
CANBERRA AIRPORT

**2018 PRODUCTIVITY COMMISSION
INQUIRY INTO THE ECONOMIC
REGULATION OF AIRPORTS**

RESPONSE TO THE FEBRUARY 2019
DRAFT REPORT

MARCH 2019



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1. Introduction

Canberra Airport welcomes this opportunity to make a further submission to the Productivity Commission's 2018 Inquiry into the Economic Regulation of Airports, specifically responding to the Draft Report released by the Commission in February 2019. Canberra Airport would be pleased to discuss any aspect of this submission with the Productivity Commission (PC), and we look forward to presenting at the upcoming public hearings.

2. Executive Summary

Canberra Airport is generally supportive of the findings and draft recommendations made by the Productivity Commission (PC). We recognize the thorough nature of the review, and also note that there are certain aspects to the report and requests for information that are not directly relevant to Canberra Airport, and in these instances, we do not make any comment.

However, we do want to specifically respond on some key points pertinent to Canberra Airport. Specifically, we are concerned that the PC comments in relation to Canberra Airport's market power are overstated, and not consistent with our market power as it has played out in practice. We provide further support and discussion in relation to this matter below, and believe some careful amendments to the PC report wording in this regard is required.

Our primary concern with the PC comments on Canberra Airport's market power is that they largely draw on the high proportion of business travellers in Canberra Airport's passenger mix. What we highlight to the Productivity Commission in this submission is that the high proportion of business travellers at Canberra Airport is not necessarily reflective of the underlying market, but that the high proportion is primarily determined by the product and pricing strategy of the airlines. So while the comment that Canberra Airport has a high proportion of business travellers relative to peer second tier airports is true, it is the airlines that are defining our passenger market segmentation. And it is the airlines that are exercising market power in that regard, not Canberra Airport, by setting high and increasing airfares for Canberra passengers.

As a result, we believe that the PC has considerably understated the countervailing airline market power in Canberra, which effectively eliminates the possibility that Canberra Airport is, or in any way can, abuse any market power in relation to passenger and airline services at Canberra Airport.

3. Factual Issues

Canberra Airport has identified several instances of factual matters in the Draft Report which require consideration and updating. These are as follows:

1. On page iv of the Terms of Reference of the Draft Report, the 2006 inquiry recommended monitoring arrangements continue for Melbourne Airport also – we believe that Melbourne has been inadvertently omitted by the PC.
2. The Terms of Reference also should identify that, in the 2011 Inquiry, the PC recommended that Adelaide be excised from the price monitoring regime, and instead be included in the ‘Tier 2’ self-administered monitoring regime.
3. On page 105 of the Draft Report, the PC states that Canberra Airport was subject to the price monitoring regime until 2012. This is incorrect – the PC recommended in its 2006 inquiry that price monitoring of Canberra Airport was no longer necessary due to a lack of market power, the countervailing power of airlines, competition from other airports and other modes of transport, and the small passenger volumes relative to the other monitored airports.

4. Commentary Corrections

On review of the commentary in the Draft Report, we request that the PC considers amending its commentary in certain areas.

On page 119 of the Draft Report, it appears that the PC has likely relied on submissions made to it to make the comments about two disagreements that were played out publicly between Qantas and Canberra Airport in 2017. This matter is unfairly used by the PC as an example of poor Airport behaviour. Canberra Airport would like it noted that the actual diversion and disputed charges occurred in March 2017¹, and the dispute was resolved within one week of the diversion flight, and importantly it was resolved confidentially. When it was raised publicly for the first time, it was brought up by the Qantas Chairman Alan Joyce and A4ANZ spokesperson Graeme Samuel, even though the matter had been fully resolved for over twelve months.

Alan Joyce described Canberra Airport as “Somali Pirates” in May 2018 when Qantas was facing public criticism for their poor reliability and cancellations on the Canberra Sydney route. Graeme Samuel compared Canberra Airport to Somali and Kenyan Airports², causing great offence to Kenyans, which he publicly apologised for³. This is an example of an airline’s and airline industry group’s poor behaviour, not an airport’s poor behaviour. We suggest this example is deleted as it is not an example of poor behaviour by an airport, as it is currently characterised.

We also request that the commentary of the PC in relation to Canberra Airport’s market power be amended, and we outline our concerns in section 5 below.

¹ <https://www.businessinsider.com.au/qantas-canberra-airport-profits-australia-regulations-2018-6>

² <https://www.canberratimes.com.au/national/act/kenyans-now-enter-the-fray-of-qantas-scrap-with-canberra-airport-20180527-p4zhsm.html>

³ <https://www.canberratimes.com.au/national/act/airline-industry-group-chair-writes-unqualified-apology-to-kenyans-20180530-p4zie9.html>

5. Market Power

We request that the PC clarify commentary in relation to Canberra Airport's market power. In the discussion of market power in the Draft Report, the PC clearly finds that Canberra Airport does not have sufficient market power to warrant monitoring at this time. However, the commentary then proceeds to single out Canberra Airport as having the next most market power and the PC recommends specifically that at the next inquiry the PC closely consider Canberra Airport's market power.

Page 106 of the Draft Report reads *"Of the two, Canberra Airport is closer to the threshold for concern and the Commission will again examine the characteristics of market power at Canberra Airport closely in its next inquiry into airport regulation."*

Our view is that terms of reference of the Productivity Commission for an inquiry into the Economic Regulation of Airports will be to consider all airports' market power and their use of it, so we believe the commentary specific to Canberra Airport and future reviews is not appropriate for this report. We therefore request that the Commission considers deleting this unnecessary reference.

Further, we do not agree with the PC view of Canberra Airport's market power, and we request the Commission has regard to the following comments and information.

Previous Productivity Commission comments on Canberra Airport's market power

Firstly, we would like to highlight to the Commission previous findings in relation to Canberra Airport's market power included below:

2006 PC Report Overview page XXVI:

The Commission also considers that monitoring of Darwin and Canberra Airports is no longer necessary.

- *They are relatively small airports dealing with some major airlines that can withdraw services (and have done so), and hence have some countervailing power.*
- *Both face some competition from other airports and/or other modes of transport.*
- *And both have less passenger traffic than some of the larger non-monitored airports.*

2012 PC Report Page 73

Adelaide, and to a lesser extent, Canberra and Darwin have a moderate degree of market power. Although Adelaide and Canberra have high proportions of business and travellers visiting friends and relatives (VFR) and do not face significant potential for airport substitution, they (especially Canberra) do face material competition from alternative transport modes.

In 2012, the Commission had regard to the following factors as mitigants to Adelaide Airport's market power (and as a result recommended the excise of Adelaide Airport from the Tier 1 regulatory regime):

- growth in low cost and foreign carriers,
- non-aeronautical revenues,
- recent investment
- size and position in the national network

- long-term (airline) customer contracting

We believe the Adelaide Airport mitigants apply to the same extent or a greater degree to Canberra Airport, and in addition, Canberra Airport faces significant modal competition for a large proportion of our passenger base.

There has been no change in the characteristics of Canberra Airport’s market that would lead to an increase in Canberra Airport’s market power compared to previous inquiries. Indeed, it is our view that Canberra Airport’s market power is lower than previous inquiries, and that the countervailing market power of the two dominant domestic airlines is an even higher constraint to any residual Canberra Airport market power.

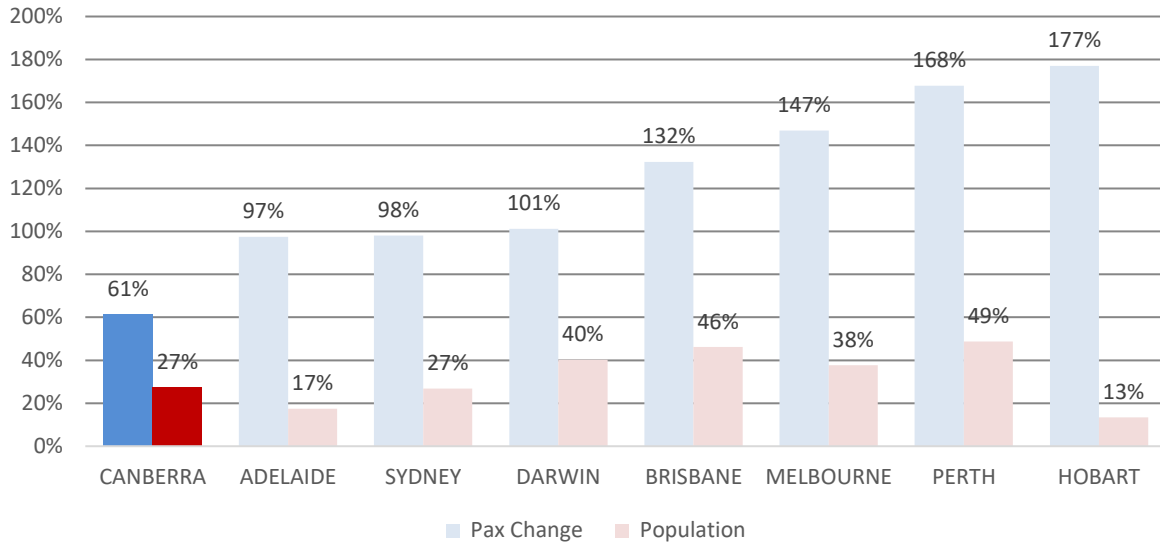
Canberra Airport’s position in the national market and relative to peer airports has not improved. Not only is Canberra Airport one of the smallest Capital City Airport’s by passenger volume, we also have the lowest passenger growth rate over the last 10 years. Based on our relative size, Canberra Airport is not “policy relevant”.

Passengers by Airport 1998 to 2018			
Sorted by compound annual growth rate %			
PAX Change	1998	2018	Movement %
GOLD COAST	1,854,715	6,486,106	6.46%
HOBART	858,624	2,676,628	5.85%
PERTH	4,669,601	12,477,914	5.04%
MELBOURNE	13,918,273	36,916,015	5.00%
TOWNSVILLE	637,028	1,610,298	4.75%
BRISBANE	9,689,581	23,465,142	4.52%
SYDNEY	21,208,628	44,430,138	3.77%
ADELAIDE	4,012,493	8,346,297	3.73%
DARWIN	1,031,494	1,972,523	3.29%
CANBERRA	1,805,091	3,248,569	2.98%
Grand Total	59,685,528	141,629,630	4.42%

Source: BITRE – Department of Infrastructure, Regional Development and Cities

As highlighted below, over the period from 1998 to 2016 Canberra passenger growth was also the lowest of all capital cities with passengers growing at around twice the rate of population growth, compared to Adelaide at five times population growth, and Hobart at fourteen times population growth.

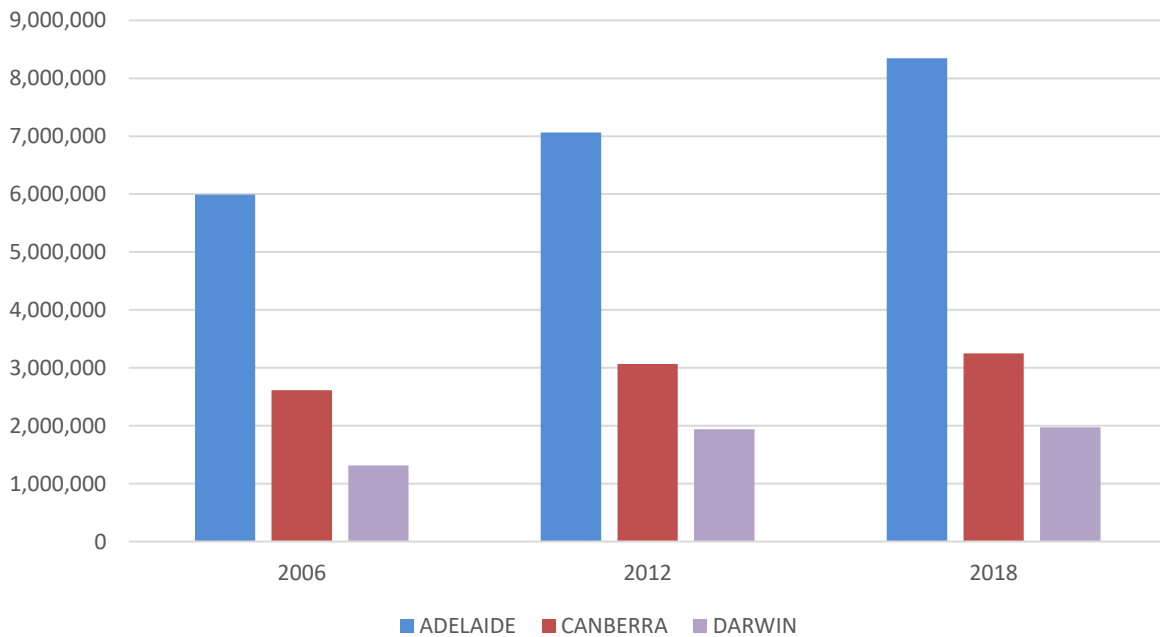
Passenger vs Population growth 1998 to 2016



Source: BITRE – Department of Infrastructure, Regional Development and Cities and Australian Bureau of Statistics census data.

And compared to our peer airports Darwin and Adelaide, Canberra Airport’s relative size and place in the national network is unchanged compared to the 2006 and 2012 PC Inquiries. Canberra Airport is now proportionally smaller than Adelaide when compared to the situation in 2006 and 2012, and Adelaide appears to have further strengthened since then.

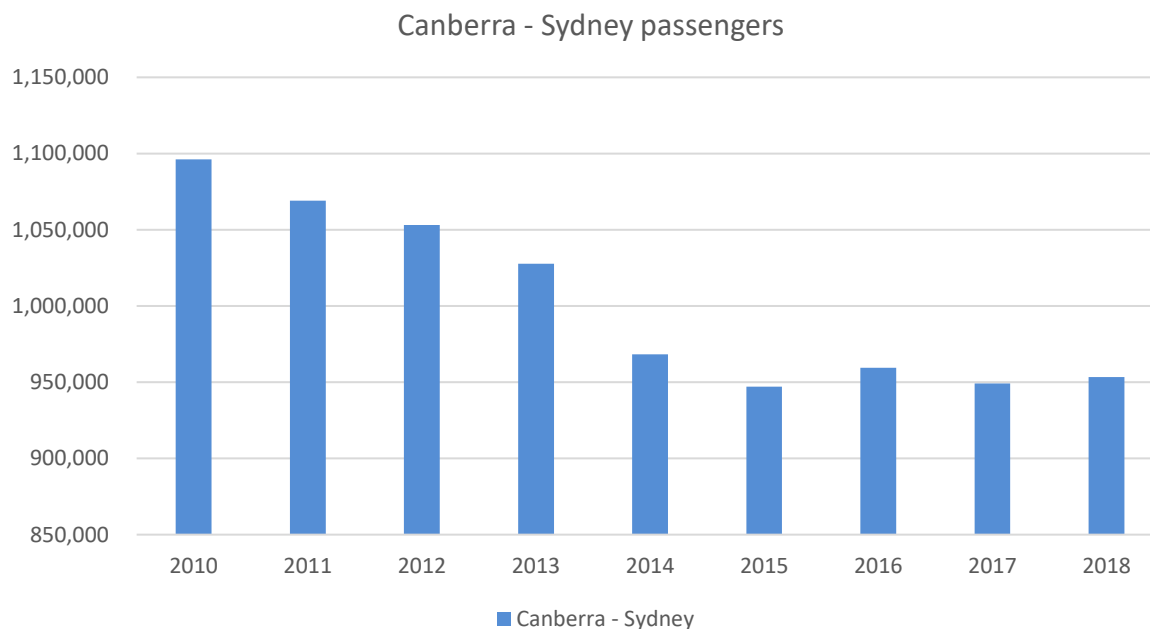
Passengers by airport (PC Inquiry years)



Source: BITRE – Department of Infrastructure, Regional Development and Cities

Competition from other modes of transport and from Sydney Airport

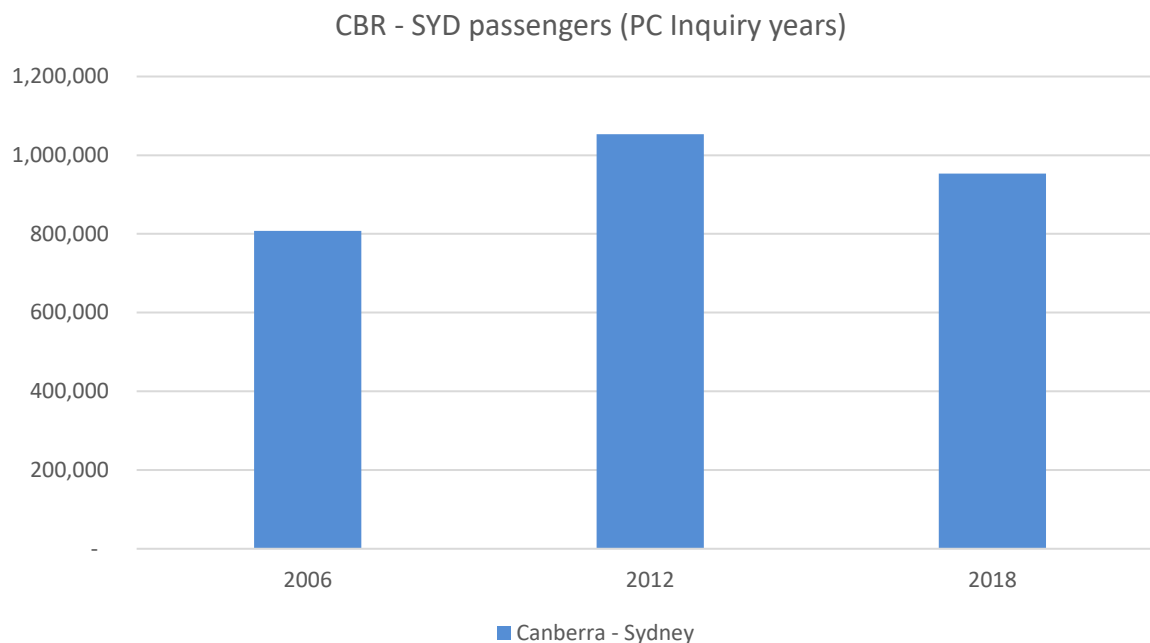
Canberra Airport faces strong competition from alternate modes of transport for a significant proportion of our passenger base. The chart below shows the decline in passenger volumes on the Canberra-Sydney route over recent years.



Source: BITRE – Department of Infrastructure, Regional Development and Cities

As a proportion of our passenger base, in 2012 Canberra-Sydney made up 35% of our passengers. In 2018, Canberra-Sydney passengers are now 29% of our passenger base, (a total decrease of 100,000 passengers) and volumes continue to deteriorate. The major drivers of this decline are:

- Significant competition from alternate modes of transport – primarily private vehicle, Murray’s, Greyhound’s and other bus services, and rail.
- Significant increases in average airfares on this route (discussed further below)
- Poor airline quality of service on this route (high cancellations; and the route is primarily serviced by turbo prop aircraft which provide substantially poorer passenger experience compared to jet aircraft).
- Traffic congestion around Sydney Airport, and the high costs of getting from Sydney Airport to destinations in Sydney.

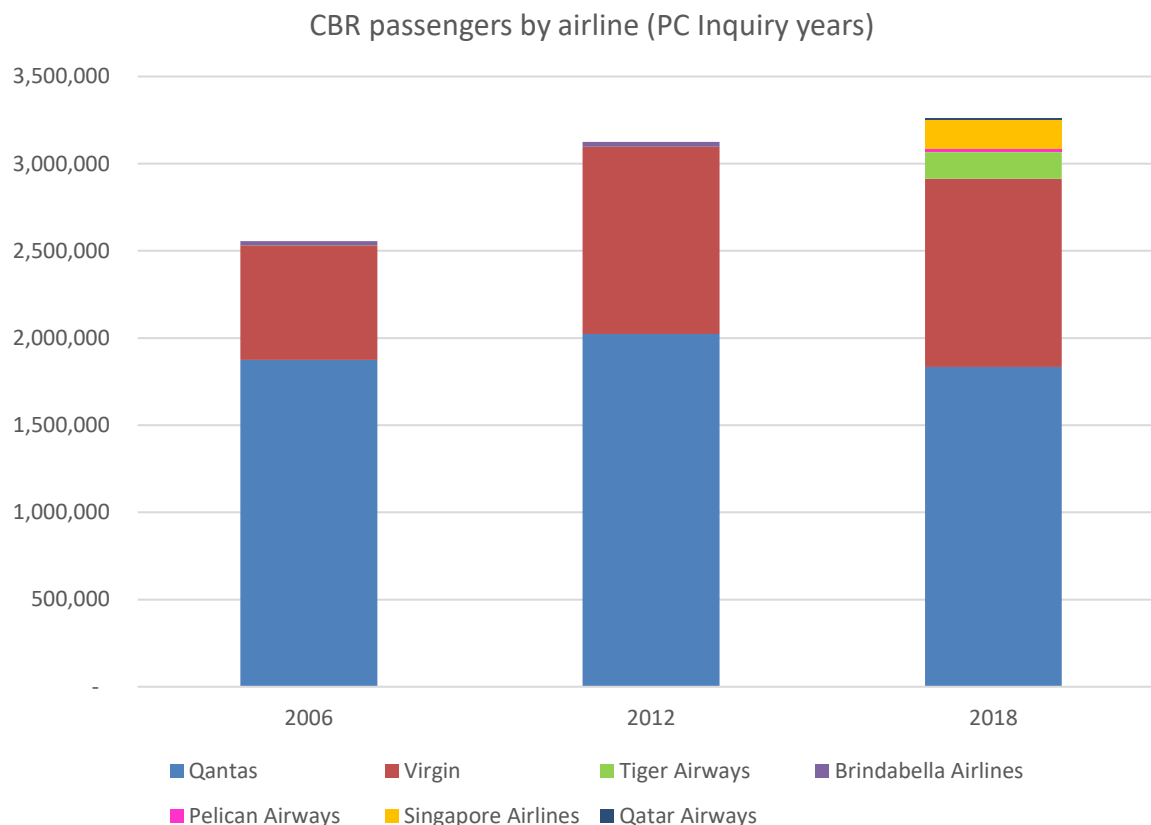


Source: BITRE – Department of Infrastructure, Regional Development and Cities

Canberra Airport is also facing significant competition for passengers from Sydney Airport, with potential passengers from our catchment travelling to Sydney Airport for their departure flights rather than using Canberra as their departure airport. Our view is that this behaviour is driven by the high airfares on the Canberra – Sydney route, and the poor transit experience from Sydney domestic to Sydney International terminals, which both act as significant disincentives to travellers from our catchment.

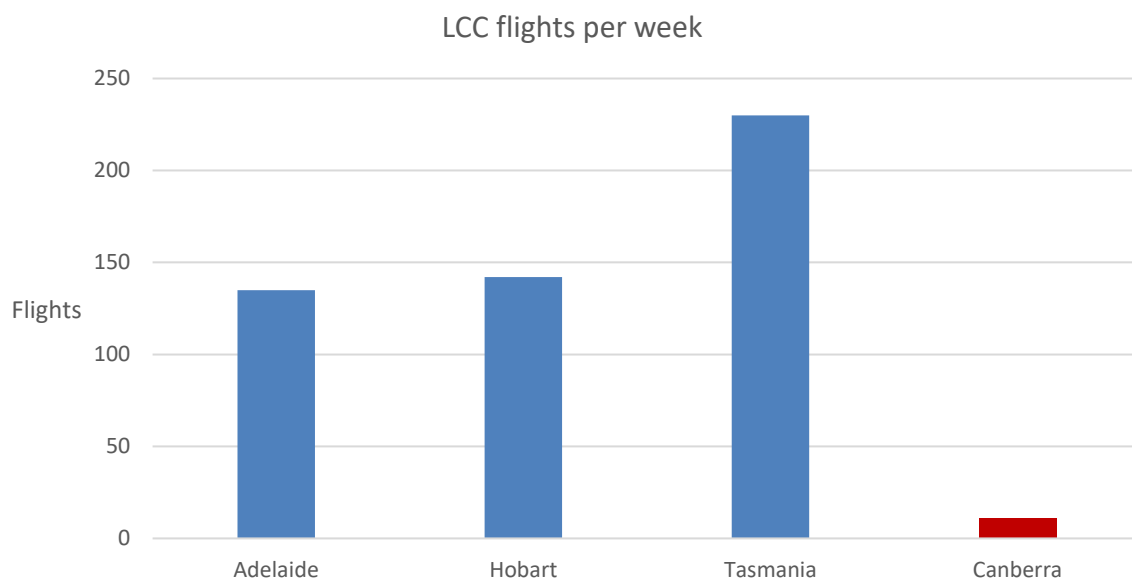
Countervailing market power of Airlines

As discussed above, Canberra Airport has the lowest passenger growth rate of all of the capital city airports in Australia over the last ten years. Over time, Canberra Airport has been primarily serviced by the two dominant domestic airlines – Qantas and Virgin Australia. Canberra has long pursued both low cost carrier and international services, and was finally successful on both fronts in 2016. Canberra Airport is now serviced by Singapore Airlines and Qatar Airways both providing daily international services, and by low cost carrier Tiger Air which flies domestic services to Melbourne and Brisbane (albeit with limited frequency). The chart below shows that the passenger growth that has been achieved in Canberra since the last PC Inquiry in 2012 has been solely due to the new airlines, with the total passenger volume of Qantas domestic reducing significantly in the last six-year period. Importantly, Canberra Airport is now served by 6 RPT airlines compared to only 2 in 2012.



Source: Canberra Airport Passenger data; Qatar 2018 data is part year volume only

The other important characteristic of the Australian domestic aviation market is that the two major airlines now own the next two largest airlines – low cost carriers Jetstar and Tiger. And it is these two low cost airlines that have stimulated significant passenger growth around Australia’s airports over recent years. However, this has not been the case in Canberra. The Qantas group has not introduced Jetstar services at Canberra Airport (despite significant marketing efforts by both Canberra Airport and the ACT Government) and Virgin has only introduced Tiger services to a limited extent. Compared to other comparable tourist destinations (Canberra has more domestic tourists annually than the whole of Tasmania, and almost as many as Adelaide), Canberra is significantly underserved by low cost airlines. This is demonstrated by the following chart.



It is a generally accepted principle in Australian aviation markets, that the introduction of new low-cost carrier routes delivers largely new incremental growth, and there is little cannibalization of existing passenger volumes. It is therefore not a significant stretch to conclude that the introduction of new low-cost carrier services in Canberra would generate additional new passenger volumes. The table below estimates the additional passenger volumes that Canberra could achieve with a similar level of low-cost services as Adelaide (which has similar annual tourist numbers).

LCC Services CBR vs ADL

CBR - Avg no of LCC services per week	11
ADL - LCC Services per week	135
Shortfall LCC services per week (ADL vs CBR)	124

Estimated annual additional LCC passengers

Passengers on B737-800 - 186 seats - 75% load	140
Annual Passengers on additional 124 services per week	1,803,072

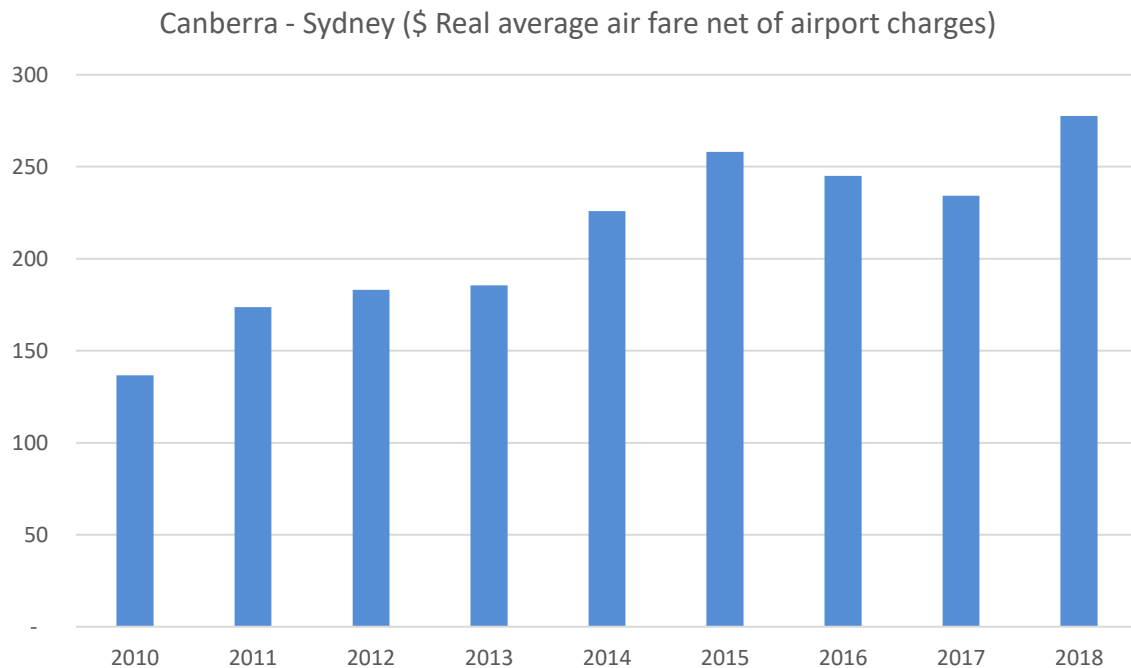
CBR passengers current vs full LCC

CBR current total passengers	3,259,772
CBR estimated passengers with full LCC services	5,062,844

Even if only half this growth was achieved in practice, it would represent an almost 30% increase in total passenger volumes at Canberra, and these lost / missing passengers would be primarily leisure travellers. This would have a substantial effect on the Canberra Airport business / leisure traveller segmentation.

In addition, as a result of a lack of low-cost carrier competition, airfares to and from Canberra Airport are very high. In our view, this demonstrates how domestic airline groups are exercising their significant market power: by withholding low cost carriers from the Canberra market and increasing and maintaining high airfares.

The following chart shows the increase in average real domestic economy airfares on the Canberra Sydney route (excluding Airport charges). Since 2010, in real terms, the average domestic economy airfare has increased by around \$130 excluding airport charges— almost doubling in *real* terms.



Source: BITRE – Department of Infrastructure, Regional Development and Cities

And the following chart demonstrates that, on the Canberra – Sydney route, while real average airfares over this period were doubling, total passenger volumes were rapidly falling. As airfares increase, the passenger mix also changes. As the Productivity Commission itself notes, business passengers are much less price sensitive than leisure travellers. So as airfares have climbed steeply at Canberra, the leisure travellers have been effectively priced out and onto other modes of transport (or to the competing airport – Sydney).



Source: BITRE – Department of Infrastructure, Regional Development and Cities

The conclusion that we reach, and that we would like to highlight to the Productivity Commission, is that the high proportion of business travellers at Canberra Airport is not necessarily reflective of the underlying market, but that the high proportion is primarily determined by the product and pricing strategy of the airlines. So while the comment that Canberra Airport has a high proportion of business travellers relative to peer second tier airports is true, it is the airlines that are defining our passenger market segmentation. And it is the airlines that are exercising market power in that regard, not Canberra Airport, by setting high and increasing airfares for Canberra passengers.

It is also worth noting that the Canberra – Sydney route:

- Is the only major capital city route pair with a decline in passengers over the ten-year period;
- Is the only capital city pair without low-cost carrier services;
- Has the highest average fare per km in Australia (excluding airport charges);
- Has the highest average fare increase of all capital city pair fares over the ten years, and
- Has had the highest average cancellation rate over this period.

For completeness, and to highlight the effective constraints to any residual market power Canberra Airport could theoretically exercise, we also note:

- Canberra Airport has long term airline agreements with fixed price paths and in those agreements, Canberra Airport has accepted volume risk. Therefore, as passenger growth is constrained by airline product and pricing decisions at Canberra increase, Canberra Airport loses revenue on the volume performance below the pricing agreement levels. We have largely contracted out of an ability to exercise any theoretical market power.

- While we cannot force low-cost carriers to fly to our market, we have actively pursued airlines for additional services including in partnership with the ACT Government.
- Canberra Airport’s airline agreements includes airport charges which are the same regardless of the type of passenger (leisure, business, VFR), regardless of the flight’s destination, regardless of the airfare the passenger pays, and regardless of the airline. We therefore have no incentive or ability to leverage any market power through airport terms and conditions, and in fact, to do so would be counter to the growth of our business and not a valid response to competition from alternative modes of transport and competition from Sydney airport.
- Canberra Airport’s airline agreements also demonstrate our lack of market power in negotiating non-price terms. For example, we have been unable to get airlines to provide financial security to support our commercial exposure to them. This is despite our, at times, significant concerns regarding their credit-risk and their non-compliance with payment obligations under signed agreements. And we have been unable to negotiate the removal of anti-competitive “Terms no Less Favorable” clauses from our airline agreements with the major domestic airlines despite a strong desire and a Board directive to do so.
- Airlines have demonstrated a willingness to withhold payment for significant extended periods when they disagree with commercial terms – a real and clear use of their countervailing power (and obvious constraint to the ability of an airport to abuse market power).

Market power summary

In relation to market power at Canberra Airport, we encourage the Productivity Commission to reconsider the language in relation to Canberra Airport’s theoretical market power, and to revise the commentary in the Report in this regard. We are of the strong opinion that Canberra Airport has low market power:

- We are a small airport by any measure and not of a “policy-relevant” size relative to our peer airports;
- We have an extremely low capability to exercise market power given the strong countervailing market power of airlines, as demonstrated by the exercising of this market power by airlines; and
- There are significant alternative travel options available on our major passenger route.

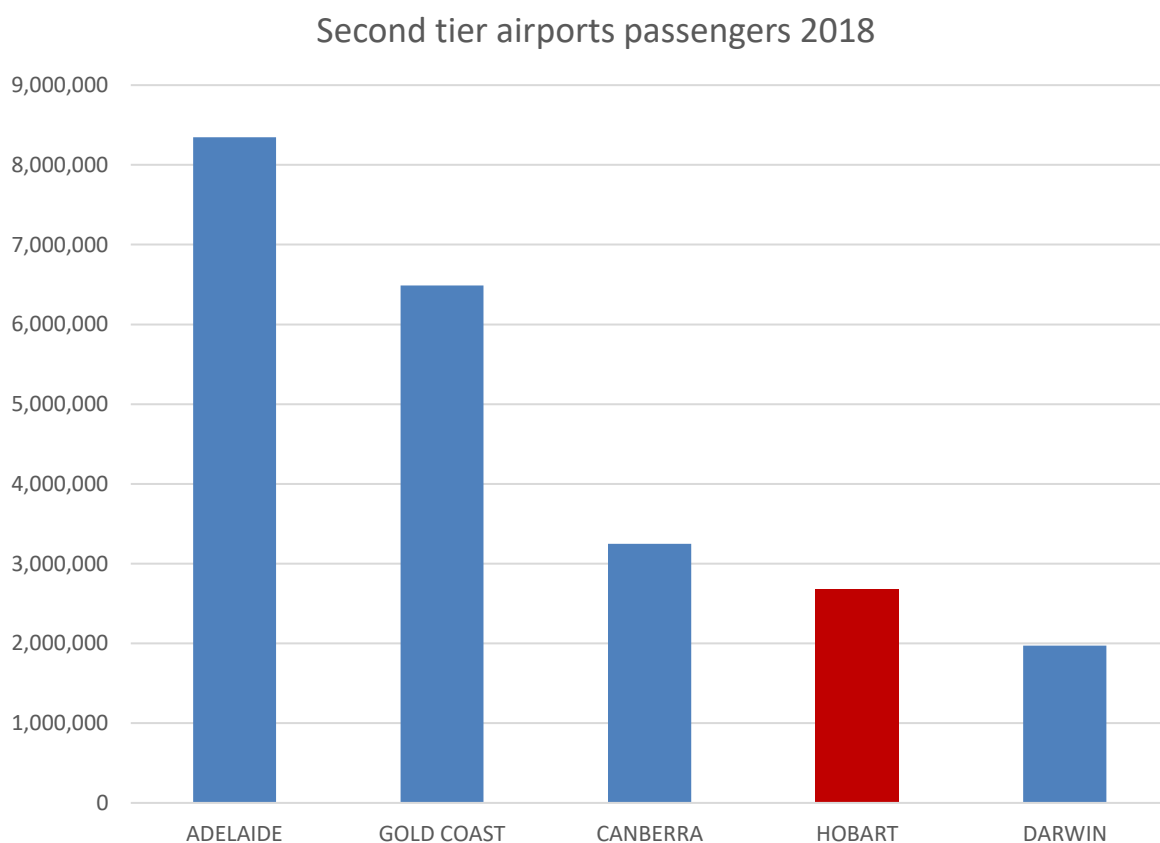
Further, it is the airlines that determine the Canberra Airport passenger market segmentation, and thereby the airlines are directly determining our passenger volume. And it is the airlines that are realizing yield and profit gains from the use of their market power at Canberra, and not Canberra Airport.

6. Voluntary Disclosure Regime

While we note the PC recommendation that the voluntary monitoring regime which Canberra Airport is subject to be discontinued, Canberra Airport believes that this regime is still beneficial for stakeholders. We believe as a matter of public confidence it is important for airport stakeholders and in particular, the travelling public, to have access to information that is important to them. This would include information regarding facilities, prices, quality of service, and have comfort that there is a complaint management process that is available if necessary. Canberra Airport supports the continuation of the current voluntary monitoring regime for second tier airports (with the current passenger volumes of those second tier airports presented in the chart below).

In any case, Canberra Airport intends to continue to report voluntarily on our quality of service, customer complaints and complaint responses, and voluntarily publishing relevant pricing information for access by customers.

Canberra Airport is proud of the quality of the facilities and services that we provide, and is focused on delivering continued improvements in the experience and value perception for our passengers. Seeking customer feedback is a key component for Canberra Airport's continual improvement and innovation focus, and something we are keen to continue.



Source: BITRE – Department of Infrastructure, Regional Development and Cities

7. Next Productivity Commission Inquiry

Canberra Airport recommends that another Productivity Commission Inquiry is not scheduled at this time. The scheduling of PC inquiries has the potential to be 'gamed' by any stakeholder (including airports and airport industry groups), and indeed the period leading up to the current inquiry has resulted in substantial gaming by some airlines and industry group A4ANZ. The public and misplaced criticism of Australian Airports by airlines and their lobbyists in the period preceding the current inquiry has been damaging to our industry as a whole, and in cases damaging to the reputation of airports unfairly criticized. It has demonstrated a particularly unpleasant lack of regard to the important relationships which need to exist between airports and airlines.

Genuine commercial agreements need a certain level of good-faith behaviour and goodwill – and this fundamental requirement has been particularly challenged in the recent period. We would recommend therefore that the Productivity Commission is only instructed to conduct an inquiry if there is evidence of abuse of market power at airports that is not adequately addressed through existing monitoring and legislation.