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## **ACCC submission to the review of demand management at Sydney Airport**

The Australian Competition and Consumer Commission (ACCC) welcomes the opportunity to provide a submission in response to the Department of Infrastructure, Transport, Regional Development and Communications' (the Department) Sydney Airport Demand Management Discussion Paper (the Discussion Paper).

In summary, our submission makes the following key points:

- demand management at Sydney (Kingsford Smith) Airport plays an important role in supporting and encouraging competition in the aviation industry;
- the existing slot management scheme can impede competition by reducing opportunities for new and expanding airlines to compete and enabling inefficient slot use;
- the fundamental objectives of the slot management scheme should be to encourage the efficient utilisation of slots, provide a level of certainty for airline planning while creating opportunities for new and expanding airlines to access slots, and facilitate competition and the competitive process;
- reform to the slot management scheme should centre around updating the legislation to reflect the objectives of the Worldwide Airport Slot Guidelines (WASG), particularly those relating to enhanced competition, and to strengthen compliance monitoring and enforcement to deter airlines from engaging in slot misuse;
- any interim measures implemented during the COVID-19 pandemic recovery period should ensure equitable access to slots for all airlines, where they can demonstrate that those slots will be used efficiently, and support long term competition in the airline industry; and
- while the price notification regime appears to be protecting regional services as intended, there is merit to the recommendation for commercially negotiated agreements to not be subject to ACCC assessment.

## **The ACCC monitors the airline and airport sectors**

The ACCC is an independent Commonwealth statutory body whose role is to administer the *Competition and Consumer Act 2010* (the CCA) and a range of additional legislation promoting competition, fair trading and regulating national infrastructure for the benefit of all Australians. The ACCC promotes compliance with these laws and, where appropriate, takes action against businesses that contravene the law.

The ACCC also has a number of specific roles in relation to the airport and aviation industries:

- Since the Treasurer's direction in June 2020, the ACCC has been monitoring the prices, costs and profits relating to the supply of domestic air passenger transport services and reporting to Government, pursuant to Part VIIA of the CCA. Through this monitoring role, the ACCC seeks to facilitate and protect competition in the domestic air passenger services industry as it recovers from the impacts of COVID-19.
- The ACCC conducts annual price and service quality monitoring of the four major airports (Brisbane, Melbourne, Perth and Sydney) under Part VIIA of the CCA and Part 8 of the *Airports Act 1996*. This includes monitoring the provision of aeronautical and car parking services at those airports.
- The ACCC has a role in assessing proposed price increases by Sydney Airport (for regional air services) and Airservices Australia under the price notification regime contained within Part VIIA of the CCA.

## **Demand management at Sydney Airport plays an important role in supporting competition in the aviation industry**

Sydney Airport is Australia's busiest airport and key international gateway. Managing access to its limited airside capacity therefore has significant implications for the price, quality and choice of flights available to passengers, as well as the broader economy that benefits from domestic and international travel.

A competitive air passenger transport industry is vital to meet the needs of consumers and the economy more broadly, especially for a large country as geographically dispersed as Australia. Access to Sydney Airport is crucial for airlines seeking to compete in the Australian air passenger services market/s, and the constraints on capacity at the airport at peak periods create difficulties for airlines looking to compete.

The ACCC considers that a fundamental objective of any reform to the demand management regime at Sydney Airport should be to ensure that the mechanisms of the regime support and encourage a competitive aviation industry.

## **The slot management scheme should provide all airlines with equitable access to slots**

Slots are an essential input for airlines looking to provide air passenger services. At slot-constrained airports, such as Sydney Airport, access to slots is a key barrier to entry and expansion.

Sydney Airport is slot-constrained during peak hours, making it difficult for airlines to access the slots needed to provide competitive services. It is important that any reform to the slot management scheme ensures equitable access and efficient allocation of slots to airlines, and ultimately supports and encourages a competitive airline industry.

The slot management scheme should provide all airlines with equitable access to slots, regardless of their existing slot holdings, where they can demonstrate that those slots will be

used efficiently. It is important that any measures implemented under the regime have the objective of supporting competition and the competitive process, not individual competitors.

### **Competition can be impeded through inefficient slot allocation and incentives to hoard slots**

Competitive markets ensure better outcomes for consumers including through greater choice, lower prices and better quality products and services. As identified in the Productivity Commission's 2019 report into the economic regulation of airports<sup>1</sup>, the existing legislated slot management scheme can restrict competition.

The ACCC considers that the existing slot management scheme can impede competition in two interrelated ways:

1. Rules allowing airlines to retain slots in perpetuity exacerbate capacity constraints by limiting the opportunities for new or expanding airlines to acquire slots needed to launch new services and compete.
2. Airlines are able to exploit the scheme by acquiring and hoarding slots for strategic reasons, such as to prevent competitors' access to slots, resulting in inefficient slot use and further diminishing opportunities for increased competition.

Under the existing slot management scheme, slots are allocated to airlines through an administrative process on the basis of historical precedence. Historical precedence gives the airline an indefinite right to retain a slot series in subsequent seasons so long as they satisfy the 'use it or lose it' and 'size of aircraft' tests in the previous equivalent scheduling season. While historical precedence provides airlines with certainty around their future slot holdings, which supports the airlines in their network planning, this system tends to reinforce the market power of incumbent airlines and hinders opportunities for future competition by new or expanding airlines.

In recent years, there have been growing concerns within industry that airlines have been able to exploit the slot management scheme to hoard slots and/or use slots inefficiently to maintain their market power and prevent entry or expansion by competitors. The concerns here are twofold: 1. that incumbent airlines lack the incentive to use slots efficiently, and 2. that incumbent airlines may have an interest in exploiting the slot allocation system so as to prevent competitors' access to slots for strategic reasons. As a result, competition between airlines can be reduced, resulting in higher airfares, lower quality service and less choice for consumers.

Under the current system, where slots are allocated to airlines based on historical precedence, airlines do not bear the scarcity value of their slot holdings. Where capacity constraints increase over time, the value of slot holdings also increase, giving the airlines an incentive to retain slots even if they are not being efficiently utilised. Airlines have a further incentive to hold onto slots given that, once relinquished to the slot pool, a competing airline will likely acquire the slot and gain historical precedence. This makes it very difficult for the original airline to re-acquire that slot again in future, reducing the original airline's ability to provide additional services in the long term.

Airlines can exploit the slot management scheme by applying for more slots than they need in order to prevent competitors or potential competitors from accessing those slots. By ensuring that they meet their obligations under the 'use it or lose it' and 'size of aircraft' tests, the airlines can retain historical precedence to those slots in subsequent scheduling seasons even though the slots could potentially be used more efficiently by another airline.

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<sup>1</sup> Productivity Commission, *Economic Regulation of Airports*, Report no. 92, p. 255.

Holding onto slots for the purpose of gaining an anticipated value increase of slot holdings, to entrench market power and/or to restrict competitors' access to slots, can mean that slots are not used efficiently. This results in an overall loss in the productivity of the airport, decreases the value of slots for consumers and inhibits competition in the airline industry.

### **Changes to the slot management scheme should ensure the most efficient use of slots and foster an environment of robust competition**

The ACCC considers that a fundamental objective of any reform to the existing slot management scheme should be to ensure that the allocation of Sydney Airport slots results in the most efficient utilisation of slots and fosters an environment of robust competition between airlines.

As outlined in the Discussion Paper, the legislation governing Sydney Airport's slot management scheme is outdated and does not reflect contemporary worldwide slot management practices. In particular, the scheme has not been updated following recent changes to the Worldwide Slot Guidelines (WSG) and the Worldwide Airport Slot Guidelines (WASG), including those designed to address competition issues.

From the ACCC's perspective, any changes to the slot management scheme should have a strong focus on supporting a competitive airline industry and, in particular, should seek to:

- reflect the objectives of the WASG, particularly those which go to supporting and enhancing competition
- minimise opportunities for airlines to engage in slot misuse, including those actions identified by the WASG as misuses of slots
- strengthen compliance monitoring and enforcement of the slot management scheme, including by increasing public transparency around such activities where appropriate, to deter airlines from engaging in slot misuse.

In addition, there may be benefits to implementing measures that create financial incentives for airlines to use slots efficiently. For example, airlines may be deterred from engaging in inefficient slot use if they face a significant financial penalty for each instance where a slot is not used. It would be necessary to set parameters around such a measure so that airlines would not be penalised for failing to use a slot for reasons outside of their control. Any financial measures that are implemented would also need to be actively monitored and enforced, so that they act as an effective deterrent against inefficient slot use. By imposing financial penalties for inefficient slot use, airlines might more readily return slots that they will not efficiently use. These returned slots would then be available for airlines who wish to enter the market or increase their services.

The ACCC is also supportive of a number of suggestions identified in the Productivity Commission's 2019 Inquiry Report into the Economic Regulation of Airports<sup>2</sup> and in the Discussion Paper which may assist in enhancing competition and encourage the efficient use of slots, including:

- **Strengthen the requirements of the 'use it or lose it' test** – increasing the percentage of slots that must be used by airlines would assist in ensuring slots are used efficiently. In addition to strengthening the test, it would be necessary to implement close monitoring of airlines' use of slots to identify any signs of slot misuse.
- **Revise the definition of a 'new entrant'** – revising the definition of 'new entrant' to have consideration for the landscape of Australia's air passenger services market/s

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<sup>2</sup> Productivity Commission, *Economic Regulation of Airports*, Report no. 92, p. 257.

may increase opportunities for smaller airlines to access slots. For example, airlines that may have historically serviced predominantly regional markets may have a number of slots at a major city airport that are used to connect regional communities to the major city. Such airlines may already hold more than four (4) or seven (7) slots for the day at the major city airport and would therefore not fall within the definition of 'new entrant' under the current legislation nor under the WASG. However, such an airline may benefit from having the priority treatment of a 'new entrant' when seeking slots to provide new services outside of the regional network, which in turn could lead to increased competition.

- **Change the definition of a regulated hour** – applying the movement cap by each hour, rather than as a rolling 60-minute period commencing every 15 minutes, may make it more likely that the 80 movements per hour could be practically achieved. This change could also reduce the productivity loss that comes with recovering from flight disruptions and delays necessitated by the movement cap and could reduce the incentive for airlines to hoard slots. When the 80 movements per hour can be practically achieved, there may be increased opportunities for competition as airlines are able to utilise a greater number of slots.
- **Exclude certain flights from the movement cap** – excluding certain flights, such as regional flights and/or those operated by aircraft that fall below a noise threshold, from the movement cap would retain the noise-related policy objectives of the movement cap while increasing the permitted capacity of the airport. Increasing the permitted capacity of the airport would, in effect, increase the potential number of flights in and out of the airport each hour (where any flights beyond the 80 movements allowed under the cap meet the criteria of an *excluded flight*). In turn, this may create opportunities for new entrant or expanding airlines to launch new services (especially during peak periods) in competition with the existing airlines.

The ACCC considers that the suggestions outlined above may assist in increasing the efficiency of slot allocation and utilisation at Sydney airport, and thereby enhance competition in the airline industry. The ACCC acknowledges, however, that any changes to the existing slot management scheme will need to be carefully designed and implemented with appropriate consideration given to practical issues and real world complexities.

### **Interim measures to support airlines and encourage competition throughout the COVID-19 recovery period and beyond**

The COVID-19 pandemic has had a severe impact on airlines, creating some of the most difficult market conditions in Australian aviation history. With demand for travel dramatically reduced, the current time provides a good opportunity to reform the slot management scheme to ensure that in the long term it enhances, supports and fosters an environment of robust competition while providing certainty for airlines.

However, it is also important to consider the short term impacts of any reform to the scheme, and, as outlined in the Discussion Paper, whether additional measures can be taken now to support the airline industry through the COVID-19 pandemic and protect competition in the long term.

Given the uncertainty facing the entire airline industry, it is equally important that existing airlines are provided with certainty around their slot holdings, while at the same time opportunities are provided to new and expanding airlines to introduce new services and compete.

The ACCC considers that it is critical that all airlines, regardless of their existing slot holdings, have equitable access to slots, where they can demonstrate that those slots will be used efficiently. It is important that measures implemented to support airlines through the

COVID-19 recovery period have regard to a key objective of protecting the competitive process.

As noted in the Discussion Paper it is unlikely that any reforms to the review of demand management will be implemented in time for the upcoming NS21 and NW21/22 seasons. In these circumstances, it is prudent to implement interim measures to support the aviation industry while the impacts of the COVID-19 pandemic continue to be felt.

### **The ACCC supports “Option 4: Reset”**

The Discussion Paper puts forward a number of options in relation to slot allocations for the NS21 and NW21/22 seasons. The ACCC’s view is that “Option 4: Reset” would create an environment most conducive to supporting and enhancing competition in the industry. The proposal to mandate the return of 20 per cent of slots by an airline that has five or more slots in an hour (with a particular focus on peak periods), would create opportunities for new and expanding airlines to access slots needed to launch new services.

In circumstances where incumbent airlines are not using all of the slots they had prior to the COVID-19 pandemic, and, in particular, where airlines may have had excess slots during peak periods prior to the pandemic, requiring airlines to relinquish inefficiently used slots back to the pool would provide an opportunity for those slots to be used more efficiently by a competing airline.

As a second choice to Option 4, the ACCC would also be supportive of “Option 3: Full or select waiver with conditions”. This option may create greater certainty for incumbent airlines, although it is unlikely to result in the most efficient use of slots, particularly where there would be a delay in enabling new or expanding airlines from accessing slots until mid-season. However, in the current environment where airlines appear to be trialling new services as opportunities present themselves, this option would allow for greater flexibility for the incumbent airlines to trial new services.

In establishing any measures to address slot allocation during the COVID-19 pandemic recovery period, the ACCC agrees that it is important that specific consideration is given to slots previously used for international services to ensure these slots will continue to be available for international services once international travel returns.

### **A Pandemic Recovery Pool of slots could encourage efficient slot use**

The ACCC would be supportive of creating a Pandemic Recovery Pool of slots if it results in the most efficient allocation and utilisation of slots while providing all airlines with equitable access to slots.

A Pandemic Recovery Pool may be beneficial if it creates opportunities for airlines to temporarily use slots differently to how they may have been used prior to the COVID-19 pandemic. For example, it may be beneficial to temporarily re-allocate international slots for domestic or regional services during the COVID-19 recovery period. Likewise, it may assist airlines to use smaller aircraft to service new regional routes out of slots historically used for domestic or international services operated by larger aircraft. It would be important to include conditions that require a re-evaluation of slots at the dissolution of any Pandemic Recovery Pool to ensure they are used as efficiently as possible once flying starts to recover to pre-COVID levels.

Allowing airlines to temporarily use slots to best suit the current situation will lead to more efficient use of slots and greater opportunities for competition in the short term, while conditions around those slots will assist in restoring maximum productivity in the long term. The transition from Pandemic Recovery Pool arrangements to normal arrangements would need to be managed carefully to avoid circumstances where airlines are able to use pool

slots to expand services and slots airlines rely on for their expanded services are no longer available once the pool arrangements conclude.

### **The price notification regime**

Sydney Airport's provision of aeronautical services to NSW regional airlines are declared services under the price notification provisions under Part VIIA of the CCA.<sup>3</sup> This means that the airport must notify the ACCC should it wish to increase the price of those services. The ACCC must then consult publicly on the proposal and determine whether it will object. While an objection does not prohibit a price increase, it is very rare for a business to go ahead with its proposal if the ACCC has objected.

The CCA sets out the matters to which the ACCC must have particular regard when conducting its assessment. For price notifications generally, the ACCC considers that these matters will normally be satisfied by economically efficient prices, which reflect an efficient cost base and a reasonable rate of return on capital.<sup>4</sup>

In its assessments, the ACCC is also required to have regard to any specific directions by the government. In relation to Sydney Airport, a government direction states that the total revenue-weighted increase in prices should not exceed the increase in the Consumer Price Index.<sup>5</sup>

The purpose of the price notification regime is to bring transparency to those markets where, in the view of the Minister, competitive pressures are not sufficient to achieve efficient prices and protect consumers. In the case of Sydney Airport, the combination of the price notification obligations and the protection of slots for regional services help to ensure that regional services will continue to operate in sufficient numbers out of the airport. This reflects a social objective for regional communities to maintain access to Sydney for purposes such as access to services and the promotion of social connectivity.

### **The regime appears to be working as intended**

Sydney Airport has lodged three price notifications with the ACCC since 2002. The ACCC did not object to notifications lodged in 2002 and 2013 because they related to pricing restructures that were unlikely to result in price increases.

Of greater relevance is the ACCC's decision to object to a price notification in 2010. The airport proposed to increase charges by up to 2.9 per cent for the provision of various services including terminal access, check-in, runway access and apron parking. The ACCC objected to the proposal despite recognising that prices had not increased since 2001. It recognised that there had been strong growth in the number of passengers on regional services over this time, which had the effect of increasing the airport's revenues. The ACCC was not satisfied that the costs of providing services to regional airlines had increased to the extent that a price increase was required.

The outcome of the price notification regime has therefore been that charges for regional airlines have remained constant in nominal terms for almost two decades, representing a fall of 33.7 per cent in real terms. In contrast, average aeronautical revenue per passenger (a proxy for average charge) at the airport across all services has increased by 38.8 per cent in real terms since 2001-02.

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<sup>3</sup> See *Competition and Consumer (Price Notifications—Aeronautical Services to NSW Regional Airlines) Declaration 2019*.

<sup>4</sup> ACCC, *Statement of regulatory approach to assessing price notifications under Part VIIA of the Competition and Consumer Act 2010*, March 2017, p. 12.

<sup>5</sup> See *Competition and Consumer (Prices Surveillance—Aeronautical Services to NSW Regional Airlines) Direction 2019*.

It is reasonable to conclude that this outcome has contributed to the objective of maintaining regional services at the airport. While profitability of a route is impacted by a number of factors and costs, a reduction in airport charges of this extent is likely to have a material impact on whether some marginal routes continue to be offered. In this regard, Rex has stated that airport charges across its whole regular passenger transport network represented 16.7 per cent of its operating expenses in FY2018.<sup>6</sup>

The Discussion Paper noted the significant disparity in charges for regional and non-regional services, and suggested that it may be appropriate for the next determination to allow for the gap to close somewhat over time. In considering this proposal, it is relevant to acknowledge that it is unlikely that the current arrangements have resulted in artificially low prices for regional services. The ACCC objected to the proposed price increase in 2010 because it did not consider that the price increase was required for Sydney Airport to recover its efficient costs. Furthermore, if there had been a material change in these factors since then, Sydney Airport would have again sought a general price increase through a subsequent price notification.

Rather, the large disparity in charges between regional and non-regional services is due to significant increases in the latter. As recognised by the Productivity Commission in its recent review of airport regulation, Sydney Airport has significant market power in the provision of aeronautical services due to its geographic monopoly.<sup>7</sup> Despite this market power, the airport does not face an effective regulatory constraint over its ability to increase its prices. While the ACCC does not consider that the price notification regime should be extended to a broader range of Sydney Airport's services, it did submit to the Productivity Commission review that commercial arbitration may be able to help address the market power of the major airports.<sup>8</sup>

### **Potential changes to the regime**

The price notification regime appears to be operating as intended and contributing to the government's objective to protect regional air services. As a result, there does not appear to be a need to make wholesale changes to the regime.

The ACCC's view is that implementing the Productivity Commission's recommendation that commercially negotiated agreements between Sydney Airport and regional airlines not be subject to price notifications would strengthen the price notification regime, and address stakeholder concerns about the disclosure of commercially sensitive information as part of the ACCC's assessment process.

This proposal is unlikely to weaken the protection of regional services because airlines that do not have a commercial agreement with the airport will continue to be charged notified prices. It is also envisaged that notified prices will also provide an anchor point for prices negotiated between airlines and the airport.

### **Further consultation and engagement**

The ACCC welcomes further engagement and consultation on these issues and would be pleased to speak with you to discuss any questions or concerns. [REDACTED]

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<sup>6</sup> Regional Express (Rex), *Response to the Productivity Commission Draft Report on the Economic Regulation of Airports*, March 2019, p. 10.

<sup>7</sup> Productivity Commission, *Economic Regulation of Airports*, Report no. 92, p. 11.

<sup>8</sup> ACCC, *Productivity Commission Inquiry into the Economic Regulation of Airports—ACCC Submission in Response to the Issues Paper*, September 2018, p. 4.



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