



Productivity Commission Inquiry into Economic Regulation of Airport Services

Response to Draft Report

September 2011

Introduction

Melbourne Airport endorses the overall conclusion of the draft report that the current light-handed regulatory regime has supported aeronautical investment and growth in air travel, facilitated by a maturing system of sophisticated and commercially-negotiated agreements between airports and airport users.

The draft report highlights that airports do not misuse their market power and that there are no grounds for further regulatory intervention along the lines of deemed declaration or mandatory codes of conduct.

Furthermore, Melbourne Airport notes the observation in the draft report that there is no evidence to support the claim that Melbourne Airport charges monopoly car park prices by impeding access to competitors.

This submission provides further comment on draft recommendation 11.1 on the proposed 'show cause' notice process, and additional information as sought by the Commission on issues such as market power and regulation; airport car parking and land access; guidelines for commercial negotiation; monitoring and quality of service surveys; land transport access and integration issues; and, extension of the Pricing Principles to regional airports.

In summary, Melbourne's Airport response to the draft recommendations is as follows:

Options for future airport regulation

Draft recommendation 11.1 - 'show cause'

Melbourne Airport does not support this recommendation. In the event the Commission decides to proceed, we offer some suggestions on its implementation.

Draft recommendation 11.2 – 'retain current Pricing Principles'

Melbourne Airport supports this recommendation.

Draft recommendation 11.3 – 'deemed declaration / mandatory codes of conduct'

Melbourne Airport supports this recommendation.

Draft recommendation 11.4 – ‘price monitoring continued to 2020’

Melbourne Airport supports this recommendation.

Draft recommendation 11.5 – ‘Quality of Service monitoring for price-monitored airports to 2020’

Melbourne Airport supports this recommendation.

Draft recommendation 11.6 – ‘ACCC administration of monitoring regime’

Melbourne Airport supports this recommendation.

Draft recommendation 11.7 – ‘Continuation of ACCC monitoring regime’:

Melbourne Airport supports this recommendation.

Land transport access and integration

Draft recommendation 11.8 – ‘no mandatory Party IIIA access for ground transport’

Melbourne Airport supports this recommendation.

Options for future airport regulation

Draft recommendation 11.1 – ‘show cause’.

The Australian Competition and Consumer Commission (ACCC), on publication of its monitoring reports, should be empowered to issue a direction that an airport has six weeks to show cause why its conduct should not be subject to scrutiny under a Part VIIA price inquiry.

To issue a show cause direction, the ACCC must form a view that there is prima facie evidence that an airport has, over time, demonstrated a consistent pattern of achieving aeronautical returns in excess of a reasonably expected band of outcomes, having regard to price paths, the quantum and timing of investment and how that bears on quality outcomes and market conditions.

Where the ACCC is dissatisfied with an airport’s response to a show cause direction, it shall recommend that the relevant competition Minister invokes a Part VIIA inquiry. If the Minister initiates a Part VIIA price inquiry, the review body would draw on the monitoring reports and also take evidence and consult with the airport operator and its customers. In forming a view about an airport’s exercise of market power, the review should examine:

- *whether airport charges have consistently been set at a level higher than would be justified on the basis of costs, investment requirements and changes to service quality;*
- *how non-price terms and conditions are treated in agreements and how rights to vary such terms are set; and*
- *the extent to which consultation mechanisms allow for the reasonable provision of (two way) information.*

The review body must be guided by the ‘Pricing Principles’.

Melbourne Airport does not support this recommendation in principle.

There is no clear rationale to justify the inclusion of a ‘show cause’ mechanism. The ACCC currently has sufficient power to request information and recommend a Part VIIA price inquiry. The Minister can also initiate actions.

Consistent with the light-handed regulatory approach, it could be argued that airport operators should be entitled to a presumption their conduct is compliant, and it is the responsibility of the regulator to investigate and prove that a regulatory obligation has been breached. The ACCC is not constrained from fulfilling its regulatory responsibilities under existing legislation.

Airports already provide the ACCC with detailed information on their operations as part of the existing price monitoring process. In the event that the ACCC decided on the basis of this information to issue a 'show cause' notice, there would need to be a clear understanding of what type of additional information airport operators could provide to the ACCC to demonstrate that airports were not earning excessive aeronautical returns.

The Commission notes the importance of the light-handed regulatory regime in attracting investment in airports. In this context, Melbourne Airport would encourage the Commission to give appropriate weight to the views contained in the submissions of airport investors about the impact of additional regulatory burdens on airport operators, including the potential cost of compliance with 'show cause' notices and how increased regulatory uncertainty could affect the viability of future investment.

The proposed 'show cause' mechanism will potentially increase the cost of regulatory compliance for airport operators and introduce regulatory uncertainty for investors without leading to a different outcome to what is already available to the ACCC and other parties under the existing mechanisms for instituting a price investigation.

However, should the Commission decide to proceed with this recommendation, Melbourne Airport would suggest it consider:

- a better-defined threshold for the 'show cause' notice that is related to particular regulatory obligations, and ensuring that the ACCC is provided clear parliamentary guidance on the extent of the proposed 'show cause' power;
- a transparent and agreed methodology based on the Pricing Principles to be used by the ACCC in making conclusions about whether an airport has demonstrated a pattern of achieving returns in excess of the 'reasonably expected band of outcomes';

- a requirement for the 'show cause' notice to be related to the aeronautical business *as a whole* and not be triggered by individual pricing or contract terms which are more appropriately a matter for negotiation and resolution in the context of commercial agreements;
- separation of the authority to issue a 'show cause' notice and recommend a price inquiry, as compared to the actual conduct of a price inquiry. Assuming the ACCC considers there is sufficient basis to initiate a price investigation by issuing a 'show cause' notice, the ACCC could be judged to hold a pre-determined view on its likely outcome.
- the ACCC's decision to issue a 'show cause' notice, an airport operator's response, and any subsequent recommendation by the ACCC to the Minister should be conducted on a confidential basis. The Minister's decision to undertake a price inquiry should be the matter of public record.

Information requests

Melbourne Airport offers the following information and comment in response to the information requests in the draft report.

Market power and regulation

The Commission requests additional information on whether an airport's ability to earn non-aeronautical revenue provides an incentive to constrain aeronautical charges, and if so, to what extent this currently occurs. (p.44)

The current structure does not provide an incentive to constrain aeronautical charges and it was never designed to do so.

The dual till system introduced at the time of privatisation created a situation where the two businesses operate separately with individual investment and pricing criteria to reflect their natural differences in the market and own business drivers. This reduces the risk of unintended long run under-investment and inefficient investment pricing decisions. For example, a cross subsidy from non-aeronautical to aeronautical in a terminal investment situation with an under-priced terminal service could lead to the long run under-investment in aeronautical terminal facilities.

The system was established to ensure the long-term investment required for the high cost long payback infrastructure services. As found in draft report, aeronautical charges do not indicate misuse of market power and quality of services are generally 'satisfactory.' In addition Australian airports' aeronautical charges, revenues, costs, profits and investment look reasonable compared with outcomes at overseas airports.

Airside and terminal effectiveness of monitoring

The Commission seeks participants' views on the appropriateness of including capital costs, such as the cost of borrowing, in the ACCC's price monitoring program. Are there reliable measures that can be collected with relatively low compliance costs? If so, which is the best measure?(p.140)

Melbourne Airport does not believe it is appropriate to include capital costs in the ACCC price monitoring program.

The current system was established as a core part of the regulatory regime. The current methods which set pricing guidelines and commercial negotiations underpin the airports' business model and are used to seek funding from debt and equity markets. These issues are reviewed through the ACCC when equity betas are set. It is also important to recognise that capital costs are also calculated in the Weighted Average Cost of Capital (WACC) which are central to the Airline Services Agreement negotiation processes.

To introduce items such as capital costs could alter the negotiating price structure for both airlines and the public. It also implies that the current price structure has not worked effectively. As mentioned previously, commercial negotiations drive airport investments, while ensuring that the community has confidence that airports do not overcharge for their services.

If it was deemed necessary to include costs, the Commission could consider published debt-to-equity ratios and average cost of debt.

Airport car parking and land access

The Commission seeks more information on the nature of the off-airport parking market, particularly in Perth and Adelaide.(p.166)

There are 17 off-airport car parking services near Melbourne Airport which contribute to a highly competitive market for car parking in close proximity to the airport.

Major Competitor Name	Capacity	Distance to Airport Terminals (kms)
United Airport Parking	2,500	3.8
Andrews Airport Parking	2,000	5.3
Discount Airport Parking / Airport Corporate Smart Park	1,000	4.4
Jetport Security Parking	1,000	4.4
ACE Parking	1,000	5.4
Europcar Parking/ Delta Airport Parking	500	3.9
Melrose Airport Parking	500	2.8
Pink Elephant (Madcap)	500	4.1
Commercial Drive	500	9.5
Alpha Airport Parking	500	4.5
Goodyear Parking	500	4.1
Metro Car parking	400	4
Ezy Parking (Tulla Transport)	300	4.1
A1 Airport Parking	300	3.1
Jetbay	100	4.8
Parking Port	50	8.5
Busy Beaver Airport Parking	1,000	9.8
Total	12,650	

Guidelines for commercial negotiation

The Commission is seeking information on whether guidelines on matters that could improve commercial negotiation – such as information on whether existing assets are being deployed efficiently prior to new investment and processes to facilitate effective service level agreements – should be:

- *devised by the Productivity Commission and incorporated into the Pricing Principles*
- *encapsulated within a new voluntary industry code – a committee comprising representatives from the Australian Airports Association, the Board of Airline Representatives of Australia, the Regional Aviation Association of Australia, Qantas and Virgin Australia (and possibly with guidance from the Australian Competition and Consumer Commission) could be tasked with this. (p.253)*

Melbourne Airport believes that guidelines on matters that could improve commercial negotiation are not required and would not significantly improve the outcomes of commercial negotiations between airports and airlines.

The draft report highlights that the process of commercial negotiation is working, and that the dissatisfaction of airlines with some aspects of the negotiation process is not indicative of systemic failure. As such, there are no grounds for regulatory intervention to address any market failure.

It is important to emphasise the dynamic nature of negotiations with airport users and the different needs of airlines in particular. Melbourne Airport provides services for airlines across the spectrum of service requirements and expectations. Unless airports are able to satisfactorily demonstrate to airlines the requirement for new capital investment, airlines will not agree to pay increased charges to recoup the cost of that investment. It should also be noted maximising the efficient use of existing assets is as much a product of airline operational requirements and behaviour as it is an airport decision.

In the event the Productivity Commission decides to recommend a voluntary code of conduct of this kind, the Commission should lead its development in consultation with all of the affected parties as opposed to a committee comprising industry and airline representatives.

Service monitoring

The Commission seeks participants' views on the potential means to standardise passenger survey methodology, such as the use of the ACI Airports Service Quality information, without incurring substantial increases in compliance costs.(p.259)

The Commission invites participants' views on its proposals in relation to airline surveys and service level agreements. In particular, would annual publication of the coverage of, and performance under, service level agreements improve regulatory outcomes? (p.259)

Melbourne Airport supports the development of a standardised quality of service methodology, and greater transparency around quality of service outcomes including publication of survey results and service level agreement outcomes.

Service monitoring is important for Melbourne Airport. It provides insight into the passenger and airlines experience. This data allows the airport to make changes to improve service and ensure we are responsive to our customers and passengers needs.

Melbourne Airport conducts two formal airport service surveys to monitor quality of service; Quality Service Monitoring (QSM) and Airport Council International (ACI):

12,000 QSM interviews are conducted per year, assessing quality of service for retail, car parks and airport services in both arrivals and departures for international and domestic terminal operated by Melbourne Airport (excluding Qantas T1). QSM provides Melbourne Airport with useful business information and is submitted to the ACCC annually in line with regulatory requirements.

350 ACI questionnaires are distributed per quarter at the departure concourses of domestic and international terminals operated by Melbourne Airport. No questionnaires are distributed in the arrivals concourse, although questions about previous experience in arrivals are included. Melbourne Airport uses this information to benchmark itself amongst other international airports. The information is not currently submitted to the ACCC.

Our understanding is that currently six Australian airports participate in the ACI survey. Of the monitored airports, Brisbane is the only airport not participating in the ACI survey. Standardising survey methodologies across all monitored airports would provide consistency.

Nevertheless, the ACI is only one indicator and must be considered with other measurement tools when assessing quality of service. There are a number of limitations with ACI data including a small sample size (not always representing all demographic and cultural groups), with questionnaires only being distributed in departures (arrival questions are asked, however these questions are not date, time or airport specific). Furthermore the outputs provide a ranking rather than a raw score.

An important issue to address in developing a better quality of service reporting methodology is achieving an appropriate weighting between passenger and airline perceptions and experience, and the delivery of agreed service levels between airports and airlines which are concluded as part of commercial negotiations.

Another limitation of service monitoring surveys for ACCC airport monitoring, is that the current research incorporates all airport services provided by airlines, airport managers and Government agencies. This makes it difficult to distinguish who influences what part of the service and therefore it is questionable how it can be used in monitoring the five major airports.

Melbourne Airport is committed to open and transparent operations and to improvements in its service for airlines and passengers. Making more survey results public would enhance transparency of our operations. Melbourne Airport is currently investigating the publishing of QSM results on its website.

Melbourne Airport would support a traffic light reporting system of service level agreements (SLAs) to provide high level insight into the type of SLA's that are in place and the airport's performance against them. Given that SLA's are an integral part of the commercial negotiation and agreement with individual airlines on pricing, their detail should be viewed as commercial-in-confidence.

It should also be noted that Melbourne Airport conducts an annual stakeholder audit to measure the quality of our relationships and communications with key stakeholders, including airlines and airport users. The audit consists of a number of confidential interviews with key stakeholders. The feedback provided through this audit is a valuable source of insight and information to assist Melbourne Airport in providing better service for airport users across a wide range of issues in addition to those areas covered by the QSM and ACI surveys.

Land transport access and integration

The Commission is seeking views about the adequacy of communication between airports and the tiers of governments in relation to the provision of information such as estimated traffic volumes, travel time projections and other key performance indicators relevant to current and future efficiency of access to airports.(p.272)

The Commission seeks views on whether an airport should contribute to the cost of infrastructure outside its boundary as a result of future on-airport non-aeronautical development. (p.286)

Melbourne Airport consults closely with local and state government agencies and departments on ground transportation issues.

The principle of competitive neutrality must apply to the development of planning and infrastructure funding policies that also give appropriate recognition to the significant contribution made by airports to the development and maintenance of infrastructure that provides a community-wide economic benefit, including significant local employment opportunities.

As outlined in its April submission, Melbourne Airport has always worked closely with all levels of governments as well as key stakeholders to ensure that airport operations and planning are integrated with existing systems, policies and future plans. This includes traffic and transport plans. In addition to the Planning Coordination Forum, Melbourne Airport established the Melbourne Airport Transport Committee which includes senior representation from the Victorian Department of Transport, Department Planning & Community Development, VicRoads, Victorian Taxi Directorate and Melbourne Airport. This group was established in June 2009. Since this time the group has assessed transport links, traffic volumes and the feasibility of an airport rail link.

Development contributions for non-aeronautical development

As part of purchasing their long-term leases from the Australian Government, airport operators are able to undertake development on airport land consistent with their obligation to use the site as an airport. Airport operators undertake non-aeronautical investment to diversify their balance sheet, enabling them to mitigate the risks that come from exposure to demand conditions in a single sector (aviation), and to broaden their sources of revenue. For example, Melbourne Airport is building a Business Park to lease to industrial or commercial tenants. The commercial risks faced by the Business Park component of the business are very different to those for

the aeronautical part of Melbourne Airport's business. The Federal Department of Infrastructure and Transport noted:

“To meet an undertaking of the government of the day that the establishment of the Federal Airports Cooperation (FAC) would not lead to higher airport user charges, the FAC actively encouraged the growth of revenue from non-aviation activities. .. Airports continue to invest in non-aeronautical infrastructure and commercial opportunities to diversity and reduce exposure to aviation industry fluctuations.” (Sub.43, pp. 8–9)

The rate of return earned on an investment depends, on part, of the commitments for further funding associated with the investment. In the event that Development Contributions are introduced, there are potential risks around the level of the contribution required for non-aeronautical and commercial development. This may discourage airports from undertaking such diversified investments and this could have broader economic impacts for businesses which would otherwise choose to locate themselves in close proximity to airports because of the economic and business benefit of doing so.

Non-aeronautical development on airports is subject to close consultation with local and state government agencies and public consultation as part of the process for approval of on airport development by the Commonwealth Government.

Consideration also needs to be given to relevant current Victorian Government policies and future directions. The Victorian Government is currently reviewing the developer contributions system, although we have been advised that the review will not take airports into account. Current planning law includes provision for voluntary agreements for contributions towards the cost of infrastructure development (through s. 173 of the Victorian Planning and Environment Act 1987). This is considered to be the most appropriate mechanism for any contribution to the cost of infrastructure associated with non-aeronautical development that would appropriately reflect the unique circumstances of each project and the contributions of different parties.

As an example of the approach taken by Melbourne Airport, we make substantial annual rate-equivalent payments to the Hume City Council for our non-aeronautical asset. These are in effect a voluntary development contribution provided by Melbourne Airport as we do not receive any local government services for the land in question and provide all of the services that would normally be the responsibility of local government.

Furthermore, Melbourne Airport recently facilitated an agreement with the Victorian Government in respect of the Sunbury Road/Tullamarine Freeway that was situated on airport land. This agreement provides VicRoads with a licence in relation to that road and Melbourne Airport has undertaken to maintain the current network connectivity, alignment, layout configuration, capacity and road reservation of the road. The agreement runs until 1 July 2047 with a request to extend for another 49 years. This provides certainty for VicRoads to ensure that the larger Victorian road network is maintained, and is particularly important as the road links into the Bulla Bypass and the Tullamarine Freeway.

These examples highlight the importance of guidelines around development contributions reflecting local jurisdictional arrangements and circumstances, and the opportunity for airports and local and state government to achieve mutually beneficial outcomes.

Potential costs and benefits of extending the Pricing Principles to regional airports

The Commission seeks information on the potential costs and benefits of extending the Pricing Principles to regional airports. How might the principles be applied and is the problem of sufficient magnitude to warrant any potential enforcement mechanisms?

To formally introduce the Pricing Principles at regional airports would create an additional layer of complexity and costs when it is not warranted.

It is for the benefit for the whole industry that all airports, including regional airports operate in a commercial manner. While they are specifically aimed at airports with significant market power to minimise the abuse of power, the Pricing Principles encourage all airports to adopt a competitive approach. The Pricing Principles have been a successful part of the light-handed regulatory regime.

Regional airports operate in highly competitive environments. They often compete for passengers from other regional airports and modes of transport. Launceston Airport for example competes against Devonport, Wynyard and Hobart Airports, and a heavily government- subsidised passenger ferry service across Bass Strait. Airlines hold significant market power at regional airports through the introduction or withdrawal of services or changes to schedules, particularly for those airports that rely on seasonal leisure traffic. With lower passenger volumes and fewer airlines, regional airports are particularly vulnerable to airline decision-making about service levels or frequency. Regional airports carry significant volume risk.

There is no evidence that regional airports are in a position to misuse their market power, therefore no grounds for the extension of the Pricing Principles to these airports. The cost of such regulation would be disproportionate to the revenue and could add significant costs with little or no benefit.