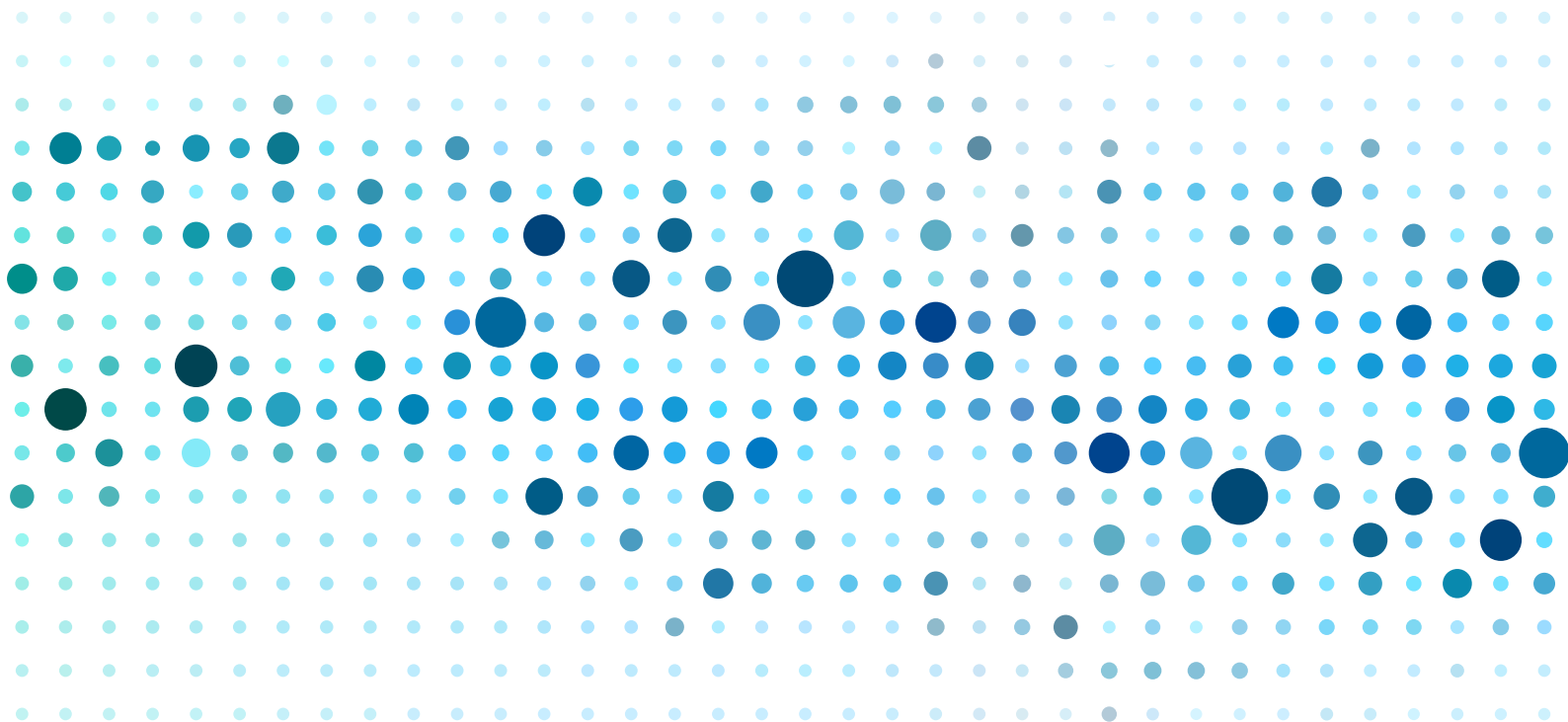


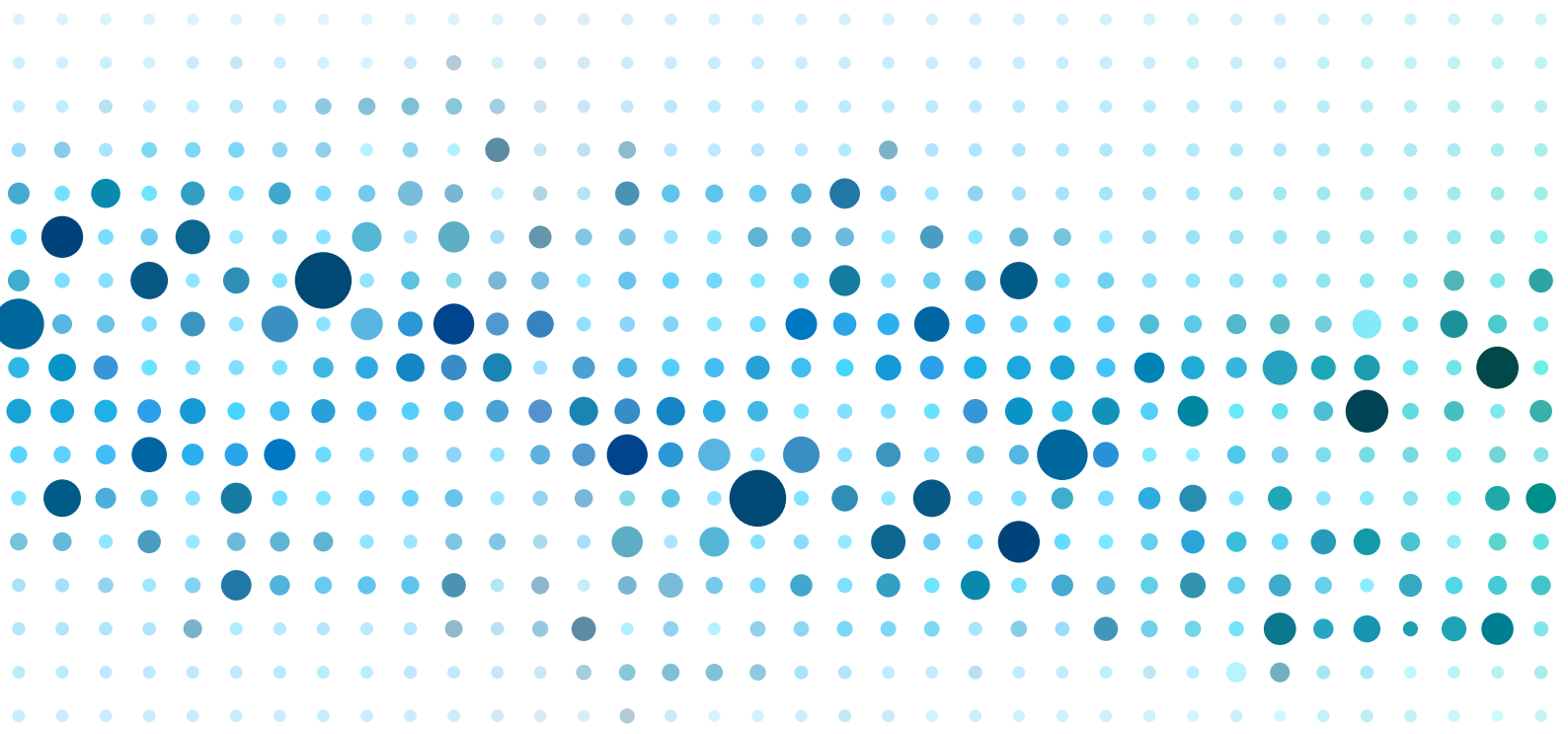


AUSTRALIAN
AIRPORTS
ASSOCIATION

AAA SUBMISSION

RESPONSE TO THE PRODUCTIVITY COMMISSION'S
DRAFT REPORT





ABOUT THE AUSTRALIAN AIRPORTS ASSOCIATION

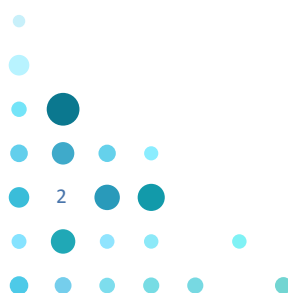
The Australian Airports Association (AAA) is a non-profit organisation that was founded in 1982 in recognition of the real need for one coherent, cohesive, consistent and vital voice for aerodromes and airports throughout Australia.

The AAA represents the interests of over 380 members. This includes more than 260 airports and aerodromes Australia wide – from the local country community landing strip to major international gateway airports.

The AAA also represents more than 120 aviation stakeholders and organisations that provide goods and services to airports.

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

The AAA is the leading advocate for appropriate national policy relating to airport activities and operates to ensure regular transport passengers, freight, and the community enjoy the full benefits of a progressive and sustainable airport industry.





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1. Introduction

The Australian Airports Association (AAA) welcomes the release of the Productivity Commission’s (the Commission) draft report on the economic regulation of Australian airports (and some related matters). As with the three previous reviews, the Commission has robustly analysed the evidence placed before it, and also that which it has sourced itself, and has reached well-informed conclusions.

Before turning to the draft report, it is necessary to address some of the commentary that has been made by representatives of domestic airlines since the release of the draft report. In particular, claims have been made that the Commission has ignored evidence put to it from an array of experts¹. Notwithstanding that some of these experts, such as the International Air Transport Association (a global industry lobbying group) and Frontier Economics, have a clear vested interest in the matters under reference, these analyses have in fact been considered by the Commission. Indeed, rather than ignoring the Frontier Economics analysis, the Commission has thoroughly examined it and found it profoundly wanting. In trying to demonstrate the existence of excess returns, airlines have focused largely on margins and in all cases on an airport as a whole (single till) basis, despite the fact that the Government’s Pricing Principles make clear that the relevant measure for assessing the abuse of market power is the pre-tax return on aeronautical tangible non-current assets (essentially property, plant and equipment including land) on the “line in the sand basis”².

Both Airlines for Australia and New Zealand (A4ANZ) and Qantas have contended that the draft report does nothing to reduce the cost of taxis, car parks and even bottled water and books³ yet nowhere in their 200 odd pages of submissions (as of 21 March) to the Commission have they identified ways in which the prices of these items might be reduced.

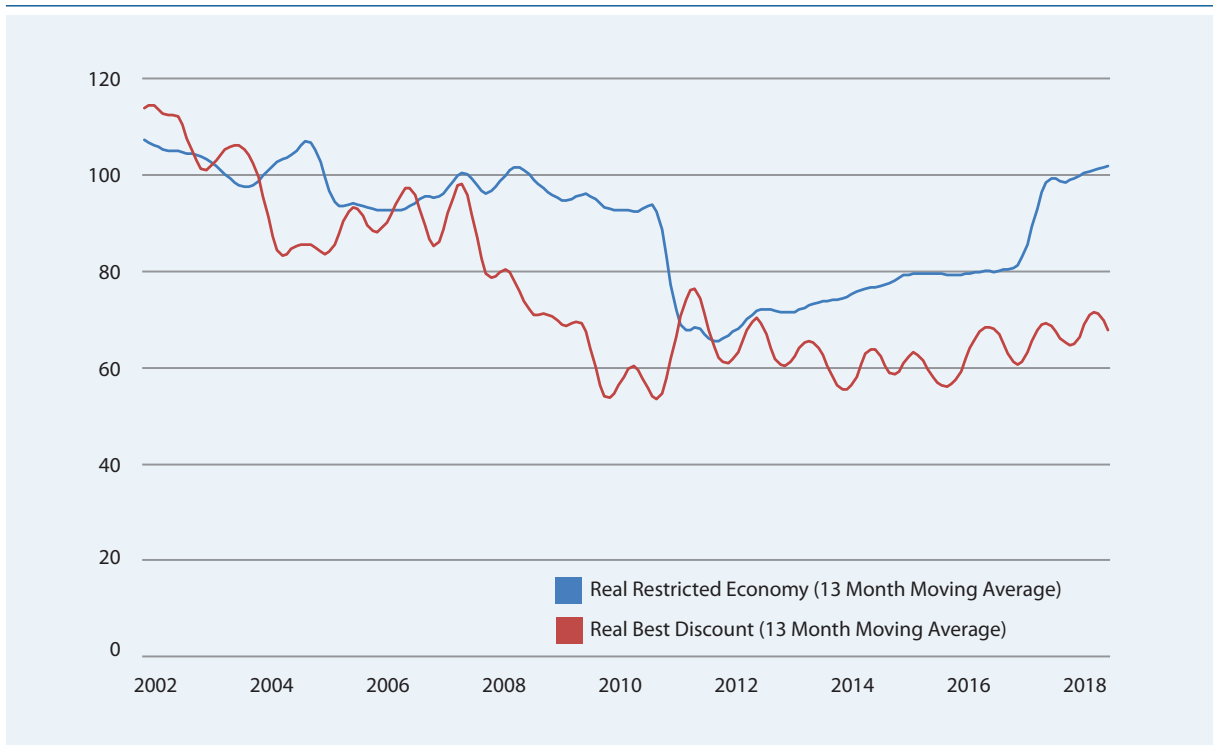
Airline calls for a single till approach will not benefit consumers of these products, rather it would merely transfer rents (in an efficiency damaging way as these rents are of a locational nature) from airports to airlines. Further as A4ANZ’s economists Frontier Economics note “there is no economic theory that supports an *a priori* assumption about the extent of cost pass through”⁴, there is no reason to believe any reductions in airport charges from a single till would be enjoyed by consumers in the form of reduced prices for books, water or indeed, airfares. Indeed, it is the acknowledgment of the absence of such a relationship that caused Frontier Economics to write down its initial estimate of the benefits of A4ANZ’s final offer arbitration proposal by some 97 per cent⁵.

In its comments at the time of the release of the draft report Qantas said “over the last 10 years average airfares have dropped by almost 40 per cent”⁶. The AAA accepts the analysis of Board of Airline Representatives of Australia (BARA) that *international* airfares have fallen by over 40 per cent in real terms since 2006⁷. However, Figure 1 which depicts data published by the Bureau of Infrastructure Transport and Regional Economics tells a different story for domestic airfares. Whilst the sharp movement in the restricted fare index in November 2017 may be associated with changes to the way the index is calculated⁸, these data show a steady increase in real domestic airfares over the last seven years, and obviously substantially higher nominal increases.

1 Samuel (2019)
2 AAA (2018, p27)
3 Joyce (2019), Samuel (2019)
4 Frontier Economics (2018b)
5 Frontier Economics (2018b)
6 Qantas (2019)
7 AAA (2018a, p11)
8 See https://bitre.gov.au/statistics/aviation/air_fares.aspx#anc_notes



Figure 1: BITRE Indices of Australian Domestic Airfares⁹



In reaching its primary conclusion that monitored airports have not systematically exercised their market power to the detriment of the community, the Commission adopted an analytical approach consistent with that used in previous inquiries. It is the consistency of this evidence-based analytical approach that provides investors with confidence in the economic regulation of airports in Australia necessary to support the \$15 billion that has been invested since the removal of prices notification in 2002 and the over \$20 billion planned for the coming decade¹⁰.

The AAA and its members note the various concerns the Commission has raised throughout the draft report. In particular, the AAA and its members are cognisant of the Commission’s warning that it would not hesitate to recommend more intrusive regulation if it felt it warranted¹¹ – airports see this as a real and credible threat.

It is the AAA’s expectation that a number of its members will address particular comments made by the Commission, and provide responses to data requests relevant to them, in their individual responses to the draft report and at public hearings. As such, the discussion that follows in this submission is primarily focused on the Commission’s draft findings and recommendations.

⁹ Data can be sourced from https://bitre.gov.au/statistics/aviation/air_fares.aspx

¹⁰ AAA (2018a, p5)

¹¹ PC (2019, p278)

2. Market power

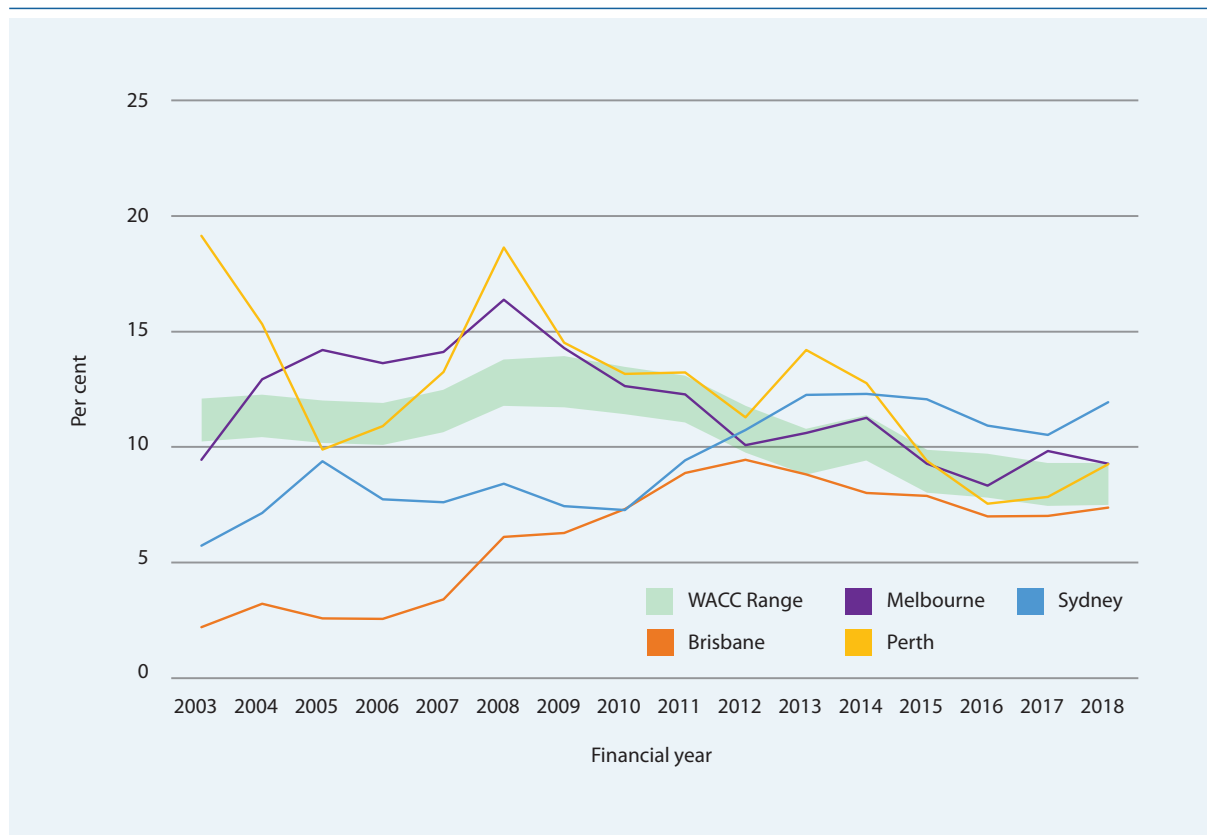
The AAA supports draft finding 5.1 that, whilst the monitored airports have a degree of market power in the provision of aeronautical services, they have not systematically exercised that market power to the detriment of the community. Although the AAA does not share the Commission's concerns regarding the potential use of market power by Canberra Airport, it agrees with the Commission's view that at this time, other than the currently monitored airports, airports lack a sufficient degree market power to warrant any additional regulatory intervention.

In its supplementary submission to the Commission, A4ANZ attached a report from Frontier Economics indicating there may be an error in Houston Kemp's calculation of the upper bound of monitored airports' aeronautical weighted average cost of capital (WACC)¹². Consistent with the AAA's total transparency approach to this inquiry, and mindful of the prohibition against providing false or misleading information to the Commission contained in section 52 of the *Productivity Commission Act 1998* (Cth), the AAA asked Houston Kemp to review its calculations.

It is the case that a spreadsheet error had occurred with the upper bound of the WACC series. The AAA and Houston Kemp regret this. That said, this error has not led Houston Kemp to vary its fundamental conclusions. In any event, as it appears that the Commission has not placed significant reliance on these data, this error has not affected the content of the draft report.

Attachment A is a short report from Houston Kemp addressing this issue. Figure 2 (below) corrects Figure 3.19 in the AAA's original submission and adds data for the year end 30 June 2018 as contained in the airport monitoring report released by the ACCC on 25 February 2019¹³.

Figure 2 Revised estimates of aeronautical return on assets and weighted average cost of capital



12 Frontier (2018a, p26)

13 ACCC (2019)



In interpreting these data in respect of Sydney Airport, care needs to be taken as the returns would be lower if asset indexation was included and Sydney Airport's long-term pricing approach may from time to time inflate annual returns on assets¹⁴. This would offset asset indexation included in the long-term pricing profile that constitutes part of the returns presented in the ACCC airport monitoring reports upon which the Houston Kemp analysis is based. The AAA understands that if appropriate adjustments were made, Sydney Airport would have had returns within or below the range established by Houston Kemp since FY2013.

Analyses of Frontier Economics

A4ANZ included in its supplementary submission further analysis from Frontier Economics purporting to demonstrate excess returns being generated by the monitored airports. That said it remains the case that A4ANZ refuses to place the entirety of Frontier Economics' analyses provided to the Commission in the public domain, something we note troubles the Commission as much as it does the AAA¹⁵.

The first observation to be made is that, notwithstanding the error discussed above, Frontier Economics has accepted Houston Kemp's approach to estimating the aeronautical cost of capital. However, Frontier Economics then seeks to apply it to the airport as a whole, rather than to aeronautical activities that are the primary focus of this inquiry. This is a somewhat curious approach given elsewhere A4ANZ suggest that the current Pricing Principles would form an appropriate basis for guidance to arbitrators¹⁶ – of course the current pricing principles mandate a dual till approach. Given that the AAA made a number of observations regarding the single till approach in its primary submission¹⁷, and noting the Commission's brief discussion of the issue in the draft report¹⁸, there is little point in debating the issue further – this is a settled matter of public policy in Australia.

Frontier Economics has undertaken a number of additional analyses which require passing comment. First, on a whole of airport basis, by comparing internal rates of return (IRR) for the monitored airports from the time of sale, it concludes that there are excess returns as the IRRs exceed the cost of funds as measured by Houston Kemp's lower bound for the WACC.

Beyond the analysis being undertaken on a single till basis, the IRR methodology used by Frontier Economics is incapable of being compared to the WACC estimates developed by Houston Kemp. Houston Kemp estimated a cost of capital in each year of the assessment period that was then compared to the return on assets in that year for each airport. However, an IRR measures the return on investments over the whole assessment period, where the asset values change over time. Consequently, the IRR should be compared to a WACC through time that is weighted by the value of assets employed.

For example, a business that invested \$1 million at the beginning of the first and second year where the WACC was 5 per cent in year one and 10 per cent in year two would earn revenues (assuming no operating expenditure or depreciation) of \$50,000 in year 1 (5 per cent on \$1 million in assets employed) and \$200,000 in year 2 (10 per cent on \$2 million in assets employed). However, averaging the WACCs over the two years would result in a WACC of 7.5%, while the IRR for these cash flows would be 8.24%, leading to the conclusion on the basis of Frontier Economics' logic that there had been an abuse of market power. It is inappropriate to compare the simple average WACC over the period with the IRR. For such an analysis to be conceptually valid, Frontier Economics would need to develop a WACC for the period that is weighted by the assets employed by each airport and as such the WACC would be expected to be different for each airport.

Frontier Economics goes on to validate its findings of excess returns by undertaking a comparative analysis of EBITDA margins despite noting these measures have "limited economic meaning, but may be easier to compare across airports"¹⁹ – ease should never be a substitute for rigour. The reasons why margins are a spurious metric is explained by the AAA in its primary submission²⁰ and acknowledged in the draft report²¹.

14 PC (2019, p171)

15 PC (2019, p280)

16 A4ANZ (2018b, p21)

17 AAA (2019, pp29-30)

18 PC (2019, p296)

19 Frontier (2018a, p16)

20 AAA (2018a, p46)

21 PC (2019, pp 162, 168-169, 302)

Putting aside the fact that the sale prices of airports were set by a competitive process, Frontier has incorrectly concluded that the sale of airport leases at prices above the book value of assets means that the Government would have likely captured benefits from the exercise of market power. The error in Frontier Economics' claim arises because the original book values did not reflect the service capability of the assets at the time of sale (as book values are known to have been significantly lower than depreciated optimised replacement cost) and book values did not properly reflect the market value of land (as was demonstrated in the price reset approved by the ACCC for Sydney Airport prior to its sale).

In addition to the distortions in asset values at the time, Professor Stephen Gray of Frontier Economics has in other contexts documented the many reasons why infrastructure asset sale values may exceed a firm's regulatory asset value, without the need for any presumption of returns that may reflect market power²².

The final piece of evidence brought forward by Frontier Economics is a report by the Grattan Institute addressing broader generic issues of concentration in the Australian economy – it is not a report directed at matters which are covered by this inquiry²³. That report claims, among other things, that around half the returns earned by airport operators are supernormal profits.

The AAA has great respect for the general reputation of the Grattan Institute, but is not aware of any particular expertise it has in the aviation industry. Like most other analyses brought forward by the domestic airlines in this inquiry, it has been undertaken on a single till basis. As the report seems to group airports with other "natural monopolies", the results are apt to mislead. For example, around half the revenues of major airports (property, retail and ground transport) are contestable in varying degrees but in all cases more so than businesses such as electricity transmission. This problem is aggravated by the fact that, as the Commission notes, Australian airports are not properly characterised as operating in two-sided markets.²⁴

The Grattan Institute's report timeframe is limited from 2011 to 2016. Any return analysis over a period that is short relative to the investment cycle and asset lives of the industry concerned is again apt to mislead. Further, as the Commission would be aware, the analysis took place at a time of significant congestion and investment across the monitored airports (corresponding with the resources construction boom) which is likely to correspond with peaking of returns (be they to assets or equity). Finally, it is not clear how equity has been measured. It is the AAA's understanding that the equity valuations of unlisted airports are closely held and not available in the public domain.

It is interesting to note in relation to airports, and other sectors, the Grattan Institute's report finds that "the net economic loss from these excess margins may be quite low, because most of the burden on consumers is offset by higher income to shareholders."²⁵ In other words, the efficiency benefits of suppressing airport charges would be minimal with the predominant impact being a transfer of rents, largely of a locational or scarcity nature, from largely Australian airport shareholders to largely foreign airline shareholders²⁶.

The recent ACCC airport monitoring report provides no basis to change the primary conclusions of the draft report

Figure 2 above shows that the general level of aeronautical returns in the year ending 30 June 2018 are broadly consistent with levels and trends seen in previous years. It is important to note that whilst the ACCC continues to wrongly place emphasis on revenue growth and margins, it has yet again made no claims that the monitored airports are earning excess returns in their aeronautical business. Indeed, as far as the AAA can tell, the ACCC has never claimed monitored airports were generating excessive aeronautical returns. The history of the monitoring regimes is not "nearly two decades of ACCC reports exposing excess profits"²⁷ when profits are properly measured but rather the exact contrary. Indeed, there have been occasions when the ACCC has actively observed that airports have not exercised their market power at the expense of airlines²⁸.

22 Gray (2017)

23 Grattan Institute (2017)

24 PC (2019, p296)

25 Grattan Institute (2017, p42)

26 The AAA understand Qantas' level of foreign ownership is generally above 40% and that Virgin and Rex are both foreign companies.

27 A4ANZ (2019)

28 ACCC (2010, p vii)

3. Commercial negotiations

The AAA welcomes the Commission’s conclusion that on balance there is little cause for concern arising from the commercial negotiations between airports and airlines²⁹. Individual AAA members are much better placed to provide the information sought via information requests 4.1 and 4.2 but that said, the AAA makes the following observations on issues relating to commercial negotiations.

Risk sharing

Since 2002 most major airports and airlines have typically entered into long-term pricing agreements where prices are indexed to CPI (possibly plus a margin)³⁰. Typically, in these cases, the revenues associated with these prices are calculated to recover the expected operating, capital and tax costs of providing the services, typically using a building block model. The AAA notes that such an approach may not be appropriate where significant capacity constraints exist, something that is explicit within the Pricing Principles.

The vast majority of aeronautical revenues in Australia have been collected on a per passenger basis, rather than a mixture of passenger fees and aircraft movement charges³¹ as is the case in many other countries. The consequence of this is that Australian airports are exposed to greater demand risk, and airlines less demand risk, than would be the case if pricing structures used elsewhere in the world were adopted.

Overlaying these revenue calculations is a range of discounting agreements which upon analysis *may* effectively uncouple costs from revenues. The AAA is aware that some airports have from time to time provided discounts to some or all carriers when an airline’s, or the entire airports’, traffic have exceeded certain thresholds. Similar arrangements have from time to time been in place in relation to the services provided by Airservices Australia.

Agreements have also typically contained provisions relating to the pass through of costs associated with “unplanned capital expenditure” – for example capital expenditure to meet new government security requirements or new services requested by airlines. These enable the parties to agree on price variations to fund new services or facilities which at the time of the agreement could not have been foreseen or were uncertain. Typically, such provisions exclude investments the airport could have reasonably expected at the time of the agreement, such as asset replacement.

Unlike some regulatory regimes, for example the electricity transmission and distribution regimes administered by the Australian Energy Regulator, airports are exposed to the full volatility associated with revenues and costs except those relating to security charges or associated with other changes in government regulation, including taxation. At the end of agreements, assets bases are rolled forward much in the same way as in a regulatory price setting framework with actual costs being added to the asset base and depreciation and disposals subtracted as specified in the Pricing Principles. In these circumstances the risks associated with cost over- and under-runs does rest with users beyond the end of the agreement. That said, the AAA is aware of instances where airlines have sought to negotiate a modification to the starting asset base of the next period on the basis of previous expenditure having been inefficient.

More recently, airlines and airports have started to explore contractual mechanisms around a different sharing of such risks. This can be seen in relation to major terminal projects where parties agree on the need for the project and a price per monetary unit (say \$1 million) at the time of the agreement and then set up a working arrangement to complete the design and oversee the delivery of the project.

As was the case during the prices’ notification period, the costs of passenger and checked bag screening labour are typically passed through to airlines on a reconciliation basis. Whilst airports work hard, and with airlines, to strike a balance between cost, service quality and compliance, the mandated security cost risk typically rests with airlines.

29 PC (2019, p109)

30 Where formal agreements have not existed, such as Perth Airport’s Prices and Services Accord that operated from 2002 to 2007, the underlying economic characteristics were broadly as described.

31 These charges can be based on a range of aircraft characteristics including the aircraft’s size (often measured by its maximum allowable take-off weight) or its environmental performance.

The domestic terminal leases left the majority of risks with the airlines. The primary risks left with airports were:

- » lost opportunity to facilitate new airline entry at those airports without domestic common user terminals;
- » default, which was manifested with the collapse of Ansett;
- » risks associated with the augmentation of the lessor's facilities during the life of the lease; and
- » reversion risks associated with airline asset management and maintenance during the life of the lease.

The Commission has specifically asked about take or pay arrangements. These have not been common in the Australian airports industry. The AAA suspects some reasons for this are:

- » recent terminal and runway investments in Australia have largely, but not exclusively, been of a common use character. Given the level of competition in international markets, it seems unlikely that international airlines would be prepared to enter into such arrangements and co-ordination issues would be substantial. Even in relation to single use facilities (such as some domestic terminals), the AAA understands that while take or pay arrangements have been discussed, the general approaches discussed above have been largely preferred;
- » entering into take or pay arrangements may have balance sheet issues for airlines in terms of recognising the pay obligation as a non-current liability and thereby creating credit and ratings issues; and
- » airport investors have invested, and continue to invest, on the basis of assuming full traffic risk and find reducing returns for major aeronautical investment unattractive from a risk/reward perspective compared to other investments in the sector and the broader economy.

Several AAA members have raised concerns regarding the banking or hoarding of slots at Sydney Airport³². This behaviour may arise at any airport that is capacity constrained and where there is a slot system in place, especially where slots are free. It is conceivable that take or pay arrangements could be put in place to discourage such behaviour.

The Commission has also raised the issue of risk sharing with suppliers in response to a submission from the Transport Workers Union (TWU) that the majority of airport functions are outsourced and this leads to suppliers competing on working conditions and hence employment levels³³. Airports are capital intensive industries, Australian airports particularly so³⁴. It is interesting to note that in its 1996 Annual Report, the Federal Airports Corporation indicated it employed 1,185 full time equivalent employees, 999 of them on a full-time basis³⁵. The AAA estimates that those airports leased from the Commonwealth employed 2,295 people (on a full time equivalent basis) last financial year. Claims that direct airport employment has reduced under the current arrangements are not made out.

With the exception of security, cleaning and ground transport supervision (where workers are typically represented by United Voice, not the TWU), outsourcing by airports is limited typically to professional services (accounting, legal, IT and so on) and some specialist technical mechanical services (lifts, elevators and travelators, aerobridges and baggage systems). The outsourced labour that seems to be of concern to the TWU relates directly to services acquired by airlines and its level and the terms and conditions of the workers concerned are not matters airports have any control over.

32 Sydney Airport (2018, pp107-108), Canberra Airport (2018, p30)

33 PC (2019, p154)

34 AAA (2018a, p40)

35 Federal Airports Corporation (1996, p73)



Benefits of arbitration may well be illusory

The AAA maintains that there are adequate mechanisms available to resolve disputes between airports and airlines. That they may be expensive and time consuming is testament to the complexity of these contracts and provides a strong incentive for the parties to reach agreement. In the absence of any systematic abuse of market power, the creation of new mechanisms would simply promote gaming and risk perverse and inefficient outcomes. Further, any arbitration framework would deliver insignificant benefits which would not cover the costs of such an arrangement. As such the AAA welcomes the Commission's sixth rejection of calls for an industry specific arbitration for access to airports.

A4ANZ's primary policy offering to this inquiry was the mandating of final offer arbitration (FOA) for disputes between an unidentified group of airports (but clearly including Dubbo and Wagga Wagga) and airlines. The Commission along with the AAA and a number of its members have identified reasons why the FOA approach is singularly unsuitable for the resolution of virtually all airport access disputes. A4ANZ recognised the validity of these observations in its supplementary submission when it said, "structures such as final offer arbitration would be considered for inclusion"³⁶.

In its primary submission to the Commission, A4ANZ claimed that the benefits from the unilateral and exclusive application of FOA would be of the order of \$17.643 billion³⁷. As a result of scrutiny by economists Houston Kemp acting for the AAA³⁸, that amount has been written down by Frontier Economics to \$479 million³⁹ – a write down of an extraordinary 97 per cent. As the Commission has noted, "even the revised estimate of the benefits in the supplementary submission from A4ANZ lacks credibility"⁴⁰.

Litigation not evidence of policy failure

During the course of this inquiry, Perth Airport has commenced proceedings against Qantas in the Supreme Court of Western Australia to recover a debt of over \$10 million it claims it is owed relating to the "short payment" of invoices for the provision of aeronautical services. The existence of these proceedings, irrespective of their merit, is used by both Qantas and A4ANZ as evidence of a significant problem in the commercial framework for airlines gaining access to airport infrastructure that requires policy intervention⁴¹.

The AAA has a different view. The right to seek redress in the courts is long established. As discussed in chapter 6 of the AAA's primary submission to the Commission⁴², litigation is one of a range of resolution mechanisms available to parties involved in disputes. The public benefits of litigation were recognised by the Commission in its seminal inquiry report on Access to Justice Arrangements:

Private and public benefits are generated when parties engage in litigation. Private parties are the primary beneficiaries — they gain by being given a forum to enforce their claims and restrain the actions of others. The wider community benefits through the enforcement of the rule of law and, in some cases, through the clarification of the law and the development of precedents.⁴³

It is clear that if this matter does not settle prior to going to trial, precedents will be made that will undoubtedly be of value to the aviation industry and potentially many others. The development of precedent will assist parties to avoid litigation in the future whilst they negotiate in "the shadow of the law"⁴⁴.

If anything is surprising in this matter, it is not that proceedings have been initiated but rather it has taken almost 17 years since the removal of prices notification for a dispute to make it to court. This is not evidence of a failed regime, it is evidence of a successful one.

36 A4ANZ (2018b, p21)

37 PC (2019, p280)

38 AAA (2018b, Attachment 2)

39 Frontier Economics (2018)

40 PC (2019, p282)

41 A4ANZ (2018c), Qantas (2018)

42 AAA (2018a)

43 PC (2014, p18)

44 PC (2014, p142)

Still room for improvement

The AAA and its members recognise that there is room for improvement on both sides. Despite A4ANZ's deliberate misrepresentation of the AAA's Chief Economist's suggestion that government guidance on negotiations would be helpful⁴⁵, and the lack of such a recommendation by the Commission, the AAA believes there is still value in a public understanding being developed as to what reasonable expectations on both sides might look like. The promulgation of such guidance would assist both airports and airlines (especially new entrants) alike.

Consistent with its supplementary submission⁴⁶ in the coming months it is the AAA's intention to explore such matters seriously. The AAA intends to reach out to BARA to see if there is any interest on the part of international airlines to find a collaborative solution to the issues that have been identified by both airports and airlines during the course of this inquiry. The AAA will also seek to work with domestic airlines to see if an understanding can be reached to improve regional airports' and airlines' understandings of what reasonable expectations of each other's conduct might look like.

45 A4ANZ (2018b, p19)

46 AAA (2018b, pp7-11)

4. Ground access

The AAA acknowledges the Commission did not find any systematic abuse of market power by the monitored airports in relation to their car parking businesses but that it still has concerns about ground access arrangements.

Ground access arrangements vary considerably between airports for a range of reasons:

- » sub-national regulatory arrangements relating to ground transport operators, including but not limited to taxis and hire cars;
- » the nature of different ground transport markets;
- » the design and utilisation of ground access infrastructure at the airport concerned; and
- » the level of security risk which may vary through time and space.

This variability means that individual AAA members are better placed to respond to information request 6.1. However, the AAA would make a few broad observations that may assist the Commission in putting this information in context.

The first is that, despite claims to the contrary, no evidence has been presented that airports have used their control of ground access to advance their own car parking businesses. As reports by Houston Kemp for the monitored airports indicate, the reality is that airports' own car parks have been losing market share. Airports have also been active in promoting other forms of land transport, such as facilitating ride sharing, upgrading taxi management and facilitating public transport projects including major heavy rail links. All of these alternatives compete with airports' car parking businesses.

The primary objective of airport landside access arrangements is the safe and efficient management of the entry to terminal buildings. Airports are mindful of the fact that ground transport operators are in competition with each other and accordingly endeavour to ensure that their pricing and operational decisions do not provide an advantage to one operator, or type of operator, over others. There will be occasions, however, when the commercial desires of a particular ground transport operator, or group of ground transport operators, cannot be satisfied because of broader safety, security and/or efficiency concerns – there can be occasions where there is little to negotiate over beyond price.

Despite the best efforts of airports to explain situations, processes may be interpreted by ground transport operators as airports acting in a “take it or leave it” fashion. When considering evidence in this regard the AAA would encourage the Commission to consider the operational context in which examples are set and that the obligation of an airport to place safety and security ahead of other considerations is sometimes lost on other businesses who have other objectives.

5. Future regulatory regime

The AAA supports the recommendation of the Commission that Sydney, Melbourne, Brisbane and Perth airports, and only those airports, should continue to be subject to the monitoring of prices, costs and profits. The AAA also supports draft recommendation 10.3 to discontinue the second-tier monitoring regime given those airports do not possess significant market power.

The AAA has noted above the importance of the Commission's consistent approach to changing market facts across inquiries in maintaining investor confidence in the Australian airports industry. Further, the AAA recognises that the periodic public inquiries conducted by the Commission are a central feature of the regulatory framework that sets evidence and analysis above rhetoric and lobbying in the policy process and as such the AAA strongly supports draft recommendation 10.2. That said, we would raise two points:

- » Some further clarification of the Commission's reasoning as to why five years is an appropriate time until the next inquiry would be helpful to participants. It does seem that even if the Commission received a reference in early 2024 and with a relatively short inquiry period, say nine months, the Commission is in fact suggesting a six-year monitoring period from 1 July 2019 to 30 June 2025. Given the consistency of the draft report with previous inquiry reports, and in particular the absence of any material findings in relation to abuse of market power by airports, we would encourage the Commission to consider whether a longer period, as recommended in some previous reviews, might be more appropriate.
- » Given the powers the Parliament has invested in the Commission by virtue of section 48 of the *Productivity Commission Act 1998* (Cth) it is difficult to see the necessity or utility in the last paragraph of the draft recommendation.

Contract provisions

The AAA supports draft recommendation 10.1. It makes it clear to airlines that they should not use their size, incumbency or market power to seek to obstruct airports encouraging competitive entry (or expansion) by airlines into new or existing markets.

The AAA understands the Commission's concerns that motivate the other part of this draft recommendation. That said, the AAA notes that clauses that restrict the use of parties' common law rights are quite common in commercial agreements, particularly in circumstances where dispute resolution is involved. While not universal, it is often the case that parties will either defer or waive their rights to take legal action in relation to certain matters that are subject to dispute resolution arrangements provided for by the agreement in question.

Airports have sought clauses that protect agreements entered into by the airport and airlines in good faith, upon which investment has been based, from being unsettled by regulatory action, particularly Part IIIA of the *Competition and Consumer Act 2010* (Cth). Airports have seen this approach as presenting less risk than having to rely on arguments in relation to declaration and potentially during arbitration on other protections (such as the legitimate interests of the service provider – s44X(1)(a)). That said, the AAA can accept that the benefits of obviating these risks may be outweighed by the community wide benefits from the removal of anticompetitive clauses sometimes sought by domestic airlines.

AAA members are better placed than the AAA to respond to information request 10.1.

Cost and revenue monitoring

The AAA supports draft recommendation 10.4 in principle. It is good regulatory practice to periodically review and, where the benefits outweigh the costs, update regulatory instruments such as Part 7 of the *Airports Regulations 1997* (Cth), which is among the most important in the airports' regulatory framework.

The AAA agrees that it would be desirable to improve the understanding of the revenues and costs associated with different market segments – domestic, international and in the case of Sydney, regional. Revenue is not a challenge nor is cost information relating to terminals, particularly where domestic and international passengers use separate terminals or clearly separate areas in the same terminal – this is currently the case at the monitored airports but less so in Canberra and Adelaide. However, there may be circumstances where a terminal is used by a small number of airlines, and as a result disclosure of terminal passenger numbers may amount to information being released to the market that is not otherwise available – the AAA understands that it is for this reason that the ACCC does not publish data of this kind that it currently collects. In relation to costs, the AAA is not certain of the utility of gathering information on detailed costs of individual terminal components, such as aerobridges.

The costs of the airfield, however, present a serious methodological challenge. The total economic cost of runway services is dominated by the return on and of capital on the runways and taxiways, their associated lighting and other systems, and the land on which they sit. The length, and to a lesser extent, the strength of a runway is determined by the largest aircraft that will (or have) used it, whereas the extent of the taxiway network reflects the design of the airfield (primarily the location of the terminals and runways) and the level of demand at peak times. Operating costs are comprised of sweeping and cleaning, patrolling and security, and repair of surfaces and systems and are small relative to the capital costs.

There is no immediately obvious way to distribute this common cost but options include the number of aircraft movements, the weight of aircraft and passenger numbers. The method for the allocation of these costs was at the kernel of the dispute between (as it was then) Virgin Blue and Sydney Airport that led to Sydney Airport being declared in 2005. Each method leads to very different allocations – passenger numbers and aircraft movements will tend to allocate more to smaller (domestic) aircraft whilst weight-based charges will allocate more to larger (international) aircraft.

Similar challenges exist in relation to landside access services. Demand and revenue data are relatively easily obtainable. However, costs are a different issue. Ground access operating costs include cleaning, management and maintenance of the forecourt area whilst the capital costs largely relate to pavements, barriers and lighting and of course land. If one considers the area between Terminals 1, 2 and 3 and the multi-deck carpark at Melbourne Airport, it is difficult to see how costs could be allocated between users on anything but an arbitrary basis. Service specific costs are likely to be quite small. It should also be understood that when considering ground access prices, airports will typically have regard to the proximity to the terminal of where various vehicles park, introducing an element of locational amenity that will not be reflected in costs.

Quality of service monitoring

The AAA believes that the ongoing development of contractual arrangements will render the monitoring of service outcomes relevant to airlines redundant⁴⁷. That said, it believes that reviewing the current indicators to bring them more into line with the commercial agreements struck by airports and airlines is a sensible suggestion and as such the AAA supports draft recommendation 10.5.

In finalising this draft recommendation, the AAA does suggest that the Commission clarify what it means by “other airport users” and on what areas of quality they should be consulted – if the user is a taxi operator then there is no need to discuss issues around baggage system performance.

Finally, the AAA suggests the Commission consider explicitly whether any passenger related measures, including the current survey framework, require review and how the travelling public should be consulted by the ACCC in the course of such a review.

47 AAA (2018, p93)

6. Regional airports

The AAA welcomes the Commission's acknowledgement of the financial challenges faced by Australia's regional airports⁴⁸ and its subsequent conclusion that such airports do not possess market power that might justify some form of regulation. The AAA notes and agrees with the Commission's more general conclusion in relation to market power of regional airports, some of which are privately operated, and indeed all airports smaller than the four currently monitored.

Funding

Draft recommendation 10.6 explicitly acknowledges the need for Australian governments to provide grant funding to regional airports and the AAA welcomes this. Whilst it is not clear whether or not the Commission believes there has been a material waste of public resources supporting regional airports, the AAA acknowledges the need for appropriate and transparent assessment of the expenditure of public money.

That said, the AAA is concerned that whilst the approach recommended by the Commission may be appropriate for the assessment of, say, a new regional terminal costing several tens of millions of dollars, it may be disproportionate for the assessment of relatively small essential aviation infrastructure projects (less than say a few million dollars) contemplated by the AAA's proposed Regional Airport Infrastructure Fund (RAIF)⁴⁹.

It is also important to recognise that the Commission's proposed independent analysis of regional airport infrastructure funding focuses almost exclusively on the economic and financial viability of potential projects, and their links to long-term strategies. For small regional airports, demonstrating direct economic benefits for certain infrastructure projects can be difficult due to the often-limited revenue generated from aeronautical operations.

The most substantial benefits that are derived from investments at small regional airports are often of a social welfare nature, particularly in regards to reducing isolation and maintaining connectivity with larger regional/ metropolitan centres, as well as facilitating essential services such as mail, banking, fresh produce, aeromedical and emergency services. While these essential community services may not result in significant economic boosts for the region, they are critical for ensuring small regional communities remain supported and are able to access basic essential services.

The most essential projects at these regional airports, which the AAA's proposed RAIF has been designed to assist with, are to address deficiencies in meeting required safety standards to continue operating services into the future. These include projects such as runway and taxiway overlays, airfield lighting upgrades and perimeter fencing, all of which are essential to facilitating safe air services but do not necessarily result in direct economic benefits for those communities. It is important the Commission includes consideration of social benefits in any proposed independent assessment process for proposed regional airport infrastructure projects.

The AAA suggests that the Commission consider reworking this draft recommendation in such a way that assessments are appropriate to the scale of fiscal and other risks posed by the project to all levels of government and users in a way that maintains the essential transparency and accountability features that rightly motivate the Commission in this regard. It would also be prudent for the Commission to consider amending the draft recommendation to take into account the social benefits (as well as the economic) that may result from the development of a regional airport infrastructure project.

48 PC (2019, p175-177)

49 AAA (2018c)



As an aside, the Commission seems to have misinterpreted the AAA's observation about the prudence of councils ensuring their airports are capable of facilitating operations of aircraft not currently using the airport. The Commission will no doubt recall its own work on the application of real options to water supply augmentation⁵⁰. The AAA's suggested analysis would take account of: the benefits of delaying the investment until some uncertainty is resolved; the risks and costs incurred by the community by being without services; and the benefits that might accrue from increased competition resulting from the removal of the bottleneck caused by the runway restriction. This is an empirical question and would be borne out by the sort of analysis contemplated in draft recommendation 10.6 – in no sense does the AAA suggest it would be appropriate in all circumstances.

Asset management

The AAA is pleased that the Commission recognises its work with the Western Australian Department of Transport in developing the Strategic Airport Asset and Financial Management Framework. Before endorsing its deployment, it would be prudent for the Commission to satisfy itself that it would not be duplicating, in part or whole, the operation of council asset management frameworks in place in other jurisdictions.

The AAA believes the primary benefit for the Strategic Airport Asset and Financial Management Framework is that it could be a useful tool for small local government operated regional airports, where there may not be a detailed understanding of the complexities involved in managing a unique asset such as an airport.

For larger regional airports operated by local councils, particularly where there are healthy levels of air traffic and the airports generate enough revenue to be self-sustaining, it is more likely that there is the resourcing, time and effort available to establish a mature and fit-for-purpose asset management and financial framework. In instances such as this, it may not be necessary (or at worst detrimental) to require such airports to implement the proposed framework being developed in Western Australia.

The AAA is maintaining close involvement in the steering group responsible for oversight of the framework project in Western Australia. In discussions with the Western Australian Department of Transport, it has been agreed that the AAA would be able to utilise the finalised framework developed for Western Australian airports and re-publish it as a nationally applicable guidance document for other regional airports to access. This document, as with all AAA guidance documents, would seek to provide best practice advice to regional airports needing to strengthen their asset and financial management processes. The AAA considers it should only be applied on a voluntary basis, particularly where an airport already has an effective and robust asset and financial management framework in place that is fit-for-purpose. It is important that any application of an asset and financial management framework on a regional airport be done with due consideration of the existing processes in place and recognition of the size and scale of operations to ensure that it can be adapted to be fit-for-purpose and not an unnecessary regulatory burden.

50 PC (2011, pp105-112)

7. Sydney Airport

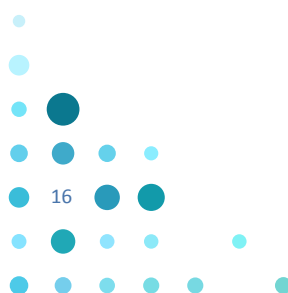
The AAA welcomes the Commission’s acknowledgment that the current environmental noise mitigation measures in place at Sydney Airport can have airport and network wide efficiency impacts, especially when operations have been disrupted. The AAA would support a review of the current processes to improve efficiency and resilience whilst maintaining the social compact between government, the aviation industry and noise affected communities in Sydney.

The AAA also supports Sydney Airport’s view that reform of the regional price notification regime (that applies only to Sydney Airport) to exclude services provided under a confidential agreement negotiated between providers of regional air services and Sydney Airport, would be beneficial as it would enable regional airlines to implement mutually beneficial agreements with Sydney Airport on a confidential basis.

8. Jet fuel

The AAA supports the draft finding and recommendations regarding the supply of jet fuel.

AAA members are better placed to respond to information request 8.1 although the AAA would observe that the right to impose fuel throughput levies was a right inherited from the Federal Airports. In the Information Memoranda associated with the sale process, the Commonwealth did indicate this was an additional revenue source available to lessees. Obviously, the passage of time will have led to more varied circumstances as revealed during the course of this inquiry.





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