



Australian Government
Productivity Commission

Economic Regulation of Airports

Productivity Commission
Draft Report
Overview

February 2019

This is a draft report prepared for further public consultation and input. The Commission will finalise its report after these processes have taken place.

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The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au).

Opportunity for further comment

The Commission thanks all participants for their contribution to the inquiry and now seeks additional input for its final report. You are invited to examine this draft report and comment on it by written submission to the Productivity Commission, preferably in electronic format, by **Monday, 25 March 2019** and/or by attending a public hearing. Further information on how to provide a submission is included on the inquiry website: www.pc.gov.au/inquiries/current/airports-2019/make-submission.

The final report will be prepared after further submissions have been received and public hearings have been held, and will be submitted to the Australian Government in June 2019.

Public hearing dates and venues

Location	Date	Venue
Canberra	Monday 25 March	Hotel Realm, 18 National Circuit, Barton
Sydney	Tuesday 26 March	The Grace Hotel, 77 York Street, Sydney
Mildura	Wednesday 27 March	Mildura Visitor Information Centre 180 - 190 Deakin Avenue, Mildura
Melbourne	Thursday 28 March	Level 12, 530 Collins Street, Melbourne

Please note, public hearings are subject to interest and may be held in other locations, if required. Participation in public hearings is available via teleconference. Please visit the inquiry website www.pc.gov.au/inquiries/current/airports-2019/public-hearings to register your interest in participating in a public hearing.

Commissioners

For the purposes of this inquiry and draft report, in accordance with section 40 of the *Productivity Commission Act 1998* the powers of the Productivity Commission have been exercised by:

Paul Lindwall	Presiding Commissioner
Kenneth Baxter	Commissioner
Stephen King	Commissioner

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The full report is available from www.pc.gov.au/

OVERVIEW

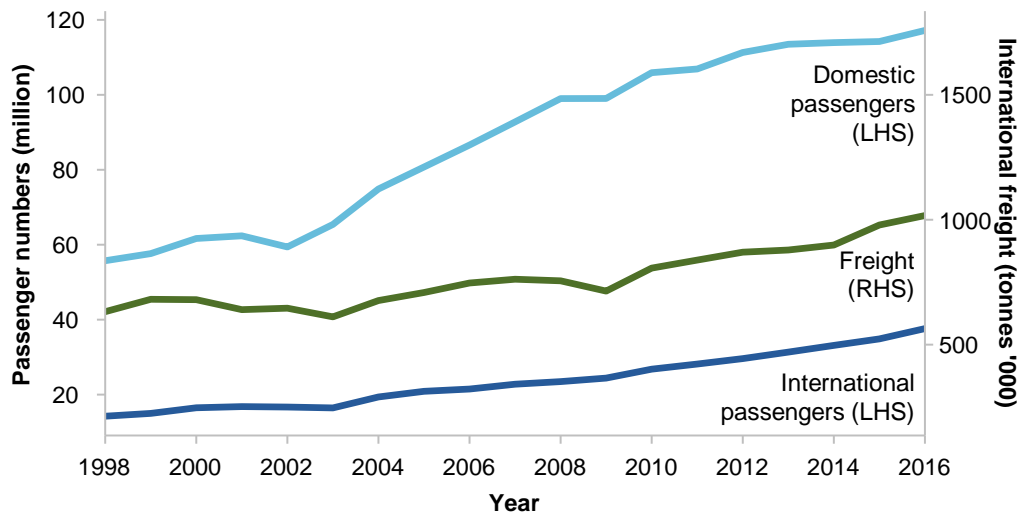
Key points

- Existing airport regulation benefits the community, and remains fit for purpose.
 - The four airports monitored by the Australian Competition and Consumer Commission — Sydney, Melbourne, Brisbane and Perth — have not systematically exercised their market power to the detriment of the community.
 - Each has generated returns sufficient to promote investment while not earning excessive profits.
 - Most indicators of the monitored airports' operational and financial performance are within reasonable bounds, although some could present cause for concern if considered in isolation.
- There is no reason for airport operators to become complacent — further scrutiny of some aspects of airports' performance is warranted, and tailored reforms are needed to address specific areas of concern.
- Sydney, Melbourne, Brisbane and Perth airports have market power in services provided to airlines. Charges to airlines for international services at Sydney and Brisbane airports, in particular, are high compared to overseas airports.
 - Sydney, Melbourne, Brisbane and Perth airports should be required to separately report revenues and costs of providing domestic and international services to airlines.
 - Separate reporting is needed to determine whether charges are the result of an airport exercising its market power, or the higher costs of providing international services.
- Airports could exercise their market power in landside access services, such as for those used by taxis and shuttle buses, to encourage people to use airport-owned car parks, but there is insufficient data to determine whether this is the case.
 - The collection of detailed data on access charges, terms of access, costs and revenues for landside services would enable an assessment of exercise of market power in landside access.
- On balance, commercial negotiations between airports and airlines give little cause for concern. However, some agreements contain clauses that constrain an airline's access to regulatory remedies for the exercise of market power and clauses that restrict an airport's ability to offer incentives to airlines other than the signatory airline.
 - These clauses are anticompetitive and should be removed from all agreements.
- Many consumers resent the cost of car parking at the monitored airports. Car parking charges are not due to airports exercising their market power — the price of parking at-terminal can largely be explained by the value passengers place on convenience, the limited amount of land close to the terminal, and the need to manage congestion.
- Sydney Airport's regional access arrangements facilitate access for airlines flying to regional destinations, but the regime should be changed to allow airlines to use non-regional aircraft movement slots for regional or non-regional flights.
- Sydney Airport's cap on aircraft movements restricts the effect of aircraft noise on local residents, although this reduces the airport's efficiency. The Commission is seeking further evidence on options that could meet current noise objectives at lower cost.
- *Prima facie*, the characteristics of markets to supply jet fuel have enabled incumbent fuel suppliers to restrict competition, which has led to a small number of fuel suppliers at some airports. This has likely led to higher prices to access infrastructure services and higher fuel prices.
- Government funding for infrastructure investments at regional airports should be subject to rigorous published assessment. There is also considerable scope to improve the financial management of airport assets at some regional airports.

Overview

Australia is heavily reliant on air transport — it has the highest number of domestic airline seats per capita in the world. Air transport services connect people, provide regional communities with access to essential services, such as healthcare and emergency relief, and contribute to economic growth through business and leisure travel, and trade. The number of passengers travelling through Australian airports has doubled over the past 20 years, to about 160 million in 2017, and the volume of international air freight has increased by about 80 per cent (figure 1). Australia’s airports are critical infrastructure and their performance depends on, among other things, high-quality management and a regulatory regime that promotes efficient operations and timely investment, and facilitates commercial negotiation between airport operators and users of airport services.

Figure 1 **Passenger and international freight movements^a**



^a International freight includes dedicated freight aircraft and freight carried in the body of passenger aircraft.

Increasing demand for domestic air transport services has been driven by population and income growth, and facilitated by the expansion of low-cost carriers (LCCs). Growth in international air transport has outpaced growth in domestic air transport every year since 2009 and Tourism Research Australia has forecast that international visitor numbers will nearly double between 2017 and 2027. About three quarters of international visitors come to Australia for leisure (holidays and to visit friends and relatives).

Increasing passenger demand for air transport has led to increasing demand by airlines for airport services. Airports have invested in new services and facilities to manage congestion and improve the passenger experience. Airport investments are complex and involve significant risks, as do those undertaken by airlines. Changes in the mix and volume of passengers can affect the level and type of investments required. For example, airports that are serving an increasing proportion of international passengers must provide terminal space for security, biosecurity and border processing services. Some airports have built dedicated terminals to meet the needs of LCCs.

Similarly, changes in aircraft technology alter airports' infrastructure requirements. Airports upgraded to wider taxiways, more apron and gate space and two-level aerobridges to accommodate the introduction of the Airbus A380 in the mid-2000s. Ten years on, these aircraft are falling out of favour with many airlines because they are less fuel efficient than smaller, long-range twin-engine wide-bodied aircraft like the Airbus A350 and Boeing 787. Airlines are now running smaller aircraft more frequently, and expect airports to provide services and infrastructure that can support an efficient turnaround on the ground.

What has the Commission been asked to do?

The purpose of this inquiry is to determine the effectiveness of the economic regulation of services provided by airports to airlines, passengers, and people and businesses that access the terminal precinct. The Australian Government has asked the Commission to assess the current regime for airport regulation against the following objectives:

- promoting economically efficient operation of, and investment in, airports and related industries
- minimising compliance costs
- facilitating commercially negotiated outcomes between airport operators and users.

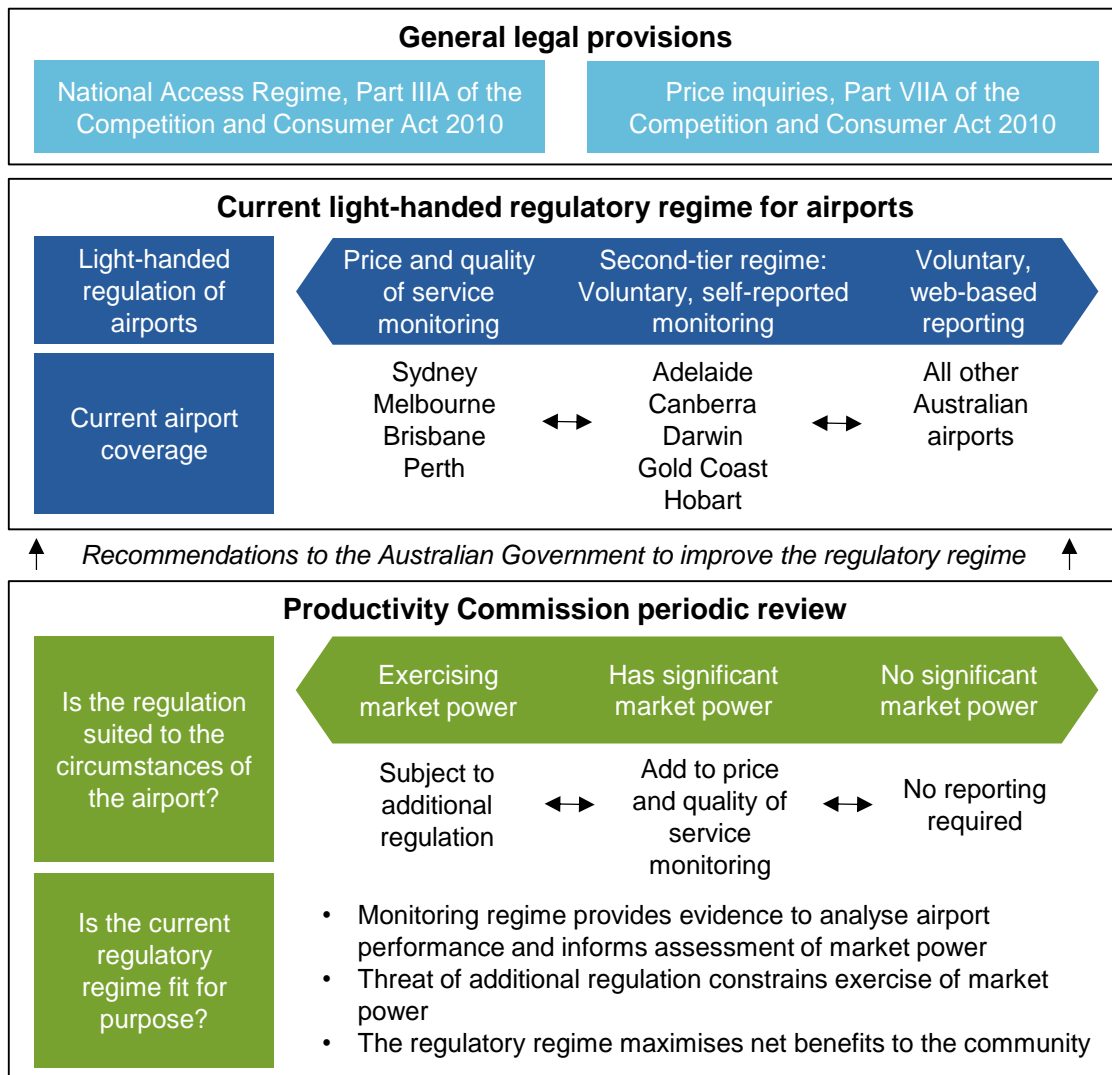
The Australian Government has also asked the Commission to examine access arrangements for regional communities into Sydney Airport and competition in markets to supply jet fuel.

A light-handed approach to regulation

Many airports in Australia face limited competition, potentially giving them market power. The rationale for the economic regulation of airports is that the operator of an airport with market power could *exercise* that power by setting excessively high charges for airport services, operating the airport inefficiently or making inefficient investment decisions. These behaviours could lead to poorer outcomes for airport users and the community more broadly.

Economic regulation of airports includes the general provisions of competition and consumer law, and airport-specific light-handed regulations that were introduced following privatisation of airports in the late 1990s (figure 2).

Figure 2 The light-handed regulatory regime



Under the light-handed regime airport users, such as airlines, negotiate directly with airport operators on charges and other terms of access to a range of infrastructure services — the government does not intervene in the setting of charges or other terms of access (with the exception of regional services at Sydney Airport, discussed below). Instead, the government mandates the collection and publication of information about airports’ financial and operational performance. Light-handed regulation is intended to achieve outcomes that would be consistent with those found in markets with effective competition, but will only do so if there is:

- transparency as to how an airport operator is performing over time *and*
- a credible threat of further regulatory intervention if an airport operator is found to be exercising its market power to the detriment of the community.

Assessing airport performance

The Australian Competition and Consumer Commission (ACCC) administers a price and quality of service monitoring regime (the monitoring regime). The operators of Sydney, Melbourne, Brisbane and Perth airports are required to provide the ACCC with information annually on their prices, costs and profits for aeronautical services and car parking. The ACCC also monitors the quality of service of some aeronautical services, such as terminal and aircraft services and facilities, and non-aeronautical services, such as car parking and landside access. At its own discretion, the ACCC collects financial information relating to landside access, including revenue and access charges for selected landside services, such as taxis, hire cars and buses. Airports comply with the ACCC's request voluntarily. The ACCC compiles these data into a monitoring report each year and outlines general trends and developments across the industry.

The Productivity Commission has conducted inquiries into the performance of the light-handed regulatory regime for Australia's airports approximately every five years since 2002. Essentially the Commission's role is to conduct a health check of the regime to determine whether it remains fit for purpose. The Commission can recommend (among other things) adding airports to the monitoring regime or removing them; tightening or relaxing regulatory requirements for monitored airports; and consequences for any airport found to have systematically exercised its market power to the detriment of the community. The Commission has recommended changes to the regulatory regime in each of the three previous inquiries and governments, for the most part, have implemented these recommendations.

The second-tier regime — voluntary monitoring

In addition to the ACCC's monitoring of the four major airports, a second tier of airports — Adelaide, Canberra, Darwin, Gold Coast and Hobart — are subject to a self-administered monitoring regime. These airports voluntarily publish information on their aeronautical charges, car parking, service quality and complaint handling procedures. Cairns Airport, which is operated under a 99 year lease from the Queensland Government, is not regulated under the *Airports Act 1996* (Cwlth), but it has been encouraged by the Australian Government to publish the same information as the second-tier airports, and it does so with the exception of service quality outcomes. The second-tier monitoring regime was established through a policy statement rather than legislation or regulation, there are no guidelines for the level of detail to be provided by airports, and there are no repercussions for airports that do not participate.

A credible threat of consequences

The Productivity Commission (and others) can use the annual monitoring reports to make judgments about whether an airport is operating efficiently, including in its pricing and investment decisions. Airports found to have systematically exercised their market power to

the detriment of the community face potentially serious consequences, including an increase in the burden of regulation. The Commission would not hesitate to recommend regulatory changes, including price regulation, for any airport that was found to have systematically exercised its market power. The ongoing potential for such consequences acts as a deterrent against the exercise of market power.

Airports that exercise their market power face consequences through other avenues as well. The National Access Regime under Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA) provides for regulatory ‘declaration’ of access to infrastructure services which can lead to ACCC arbitration over terms of access. The ACCC also has general powers under the CCA that guard against anticompetitive behaviour.

Airlines have called for change

Participants in this inquiry have intensely debated the effectiveness of the current regulatory regime. Airports have broadly supported the existing regime. Some airport users, however, argue that airports are not sufficiently constrained from exercising their market power and, consequently, airports are earning excessively high profits and rates of return, and making inefficient investments.

Despite these disagreements, it is notable that participants in the inquiry have not called for a return to price caps — both airports and airlines have stated that they prefer commercial negotiation to determine price and other terms of access to infrastructure services. Airport users and the ACCC have suggested regulation to ‘level the playing field’ in their negotiations with airports. Participants have called for airports to be obliged to provide more information on their investment plans and how they determine their charges. Some have suggested that airlines should have automatic access to arbitration if they cannot reach agreement with airports.

The Commission’s approach

The Commission has developed a framework to analyse the evidence in a consistent way (figure 3). A guiding principle for the analysis is that the Commission takes into account the effects of existing regulations and reform options on the community as a whole.

Broadly speaking, the presence of market power is sufficient for an airport to be subject to the monitoring regime and, as discussed below, the four monitored airports should continue to be monitored. Governments should only make changes to the type of regulation under which the four monitored airports operate *if* those airports are systematically exercising their market power to the detriment of the community, *and* changes to the regime would likely lead to net benefits to the community. The mere fact that an airport *has* market power is, of itself, insufficient to justify a change to the regulatory regime.

There is no single indicator or benchmark that can demonstrate that an airport has market power and should be added to the monitoring regime, or that an airport in the monitoring regime is exercising its market power to the detriment of the community. Airports’ exercise of market power could be manifested in a variety of ways, and should be assessed over a period of several years to account for the long-lasting nature of airport assets and the short-term volatility in measured indicators. Rigid benchmarks could be exploited by airports operating up to or gaming those constraints. To account for this, the Commission has examined a range of indicators and assessed airports’ performance over time, and relative to comparable airports in Australia and overseas.

Ultimately, the Commission’s determination of whether an airport has systematically exercised its market power is based on analysis using the evidence that is available to it. This report provides an opportunity for the Commission to test that analysis and its draft conclusions and recommendations with participants. Interested parties are invited to provide feedback through submissions, which are due by **25 March 2019**. The Commission will continue to accept genuinely commercially sensitive material on a confidential basis but asks that, where possible, submissions are provided in a form that can be published. Participants are also invited to appear at public hearings in late March 2019. The Commission will conduct further wide-ranging consultations.

Figure 3 Assessing the economic regulation of airports

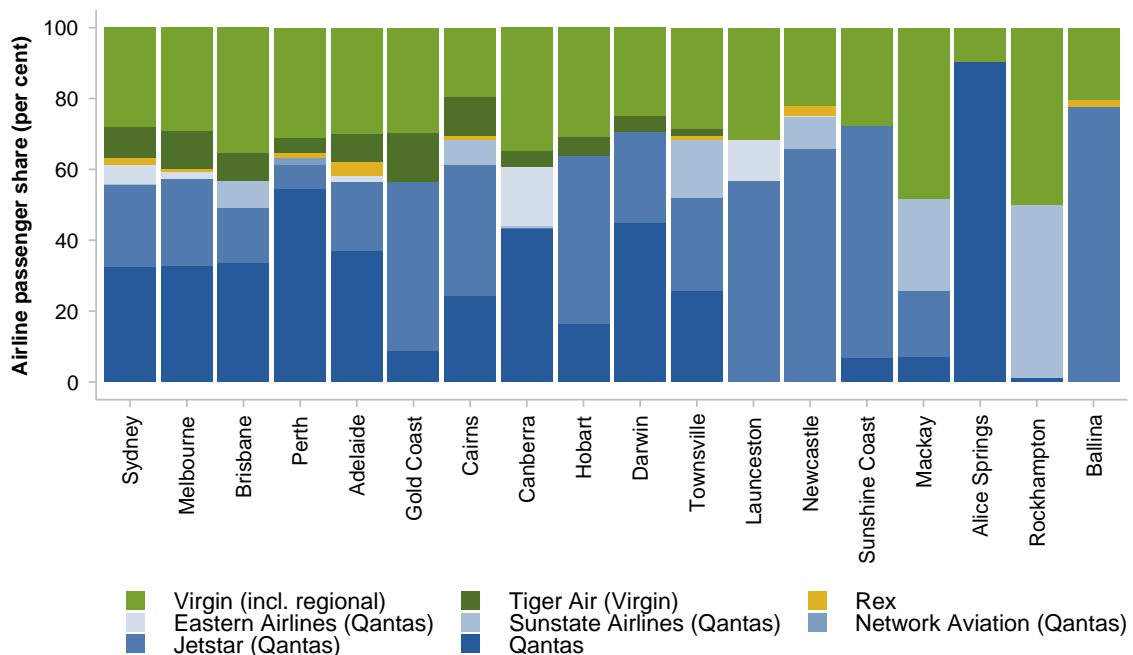


The monitored airports have market power in aeronautical services

Whether an airport has market power in aeronautical services depends on the structure of the market in which it operates. This includes barriers to entry and exit, whether there is a nearby airport and the costs of an airline switching to it, passengers' purpose of travel and the availability of a different mode of travel.

Even if an airport has market power, its ability to exercise that power may be limited. Airlines can, and do, exert countervailing power on airport operators when they control a significant proportion of the market. The market for domestic air transport services in Australia is highly concentrated. Together Qantas Group, Virgin Australia Group and Regional Express (Rex) account for over 95 per cent of all domestic regular public transport flights. Qantas Group, in particular, is a dominant player in the domestic market accounting for about 60 per cent of all passenger movements in Australia and the majority of passenger movements at Australia's largest airports (figure 4).

Figure 4 Domestic air transport services are concentrated^a



^a Airports serving more than 500 000 passengers annually.

An airline can threaten to withdraw some or all of its services at a particular airport if it is not satisfied with access conditions. An airline's threat to reduce services is less credible at a congested airport, such as Sydney Airport, given its competitors could readily meet any gap in demand for services. In practice, complete withdrawal of services is only likely to occur at regional airports, where a single airline is the airport's main, or only, customer.

Rex withdrew services on the Mildura to Sydney route in response to what it described as ‘exorbitant’ aeronautical charges and has redeployed resources to Griffith Airport as part of a five-year partnership agreement with Griffith City Council.

Sydney, Melbourne, Brisbane and Perth airports exhibit characteristics of market power in the domestic market that create a *prima facie* case for regulatory intervention, even when airlines’ countervailing power is considered.

- Sydney Airport has strong market power in the provision of domestic aeronautical services. It:
 - is a geographic monopoly (at least until Western Sydney Airport commences operation after 2026)
 - is the gateway to Sydney, which is a significant business hub and highly differentiated product in domestic (and international) tourism markets and passengers are less likely to substitute to another destination
 - has few modal substitutes, with the exception of the Sydney-Canberra route, which accounts for less than two per cent of total domestic passenger movements at Sydney Airport.
- Melbourne Airport has strong market power in the provision of domestic aeronautical services. Like Sydney, as a business and tourism hub, passengers are less likely to substitute to another destination. There are no strong modal substitutes for the majority of its passengers and it faces little competitive constraint from Avalon Airport, even in the market to serve LCCs.
- Brisbane Airport has a high level of market power in the provision of domestic aeronautical services. Brisbane faces competition for some domestic services — the Gold Coast and Sunshine Coast airports could theoretically service up to 90 per cent of its passenger movements. In reality, these two airports are imperfect substitutes for Brisbane Airport as flight times and schedules, facilities and travel time to Brisbane vary significantly.
- Perth Airport also has a high level of market power in the provision of domestic aeronautical services. It is a geographic monopoly with few modal substitutes — 94 per cent of interstate overnight domestic visitors to Western Australia use air transport. However, it is less of a business and tourism hub compared to the other monitored airports (and following the end of the mining investment boom).

Sydney, Melbourne, Brisbane and Perth airports also have market power in international aeronautical services at a level that creates a *prima facie* case for regulatory intervention. They are — to varying extents — gateways to cultural, business and tourism hubs and, for many passengers, are not readily substitutable for other locations. Further, the market for international flights is highly competitive, reducing the potential for airlines to exert countervailing power.

The airports that participate in the second-tier voluntary monitoring regime — Adelaide, Cairns, Canberra, Darwin, Gold Coast and Hobart — do not have a level of market power that warrants regulatory intervention, although this could change over time. Of these airports, Canberra is closer to the threshold for concern.

- Canberra Airport has a high proportion of non-leisure passengers, which tend to be relatively insensitive to price changes. However, there is good availability of road transport alternatives for the Canberra–Sydney route, a route that accounts for one third of passenger movements at Canberra Airport.
- Adelaide Airport serves a relatively higher proportion of leisure passengers than the monitored airports. Leisure passengers are more responsive than non-leisure travellers to increases in charges (which reduces the airport’s market power).
- Gold Coast, Cairns, Hobart and Darwin airports do not have a level of market power that warrants regulation at this time — these airports are not gateways to major business hubs and they serve a relatively higher proportion of leisure passengers than the monitored airports.

As none of these airports currently have a level of market power that is of concern, the second-tier monitoring regime serves no policy purpose — it should be discontinued. The information published is not necessary to make an assessment of whether an airport has market power or whether it should be added to the monitoring regime. There is sufficient public information available for the Commission to make these assessments. It has also become clear in consultations that government agencies, industry bodies and other stakeholders have little use for this information.

Many regional airports do not have market power

Many regional airports do not have sufficient demand to cover the costs of running the airport, which means the efficient charge for aeronautical services is *more* than passengers are prepared to pay. Regional airports that face these circumstances do not (and cannot) possess market power. Countervailing power from airlines generally constitutes an additional constraint — of the 103 airports for which the Commission has data, 51 are serviced by a single airline. Inquiry participants have raised concerns about investment decisions and asset management practices at some regional airports (discussed below).

Negotiating commercial agreements with airports

Airports and airlines typically engage in commercial negotiations to secure airfield and terminal agreements on price, types of services provided, service quality and future capital investments. They may also negotiate agreements for specific services, such as aircraft hangars. Typically these agreements outline service charges, including price paths for future access, charges to recover costs of passenger security screening, and discounts on scheduled aeronautical charges if, for example, agreed passenger numbers are reached. Negotiated

agreements also typically include agreed service outcomes defined in a service level agreement, future consultation requirements and dispute resolution processes. Recently negotiated agreements include improved performance indicators for, among other things, on-time performance, queue time or baggage handling, and financial consequences where those outcomes are not met.

Agreements are tailored to the requirements of an airline, sometimes with bespoke arrangements within the same corporate group, which airport operators noted adds to the complexity of each negotiation. There is no doubt that negotiating agreements for airport services is challenging — it is time consuming, resource intensive and costly, and the argy bargy between airports and airlines sometimes plays out in the media. While threats and colourful language are commonplace between some parties, ultimately the negotiating parties have commercial and operational incentives to reach an agreement, especially given the need for new investments to meet demand growth and passengers' expectations of service quality.

An infrastructure operator who is exercising its market power during negotiations could, for example:

- deny access to the service (or threaten to)
- refuse to provide sufficient and timely information to negotiating parties to assess the service offer
- make take-it-or-leave-it offers on charges and other terms of access that are accepted by negotiating parties, given an inability to negotiate any alternative
- set charges above the efficient long-run average cost of provision — the minimum an airport operator can charge to ensure it remains viable over time (and a benchmark for economic efficiency).

On balance, the Commission is satisfied that airports have not systematically exercised their market power in commercial negotiations with airlines to the detriment of the community. There are a number of reasons for this.

First, airports have strong incentives to reach agreements with airlines. Agreements underpin cash flow and other measures of financial performance that support investor certainty. Further, government lease conditions under which airports operate do not permit them to deny airlines access to airport services. Even without an agreement in place, airlines are able to access airport services and can refuse to pay charges at the level determined by the airport. The Commission heard, for example, that Qantas Group does not pay charges it does not agree to. Perth Airport commenced legal action in the Supreme Court of Western Australia in December 2018 to recover charges for aeronautical services from Qantas Group. Other airlines have also previously refused to pay charges at the level determined by airports. This practice means it may be airlines, rather than airports, that have an incentive to hold out on reaching agreement.

Second, negotiating agreements is information intensive and some airports have taken steps to improve the flow of timely and relevant information to airlines. Examples include a publicly accessible website hosted by Perth Airport that has information on its indicative 10 year capital expenditure plan, 10 year forecasts for passenger numbers and operational costs, and proposed pricing models, among other things. Melbourne Airport has a Quarterly Consultation Forum to review service quality issues and share data on on-time performance with its airline customers that have reached an agreement.

Third, the Commission had insufficient evidence to conclude that airport operators make take-it-or-leave-it offers to airlines *and* that airlines are compelled to accept them. In practice, airlines have more mobile capital than airports and, as discussed above, are able to reduce or withdraw services at some airports. Further, Qantas Group, Rex and Virgin Australia Group each have countervailing power at some airports, in some circumstances. Where this is the case, airports have limited ability to exercise their market power using take-it-or-leave-it offers.

Fourth, the operational and financial performance of the four monitored airports does not indicate they are systematically exercising their market power by setting aeronautical charges above efficient levels (discussed below).

This does not mean that an airport with market power would not exercise that power in the future if there were changes in the structure of the market in which it operates. The annual monitoring regime, periodic reviews by the Productivity Commission and a credible threat of consequences are essential to encourage airports to engage in genuine commercial negotiations with airlines and other airport users in the future.

Anticompetitive clauses should be removed from all agreements

Some agreements contain anticompetitive clauses that:

- establish financial disincentives or loss of contractual rights if an airline is involved in a declaration application under the National Access Regime — these clauses could reduce the effectiveness of the regulatory regime by reducing the threat of declaration
- restrict an airport operator’s ability to offer lower charges or other incentives to airlines other than the signatory airline — these ‘no less favourable’ clauses seek to limit competition in both domestic and international markets, and protect the incumbency of an airline that has negotiated these favourable terms.

There may be other anticompetitive clauses in aeronautical agreements, and in agreements to provide non-aeronautical services, to which the Commission is not privy. The Commission is seeking further evidence from participants about anticompetitive clauses in commercial agreements between airports, airlines, landside operators or other airport users.

Anticompetitive clauses should be removed from all agreements. The Australian Government should amend the *Aeronautical Pricing Principles* (which are used by airports

and airlines as guidelines during the negotiation process) to specify that agreements should not include such clauses. To ensure that these terms do not appear in future agreements, the Australian Government should stipulate in the terms of reference for any future Productivity Commission inquiry that airports should, on request, make their agreements with airport users available to the Productivity Commission on a commercial-in-confidence basis.

Negotiations between airports and landside operators warrant further scrutiny

There is no substitute for the land that airport operators control for people and businesses needing to access airport terminals. Airport operators have an incentive to exercise their market power in landside access by setting charges above the efficient level and restricting access. The more restrictive the terms of access for landside services, the less competition the airport faces in on-airport car parking, particularly from off-airport car parks (car parking is discussed below).

Airport operators have the potential — and some incentive — to exercise their market power in landside access and face fewer constraints on their behaviour than they do for other services. Landside operators do not have the same degree of countervailing power as airlines, and appear more likely to be at the risk of receiving and accepting take-it-or-leave-it contracts. About 50 per cent of rental car operators' revenue comes from customer demand at airports in many cities and the business model for off-airport car park operators relies on timely access to the airport terminal on reasonable terms — there are no substitutes.

Inquiry participants raised concerns about airports' behaviour in providing landside access services, including inadequate consultation and engagement with landside operators, and the transparency and sharing of methods used to set charges and allocate costs for common-use landside areas, such as access roads. The Australian Finance Industry Association, which represents rental car operators, stated in its submission:

They are not commercial negotiations at all. We have no leverage as the airport knows we need to be there and so there is no meaningful negotiation. There have been occasions where we have tried to negotiate on issues which we think create an unfair outcome for consumers and have literally been told that if we are still on the airport the next day that we are deemed to have accepted the concession agreement as presented.

The Commission's assessment of whether the airports have exercised market power in landside services has been constrained by a lack of evidence on the process of negotiation between airport operators and users of landside services, as well as cost and revenue data. The Commission is seeking further information from participants on the negotiation and consultation process between airports and landside access operators, and on charging and investment decisions, to inform its final report.

The Commission does not have detailed, time series information about charges and other terms of access to landside services. Nor does it have information that would enable it to

assess whether access charges are consistent with the efficient costs of providing landside services (taking into account locational rents and the opportunity cost of airport land).

Changes should be made to the monitoring regime to include costs (including capital costs) and revenues associated with providing each of the landside access services, and access charges for all services. These data would inform future assessments of airport market power and improving the transparency of airport operators' performance would help act as a brake on the potential exercise of market power in this area.

Airports' operational and financial performance

As well as examining the conduct of airports during negotiations, the Commission has assessed indicators of the four monitored airports' operational and financial performance across three broad areas where performance could be affected by the exercise of market power:

- operational efficiency — whether an airport provides services at relatively low cost and uses its inputs efficiently, with a level of service quality that meets users' reasonable expectations
- aeronautical revenues and charges — whether the prices of aeronautical services (as measured by revenues and charges) reflect efficient costs
- profitability — whether an airports' returns are reflective of the cost of capital, accounting for the long-term nature of airport investments and operational constraints.

The Commission has not sought to set benchmarks for individual indicators. Each airport has different circumstances so it is not practical (or sensible) to define a benchmark for each indicator that would signal an exercise of market power at each airport. Instead of comparing indicators with benchmarks, the Commission has assessed indicators of airport performance over time, and relative to comparable airports in Australia and overseas to determine whether they could be consistent with the exercise of market power. It has then assessed whether the overall performance of each airport could be consistent with the systematic exercise of market power.

Sydney Airport

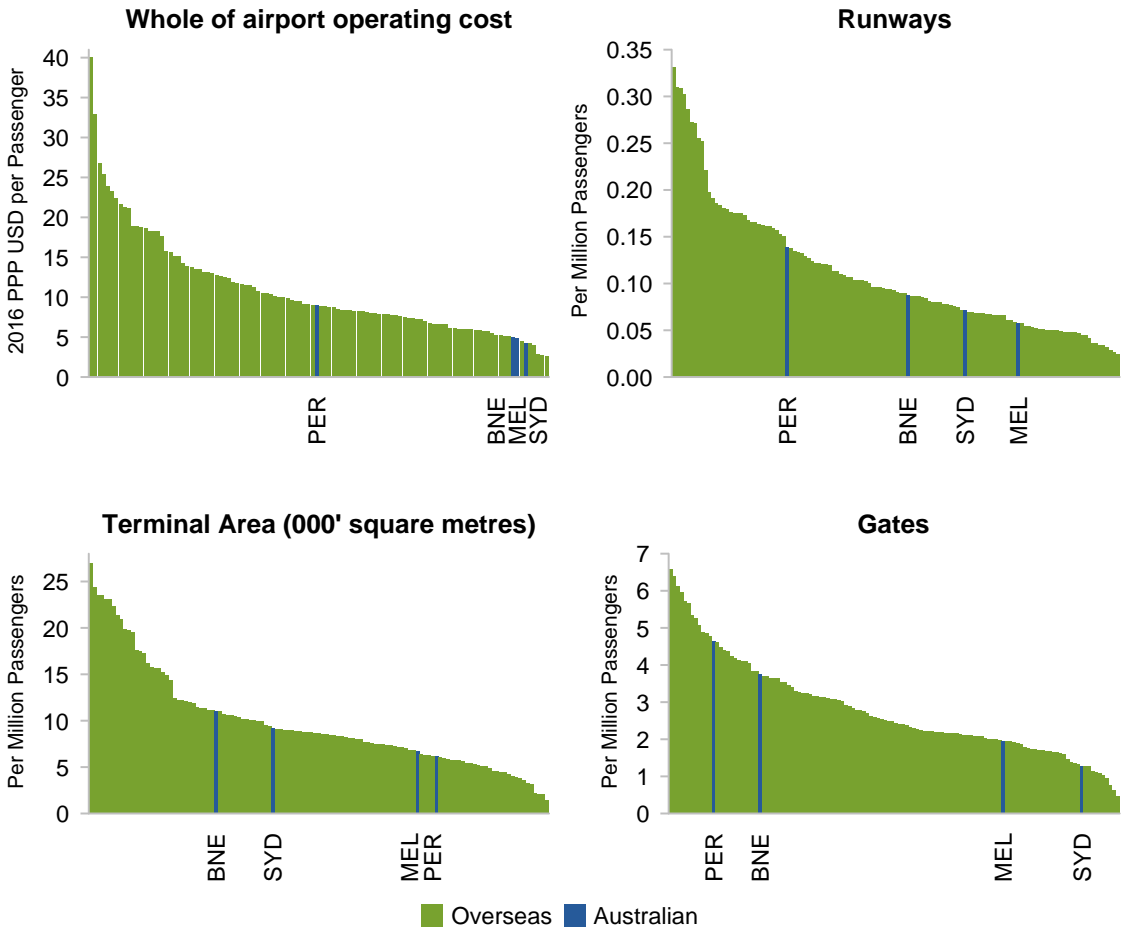
Sydney Airport faces physical and regulatory constraints — it has limited space to expand and its operations are constrained by caps on aircraft movements and a curfew. These constraints and strong passenger growth have led to some congestion at peak times, but Sydney Airport continues to operate efficiently. Its aeronautical operating costs per passenger are the lowest of the monitored airports, and it has very low whole of airport operating costs when compared to most overseas airports. Similarly, it processes a large number of passengers for the number of gates and runways it uses (figure 5). Sydney

Airport’s operating efficiency could be further increased with changes to regulatory constraints on aircraft movements (discussed below).

Aeronautical charges for domestic services at Sydney Airport are higher than those for Melbourne and Brisbane airports, but are not particularly high by international standards and have been relatively stable in recent years. Charges for international services have grown more rapidly and are high when compared with overseas airports (figure 6).

Sydney Airport is a profitable business. In 2016-17 it earned the highest return on aeronautical assets (ROAA) of all the monitored airports (11 per cent), a figure that could present cause for concern when considered in isolation (figure 7).

Figure 5 Australian and overseas airports — operating costs and input utilisation, 2016

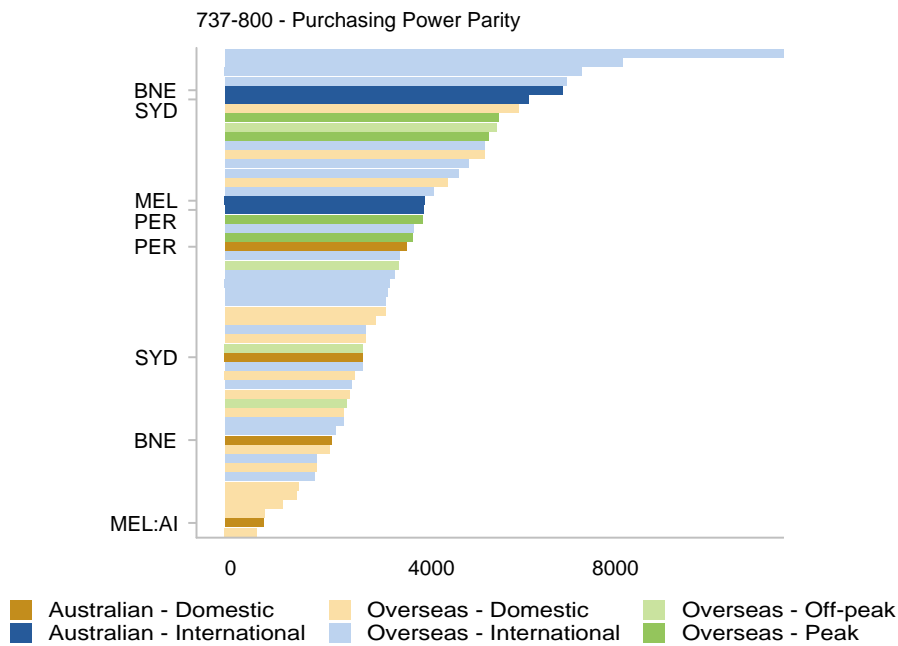


Deeper analysis reduces the concern that Sydney Airport’s profits might reflect the systematic exercise of market power. First, the long-lasting nature of airport assets and the inherent lumpiness of their investment schedules means that returns in a single year have

little value as evidence. Sydney Airport’s ROAA averaged about 10 per cent per year over the 10 year period to 2016-17 — still an attractive return, but less than Melbourne and Perth airports, which averaged about 11 and 12 per cent per year, respectively. Second, at least part of the reason for Sydney Airport’s high returns is that it has had fewer opportunities to invest than the other monitored airports due to land constraints. Passenger demand has grown more rapidly than the asset base, which has led to increasing returns on the existing assets.

Sydney Airport’s ROAA would be expected to continue to increase if current regulatory constraints remain in place and demand for Sydney Airport’s aeronautical services continues to grow. With scarce capacity, the airport may have an incentive to efficiently ration services by increasing prices. This would not be caused by an exercise of market power by the airport (or airlines), but by ‘scarcity rents’ that are created by regulations, to the detriment of passengers.

Figure 6 Australian and overseas aeronautical charges
 Airport turnaround costs in USD (current published schedules)^a



^a Schedules published as at October 2018. Charges were last updated at most airports between 1 January and 1 July 2018. The domestic charge at Melbourne Airport (MEL: AI) is for airfield and infrastructure services only (it excludes terminal services). From 1 July 2015 Melbourne Airport stopped publishing an all-inclusive domestic charge — refer to section 5.3 for further details.

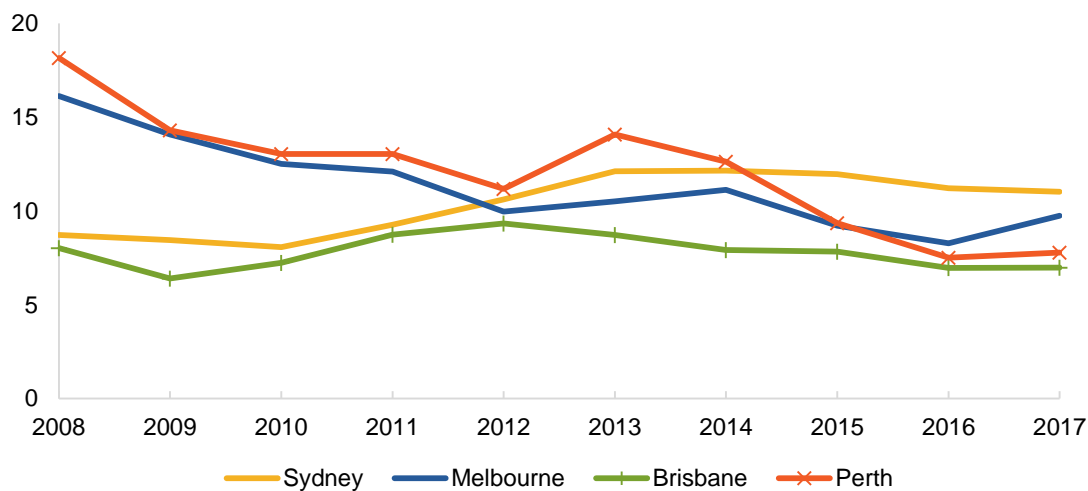
Sydney Airport clearly belongs in the monitoring regime — it has market power and its returns on assets and aeronautical charges for international services present some cause for concern that it could exercise that power. Taken as a whole though, the indicators of Sydney Airport’s performance do not suggest that it has systematically exercised its market power in aeronautical services.

Melbourne Airport

International passenger numbers at Melbourne Airport more than doubled over the past decade, which meant they went from comprising less than 20 per cent of all passengers in 2007-08 to almost 30 per cent in 2016-17. Meeting this growth has required continued investment, including new and upgraded terminal infrastructure. Melbourne Airport has high input utilisation and low costs (figure 5) and, on balance, it also has good service quality when compared to overseas airports. Substantial investment at Melbourne Airport came with a decline in profitability — the Airport’s ROAA decreased from about 16 per cent in 2007-08 to less than 10 per cent for the past three financial years (figure 7).

Melbourne Airport’s trend in profitability and high level of operational efficiency do not suggest it is exercising its market power. Although international charges have increased somewhat faster than domestic charges, they are in line with overseas airports and so are also unlikely to reflect the systematic exercise of market power.

Figure 7 Return on aeronautical assets
Per cent per year from 2007-08 to 2016-17^a



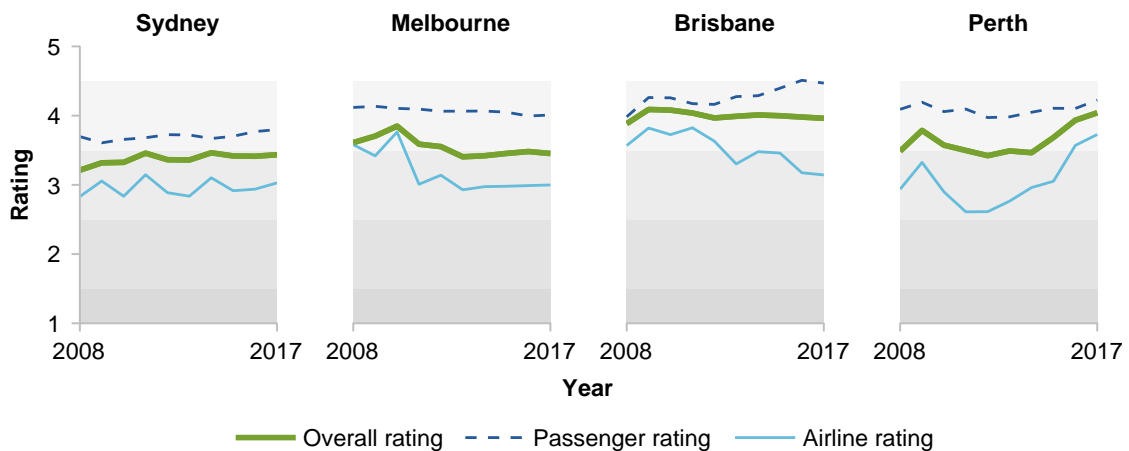
^a Financial years ending 30 June. Returns are calculated using 'line in the sand' asset values from the ACCC monitoring report.

Brisbane Airport

Brisbane Airport had the highest scheduled international charges of the monitored airports, and these charges are also high when compared to its overseas peers (figure 6). It has recently expanded its international terminal building and associated apron and aircraft parking facilities. The high charges at Brisbane Airport could reflect the costs of these investments, but they could also be consistent with the airport exercising its market power.

While Brisbane Airport’s international charges are relatively high, it performed better on other indicators. Its total costs per passenger increased significantly from 2007-08 to 2016-17, but were low compared to other monitored airports. Brisbane Airport’s overall service quality rating was the highest of the monitored airports in nine of the past 10 years according to ACCC monitoring (figure 8).

Figure 8 Average quality of service ratings from ACCC monitoring
2007-08 to 2016-17



Finally, high international charges have not translated into excessive airport profitability, with Brisbane Airport’s ROAA seldom exceeding 8 per cent in the past decade (figure 7). Overall, Brisbane Airport’s moderate level of profitability and reasonable operational performance suggest that it is not exercising its market power. However, like Sydney, its high international aeronautical charges are a potential concern.

Perth Airport

Perth Airport opened a dedicated regional terminal in 2013 and a new domestic pier in 2015, but there was an unexpected fall in passenger numbers with the end of the mining investment boom. This partly explains why it had the highest operating costs per passenger and the most underutilised resources of the monitored airports (figure 5), despite previous criticism of the airport for having insufficient capacity during the mining investment boom. The investments were considered to be beneficial by both Perth Airport and airlines using these terminals at the time and resulted in the greatest improvement in service quality of the monitored airports since 2011-12 (figure 8). These investments were accompanied by a more than 100 per cent increase in domestic scheduled charges from 2011-12 to 2016-17. Perth Airport has stated that the large increase in domestic charges from 2012 was implemented to fund the construction of the two new terminals, and that domestic charges will be reduced by 39 per cent in real terms in the 2019 financial year.

Movements in Perth Airport's ROAA appear to be heavily influenced by its investment decisions. Since 2007-08, ROAA at Perth Airport has averaged about 12 per cent, which is the highest of the monitored airports. This was driven by higher returns earlier in the period when it had a relatively small asset base and increasing passenger numbers. Its asset base quadrupled in real terms from 2007-08 to 2016-17, with significant terminal expansions. This investment, combined with lower passenger numbers in recent years, led to a substantial fall in ROAA over the period. ROAA was about 18 per cent in 2007-08, and fell sharply to about 13 per cent by 2009-10. It rose again in 2012-13 but fell again in 2014-15 and has been less than 8 per cent in the past two financial years.

Overall, Perth Airport's performance can be partly explained by increased passenger demand during the mining investment boom and substantial investment, followed by a decline in passenger numbers after the mining investment boom. The investments undertaken by the airport seem to have been considered necessary, given that airlines were supportive of them at the time and, to the extent that they were completed at a reasonable cost, then these findings do not suggest that Perth Airport has exercised its market power.

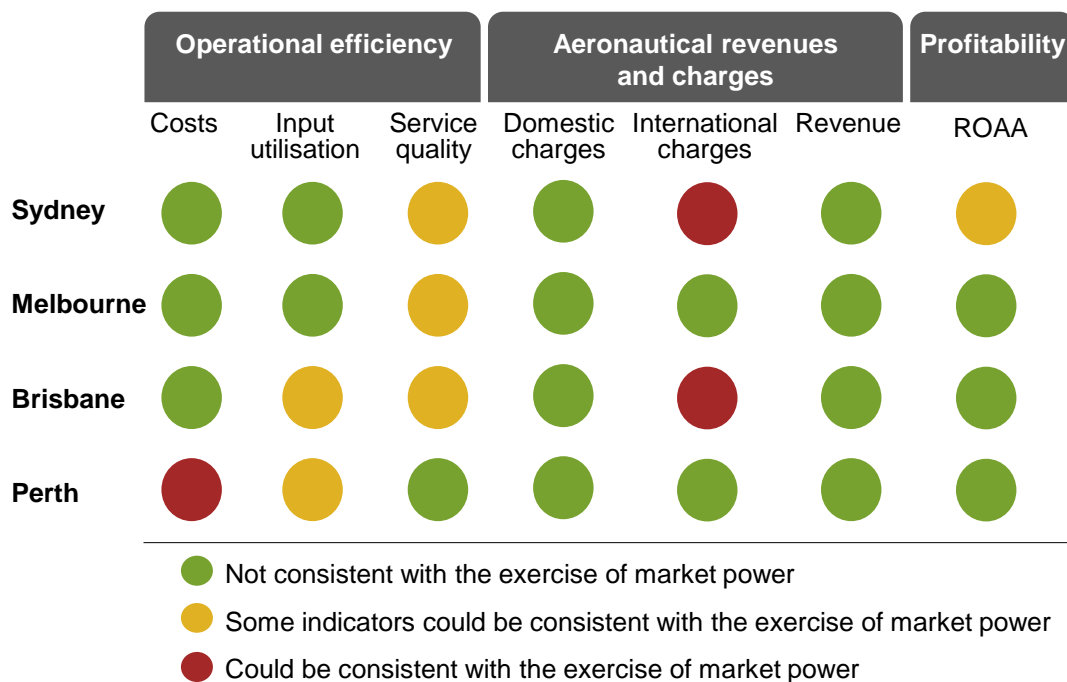
No systematic problem but airport performance requires more scrutiny

Some indicators of financial performance at particular airports could be consistent with the exercise of market power when taken in isolation. The high international charges at Sydney and Brisbane airports, Sydney Airport's profitability, and the high operating costs at Perth Airport show that there is reason to be vigilant (figure 9).

When taken as a whole, the evidence does not suggest that airports have systematically exercised their market power to the detriment of the community. There is no justification for significant change to the current form of regulation of aeronautical services at these airports. There is, however, a need to increase the transparency of airport performance through changes to the monitoring regime.

The Commission would need information on the costs and revenues associated with international aeronautical services to determine whether relatively high international aeronautical charges at Sydney and Brisbane airports are a result of an exercise of market power. This evidence base does not exist because airport operators are not currently required to provide this information to the ACCC. The Commission is recommending improvements to the monitoring regime so the magnitude of international aeronautical costs and revenues can be evaluated in the future.

Figure 9 **Summary of airport performance**



Prices at airport car parks are not the result of market power

Many consumers resent the price of parking at a major airport because a few hours in a short-term car park close to the terminal building can cost more than an airline ticket.

Airports own and operate car parks on airport land, including at-terminal and at-distance (requiring users to catch a shuttle bus to the terminal). Airport operators have market power in at-terminal car parking — they are the sole provider and there are no substitutes for people who want the convenience of parking within a short walk to the terminal. Airport operators are likely to face greater competitive constraints in the market for at-distance car parking, provided the operators of independent car parks have access to airport terminals for their shuttle buses.

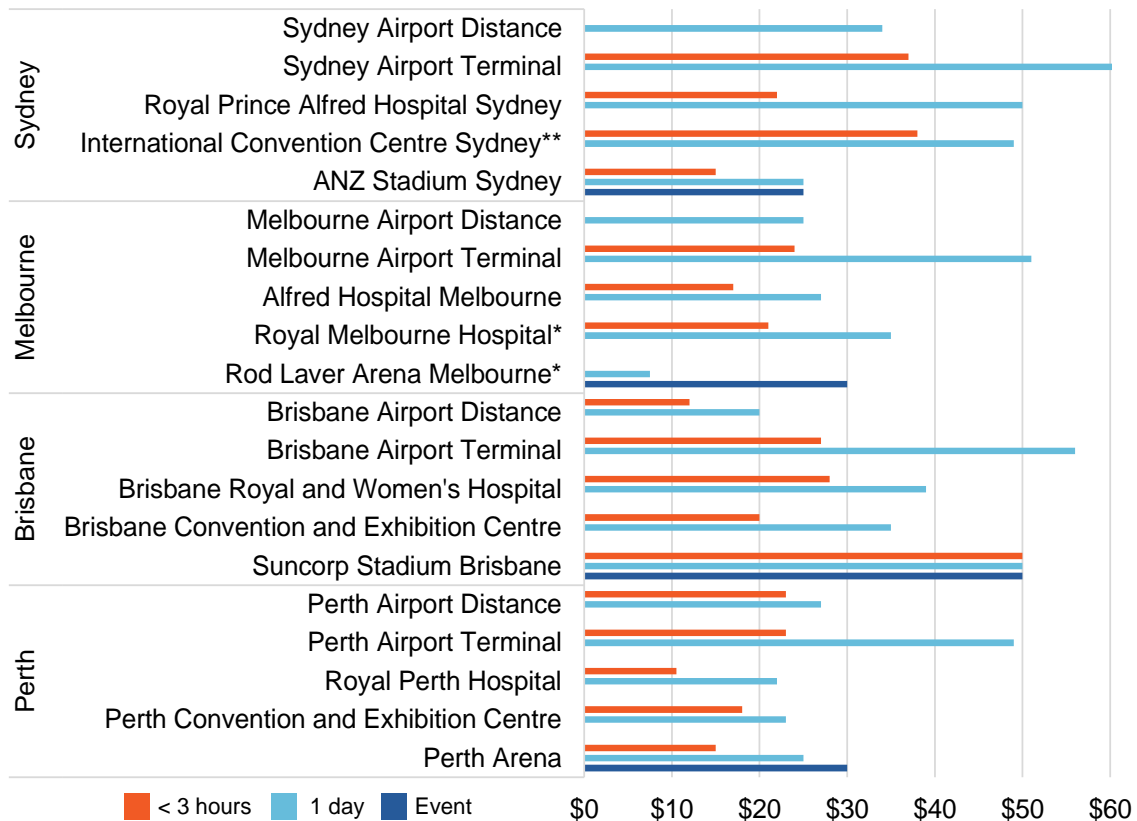
There is little evidence that the monitored airports are exercising their market power in car parking. The price of parking at-terminal can largely be explained by:

- the high opportunity cost of land close to the terminal — forecourt land is scarce and could be used for other purposes, such as car rental facilities, retail outlets or hotel accommodation
- location — people value the convenience of parking close to the terminal buildings. The premium that users are prepared to pay for limited space close to terminals creates

locational rents. This is also true of other locations where proximity is highly valued but space is limited, such as hospitals, and entertainment and sporting venues, which have broadly comparable prices, particularly for short-term use (figure 10)

- airport operators use pricing to manage demand and reduce congestion in highly sought after car parking facilities. This is especially the case for at-terminal car parks that are limited in number due to space constraints
- car park amenities — at-terminal car parks are generally multi-storey facilities providing covered parking and services such as CCTV security, all of which are more costly to build and operate than open-air car parks.

Figure 10 Car park prices at monitored airports, selected hospitals, and entertainment and sporting venues^{a,b}



^a State-government annual congestion levies apply to car parks in some metro areas of Sydney and Melbourne. ^{**} Congestion levy of \$2400 per car park space. ^{*} Congestion levy of \$1400 per car park space.
^b Car park prices at some event venues are dynamic.

There are many ways for people to access the airport precinct, such as taxi, Uber, off-airport car parks and public transport and, while they are not perfectly substitutable for those wishing to park at the terminal, they do constrain the ability of airport operators to increase prices significantly. Likewise, the increase in the use of technology, such as web-based apps

to compare car parking prices, provides consumers with more information about their options and the means to decide in advance rather than be hit with a nasty surprise.

As is the case in other areas where airports have market power, there is an ongoing need to scrutinise the performance of airports' car parking operations. Changes should be made to the monitoring regime to improve data to allow greater scrutiny of airports' car parking operations, including separately reporting the costs, revenues and utilisation rates for at-terminal and at-distance car parking.

Reforming the regulatory regime

The monitored airports have market power in domestic and international aeronautical services at a level that create a *prima facie* case for regulatory intervention. Other capital city airports and airports in regional centres have less (or no) market power and should not be subject to increased monitoring at this stage.

The light-handed approach to regulation has performed well — Sydney, Melbourne, Brisbane and Perth airports have not systematically exercised their market power to the detriment of the community. Each has generated returns sufficient to promote investment while not earning excessive profits, although some indicators of performance could be cause for concern when taken in isolation or over a short time frame. Wholesale changes to the regulatory regime are not justified, but this is no reason for airport operators to become complacent.

The pillars of the economic regulation of airports should remain in place, including the annual monitoring administered by the ACCC and periodic reviews by the Productivity Commission — both are critical to the regulatory regime to maintain a credible threat to airports of increased regulation. The combination of the monitoring report and Commission reviews allows a regular assessment of the performance of airports, whether an airport should be added to the list of monitored airports (or removed from it), and whether a monitored airport should be subject to more onerous regulation.

More detailed reporting on airports' financial performance

The monitoring regime could be made more useful to the Commission for its inquiries into airports (and to others), and for airport users in their commercial negotiations, if it included more detailed information on airports' operations and financial performance. The annual monitoring reports should be expanded to include separate reporting of costs and revenues in relation to:

- aeronautical services for domestic flights and for international flights
- the provision and use of at-terminal and at-distance car parking
- the provision and use of landside access services (see below).

Cost information should be provided separately for service-specific costs and common costs. Service-specific costs could include operational costs, such as the costs of providing an aerobridge to a domestic or international flight. They could also include capital costs, such as terminal costs where there are separate terminals for international and domestic services. Common costs apply to common-use infrastructure, including runways and other airside infrastructure, as well as some landside infrastructure. To augment this information the airports should disclose any methods they use to allocate common costs between domestic and international services, and should report allocated costs for aeronautical, car parking and landside access services.

Separate reporting of service-specific and common costs would enable costs and revenues to be attributed to either domestic or international services. This information would assist in more detailed assessments of whether airports are exercising their market power in either of these services.

Improving quality of service monitoring

The monitored airports performed well relative to overseas airports on passenger service quality measures but airline service quality measures present a less favourable picture. Methodological issues and biases limit the robustness of quality of service ratings under the monitoring regime. Quality of service monitoring should be updated to emphasise indicators that reflect outcomes that are valued by airport users (airlines and passengers), drawing on the indicators that airports and airlines use in service level agreements.

More information on landside access

Airport operators at the four monitored airports have the ability and incentive to exercise their market power in landside access and face fewer constraints on their behaviour than they do for other services. Improvements to the monitoring regime are needed in order to determine if airport operators are exercising their market power in landside services. This is important not only for the effect it has on landside services, but also because an operator could use unreasonable conditions of access to boost demand for its on-airport car parks.

The benefits of updating the monitoring regime outweigh the costs

Collecting additional data will increase compliance costs for the monitored airports and administration costs for the ACCC. The Commission considers that these costs will be modest and proportionate to the benefits of enhancing the monitoring regime to increase the oversight of airports' operations and financial performance. Much of the additional data required from airports should be readily accessible from airports' financial reporting systems and there would likely be a relatively small impost on the ACCC. The alternative — new regulatory frameworks, such as a negotiate-arbitrate framework discussed below — would have costs and risks that are higher than the Commission's draft recommendations.

A negotiate-arbitrate framework would have few benefits and many risks

Airlines and the ACCC suggested replacing the existing regime with a much more interventionist approach — making airport services subject to a negotiate-arbitrate framework. Airports and airlines would engage in commercial negotiations on the terms of access to airport infrastructure. If either party considers that the negotiations are not going to lead to a satisfactory commercial outcome, it could request that an arbitrator be appointed to resolve the dispute. This type of regulation currently applies to some east coast gas pipeline services. Compulsory arbitration can also apply to services that are declared under the National Access Regime, but the ACCC and airline proposals would effectively skip the declaration stage (and the case-by-case analysis that it involves).

Airports are complex operations that make long-lasting investments in costly, and often common-use, infrastructure. Airport operators manage the requirements and preferences of many airlines (47 at Sydney Airport) and recover the costs of investments from those airlines over decades. Each agreement for airfield and terminal services is a package of conditions that is intertwined with the conditions of agreements with other airport users.

The arbitration process would be time-consuming and financially costly, and would change the incentives for parties to reach outcomes through commercial negotiation. Airlines that disagree with investment proposals (including proposals that might threaten their incumbency) would have incentives to use the arbitration process to hold up investments that could increase airport capacity and competition between airlines. An arbitrated outcome for one airport user might reduce the efficiency of airport operations for other airport users and the community as a whole.

The proponents have also failed to demonstrate why a negotiate-arbitrate framework specific to airports is needed when the National Access Regime enables airport users to seek declaration of airport services and subsequently to seek access to arbitration by the ACCC if negotiations fail.

There is no doubt that some commercial negotiations between airports and airlines have been challenging but, on balance, the process and the outcomes reached give little cause for concern. A negotiate-arbitrate framework would have substantial perverse effects that would harm the efficiency of the sector and negatively affect passengers. The benefits would need to be very large for the costs and risks of such a framework to be tolerable. They are not.

Regional access arrangements at Sydney Airport

Airline access to Sydney Airport is more difficult than to other Australian airports because of its regulatory constraints, including restrictions on the number of aircraft movements. Sydney Airport is also a significant domestic and international air transport hub and high demand for the airport's infrastructure shows up in congestion, especially during the morning and evening peak hours.

The regional ring fence, price cap and price notification regimes

The Australian Government has put in place unique arrangements — a regional ring fence, price cap and price notification regime — at Sydney Airport, to facilitate access for airlines servicing destinations in regional New South Wales. The ring fence reserves a number of aircraft movement slots at Sydney Airport for airlines operating flights to or from regional New South Wales. Under the price cap and notification regime, Sydney Airport must notify the ACCC before it can change its prices for aeronautical services and facilities provided to airlines operating flights servicing NSW regions. The ACCC can object to a price increase proposed in a price notification if it considers the increase would exceed the CPI-linked price cap, or if the increase is not required to recover the costs for the provision of aeronautical services to airlines operating regional flights. Regional aeronautical charges are about half of the scheduled domestic aeronautical charges. These arrangements help to facilitate access for airlines operating regional flights into Sydney Airport but they can be improved.

The ring fence supports access to Sydney Airport for airlines operating regional flights, particularly in peak periods, as evidenced by the close to full allocation of slots, including regional slots, in peak periods. However, the cap on regional slots in peak periods and the fact that non-regional slots in peak periods cannot be used for regional flights prevents airlines from testing and growing regional routes.

Changes to the regime to allow airlines to use non-regional slots for regional air transport would enable them to more easily trial regional flights in peak periods (when spare regional slots are scarce), more flexibly respond to changes in market demand on different routes, and more efficiently use their aircraft. Non-regional slots that are used for regional air transport should not become permanent regional ring fenced slots as this would reduce the flexibility of these slots.

Further, airlines that use non-regional slots for regional air transport should pay domestic aeronautical charges or negotiate charges with Sydney Airport, rather than pay the price-capped regional aeronautical charges. This would prevent the price cap regime, and any associated costs, from expanding due to a change in the use of slots.

The price cap and notification regime applies to terminal and airfield charges as well as prices for other aeronautical services and facilities, such as hangars, for airlines operating NSW regional flights. The price cap is only one factor in airlines' decisions to service a route. Airlines base their decisions on many other factors, such as passenger demand, charges at destination airports, fuel and other operating costs and slot capacity constraints. The benefits of the price cap appear to be limited to marginally profitable routes and the costs are uncertain. Given the potential benefits at the margin, the price cap should be retained in its current form at this time.

Although inquiry participants did not identify major issues with the price cap, Sydney Airport stated that the public nature of price notifications can discourage commercially negotiated outcomes because airlines may not wish for sensitive information to be known by their competitors. Sydney Airport suggested that outcomes reached through negotiations

with airlines should not be subject to price notifications. Rex supported this proposal, as long as the safety net for regional airlines that do not have commercial agreements continues to be preserved. The price notification regime at Sydney Airport should be updated to apply only to prices for regional aeronautical services that are not covered in commercial agreements between Sydney Airport and airlines operating NSW regional air transport services.

The opening of Western Sydney Airport in 2026 could provide greater opportunities for regional air transport directly through flights to regional areas and indirectly where it leads to more capacity at Sydney Airport. The next Commission inquiry into airport regulation should consider the continued need for regional access arrangements at Sydney Airport in light of the development of Western Sydney Airport and any other future considerations. This analysis would be supported by the Commission's proposal to expand the monitoring regime to include data for Sydney Airport on costs and revenues in relation to the provision of aeronautical services for air transport to regional New South Wales. This would allow the costs of the regional access arrangements to be more easily assessed and then evaluated against their potential benefits.

Broader regulatory constraints at Sydney Airport

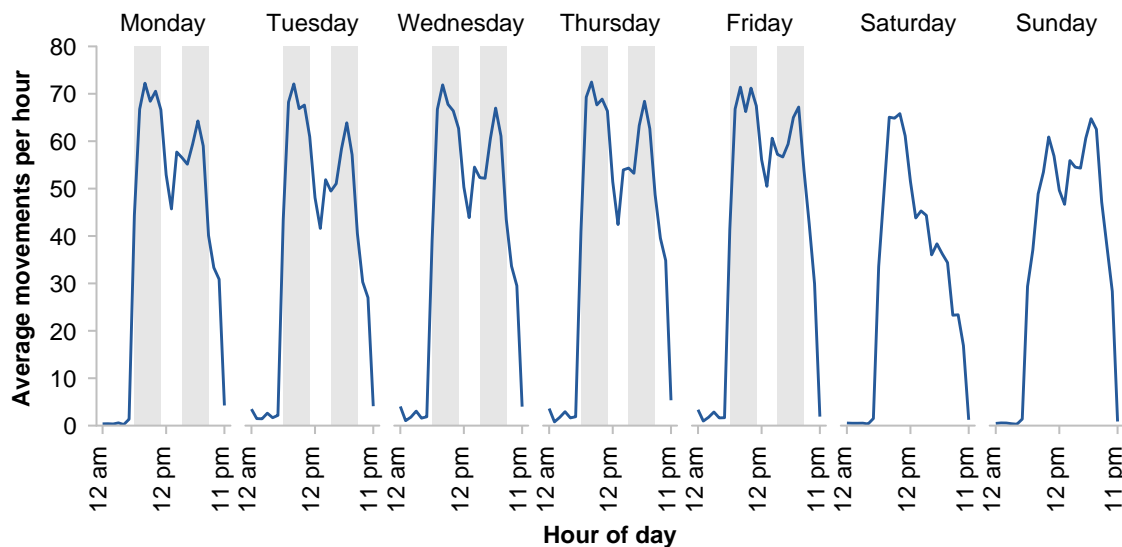
Regulatory constraints at Sydney Airport, including the movement cap, curfew and the slot management scheme, restrict the effect of aircraft noise on local residents, but come at the expense of broader airport efficiency. The capacity of Sydney Airport is capped at 80 movements per 15-minute rolling hour (in non-curfew periods) but it rarely reaches this cap. Airservices Australia, which manages air traffic at Sydney Airport, aims to process 78 movements per rolling hour in practice, which ensures that it does not exceed the movement cap after allowing for potential counting errors or aircraft speed differences. The average number of movements rarely exceeds 70 per hour, even in peak periods (figure 11).

Sydney Airport's movement cap and airport curfew can exacerbate delays when there are unexpected incidents, such as weather events. Delays that lead to congestion, particularly during peak periods, can force some aircraft to wait on the ground or in the air until the next 15-minute rolling hour before they are allowed to take off or land in order to avoid breaching the movement cap. Aircraft movements can be prohibited entirely when delays stretch toward the curfew period. Delays interfere with passengers' schedules, create costs for airlines and have flow-on effects for Australia's aviation network more broadly due to the high number of aircraft that pass through Sydney Airport.

The movement cap and curfew sometimes result in more noise and emissions, in spite of their noise reduction objective. Inquiry participants, including Sydney Airport and the Tourism and Transport Forum, said that aircraft that arrive earlier than scheduled (due to catching a tailwind, for example) may be forced to wait in the air rather than land to avoid breaching the movement cap or curfew, creating additional noise, excess environmental

emissions and unnecessary fuel burn. Further, the legislation permits the use of one type of jet aircraft for freight operations during the curfew, but not newer quieter aircraft.

Figure 11 Average hourly movements at Sydney Airport by day of the week^{a,b}
October 2017 to September 2018



^a Shading indicates legislated peak periods (6 am to 11 am, and 3 pm to 8 pm, on weekdays). ^b Underlying data include all movements at Sydney Airport, including those that are exempt from the movement cap.

The objective of managing the effect of aircraft noise on local residents should be balanced with reforms that benefit the community at large, including through improvements to the efficiency of Sydney Airport. Changes that increase the flexibility of the movement cap and that target noise outcomes more directly would most likely improve the operational efficiency of Sydney Airport as well as airlines. This could be done in a way that meets current noise objectives, but that reduces unintended consequences from the existing arrangements. Options include removing the cap on actual movements but retaining a cap on scheduled movements or adopting noise-based criteria for determining which aircraft are permitted to operate during the curfew, rather than the current prescribed list of aircraft types. The Commission is seeking further evidence from participants on these options with a view to making a recommendation in its final report.

The legislated slot management scheme at Sydney Airport, which allocates aircraft movement slots to airlines, can limit competition. Historical precedence provisions in the scheme mean that airlines are automatically entitled to their slots from a previous season, provided they meet certain criteria. These provisions can provide certainty to existing airlines and their customers, but also prevent new entrants from gaining access to the airport and could be exploited by incumbent airlines. Historical precedence provisions that prevent an increase in competition can have negative effects on broader operational efficiency at

Sydney Airport and airfares, to the detriment of passengers in the long run. The Australian Government should commission a public review of Sydney Airport's slot management scheme to consider possible reforms to the current arrangements in order to improve competition.

The Commission supports the plans for Western Sydney Airport to operate without a curfew. Further, government planning and development activities should promote the efficient operation of the airport and ensure that the surrounding land is not developed in a way that ultimately creates pressure to reduce the airport's 24-hour operations.

Competition in markets to supply jet fuel

The cost of jet fuel accounts for the largest single source of airline operating costs, at about 20 per cent in 2017-18. In the same year, the demand for jet fuel in Australia was 9000 mega litres, which cost the airlines between \$7–9 billion. This means a one cent per litre decrease in the jet fuel price could result in a \$90 million reduction in operating costs for airlines uplifting their fuel in Australia.

Infrastructure for the supply of jet fuel

Markets to supply jet fuel comprise a complex chain of infrastructure services to transport jet fuel from its origin as refined crude oil in international or domestic refineries to the wingtip at Australian airports. The supply chain includes import terminals, off-airport storage tanks, pipelines or trucks, on-airport storage and hydrants and into-plane providers.

The jet fuel supply chain is dominated by four large vertically integrated suppliers — BP, Caltex, Mobil and Viva — that are involved in each part of the supply chain, often in a joint venture arrangement between two or more of these suppliers. Vertical integration and horizontal coordination generate benefits to fuel suppliers by capturing economies of scale or scope, or by lowering coordination costs, where related services, such as the piping, storage and distribution of fuel, would otherwise be provided separately.

These arrangements can result in more efficient provision of infrastructure services, but they could also enable incumbent fuel suppliers to use their dominance to restrict competition in markets to supply jet fuel.

- Fuel suppliers seeking to access the market face high barriers to entry. A fuel supplier entering the market would require access to multiple infrastructure services, yet few infrastructure owners offer open access to third parties. For example, only one pipeline — the Caltex pipeline to Sydney Airport — allows access to third parties, but access to the supply chain can be constrained or denied at several other points. The Commission has heard that a number of new entrants would like to enter markets to supply jet fuel but have so far been unable to.

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- It appears that the market power of the incumbent fuel suppliers is leading to opaque terms for access to the Joint User Hydrant Installation (JUHI) infrastructure, likely deterring potential entrants. In addition, the incumbent firms may be using the decision-making process for granting access to hinder the ability of new entrants to enter a market at all, or to delay access opportunities for competitors.
 - Most of the fuel supplied to the monitored airports is transported from import terminals to the airports through pipelines owned by existing suppliers. New suppliers could truck fuel to the airport, but in the long term there are congestion and environmental externalities as well as cost disadvantages to using trucks. This means that trucking is unlikely to be a viable substitute to the long-term provision of jet fuel by pipeline to the monitored airports.

There is scope to improve competition and coordination

The Commission has received insufficient publishable information to present a full analysis of competition in markets to supply jet fuel. The Commission's conclusions have relied on analysis of the characteristics of those markets, along with information provided in submissions and public hearings.

The supply of jet fuel at some Australian airports is characterised by conflicts of interest associated with fuel companies owning the JUHI infrastructure and a lack of open access to necessary infrastructure services. There is limited transparency on the terms of third party access to infrastructure services, which makes it difficult for potential competitor fuel suppliers to decide whether to enter a market or to assess whether these terms are reasonable. *Prima facie*, this has enabled incumbent fuel suppliers to restrict competition, which has led to a small number of fuel suppliers at some airports. This has likely led to higher prices to access infrastructure services and higher fuel prices.

The Commission has identified two options that could, depending on further evidence from participants, improve the conditions for competition in markets to supply jet fuel. The Commission could recommend:

- the designated Minister apply to the National Competition Council asking it to recommend that a service, such as those provided by the JUHI, a pipeline or the whole supply chain, at the capital city airports, be declared under the National Access Regime
- an industry-specific access regime for infrastructure services that are necessary for the provision of jet fuel.

However, there may not be a need for a government response at some airports — the Commission notes that some airport operators have already acted to improve competition at the JUHI by introducing open access regimes.

In the case of Western Sydney Airport, the Australian Government should recommend to the Western Sydney Airport Corporation Board that the JUHI operates on an open access basis and that this is a condition of any future privatisation.

There is also scope to improve the planning and coordination of jet fuel infrastructure. The jet fuel supply chain is critical for commercial aviation operations and requires sufficient capacity to minimise fuel disruptions. This is aided by ensuring industry participants have incentives to invest in capacity and good coordination between fuel companies, airports, airlines and Australian, State and Territory Governments. A jet fuel supply coordination forum should be established at each of the monitored airports as part of the master planning process, to enable better coordination and information sharing between these parties. The forum could discuss, among other things: capacity constraints and any potential pressure points; linkages between different parts of the infrastructure supply chain; demand forecasts and actions to ensure security of supply; and future infrastructure requirements and investment planning.

Regional airports

Airports in regional areas provide important services to communities. Regional airports have a variety of ownership and management structures but local government councils own and operate the vast majority. Participants raised concerns about infrastructure decisions, aeronautical charges and asset management practices at some regional airports.

Participants argued that infrastructure upgrades at some regional airports are driven by politics and regional development objectives. These objectives include, for example, facilitating international tourism by upgrading runway and terminal capacity to cater for larger aircraft than any airline is proposing to fly at that destination. Participants noted that Australian, State and Territory Governments support many infrastructure improvements at regional airports and that the assessment criteria used to assess projects can lack rigour and lead to unwarranted infrastructure investments. The Commission shares these concerns — unnecessary or unjustified infrastructure upgrades could lead to the perverse outcome of a loss of air services to communities if they result in increased aeronautical charges that airlines (and by extension, passengers) are not willing to pay.

Airlines also argued that regional airport operators do not adequately consult airport users when undertaking infrastructure investments that lead to increased aeronautical charges. Consultation with airport users is likely to assist airport operators to identify necessary investments in regional airports and help to avoid unnecessary or unjustified expenditure.

Australian, State and Territory Government funding of airport infrastructure should be transparent and subject to an independent public assessment of the project, including an assessment of airport users' willingness to pay for the infrastructure.

Airlines and associated representative bodies questioned the financial asset management practices of some council-operated airports. Concerns raised included lack of in-house knowledge and experience in managing airport infrastructure, arbitrary revaluations of airport assets that result in increases in aeronautical charges, and the treatment of government-funded assets in financial reporting. Previous Commission work, including the *Transitioning Regional Economies* study, also found that the capacity and capability of local councils vary significantly. Consistent with that study, government funding of new airport infrastructure and improvements to existing airport infrastructure should occur at a regional level, rather than at a local-council level, to reflect that local areas are linked by the interactions between people across neighbouring areas (functional economic regions).

More could be done to assist some local councils in the financial management of airport assets. The WA Department of Transport is developing a Strategic Airport Asset and Financial Management Framework (Framework) for regional airports. The aim of the Framework is to provide a standardised template for asset management at council-operated regional airports including the determination of charges required to maintain and replace assets. The Commission considers that the Framework would help build capability of local councils in managing airport infrastructure and address issues raised by participants.

The Australian Government should review the efficacy of the Framework in 2022, in consultation with State, Territory and Local Governments. Pending the findings of that review, the Framework should be adapted and rolled out by governments in other jurisdictions with the objective of providing a template for sound asset management practices and greater transparency when determining airport charges at regional airports.

Draft recommendations, draft findings and information requests

Commercial negotiation

INFORMATION REQUEST 4.1

The Commission is seeking additional information or examples of take-it-or-leave-it offers by airport operators, including:

- scope and circumstances of the negotiation*
 - overview of the negotiation process and actions of each party*
 - negotiation outcomes, including acceptance of such offers by airport users*
 - the extent to which such conduct during the negotiation process may reflect an exercise of market power.*
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INFORMATION REQUEST 4.2

The Commission is seeking additional information on the ways in which airports and airport users share risks through negotiated agreements including:

- mechanisms to share investment risks, such as offers or use of take-or-pay contracts, where users are required to guarantee a level of future service use*
 - current or proposed contract terms that do not reflect a reasonable sharing of risk, and the rationale for their use*
 - instances where airport users have pre-financed capital projects and why this did or did not represent a reasonable sharing of risk*
 - the extent to which any risk transfer reflects an exercise of market power, and why.*
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Airports with market power

DRAFT FINDING 5.1

The four monitored airports — Sydney, Melbourne, Brisbane and Perth — have market power in aeronautical services, but they have not systematically exercised their market power to the detriment of the community. There is no justification for significant change to the current form of regulation of aeronautical services at these airports.

Landside access

INFORMATION REQUEST 6.1

The Commission is seeking evidence on:

- *how airport operators consult and engage with landside operators when setting access charges and undertaking investment in landside infrastructure*
 - *how consultation between airports and landside operators could be improved*
 - *mechanisms available to landside operators to raise issues with airport operators that relate to landside access and how issues are resolved*
 - *the pricing frameworks airport operators employ to determine the access price of specific- and common-use landside infrastructure and whether these frameworks, and the associated methodology, are included in negotiations with airport users*
 - *airport operators making take-it-or-leave-it offers when negotiating charges and other terms of access with landside operators*
 - *negotiation outcomes, including acceptance of take-it-or-leave-it offers by landside operators.*
-

Access arrangements at Sydney Airport

DRAFT RECOMMENDATION 7.1 REGIONAL ACCESS TO AND FROM SYDNEY AIRPORT

The Australian Government should amend the Sydney Airport Slot Management Scheme 2013 (Cwlth) to allow slots that are not part of a permanent regional service series (PRSS) to be used for either regional or non-regional flights. These slots should not become PRSS slots when used for regional flights.

Future Declarations relating to the regional price cap and notification regime should only apply to regional flights operated through PRSS slots, after the current Declaration no. 94 ceases on 30 June 2019.

DRAFT RECOMMENDATION 7.2 COMMERCIAL NEGOTIATIONS FOR NSW REGIONAL SERVICES

The Australian Government should ensure that future Declarations relating to the regional price cap and notification regime at Sydney Airport only apply to aeronautical services that are not covered in commercial agreements between Sydney Airport and airlines operating NSW regional air transport services, after the current Declaration no. 94 ceases on 30 June 2019. Future Declarations should also specify that prices in commercial agreements cannot be used to assess whether Sydney Airport has breached section 95Z of the *Competition and Consumer Act 2010* (Cwlth).

INFORMATION REQUEST 7.1

The Commission invites comments on the potential costs and benefits of reforms to Sydney Airport's regulatory constraints on aircraft movements that can also meet current noise objectives.

Options that could improve the efficiency of the movement cap without leading to a net increase in noise include:

- spreading the measurement of the movement cap over a longer time period than the current measure of 80 movements per 15-minute rolling hour*
- removing the cap on actual movements but retaining a cap on scheduled movements.*

Options that could improve the targeting of noise outcomes include:

- replacing regulatory constraints on aircraft movements with noise caps based on the amount of noise made by each aircraft*
- adopting noise-based criteria for determining which aircraft are permitted to operate during the curfew, rather than the current prescribed list of aircraft types.*

DRAFT RECOMMENDATION 7.3 REVIEWING SYDNEY AIRPORT'S SLOT MANAGEMENT SCHEME

The Australian Government should commission a public review of the Sydney Airport Slot Management Scheme 2013 (Cwlth) following the outcomes of the International Air Transport Association's review into the Worldwide Slot Guidelines, expected to be completed in 2019.

The review of the Scheme should assess how effectively it contributes to the efficient use of scarce airport infrastructure while taking into account regional access and noise management objectives. It should consider reform options in relation to:

- whether slot allocation arrangements generate the greatest benefits to the community or if alternatives that are not based on historical precedence would improve competition
- slot performance monitoring to ensure that slots are being used in accordance with the intent of the Scheme
- the costs and benefits of continued alignment with the latest Worldwide Slot Guidelines, including the effects on competition between airlines.

Competition in markets for jet fuel

DRAFT FINDING 8.1

The supply of jet fuel at some Australian airports is characterised by conflicts of interest associated with fuel companies owning the Joint User Hydrant Installation infrastructure, and a lack of open access arrangements to infrastructure services needed to supply jet fuel.

There is limited transparency on the terms of third party access to infrastructure services, which makes it difficult for potential competitor fuel suppliers to decide whether to enter a market or to assess whether these terms are reasonable.

Prima facie, this has enabled incumbent fuel suppliers to restrict competition in markets to supply jet fuel, leading to some airports having a small number of fuel suppliers, and has likely led to higher prices to access infrastructure services and higher fuel prices.

INFORMATION REQUEST 8.1

The Commission is seeking information from participants on markets to supply jet fuel at the capital city airports.

Fuel infrastructure owners:

- *fuel companies' return on assets for the terminals, pipelines, Joint User Hydrant Installation (JUHI) infrastructure and into-plane services*
- *terms of third party access, including price, to infrastructure services for the provision of jet fuel*
- *the number of applications for access to JUHI infrastructure that have been successful and unsuccessful over the past 10 years*
- *details of the JUHI access application process, including the information required from access seekers, time taken for a decision on access to be made and reasons as to why access seekers were unsuccessful*
- *the assessment process for granting access to JUHI infrastructure at individual airports.*

Potential entrants:

- *the reasons why third parties have not sought access to infrastructure services through the National Access Regime (Part IIIA of the Competition and Consumer Act 2010 (Cwlth))*
- *the extent to which the terms and process for granting third party access to infrastructure services reflect an exercise of market power by fuel infrastructure owners, and why.*

(continued next page)

INFORMATION REQUEST 8.1 (continued)

Airport operators:

- *justification of the structure and size of the fuel throughput levies charged by airports to the jet fuel suppliers*
- *future plans to change lease arrangements for JUHI infrastructure to improve competition, including moving to open access.*

Airlines (both domestic and international):

- *prices paid per litre of fuel at each capital city airport*
- *the number of fuel suppliers tendering for contracts, and the number of successful tenderers, at each capital city airport*
- *the estimated additional costs (including, for example, the price differential) faced by airlines due to a lack of competition in the jet fuel supply chain*
- *the extent to which airlines substitute the location where they uplift fuel to take advantage of better prices.*

This information should be provided to the Productivity Commission in a form that can be published and scrutinised by others.

DRAFT RECOMMENDATION 8.1 OPEN ACCESS JUHI AT WESTERN SYDNEY AIRPORT

Through the Shareholder Ministers of the Western Sydney Airport Corporation (the Minister for Finance and the Minister for Urban Infrastructure), the Australian Government should recommend to the Western Sydney Airport Corporation Board that the Joint User Hydrant Installation infrastructure operate on an open access basis and that this should be a condition of any future privatisation.

DRAFT RECOMMENDATION 8.2 INTRODUCING A JET FUEL SUPPLY COORDINATION FORUM

The Minister for Infrastructure should recommend a jet fuel supply coordination forum be incorporated into the master planning process at each monitored airport. The forum should be tasked with discussing, among other things:

- capacity constraints and any potential pressure points
- linkages between infrastructure
- demand forecasts and security of supply
- future infrastructure requirements and investment planning.

Reform directions

INFORMATION REQUEST 10.1

The Commission invites evidence about anticompetitive clauses in commercial agreements between airports, airlines, landside operators and other airport users.

DRAFT RECOMMENDATION 10.1 **PREVENTING ANTICOMPETITIVE CONTRACT PROVISIONS**

The Australian Government should amend the *Aeronautical Pricing Principles* to specify that any agreement between an airport and an airport user must not contain anticompetitive clauses. This includes clauses that would constrain that user's access to regulatory remedies for the exercise of market power or that directly or indirectly reference the terms being offered to users' competitive rivals.

DRAFT RECOMMENDATION 10.2 **FUTURE PRODUCTIVITY COMMISSION REVIEWS**

The Australian Government should request the Productivity Commission to inquire into the regulation of airports in 2024, to determine the effectiveness of the regulatory regime in achieving the following objectives:

- promoting the economically efficient operation of, and timely investment in, airports and related industries
- minimising unnecessary compliance costs
- facilitating commercially negotiated outcomes in airport operations.

In requesting the inquiry, the Australian Government should also ask the Commission to consider whether:

- any airports should be added to, or removed from, the list of monitored airports
- there is a continued need for arrangements to help facilitate access for airlines that provide flights to regional New South Wales.

The Australian Government should stipulate in the terms of reference for that inquiry that, on request, the monitored airports should make their agreements with airport users available to the Productivity Commission on a commercial-in-confidence basis.

DRAFT RECOMMENDATION 10.3 **DISCONTINUE SECOND-TIER AIRPORT MONITORING**

The Australian Government should issue a statement that the voluntary self-reporting system for second-tier airports is discontinued.

DRAFT RECOMMENDATION 10.4 MORE DETAILED INFORMATION ON AIRPORT PERFORMANCE

The Australian Government should amend part 7 of the Airports Regulations 1997 such that, in addition to current requirements, monitored airports are required to provide to the Australian Competition and Consumer Commission (ACCC), for each financial year, statements that:

- show the number of passengers that depart from and arrive at each terminal
- separately show the costs and revenues in relation to the provision and use of aeronautical services for domestic flights and for international flights
- for Sydney Airport, also show the costs and revenues in relation to the provision and use of aeronautical services for flights to regional New South Wales
- separately show the number of users, costs and revenues in relation to the provision and use of at-terminal and at-distance car parking and the utilisation rates for each type of parking
- separately show the number of vehicles that use landside access services, charges and other terms of access for each landside service, and the operating costs and revenues in relation to the provision and use of the various landside access services, such as services for shuttle buses, taxis and hire cars
- report all costs on the basis that they are specific to a service or common across more than one service (stating the relevant services). In addition, airports should report costs on an allocated basis and should clearly set out the methodologies used for allocating the costs to international and domestic aeronautical services; at-terminal and at-distance parking; and landside access services.

The ACCC should continue to publish annual monitoring reports. It should audit and publish a database of the information the airports provide. The ACCC should publish the methodologies the monitored airports use to allocate costs across different services.

DRAFT RECOMMENDATION 10.5 IMPROVING QUALITY OF SERVICE MONITORING

The Australian Competition and Consumer Commission (ACCC) should, within 12 months, provide advice to the Australian Government on an updated set of quality of service indicators, in consultation with airports, airlines and other airport users.

Once the ACCC has developed its recommended list the Australian Government should amend schedule 2 of the Airports Regulations 1997 to codify the updated list of indicators.

DRAFT RECOMMENDATION 10.6 FUNDING FOR REGIONAL AIRPORT INFRASTRUCTURE

The Australian, State and Territory Governments should ensure that:

- an independent analysis of proposed government funding of regional airport infrastructure is completed, and made available for public comment, before funding is committed. The analysis should:
 - assess the economic and financial viability of proposed infrastructure investment
 - assess whether the project is consistent with the long-term strategy of the region and the airport’s master plan
 - quantify the economic benefits delivered and the recipients of those benefits
 - assess users’ (airlines and communities) willingness to pay for the infrastructure
- government-funded investments in airport infrastructure are undertaken using the relevant functional economic region as the basis for decisions, not individual local councils
- any project funded by government is monitored, and an independent evaluation is conducted and published that assesses whether the project outcomes have been achieved.

The Australian, State and Territory Governments should publish the justification for funding an infrastructure project that was not supported by independent analysis.

DRAFT RECOMMENDATION 10.7 ASSET MANAGEMENT AT REGIONAL AIRPORTS

The Australian Government should review the efficacy of the Western Australian Strategic Airport Asset and Financial Management Framework in 2022, in consultation with State, Territory and Local Governments. Pending the findings of that review, the Framework should be adapted and rolled out by governments in other jurisdictions with the objective of providing a template for sound asset management practices and greater transparency when determining airport charges at regional airports.