

## CHAPTER TEN



### Economic regulation of airports



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### POLICY GOAL

Incentives to invest in Australia's airport infrastructure are balanced with fair pricing and transparency.

### BACKGROUND

Australia's airports are a major component of the national transport infrastructure and make a significant contribution to Australia's overall economic prosperity. Continued investment in aeronautical infrastructure is a key objective of the Australian Government. At the same time, airports have significant market power and this is an important factor in determining the most appropriate economic regulatory regime.

There is also a need to ensure that the aviation industry generally, and Australian airports specifically, continue to provide access to national and international services and infrastructure that meet the broad range of passenger needs and expectations.

Airports are, within their relative geographic markets, natural monopolies, and it is important to prevent abuse of market power through excessive pricing. To this end, in 1997 and 1998, following the privatisation of the airports formerly managed by the Federal Airports Corporation, the former Government implemented a prices oversight regime for the Phase I<sup>33</sup> and Phase II<sup>34</sup> privatised airports, and Sydney Airport (which was corporatised in 1998 but not sold until 2002), consisting of:

- > price notification for aeronautical services;
- > a Consumer Price Index (CPI) minus X price cap on aeronautical services;
- > price monitoring of certain aeronautical-related services; and
- > cost pass-through provisions for necessary new investment and government-mandated security services.

The airports subject to price oversight were also subjected to quality of service monitoring to ensure airport assets were not allowed to rundown at the expense of service standards.

Based on the findings of a 2002 Productivity Commission inquiry, a more light-handed regulation of airports was introduced in place of price caps and price notification of aeronautical services. A regime comprising aeronautical pricing principles, commercial pricing negotiations between the airports and their airline customers, and price monitoring of both aeronautical and aeronautical related services was implemented at Adelaide, Brisbane, Canberra, Darwin, Melbourne, Perth and Sydney airports. Quality of service monitoring of the seven airports was also continued.

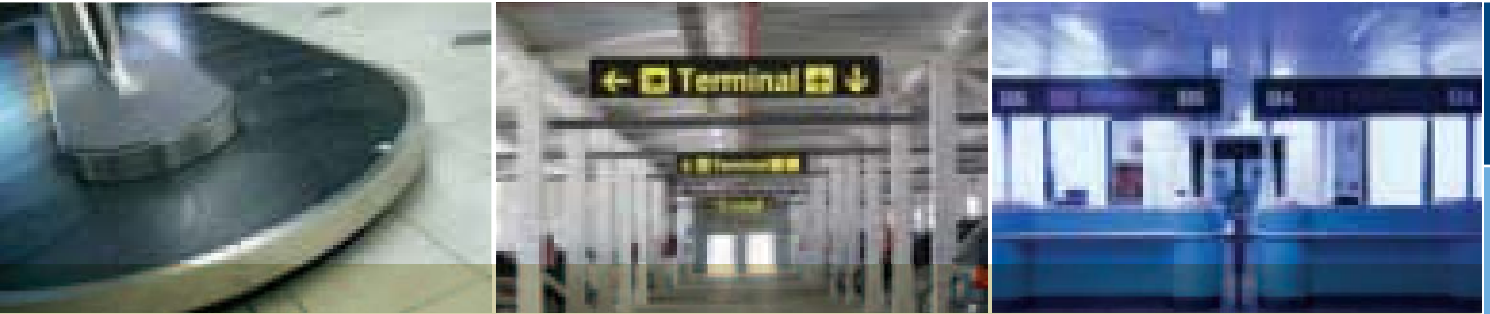
Under the light-handed regime, the seven designated airports are required to provide annual financial statements in relation to the provision of aeronautical services and non-aeronautical services separately to the Australian Competition and Consumer Commission (ACCC). The airports were also required to report costs, revenues and profits relating to the supply of aeronautical and aeronautical-related services to the ACCC. This approach has broadly continued following a further review by the Productivity Commission in 2006, with the designated airports being reduced to five with the exclusion of Canberra and Darwin from the monitoring scheme.

In 2008 the Government expanded the range of services monitored by the ACCC to include car parking costs and revenue at the five major airports. The Government was concerned to ensure that airports do not use their monopoly position to exploit the travelling public and that greater transparency and accountability for car parking costs was available to the public.

This approach to airport regulation has provided scope for airports to price, invest and operate efficiently while price monitoring allows the Government and the community to scrutinise prices and market outcomes and to provide evidence of unjustifiable price increases were this to occur.

<sup>33</sup> Brisbane, Melbourne and Perth Airports

<sup>34</sup> Adelaide, Alice Springs, Canberra, Gold Coast (Coolangatta), Darwin, Hobart, Launceston and, Townsville



The Aviation Green Paper outlined a number of proposals the Government was considering to ensure an airport pricing regime that limits the misuse of airports' pricing power, encourages investment and provides passengers and airlines with more information to make better informed decisions.

### POLICY ISSUES

#### Current system of economic regulation

The Government recognises that a degree of regulation is required to minimise the potential misuse by airports of their market power, the capacity for airports to provide services below community expectations or to neglect the maintenance of essential national infrastructure.

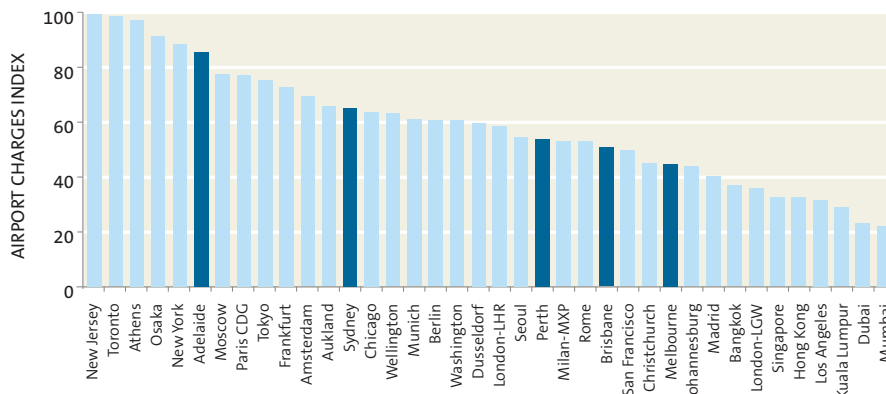
The purpose of the current ACCC price monitoring regime is to provide stakeholders with transparent information on airport prices and profits. This assists airlines to negotiate more effectively with airports on airport access charges and allows the Government to determine if further investigation into an airport's pricing behaviour is required under the *Trade Practices Act 1974*.

The 2006 Productivity Commission review into the price regulation of airport services found that "price outcomes to date do not appear to have been excessive."<sup>35</sup> The review also found that under the current price monitoring regime, productivity performance has been high by international standards.

Figure 10.1 shows prices charged by Australian airports relative to international comparisons.<sup>36</sup>

**Figure 10.1:** Comparison of airport charges between Australian and international airports

Source: Productivity Commission, Review of Price Regulation of Airports Services, 2006.



35 Productivity Commission, Review of Price Regulation of Airport Services, 2007

36 PC (2007, p.xvii)

This review also found that the price monitoring regime and the absence of price controls had made it “easier for airports to undertake the investment necessary to sustain and enhance airport services in the face of growing demand for air travel.” Further, price monitoring “has made it easier for airports and airlines to agree on what new investment is required and the charges necessary to pay for it.” This system has also facilitated commercial relationships more generally and focused airport decisions on the needs of the consumer.

The Green Paper proposed the continuation of the price monitoring regime until at least 2013, allowing a review to be undertaken in 2012. In the main, submissions to the Green Paper were not opposed to the continuation of price monitoring.

The Government recognises that regulatory stability is important for airports as they make long-term investment decisions. It will continue with price monitoring – including in relation to car parking – at the five major airports, as the basis for economic regulation. A full review of Australia’s airport economic regulatory regime will be undertaken by the Productivity Commission in 2012.

### National Access Regime

In addition to price monitoring, third party access regulation applies to nationally significant airports in certain circumstances.

The National Access Regime in Part IIIA of the Trade Practices Act allows third parties to seek access to certain nationally significant infrastructure services, on reasonable terms and conditions.

The National Access Regime is not designed to replace commercial negotiations between facility owners and access seekers. Rather, it seeks to enhance incentives for negotiation and provide a means of access on reasonable terms and conditions if negotiations fail.

Airside services at Sydney Airport are currently declared under the National Access Regime. The Government is encouraged that, following declaration, Virgin Blue and Sydney Airport Corporation were able to negotiate a commercial outcome prior to a final arbitration determination being imposed by the Australian Competition and Consumer Commission.

In November 2009 the Government introduced a reform package into Parliament to improve regulatory certainty and streamline administrative processes under the National Access Regime.

### Quality of service monitoring

Any effective price monitoring regime needs to be accompanied by a quality of service monitoring regime to enable the Government, passengers and airlines to better understand the relationship between pricing and investment decisions.

As part of the current price monitoring regime, the ACCC monitors the quality of certain aspects of airport services and facilities.

The ACCC considers that the objectives of quality of service monitoring are to:

- > assist in the assessment of an airport operator’s conduct in a prices monitoring environment; and
- > improve the transparency of airport performance to:
  - discourage airport operators from deteriorating standards for services that are associated with significant market power;
  - provide information to users of airport facilities, including passengers and the aviation industry, as a basis for improved consultation and negotiation on pricing and investment proposals; and
  - assist the Government in its industry analysis.

The ACCC recognises the need to minimise the cost of compliance for airport operators and monitoring is an incentive for airport operators to maintain appropriate levels of service, particularly as results across airports are directly comparable through the ACCC's annual airport monitoring reports. It is also an important vehicle for tracking investment in important aeronautical infrastructure. ACCC reports show that the quality of service at monitored airports has been relatively stable, despite increased pressure on facilities due to the growth in passenger numbers in recent years.

In March 2009 the Government released a Discussion Paper on *Improving the passenger experience: quality of service monitoring of airports* to consult on how to improve the current quality of service monitoring arrangements to make these more meaningful to passengers and other airport users.

The Discussion Paper sought comment on whether the quality of service framework should include:

- > airline operated terminals;
- > access to and from an airport and aspects of car parking;
- > disability services;
- > availability of banking and foreign exchange facilities;
- > availability of eating places; and
- > proximity to car hire and shuttle bus services.

The Discussion Paper also sought comments on how best to monitor capacity constraints and their potential impact at airports. The Discussion Paper was designed to elicit comments from the travelling public on their views of Australia's airports and to move the quality of service debate into a broader arena.

In response to the Discussion Paper airports argued that quality of service monitoring should be applied only as an economic regulatory tool and not extend beyond the airport price monitoring regime administered by the ACCC. Airports also argued that it would be inappropriate for airports to be held accountable for the quality of services provided by third parties over whom they had no control, such as airlines, eating places and other ancillary services provided by commercial sub-tenants.

Airline submissions generally supported current quality of service arrangements but some argued that financial incentives to maintain quality should be imposed. Alternatively, airline stakeholders argued formal service level agreements should be established between airlines and airports, informed by quality of service reporting.

Responses to the Discussion Paper were unresponsive to the proposal that ancillary services such as eating places and banking and foreign exchange facilities might be included in a quality of service monitoring regime. The Government will not proceed with any monitoring of these facilities.

However, the quality of the service offered at passenger terminals is a major component of the passenger experience and should be monitored. Most passenger terminals are operated by airports and are currently included in quality of service monitoring regime, but a small number of airport terminals are operated by individual airlines. Leases to these terminals have pre-dated the sale of the airport lease to private operators and have been excluded from price and quality of service monitoring to date.

The Government recognises the limited control airport lessees have over these particular domestic terminal leases. However, to the passengers travelling through these terminals, the quality of service they experience is what is relevant, not the historic lease arrangements between the airports and the airlines. The Government considers this is an area where the industry should provide a coordinated response through self-reporting. The Government will be encouraging relevant airlines and airports to work together to ensure these terminals are covered in the expanded quality of service monitoring regime being developed by the industry.

The Discussion Paper also considered the issue of how best to address the monitoring of overall airport capacity constraints. Having regard to the timing involved in planning new airport infrastructure capacity, the Government considers that monitoring the adequacy of airport capacity is best addressed through the existing Master Planning process rather than through a quality of service monitoring scheme. The Master Planning process enables airport users to comment on the adequacy of the airport's strategy to manage increased capacity and airports are required to give due regard to these comments.

### Extending the benefits of economic regulation

The current price monitoring scheme has provided benefits to airports, passengers and airlines. The Productivity Commission has concluded that prices charged by major Australian airports are reasonable by international standards and investment at airports has been tailored to the needs of airport users to improve the quality of service afforded to passengers. For example, Australian airports were amongst the earliest in the world to be ready for the new-generation high capacity A380 aircraft.

However as more than 30 per cent of domestic passenger aircraft movements involve airports outside the ACCC price monitoring scheme<sup>37</sup>, the Australian Government considers it is in the public interest to adopt some form of monitoring beyond the five airports currently being monitored by the ACCC.

In the Green Paper the Government proposed to examine options to reintroduce a level of price monitoring at Canberra and Darwin airports. The Government also committed to investigate options for a tiered approach to economic regulation which would apply an appropriate level of monitoring and reporting requirements to airports with lesser market power than the five major airports.

Many stakeholders supported the extension of a form of price monitoring beyond Adelaide, Brisbane, Melbourne, Perth and Sydney airports, but suggested that as other leased federal airports serviced smaller passenger volumes and were not major international gateways, these other airports did not have the same degree of market power and hence did not require a price monitoring scheme as comprehensive as that administered by the ACCC.

The Government considers that the current ACCC price monitoring scheme remains appropriate to monitoring the pricing activities of Australia's five largest airports, which are also Australia's main international gateways.

Most regional airports handle relatively small volumes of passenger traffic, have lower levels of demand than larger airports and are serviced by a limited number of carriers. These characteristics limit their market power and lessen the case for a form of pricing intervention. Nevertheless there are a number of airports whose volume of passengers suggests some form of monitoring could be appropriate. As the following table shows, Gold Coast, Cairns, Canberra, Hobart and Darwin have large passenger volumes and a high level of aircraft movements. Gold Coast and Cairns Airport service significant tourism destinations of high demand, while the other three airports are significant regional gateways. In addition, Canberra Airport experiences relatively high levels of business travellers who are less sensitive to price, and this may reduce competitive pressures to keep prices down. The Government considers that these factors warrant consideration of a supplementary, self-administered monitoring scheme and has been working with the industry to establish such an approach. The Government considers it is in the interests of the travelling public and the industry to increase transparency while being mindful of the need to minimise unnecessary regulatory burdens.

<sup>37</sup> BITRE Domestic Aviation Statistics, September 2009

**Table 10.2:** Australia's busiest RPT airports

Airport	Passengers (million) <sup>38</sup>	Aircraft Movements (thousands)	Car parking prices <sup>39</sup>	
			1 hour short stay	1 day long stay
Sydney	32.4	267.4	\$12	\$25
Melbourne	24.4	184.0	\$12	\$25
Brisbane	18.7	154.1	\$10	\$25
Perth	9.4	77.8	\$5.40	\$17
Adelaide	6.8	73.4	\$4	\$20
Gold Coast	4.6	32.0	\$4	\$16
Cairns	3.7	39.1	\$3	\$14
Canberra	3.1	44.1	\$2.50	\$17
Hobart	1.9	14.3	\$5	\$13
Darwin	1.5	22.2	\$5	\$12

The Government will introduce a second tier for airport monitoring for some of the leased federal airports to participate in a self-administered price and quality of service monitoring and reporting scheme. The Government intends that the self-administered scheme will apply to Canberra, Darwin, Gold Coast and Hobart airports in the first instance. As Cairns Airports is not regulated under the Airports Act, the Australian Government does not have the power to compel Cairns Airport to participate in the scheme. However, Cairns Airport is encouraged to participate in the self-administered scheme.

Under the self-administered scheme, the participating airports will be expected to disclose on their website:

- > prices of aeronautical services;
- > prices of car parking services;
- > various quality of service outcomes; and
- > the airport complaint-handling processes and outcomes.

The Government intends that these airports also publicly disclose results of their customer/passenger satisfaction surveys.

The Government also encourages other airports not covered by the self-administered scheme to conduct customer/passenger satisfaction surveys and publicly disclose the results of these surveys on their websites. These surveys could also include customer/passenger satisfaction of airline-operated terminals as well as common use areas of passenger terminals.

It is expected that surveys will cover a range of areas including, but not limited to, the movement of passengers between international and domestic terminals; the provision of appropriate services and facilities to provide for the mobility impaired; check-in, information systems and baggage handling that assists travellers to be at the gate on time; and the range of retail and financial services for travellers and companions. Information on the airports' complaints handling mechanisms will also assist in building confidence in Australia's airports.

Currently, the Bureau of Infrastructure, Transport and Regional Economics (BITRE) publishes information on activity levels and charges for the five major airports and a number of regional airports in its *Avline* publication. The airports in the second tier of monitoring will also be included in future *Avline* publications.

These measures will extend the benefits of price monitoring and ensure that passengers and airlines using airports outside of the five major national metropolitan centres have more

<sup>38</sup> Traffic Data – BITRE, Airport Traffic Data, www.bitre.gov.au, September 2009

<sup>39</sup> Car parking rates – airport web sites, April 2009

information to make better informed decisions. It will extend elements of the primary monitoring scheme with the objective of maintaining appropriate pricing and encouraging additional investment that improves the quality of service offered by the key airports.

### A 'show cause' mechanism

The ACCC price monitoring regime provides the Government with better information to determine if an airport has engaged in serious pricing misbehaviour. However, this system provides only a limited range of remedies where there is suspicion of an abuse of market power.

The Green Paper proposed the Government consider a 'show cause' process, as recommended by the Productivity Commission, which was to apply if there was prima facie evidence of serious pricing misbehaviour by an airport. A draft 'show cause' guideline was released for stakeholder comment.

Airports have raised concerns that the proposed 'show cause' process might impede their capacity to acquire loan finance because lenders believed that the process introduced uncertainty into the risk environment upon which loans were predicated. Airline representatives considered the 'show cause' process would not necessarily help resolve negotiation disputes with the airports. Both airports and airlines expressed concerns that the 'show cause' assessment would be resource and time intensive to establish and maintain.

In light of the concerns expressed by stakeholders regarding the draft guideline, the Government is not proposing to introduce the annual 'show cause' assessment at this time. The Government is sensitive to any potential impact a show cause assessment could have on airports' ability to attract capital, particularly because of the impact of the global financial crisis on investor confidence and access to finance, now is not the time to introduce this. However, should the ACCC monitoring report or other evidence indicate that an airport warrants further investigation for its pricing behaviour, the Minister retains the discretion to recommend a formal inquiry under the Trade Practices Act.

### Improving passenger engagement

Because not all aspects of airports' services will be included in the ACCC's quality of airport service monitoring role, it is the Government's intention that stakeholders be able to use relevant airport community forums to discuss broader issues relating to airport operations that impact on the passenger experience — for example, issues like road access and traffic management to and from the airport. Airport users will have the opportunity to shape the quality of service that airports provide by commenting on airport master plans and airport major development plans and participating in community consultation groups that will discuss airport planning and development issues.

### Supporting investment in aeronautical infrastructure

At the time of privatisation, financiers were reluctant to provide funding to the major airports unless the Australian Government provided some level of protection in relation to the Government's ability to exercise its step-in rights. The Government agreed to provide that protection by entering into 'tripartite deeds' with the major airports and their senior financiers.

Tripartite deeds effectively supplement the airport head leases by providing certain rights to financiers that would help them protect their position in the event the Commonwealth, as lessor, terminates the airport head lease. The deeds were entered into on the basis that they would operate for only twenty years from the date of the original airport lease.

More recently, a number of major airport operators have made representations to the Government to extend the lifespan of their tripartite deeds. The major airports state that without the extension of the deeds, access to capital will be severely limited as the cost of financing will significantly increase and, in certain circumstances, access to sufficient investment capital may not be possible.

The Government will continue to work with industry to assess this and other potential options for serving the overriding objective of encouraging continued investment in aeronautical infrastructure.

## CONCLUSION

Major airports require an appropriate economic regulatory framework to prevent abuse of market power. The Government is committed to striking a balance between the needs for effective oversight, transparency for all airport users and incentives to invest.

The Government will:

- > continue the existing economic regulatory regime for leased federal airports, including the price and quality of service monitoring regime conducted by the ACCC until at least 2013, with a full review by the Productivity Commission in 2012;
- > continue with the monitoring of car parking prices and revenue at the five major airports, re-established in April 2008;
- > introduce a self-administered price and quality of service monitoring regime for second-tier airports;
- > encourage airports to pro-actively adopt web-based reporting to present a full picture of the quality of experience and charges passengers can expect at their airports; and
- > include the second-tier monitoring system in the 2012 Productivity Commission review to assess the effectiveness of these arrangements.