ADELAIDE AIRPORT LIMITED

October 2001

Submission for the Second Round of Productivity Commission Public Hearings

Inquiry into Price Regulation of Airport Services

Adelaide Airport

Table of Contents

1.0 Summary – Adelaide Airport's Response to the Productivity Commission's Draft Report

1.1 AAL is generally in accord with the findings of the Productivity Commission's Draft Report regarding price regulation of airport services and supports its recommendations for price monitoring at Adelaide Airport in place of the current CPI-X regime. The failure of Ansett will undoubtedly have important implications for the Productivity Commission's final recommendations and report.

1.2 AAL believes that recent market developments have substantially reinforced the logic for the Productivity Commission's suggested move to price monitoring particularly by redefining the nature and intensity of both airport and airline competition. Whilst airports generally now face a challenging struggle amongst themselves to regain lost traffic from Ansett's demise as quickly as possible, airlines have greatly enhanced counter-veiling market power. Beyond the supply of a base level of seat capacity on core routes, airlines can currently more or less dictate the pace and location of replacement or new domestic and regional seat capacity.

In the context of responding to dynamic change in the aviation industry, rarely has the contrast between the fixed assets of airports and the mobile assets of airlines been more evident.

1.3 These issues are a cause for genuine concern to AAL's shareholders and drive the need to replace lost revenues as quickly as possible by exploring all potential avenues and not simply increases in aeronautical charges.

1.4 For the foreseeable future within Australia, airlines have considerably reduced exposure to sunk costs associated with new route development or frequency build since there is monopoly provision of air services on a very large number of routes and greatly reduced competition on virtually all others. The severe reduction in supply of seats will probably take a long time to be restored to pre-Ansett levels and in the foreseeable future there will be an almost unprecedented range of options for profitable airline operations in Australia flowing from generally enhanced yields that will be achievable in a market without network-wide intense competition. At the same time, Airports have had to make contingency plans to cover the significant shortfalls in revenues associated with the failure of Ansett. This situation will be aided by the recent announcement by the Treasury of the revised prices oversight arrangements for airports. Nevertheless, airports will face a difficult challenge in addressing this revenue shortfall and yet remain competitive in order to regain as much traffic as soon as possible.

1.5 AAL regards excessive aeronautical price increases as being counter-productive to delivering traffic growth and the total revenue growth associated with it. Meanwhile, airlines have already increased average airfares at Adelaide on key routes by a substantial margin in response to the failure of Ansett.

AAL's aeronautical charges would have to increase considerably in order for its charges to retain the same proportional impact on airfares for the end consumer.

2.0 The Impact of the Ansett Collapse on Adelaide Airport

2.1 The impact of the collapse of Ansett Australia has been felt across all areas of the travel and tourism industry and Adelaide Airport is no exception. This unfortunate event has seen a loss of around 182 weekly flight arrivals equivalent to 43% of the Airport's domestic landed tonnes/week and a similar short-term reduction in available seat capacity to and from the city. Moreover, the loss of Kendell Airlines, a subsidiary of Ansett, has had a most profound impact on the already troubled regional aviation market in South Australia. Kendell accounted for approximately 70% of regional airline seat capacity to/from Adelaide and within South Australia. Kendell has recommenced operations under the Ansett Administrator but frequencies are reduced from previous levels.

2.2 The impact on flight movements by aircraft weight category of the failure of Ansett can be seen in the latest Airservices Australia statistics in Table 1. These figures should be treated with caution when comparing airports particularly since the scale/type of regional operations at any given airport will affect the overall number of movements more than landed tonnes and revenue. However, the figures show that there was a substantial decline in September 2001 for the main category of Adelaide's domestic market (7-136 tonnes) that was larger than most other capital city airports.

2.3 The failure of Ansett, one of the Airport's core tenants, has a major potential impact for property income. AAL's former revenue level is in jeopardy mainly through the domestic terminal leases. This income is unlikely to be maintained at current rates in the short term unless a new carrier can be found to use the Ansett terminal to the same extent. Under current market conditions, it is unlikely that a new or existing competitor to Qantas will reach the former market size of Ansett within a foreseeable timescale. There is also an issue of non-recoverable outgoings (rates and taxes) and the outstanding debt.

2.4 Altogether the collapse of Ansett puts nearly 18% of the Airport's revenue at risk. A snapshot of the overall impact of the Ansett failure is provided in Table 2 (overleaf).

2.5 Another reason for AAL's significant exposure to the Ansett crisis has been the small relative proportion of Adelaide Airport's international market especially when compared with the larger state capitals. Adelaide Airport was already forecasting a decline in international traffic during 2001 as result of the knock-on effects of losing two flights per week to Singapore - one each by Qantas and Singapore Airlines. Whilst longer-term growth in the international market is anticipated the small relative size of the traffic base with only 5 airlines provides limited cushioning from the loss of domestic traffic.

Table 1 Airservices Australia Aircraft Movement Statistics Pre and Post Ansett

	ADL	BNE	CBR	OOL	DRW	MEL	PER	SYD
September 2000								
7-136 tonnes	5,248	10,214	4,086	1,308	1,902	10,580	4,828	15,854
>136 tonnes	184	2,198	6	370	182	4,012	1,178	7,528
August 2001								
7-136 tonnes	5,758	10,830	4,522	1,502	1,890	11,242	4,610	16,376
>136 tonnes	236	2,382	0	220	282	4,344	1,268	7,322
September 2001								
7-136 tonnes	4,002	8,164	3,114	1,336	1,644	8,180	3,630	12,184
>136 tonnes	242	2,204	4	108	274	3,720	1,140	6,444
% Change - Sept. 2001 vs. Aug. 2001								
7-136 tonnes	(30.5)	(24.6)	(31.1)	(11.1)	(13.0)	(27.2)	(21.3)	(25.6)
>136 tonnes	2.5	(7.5)	n/a	(50.9)	(2.8)	(14.4)	(10.1)	(12.0)
% Change - Sept. 2001 vs. Sept. 2000								
7-136 tonnes	(23.7)	(20.1)	(23.8)	2.1	(13.6)	(22.7)	(24.8)	(23.1)
>136 tonnes	31.5	0.3	(33.3)	(70.8)	50.5	(7.3)	(3.2)	(14.4)

Source: Airservices Australia

Table 2 The Impact of the Ansett Failure on Adelaide Airport

	Ansett	Total	% of Total
Domestic passengers/week (000s)	31,800	74,500	42.7
Domestic landed tones/week (000s)	13,674	25,900	43.0
Domestic flights arrivals/week	182	446	40.8
Total revenue p.a. ($million)	7.9	43.6	18.1
Debtors ($million)	0.7		

Source: AAL

2.6 Since the termination of Ansett's flights at Adelaide Airport on 13th September the Airport has been anxious to assess how other carriers could fill the seat capacity gap. Qantas have operated a limited number of additional services and have indicated that they have plans to increase capacity further. However they are estimated to be replacing around 30% of the previous level of seats offered by Ansett to/from Adelaide by November 2001 although the situation is subject to change as new aircraft become available. Virgin Blue has not yet increased flights to/from Adelaide since the failure of Ansett primarily because of aircraft availability problems. Meanwhile Adelaide has been the only major capital city not to be served by Ansett II's new operations under direction from the administrator. Although Adelaide can boast two of the country's largest five air markets (ADL-SYD and ADL-MEL), the city remains a low priority for most carriers indicating that despite a sizeable flow of business traffic overall, airline yields are lower than for other major centres.

The slow pace of replacement of Ansett's capacity at Adelaide provides further evidence that AAL does not enjoy the large degree of potential monopolistic power that the airlines or the ACCC have argued is common to all of the major airports.

2.7 Adelaide's perceived limited attractiveness places severe limits on the Airport's ability to misuse any potential market power and strengthens the counter-veiling power of the airlines using the Airport. As ever, the East Coast cities remain the priority for the major airlines whilst Adelaide remains a low priority.

3.0 Competition and Counter-veiling Airline Market Power in the Post-Ansett Market

3.1 Following the failure of Ansett, the intensity of competition in the domestic Australian aviation market has been dramatically reduced. Adelaide Airport is faced with the potential for one customer to control around 85-90% of all domestic seat availability. This situation may change over time as Virgin Blue expands and if some form of new carrier emerges from the ashes of Ansett. However, it is unlikely in the foreseeable future that any airline will be able to challenge Qantas with true network coverage or market share across Australia in a similar way to Ansett. It is likely that a number of Adelaide's domestic markets will now only be served by one airline for some time to come reducing the benefits of competition for consumers and potentially suppressing demand. These emerging new market dynamics are likely to have a profound impact on the ability of Airports to abuse any perceived monopolistic market power in future.

3.2 Firstly, airports generally will become much more dependent on Qantas as the only giant in the domestic airline industry capable of generating "bread and butter" traffic throughput comparable in volume to the pre-Ansett failure days.

Adelaide Airport's economic wealth will be inextricably linked to the decisions made by one key customer. Adelaide Airport is more sensitive to this than the other large capital cities because of the dominance of the domestic traffic and small size of international market.

3.3 Secondly, there is now such a large imbalance between supply of airline seats and demand that all airlines can retain their existing or slightly enhanced levels of operation and simply optimise yield management accordingly. This may mean a sharp reduction in the number of discounts fares available and a general increase in average fare levels subsequently reducing overall consumer demand for air travel. The airlines can dictate the rate and location of replacement seat capacity for the Ansett shortfall across the country as they choose according to either perceived additional profitability or competitive pressures (if indeed they still exist at all). This issue is particularly relevant to lower priority airports like Adelaide.

Airlines now have a completely enhanced position of counter-veiling market power versus the pre-Ansett failure scenario where options such as limiting seat capacity were tactically dangerous and a competitor with national network coverage would be likely to quickly capitalise on such behaviour.

3.4 Airports may still retain a small degree of market power with regard to their existing level of flights but even here this power has been reduced by the Ansett failure. The shortage of aircraft that will inevitably remain for some time to come will ensure that airlines maximise their own profit opportunities balanced with their overall strategic development objectives. This means that if airport prices are indeed an important influence on airline behaviour (and AAL does not believe they are under current market conditions) then the airline has every incentive to move at least some of their mobile assets (i.e. aircraft) onto other more lucrative routes. Certainly the airline can opt to use their new aircraft capacity at airports that are not perceived to be abusing their position.

3.5 At the current time the remaining domestic incumbent airlines have a wide range of route development options for a limited number of new aircraft coming into the country.

Potentially profitable domestic market development opportunities for the airlines have probably never been more plentiful whilst the ability of airports to influence these choices has rarely been weaker.

3.6 Airports have limited scope given the large fall in aeronautical revenues to offer large incentives (and in effect would be discounting replacement traffic that had previously paid normal rates) and the level of airport charges (and discounts) is likely to be an even smaller contributor to the route development profit/loss equation in the post-Ansett market.

3.7 Whilst the new market dynamics described above have led to reduced airline competition there is likely to be intensified competition between airports as each seeks to gain replacement seat capacity as quickly as possible. Although individual airports may have limited scope to induce airlines to increase operations to their particular gateway using discounted charges alone, they can often assist airlines in evaluating/identifying profitable route development options and can be more influential when additional incentives are offered by individual State Governments. The strength and resources of airport/government partnerships varies from state to state and so does the willingness of state government departments to openly incentivise new airline services either domestically or internationally.

Airports such as Adelaide will have to compete in future both to gain and keep new/replacement air services with all other major airports around the country in a way that was not necessary prior to the fall of Ansett.

3.8 The ground rules between Ansett and Qantas regarding schedule and seat capacity matching network-wide across Australia have been torn up leaving both Qantas and any smaller competitors with a completely new degree of flexibility to open (and close markets), or at least manipulate flight frequencies substantially to maximise profit with little regard to community interests.

In the above contexts, the scope for Adelaide Airport to abuse its market power is limited and any attempt to do so would be totally counter-productive to gaining additional seat capacity as quickly as possible. This reinforces the point made in AAL's first submission to the Inquiry that Adelaide Airport needs the airlines far more than they in turn need Adelaide Airport.

4.0 Consumer Issues – Airport and Airline Prices in the Post-Ansett Market

4.1 In AAL's first submission to the Productivity Commission the materiality of aeronautical charges and the impact of price regulation on aeronautical charges were addressed in sections 3.2 and 3.3 respectively. The point was made that even a 22% reduction in airport charges as a result of price regulation over 5 years (claimed by the ACCC) would result in a negligible impact on prices paid by end consumers for air tickets. Meanwhile, new entrants Virgin Blue and Impulse stimulated a dramatic fall in average air fares on most major domestic trunk routes including a 44% reduction in Qantas' cheapest 21-day advance fares on the ADL-SYD and ADL-BNE routes.

4.2 Since the collapse of Ansett, the cheapest 21-day advance purchase fare on the ADL-SYD route available from Qantas seems to be 41% higher than the equivalent price on 3 July 2000 before Virgin Blue and Impulse commenced competitive jet operations in Australia (see Appendix A). This Qantas 21-day advance purchase fare is thought to be 154% higher than the equivalent fare

offered whilst both Ansett and Virgin Blue were operating in competition on the SYD-ADL route. All carriers offered "special fares" below the level of the 21-day advance ticket during the period of intense competition.

Whilst some special fares are still available their number is dramatically reduced and average fare levels have increased markedly.

4.3 Qantas have not appeared to increase their business class and full economy fares by such a large margin presumably since these fares remained fairly constant even during the period of intense competition. Meanwhile, Virgin Blue have seemingly increased their lowest available fares by around 20% on both the ADL-SYD and ADL-BNE routes following the collapse of Ansett.

4.4 The scale of the increase in some fare types is relevant given that it is the key driver of the end cost to consumers. Whilst some new costs and taxes account for a small part of the rise in fares they cannot possibly account for the huge differences between the pre and post Ansett fare levels seen in some fare categories.

Given that airport charges constituted only around 3-4% of the domestic airline ticket purchase price prior to the failure of Ansett, there would have to be a substantial increase for airport charges to retain this already small proportional contribution towards the average consumer air ticket cost.

4.5 AAL notes that airlines have also increased fares at short notice to cover additional fuel and insurance costs and for political expediency, albeit in a good cause, Government has introduced a passenger tax to potentially cover Ansett entitlements that is greater than AAL's proposed new terminal passenger facility charge (despite this taking a number of years to negotiate with airlines under commercial conditions).

The new Government passenger tax for Ansett entitlements, that has been created almost overnight, is in itself three times higher than AAL's typical total domestic aeronautical charges per passenger. Any future changes in AAL's aeronautical charges under a price monitoring regime should surely be evaluated in the light of the much more substantial influences on the final price paid for air tickets by the consumer.

4.6 AAL has already stated, and the Productivity Commission has recognised that large increases in aeronautical charges are counterproductive to the Airport's aspirations to grow traffic (and thereby overall airport revenue) at the fastest possible rate. However, the issues related to airfares once again illustrate which players in the aviation market really control the vast majority of the cost for consumers. The introduction of new aircraft seat capacity over coming months will probably ensure that average prices fall back at least to some extent but this will only really happen where true airline competition exists.

In the post-Ansett market in many parts of Australia it is the potential monopoly power of airlines and not airports that should be the key concern of the public and the ACCC.

5.0 Future Airport Development Issues

5.1 After numerous years of painstaking negotiation with its main airline customers Adelaide Airport finally gained signatures by the end of August 2001 from all key domestic carriers to agree to collect a common domestic passenger facilities charge to finance its $220 million Multi User Integrated Terminal (MUIT). This state-of-the-art combined domestic and international terminal facility had been planned to become the Airport's principle generator of wealth in terms of long-term growth of the business. The completion of a revitalised world-class facility would have levered in various aviation and non-aviation investments and property developments creating increased wealth across the whole airport site.

5.2 The fate of these airport development plans at Adelaide suffered a cruel blow at this late stage with the demise of Ansett thus leaving AAL's terminal facility plans without one of its principle sponsors and revenue sources. Under foreseeable market conditions it is virtually impossible for the MUIT to be built according to the original design even with internal modifications. However, AAL has already assessed alternative options and has a new concept (Project Phoenix) that would provide high standard terminal facilities on a common user basis for reduced cost. Under a scenario where Qantas retains around 65-75% of the domestic market and thereby the vast majority of traffic at Adelaide Airport, it is extremely difficult for AAL to progress with an integrated upgrade of its sub-standard terminal facilities without the full co-operation and participation of Qantas.

5.3 Following the collapse of Ansett the initial reaction from Qantas regarding the MUIT terminal development issue at Adelaide Airport was positive. The airline indicated that it still wanted to proceed quickly with a new terminal facility that could probably remain similar in concept to the MUIT given their anticipated growth above previous levels. More recent feedback has indicated that Adelaide Airport's new terminal developments are a relatively low priority versus issues at other major airports and no significant progress can be anticipated in the immediate future. Whilst AAL can pursue alternative terminal build and upgrade options with its other airlines the scope for an integrated world-class facility with similar direct and indirect revenue generating potential as the MUIT is severely limited. Therefore with such a dominant market position, Qantas is not only able to dictate the pace and location of new/replacement aircraft seat capacity but also enjoys a greatly enhanced power of influence over the Airport's timing and scale of future development.

By default, the major airlines operating at Adelaide now have a marked and much higher degree of direct and indirect control over the entire revenue-generating potential for the Airport business over its longer-term future through action, inaction or the chosen level and timing of participative engagement with AAL's strategic planning process.

6.0 Suggested "Good Practice" For Airports Regarding Future Aeronautical Charging

AAL supports the basic principle of airport charges being, as far as possible, transparent, cost-related and non-discriminatory between customers. To this end AAL is keen to establish a formal process of consultation with its airline customers regarding its aeronautical and other charges where relevant.

6.1 Other than in extraordinary circumstances like those currently prevailing, AAL would propose that the new consultation process would commence three months before the publication of revised annual charges and whenever possible well in advance of any interim pricing changes that may be necessary from time to time.

6.2 Whilst it may not be possible to take account of all individual airline views regarding airport pricing strategy, AAL is very keen to ensure that customer views receive appropriate attention and are officially noted. The need for such a formal process will probably vary between airports so it is perhaps difficult to produce universal formalised codes of practice to this effect. However, similar processes of customer consultation have worked well in other countries (like the UK albeit in a regulated pricing environment) and may provide some comfort to airlines that are suspicious of airport behaviour under a formal price monitoring regime.

6.3 AAL therefore proposes that all airline customers be invited to send representatives to discuss proposals for forthcoming changes in AAL's aeronautical charges. The Productivity Commission may deem it appropriate to also invite a representative from the price monitoring authority.

APPENDIX A

Return Air Fare Comparisons in the Period July 2000-October 2001

	Pre-competition 3/7/00	After new entrants 19/3/01	Post-Ansett 12/10/01	% change post-Ansett vs. pre-competition	% change post-Ansett vs. after new entrants
ADELAIDE-SYDNEY					
Qantas					
Business Class	$1,180.74	$1,200.54	$1,229.19	+4%	+2%
Full Economy	$874.94	$894.74	$923.39	+6%	+3%
21-day Advance	$412.94	$229.24	$582.39	+41%	+154%
Virgin Blue					
Fully Flexible		$454.00	$520.98		+15%
Lowest standard fare		$198.00	$240.98		+22%
ADELAIDE-BRISBANE					
Qantas					
Business Class	$1,656.60	$1,656.00	$1,704.86	+3%	+3%
Full Economy	$1,225.40	$1,225.00	$1,273.66	+4%	+4%
21-day Advance	$533.50	$297.00	$686.46	+29%	+131%
Virgin Blue					
Fully Flexible		$598.00	$613.50		+3%
Lowest standard fare		$218.00	$260.98		+20%

Source: AAL