

**PRODUCTIVITY COMMISSION INQUIRY
INTO THE ECONOMIC REGULATION OF AIRPORT SERVICES**

SUBMISSION MADE BY MEMBERS OF THE AIRLINE INDUSTRY

21 April 2011

Introduction and purpose of joint submission

This joint submission to the Productivity Commission's inquiry into the economic regulation of airport services is made on behalf of the following airlines and airline representative bodies:

- the Qantas Group;
- Virgin Blue Airlines;
- the Regional Aviation Association of Australia (RAAA); and
- the Board of Airline Representatives Australia (BARA)
(together, – the **Airline Industry**).

A full list of parties that are represented by RAAA and BARA is attached.

Each party to this submission has provided its own individual submission to the Productivity Commission Inquiry. This joint submission presents to the Productivity Commission the Airline Industry's shared view that:

- airports have market power and the ability and incentive to exercise that power;
- as a result, there is an imbalance of bargaining power between airlines and airports, making commercial negotiations difficult; and
- there is evidence of excessive pricing and inconsistent application of service standards by airports.

Implementing appropriate economic regulation of airports is central to addressing these issues. The purpose of this joint submission is to present to the Productivity Commission a shared position on how the current regulatory regime should be enhanced in order to better facilitate constructive engagement and agreed commercial outcomes between airports and airlines.

The Airline Industry remains committed to a process of constructive engagement between airports and airport users in Australia. While we support improvements to the current regime, there is no interest in re-regulating airport services and pricing, by introducing a requirement for regulatory approval of all changes to pricing. Such re-regulation would only increase costs for all parties and lead to inefficient outcomes.

Since the introduction of light handed monitoring there has been progress with certain airports towards a more appropriate commercial negotiating approach. Notwithstanding this progress, the Airline Industry view is that the current regulatory framework does not strike the appropriate balance between providing incentives for airports to invest in airport infrastructure and ensuring that mechanisms are in place to prevent airports' unreasonable behaviour and excessive pricing of facilities and services.

Airports are expected to invest significantly in major airport infrastructure over the next ten years. The impact on airlines of current inefficiencies and inequities in the

development, delivery and pricing of infrastructure is likely to be exacerbated unless the current regulatory regime is improved to more effectively address these concerns. This is particularly pertinent given the impact of external factors, such as continued high oil prices and natural disasters, on the aviation industry.

Airports have substantial market power

Airports are natural monopolies with substantial barriers to market entry, large sunk costs and strong economies of scale. Due largely to geography, in Australia, unlike other countries, there is very limited competition from secondary airports or other modes of transportation.

As the Australian Competition and Consumer Commission (**ACCC**) has most recently recognised in its *2009-10 Airport Monitoring Report*, '*The price-monitored airports have significant market power and the ACCC considers that the airports have the incentives and ability to exercise their market power.*'¹

The current light handed monitoring approach to regulation has been ineffective in preventing the operators of major airports from exerting significant market power in the provision and pricing of airport facilities and services. In the experience of the Airline Industry, the non-monitored capital city and larger regional airports also have significant market power and exhibit behaviours that are not consistent with those of service providers operating in a competitive environment. While the Government's *Aeronautical Pricing Principles* were intended to serve as a guide for the pricing of aeronautical services at airports, in the Airline Industry's experience, both monitored and non-monitored airports often engage in pricing which is inconsistent with these Principles.

The Global Financial Crisis (GFC) demonstrated that airports and airlines have asymmetric risk profiles and that airports exercised significant market power in transferring risk to airlines during a particularly turbulent global economic period. Australian airports derived significant benefit when airlines discounted airfares to stimulate passenger demand; passenger volumes increased driving an increase in airport yield. This is evidence of the market distortion whereby airports do not share downside risk and enjoy upside benefits in their entirety, given no mechanism exists for airlines to share these upside benefits. A comparison of airline earnings to airport earnings during the GFC clearly illustrates this point.

Airlines generally have very limited countervailing power in negotiating the terms and conditions of access to airports. Airports are aware that any threat to withdraw services is not credible or viable, due to the considerable competition that exists between airlines. This view has been supported by both Productivity Commission and the ACCC.

There is strong evidence of excessive pricing and inconsistent application of service standards

Across a range of airports, charges for aeronautical services (and other services not currently classified as aeronautical) have been rapidly increasing over the last decade, to the point where they are now significantly above the long run costs of providing these services.

¹ ACCC 2009-10 *Airport Monitoring Report*, January 2011, p x.

The Airline Industry believes that airports exhibit unreasonable behaviour and excessive pricing in relation to:

- Airport profitability being achieved at the expense of airline profitability (as particularly evidenced during the GFC);
- Negotiating commercial leases;
- Inefficient airport investment decisions;
- Inequitable pricing of aeronautical assets;
- Excess returns from aeronautical assets;
- Inconsistency in use of the regulatory modelling process across airports;
- Application of 'line in the sand' valuations; and
- Staff car-parking services.

Evidence of these airport behaviours is provided in the individual submissions of the Airline Industry to the Productivity Commission's Inquiry.

There is no consistent ability for airport users to seek the maintenance of or improvements to services. Similarly, there is no ability for airport users to demand reduced prices where services or facilities are not performing to the required standards.

As a result, the cost of travel is higher than would be the case in a competitive market. This has a significant economic and welfare impact on passengers and on the broader economy, as well as airlines. In the Airline Industry's view, the current regulatory regime should be improved to address the impacts on airlines and, undoubtedly, on passenger welfare.

Enhancement of the regulatory regime will facilitate constructive engagement and agreed commercial outcomes between airports and airlines

The preferred approach of the Airline Industry is to engage in bilateral commercial negotiations with airports to reach a mutually acceptable outcome. However, the current regime does not facilitate truly commercial negotiations between airlines and airports due to the inequitable bargaining position airlines experience as a result of airports' substantial market power.

The principles that should be encompassed in an enhanced regulatory regime are described below and specific mechanisms to address them are explored further in the Airline Industry's individual submissions.

The key features of an improved regulatory regime should include:

- i. Commercial negotiations as the key method to determine the terms and conditions on which airport services are provided.
- ii. A set of guidelines that address the key issues raised in negotiations between airlines and airports over the provision of aeronautical services. These guidelines should address issues such as pricing, transparency of information, the negotiation process, investment in airport infrastructure, and the measurement and allocation of costs and efficiencies.

These guidelines would assist commercial negotiations and reduce the need for arbitration. In the event of arbitration, they could also be used to guide the arbitrator.

- iii. The ability for airports and airlines to refer to binding and independent arbitration for any dispute over the terms and conditions on which aeronautical services are provided by the airport, in the event that commercial negotiations fail. This binding arbitration would be carried out by an independent party. This proposal could be implemented through the deemed declaration of aeronautical services at major airports. Under deemed declaration, the ACCC would be the relevant arbitrator.
- iv. A more equitable treatment and allocation of aeronautical and non-aeronautical services, costs and revenues to reflect the downside risks being borne by airlines and excessive pricing behaviour impacting the consumer. Specific suggestions have been set out in each party's individual submission. Approaches could include an expanded definition of aeronautical services or application of a new non-aeronautical revenue allocation methodology.



ATTACHMENT

RAAA Membership

As at March 2011 – 27 AOC Members

AIR LINK PTY LTD	AIRNORTH
ALLIANCE AIRLINES PTY LTD	BASAIR AUSTRALIA LTD
BRINDABELLA AIRLINES PTY LTD	CHARTAIR PTY LTD
COMPLETE AVIATION SERVICES	CORPORATE AIR
CURRY KENNY AVIATION GROUP	HARDY AVIATION
KIMBERLEY AVIATION	MAROOMBA AIRLINES
PIONAIR AUSTRALIA PTY LTD	REGIONAL EXPRESS (REX)
ROYAL FLYING DOCTORS SERVICE CENTRAL OPERATIONS	ROYAL FLYING DOCTORS SERVICE QUEENSLAND SECTION
ROYAL FLYING DOCTORS SERVICE SOUTH EAST SECTION	ROYAL FLYING DOCTORS SERVICE WESTERN OPERATIONS
ROSSAIR CHARTER	SHARP AIRLINES
SKIPPERS AVIATION	SKYTRANS AIRLINES
SKYWEST AIRLINES	TOLL AVIATION
UNIVERSITY OF SOUTH AUSTRALIA AVIATION ACADEMY	VINCENT AVIATION
WEST WING AVIATION	

BARA Membership

As at March 2011 – 32 members

AIRCALIN (SB)	GARUDA INDONESIAN AIRWAYS (GA)
AIR CANADA (AC)	JAPAN AIRLINES (JL)
AIR INDIA (AI)	KOREAN AIR (KE)
AIR MAURITIUS (MK)	MALAYSIA AIRLINES (MH)
AIR NEW ZEALAND LIMITED (NZ)	PHILIPPINE AIRLINES (PR)
AIR PACIFIC LIMITED (FJ)	QANTAS AIRWAYS LIMITED (QF)
AIR TAHITI NUI (TN)	QATAR AIRWAYS (QR)
AIR VANUATU (NF)	ROYAL BRUNEI AIRLINES (BI)
ASIANA AIRLINES (OZ)	SINGAPORE AIRLINES (SQ)
CATHAY PACIFIC AIRWAYS LTD (CX)	SOUTH AFRICAN AIRWAYS (SA)
CHINA SOUTHERN AIRLINES (CZ)	THAI AIRWAYS INTERNATIONAL (TG)
DELTA AIRLINES (DL)	TURKISH AIRLINES (TK)
EMIRATES (EK)	UNITED AIRLINES (UA)
ETIHAD AIRWAYS (EY)	VIETNAM AIRLINES (VN)
EVA AIRWAYS CORPORATION (BR)	VIRGIN ATLANTIC AIRWAYS (VS)
FEDERAL EXPRESS (FX)	VAUSTRALIA (VA)