



Hobart International Airport Pty Ltd Submission

to

**Productivity Commission's Inquiry into the Regulation of
Airport Services**

7 April 2011

Introduction

It is Hobart Airport's understanding that the key objectives of the current regulatory regime were to:

- facilitate commercially negotiated outcomes between airports and their business partners;
- promote economic efficiencies to ensure timely investment in airport infrastructure; and
- minimise unnecessary compliance costs.

It is our view that these objectives have been met as there is now a mature network of flexible and mutually beneficial commercial arrangements, which have been negotiated between Australian airports and their airline partners. Coupled with this there has been unprecedented major infrastructure investment at the vast majority of Australian airports, which have been supported under these new commercial arrangements. Given these outcomes and the underlying legal environment in which airports operate it is our view that there is no need to continue with airport specific economic regulation.

Hobart International Airport Pty Ltd ("Hobart Airport") was privatised with effect from 11 June 2008. The privatisation of Hobart Airport has led to significant investment and improvement of airport services and infrastructure for all users of the airport.

In addition to significant investment in airport infrastructure, Hobart Airport has developed a heightened focus on its customers and the service that they are provided. In defining the 'customer' Hobart Airport seeks to deliver for key commercial partners, particularly airline partners, as well as all airport users.

The privatisation of Hobart Airport has promoted commercial negotiation and agreements between the airport itself and existing and new business partners, in addition, since privatisation significant infrastructure investment has been made at

Hobart Airport. The current regime has led to a cooperative and strategic approach to airport commercial partnerships that deliver benefits for all parties, Hobart Airport has been successful in reaching agreements of this nature clearly demonstrating this.

Previous pricing regimes which included Hobart Airport were restrictive to the maturation of the partnership between the airport and its customers. Today, Hobart Airport has successfully undertaken commercial negotiations developed from fundamental pricing principles undertaken in good faith to achieve mutually beneficial business outcomes.

Hobart Airport operates in an environment whereby they are regulated and impacted upon by a variety of means and agencies, the involvement from each and every one of these parties has an impact on Hobart Airport and particularly the costs associated with compliance, the addition of further regulatory involvement will only add additional costs on the airport and ultimately the airport user, an outcome that Hobart Airport would prefer to avoid

In the opinion of Hobart Airport, we have no capacity to exercise monopolistic market power, in fact in the case of Tasmania this is quite the contrary whereby the purchaser yields significant power This submission seeks to substantiate that position and support the continuation of Hobart Airport's current regulatory regime which promotes commercial partnerships between airports and their customers whilst minimising unnecessary compliance costs.

Tasmanian Operating Environment

Hobart Airport wishes to provide an overview of the environment in which it operates and the impact that this environment has on commercially-driven pricing, as opposed to regulatory price control.

Hobart Airport does not possess market power and do not have the ability to abuse prices. Hobart Airport currently has domestic services only, has close proximity competition and is a low yielding, end-point destination, all factors which do not allow the airport to behave in a monopolistic manner; the success of the airport

operation is driven by the quality of service and support that the airport provides to its customers, customers which are ever increasingly price sensitive.

Tasmania has four regional airports servicing what is a fairly static population. Hobart Airport and Launceston Airport are the most significant in size of the four airports and with a travelling distance of approximately 200 kilometres or two hours' drive are in extremely close proximity to each other. This proximity is a short distance when compared to other states and territories in Australia and presents both ports as a viable option for both inbound and outbound customers to choose from, choice that is greatly impacted on retail price offering. Recent studies have shown that there is a growing contestable market between Hobart and Launceston Airports, this again demonstrates the inability to behave in a monopolistic manner and the ability for the purchaser to demonstrate power in the Tasmanian market

Hobart Airport has a general aviation aerodrome that sits adjacent to the airport, but also has an industrial estate that has undertaken significant recent development that is also adjacent to the airport. The industrial estate has undergone significant growth and has shown an ability to be flexible in its purchasing options to tenants in the local and national market.

Hobart Airport also faces competition from an off-airport car parking provider who is situated within close proximity to the Airport. This business provides a free shuttle bus to and from the airport as well as other value-added services. The off-airport competitor provides airport users with an alternative and again removes any ability to demonstrate market power in the area of car parking in the Hobart market. Hobart Airport provides adequate car parking options at prices that are reasonable benchmarked against local market averages.

In terms of airport land transport options, Hobart Airport has no foreseeable congestion points and works well in cooperation with local and state governments on land access planning initiatives. This interaction is only strengthened by the introduction of the new Planning Coordination Forum to facilitate these strategic discussions with all tiers of government.

Airport users are also provided with a number of transport alternatives that do not involve driving a car to the airport and using airport car park products. The range of potential alternatives includes -

- dropping-off and picking-up passengers for free in a designated lane; and
- travelling to and from the airport by taxi, hire car or shuttle bus

In addition to the close proximity of airports, Tasmania is also well serviced internally by the national road network and non-passenger rail. External sea services are provided for both freight and passenger movement with the Spirit of Tasmania and sea freight terminals in the north, south and north-west coast. Sea services provide a viable option for both passenger and freight movement and continue to be supported and subsidised by the Commonwealth Government's Freight Equalisation Scheme, support that is not paralleled into air access freight or passenger options in Tasmania.

There is a high level of ease for passengers wishing to access Tasmania by vehicle, it Tasmania has a significant fly-drive tourism market, and also many Tasmanians take their own vehicles interstate to avoid airline excess baggage charges.

The Commonwealth's subsidisation of passenger and sea freight has a detrimental impact on Tasmania's airports and their tenants, including car rental and freight companies. The freight subsidisation particularly affects passenger services and opportunity for capacity growth derived by airline's opportunity to grow freight returns.

Tasmania's air access and passenger growth is driven by demand growth, this is made more difficult by such close proximity competition vying for market share. It is not uncommon to see competitive marketing and distribution activities being undertaken by Tasmania's respective regions where the airports are located. This has been made even more prolific by the introduction of 'Zone Marketing' activities in the Tasmanian market driving visitors to specific areas, rather than undertaking a touring experience.

It is evidenced by a number of examples that there is significant competition for the visitor to Tasmania.

Hobart Airport's passengers comprise approximately 45% Tasmanian users and 55% tourist to the island. Share of the 55% of visitors is toughly contested, with both Hobart and Launceston Airports working closely with airlines and other suppliers in marketing and distribution initiatives to capture at least one leg of the passenger's Tasmanian journey. This common passenger trend means that significant airport infrastructure is duplicated at (least) two airports, but revenues are either only experienced by one airport or diluted between the two.

Hobart Airport's customer profile is one that might be classified as discretionary, a largely tourism driven market that does not deliver high yields to airlines, passengers that are flexible in their choice of airline, service and even destination with price being the predominant determining factor.

The high reliance on tourism passenger traffic at Hobart Airport provides uncertainty in passenger number projections. Global shocks and other environmental impacts can (and do) have a significant impact on passenger demand.

The operating costs of the airport are generally fixed and growing. Mandated capital and maintenance works expenditure as well as regulatory safety and security compliance all add significant costs to the airport with limited ability to guarantee revenue or growth. During recent years, Hobart Airport has agreed a significant level of replacement of infrastructure approaching the end of its life cycle, this agreement has been achieved through commercial negotiation.

In the case of Hobart Airport airline services are frequently cancelled or limited, or aircraft type changed. As a non-hub airport at the end of the domestic network this has great impact on airport revenues. The decisions made by carriers to remove or downgrade services are often done without consultation (or even advice) to the airport operator all having a significant impact on projected airport revenues and clearly demonstrating the level of purchasing power evidenced in the market

As outlined above, Hobart Airport does not operate in a monopolistic environment and in reality aviation performance is governed by the business decisions of our largest customers, airline operators.

Economic Contribution

Airports are significant contributors to local economies and Hobart Airport is no exception to this statement. As outlined in the Aviation White Paper “...aviation is an industry of national strategic importance to Australia.” In the case of Tasmania, being an island, this statement is absolutely supported with access being critical to the lifeblood of the destination.

Hobart Airport provides over half of the access options for Tasmanian’s travelling on and off the island and for the increasingly important travel and tourism industry in Tasmania.

Hobart Airport also provides significant direct and indirect employment opportunities to a range of aeronautical and aeronautical-related businesses. In addition to this, the capital investment provided by the airport and its stakeholders represents a significant stimulation to the Tasmanian economy.

The flow-on impact to the local economy of airport operations and airport business is significant. Hobart Airport commissioned an independent economic benefit analysis as part of their 2009 Master Plan study. This study indicated the considerable impact the Airport has and will continue to have on the Tasmanian economy.

Low level estimates predict that the number jobs directly and indirectly in the Tasmanian economy associated with Hobart Airport will increase by over 800% in the next 20 years. Hobart Airport’s economic contribution is forecast (at a low level estimate) to also increase by nearly 700%. Airports are key economic contributors and Hobart Airport is certainly no exception to this rule.

The ability for the airport to reach appropriate commercial outcomes within a supportive regulatory environment is critical to sustaining and growing this economic contribution which Hobart Airport has on the Tasmanian economy.

The current regime for Hobart Airport has been supportive of undertaking commercial negotiation and infrastructure investment. Any changes to the current regime could have a detrimental impact on the ability for Hobart Airport to continue to play such an important part in the Tasmanian economy.

The Current Regime

Hobart Airport is pleased to note that it has been successful in reaching commercial pricing outcomes under its current regulatory regime, a current hands-off regime for Hobart that should be maintained to ensure the ongoing development of commercial relationships between the airport and its major customers.

Hobart Airport is aware that airlines are very sensitive to any growth in aeronautical charges because of the impact that this will have on their performance in a particular market, Hobart Airport works to minimise charging changes where possible and understands that reaching a mutually beneficial agreement is critical. Hobart Airport needs to reach commercial agreements with its airline partners due to lack of market power, for without commercial agreements there is heightened uncertainty in future aeronautical growth, an uncertainty which has significant impacts on the Tasmanian economy. Hobart Airport has sought (successfully) to reach long-term growth partnerships with airlines that are beneficial to all parties, agreements which are reached through a process of commercial negotiation.

Hobart Airport has clearly demonstrated on a number of occasions their ability to reach commercial outcomes with their partners, this has been able to occur as a result of the current regulatory regime and the non-interventionist approach.

Hobart Airport has no ability to negotiate on a 'take it or leave it' basis, with no market power, this would be an unacceptable way for our business to enter pricing discussions and would result in airlines flexing their countervailing market power by

reducing capacity and subsequent passenger traffic. As outlined above, due to the discretionary nature of passenger traffic at Hobart Airport, we cannot afford to negotiate in a non-commercial manner; with no market power the cost to our business and the Tasmanian economy of not reaching a commercial outcome is far too high.

Under the current regulatory environment Hobart Airport has been able to undertake substantial investment in its infrastructure, and over the last four years the Airport has spent in excess of \$24 million on improving the airport's facilities and aeronautical infrastructure. Over the next five years Hobart Airport intends to undertake additional invest of a similar amount. These levels of investment have been achieved in partnership with Hobart Airport's airline customers without regulatory intervention.

Hobart Airport has been able to demonstrate that without regulatory intervention that they are able to reach suitable commercial outcomes with its airline partners, agreements that can drive long-term productive partnerships between the airport and airlines and ultimately benefit all parties.

Cost of Compliance/regulation

The cost of compliance for an airport the size of Hobart is significant. With passenger numbers just over 1.85 million and a staffing count of less than 30, Hobart Airport's resources are stretched.

Recent additional compliance costs have necessitated senior staffing increases at Hobart Airport, as well as physical infrastructure works completion. These costs are not insignificant for the size of our company and are not costs that can easily be 'passed on' to business partners.

Requirements from regulatory authorities often do not take into consideration the local operating context, this results in significant compliance expenditure which do not deliver any objective outcomes. Hobart Airport is very much of the opinion that a one size fits all model does not apply and that, if regimes do exist, that they take into consideration the local operating context of that airport, and particularly the amount of market power demonstrated.

Market Power

As outlined above, Hobart Airport does not possess market power. Hobart Airport has another airport located in close physical proximity, we are an end-point destination with no international traffic and are a low-yielding tourism driven destination. Hobart Airport can clearly demonstrate on a number of occasions whereby airlines have demonstrated significant purchasing power through yield management strategies.

When this does happen, Tasmania as a destination is left to suffer. Airline seats are restricted, fare prices increase and the airport and the local industry are left to wonder what to do.

Hobart Airport is left to ask the question, what motivation is there for their partners to negotiate and reach commercial outcomes with us when they yield such significant purchasing power? Is there a way to encourage partners to reach commercial outcomes and if so, how do you achieve this with no market power? Hobart Airport must, and does, take a commercial approach to reaching aeronautical pricing agreements, and during this monitoring period has demonstrated that it can achieve this.

The Need for Regulation?

Hobart Airport questions the need for airport pricing regulation. Hobart Airport is an important participant in the local and Tasmanian economy and a critical piece of infrastructure. It is in the interest of Hobart Airport to ensure that it negotiates effectively with all of its partners and monitors its quality of service offering to be of an acceptable standard to all users, further/new regulation is not required to monitor this and in fact, will only add further costs to operating the business.

In a market whereby the consumer has a competitive choice, Hobart Airport cannot afford to **not** be monitoring their own business and ensuring that it delivers for its

customers and passengers, it is for this reason that the current self-administered regime for Hobart remains appropriate.

The current regime whereby Hobart Airport operates on a self-administered price and quality of service scheme is more than adequate in fulfilling the needs of all current and potential airport users whilst providing the opportunity to negotiate in a commercial manner.

Summary

The Australian Airports Association submission will look at the industry-wide regulatory environment, however this submission should be treated as uniquely focused on Hobart Airport's operating environment.

The current regulatory regime which Hobart Airport operates within has allowed the Airport to work with its major partners to develop commercial agreements. Further to this, the current regime has allowed Hobart Airport to invest in major infrastructure development.

Hobart Airport does not demonstrate market power and can therefore not behave in a monopolistic manner due to a range of factors. Not possessing market power demands that Hobart Airport works closely and cooperatively with its customers to develop appropriate commercial agreements that meets the needs of all parties, Hobart Airport does not possess the power to set prices on a 'take it or leave it' basis.

Hobart Airport considers a continued non-interventionist regulatory regime to be the most appropriate for their company and their customers.