jetstar has set new benchmarks for low-cost air travel and is a very effective competitor

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to Virgin Blue. Unfortunately, Jetstar does not service the Canberra market and this has allowed Virgin Blue to generate a higher yield on Canberra airfares relative to other markets where it competes with Jetstar. The combined effect for the Canberra market of an absent Jetstar (and having Qantas and Virgin Blue pricing their Canberra airfares accordingly) and the short travel time to Sydney Airport (and the greater choice of direct flight destinations available from Sydney Airport), is that the 'drive to fly' option provides very effective competition for servicing the Canberra leisure travel market. The same is also true for international travel given that international passengers from Canberra will still generally transit through Sydney Airport. In both the above cases, the 'drive to fly' option is typically more flexible and more cost effective.

With competition firstly from road transport for the Canberra-Sydney market, and secondly from Sydney Airport for the beyond markets (both domestic and international), Canberra Airport has little market power due to the available alternatives. Admittedly, these alternatives are less attractive to business travelers in the beyond Sydney markets; however these represent a relatively small subset of the overall Canberra travel market.

It should also be noted that airport substitution opportunities are also available to general aviation users of Canberra Airport. The Canberra region is serviced by a number of smaller (non-regulated) regional airports such as Goulburn, Cooma and Moruya, as well as some rural airfields on the outskirts of Canberra at Hall, Tralee and Bungendore. Canberra Airport has witnessed mobility in approximately 10% of the Canberra based general aviation community.

Key Point – Canberra Airport is subject to very effective modal substitution on what is traditionally its largest route (CBR-SYD). This provides direct competition for the Canberra-Sydney travel market, as well as offering airport substitution in the 'beyond markets' as a result of the accessibility of Sydney Airport to the Canberra air travel market.

1.4 The relative market power of airlines

In the Productivity Commission's 2002 report on airport price regulation, Canberra Airport was assessed as possessing a 'low/moderate' overall degree of market power (reproduced as Table 2 in the Productivity Commission's Issues Paper for this Inquiry).

In assessing the overall market power of price monitored airports, the Productivity Commission's 2002 report did not take into explicit consideration the countervailing power of airlines to negate the perceived monopolistic pricing tendencies of airport operators (and 'countervailing power' was not included as one of the columns in the Productivity Commission's summary table of market power). This omission is particularly important in the case of Canberra Airport, which is utilised by only two major airlines (Qantas and Virgin Blue) and one regional airline (Brindabella Airlines). In particular, as the only airline servicing the traditionally dominant Sydney-Canberra route, Qantas has very significant bargaining power in negotiating with Canberra Airport over airport fees and charges.

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In standard economic models of bargaining (such as the Nash bargaining model), the equilibrium price that 'solves' the price or wage bargaining problem depends on the *relative* bargaining strength of the two parties involved. In short, one must not only take into consideration the monopoly power of airports, but also the *monopsony* power of the purchaser(s) of airport services.

The monopsony power of airlines is especially strong in the case of Canberra Airport compared with the other price monitored airports, namely Adelaide, Brisbane, Darwin, Melbourne, Perth and Sydney. For example, even the smallest of the other airports - Darwin Airport - is utilised by four domestic airlines (Airnorth, Qantas/Qantas Link/Jetstar, Virgin Blue, and SkyWest) and five international carriers (Airnorth, Qantas, Garuda Indonesia, Merpati Nusantara, Royal Brunei, and Tiger Airways).

In consideration of the monopsony power of the airlines, together with the modal and airport substitution opportunities discussed in the preceding section, it seems clear that the overall degree of market power possessed by Canberra Airport is more accurately classified as 'low' rather than 'low/moderate'.

Market Power of Canberra Airport

Potential for demand substitution	Potential for modal substitution	Potential for airport substitution	Countervailing market power of airlines	Overall degree of market power
Low	High	Moderate/high	High	Low

Key Point – Canberra Airport's overall degree of monopoly power is very effectively mitigated by the monopsony power of the major airlines.

1.5 Quality monitoring

It is also instructive to consider the merits of ongoing quality monitoring of Canberra Airport.

Canberra Airport is acutely aware of the importance of quality in the provision of facilities and services. Since privatisation, significant improvements have been made in the quality of aeronautical services at Canberra Airport. Internal performance reporting has seen marked improvements in the standard of cleanliness, performance of finishes and fittings and the maintenance of equipment. Unfortunately, these widely recognised improvements have not been adequately reflected in the annual Quality of Service (QoS) reports prepared by the ACCC.

Notwithstanding the results of the QoS reports, Canberra Airport maintains a commitment to quality across its business. Since privatisation, the quality of infrastructure and services provided by Canberra Airport has never been an issue. On the contrary, the standards of general upkeep that the Airport imposes on users of the terminal (airlines and retail tenants) in commercial agreements and in the day-to-day management of facilities have often been criticised for being too stringent. These same standards apply across the entire airport business, and this is evident in the non-

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regulated parts of the business (two office parks and a retail centre) that have received numerous quality based awards.

Based on its performance on quality, Canberra Airport is comfortable with its commitment to the development of service level agreements (SLAs) with its major airline customers, as part of its negotiations on a 15-year terminal contract. These SLAs will formalise Canberra Airport's existing internal quality monitoring regime and, importantly (and in contrast to the ACCC QoS reporting), the performance indicators and benchmarks will be tailored to suit the local requirements.

Therefore, on the basis of Canberra Airport's stated and demonstrated commitment to quality, as well as its undertaking to formalise its existing internal quality regime in a **long-term** service level agreement, the annual reporting by the ACCC on quality of service is largely redundant.

Key Point – Canberra Airport's culture of quality and its commitment to the development of service level agreements with its major users will ensure that the current high quality of service at Canberra Airport is maintained regardless of the presence or otherwise of a formal quality monitoring regime.

Summary

In summary, there are negligible benefits to be gained from ongoing formal regulation of Canberra Airport.

Firstly, the structural changes in airport-airline dealings no longer need the support of a regulatory framework as the parties have successfully negotiated the airport price adjustment that needed to occur, and have demonstrated a capacity to reach commercial agreements and foster long-term commercial relationships.

Secondly, while market power is itself not sufficient to justify ongoing regulation, Canberra Airport's market power is, in any case, low due to highly effective modal competition, increasing airport substitution opportunities and the countervailing market power of the major airlines.

Finally, as the benefits of prices monitoring become increasingly negligible, so too does the justification for the quality monitoring framework that supports prices monitoring. Furthermore, the introduction of airport-specific service level agreements between airports and users is more effective in achieving the quality objectives intended from the monitoring framework.

The above factors therefore serve to substantially erode any perceived benefits from ongoing formal price and quality monitoring of Canberra Airport.

2. Regulatory Costs

In a dynamic industry environment, airports need to be responsive to investment demands in order to meet often unpredictable levels of market growth and the ever increasing infrastructure requirements associated with government-mandated security

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initiatives. However, Canberra Airport's experience is that it incurs unnecessary regulatory delays and uncertainty as a result of its inclusion in the group of monitored airports. Further, it incurs significant financial costs that could otherwise be returned to airport users.

2.1 *Responsiveness to investment demands*

Canberra Airport has experienced above-average growth since 2003 (returning to average growth in 2005/2006); primarily due to the restoration of pre-Ansett collapse capacity, but also due to 'new' market growth (although to a lesser extent than most other Australian airports). This, combined with the fact that Canberra Airport suffered from significant under-investment in the 10-15 years prior to privatisation, and the limited capacity to address this investment deficiency during the price cap regime, has resulted in a relatively high demand for aeronautical investment at Canberra Airport.

Within a short timeframe of five years, it will have been necessary for Canberra Airport to significantly upgrade the bulk of its aviation infrastructure, including a new multi-user passenger terminal, strengthened airfield pavements and an extension of the main runway. In addition, there has been and continues to be a requirement to fund the significant costs associated with government-mandated security initiatives.

With a strong forward investment profile incorporating projects with short lead times for delivery to meet (government and airline) deadlines, Canberra Airport has found that in many cases, due to limited airline resources, it is difficult to engage airlines in a timely manner. As a regulated airport, Canberra Airport's negotiations achieve a level of status within the airlines that are akin to those at major airports, but the reality is that Canberra is relegated well down the priority action list. In contrast, the non-price monitored airports are afforded a more streamlined path of negotiation with the airlines.

For Canberra Airport to be responsive to investment demands, it cannot afford to be in the regulatory 'holding pattern' awaiting the absence of priorities at the major airports in order to progress investment projects at Canberra.

*Key Point – In order to meet the current and future investment demands in a timely manner, Canberra Airport requires a **streamlined negotiation process** that is not afforded to small airports captured by the prices monitoring regime.*

2.2 *Regulatory delays*

As a regulated airport, Canberra is also subject to further delays and uncertainty due to regulatory distractions.

Canberra Airport experienced a notable delay in the negotiation of its five-year airfield services agreements. After waiting over 12 months for the commercial resources of the major airlines to become available following the negotiation of similar arrangements at Melbourne and Brisbane airports, Canberra's agreement was unintentionally delayed by Virgin Blue's application to the National Competition Council (NCC) for declaration of Sydney Airport. Not only did this action distract the commercial resources of both Virgin and Qantas (due to the same personnel working on both projects), but it also

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resulted in the airlines not wanting to finalise the Canberra agreement for fear that it may either compromise the more important process of seeking declaration of Sydney Airport, or that the NCC process may yield a better outcome that could then be applied at Canberra.

This demonstrates that Canberra Airport has experienced delays in progressing negotiations due to unrelated regulatory matters at other airports. Arguably, Canberra Airport would have been impacted to a far lesser extent (or not at all) if it was a non-price monitored airport.

Key Point – Canberra Airport is unfairly disadvantaged by the delays it incurs in negotiations with airlines as a result of its inclusion in the regulated airports group, and its subsequent relegation in priority relative to other members of this group.

2.3 Regulatory uncertainty

Canberra Airport has also faced regulatory uncertainty due to its status as a price monitored airport. In December 2005, after three years of negotiations, Canberra Airport finally agreed terms and signed a document with a major airline for the construction of a new multi-user terminal.

On 13 January 2006 (less than one month after execution of the abovementioned document) the Commonwealth Department of Transport and Regional Services (DoTaRS) announced that it would conduct a review of the definition of aeronautical services for the purposes of regulating the price monitored airports (refer Appendix #1). The proposed changes to the definition unwittingly had the effect of fundamentally changing the ground rules upon which the 15-year terminal deal had been negotiated between Canberra Airport and its airline customer.

DoTaRS subsequently elected to defer its review and to instead have the matter considered as part of the recommendations emanating from the current Productivity Commission review. However, by the time that this matter was resolved (or rather deferred), the next steps in progressing the terminal deal had already been delayed by more than 13 weeks. This matter continues to create uncertainty for Canberra Airport.

Similarly, when Canberra Airport was nearing the conclusion of negotiations on an airfield services agreement with one of the major airlines, the impending release of the ACCC annual monitoring report, and then the unnecessary commentary contained therein, served to delay and frustrate the completion of the negotiations. This was due to the perceived support that the ACCC's commentary lent to a position adopted by the airline during the negotiations. This reopened an issue that had already been overcome in the negotiations through the provision by the Airport of more detailed information than was available in the ACCC reports.

Therefore, Canberra Airport is unnecessarily and unfairly disadvantaged by regulatory delay and uncertainty relative to other comparable airports such as Cairns, Gold Coast and Hobart. Canberra Airport has a strong desire to get on with the business of doing business instead of being caught up in the complex regulatory issues faced by the major airports.

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While Canberra Airport should not be a price monitored airport, any continued form of regulation for the major airports should adopt a 'set and forget' or a 'set and monitor' approach without intra-period intervention by a regulator (whether by the NCC or DoTaRS, or the ACCC annual reports). Airports are recognised as long term businesses and as such there is no incentive for an airport to operate outside established parameters in pursuit of short-term gain. However, in such an unlikely event, the matter would be most appropriately considered at an inter-period review. The actions of the NCC, ACCC and (unintentionally) DoTaRS during the current regulatory period have been most counterproductive to Canberra Airport's commercial negotiations with airlines.

Key Point – As a member of the regulated airports group, Canberra Airport unnecessarily faces regulatory uncertainty as a result of regulators seeking to address perceived issues at the major airports.

2.4 Financial costs

In addition to the non-financial costs of delay and uncertainty, Canberra Airport also incurs significant financial costs attributable to the price and quality monitoring regime. Canberra Airport estimates its cost of partial compliance with the current price and quality regime at \$300,000 - \$375,000 per annum, inclusive of management and administration time, ongoing systems development, reporting and audit costs. Given Canberra Airport's small size relative to the major airports (in both revenue and staff terms), these non-value adding costs have a proportionately greater impact on Canberra Airport.

The cost of full compliance, or rather an additional level of compliance but still short of full compliance, is estimated at between \$1,200,000 - \$2,000,000 per annum on the basis of the new information technology and baggage systems that would need to be procured, as well as the associated hard infrastructure costs. Canberra Airport acknowledges that the additional systems included in this calculation would bring other advantages, although these are not currently required ('nice to have' vs 'have to have'). Implementing these additional systems would represent an additional cost that airport users have already indicated an unwillingness to fund.

In the event that Canberra Airport became a non-price monitored airport (and therefore did not incur these costs), the savings in regulatory costs would be realised by users of the Airport.

Key Point – In partially complying with the current price and quality monitoring regime, Canberra Airport incurs significant costs for a small airport which would otherwise be returned to users of the airport in the absence of formal ongoing regulation.

Summary

As a small airport with one-fifth (or less) of the staff of the major airports, Canberra Airport is disproportionately impacted by the direct financial costs and the indirect costs

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imposed by the delays and uncertainty that are attributable to its classification as a monitored airport.

Both the airport and its users would benefit from the reduced regulatory costs that would result from the reclassification of Canberra Airport to a non-monitored airport.

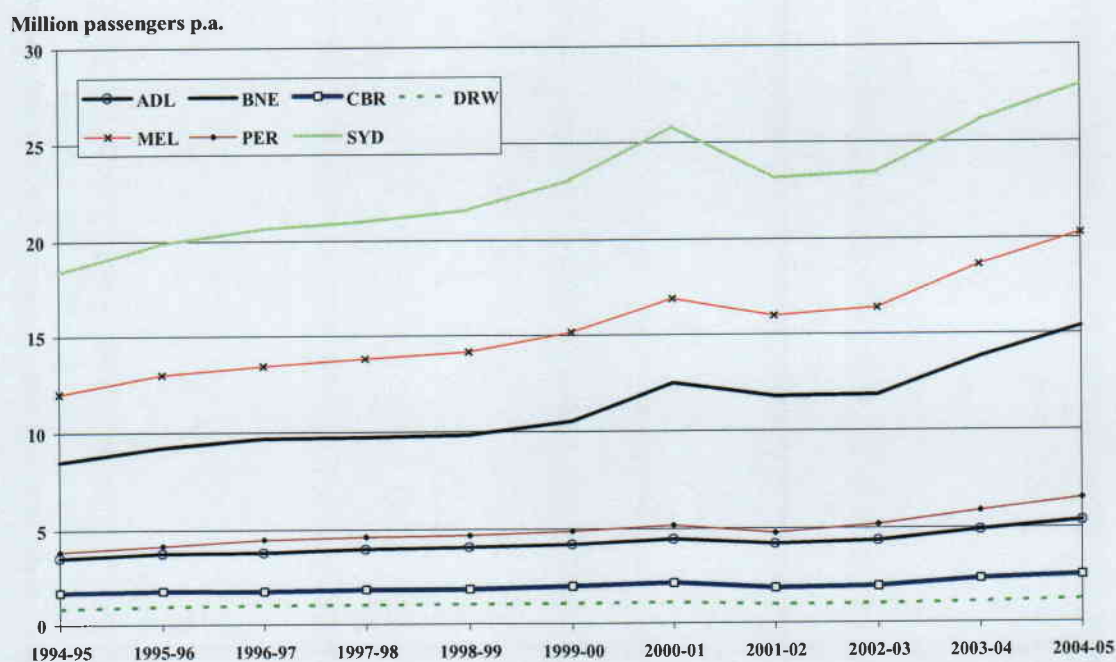
3. Regulatory Consistency

There are obvious inconsistencies in the application of the current regulatory framework to Canberra Airport. Firstly, there is inconsistency in the treatment of reasonably comparable (and competing) airports resulting in Canberra Airport being materially disadvantaged relative to its industry peers. Secondly, there is inconsistency in the capacity to comply with the regulation across the current seven monitored airports. These issues are discussed in further detail below.

3.1 Comparable airports, different regulation

Figure 2 depicts the level of passenger traffic at the seven regulated airports, which are the subject of the PC Inquiry (Adelaide, Brisbane, Canberra, Darwin, Melbourne, Perth and Sydney). An anomaly in the chart is the small amount of passenger traffic at Canberra and Darwin airports compared with the other five regulated airports. In the most recent year where data is available for all airports (2004-05) Canberra had 2.5 million passenger movements and Darwin had 1.2 million, while all other regulated airports had over 5 million passenger movements.

Figure 2: Passengers per annum at price-monitored airports

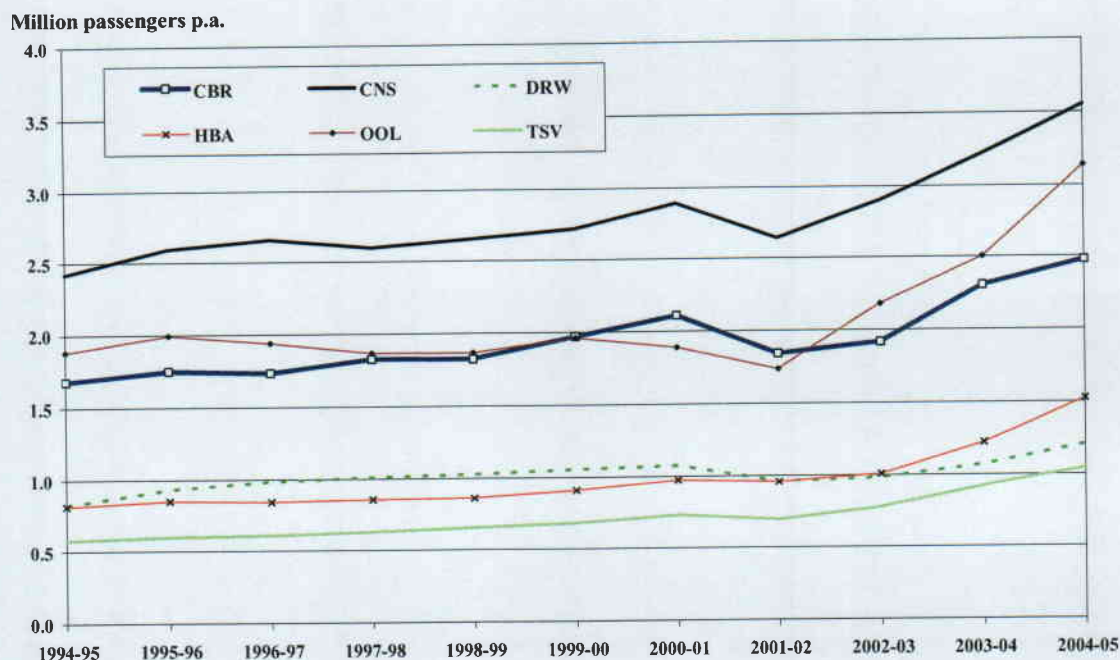


As illustrated above, Canberra Airport's passenger traffic is low compared with the other regulated airports. Figure 3 provides a comparison of Canberra Airport with other unregulated airports of comparable size (and Darwin, which is in the regulated group of

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seven). As shown in the chart, Cairns Airport (CNS) and Gold Coast Airport (OOL) have more passengers than Canberra. Hobart, Townsville and Darwin are smaller. The lack of consistency in the application of regulation to airports of comparable size is a clear anomaly in the current regime.

Figure 3: Passengers per annum at airports comparable with Canberra

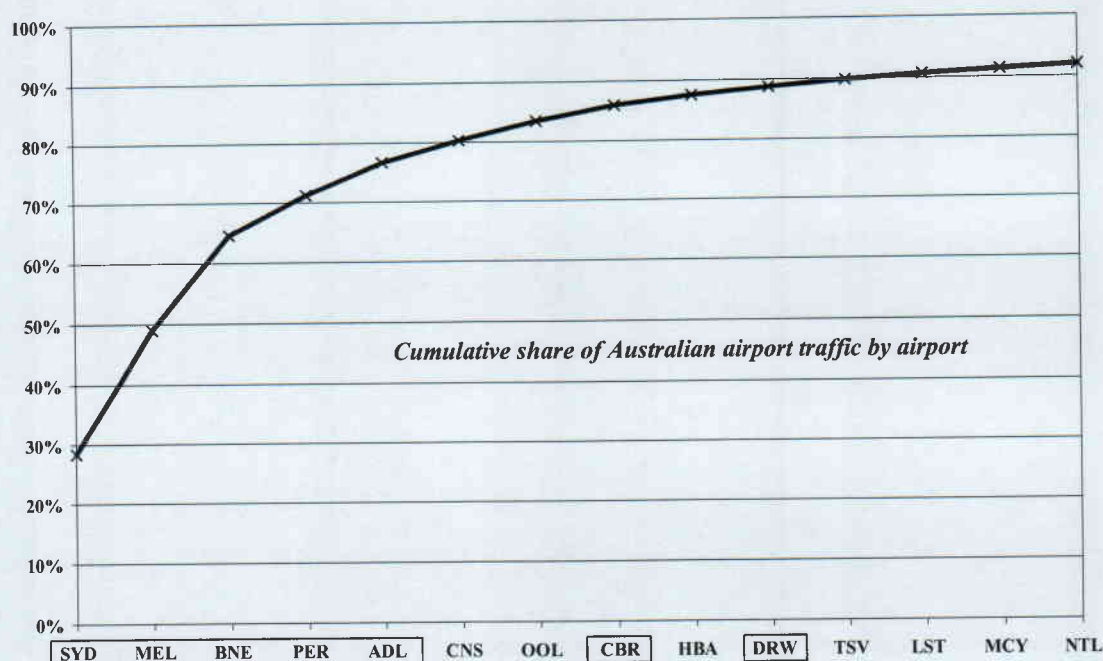


It is interesting to note from the above chart that since the removal of price cap regulation in 2001/2002, annual passenger numbers at Gold Coast Airport (non-price monitored) have overtaken Canberra Airport (price monitored). While this can be partly attributed to market factors, it is also a function of the Gold Coast Airport being able to devote its commercial resources toward actively pursuing aviation development opportunities (where it competes with Canberra and other airports for scarce additional airline seat capacity). In contrast, those equivalent resources at Canberra Airport have been bogged down in regulatory issues.

Figure 4 shows the cumulative share of airline passenger traffic in Australia by airport from which two noteworthy points can be made. First, of the top 14 airports in Australia, Canberra Airport ranks 8th (and Darwin 10th) in terms of passenger traffic. There are two non-price monitored airports ahead of Canberra in the rankings (and another non-price monitored airport between Canberra Airport and the 10th placed Darwin Airport). Secondly, the top four or five airports account for three-quarters of Australian passenger traffic. The inclusion of Canberra Airport captures a negligible 2% increase in regulated passenger activity.

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Figure 4: Cumulative share of Australia airport traffic by airport



It is apparent that, in terms of size, Canberra and Darwin Airports are more closely aligned with the majority of the other Phase II (now non-price monitored) airports rather than the regulated major airports.

Key Point – The anomaly in the current regime is that Canberra Airport is captured by regulation intended for major airports, while the majority of other comparable Australian airports benefit from a light-handed regime that reflects the simple nature of small airports.

3.2 Compliance with prices monitoring

Canberra Airport is unable to reliably meet the requirements of the price monitoring framework. Again, this is due to the relative simplicity of Canberra Airport's business and the absence of a need to collect the required data.

For example, the price monitoring framework requires the disaggregation of terminal revenues between aeronautical, aeronautical-related and non-aeronautical. This is reasonably straightforward at a large international airport where payments are made for the hourly rental of check-in counters (aeronautical-related), turnaround charges for use of an aerobridge or gate lounge (aeronautical) and annual rental for airline offices and club lounges (non-aeronautical). However, in the case of Canberra Airport these services are currently aggregated into a single fee in response to customer demands and any disaggregation would be largely arbitrary. This simple commercial structure reflects the small and comparatively simple operating environment at Canberra Airport where, for example, airlines elect not to rent check-in facilities by the hour.

As a result of the framework being tailored to the larger airports, Canberra Airport is only capable of partial compliance with the regulatory requirements.

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Key Point – Canberra Airport is unable to fully comply with the current prices monitoring regime as it is tailored towards the reporting requirements of the major airports which are fundamentally different in their operating environment and commercial pricing structure to small airports.

3.3 Compliance with quality of service monitoring

The quality of service indicators used by the ACCC are appropriately tailored towards larger airports. However, in seeking to adopt a consistent dataset, those same indicators are adopted for smaller airports. In many cases, the information required is either not captured (due to the simple systems involved), not relevant (due to the simple processes involved) or not applicable (due to the absence of the requirement). In many cases, Canberra Airport uses best estimates to complete the surveys (i.e. number of arriving passengers, planned/unplanned interruptions to baggage systems) while in others no information can be provided (number of bags handled, hours of operation of check-in facilities).

In addition, with the exception of Canberra and Darwin Airports, the major airports are required to undertake an annual passenger perception survey. The high cost and lack of relevance of these surveys to smaller airports has always been recognised and resulted in Phase II airports being excluded from this obligation since privatisation. However, it now yields a curious regulatory outcome where two out of seven of the regulated airports are monitored on a different basis.

Therefore, in terms of quality of service monitoring, Canberra Airport is, at best, only capable of partial compliance with the regulatory framework applicable to the larger airports.

Key Point - Canberra Airport is unable to fully comply with the current quality monitoring regime as it is tailored towards the reporting requirements of the major airports which are fundamentally different in their operating nature to small airports.

Non-compliant and non-consistent

The anomalies in the price and quality reporting for Canberra Airport are recognised in the reports by the ACCC. In fact, in 2003 the ACCC accepted an invitation to attend an inspection of Canberra Airport in order to understand its relative simplicity relative to the larger airports, as a means of explaining the shortcomings in the data provided.

Resolution of this anomaly requires a consideration of the following:

- (a) Enforce Full Compliance
 - Canberra Airport continues to be treated like a major airport for the purposes of price and quality regulation with full compliance expected.
 - In some cases, compliance will be cost prohibitive (millions of dollars) while in others it will remain impossible.

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(b) Accept Partial Compliance

- Canberra Airport continues to be treated like a major airport for the purposes of price and quality regulation but is not required to fully comply.
- This yields a curious regulatory outcome where rules are made on the understanding that they will be broken.
- Incomplete datasets continue to be provided to the ACCC for the purposes of reporting.

(c) Regulatory Consistency

- Canberra and Darwin airports join the other Phase II airports (Gold Coast, Hobart etc) and other non-regulated airports (Cairns, Newcastle) in not being price and quality monitored.
- Consistency in regulatory approach is maintained at the major airports and the regulatory anomaly at smaller airports is removed.

These options should be considered in the context of the negligible benefits of ongoing price and quality monitoring of Canberra Airport.

Summary

Canberra Airport is fundamentally different to the major airports, not only in terms of size but also in terms of business nature. As a result of being captured by the regulation applying to the major airports, Canberra Airport is materially disadvantaged compared with comparable (and competing) airports that do not have the same compliance obligations and costs, and also relative to the major airports which are capable of regulatory compliance without the inordinate burden experienced by Canberra Airport.

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Summary of Key Points

- 1.1 The prices monitoring regime supported the transition from inefficient airport pricing to location specific pricing. Following the adjustment in airport prices, there is no longer a need for annual price monitoring of airports.
- 1.2 With the provision of aeronautical services at Canberra Airport being covered by long-term commercial agreements with airlines, as well as the evidence of the development of high-level partnership relationships between airports and airlines, there are negligible benefits to be obtained from ongoing annual price monitoring.
- 1.3 Canberra Airport is subject to very effective modal substitution on what is traditionally its largest route (CBR-SYD). This provides direct competition for the Canberra-Sydney travel market, as well as offering airport substitution in the 'beyond markets' as a result of the accessibility of Sydney Airport to the Canberra air travel market.
- 1.4 Canberra Airport's overall degree of monopoly power is very effectively mitigated by the monopsony power of the major airlines.
- 1.5 Canberra Airport's culture of quality and its commitment to the development of service level agreements with its major users will ensure that the current high quality of service at Canberra Airport is maintained regardless of the presence or otherwise of a formal quality monitoring regime.
- 2.1 In order to meet the current and future investment demands in a timely manner, Canberra Airport requires a **streamlined negotiation process** that is not afforded to small airports captured by the prices monitoring regime.
- 2.2 Canberra Airport is unfairly disadvantaged by the delays it incurs in negotiations with airlines as a result of its inclusion in the regulated airports group, and its subsequent relegation in priority relative to other members of this group.
- 2.3 As a member of the regulated airports group, Canberra Airport unnecessarily faces regulatory uncertainty as a result of regulators seeking to address perceived issues at the major airports.
- 2.4 In partially complying with the current price and quality monitoring regime, Canberra Airport incurs significant costs for a small airport which would otherwise be returned to users of the airport in the absence of formal ongoing regulation.
- 3.1 The anomaly in the current regime is that Canberra Airport is captured by regulation intended for major airports, while the majority of other comparable Australian airports benefit from a light-handed regime that reflects the simple nature of small airports.
- 3.2 Canberra Airport is unable to fully comply with the current prices monitoring regime as it is tailored towards the reporting requirements of the major airports which are fundamentally different in their operating environment commercial pricing structure to small airports.
- 3.3 Canberra Airport is unable to fully comply with the current quality monitoring regime as it is tailored towards the reporting requirements of the major airports which are fundamentally different in their operating nature to small airports.

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Conclusion

In conclusion, the case for regulatory change at Canberra Airport is supported by the negligible and diminishing benefits of ongoing formal regulation, and the fact any marginal benefits are far outweighed by the relatively heavy regulatory burden imposed on a small airport as a result of the requirement to comply with regulation intended for the major airports. On this basis, Canberra Airport seeks a finding from the Productivity Commission's Inquiry that it be reclassified from a monitored airport to a non-monitored airport.