

26 June 2009



Ms Marlene Tucker
Director – Economic and Legal Policy, Airports Branch
Department of Infrastructure, Transport, Regional Development
and Local Government
GPO Box 594
CANBERRA ACT 2601

Australia Pacific Airports
Melbourne Airport Management
Level 2 International Terminal
Locked Bag 16 Gladstone Park
Victoria 3043 Australia
Telephone: (61 3) 9297 1600
Facsimile: (61 3) 9297 1778
Australia Pacific Airports Corporation Ltd.
ACN 069 775 266

Dear Ms Tucker

Marlene

Quality of Services Discussion Paper – Improving the Passenger Experience

Australia Pacific Airports Corporation (APAC), the controlling entity of both Melbourne and Launceston Airports, welcomes the opportunity to comment on this Discussion Paper. The comments set out in this letter should be seen to represent the views of both airports and the company as a whole.

APAC shares the Government's desire to drive continuous improvement in all aspects of passenger experience at the airports it leases from the Commonwealth. This can be seen in our ongoing investment in both aeronautical and non-aeronautical facilities at both our airports.

We welcome the Discussion Paper's acknowledgement that the quality of the airport experience is in many regards a matter that airport operators have limited control over although we do not believe the wholesale extension of the current quality of service monitoring (QSM) arrangements will address concerns in this regard and that market and other mechanisms are better placed to address the interests of consumers in many areas.

That said, in relation to core aeronautical services, airports are responsible for quality outcomes. When prices notification was removed in 2002, it was clear to us that proper specification of the services we provided to airlines and the level or quality that those services were provided at, would be key features, along with prices, of the commercial arrangements that we were to enter into. We believe that it was as much our approach to quality as anything else that saw Melbourne Airport awarded the prestigious IATA Eagle Award in 2003. We note that since that time, many other Australian airports have followed our lead although this has not been universal and service quality was obviously a concern of the Productivity Commission in its 2007 report.

We also accept that in those areas of ground access where airports possess substantial market power (such as short term car parking adjacent to terminals) there is a legitimate role for QSM to supplement price monitoring.

We set out our views on each of the issues raised in the Discussion Paper in some more detail below.



Underlying rationale for QSM and its relationship to policy

The Discussion Paper and the report prepared by Booz and Company for the Department both correctly identify the potential for price regulated firms to pursue quality degradation as a profit maximising strategy. Given that the concept of quality is somewhat more difficult to define in relation to airport services, than say electricity or gas, and that the quality preferences and range of outcomes is much less homogenous, this poses a particular challenge in relation to airport services.

It is important to understand that the incentive to degrade quality is created by the presence of price controls of some form even price monitoring. If a firm has a limit imposed on its pricing behaviour over a fixed period, then the only two strategies it has available to enhance profit is to expand output or reduce cost. Whilst price control regimes are specifically designed to encourage firms to reduce cost through productivity enhancement, quality reduction is another source of potential cost savings.

However quality degradation is only a short run strategy as the costs that are saved by the firm will generally be passed onto users when prices are reset. As such, service quality issues will typically be found where operating costs are relatively high with respect to capital costs and effects will not impact on the throughput of the airport (in other words will not reduce revenue in the short run).

Whilst it is acknowledged that capacity shortages do affect customer experiences, the ability of airports to reduce costs in the short run in this regard are limited. This type of behaviour is readily identifiable at price resets and regulators have a range of well tested mechanisms to ensure that capacity is provided under such regimes.

An illustration of this distinction in quality effects can be found in the recent decision in relation to charges at Stansted Airport by UK Civil Aviation Authority (CAA). General airport capacity is very tight at Stansted and proposals are in place to develop new terminals and potentially a new runway. At the same time, as a result of both increased throughput and a heightened security environment, there has been a substantial degradation in security processing quality. The general capacity issues have been dealt with via a rigorous examination of the airport's capital program as it is acknowledged that the solution to this problem is a long term one. On the other hand, the solution to security screening quality involves relatively little capital (most of which is in short lived assets) but substantial management attention, better processes and potentially more labour with the quality being measured by QSM. If security QSM results do not meet the standards set by the CAA, 1.5% of the airport's aeronautical revenue is put at risk. Similar arrangements are in place for other terminal related quality issues. QSM however is not used for issues such as runway or apron capacity.

Whilst Australia has elected to avoid the problems arising from unnecessary price regulation that has plagued the London's three largest airports in preference for a monitoring and contractual framework, it seems that the CAA's approach to what areas of quality should be built into its price control formula is a very useful guide to the extent that QSM should be applied to services provided by Australian airports. As matters stand today, the extent of QSM at major Australia airports is quite similar to the required by the CAA and we see no compelling case to extend these. That said it is the case that in our contractual arrangements, we have incorporated, at the request of our airline customers, a number of measures (mainly relating to baggage system efficiency) that are not covered by ACCC monitoring.

It is valid to note that the capacity and capital expenditure monitoring performed by a regulator such as the CAA is not undertaken in Australia. However, there are three mechanisms by which capacity and development is assessed in Australia. The first is a public process through the airport master planning process. This in our view is the primary avenue by which the government and the community can achieve satisfaction that an airport has plans in place to deliver the aviation capacity the community needs and we do accept that reforms may be needed provide more confidence in this process.

The second is the contractual processes between airports and airlines. This process ensures that there is a sound commercial basis for the investments that airports are making and refines the capacity delivery timetable. The ongoing consultation process built into most of these agreements ensures these are no five-year "set and forget" arrangements but rather form part of an ongoing dialogue between airports and airlines.

The third mechanism is the periodic reviews conducted by the Productivity Commission. These allow all interested parties to make submissions and give evidence that is publicly tested not only about prices but about quality and investment. From these inquiries have come suggestions to reform arrangements to encourage better long term capacity and quality outcomes that rise above the limited analysis often associated with the release of the annual ACCC reports.

In summary, it is our view that QSM best deals with those issues that are typically addressed by operating arrangements and small amounts of investment whilst capacity related issues involving large capital expenditures are better dealt with in a long term pricing and planning context.

Comparisons of airport quality outcomes

The Discussion Paper is confused when it suggests that the QSM results published by the ACCC are directly comparable across airports (page 5). Indeed it says as much when it acknowledges that a wide range of factors come into play when assessing quality at airports and these vary over time at each airport and too much emphasis should not be placed on raw rankings alone (page 6).

Quality at any given airport at any given time will depend on a range of issues including but by no means limited to:

- the age and level of utilisation of assets;
- the geographic, engineering and environmental feasibility of capacity and quality improvements;
- the impact of government policy in areas such as customs, security and quarantine;
- the extent to which the airport is undergoing development at the time; and
- the cost associated with quality and capacity improvements and the preparedness of airlines to pay for improvements given the product preferences of their customers and the capacity of the market to pay.

We would suggest that at any given time, some or all of these conditions will be profoundly different at each of Australia major airports. As such, year on year comparisons between airports are to a large extent meaningless.

However, in a way that is not dissimilar to price monitoring, looking at longer term trends in quality over the capacity cycle should enable a view to be formed as to whether quality is being maintained and as such we do consider QSM is an important part of the monitoring framework when viewed in this way.

To the extent that views can be formed about differences in measured quality between airports overtime, putting aside statistical issues, this may simply reflect the persistence of a number of the factors outlined above. A similar observation can also be made to some extent about persistent difference in airport prices.

What services should be monitored

The Discussion Paper raises a number of areas which Government might extend QSM to and that the ACCC might be a suitable agency to monitor. The ACCC is a competent economic regulator and to the extent that QSM is part of the Government's economic regulation framework for airports (be it a monitoring regime or some other approach) it is appropriate for the ACCC to undertake this function.

However, a significant number of the issues raised in the Discussion Paper, and indeed in the Booz and Co report, as potential areas for the application of QSM do not relate to market failure. Rather they relate to compliance with other legal requirements or policy objectives not of an economic nature. In these circumstances, the ACCC is not an appropriate monitoring agency and in most cases QSM is an inappropriate policy tool and in some no policy action is required. As discussed above, even where there are legitimate quality concerns, QSM may not necessarily be the best policy tool to address them.

We address each of the possible QSM areas raised in the Discussion Paper below.

Disability access

APAC supports the Government's desire to improve access to aviation services for people with disability and commends Minister Albanese and Parliamentary Secretary Shorten for establishing the Aviation Access Working Group (AAWG). APAC, through the Australia Airports Association, will continue to support the work of the AAWG.

We do not believe that QSM by the ACCC is the best way to improve access to aviation services for disabled people as issues regarding disability access are not predominantly issues about market power or consumer protection. The issues confronting the aviation industry in this regard are similar to those faced by other transport modes and best addressed as part of the wider transport policy agendas. To the extent that a regulator is required the Australia Human Rights Commission seems more appropriate as it is the agency responsible for the *Disability Discrimination Act 1992*.

The issues involved are complex involving operational activities of airlines and facilities design issues for terminal operators. The latter in particular will exhibit quite specific locational issues, especially in relation to the retro-fitting of existing facilities some of which are now almost forty years old. Whilst some standards exist in building codes, we would support the development of a more detailed set of industry wide expectations and guidelines and believe that the AAWG is an appropriate body to undertake such work. Once these were established, it would be reasonable for the Government to expect an implementation group at each major airport to be established to attend to their

implementation and set out a program of continuous improvement. We would expect that implementation group to include the airport, government agencies, airlines and disability group representatives.

Surface access

As is the case in many other countries around the world, the road infrastructure supporting Australia's airports is becoming increasingly congested. Surface access issues do not develop over short periods of time nor are a result of short run profit maximising adopted by airports and as such are not appropriate issues to be dealt with by QSM by the ACCC. Rather they are the result of complex interactions between the development of the airport and the spacial development of the city concerned and the transport and planning responses of state and local governments to these developments.

The Discussion Paper asserts that non-aeronautical developments can contribute to high levels on congestion on arterial roads around the airport. We would be interested to understand what analysis the Department has undertaken to reach this conclusion and in particular what data and methodology it has used to separate the impacts of this type of traffic from the impact of aeronautical related traffic and traffic associated with non-airport activities.

We would make one further point very clear in relation to road infrastructure funding. We do not use revenues from our non-aeronautical businesses to subsidise our aeronautical business. This is a fallacy that the Department and other industry participants (including some who represent airports) continue to perpetuate. In relation to road infrastructure as part of our discussions with our airline customers, and in some cases as part of other commercial agreements, we allocate road costs according to their use. The costs associated with road infrastructure attributable to the provision of aeronautical services are fully recovered (including our normal aeronautical return of capital consistent with the principles established by the ACCC between 1997 and 2002) by our aeronautical charges.

Limiting QSM monitoring to roads owned by the airport would be problematic as it is unlikely people surveyed would know where the airport roads start and end and congestion on airport roads may be a result of infrastructure problems off airport – it would be undesirable to fuel any sort of "blame game" between road infrastructure survivors.

We expressed the view in our submission to the National Aviation Policy Issues Paper that that master planning arrangements contained within the *Airports Act 1996* should be strengthened by the inclusion of a requirement for airports to develop a Surface Access Strategy in consultation with relevant state and local government authorities. If this or a similar approach is adopted for airport master planning, accompanied by better liaison between airports and state and local authorities as contemplated by the National Aviation Policy Green Paper, then annual QSM in relation to these issues will contribute little but additional compliance costs. The community will be consulted every five years on these issues and rather than be provided with what will inevitably be partial and potentially confusing data. Annual QSM results can be affected by one off events such as major roads works.

More importantly by leaving these issues to be the subject of the master planning process, not only will the community and stakeholders be consulted on the problem but they will also be consulted on the solutions jointly arrived at by the airport and the relevant state and local authorities not only in relation to road provision but also the ongoing development of integrated public transport solutions.

Given the level of community concern about car parking, it is appropriate for the current QSM arrangements to continue until the next schedule review by the Productivity Commission so quality issues can be properly examined in concert with issues of price.

As acknowledged in the ACCC's 2007-08 Monitoring Report, there are significant variations in the configuration of car parks at major airports and in this area more than any other, care must be taken in making comparisons between airports in terms of both price and quality. Variations in the reported quality measure at individual airports overtime seem to reflect little more statistical variation and movements in available capacity but more over, result always exceed satisfactory. As such there seems to be no substantial issue with regard to quality that needs dealing with at this time in terms of the matters currently monitored.

The Discussion Paper raises a number of other surface access issues. Extension to include airport road signage may be appropriate. Whilst we do not consider airports can be held responsible for the supply or quality of taxi services, they are responsible for the quality of the service provided at the terminal kerb – this issue is dealt with under current arrangements and as far as we can see is adequate.

Terminal services

The Discussion Paper invites comments about quality measures for a range of services provided in terminals. Of those listed public information services, check-in and baggage services, baggage trolleys, washrooms, and security processes are dealt with under current arrangements which we consider to be generally adequate. Issues relating to disability access are dealt with above and general complaint mechanisms are dealt with below.

It should be noted that in its agreements with airlines Melbourne Airport has developed further quality measures in relation to international baggage system performance in recognition of the fact that this is an area where the quality of the airports performance can directly impact on the on-time departure performance of airlines.

Melbourne and Adelaide Airports by virtue of having their domestic and international terminals under one roof provide the best infrastructure solutions at Australia airports for passengers transferring between international and domestic flights. At other airports, the transfer experience is much more dependent upon staff and other services such as connecting train and bus services. Given these very different arrangements, QSM of this activity will not provide meaningful benchmarking and it will be very difficult to unbundle the quality impacts of the various service components. Further, given that the extent of transferring passengers is relatively small, and it is very difficult to identify them, it is difficult to see how statistically robust samples could be constructed. It seems more likely that competition between airlines and between airports to attract transfer traffic will lead to quality improvements than QSM that could not be expected to deliver useful data.

The travelling public generally have no interaction with airport staff other than their security staff which is currently covered by QSM. The limited extent of interaction with other airport staff would render any survey based QSM statistically irrelevant. Check-in and boarding are a matter for airline staff or the airlines agents and is part of overall product offering of the airline. We neither seek to be involved in this area of competitive interaction nor believe that monitoring other than the consumption decisions of the travelling public should

be applied. As such we do not believe QSM should be applied to the activities of airline staff or their agents.

The other major human interaction of international passengers is with the customs and quarantine services. Quality outcomes in these areas currently at best lack transparency to the public and at worst are non-existent. This is despite the fact that at Melbourne Airport international passengers pay more in departure tax than airlines pay in airport charges. As an outcome in the National Aviation Policy, the Government should direct the Australian Customs Service and the Australian Quarantine and Inspection Service to consult with the Department, the ACCC, airlines and airports on the development of a comprehensive suite of QSM measures. Data collection should commence on 1 July 2010 with the results being published by the ACCC at the same time it publishes airport reports for the 2010-11 financial year. The data should be on an airport by airport basis and cover those airports with international services subject to QSM.

We find it extraordinary that the Department would suggest QSM should be extended to food and beverage offerings and banking and foreign exchange. Putting aside the methodological issues (presumably for data to be meaningful each outlet would need surveying), these services are provided in competitive circumstances and the extent to which they are consumed is at the absolute discretion of the consumer. Take the example of foreign exchange. A person travelling to or from Australia can purchase foreign exchange at any bank or foreign exchange dealer in their country of origin, destination or intermediate points and those located at airports (be they in Australia or elsewhere) make up a very small proportion of such outlets. Further, cash can in most countries be obtained from automatic teller machines and debited from credit and cash accounts and increasingly travellers are using non-cash based forms of payment. QSM applied in this area would be nothing more than red tape and an unnecessary cost burden on airport operators.

Airside services and Airport capacity

Airports are required to comply with the Aerodrome Manual of Standards (the MOS) issued by CASA that is developed consistent with standards and guidance issued by ICAO. The MOS covers a wide range of aerodrome design criteria and standards and addresses at length a wide range of issues include the design and locations of roads and airfield and apron lighting. These issues are the subject of ongoing dialogue between airports and CASA. New developments need approval of CASA and where appropriate Airservices Australia must also be consulted. We do not consider QSM is an appropriate tool for dealing with safety compliance and further that its application will do nothing but add to costs, produce data that is difficult to interpret and may potentially jeopardise safety outcomes by confusing regulatory processes that are properly the domain of CASA.

Subject to compliance with relevant standards, airfield quality outcomes will in the vast bulk of cases be the result of capacity utilisation and as such, are best addressed by the same tools used to ensure adequate capacity is provided for airport users. Further, this is largely an issue that needs to be addressed by airports in consultation with airlines that are best placed to assess capacity requirements and balance the capital costs of new capacity against the costs of congestion. The Board of Airline Representative has acknowledged that the current contractual arrangements ensure that as a general rule capacity is being delivered as airlines require it.

It is fair to say that the ACCC has for many years struggled to develop meaningful capacity indicators and that those which are now in place provide only a partial view. We do not

agree with the proposition advanced in the Discussion Paper that the master planning framework is not sufficient for assessing future capacity needs, or at least that QSM will enhance the situation. Other than in isolated incidences such as those related to the mining boom in Western Australia airports and airlines have succeeded in anticipating future capacity needs.

Capacity issues are planning issues. Neither the Discussion Paper nor any other document we are aware of in the public domain suggests that in Australia they are a market power issue. We have made a number of suggestions in our submissions to both the National Aviation Policy Issues Paper and Green Paper relating to improvements that could be made to the master planning process. Strengthen the consultation provisions of the planning framework will improve transparency and community engagement. These, coupled with the ongoing dialogue between airports, airlines and Airservices Australia in our mind offers the best route to ensuring that capacity is delivered when required. QSM beyond what is in place will add little and may actually detract from the process by causing a distraction.

Moreover, it is a process not just designed to identify a problem but also its solution, solution which in many cases involve the expenditure of tens if not hundreds of millions of dollars and take a number of years in the implementation. This can be seen from the successful augmentation of international terminal capacity at Melbourne Airport. These successful airline-airport processes are being reinforced by the increasingly effective engagement of Airservices Australia in the area of runway and terminal airspace capacity measurement.

Who should be monitored?

Given our view that QSM should be applied as part of an economic regulatory framework, it should only be applied where there is a legitimate view that there is potential for abuse of market power. As such it follows that where the Government decides it is appropriate to apply price monitoring to aeronautical services, it should also apply QSM. As indicated in our submission to the National Aviation Policy Issues Paper, and consistent with the advice of the Productivity Commission, we do not see a case for the application of price monitoring beyond those airports currently monitored and therefore we do not see a case for an extension of the current QSM framework to other airports at this time. That said, if circumstances did develop where price monitoring was justified at other airports, the QSM arrangements prevailing at that time should also be applied.

The Discussion Paper rightly identifies that terminal services at some airports are provided by airlines and asks should these services be subject to QSM in the same way as terminals operated by airports. At the moment it is our understanding that Qantas provides domestic terminal services (under a lease from the airport concerned) at a range of locations (including Melbourne and Launceston Airports) and Virgin Blue operates a domestic terminal at Brisbane Airport under similar arrangements. All other domestic and all international terminals are provided under multi-user commercial arrangements and where airlines operate domestic terminals, there is at least one airport operated terminal available to other airlines.

It is our experience that domestic travellers closely associate the quality of terminal experience with the airline they are travelling with. As such, given domestic services in Australia are provided in a relatively competitive market, QSM in those terminals operated

by airlines would not seem to be addressing any market failure issues. Passengers unhappy with service quality have the option of bringing their concerns directly to the airline or alternatively choosing another carrier who provides a more attractive price-service offering.

It is fair to say in those circumstances where an airline is the dominant but not necessarily sole user of a terminal operated by an airport, passengers also tend to identify that terminal with the dominant carrier. This is the case with Terminal 3 at Melbourne Airport used by Virgin Blue. In these cases, the need for QSM is less as the dominant airline concerned has a clear incentive to ensure that the quality of service in the terminal is consistent with its overall brand and value proposition. At our airports, and we understand generally throughout Australia, airlines in this position have been able to use the contractual arrangements that now underpin the provision of aeronautical services to achieve such outcomes. We are not suggesting that QSM should be removed in these cases immediately but rather should be a matter addressed in the next scheduled Productivity Commission review so that a greater body of evidence can be assembled and the issue can be considered within the general context of the regime as a whole.

The Discussion Paper seems to contemplate airlines (particularly LCCs) may in the future seek to develop their own terminals at airports. We consider this to be sufficiently unlikely for it not to be a consideration in determining policy. There is virtually no experience of this in Europe and is only occasionally mentioned with respect to Stansted Airport where airlines have had profound difficulties with congestion, the conduct of BAA and the perverse incentive created by the UK regulatory system that have been reported by Booz and Co. LCCs have a clear preference of deploying their scarce capital on aircraft and brand development and in avoiding sunk costs associated with the ownership of terminals and other facilities such as maintenance bases. Further given the relatively small scale that LCCs, and indeed all new airlines, enter markets, it is unlikely that they would be able to justify the investment and the risk associated with the development of even a modest terminal even if terminal capacity was not available at the airport concerned, as was the case at Sydney and Melbourne Airports when Virgin Blue entered the market. Their likely strategy is to ask the airport to develop such a facility for them.

Other consumer protection issues

Most Australia airports currently provide a substantial amount of information via their websites on such a diverse range of issues as airline arrival and departure time, surface access arrangements, retail opportunities and safety, security and quarantine arrangements. Whilst this information varies from airport to airport, in part reflecting the airport's size but also the particular needs of its passengers, given such arrangements are generally in place, regulation in this regard does not seem necessary.

Since taking over operation of Melbourne Airport from the FAC, we have supplemented our QSM (which goes beyond that required to meet our regulatory requirements) with have provided customer comment cards in those terminal we operate and for a number of years have provided a similar facility on the Melbourne Airport website. Individual comments are monitored and responded to and an analysis of the issues raised and any trends reported to the Executive and the Board on a regular basis. Again, we understand that similar arrangements are in place at other major Australian airports.

In our response to the National Aviation Green we expressed the view that the mechanisms that airports use (or will use) for community engagement are not appropriate

forums for dealing with commercial issues and in our view this logically extends to consumer protection issues. Whilst such bodies are appropriate for dealing with the concerns the community has about the development of the airport and its impacts, they would not be competent in dealing with consumer protection issues, especially where these involve airlines.

The Discussion Paper acknowledges, as have the ACCC and the Productivity Commission on various occasions, that the passenger quality experience is a complex interaction of a range of services provided by airports and other organisations involving facilities, staff and systems. If an organisation was to be established to deal with such issues, it would need to have a broad remit, be able to investigate the conduct of not only airports and airlines (and their agents and contractor) but also government agencies. It would seem reasonable that if the Commonwealth was to go to the effort and expense of establishing such a body its remit should also extend to the services provided in-flight as well.

That said, nowhere in the Discussion Paper is there an analysis set out as to the extent of any systematic policy failures in this regard nor is there an analysis why aviation should be treated any differently to other areas of the economy in relation to consumer protection. Such an organisation would require significant resources and these would either have to be found from general Commonwealth revenues or more likely, given the current fiscal challenge, from the aviation industry (and ultimately travellers) themselves. This would add cost to the industry at a time when it is most challenged and when the Commonwealth cannot even justify the current level of industry taxation represented by the Departure Tax.

We strongly doubt that if the Department was to produce an analysis of the costs and benefits of such a new regulator that it could demonstrate such an approach was consistent with the Government's laudable commitment to reduce red tape. That said we would look forward to working with the Department and others in developing such an analysis in a robust and transparent way.

If you wish to discuss any issues in relation to this matter please don't hesitate to contact me on 03 9297 1804.

Yours sincerely



Carly Phillips
Corporate and Public Affairs Manager

