



**SUBMISSION  
TO THE  
PRODUCTIVITY COMMISSION REVIEW  
OF  
PRICE REGULATION OF AIRPORT  
SERVICES**

**JULY 2006**

# **EXECUTIVE SUMMARY**

## **Introduction**

The RAAA speaks on behalf of its members, who have collectively provided a broad range of aviation services to regional Australia both before and after privatisation of airports. This experience has involved operations to and from most if not all major airports including the price monitored airports, the other major city airports, the major regional airports and regional community airports. It has also included tenancies at most of the price monitored and other major city (including regional) airports.

## **Major Airports**

Our members' experience of the major airports since privatisation has not been a happy one, and has been characterised by massive price increases, lack of adequate consideration of operational needs, and the loss of security of tenure, amenity and the ability to negotiate. From this it is clear that the major airports, with the possible exception of Melbourne, have market power well beyond what has previously been considered by the Commission. The major airports are all monopoly businesses with the power to impose "take it or leave it" conditions in the certain knowledge that operators must either "take it" or severely damage their businesses (or worse). With the exception of Melbourne, there is no alternative airport for most operators. This overwhelming market power and the associated fear of retribution has in some cases been responsible for operators feeling unable to pursue complaints or to provide evidence to this enquiry. In addition, this lack of competition appears to have generated a "cost plus" attitude within some airport operating companies. Bearing in mind the essential nature of air services, it seems appropriate that the Commission should give this issue significant consideration. In particular, the Commission might consider whether the reintroduction of price regulation is justified, and whether it would be appropriate for government to participate in negotiations to ensure that the monopoly power of the major airports is not abused.

It is increasingly clear that the motivation behind some of the purchase bids for the major airports was the promise of access to artificially cheap real estate for development, which has subsequently been pursued at times to the detriment of the aeronautical use of the airport. It seems appropriate for the Commission to consider to what extent non-aviation development is reasonable, and whether government intervention might be justified in order to ensure the primacy of aeronautical usage at airports.

## **Regional Community Airports**

Our members' experience of community owned regional airports has been different. Some of these airports are increasingly needing expensive maintenance which the communities appear unable to afford. Since the provision of air services to many

regional communities is essential to their social and economic well-being, and most routes to the more remote areas are marginally profitable at best under existing conditions, and unable to sustain high passenger levies, it seems appropriate for the Commission to consider whether it might be appropriate for maintenance of such airports to be publicly funded.

## **Recommendations**

It is recommended that the Commission:

- (1) review and report on the extent of market power actually enjoyed by the operators of the major city airports, and:
  - (a) whether there is justification to reintroduce price regulation. and
  - (b) whether it would be appropriate for government to participate in negotiations between airport operators and aircraft operators, particularly in relation to leasing arrangements and access to airside and groundside facilities;to ensure that the monopoly power of the major airports is not abused;
- (2) consider to what extent non-aviation development is reasonable, and whether government intervention is justified in order to ensure the primacy of aeronautical usage at airports;
- (3) consider the continuing relevance of the dual till approach, and whether it should be scrapped in favour of a single till process;
- (4) consider whether current aeronautical asset valuations provide a reasonable basis for price monitoring, or whether they should be re-valued to better reflect the extent of actual investment in them by the airport operator;
- (5) consider ways of enhancing the transparency of airport price fixing and the price monitoring process; and
- (6) consider whether there is justification for the maintenance of regional community airports to be publicly funded.

# **INTRODUCTION**

## **Who We Are**

The Regional Aviation Association of Australia (RAAA) is an industry association representing aviation businesses involved in the provision of air services to, from and within regional Australia, and the businesses which support them. Our members include 21 AOC Holder (aircraft operator) members, and 37 supporting businesses. Between them, the operator members:

- directly employ over 2,500 staff,
- carry over 2 million passengers annually,
- carry over 23,000 tonnes of freight annually, and
- have an annual turnover of more than \$610 million.

These operator members include:

- regional airlines, operating aircraft through the full range from 9 seat piston engined aircraft to 100 seat jet aircraft,
- air freight operators using predominantly turboprop and light jet aircraft,
- aeromedical operators, operating mostly modern turboprop aircraft,
- charter operators, operating a wide range of aircraft, and
- a flying school operating light weight training aircraft.

Our Associate members include the full range of supporting businesses including aircraft distributors, fuel companies, finance houses, insurance brokers, law firms, repair and overhaul businesses, and two regional airports.

Our members operate to and from a large number of airports around the country, including the price monitored airports, the other major city airports, General Aviation Airports, major regional airports, and smaller regional community airports. Each is also a tenant of at least one category of airport.

Some of our associate members are also, either directly or indirectly, tenants of airports.

The RAAA can therefore speak with some authority on the behaviour of the privatised airports. Our member's experience of privatised airports has not been a happy one, and has been characterised by massive price increases, loss of security of tenure, loss of amenity and a general unwillingness by many airports to negotiate.

## **Scope of Submission**

We note that the over-arching aim of the review is contained in Paragraph 1 of the Terms of Reference as follows:

*“The Commission is to report on whether airport operators have acted in a manner consistent with the Government’s Review Principles and on the effectiveness of the current form of prices regulation of airports having regard to the objectives that the regulatory regime should:*

- (a) promote the economically efficient operation of airports;*
- (b) minimise compliance costs on airport operators and the Government; and*
- (c) facilitate commercially negotiated outcomes in airport operations, benchmarking comparisons between airports and competition in the provision of services within airports (especially protecting against discrimination in relation to small users and new entrants.”*

The aim of this submission is to address primarily the matters raised in this section of the Terms of Reference, rather than the technicalities involved in the monitoring of airport pricing.

In attempting to provide input into such a review, it is necessary to point out that just as not all airports are alike, not all airport operators are alike, and neither do they necessarily behave in a like manner. Even amongst the “price monitoring airports (the capital city airports excluding Hobart), there are significant differences in behaviour patterns. Consequently this submission will dwell on those airports which are not, in our opinion, acting in “a manner consistent with the Review Principles”.

It also needs to be noted that while our members have significant issues with some of these airports over what is perceived as abuse of the overwhelming market power which stems from their monopoly position, there are other issues on which we agree and share a common interest. However this submission will concentrate only on those issues which we believe need to be addressed in order for regional aviation to receive a fair go in a market place fundamentally altered by government action.

## **Market Power**

Central to any discussion of pricing and regulation is the question of relative market power. The RAAA is concerned at what appears to be a lack of acknowledgement of the fact that airports are monopoly businesses for whom there is no competition, with the possible exception of Melbourne and Avalon. It is even reported that the contract covering the sale of Sydney Kingsford Smith to Sydney Airport Corporation Limited (SACL) incorporates a specific clause providing for compensation from the public purse in the event of a second Sydney airport being built in the first 50 years of SACL’s operation! This represents not only a lack of competition but a degree of protection from future competition. Any suggestion that airports compete with each other, or that other transport modes can compete, especially for the more lucrative business market, are simply not realistic. Consequently, as the major airports are in fact protected monopolies, and their tenants and other aviation users have no choice

but to operate from them, they each, individually, have immense, even overwhelming, market power.

The market power held by the major airports has in our opinion been regularly abused by some airports in recent years. This has been manifested in:

- the development by airports of a “cost plus” mentality;
- the loss by airport tenants of security of tenure;
- the lack of consideration by some airports of the needs of smaller aviation operators, and
- a “take it or leave it” approach to negotiations.

While members have supplied some examples of these issues, they are reluctant to have them published. The issues themselves are discussed briefly in turn below.

### Cost Plus Mentality

With airlines’ total dependence on airports and with no competition (except in the case of Melbourne), the major airports need not worry about pricing: there is simply nowhere else for operators to go. There is thus not the same incentive for airports to strive to eliminate unnecessary cost as there is for the airlines. This appears to be a major problem not only with the major capital city airports, but with some of the major regional city airports, where airlines through hard work and ruthless cost cutting to allow deep discounting of fares, have expanded their market, only to be confronted by massive cost increases levied by the airport owners to pay for overly grandiose airport terminal development.

One unusual illustration of the “cost-plus” mentality which stems directly from the overwhelming market power held by airports is Broome International Airport’s (BIA) refusal to allow airlines to carry out their own ground handling of aircraft. Ground handling is conducted by BIA and charged at rates significantly more expensive than the airline’s own staff. A similar example is Canberra Airport where the existing fuel distribution system was replaced by one owned by the airport operator, for which a very significant fuel throughput levy is charged. There seems to be no reasonable justification for such high costs being imposed on airlines and thus the travelling public. These are unnecessary costs imposed purely because there is no regulatory control in place, and the airports have overwhelming market power. No doubt there are many other similar examples.

The Commission might therefore consider whether the light handed regulatory approach is adequate, or whether a return to price regulation, and perhaps an extension to include some additional airports, would be in the national interest.

### Security of Tenure

Central to the ability of our members to plan for the future is security of tenure. Central to the ability to abuse market power is the ability to totally control tenants through fear of retribution. The denial of security of tenure is a

very effective weapon for those intent on abusing market power. It would be instructive for the Commission to investigate the recent history of aviation service providers' leases at a number of airports to determine for itself the extent to which aviation businesses enjoy security of tenure. Where an airport refuses to grant existing options or to renew leases and forces its tenants onto month by month agreements, unless there is a very good planning reason, one might reasonably assume that gross abuse of market power is to blame. A review of what has happened to leases at, for example, Canberra Airport since privatisation might be particularly instructive.

The Commission might therefore investigate and report on the extent to which each of the major city airports provides security of tenure to their aviation tenants.

### Needs of Smaller Operators

It is very easy for operators of the larger international airports to overlook the needs of smaller, regional operators. With their often smaller aircraft (and therefore smaller passenger numbers), there is always going to be a tendency for airport operators to see regional operators as merely encumbrances on the efficient operation of their airports. Viewed from a purely airport-centric economic efficiency point of view that is quite reasonable. However, regional operators provide a critically important service to the more remote areas of Australia. Government recognised the critical nature of regional airline services, and as a result guaranteed regional air services' access to slots. However they require access not only to slots, but also to operationally and administratively efficient airside and groundside facilities.

While we are not recommending that government regulate to guarantee adequate access to ground facilities, the Commission might consider whether the current arrangements are in fact adequate.

### Take It Or Leave It Attitude

Notwithstanding the provisions of Part IIIA of the Trade Practices Act, there is no formal, affordable and easily accessible means for an air service operator or airport tenant to seek redress against an airport which refuses to negotiate in good faith because of its overwhelming market power. This lack of any formal means of seeking redress in such situations has forced some operators to use the media to "shame" airports into reasonable behaviour. While it is not hard to understand and sympathise with the motivation behind taking such action, it does little for the image of the industry in the eyes of the public, and is itself open to abuse. A better system is clearly warranted in view of the abuse of market power which has occurred in some cases.

It seems to us to demonstrate a weakness in the Airports Act that airlines and other air service providers, which are so critical to the social and economic well-being of the nation as a whole, should be left entirely at the mercy of monopoly businesses with overwhelming market power and, in some cases, a history of using that power. This is clearly not a reasonable situation, would

appear to be at odds with current federal government policy, and is one which in our opinion should be remedied in the national interest.

The RAAA believes that the Commission might review its assessment of the true market power enjoyed by the major airports. Since the overwhelming market power of the current major city airports could realistically only be broken by competition, and such competition is unlikely to eventuate in the foreseeable future, then it would appear that the only way to ensure fairness in negotiations would be to boost the power of the air service providers and other aviation tenants. The Commission might therefore consider whether some form of government participation in negotiations might be justified to help prevent the continuing gross abuse of market power.

### **Use of Airports as Airports**

We note that one of the specific tasks of the Commission is to report on “whether airport operators have acted in a manner consistent with the Government’s Review Principles and on the effectiveness of the current form of prices regulation of airports having regard to the objectives that the regulatory regime should: (a) promote the economically efficient operation of airports;...”

“Economically efficient operation” is a concept that is clearly open to interpretation. While it is reasonable to assume that the author intended that economically efficient operation meant operation **as airports**, there is increasing evidence to suggest that some airport operators do not accept that concept. And indeed, in the absence of any effective government requirement for the operationally efficient use of airports as airports, why should they? They no doubt see their businesses as a single entity and seek the maximum return for their shareholders regardless of the original purpose of the land on which the airport is situated.

There is reason to believe that the operators of Bankstown, Canberra and Jandakot in particular see economically efficient operation as not necessarily involving aviation. All three have demonstrated that their yardstick for operational efficiency is financial performance overall, and with greater returns being possible from exploitation of airport land for development, have concentrated their efforts on real estate development. This is amply demonstrated by:

- (a) the pending closure by Bankstown Airport Limited of Hoxton Park as an airport in favour of real estate development;
- (b) the closure by Bankstown Airport Limited of Bankstown’s Runway 18/36, the last GA north-south runway in the Sydney basin, to allow commercial development, despite the potential impact on the safety of light aircraft during strong southerly winds,
- (c) the proliferation of major non-aviation related structures at Canberra Airport, immediately upwind of the threshold of the only runway served by ILS despite the likely negative impact on the safety of aircraft during landing in windy conditions, and

- (d) the pending closure of Jandakot Airport for real estate development, despite the substantial investment in infrastructure at the airport, and despite the impact on businesses that need to be near to the city.

It is widely believed that Bankstown Airport Limited is imposing unrealistically high charges at Bankstown specifically to force aviation businesses to move to Camden, thus freeing the land for domestic and/or commercial development, with potentially massive windfall profits for Bankstown Airport Limited at the expense of the aviation industry. Regardless of the motive, the increased charges have decimated aviation at Bankstown.

These activities have all been, or will be, to the detriment of aviation, yet have probably contributed (or will contribute) to the economically efficient operation of the airport operating company in each case. We have no issue with airports seeking to use unoccupied land for commercial development provided that it is not inconsistent with the operation of the airport as an airport. However, based on these experiences, we would argue strenuously that it is not sufficient for government to encourage the “economically effective use of airports”, since that will not prevent non-aeronautical commercial development to the detriment of aviation, from either a safety, operational, or economic point of view. Instead, government should regulate to ensure the primacy of aeronautical use of the land.

While increased regulation is obviously not a prospect that airports would view with favour, nevertheless we believe that given current trends, regulation may be necessary in some areas to protect the existing infrastructure and the industry from being sacrificed for windfall profits. Consequently the Commission might wish to consider whether government intervention would be appropriate in order to ensure that airport operators give primacy of use to aviation.

## **Price Monitoring**

One of the major difficulties facing any organisation wishing to monitor pricing is the “dual till” basis of such monitoring and the imprecise nature of the definition of aeronautical or aeronautical-related services. It is noted, for example, that taxi feeder rank service costs are included as aeronautical-related costs, while parking is not. This is despite some airports preventing kerb-side pick ups and forcing families, colleagues etc to park in pay parking areas where parking would otherwise not be required. The resulting parking fee is therefore an integral cost of air travel, and parking should therefore be included as an aeronautical service. Similarly, the provision by airports of check-in facilities is by any reasonable measure an essential aeronautical function, and should be included in the definition of aeronautical services. Several airports including Canberra, Perth and Brisbane now charge fuel throughput levies. Since the cost imposed must be passed on to the customers, this represents another source of aeronautical revenue which should be taken into account in any price monitoring regime. There are no doubt many other examples of revenue earning services that escape monitoring due to the dual till approach.

It has been the practice in the past to regard returns from non-aeronautical services as not relevant to determining if prices are reasonable or not. However, with it now

becoming increasingly clear that access to cheap real estate for commercial, non-aviation development was and remains a major interest of some airport operators, there is some justification for considering returns from non-aeronautical services when reviewing the reasonableness of pricing for aeronautical services. This is particularly the case where commercial development has been pursued to the detriment of aviation users. On the other hand, in the unlikely event that such commercial development was to result in losses to the airport operator, that should not justify increasing the cost of aeronautical services. In our opinion it is entirely reasonable to abolish the “dual till” arrangement and subject all airport activities to scrutiny, because only by doing so will such scrutiny have the effect of enhancing the economically efficient operation of airports as airports.

The Commission might consider recommending the scrapping of the dual till arrangements, and including all revenue generated from aeronautical and non-aeronautical assets in determining the appropriateness of the airports’ charging.

## **Asset Valuation**

The RAA is concerned that airport operators consistently base their pricing in part on what we believe to be unrealistic valuations of their aeronautical assets. We take the view that the only reasonable way to determine appropriate pricing is to use the price actually paid by the operator for that asset, adjusted for sales and/or additional investment, and not a value based on what can be extracted from air operators in the absence of effective price controls, or on what might be worth if unfettered development were allowed.

The Commission might review the airports’ valuation of aeronautical assets and the effect of their valuation practices on the price monitoring process. In the event that (as expected) the over-valuation distorts the process, the Commission might consider requiring airports to revalue their assets to more realistic values for price monitoring purposes.

## **Transparency**

Regardless of what the Commission might decide in relation to re-regulation or improvements to the current price monitoring regime, one thing is clear: while ever airports are expected to justify their charging regime, much greater transparency is required. As a general rule there is just insufficient data available to make objective judgements on matters of detail.

The Commission might consider ways of enhancing the transparency of airport pricing processes and information.

## **Regional Community Airports**

At the other end of the spectrum from the major city airports (including regional city airports) are those owned and operated typically by the local shire councils or equivalent in the more rural and remote areas. These airports tend to be critically important to the medical, social and economic well-being of their local communities, with their value being inversely proportional to the quality of their road links to the major centres. Most of the airports in this category were handed over by the federal government in good condition, but with normal deterioration over time, many are now in need of significant refurbishment. The cost of such maintenance is high, and in the case of the smaller communities, could never be recovered from the necessarily limited aeronautical services which might be provided. Consequently those communities face isolation, particularly during the Wet, unless alternative funding is found. Such isolation could be expected to impact heavily on the affected communities, and on that basis it seems reasonable that funding might be provided from the public purse.

The Commission might consider the justification for the maintenance of the more remote regional community airports to be publicly funded.

## **Conclusions**

The RAAA believes (with the benefit of hindsight), that the privatisation of airports has not necessarily been in the national interest. While it would be inappropriate to comment on the underlying ideology of the sale of the airports, it is appropriate to note that it has resulted in massive increases in costs and, in some cases, significant detriment to the aviation industry through increased costs, loss of security of tenure, and inappropriate development. This is hardly in the national interest. But perhaps the worst aspect is that it has produced a number of monopoly businesses, protected by geography from competition, which are critical to the social and economic well-being of the nation, but which have overwhelming market power as a result of their protected monopoly positions, and in some cases are prepared to abuse that power.

While the RAAA has no issue with airports making a reasonable profit from their investments and operations, it is clear that there are some which are using their overwhelming monopoly power to make excessive profits at the expense of the rest of the industry, and by extension the national interest. The RAAA considers that, as a consequence, it is entirely appropriate that these matters be addressed by government in the interest of protecting an essential part of the national transport infrastructure and a major contributor to the national economy.

## **Recommendations**

It is recommended that the Commission:

- (1) review and report on the extent of market power actually enjoyed by the operators of the major city airports, and:
  - (a) whether there is justification to reintroduce price regulation, and
  - (b) whether it would be appropriate for government to participate in negotiations between airport operators and aircraft operators, particularly in relation to leasing arrangements and access to airside and groundside facilities,to ensure that the monopoly power of the major airports is not abused;
- (2) consider to what extent non-aviation development is reasonable, and whether government intervention is justified in order to ensure the primacy of aeronautical usage at airports;
- (3) consider the continuing relevance of the dual till approach, or whether it should be scrapped in favour of a single till process;
- (4) consider whether current aeronautical asset valuations provide a reasonable basis for price monitoring, or whether they should be re-valued to better reflect the extent of actual investment in them by the airport operator;
- (5) consider ways of enhancing the transparency of airport price fixing and the price monitoring process; and
- (6) consider whether there is justification for the maintenance of regional community airports to be publicly funded.

Canberra  
20 July 2006