



**SUBMISSION TO THE
PRODUCTIVITY COMMISSION**

**REVIEW OF PRICE REGULATION
OF AIRPORT SERVICES**

by

**REGIONAL EXPRESS HOLDINGS
LIMITED**

JULY 2006

INTRODUCTION

Regional Express Holdings Limited (Rex) is Australia's largest independent and publicly listed regional airline.

Operating 38 aircraft on a total of 38 routes to 31 regional destinations from Sydney, Melbourne and Adelaide, the combined Rex and Air Link operations have a long history in dealings with airports both large and small given the legacy of their forerunners, Hazelton and Kendell Airlines, both of which operated regional air services for in excess of thirty years.



Currently Rex carries more than 1.1 million passengers per year on over 1,100 flights each week. Over half of those flights operate to and from Australia's largest and most congested airport, Sydney. Rex has the largest number of slots in and out of Sydney behind Qantas and Virgin Blue.

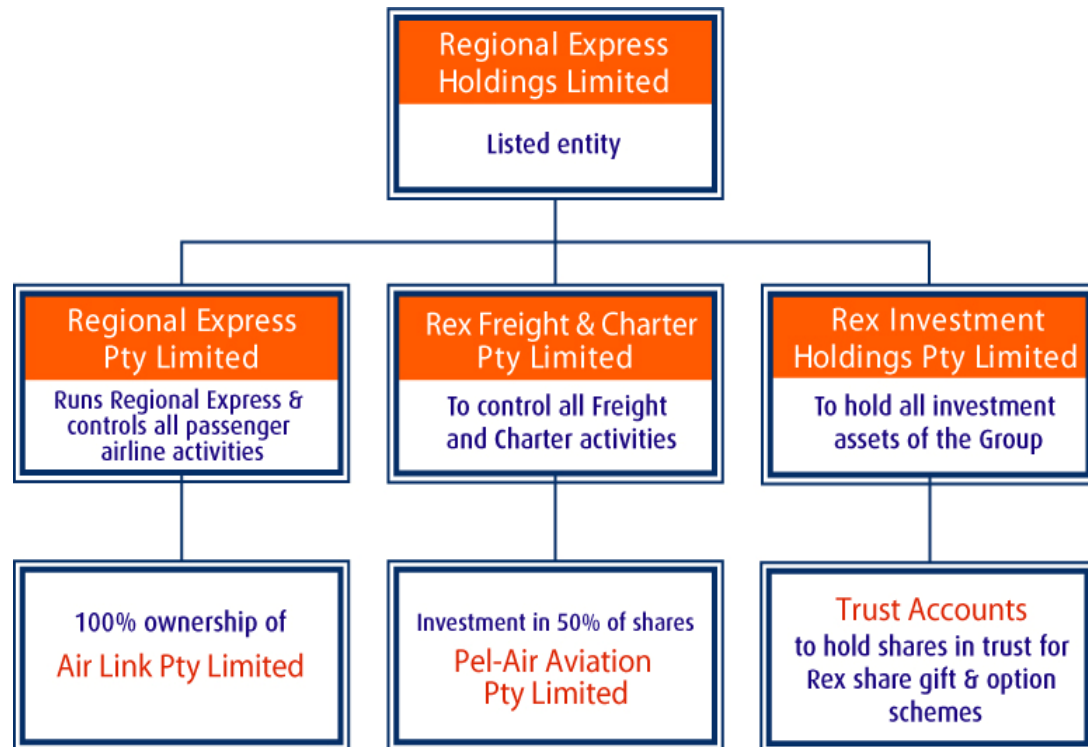
It has been well established that regional air services are vital to the economic and social development of regional and local communities. Since commencement in August 2002, Rex has achieved tremendous passenger growth with levels on almost all routes far exceeding historic highs prior to the Ansett collapse. The airline has also developed to become a leader in the airline sector with record achievements in financial returns, on time performance and customer satisfaction.

Rex's growth and success is based on three primary strategies:

- Making fares more affordable for regional air travellers (by reducing cost and improving efficiency)
- By operating reliably and on time
- By being a partner to the regional communities we serve.

Rex sees its future in continued growth. It also has a strategy to align with other partners in aviation to gain synergies and further develop its business. This is reflected in the acquisition of the Dubbo based regional airline, Air Link and investment in the air freight and charter operation Pel - Air Aviation.

In November 2005, Regional Express Holdings Limited listed on the Australian Stock Exchange. The corporate structure of the Rex Group is as follows:



Rex sees the ongoing increases in costs associated with infrastructure and regulation as the biggest threat to regional air services. While Rex has worked hard to reduce its controllable costs and improve productivity and efficiency in those areas, it continues to witness increases in uncontrollable costs particularly from monopoly suppliers of airport and related services, air traffic services including air traffic control, aviation rescue and fire fighting services as well as costs associated with industry regulation including services provided by the Civil Aviation Safety Authority (CASA) and mandated security requirements. The continued cost increases from these monopoly providers undermine Rex's achievements in cost reduction and low fares.

Rex has had a mixture of dealings with airports from a full and productive partnership approach, to major conflict and difference. There are and have been great examples of co-operation and mutual benefit to all parties. On the other hand there have been very public conflicts which have resulted in substantial costs being incurred and much waste of precious time and resources.

This submission provides our views in regard to the approach of the airport owners and operators, attempts to cover relevant matters set out in the "Issues Paper" and makes suggestions and recommendations for future arrangements.

AIRPORTS

The airports with which Rex deals can be divided into three categories:

- Three of the seven major privatised airports to which the price and service monitoring requirements are in place (Sydney, Melbourne and Adelaide)
- Major regional airports - Albury, Wagga Wagga, Ballina, Dubbo, Mildura – (generally airports with annual passenger throughput in excess of 130,000)
- Smaller regional airports – some of which have annual passenger throughput of around 10,000

By their nature, airports in Australia are monopolies. There are few situations where airports can compete effectively. This is particularly the case for regional services at capital cities. Of the three capital cities on the Rex network, not one of the secondary airports offers an effective alternative to the major airport for regional services. All of them would need extensive runway and infrastructure upgrades to accommodate Rex's current fleet. More to the point, none provide effective on-carriage to interstate trunk and international services. In most cases they are also less attractive in terms of access to the main capital city CBD.

As a general rule 20 to 30 percent of regional travellers on the Rex network connect with other carriers at hub airports. Removal of such connectivity would seriously inhibit the effectiveness of the total air service and thereby the regional air link.

In regional Australia, the same natural monopoly situation is present, although there are some exceptions where there is a level of competition, for example – the Tasmanian airports of Burnie, Devonport and Launceston and Lismore and Ballina on the north coast of NSW.

Regional air travel is about time and convenience. The nature of short sector distances and times, direct competition from land transport (particularly car travel) as well as the need to travel at peak times leaves the potential use of alternative airports out of the equation.

Decisions by consumers to use air services have regard to the aggregation of the cost components of the total service, not simply the air fare. Prices for parking, taxi services, add-on taxes and charges are taken into account. Increases in charges by airports which flow directly to these cost components have a corresponding direct impact on consumer choice and hence demand.

MAJOR PRIVATISED AIRPORTS (MPA)

As natural monopolies, the major airports wield considerable market power over regional airlines. As the major airports are hubs for regional services (see route map above) the level of control and influence on the effective operation of services is substantial.

Apart from Sydney Airport where the Commonwealth legislated Slot Scheme guarantees access to arrival and departure times for regional airlines (in terms of runway operational access), and the operation of the "price notification" requirements under the Trade Practices Act 1974 (TPA) "Direction 28" relating to maintaining such aeronautical and aeronautical related charges for regional airlines at or below the CPI, the only level of protection for regional airlines at the major privatised airports is in terms of access and pricing under the current aeronautical and aeronautical related price monitoring "Direction 27" of the TPA.

Generally, experience has shown the MPAs have met their obligations in regard to these provisions – but to the letter.

Where the MPAs have power over operators is in the many other activities required to operate an efficient and effective regional airline. This includes terminal space for check-in counters and gate lounges, office facilities for operations staff and flight crew facilities, hangar and associated engineering facilities including parts and equipment storage and facilities for ground handling and catering etc. While not tested at law, access to these facilities, according to the airports, are not covered under the definition of aeronautical or aeronautical related services. It is only those services directly related to aircraft movements and passenger processing which have been covered in terms of price monitoring.

For example, the price monitoring covers general per passenger charges for the use of a terminal including use of common-user gates and check-in facilities. However, the experience is that it does not cover charges associated with sole use gates or office / lounge and facility rentals.

To meet all the requirements for an Air Operator's Certificate, an airline must have facilities and provide services which meet and are approved by CASA. For example, the airline must provide to CASA's satisfaction, facilities which enable flight crews to gain information on weather and NOTAMs, receive manifest and loading information for the completion of aircraft weight and balance, have suitable spares and line maintenance facilities on airport adjacent to the operation so that it can achieve its schedule of operations and so on. The airline must satisfy CASA that it has adequate control over all operational aspects of arrival and departure at the airport. This requires space and facilities.

Most major hub operations also require sufficient aircraft maintenance facilities to maintain the aircraft fleet operating that network – at least line maintenance if not heavy maintenance. This requires access to hangar facilities or land and services for the construction of those facilities. Rex has hangar, workshop and training facilities at Sydney and Adelaide airports as well as commercial arrangements for access to such facilities at Melbourne Airport.

On top of that, an airline providing quality services in a competitive environment, must also have access to corporate and commercial facilities which do not place it at a disadvantage. Rex has special Corporate Lounge facilities at Sydney and Adelaide airports and is currently seeking facilities at Melbourne Airport. It previously leased such facilities at Canberra Airport.

As the pricing and access to these facilities are outside the coverage of the price notification and price monitoring directions, they are left to commercial negotiation between the airport and operator. Rex's experience with negotiations with the major airports for these facilities has been far from satisfactory.

Rex's experiences, views and recommendations for future arrangements for the major privatised airports are further discussed in the "Issues" sections below.

MAJOR REGIONAL AIRPORTS (MRA)

While significant focus has been directed towards the activities of the major privatised airports, Rex's experience with the major regional airports highlights a similar approach and outcome.

Following a decision by the Commonwealth in the mid 1980's, regional and local airports then owned by the Commonwealth were transferred free of charge to local authorities – mostly local government bodies. Airports which were previously owned and operated by local government, received funding from the Commonwealth under

the Aerodrome Local Ownership Program for major maintenance and upgrading - generally on a dollar for dollar basis.

The change in the late 1980's meant that many airports received significant funds for runway and terminal works on the basis that they were then on their own in terms of future funding. As a result, the airports introduced charging regimes to cover recurrent operational costs and reserve funds for major maintenance. It is apparent this process has worked well for the larger regional airports which have had the benefit of substantial passenger growth, but without major development costs.

The larger regional airports introduced substantial passenger head taxes and aircraft landing charges designed to produce high revenues. This has been the case particularly where there has been significant competition by larger regional carriers (especially Rex and QantasLink). The cost plus approach and high rates of contribution to reserve and return to general revenues, has resulted in major regional airport passenger charges being substantially higher than capital city and smaller regional airports.

While some airports have relatively transparent airport accounts, there are a number which do not publish stand alone airport accounts. There are examples of local councils using airport revenues for other activities. Generally the major regional airports not only have higher passenger head tax rates, they also generate substantially higher revenues than smaller airports given their passenger throughput.

Table 1 below sets out the passenger head tax charges (incorporating landing charges where applicable) for a range of regional airports on the Rex network

Table 1 – Per Passenger Charges Regional Airports

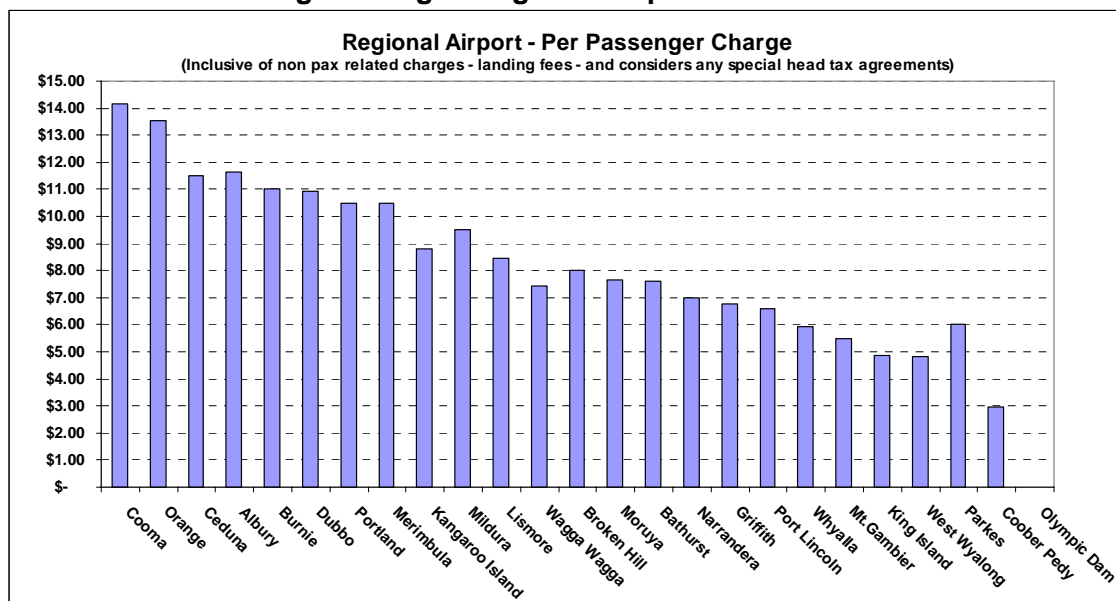


Table 2 below highlights the airport revenue generated by the passenger throughput for a range of airports on the Rex network.

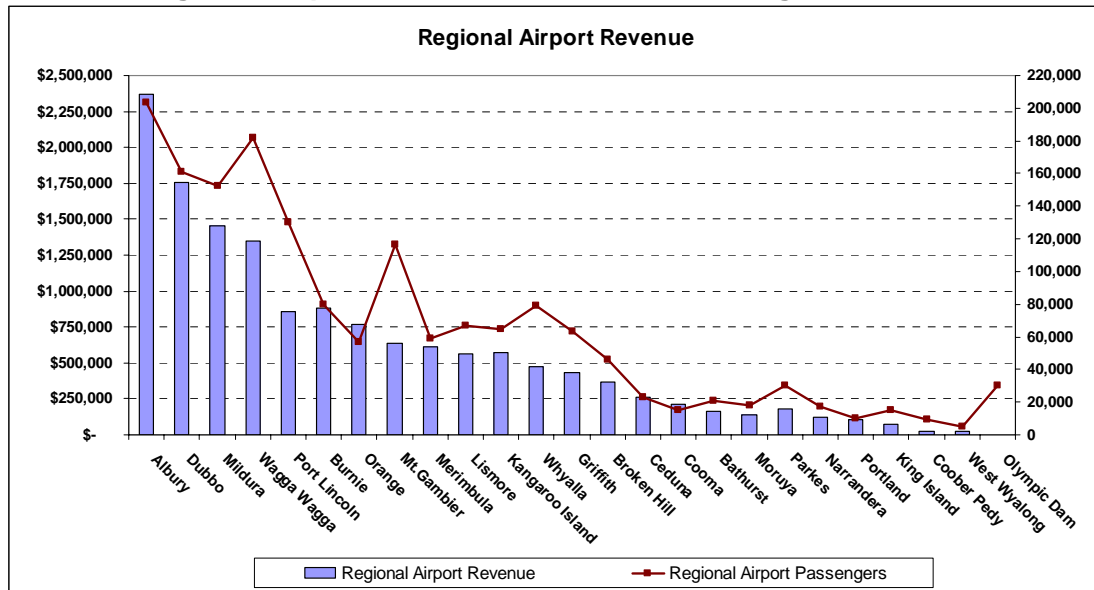
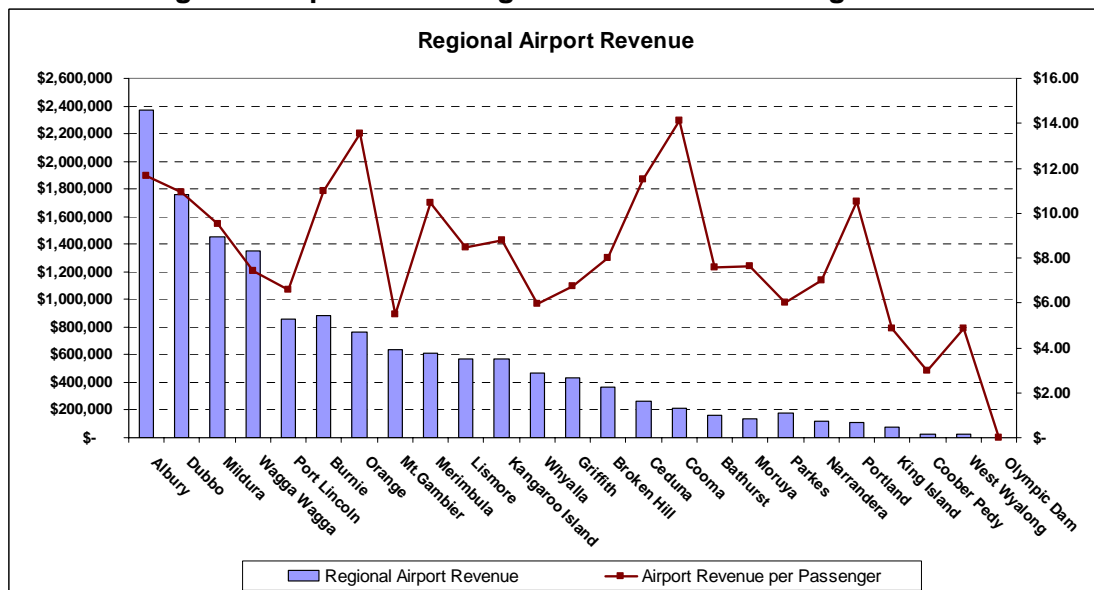
Table 2 – Regional Airport Revenue and Annual Passengers

Table 3 below puts into context the annual level of revenue versus the average per passenger revenue received. It shows those with large revenue receipts also have high average unit charges.

Table 3 – Regional Airports – Average Revenue Per Passenger

The tables (which aggregate passenger and landing charges where applicable for each airport) clearly show the substantial differences between airports in terms of their charging rates and revenue generation.

It is clear that the Major Regional Airports have a high degree of monopoly power to generate high revenue streams. All received substantial benefits from initial handover funding provided by the Commonwealth in addition to the free gift of the airport to the local authority. Competitive passenger growth funded by the airlines has provided even greater levels of income. However, as future growth at such airports will slow as markets reach their peak levels, further increases in charges by airports will be detrimental to passenger growth.

Rex has argued that the Major Regional Airports in particular must achieve higher levels of productivity, cost reduction and reduced per unit charges to continue to foster regional airline service growth and quality improvement. Their monopoly position places them in the position of being the last to be affected by cost pressures because of their cost plus charging regime. There are also no productivity or efficiency requirements or targets imposed. Unlike the MPAs, there is no government oversight or control of these charges.

The lack of full transparency in the accounts of most local government airports results in suggestions that funds are being re-directed from airports to fund other Council activities instead of being set aside for future upkeep of the airport. There are some notable airports where the evidence clearly suggests this to be the case.

Given the importance of regional airline services to regional community economic and social development and the primary role the airport plays in providing the infrastructure for such services, airport accounts must be fully transparent to the public and the airport owner accountable for the costs and revenues.

SMALLER REGIONAL AIRPORTS

The majority of airports to which Rex operates are in this classification and range in annual passenger throughput from 100,000 at Port Lincoln to less than 10,000 at Moruya, Coober Pedy and West Wyalong. Most receive a service from Rex as sole operator.

Apart from a few of the larger airports like Port Lincoln, Mount Gambier and Burnie, these airports struggle to meet their on-going cost of operation and upkeep. It is estimated that the average running cost of a small regional airport is in the region of \$250,000 to \$300,000 annually. Contribution to a sinking fund for major maintenance and upkeep would vary depending upon the condition of runways and taxiways on transfer but \$50,000 to \$100,000 would be considered a minimum.

Lower overall passenger throughput combined with significant price sensitivity associated with maintaining or generating additional passenger demand has meant that efforts to increase revenue from greater levels of passenger charge is not possible. As a result, the passenger charges at these airports have remained relatively low – see Table 1 above. This enlightened approach recognises that the air services have a vitally important social and economic role for the local community and hence merits direct contribution in the same manner as local roads and other local community infrastructure.

Most local council operators of such airports have taken the view that it is preferable to maintain their lower passenger charges and hence air fares to maintain the air service viability than increase charges in an endeavour to meet the full cost of operating and maintaining the airport. This has meant a level of contribution from the local ratepayers to their airport.

Rex has recognised this situation and has entered into formal partnership arrangements with a number of the smaller airports by combining low passenger charges with further reductions in deep discount lead-in fares to generate passenger growth.

However, the long term impact of this approach is that the basic airport infrastructure is being run down to the point where many airports in this category are in need of substantial heavy maintenance on runways, taxiways, lighting and terminal facilities.

While the Rex partnership arrangements have been successful in generating passenger growth, in many cases even with that substantial growth, the passenger throughput and increased revenues received still are not enough to generate a level of funding for the airports to be self-sufficient.

While the smaller airports are monopolies, in many cases their market sizes are such that they have little ability to adopt excessive monopoly practices for fear they will lose their sole airline service. They are also at the mercy of the actions of the MPAs as pricing and access decisions by those airports directly impact on the price of air travel to their airport as well as the potential viability of the service provided.

As a consequence there is a disconnect between the ability of the smaller airports to generate sufficient income to fully fund their airport and the level of fare the market will accept to maintain the viability of their air service.

It is apparent there is little ability for the tools available via the TPA and the ACCC to assist in overcoming this situation. While it may be possible to make the accounts of such airports fully transparent, other means of direct intervention and assistance by Governments is necessary.

It is recommended therefore, that the Commonwealth consider means of direct assistance to these airports in the form of funding for major maintenance and appropriate development works as it does with other vital regional transport infrastructure. Associated with such funding, the Commonwealth may wish to apply appropriate conditions to ensure government policies on regional air services are achieved.

ISSUES

Direction 27 – Price Monitoring of Major Privatised Airports – Dual Till Approach

The ACCC's established approach for considering the charging arrangements of the MPAs has been to monitor on a "dual till" basis. That is, charges and activities outside the scope of what may be defined as aeronautical or aeronautical related services are not considered.

The Productivity Commission Issues Paper states: "The dual till approach is premised on the view that, to promote efficient delivery of, and investment in, airport services, the aeronautical component should be priced on a stand alone basis, without regard to any net revenues from the non-aeronautical side."¹

Aeronautical services are defined as those relating to aircraft movement (runway, taxiway and parking areas) passenger processing facilities and activities (passenger terminals along with baggage handling systems – also actual passenger handling and baggage services where they are provided by the airport) and security services.

Aeronautical – related services are defined as those "...services which support the operation of aeronautical services, but which do not entail the use of the infrastructure involved in aircraft movements or passenger processing facilities. Examples include landside vehicle access to terminals, taxi holdings and feeder rank services 'on airport' and check-in counters and related facilities"²

¹ PC Issues Paper – p11.

² PC Issues Paper – p11.

Non – aeronautical services outside the price monitoring direction include car parks, taxi rank services, retail outlets, hotels, car valet services, corporate parks and factory outlets.

It is clear there are grey areas between what may be considered aeronautical and non-aeronautical – related services and non-aeronautical services. As a consequence the “dual till” approach can also include areas of greyness. The ACCC in its price monitoring reports has highlighted difficulties in the allocation of costs between these categories.

Rex is of the view that without full transparency and accountability, the “dual till” approach will continue to provide uncertainty and incomplete information on airport costs and revenues, the profitability of the various activities and hence charges.

Rex believes there is a major issue of principle to be established with regard to the price monitoring / notification requirements of the MPAs.

Rex maintains that the mandatory requirement incorporated into the sale agreements and in the Airports Act that the MPAs remain as major airport facilities, must be carried through to all facets of the airports’ operation and management. It is clear from their actions so far, the MPAs are adopting the approach of real estate developers rather than airport owners and operators. The significant “non – aeronautical” development is clear to see. These activities are generating substantial income but are also demanding substantial capital investment and day to day resources

Given the advantageous position the MPAs hold because of their physical location and monopoly status as a single supplier of infrastructure to a primary transport sector, the full range of aeronautical and non-aeronautical activities must be taken into account in the price notification and monitoring activities.

However, Rex further maintains that this should be on a one way basis only. All revenues and surpluses achieved from non-aeronautical activities must be taken into account for the determination of aeronautical charges. However, where the MPA makes losses in non – aeronautical activities, those losses must be borne fully by the MPA shareholder and not be a burden on the aeronautical activities of the airport. In other words, aeronautical activity should not fund non-aeronautical activity, but the converse is true.

To achieve this, the full accounts of the MPA must be completely transparent and the MPA fully accountable for them.

Access Regulation

The current arrangements provide for access and pricing for all but aircraft landing and take-off, general terminal usage and security, to be commercially negotiated between the MPA and operator. For Rex, this means terminal office accommodation, passenger lounge, crew facilities, and engineering facilities all must be negotiated on a commercial basis.

Rex believes that access to what would normally be considered proper terminal facilities in terms of gate lounges and passenger check-in facilities should be subject to fair and equal treatment by the MPA. Under the terms of the current arrangements, where agreement cannot be reached, the aggrieved party (the operator - as the MPA has the vastly stronger negotiating power) has recourse through Part 111A of the TPA to have the service “declared” and then have the protection of determined conditions including charges.

The Commission is no doubt aware of the protracted and quite public dispute Rex had with Sydney Airport Corporation Limited (SACL) in 2004 over access to gate lounge facilities. The issue was of primary importance to Rex to the extent that an unfavourable outcome could have resulted in Rex's failure. Use of the provisions of Part 111A of the TPA and the resultant legal proceedings could also have resulted in Rex's demise given the time and cost associated with achieving an outcome.

Rex was left with little option but to pursue a strategy to achieve an outcome via public and political means. This was costly and used significant resources by all parties. While there have been some notable uses of the TPA provisions, the long lead times and significant cost involved again balances the power in the hands of the MPA. A simpler, more open approach is necessary.

Generally, the MPAs hold the premise that "commercial negotiations" and "commercial agreement" include not only the "take it or leave it" approach but also the principle that such matters remain confidential between the parties. In all negotiations Rex has had with MPAs, the MPA has strongly implied this requirement. In one particular case, the MPA became very aggressive when it was suggested the terms of an arrangement may become public knowledge.

Rex continues to believe that the MPAs have entered into a wide range of "commercial" agreements with different users at vastly different rates and terms. The confidentiality of such agreements places the MPA, with its market monopoly, in an extremely strong bargaining position. Rex maintains that the private owner of a major monopoly infrastructure facility which has substantial community service obligations should be subject to full public scrutiny in all its dealings, not just a select few.

Rex considers that the public interest is at risk where an MPA and another organisation can enter into long term commercial arrangements which could be to the detriment of not only competitive air services but also establish a regime where certain services are prevented from being provided or communities served. This is a particular risk where the availability of land, space or services is at a premium.

Rex therefore recommends that the MPAs be required to publish the details of all such agreements and arrangements so that there is full public transparency. We also recommend the MPAs be accountable for compliance with this requirement. Without this level of transparency and accountability there is really no way any reasonable assessment can be made as to the efficient use of or investment in infrastructure services at the MPAs.

No doubt the MPAs will suggest that such disclosure will be too burdensome. Rex suggests this is not the case, especially if only the basic terms of the arrangements are required to be disclosed.

The current disclosure requirements for price monitoring are distorted because of the "dual till" approach. As mentioned above, Rex seeks full accountability of the whole range of activities at MPAs, with sufficient detail so that aeronautical and non – aeronautical activities are fully transparent. We do not see this as any substantial increase in the disclosure burden and sufficiently important in the public interest to be provided.

In regard to quality monitoring, Rex sees little benefit. This may be a reflection of the fact that as a regional airline we use fewer of the services and facilities than the major domestic and international carriers. We believe there is more merit in achieving proper outcomes with regard to the access and pricing issues than in service quality.

Price Levels

Generally aircraft landing fee levels have remained stable for Rex at the MPAs.

Landing charges and passenger charges at most MRAs have been subject to CPI plus adjustments over the last three years. This has occurred despite the substantial growth in passenger numbers and revenues by the airport.

At the MPAs, a significant change has occurred over the last four years since the collapse of Ansett.

Prior to Ansett's demise, the domestic terminals which were also used by connecting regional carriers, were owned and operated by Ansett and Qantas. As such the MPAs received building or land rentals. Following the collapse, the MPAs moved to acquire the terminal facilities which were previously occupied by Ansett and its regional operators and these were converted to multi-user facilities. As these were acquired from the Ansett Administrator, it is likely the prices paid by the MPAs were attractive.

In Sydney, Terminal T2 eventually became the home of Virgin Blue, Rex, Qantaslink and Jetstar along with a few smaller regional operators.

In Melbourne, a similar situation arose where the previous Ansett leased / owned and operated terminal area and concourses were acquired by Melbourne Airport and are now used by Virgin Blue and Rex.

Adelaide involved a similar outcome, although Adelaide Airport Limited (AAL) has now completed a new Multi – User domestic and international terminal which also houses regional services including Rex.

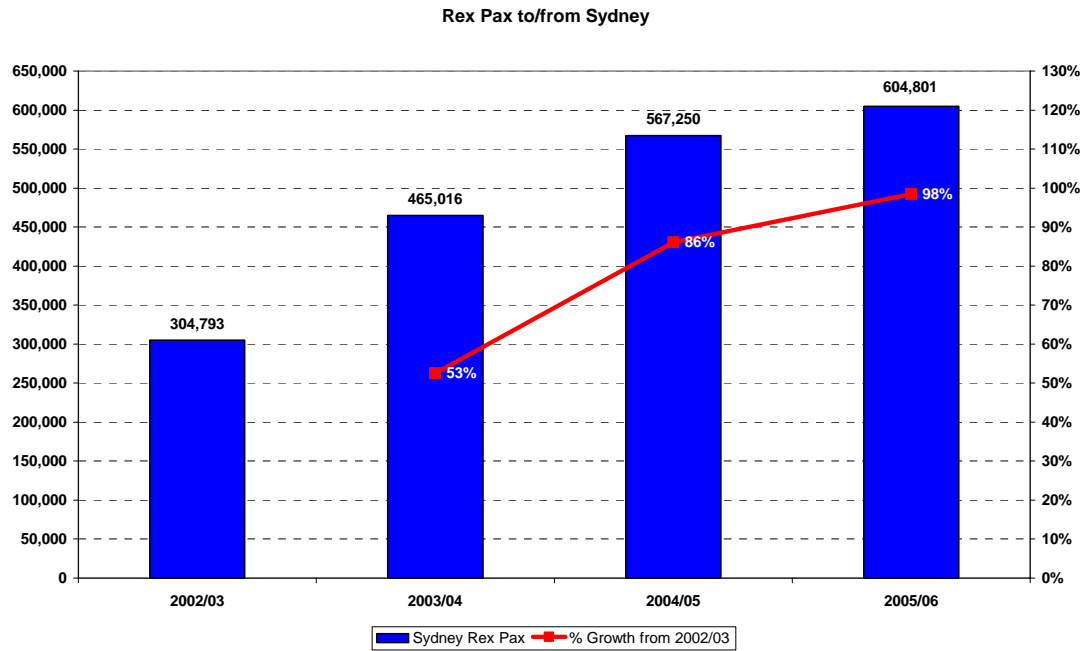
This was a major development for the MPAs. It has meant they have now even greater market control because they have the ability to allocate gate facilities as well as develop substantial new retail and retail related facilities and services.

The ACCC's Airport Price Monitoring and Financial Reporting 2004 – 2005 Report clearly shows the increases in per passenger charges for aeronautical and aeronautical related services at the MPAs. These increases in per passenger charges follow on the back of substantial growth in passengers and aircraft movements over recent years.

Attachment A sets out the growth in Rex passengers and aircraft movements at our three capital city hubs.

It is argued that while the unit charges have not increased substantially (or above the CPI at Sydney), airport revenue has increased substantially given the substantial increase in movements and passengers.

Table 5 below shows the increases in Rex passengers through Sydney Airport over the last four years.

Table 5 Rex Passenger Growth Sydney Airport 2002-03 to 2005-06

In terms of total activity, based on the ACCC's Report for 2004 – 05³, Sydney Airport's results are

Table 6 – Sydney Airport Revenue

| | 02-03 | 03-04 | % change | 04-05 | % change |
|--|-------|-------|----------|-------|----------|
| Aeronautical Services \$m | 243.4 | 271.1 | 11.4 | 297.8 | 9.8 |
| Aeronautical Related Services \$m | 69.7 | 78.3 | 12.3 | 88.7 | 13.3 |
| Total \$m | 313.1 | 349.4 | 11.6 | 386.5 | 10.6 |

Table 7 – Sydney Airport Margins (Revenues less Costs)

| | 02-03 | 03-04 | % change | 04-05 | % change |
|--|-------|-------|----------|-------|----------|
| Aeronautical Services \$m | 90.3 | 114.9 | 27.2 | 144.9 | 26.1 |
| Aeronautical Related Services \$m | 36.3 | 46.7 | 28.6 | 57.3 | 22.7 |
| Total \$m | 126.6 | 161.6 | 27.6 | 202.2 | 25.1 |

³ See Table 3.7.2 at p112

The substantial increases in margins – in the high twenties – clearly show that overall Sydney Airport has been able to increase unit rates on top of gaining the substantial benefits of increased throughput while reducing average unit costs.

According to the ACCC's Report for 2004 – 05 average revenue per passenger increased slightly while operating expenses decreased providing a substantial increase in margin.⁴

The ACCC highlighted similar experiences in Melbourne and Adelaide.

Table 8 below shows the Rex passenger growth through Melbourne Airport

Table 8 – Rex Passenger Growth Melbourne Airport 2002-03 to 2005-06

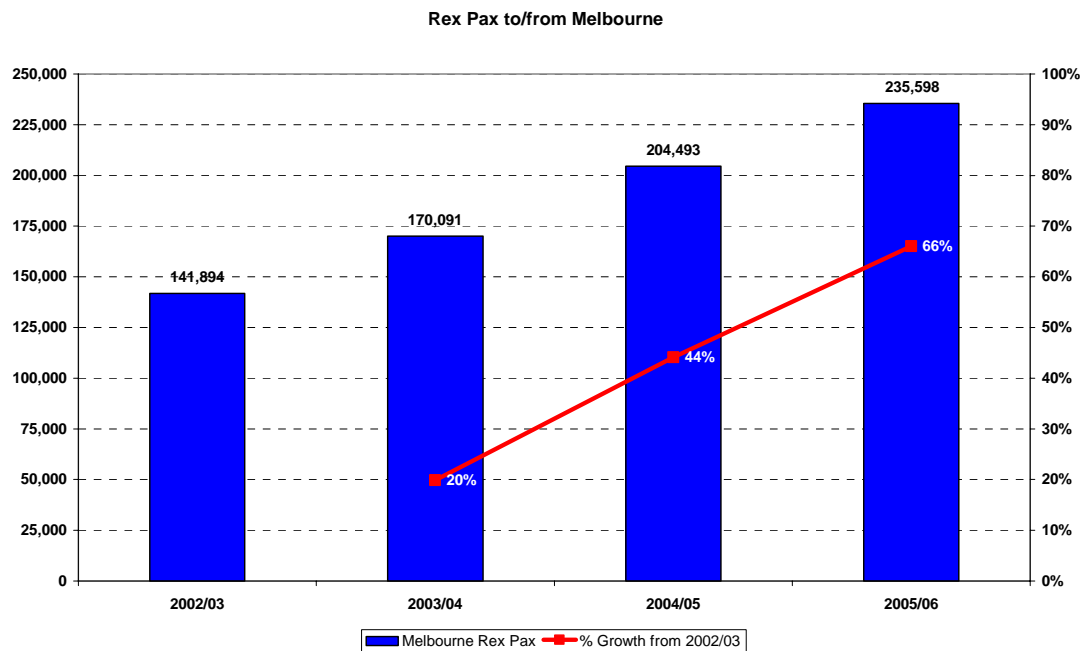
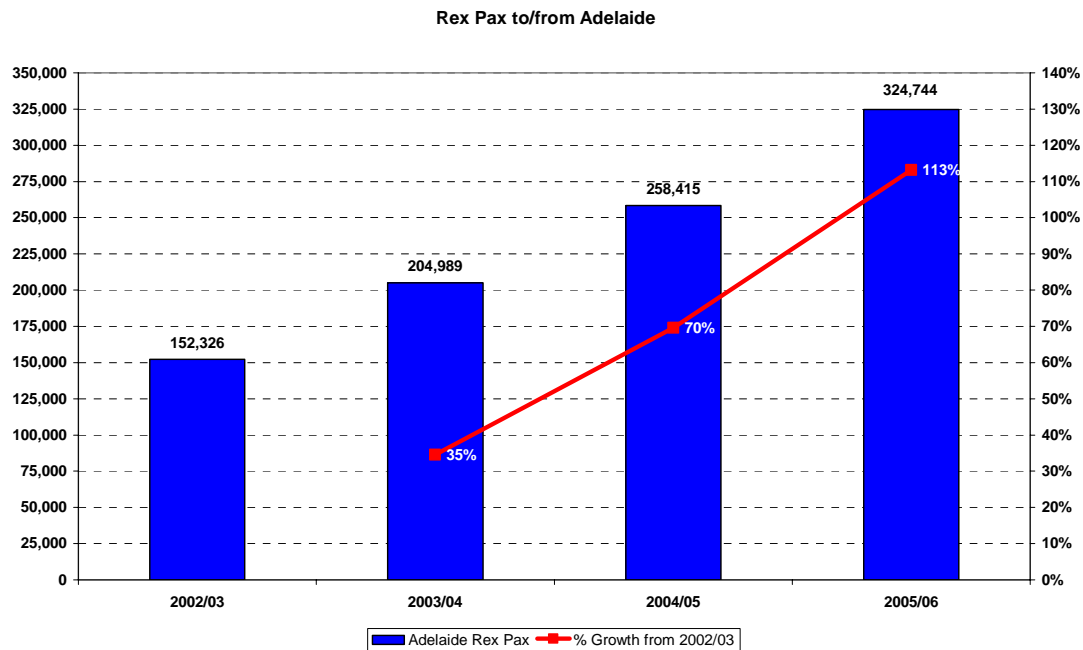


Table 9 – Melbourne Airport Margins (Revenues less Costs)⁵

| | 02-03 | 03-04 | % change | 04-05 | % change |
|--|-------|-------|----------|-------|----------|
| Aeronautical Services \$m | 41.2 | 55.7 | 35.2 | 64.4 | 15.6 |
| Aeronautical Related Services \$m | 26.4 | 36.7 | 39.0 | 42.5 | 15.8 |
| Total \$m | 67.6 | 92.4 | 36.7 | 106.9 | 15.7 |

⁴ See section 3.7.3, p 114

⁵ See Table 3.5.3 at Page 85

Table 10 – Rex Passenger Growth Adelaide Airport 2002-03 to 2005-06**Table 11 – Adelaide Airport Margins (Revenues less Costs)⁶**

| | 02-03 | 03-04 | % change | 04-05 | % change |
|--|-------|-------|----------|-------|----------|
| Aeronautical Services \$m | 3.8 | 9.4 | 147.4 | 11.6 | 23.4 |
| Aeronautical Related Services \$m | 3.7 | 4.7 | 27.0 | 5.4 | 14.9 |
| Total \$m | 7.5 | 14.1 | 88.0 | 17.0 | 20.6 |

Rex argues that a MPA should not be in a position to gain rate rises in an environment of substantial passenger and movement growth while operating costs reduce. The increase in passenger numbers is due primarily to the hard work of the airlines and translates into huge increases in passenger revenue for the MPA with hardly any corresponding increase in cost. It is therefore ludicrous that the MPA should be allowed to increase rates linked to the CPI as this in itself provides a real increase in revenues leading to higher margins and higher profits. If anything, the revenue gain should be shared between the MPA and the airlines via reduced unit charges.

This again shows how the MPAs are able to use their monopoly position to gain revenue and margins in aeronautical and aeronautical related services above that which would normally be expected in a fully competitive environment.

On top of this, the MPAs are now in a position given their ownership and control of terminal facilities to generate even greater revenues and margins from non – aeronautical activities. One only has to look at the massive increases in retail

⁶ See Table 3.1.2 at Page 28

development at Sydney's T2 terminal and the developments occurring at other airports to see the impact (some at the expense of airline gate and lounge facilities and the effective flow of passengers). At this time, a considerable amount of the increased revenue from these activities will flow directly through to the MPAs bottom lines as the basic facilities were already in place. This will mean even further increases in overall return.

On the back of increased commercial demand for retail space in terminals and airport land where there are capacity limitations, the MPAs are now demanding the airlines pay full retail commercial rentals for essential airline facilities. For example, at Sydney Airport Rex has been asked to pay a rate for an extension of its Corporate Lounge facility at a level equivalent to the most expensive rate in the Sydney CBD on the basis that it is a level SACL considers it could get for the space (which is yet to be constructed).

Another example is access to and the rates applied for land rental for hangar facilities at Sydney Airport. Rex's lease of its current facilities is about to expire. We have been denied renewal but told we can bid for space in the appropriate place for these facilities. Rex has also been told that we must pay the same rate as that which any alternative commercial use of that space may be prepared to pay. Accordingly, Rex must compete with other potential users such as fast food outlets and other retail activities for space for its fundamental activity. Where the space is specifically zoned for "aviation" activities, Rex must also compete with private and other aircraft service providers for such scarce space, yet the airline brings a far greater level of business to the airport overall.

What these examples underscore is the fundamental flaw in the approach of the MPAs and the price regulatory mechanisms which have been put in place. Without any overall competitive pressure on them, the MPAs are able to adopt a mechanism to extract the highest revenue from each parcel of land or space without appropriate regard to their proper use as air transport infrastructure.

In a fully commercial environment where Sydney Airport, for example, was subject to significant competition, a customer like Rex would be afforded preferential treatment in terms of access and rates for hangar and similar facilities on the airport given the 550,000 customers per annum who use Rex's services through the airport. Those passengers pay airport and terminal usage charges, are directed past a host of retail outlets in the terminal and nearby and provide customers for the thousands of car parking spaces at the airport. Indeed, elsewhere in the world, airport owners provide special incentives to airlines which can bring additional passengers and commercial activity to their airport.

In fact what is happening in Australia is quite perverse as the airlines end up paying a penalty for the MPA making more money. Where airlines like Rex are highly successful in growing passenger numbers at a MPA, the retail space becomes even more expensive and consequently the airlines are asked to pay more in the form of higher rentals for the very success they have created.

So while the MPAs are now in a position to generate massive increases in revenue and margin generated by both higher retail values and greater economies of scale, there is not the corresponding reduction in unit charges for use of facilities for the airlines and their passengers. In short, the airports are reaping the benefits from increased demand and margins off the backs of the airlines and passengers. All facets are loaded in the MPAs' favour.

Nevertheless, it must be highlighted that even though the airports were privatised, the MPAs have an implicit social responsibility as the custodians of such primary and

vital air transport infrastructure to ensure that the community generally and the regional communities served from their hub particularly, should not be disadvantaged. This includes not having the same pricing structure for regional airline services as the larger domestic and international carriers which benefit from substantially greater economies of scale.

Charging Structures

At the MPA's Rex is generally charged as follows:

- Landing fees based on the Maximum Take-off Weight of the aircraft
- Terminal Passenger Facilitation Fees on a per passenger basis for access to terminal common areas, common user gates, baggage systems etc
- Security services – generally on a per passenger basis for security across the airport, passenger and baggage screening – these can vary from per passenger to per departure
- Facility rental – on a sq m basis for offices, staff facilities, Corporate Lounges etc
- Land rental – on a sq m or fixed monthly basis for land for hangars, staff car parks etc.

There is no doubt the MPAs have been inventive in introducing additional charges, especially where those charges are considered outside the price notification and price monitoring areas. Some airports are now charging for aircraft parking on stand – off areas and outside owned / leased hangar areas. Charges have been introduced for aircraft parked on bays over a specified time period and on bays overnight when operations are suspended (including curfew periods). Staff car parking charges have not only increased but their locations moved further away adding to the costs of bus transfers and time.

Increased charges relating to increased security measures have been substantial. Here Rex considers that the significant changes in security service provision require a review of the charging structures. Many of the charging arrangements have developed over time based on initial commercial arrangements between the MPAs and operators then varied to cover additional requirements. In some cases, operators have been required to provide and meet the full cost of security screening where the overall requirement should mean a sharing of the total task.

In the Sydney and Adelaide terminals where Rex operates, for example, the total cost of passenger and baggage screening is bundled and then shared by the operators on a per passenger basis. In Melbourne, charging arrangements are determined between the airport and the individual operators based on “usage”. However, Rex argues that the full sharing approach is the most logical and equitable.

While the structure of the charging regimes may be similar, Rex suspects the actual rates applied to different operators varies based on “commercial” negotiations. While Rex believes it pays a higher per passenger rate for the use of terminal facilities at one of the MPAs, the lack of transparency through full disclosure prevents us knowing. Rex argues that in terms of equity, a regional carrier not using aerobridges or taking up as much terminal gate space as a larger jet operator, should pay a lower rate especially when the throughput of the regional using a single departure gate is equivalent if not more than the major operator over the course of a day. (Rex

consistently turns around over six Saab 340 aircraft from one gate in a 40 – 50 minute time period.)

Table 12 shows the current per passenger bundled charges for Rex operations at the MPAs.

Table 12 – Rex Hub Airport Per Passenger Charge

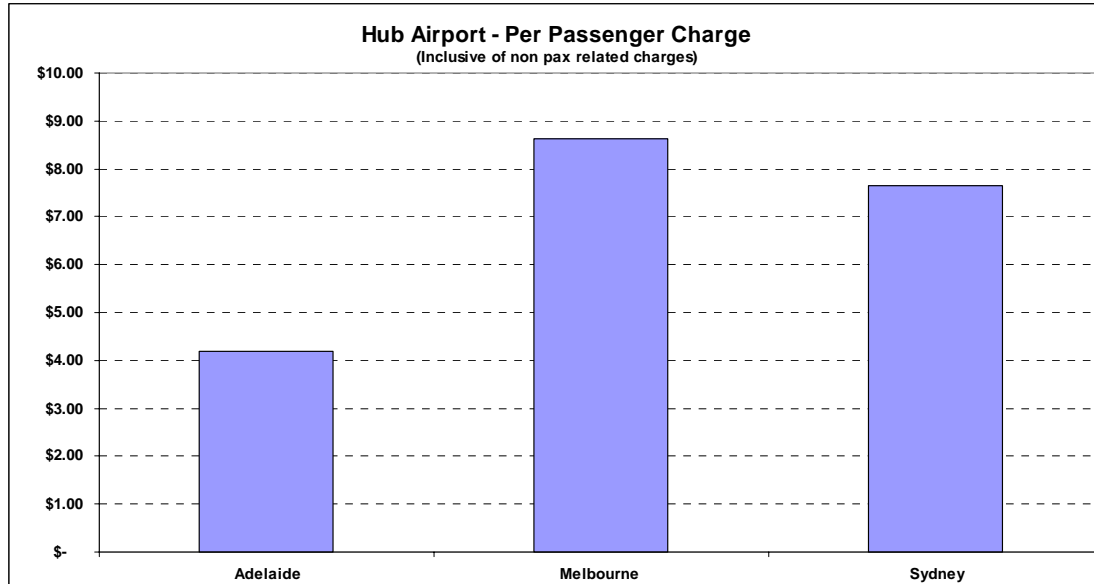
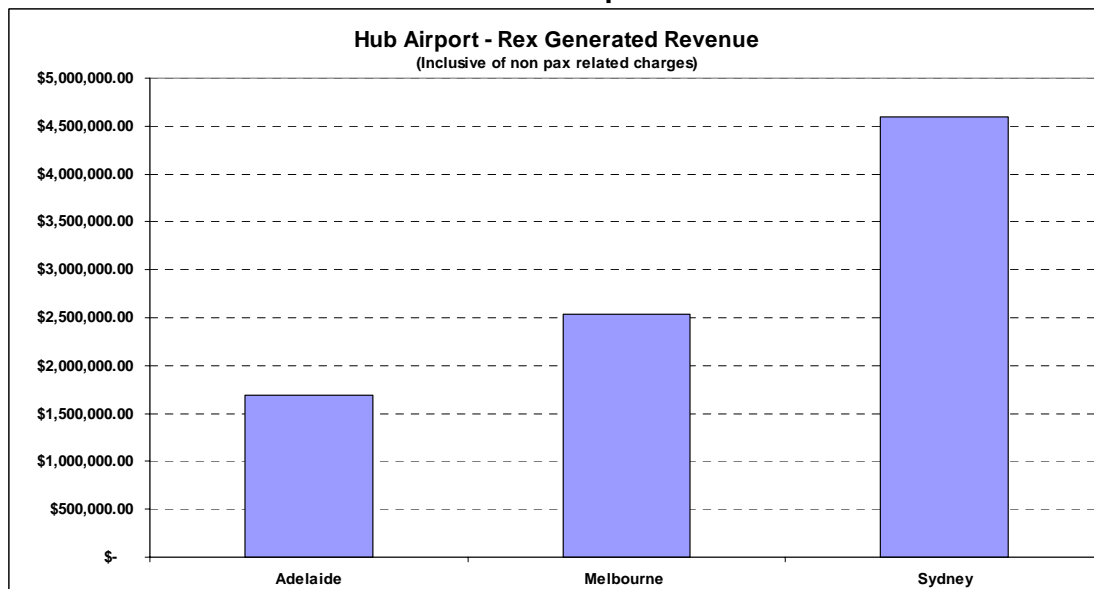


Table 13 – Rex Generated Revenue Hub Airports



There is no doubt the “ring fencing” of regional airline slots under the Slot System and the operation of the Price Notification requirements at Sydney Airport have resulted in not only access to that airport by regional airlines and the communities they serve, but has also prevented the airport from peak period pricing or loading up the price structure for regional airlines.

In a completely unregulated environment it would be very simple for SACL to drive out regional airline services from the airport. Re-distribution of peak time slots and increasing the landing or unit charges for regional airlines would quickly make the

fares too expensive and schedule times unacceptable thus rendering the service unviable.

For regional airlines to continue to provide viable and affordable air services to MPAs like Sydney, regional slot ring fencing and price notification are mandatory.

Rex would argue further that such price notification requirements should be extended to include all air service facilities and services including all airline offices, lounges, crew facilities, engineering facilities, hangars and associated services, catering and ground handling facilities and services – any facility or activity which an airline requires to undertake its daily operation.

Without access to such essential facilities at reasonable prices it is impossible for regional airlines to function. Rex is certain the reason the Commonwealth ring fenced regional slots at a major airport like Sydney was to guarantee ongoing access for regional airlines in the post privatisation era. It is reasonable, therefore, that these other facilities are just as essential to the ongoing effective access by regional airlines to major airports, as access via slots.

While the MPAs and to a degree the major airlines will argue that making special arrangements for regional airlines in such a manner does not provide the most economically efficient outcome, airports and especially the major airports are essential community facilities and services and it is therefore necessary that regional services are not only not disadvantaged but provided with the ability to actually provide that essential community service.

Quality of Service Monitoring and Procedural Efficiency

As mentioned above, Rex does not believe the activity of the ACCC in undertaking service quality monitoring has served to provide much benefit in specifically making the MPAs address quality issues.

Generally speaking apart for the issue of access to proper facilities at Sydney Airport (discussed above) and the quality of the facilities for regional passengers at Adelaide, the facilities and services generally provided by the MPAs have been satisfactory.

Having said that, Rex also is firmly of the view and recommends that the MPAs as part of their charter, must set and publish appropriate Service Level Key Performance Indicators for each of the services they provide to the airlines and therefore the travelling public. Such KPIs could include runway, taxiway and tarmac closures, operational movement area lighting failures, baggage system faults, check-in system faults and failures, IT and communication failures, aerobridge failures, security screening breaches, terminal cleanliness failures, air-conditioning failures, lighting/power failures etc, etc.

Rex also recommends AVSTATS collect and publish data on airline On Time Performance impacts which are related to airport provided services.

While Adelaide's new multi-user terminal is considered a massive improvement over previous facilities, the new terminal design and construction exposed major issues in terms of adequate facilities for regional passengers – long distances to walk, four flights of stairs to be negotiated and totally unacceptable covered walkways at tarmac level which were extremely hot, had little ventilation, poor drainage and raised issues of public liability and occupational health and safety. Most regional travellers also could not understand why all inbound regional passengers were required to be

security screened and directed up four flights of stairs back some 400 metres through the main terminal past the retail shops.

For reasons similar to the issue of access at Sydney Airport, Rex again had little option in our response to serious complaints from customers and their regional communities, but to instigate a public and political strategy to gain a satisfactory outcome. This was pursued and again it was a drawn out and costly exercise. If this was not done, Adelaide Airport could have effectively used its monopoly power to adopt the “take it or leave it” approach.

It is clear the generic, national access regime has been of no use for Rex in this arena. We do not believe either issue – at Sydney or at Adelaide - would have been settled by now. Put simply, by the time we would have gone through all the processes, Rex would have gone broke.

Nevertheless, Rex does believe there is a place for an independent dispute resolution process and arbitration on matters concerning access and quality of service. Rex recommends as such and further recommends that a formal process be established which covers all airports not just the MPAs.

FUTURE ARRANGEMENTS

Given their considerable monopoly market power, there is no doubt that any future arrangements must involve a high level of transparency and disclosure on the part of all airports – especially the MPAs.

Rather than a reduction in market power, the MPAs have undertaken strategies to improve their position by developing their own terminal facilities and using their planning and land development controls to further control access and pricing in “non aeronautical” activities which affect airline services.

Given the experience so far and the high probability of future misuse of monopoly power by the MPAs for the benefit of their shareholders rather than the community at large, effective access and pricing for the less powerful airline operators and tenants is unlikely to result. Government policies concerning economic and social development in regional Australia in particular will be compromised as a result. A “light handed” approach is not enough to provide an effectively robust framework for this not to be the outcome.

As far as we are aware, no where else in the world do the private owners of such essential community facilities have the freedom the MPAs enjoy currently. In such cases elsewhere, strict controls are in place to ensure that not only does the privatised activity not abuse its monopoly position but it also meets its community service obligations. This is what is needed in Australia.

Rex proposes that the requirement for price notification be extended to all MPAs and to selected MRAs with five year reviews of its effectiveness conducted by the Productivity Commission.

There is no doubt air travel will continue to grow both domestically and internationally in Australia. However, the probability of the MPAs restricting unit price increases on the potential of a resulting reduction in demand, is unlikely. We have already seen small increases in unit charges resulting in massive increases in margins and returns for the MPAs.

On the contrary, in regard to regional services, the clear strategy of MPAs could be to increase unit charges substantially for regional passengers / operators as well as

work to limit access to facilities necessary for an efficient and viable regional airline service. The result would be cessation of regional services leaving facilities and landing slots for the further development of larger aircraft and more profitable operations. This continues to be a major threat especially at airports with capacity problems.

Enhancement of Price Monitoring / Notification

Rex recommends price notification for all prices which are related to the provision of airline services at an airport, including those items which are now not considered aeronautical or aeronautical related – such as land for hangar facilities, staff car parking, corporate lounge facilities etc. Fuel throughput levies must be classified as aeronautical charges and subject to full price notification.

Rex also recommends price monitoring of all MPA revenues and arrangements. We suggest this can be streamlined to the extent that each MPA must disclose on its web site the basic terms of all leases and contracts at the airport including the applicable Service Level requirements so that there is full disclosure. From full disclosure comes accountability.

Rather than a major quality survey process, Rex recommends that each MPA be required to complete a quarterly report on an agreed list of Service Level KPIs. These should also be disclosed on their web site and published by the Department of Transport and Regional Services on an overall comparison basis in a similar manner as airline On Time Performance is published.

Airport Land and Asset Valuations

It must never be forgotten that the land on which airports are located remains public land. In the case of MPAs, it remains Commonwealth land. The privatisation process has simply provided the MPAs with management rights for the airport on a long term lease basis. The situation at most other airports is similar in the sense that the land is public and not private freehold.

It is therefore totally inappropriate for the land to be valued for anything other than for the use it is intended – operation of an airport.

The same principle must be applied to airport facilities.

Valuations based on potential alternative uses for airport land or facilities are totally inappropriate and provide a false outcome in terms of the real position. The airports and the land they have been established on were never considered for anything else and should not be viewed any other way by the new custodians. Indeed Rex argues that valuations for rental purposes should be based solely on cost recovery to maintain the land or facility.

In addition, Rex argues that where land and facilities are used to provide air services for important economic and social reasons as part of Government policy, then that usage should also be taken into account in determining rental and associated charging. Land and facilities used for the provision of vital regional services should therefore receive appropriate consideration.

Of course, Rex recommends that all valuations must be fully disclosed.

Pricing Principles

Rex recommends that future Pricing Notification regimes should include the following basic principles:

- prices have regard to the efficient cost of providing the facility or service
- prices and terms provided to customers with similar access and usage requirements should likewise be similar, that is, there is appropriate equity in treatment between customers
- demand for the facility or service having regard to the fact that aeronautical services have priority over other commercial customers

Dispute Resolution

As mentioned above, two important strategies will assist in both reducing disputes and improve the timely settling of disputes concerning access and pricing. These include:

- The full disclosure by the MPAs of all agreements and arrangements both aeronautical and commercial and their prices and terms
- The establishment of an independent dispute resolution process including the provision of arbitration. The establishment of an Airport Ombudsman or equivalent with the power to overview all activities at all airports and resolve disputes through arbitration where necessary will provide an effective and timely process which is outcome based

Regional Airlines

Rex has commented and made recommendations concerning future arrangements at the MPAs from a regional airline view point.

The principle issue is that regional airlines have much less commercial negotiating power with the MPAs, particularly Sydney Airport, than the larger airlines and other users. However, the actions of an MPA can mean survival or failure of a regional airline.

An unregulated market force approach will simply mean regional air services will not survive.

If the Government believes there is a need for regional airline services to provide the benefits of economic and social development for regional communities, then regulation is required.

Any such regulation will distort the outcome in terms of the most efficient use of MPAs resources. However, if there are going to be community service obligations built in to the regulatory regime, then it is mandatory for price notification and slot management to continue. Rex believes this is necessary not only at Sydney but also at Melbourne and other airports where peak time capacity restrictions are becoming the norm.

Other Activities

At Sydney in particular (but the phenomenon is appearing elsewhere) the establishment of other retail, non aeronautical activities in terminal T2 has resulted in increased difficulties in achieving On Time Departures. Rex has direct experience of

passengers being side tracked at food halls, retail shops and even subject to pressure sales talk from credit card retailers delaying boarding of flights and in some cases missing flights all together thereby causing additional delays involving off-loading baggage. This adds to cost, delays and stress for staff as well as reducing directly the quality of the air service experience for our passengers.

At Adelaide, the opening of a large retail outlet which is also accessed via the single main access roadway to the airport led to traffic congestion, delays in passenger processing, flight delays and passengers missing flights.

RELATED ISSUES

Rex takes this opportunity to raise the matter of productivity and efficiency of the other two principal suppliers of infrastructure and regulatory services, Air Services Australia and the Civil Aviation Safety Authority (CASA).

Airservices Australia is already subject to price monitoring requirements and has complied with the consultative and notification processes of the ACCC with regard to its activities. However, with continued change in technology and operating environments along with substantial growth in revenues, Rex considers the time is right for a more formal review of its activities for the future by the Productivity Commission.

CASA is currently not subject to any formal price monitoring or review processes except for basic consultative requirements as proposed by the Minister. Charges for CASA services are currently developed in-house with some limited input from industry. The direction from the Minister for CASA to achieve a higher level of cost recovery has resulted in substantial increases in charges on top of a major expansion in its time based charging regime.

Rex argues the CASA pricing arrangements involve a fundamental flaw in that the organisation with responsibility for regulating the industry on a monopoly basis, also sets the charging rate and determines the time and extent of the task.

In general, Rex believes there must be an independent and on-going assessment of the productivity and efficiency of CASA. Rex therefore recommends CASA pricing and charging should also be subject to formal review by the Productivity Commission.

RECOMMENDATIONS – SUMMARY

For ease of reference, set out below is a listing of the recommendations contained in this submission

- The accounts of all airports be required to be fully disclosed so that full transparency and accountability is therefore provided.
- The Commonwealth consider direct assistance to smaller regional airports in the form of funding for major maintenance and appropriate development works as it does with other vital regional transport infrastructure. Associated with such funding, the Commonwealth may wish to apply appropriate conditions to ensure government policies on regional air services are achieved.
- Given their advantageous position the Major Privatised Airports hold because of their physical location and monopoly status as a single supplier of

infrastructure to a primary transport sector, the full range of aeronautical and non-aeronautical activities be taken into account in the price notification and monitoring activities.

- All revenues and surpluses received by the Major Privatised Airport from non-aeronautical activities be taken into account in the determination of aeronautical charges. However, where an airport makes a loss in non – aeronautical activities, those losses must be borne fully by the airport shareholder and not be a burden on the aeronautical activities of the airport. In other words, aeronautical activity should not fund non-aeronautical activity, but non-aeronautical activity should fund the aeronautical activity.
- In considering issues of access, all aspects associated with operating an air service be included as part of the access regulatory regime, not just arrival or departure slots or general access to a multi-user terminal facility. Access to effective facilities and services to enable an efficient airline operation is necessary – these include passenger check - in facilities, baggage handling systems, departure gates, passenger lounges, office and crew facilities, facilities for ground handling activities, hangars, workshops and stores, catering facilities, etc.
- The Major Privatised Airports be required to publish the details of all lease and licence agreements and arrangements associated with access to land and facilities so that there is full public transparency.
- All aviation related prices charged by the Major Privatised Airports and selected Major Regional Airports be subject to Price Notification requirements of the TPA with five year reviews conducted by the Productivity Commission.
- Consideration be given to introducing slot management systems and appropriate ring fencing of regional slots at major hub airports where capacity is becoming a premium, in addition to Sydney.
- Specific consideration be given to charging lower rates for regional airlines given the Government policy objectives associated with regional economic and social development and on the basis that such airlines generally do not use the same level of facilities or have the same economies of scale as the major domestic and international airlines.
- As an alternative to the ACCC's survey and report on quality of service, the Major Privatised Airports be required to publish on a quarterly basis, appropriate Service Level Key Performance Indicators for each of the services they provide. Such KPIs could include runway, taxiway and tarmac closures, operational movement area lighting failures, baggage system faults, check-in system faults and failures, IT and communication failures, aerobridge failures, security screening breaches, terminal cleanliness failures, air-conditioning failures, lighting/power failures, etc.
- The Department of Transport and Regional Services AVSTATS be directed to collect and publish data on airline On Time Performance impacts which are related to airport provided services.
- The valuation of airport land and facilities should only have regard to their use as "airport". Valuations and hence charging should be determined on a cost recovery basis of maintaining the asset in its current form. All such valuations to be fully disclosed.

- Future Pricing Notification regimes should include the following basic principles:
 - prices have regard to the efficient cost of providing the facility or service
 - prices and terms should be equitable between similar customers
 - demand for the facility or service having regard to the fact that aeronautical services have priority over other commercial customers
- The Productivity Commission also undertake formal reviews of the effectiveness and efficiency of Airservices Australia and the Civil Aviation Safety Authority

21 July 2006

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