



13 April 2011

The Commissioner  
Economic Regulation of Airport Services  
Productivity Commission  
GPO Box 1428  
CANBERRA CITY ACT 2601

Dear Commissioner,

Please find attached the RAAA submission to the Productivity Commission Economic Regulation of Airport Services Public Inquiry.

If you have any questions or require any further information please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, reading 'Paul Tyrrell', is positioned below the typed name. The signature is written in a cursive, slightly slanted style.

Paul Tyrrell  
Chief Executive Officer



# **RAAA Submission to the Productivity Commission Inquiry into the Economic Regulation of Airport Services**

*Serving regional aviation, and through it, the people and businesses of regional Australia*

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## KEY POINTS

RAAA members' experience of airports since privatisation has been largely negative, with the possible exception of a small number of regional airports.

It has been characterised by inappropriate use of airports' market power in the form of massive price increases, lack of adequate consideration of operational needs including safety issues, the loss of security of tenure, amenity and the ability to negotiate.

Airports, including airports other than the five major airports, are intrinsically monopolies.

The inappropriate use of Airports' market power is routine and commonplace.

The current Airport regulatory and reporting mechanisms are manifestly inadequate .

The Inquiry terms of reference are too narrow given that the inappropriate use of Airports' market power extends beyond both the five monitored airports and major airline passenger operations.

In light of the last point, the RAAA encourages the Commission to review within the current Inquiry or a subsequent Inquiry the inappropriate use of Airports' market power by Airports other than the five monitored airports, and in regards to operations other than major airline passenger operations.

A mechanism is urgently needed to ensure Airports and users of airports can reach the equivalent of 'fair and reasonable' market based outcomes despite the absence of competitive forces.

The RAAA supports the declaration under Part IIIA of 'Aeronautical Services and Facilities'.

The scope of 'Aeronautical Services and Facilities' needs to be widened from the current definition to include ALL services and facilities essential to the operation of civil air services including aircraft maintenance and freight operations.

The inappropriate use of market power by Airports is adversely affecting investment in and the long term future viability of Regional Aviation and as a result adversely affecting regional communities.

The RAAA encourages the Commission to undertake a 'Regional Aviation' Inquiry to investigate those issues above and other pressing matters such as skills shortages.

## **RAAA SUBMISSION TO THE PRODUCTIVITY COMMISSION**

RAAA members believe the current Inquiry is a welcome and much needed initiative from government to address adverse outcomes relating to monopoly powers exercised by airport operators in the provision of aeronautical services and facilities.

The RAAA expresses a view that fair and reasonable access on fair and reasonable terms to aeronautical services and facilities is not always possible in part due to inherent limitations within the current regulatory regime.

RAAA members anticipate Inquiry recommendations consistent with ensuring fair and equitable future outcomes for both RAAA members and airport operators.

### **Pertinent feedback concerning the RAAA submission**

In order to be effective, the RAAA relies on feedback from its members. When concerns are being raised, the RAAA seeks examples to illustrate members' issues.

There is no question that members are arguing for substantial improvements in the economic regulation of airport services. But it is worth stating up front that in gathering information for this submission, only a relatively small number of members have provided examples to demonstrate the inappropriate use of monopoly powers by airport operators. Some members have not provided examples because they are seriously concerned about the potential adverse ramifications if the examples enter the public domain and are negatively received by the relevant airports. This concern remains, even with an assurance by the Productivity Commission that specific examples can be incorporated into a confidential submission that will not be published.

A significant number of RAAA members are concerned that airport operators are in a position to adversely impact without recourse, their business' viability by the withholding of, or manipulation of, costing and terms of aeronautical services and facilities. Members' concerns are understandable given the already challenging dynamics of the regional aviation sector (eg large capital investment costs, narrow profit margins, high regulatory barriers, significant competitive forces, and relatively high levels of risk), the fact that regional operators typically have limited bargaining power, and the prohibitively expensive and largely ineffective processes for challenging airport behaviour.

## **INTRODUCTION**

### **Who We Are**

The RAAA was formed in 1980 as the Regional Airlines Association of Australia to protect, represent and promote the combined interests of its regional airline members and regional aviation throughout Australia.

The Association changed its name in July 2001 to the Regional Aviation Association of Australia (RAAA) and widened its charter to broaden the membership - which now includes regional airlines, charter and aerial work operators, and the businesses that support them.

The RAAA members collectively provide a broad range of aviation services to regional Australia and many have done so since before privatisation of the airports. Members' experience encompasses airline and non-airline operations at the five price monitored airports, the other major city airports, the major regional airports and smaller regional community airports. It also includes firsthand experience of lease and tenancy arrangements at a large number of airports.

The RAAA has 27 Ordinary members (AOC holders) and 55 Associate/Affiliate members. The RAAA's AOC members directly employ over 5,000 people and indirectly support the employment of many others. Many of these jobs are in regional areas. On an annual basis, the RAAA's AOC members jointly turnover more than \$1B, carry well in excess of 2 million passengers and move over 23 million kilograms of freight.

RAAA members operate in all states and territories and include airlines, airports, engineering and flight training companies, finance and insurance companies and government entities. Many RAAA members provide employment and contribute towards economic sustainability within regional areas. The membership includes large domestic companies as well as internationally based multi-national organisations.

Members' presence in regional Australia includes the Royal Flying Doctors Service in all states and territories, the REX hub in Wagga Wagga, SkyWest in WA, Sharp Aviation in Hamilton, Airnorth, Chartair and Vincent Aviation Northern Territory networks, West Wing Aviation in Mt Isa and Skytrans operations from Cairns, to name a few.

The RAAA network represents over 20% of the total Australian aviation industry and over 80% of the Fly-in/Fly-out (FIFO) operators servicing the economically vital resources sector.

## **RAAA Charter**

The RAAA's Charter is to promote a safe and viable regional aviation industry. To meet this goal the RAAA:

- promotes the regional aviation industry and its benefits to Australian transport, tourism and the economy among government and regulatory policy makers;
- lobbies on behalf of the regional aviation industry and its members;
- contributes to government and regulatory authority policy processes and formulation to enable its members to have input into policies and decisions that may affect their businesses;
- encourages high standards of professional conduct by its members; and
- provides a forum for formal and informal professional development and information sharing.

The RAAA provides wide representation for the regional aviation industry by direct lobbying of Ministers and senior officials, through parliamentary submissions, personal contact and by ongoing, active participation in a number of consultative forums.

## **Regional Air Services**

Over 4 million regional Australians rely on regional air services. Without these services the social and economic existence of regional and remote communities and many regional industries are at risk. Servicing this need are the regional operators who service more communities in Australia than the major domestic operators and provide:

- essential access to markets and services;
- vital aero-medical assistance and health services;
- transport & freight services to the resource industry;
- bushfire and Search & Rescue operations;
- exploration via airborne surveying;
- pipeline and other infrastructure inspections;
- law enforcement & border patrols;
- business & recreational travel;
- airport facilities; and
- flight training.

Our operator members use a diverse range of aircraft types:

- regional airlines: operating aircraft through the full range from 9 seat twin-engine piston aircraft to 100 seat jet airliners,
- air freight operators: using predominantly turboprop and light jet aircraft,

- aero-medical operators: operating mostly modern turboprop aircraft, single and twin-engine,
- charter operators, operating a wide range of aircraft from light single-engine piston aircraft to 100 seat jet airliners, and
- flying schools operating light single and twin piston engine training aircraft.

These aircraft are operated to and from a large number of airports around the country, including the price monitored airports, the other major city airports, General Aviation Airports, major regional airports, and smaller regional community airports.

Each of our operator members is also a lessee/tenant of at least one category of airport.

Our Associate members include the full range of supporting businesses including aircraft distributors, fuel companies, finance houses, insurance brokers, law firms, repair and overhaul businesses, and four regional airports.

Some of our associate members are also, either directly or indirectly, tenants of airports.

Against this background, the RAAA can speak with considerable authority on the behaviour of the privatised airports.

### **The economic challenge for Regional Aviation**

The latest research can be seen in Bureau of Transport Infrastructure & Regional Economics (BTIRE) statistics shown in **Table 1 – Declining Regular Public Transport (RPT) services**. This highlights declining Regular Public Transport (RPT) services for regional and remote communities in Australia.

The number of regional airports serviced by RPT operators was 268 in 1985, 182 in 2000 and 138 in 2008 – a decrease of nearly 50%

The number of airlines servicing those regional airports was 53 in 1985, 38 in 2000 and 27 in 2008 – a decrease of nearly 50%

The number of regional RPT routes was 436 in 1985, 344 in 2000 and 243 in 2008 – a decrease of nearly 45%

**Table 1 – Declining Regular Public Transport (RPT) services**

RAAA analysis of the most recent data available suggests that these trends have continued. In March 2011, the number of airlines servicing regional airports had decreased to 24, a further decrease of 11%.

When asked by the parliamentary Rural Affairs and Transport References Committee about the viability of regional aviation at a hearing on 25 February 2011, Jeff Boyd, CEO of Brindabella Airlines said:

*“At the moment it is quite dire. There are substantially fewer regional airlines than there were 10 years ago, and I would say in 10 years time there will be substantially fewer again. The smaller operators have been financially pushed out of the business. Many, many towns in Australia that used to have a service no longer have a service. We are one of the few airlines, along with Sharp, that have reintroduced services to towns, for example, our Cobar service.... But that is not the norm. A lot of small towns are losing their service ...”*

The National Aviation Policy White Paper (December 2009) describes the situation succinctly:

*“A trend towards larger aircraft has seen a decrease in both the number of regional airports served and the number of airlines and flights serving them.”*

While data for individual operators is commercial in confidence, industry profitability for regional operators as measured by return on investment is parlous by comparison with that of the airports. In a good year it is expected to be no better than 5% and in an average year is about 1%. During the GFC the return on investment was negative for much of the regional industry.

### **Airport services and the impact on regional aviation**

The experience of RAAA members is that the cost of airport and airport-related services is a key impediment to the continuing provision of services by regional airline operators and other industry participants. Monopoly pricing and other monopoly practices deter investment and impose unjustified and inefficient costs and conditions on regional operators, adversely affecting their economic viability and the continuing existence of the regional aviation network.

This is evidenced by the dramatic BTIRE statistics referred to in **Table 1 – Declining Regular Public Transport (RPT) services**.

Such a result is not in the national interest, nor is it efficient management of the national economy.

To overcome the obvious detriment, successive Governments, both State and Federal, have provided various schemes to assist regional aviation, for example, at Commonwealth level, the Enroute Charges subsidy, Remote Areas Services subsidy, and at State level, some route subsidies. A number of local governments also have assisted (and in remote areas been assisted by the Remote Aviation Infrastructure Fund) to keep viable what they regard as an essential service, for example, by reduced or subsidised airport charges.

RAAA members can report that there are some good examples at the industry level of airports and airlines working together to achieve positive outcomes.

Some local government airport operators have partnered with small airline operators to open new routes or re-establish closed routes by offering incentive deals in relation to passenger charges or other start-up costs. Some have assisted the introduction of routes by arranging meetings with and surveying local businesses to gauge the level of support for a new or re-introduced route.

This is a good example of local stakeholders recognising the inherent importance of the aviation network to their regional community. However, there needs to be a greater understanding of the importance of regional aviation and the regulatory settings should assume that all participants in the network require return on their investment and fair and equitable outcomes.

Whether it is FIFO operations, RPT, medi-vac, charter, tourism or training flights, regional aviation is an essential partner in the growth, prosperity and amenity of our regions. Our law-makers accept this inextricable link for health, communications and other forms of transport, namely regional road and rail networks, and the funding is distributed accordingly, but not for regional aviation. One third of our population lives in regional Australia and contributes well above its numbers in growing Australia's wealth.

One way to ensure such Government subvention at any level is reduced as much as possible is to provide a regime for the economic regulation of airports that ensures costs to regional operators are not inflated by monopoly practices, and that pricing outcomes for regional operators are no worse than what is achieved by the majors who have some market power to restrain monopoly airport operators.

### **The aviation network**

The Australian aviation network consists of a network of infrastructure and services provided by airports, aircraft operators and associated support organisations. The network extends from major cities to regional and rural Australia.

In all its aspects, the aviation network is essential national infrastructure that is crucial to various state economies and the Australian economy as a whole.

Whilst the importance of large aviation industry participants such as big city airports and major airline operators is taken for granted, the aggregated investment of smaller aviation players including those in regional Australia is less well understood but is at least as important and may well be more important to Australia's national economic efficiency.

The aviation network has very visible components in airports and aircraft and less visible components in aircraft handling, air traffic management and communications systems. The need for capital investment in the visible components is obvious to all although the focus is typically on airports rather than airlines. But the requirement for capital investment in the less visible components is less obvious and less well understood. For example, upgrades to air traffic management systems and safety systems require operational and capital expenditure by airports and aircraft operators.

### **Regional Australia and the aviation network**

The importance of the aviation network grows as it extends into regional Australia because other transport options become less and less competitive as alternatives.

Without the aviation network some of Australia's vital extractive and agricultural industries could not function, and regional communities would be dislocated and disconnected from basic services. The importance of regional aviation to a country with a relatively small population and a large geographic expanse with important agriculture and mining industries has been recognised by successive Governments in the past. Governments have sought to protect the access of regional aviation to Sydney Kingsford Smith airport and have provided financial and other support for the sector to ensure it survives, however this support is decreasing in an environment where the challenges for regional aviation have been dramatically increasing. The effect is the loss of much of the network and a drastic reduction in services to regional Australia that looks set to continue.

A national perspective on the challenges facing regional aviation is vital in ensuring the settings are right to encourage competitive outcomes and to ensure that the sector remains healthy. The regulation of airports is a critical part of these settings. If working effectively it will enable the whole network to meet efficiently the wider national interest in ensuring that wealth generation in regional and capital city Australia continues and is enhanced.

## THE INADEQUACY OF THE CURRENT REGULATORY CONTROLS

### The consequences of airport privatisation

The National Aviation Policy White Paper acknowledged a consequence of privatisation has been that:

*“Airports are, within their relative geographic markets, natural monopolies, and it is important to prevent abuse of market through excessive pricing”*

Our members’ experience of the five major, monitored airports since privatisation has, broadly speaking, not been a happy one, and has been characterised by massive price increases, lack of adequate consideration of operational needs including safety issues, and the loss of security of tenure, amenity and the ability to negotiate.

The major airports, in the context of their respective geographical areas, are all monopoly businesses with the power to impose “take it or leave it” conditions in the certain knowledge that operators, particularly regional operators, must either “take it” or severely damage their businesses (or worse).

From the experience of RAAA members it is clear that the major airports have excessive market power and in many instances are able to exercise it, despite the current regulatory settings. However it is also clear that the existence of market power and preparedness to exercise it is not limited to the major regulated or city airports.

As noted earlier, this overwhelming market power and the associated fear of retribution has in some cases been responsible for operators feeling unable to pursue complaints or even to provide evidence to this Inquiry.

With privatisation an irreversible fact, Government and the aviation industry must now focus on how the generally commercially based airport monopolies are managed and whether the current regulatory regime is adequate.

The RAAA strongly agrees with the ACCC’s view:

*“an unconstrained airport can be expected to set excessive aeronautical charges, and the airport may deliver lower levels of quality, and delay investment. Also, an airport operator may undertake unproductive activities due to a lack of external pressures on the business (so-called X-inefficiency), and rent seeking behavior”*

These exact outcomes are widely experienced by RAAA Members who currently have no realistic means of redress.

Whilst airport monopoly power was intended to be moderated by various regulatory provisions (ie the Airports Act 1996, the particular terms of the airport leases, the access provisions of the Competition and Consumer Act 2010, the regional airline protections at Sydney airport and the price capping, replaced by the monitoring regime under the ACCC), in the view of RAAA members, the current regulatory controls are substantively inadequate and fail to achieve economically efficient outcomes because they:

- do not adequately acquit the Commonwealth's rights and obligations as owner and lessor of the airports on behalf of the Australian people;
- do not extend to airports other than the five major regulated airports;
- do not protect aviation infrastructure from being negatively impacted by commercial developments;
- do not ensure fair pricing, access, service provision or transparency for all industry providers who require access to the airport;
- do not have adequate regard for the need to encourage investment in the whole aviation sector;
- are too expensive for small operators and are open to tactical abuse such that outcomes can be delayed and other commercial pressures can be brought to bear to impede fair outcomes;
- focus heavily on passenger related aspects of aviation ignoring other very economically important industry participants and services such as freight handling and maintenance providers;
- do not take in to consideration the Commonwealth's provision of aeronautical services; and
- do not address the imbalance of bargaining power between large airline operators and small airlines operators with the effect that small operators (typically regional operators) will eventually be driven out of the market.

### **Commonwealth's rights and obligations as owner and lessor of the airports**

In paragraph one of the Introduction to the 2007 report titled *Management of Airport Leases: Follow up* the Australian National Audit Office (ANAO) noted:

*"Between 1997 and 2003, 22 Federal Airports were privatised raising more than \$8.5 billion in Commonwealth sale proceeds. The airports privatisation program involved leasehold, rather than freehold, sales. As a result, the Commonwealth has an ongoing interest in airport operations, both as landlord and because 21 of the 22 airport sites revert to the Commonwealth at the conclusion of the Airport Lease."*

The document notes that the exception to this was Hoxton Park airport which was sold with a shortened five-year lease, after which time it reverted to freehold title. Hoxton Park airport no longer exists.

The ANAO also noted:

*“significant attention is now being given to post sale management of leased Federal Airports. This reflects the extent and significance of the Commonwealth’s rights and obligations under the sale documentation.”*

Given the importance of the aviation network to the national economy, regardless of ownership, the Commonwealth government should take a keen interest in the way the network is operating and the overall economic health and viability of the network. Whether or not airports are owned or controlled by the government or other parties, they are part of the national aviation network which is essential national infrastructure, and the government will continue to have ultimate responsibility to the people of Australia to ensure that the infrastructure will provide the services necessary for future generations.

However, in light of the Commonwealth government’s ongoing ownership of all of the privatised airports, the RAAA submits that there is in fact a higher and more direct obligation, as owner and lessor, to ensure that the airport network continues to operate efficiently, that investment in the sector is encouraged and that when airports are returned to the government at the end of the leases, they are a vital and effective part of the national infrastructure.

Airport infrastructure remains in government ownership and at the conclusion of the airport leases, in the absence of another lease arrangement, they will revert to the government’s control. At its most basic, the RAAA submits that ordinary Australians would find it odd that the Government must rely on standard regulatory tools that are usually applied to privately owned infrastructure in order to limit the abuse of market power by its own lessees.

In the view of RAAA members, the lease conditions on each airport, the interpretation of those conditions and the review processes implemented by the government to ensure the conditions are complied with by airport lessees, are not well understood and are not transparent. It is even less clear when the airports are operated by local councils.

The RAAA submits that as a first principle, government should make these lease arrangements transparent and seek input from airport users when reviewing and determining whether airport lessees and airport operators are meeting their obligations.

In addition, the RAAA considers that, currently, the interests of the Commonwealth and regional aviation remain subservient to the commercial interests of the airport operators.

This is to the detriment of regional aviation and to regional communities.

Given the continuing and increasing divergence between the commercial interests of airport operators and the interests of regional communities the post sale management of leased Federal Airports needs further urgent review. This is particularly so given the time elapsed since the privatisation of the airports and the most recent Australian National Audit Office report.

In the public interest, in light of the Commonwealth's ongoing ownership and the reliance of regional communities on the aviation network, this review needs to consider carefully the following questions:

- What are the Commonwealth's rights and obligations as owner and lessor of the airports; are they adequate and will they continue to be adequate?
- Are the applicable airport leases sufficiently detailed and if not, what additional detail is required?
- How can the leases and review processes be made more transparent and more robust and can airport customers be included in the reviews without raising the threat of retribution from airport operators?

### **Airports other than the five major regulated airports**

The RAAA is concerned that limiting the Commission's Inquiry to the major airports ie Adelaide, Brisbane, Melbourne, Perth and Sydney, is unnecessarily restrictive and ignores the growing inappropriate use of market power by airports that are not defined as major airports.

Whilst understandably Government focuses on large numbers and capital city infrastructure, the RAAA submits that a focus only on the "Big 5" with their car parking and surface transport access problems overlooks the broader impacts on regional aviation and on a significant proportion of the Australian community.

In the experience of RAAA members, airports that are not major airports often do have monopoly power in their geographic market and, with no or limited regulatory oversight, often use that monopoly power with little or no fear of redress by an operator or government.

Other capital city airports, and both major and minor regional airports, are equally critical to the viability of Regional Aviation and in the interests of ensuring fairness and equity should be considered in this Inquiry or as part of a subsequent, separate Inquiry into regional aviation.

At p178 of the National Aviation Policy White Paper it is asserted that:

*“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 price intervention.”*

This assertion is used to suggest that airports other than the five major airports do not need any form of regulation, even self-administered monitoring.

Even though the number of passengers and movements at other city airports may be lower than at the major airports, and at regional airports may in fact be low, these airports are no less monopolies in their geographical areas than the five monitored airports. Whilst fewer people may be affected, these airports are still monopolies and often exhibit monopolistic behaviour. Indeed, some, although certainly not all, local government owners see their airports as “cash cows” to supplement their revenues and for the additional revenue to be used on totally non-aviation related activities.

Even accepting that the regional airports account for only 10% of passenger movements, as explained earlier this is not the full picture. These airports provide a vital link between rural communities and the rest of Australia and are essential infrastructure within the national economy.

### **Aviation infrastructure being negatively impacted by commercial developments**

In the National Aviation Policy White Paper, the Government states:

*“The Government’s position is that the primary purpose of the federal leased airports is aviation. The Government accepts that the federal airports will continue to identify opportunities for non-aeronautical land use and commercial developments on airport sites. However these alternative uses should not be allowed to compromise or constrain the ability of an airport to undertake its core aviation business. A non-aeronautical development will only be consistent with the airport planning framework where it places no unnecessary restriction on aviation at the airport.”*

It is increasingly clear that a competing motivation for airport operators was and is access to real estate for the purposes of non-aeronautical development such as retail or industrial uses. This in many cases has subsequently proven to be at the detriment of the aeronautical use of the airport.

This dual purpose model provides airport operators with a virtually guaranteed return on aviation infrastructure which subsequently enables them to leverage non-aeronautical opportunities, often with significantly stronger commercial returns.

This has sometimes led to the areas of airports devoted to aeronautical uses being reduced substantially or negatively affected in favour of non-aeronautical uses.

The RAAA is aware that various airport representatives would argue that aeronautical usage should not necessarily be the paramount consideration in development at airports. However, in the context of a review of economic regulation of airports it is, in the RAAA's view, appropriate for the Inquiry to consider to what extent non-aviation development is reasonable, and whether government intervention might be justified in order to ensure the primacy of aeronautical usage at airports.

For Canberra Airport, Airservices Australia has been obliged to put the following warning in its En Route Supplement Australia:

*“During strong westerly winds TURB may be experienced in touch down area LDG RWY 35”*

This warning of turbulence resulted from airline pilots complaining about a safety issue arising from severe turbulence caused by a hangar that was built too close to the runway. The hangar could have been placed further away from the runway if the land behind the hangar was not being used for non-aeronautical commercial development.

In addition the ATSB recently completed an extensive investigation as a result of an Air Safety Incident Report relating to severe wind turbulence over the threshold of Runway 12 at Canberra due to buildings being too close to that threshold. The report was released April 5<sup>th</sup> 2011 and noted significant shortcomings and a commensurate reduction in safety as a result of poor consideration of the effect of non-aeronautical developments on Runway 12.

The closure of Runway 18/36 at Bankstown Airport to reduce the land at the airport devoted to aeronautical use eliminated the only north/south runway available in the Sydney Basin to aircraft not able to use Sydney (Kingsford-Smith) Airport. This is a serious restriction on days when a northerly or southerly wind is blowing and has safety implications.

### **Fair pricing, access, service provision and transparency**

The National Aviation Policy White Paper stated a key goal in relation to the economic regulation of airports was that:

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

In the RAAA's submission the current regulatory controls fail to manage abuse by airport operators of their market power or to balance investment incentives against fair and transparent outcomes. They also fail to address other important factors vital to the overall health of the aviation network and industry.

In the RAAA's view, the regulatory settings work much better, but are still not adequate, for the large airlines with their own market power. However the settings have failed manifestly to provide a fair market environment for smaller operators who provide the backbone of essential regional aviation services.

With many airport owners or leaseholders subject to commercial imperatives and limited relevant regulatory controls, airport owners typically seek to exact the greatest shareholder value without regard to broad economic infrastructure and efficiency considerations and without regard to particular industry groups or network effects.

Where regulation applies, airport pricing is a dual till model and some transparency applies, particularly in relation to the major airports. However transparency drops away seriously where other city and regional airports are concerned.

In addition, many airports do not share consistently their pricing models for the use of aviation related infrastructure although they may be more transparent when they engage individually with large airlines that have more bargaining power. And there are few, if any airports that share pricing models in relation to airport-essential services that are not directly aviation services (ie property rents and other terms, car parking charges for on-airport employees, etc). And yet these latter services can be as, if not more, important to the viability of an airport customer.

With minimal transparency, regional operators are left to negotiate with airports directly and are usually the smallest airport customer, with limited bargaining power vis a vis the airport and relative to other, major airline operators. The result often is that whilst airport capital investment and operating costs are passed onto airlines on a common user basis and regional airlines pay their share, they do not require or use the infrastructure or services that generate these costs, they sometimes pay a higher per passenger rate and yet receive a lower standard of service (ie parking on aprons located away from the terminal requiring bussing arrangements).

The fact that a number of RAAA members believe sincerely that if they criticise their airport operator they will be subject to further victimisation is itself a clear indicator that the current regulatory arrangements are not working. Leaving aside the individual bullying aspect of this behaviour, from an industry point of view, these concerns create business uncertainty which can potentially seriously affect the strategic development and long term viability of the members' businesses and the aviation network as a whole.

RAAA members have experienced many adverse outcomes relating to monopoly powers exercised by airport operators in the provision of aeronautical services and facilities, outcomes that would not realistically occur in a competitive market. These include:

- A declining lack of security of tenure for airport lessees and tenants, especially the smaller ones;
- Former lessees being refused exercise of options or renewal of leases and being offered tenancies of built facilities on a “take it or leave it” basis at markedly higher rents where those facilities may not suit the tenant’s business as well as the resumed lease premises;
- Terms of leases declining from the former FAC standard of 25 years + 5 years + 5 years to as little as 12 months;
- Unreasonable purpose clauses in renewed leases or new tenancies and unduly restrictive interpretation of existing purpose clauses notwithstanding existing condoned use;
- Unreasonable enforcement of reversionary leases which effectively deprive lessees and tenants of their property improvements for little or no recompense to the benefit of the airport operator;
- Denying reasonable access to leased sites as a way of pressuring potential lessees to improve basic common infrastructure that the lessor ought to provide;
- Offering new leases to existing lessees on sites where the infrastructure is clearly incapable of supporting their existing business;
- Offering leases to new and existing lessees on “greenfield” sites and demanding that the lessee pay for the access infrastructure;
- Ramping up rentals with little regard to the price in a “real” market, often with no transparency as to what the “market” on the particular airport is; and
- A clear discrimination in the way that small lessee/tenants are treated due to unequal bargaining power.

### **Pricing of Services**

Where pricing models are transparent and there is a capacity to negotiate the costs that are fed into the model, a commercially negotiated market solution is possible. That ideal, however, is not common place.

As history shows, pricing models can be distorted by the arbitrary revaluation of assets, particularly land. The ACCC’s June 2005 “line in the sand” has attempted to deal with this major problem.

Smaller operators often find that despite the pricing models, transparent or not, once prices are set they are denied because of a lack of bargaining power, or any access to discounts or offset. They then effectively pay more for the same service and, again because of their relative size, the quality of the service provided is often less. For example, they pay the same head tax, but have no access to aerobridges and must bus their passengers to the terminal.

At a more general level, there is little evidence that price monitoring without some enforcement or compliance mechanism is effective to restrain monopoly pricing. The ACCC in its 2008/09 monitoring report concluded that:

Sydney Airport has increased profits by permitting service-quality levels to fall below that which could be expected in a competitive environment over a sustained period.

In its 2009/10 monitoring report the ACCC concluded that:

*“Over several years, airlines have raised concerns about unsatisfactory levels of service at Sydney Airport. Over the same period, prices and profitability continued to increase. The monitoring results, when considered within the context of the airport’s market power as well as the incentives and ability to use that market power, point to Sydney Airport earning monopoly rents from services provided to airlines.”*

In relation to leased premises on airports it is worth noting that the old FAC leases operated on the not uncommon basis of annual CPI based increases and periodic reviews to market, with review disputes being settled by arbitration usually through the local Institute of Valuers or its equivalent. This worked reasonably satisfactorily.

Since privatization there have been a number of variations. In situations where the annual CPI based increases plus periodic reviews have been continued, there has often been unrealistic assertions as to what the “market” is, with little transparency as to comparative rates on the particular airport. Smaller players particularly are told that off airport comparisons are not applicable and are being offered a “take or leave” rentals which have inflated considerably. Such increases are based on supposed infrastructure improvement costs to the airport, however improvements are done without consultation with the affected lessees and, in some extreme cases, the lessee has been expected to pay for or provide access infrastructure which will revert to the airport.

In other cases leases are being offered with no periodic review to market but with an annual increase of 4% or 5%, considerably higher than any CPI increase.

The ability to increase rents excessively is based on the monopoly market power the airport has in relation to operators or service providers who must be on the airport to serve their customers and operate their businesses.

### **Security and terms of tenure**

It is impossible for a business to plan properly if it has insufficient security of tenure and no reasonable confidence that the future costs of its business premises are predictable.

With this in mind RAAA members, including aircraft operators and the providers of services to operators, are extremely concerned regarding security and terms of tenure on privatised airports.

Lessees with relatively long leases and one or more options for extension have been:

- pressured to surrender those leases
- denied reasonably anticipated options
- denied reasonably expected renewals (even if this requires relocation) or offered renewals that clearly are inappropriate to their businesses

Another trend which causes great concern in relation to security of tenure is the denial of leases in favour of tenancies, often in facilities that are built by the airport operator to be suitable for multiple uses and are not necessarily suited to use by the potential tenant. The tenancies are often very short and the tenant is exposed to being relocated, sometimes repeatedly.

### **Reversionary Leases**

The use of reversionary leases is not in question as it is reasonable for a lessor to require a lessee to remove additions to the leased land or to assume ownership of additions at the end of a lease.

The difficulty airport lessees have is that airport operators are abusing this reasonable business practice with short leases, uncertain options and renewals, and “Rolls Royce” building requirements.

The combined effect of a short term lease and the depreciation rules for taxation purposes is that at the end of the lease the tenant is effectively gifting a partially depreciated building to the airport operator.

In relation to FAC leases which existed at privatisation where lessees were led to believe that similar terms and conditions would apply post-privatisation (and were denied renewals by the FAC on this assurance), this could be classed as deprivation of property because the lessee had entered into the original lease reasonably expecting the exercise of an option(s) or renewal on similar terms.

In relation to a post-privatisation lease it might be argued that the lessee should have understood the changed risk. In a perfect market that would be fair comment. In a market deformed by monopoly it would ignore the realities. So, to the extent that an airport operator is able because of its market power to impose building and infrastructure requirements in excess of the lessee's requirements it is exacerbating the detriment to the lessee, almost certainly to the financial advantage of the lessor.

### **Refusals to agree to transfer of existing leases to willing and able purchasers**

Many examples have been provided to the RAAA of airports utilising subjective interpretation of lease clauses to refuse consent to the transfer of an existing lease to a willing and able purchaser of a business on an airport.

Thereafter the airport exercises the reversionary terms of the lease effectively depriving the business proprietor of his goodwill asset and in most cases significant capital improvements and investment.

There are cases where this practice has been used to turn an existing lease into a tenancy, thus reducing the incoming business's security of tenure, and to exact rents far higher than provided for in the determined lease because the airport operator without any capital investment on their part is able to offer the premises as improved premises.

### **Provision of infrastructure**

It is common for commercial or government entities to offer a leasehold with appropriate access infrastructure to be used for the proposed purposes of the lease. The costs of the provision of this infrastructure is typically recovered through the pricing of the lease rent.

A number of airport operators, however, are charging rents at the high end of any reasonable market comparison and then requiring the lessee to fund access infrastructure or build that infrastructure themselves. In several examples airports have proposed that the tenants would subsequently incur ground rent for roads, taxiways and tarmacs that could be argued are common user infrastructure.

### **Discriminatory access to leases**

RAAA members report subjective decisions by airports that favour one business over another; in particular the presentation of a commercial offer to one business that is distinctly different and advantageous relative to a comparable offer made to a competitor.

In an extreme example a 3<sup>rd</sup> party acted on behalf of an RAAA member to ascertain availability of available leasehold on-airport office space. The airport confirmed with the 3<sup>rd</sup> party the availability of a variety of possible tenancies and draft terms were presented. At that time the RAAA member making independent enquiries for an identical requirement was politely told no tenancies were available precluding their business locating to that airport.

### **Restrictive application of purpose clauses and business licensing**

RAAA Members report the use of Restrictive Application of Purpose Clauses or at Lease renegotiation, the modification of Application of Purpose Clauses so as to be more restrictive, and the use by airports of business licences on airports to restrict for example generic services such as ground handling.

Effectively airports become a self contained economy without oversight regulating supply to maximize return.

In those cases Airport Operators are able to maximise returns by limiting a business' ability to respond and adapt to changing market conditions, subsequently creating conducive conditions to new entrants or forcing an existing business to relocate or duplicate facilities often incurring substantial new costs.

### **Encouragement of investment in the whole aviation sector**

Regulatory settings aim to ensure the public interest is met in part by the promotion of investment. In its White Paper the government made it clear that:

*“regulatory stability is important for airports as they make long-term investment decisions”*

While the RAAA agrees it is important for any infrastructure owner to have certainty and stability and to achieve an acceptable return, the regulatory settings do not have regard for these same issues in respect of other aviation network participants.

Stability and adequate returns are also important to airline and other providers of aviation services if they are to make long-term investment decisions. Airlines are often making decisions with 20 year implications with respect to new airframe/engine purchases and the capital outlays are often as, if not more, substantial than those of airports. Any regulatory system that does not address the abuse of market power by airport operators fails to provide the necessary long-term stability and return on investment for these other participants.

The RAAA expresses a high level of concern and supports the ACCC view:

*“Airlines may be reluctant to undertake sunk investments for fear of opportunistic behavior by the airports.”*

For example, investment could take the form of construction of customised facilities (such as customised terminals or maintenance bases), marketing of services to or from an airport, acquisition of take-off and landing slots, or the establishment of flight schedules, operating procedures and staffing.

Airlines could be reluctant to undertake relationship-specific investments for fear that once the investment has been sunk, the airport would be able to expropriate the value of the investment by increasing prices or reducing service quality.

One way the airlines may seek to reduce this risk is by negotiating long-term contracts. However, it is difficult to contract against opportunistic behavior by an airport.

It is worth noting that the risk of inadequate contractual protection could give rise to under-investment in specialised equipment or knowledge. This could reduce the value of, and lower the demand for, air travel in Australia. This outcome has implications for the efficient use of airport infrastructure over time and, consequently, could result in dynamic efficiency losses.

The RAAA believes the current regulatory regime focuses far too heavily on encouraging investment by airport operators at the expense of other participants within the aviation network. There appears to be little policy acknowledgement or understanding of the huge capital investment required by operators to ensure passengers and freight fly in the most modern equipment.

Investment in regional aviation is regulatory intensive, involves large capital investment costs, narrow profit margins, significant competitive forces and pressures, and relatively high levels of risk.

To highlight the significant capital challenges facing airlines the list price acquisition costs (exclusive of GST) for a single new Regional Aircraft (source respective manufacturers April 2011) in most cases significantly exceed typical airport capital project costs. In addition, Airports are typically able to recoup their investments from many operators and aircraft.

ATR 42-500	USD\$18.10m
ATR 42-600	USD\$18.90m
ATR 72-500	USD\$21.90m
ATR 72-600	USD\$22.70m
Cessna 206H	USD\$ 0.59m
Cessna 208B Grand Caravan	USD\$ 2.15m
Embraer E170	USD\$36.25m
Embraer E175	USD\$39.04m
Embraer E190	USD\$43.22m
Embraer E195	USD\$45.67m
Gippsaero GA8 Airvan	AUD\$ 0.69m
Gippsaero GA8 Airvan Turbocharged	AUD\$ 0.72m
Gippsaero GA10 Airvan	AUD\$ 1.50m (estimate only)
Gippsaero GA18 Nomad	AUD\$ 3.40m (estimate only)

This is in addition to construction or the lease of customised facilities (such as customised terminals or maintenance bases), marketing of services to or from an airport, acquisition of take-off and landing slots, or the establishment of flight schedules, operating procedures and staffing.

### **Regulatory controls expensive and open to abuse**

Despite real and very serious examples of the exercise of monopoly power by airports, there are very few examples of airline or other industry operators taking or even threatening to take action against airport operators or seeking redress under Part IIIA or Part IV of the Competition and Consumer Act 2010. In the RAAA members' experience this is not because industry operators have no complaints about airports.

For smaller players the current avenues of contesting monopolistic behaviour are prohibitively expensive and time consuming.

Aviation is in almost all cases time critical and as such proceedings are open to tactical abuse such that outcomes can be delayed and other commercial pressures can be brought to bear to impede fair outcomes.

### **Heavy focus on passenger related aspects of aviation**

The challenges and issues created by monopolistic behaviour of airports occur similarly in passenger and non-passenger aviation.

The current regulatory settings are focused on passenger based activities at major city airports. This is a particularly narrow focus and does not recognise the geographic breadth of the network or the importance of other elements vital to the success of the network such as freight, maintenance and aero-medical services.

The RAAA notes that the ACCC suggests:

*Aeronautical services, for the purpose of declaration, could be defined as services, provided by an airport, that are being used for the operation and maintenance of civil aviation services.*

The RAAA believes it is critical the Inquiry consider increasing the scope of aeronautical services and facilities defined by regulation 7.02A of the Airports Regulations 1997 (Amdt 8) to include critical infrastructure such as airside freight handling facilities and aircraft maintenance facilities.

### **The Commonwealth's provision of aeronautical services**

The RAAA takes the opportunity to highlight to the Inquiry the Commonwealth's inherent monopoly power in the provision of Aeronautical Services, particularly relating to the provision of Regulatory oversight (CASA) , the provision of air traffic management and navigation services (Airservices Australia (AsA)) and the provision of Security oversight (OTS).

Regional operators accept that those bodies are monopoly service providers that work within the framework of over-arching government policies of reasonable access for regional communities to high quality transport, telecommunications, education and health services.

However the RAAA wishes to highlight the very significant impact that policy changes, poor service delivery and pricing for services have on the viability of Regional Aviation, including the very limited redress RAAA Members have.

A prominent recent example is CASA funding a projected budgetary shortfall through the Excise Tariff Amendment (Aviation Fuel) Bill 2010 that resulted in an increased Aviation Fuel Excise of AUD\$0.00702 per litre. This increase was roundly criticised by the RAAA, was made without prior consultation to the industry, added to significant costs challenges within the industry and overlooks the obvious need for CASA to find internal efficiencies just as industry must.

Additionally with regard to the recent and yet to be finalised 2011 AsA Draft Price Proposal the RAAA is strongly opposed to pricing on a location specific basis and supports network charging. This has been the RAAA's consistent position for over ten years and this view has been expressed regularly to AsA and the Australian government.

Regional air services form an essential part of Australia's transport infrastructure. Location specific charging is highly disadvantageous to regional operators, many of whom are trying to rebuild regional air-routes. The number of towns/communities served by regional carriers has more than halved over the past twenty five years. There is a growing realisation that this shrinkage has gone too far and is holding back regional development at a time when it is most needed.

Further, the steadily and dramatically increasing cost of compliance with security considerations promulgated by the OTS also is incurred without redress.

While the RAAA supports the provision of safe air services to the public the reality exists that Commonwealth implementation of policy or lack of implementation of policy provides significant challenges to the viability of Regional Aviation businesses. This is particularly apparent when multiple governmental bodies are individually and in an uncoordinated manner increasing the financial impost to industry.

Industry is experiencing and projecting large overall increases in compliance costs as a result of these changes and others.

The RAAA encourages the Inquiry to consider initiatives to review the entire Government approach to the provision of relevant aeronautical services and the negative cumulative effect on industry.

In addition some government agency cost models are based on inputs that are higher than the industry can afford. Few companies in regional aviation would have salary levels that compete with the government regulatory and service delivery agencies.

### **Imbalance of bargaining power**

The RAAA strongly agrees with the ACCC's view that:

*“not all airlines have countervailing power in negotiations with the major airports sufficient to constrain any exercise of market power. In addition, the general provisions of Part IIIA do not present an effective constraint on the behaviour of the airports given the considerable time, costs and uncertainty faced by airlines seeking declaration”.*

The RAAA notes this is especially pertinent to smaller airlines and organisations such as those commonly found within the regional aviation sector. Further, such considerations are not solely limited to the major airports and the Inquiry needs to consider issues pertinent to smaller airports such as those commonly serviced by the regional aviation sector.

The regulatory settings should, ideally, also recognise that within an effective market, outcomes will benefit larger operators to the detriment of smaller operators and over time, smaller regional airlines and regional Australia will be the losers. This is already happening where airport costs are recovered on a common user basis and small airlines are paying for infrastructure they do not require and do not use. In addition, large airlines are able to negotiate more favourable outcomes that effectively create a cross subsidy from smaller operators. This gives rise to a triple effect where the smaller operator is bearing a disproportionate burden relative to the larger operator and is less able to bear this burden because of the lower economies of scale applying.

## CONCLUSION

### The context

In response to the Terms of Reference for this Inquiry, the RAAA considers there is sufficient evidence to conclude that:

- the privatisation of airports has resulted in the creation of monopolies, including many regional airports;
- not unexpectedly these monopolies are abusing their market power, especially in relation to smaller players who require access to airports to conduct their businesses but have little bargaining power;
- this inequality of bargaining power means commercially negotiated outcomes are not a realistic expectation, which leads to:
  - prices rising in excess of what would be expected in a reasonably competitive environment;
  - a lack of security of tenure;
  - a loss of lessee/tenant improvements without reasonable compensation; and
  - discrimination against smaller players in the pricing and quality of services offered.
- It would seem that a monitoring regime without compliance procedures or an enforcement mechanism is ineffective in restraining monopoly behavior.
- a price monitoring regime is substantively inadequate to restrain these abuses of monopoly market power.

### Recommendations

The RAAA supports an efficient market based access environment, which takes in to account that airports are monopolies, by providing appropriate regulatory settings.

The RAAA believes there is a pressing need to address serious problems and inefficiencies inherent within the current regulatory regime by strengthening and broadening the current regulatory settings to counter-balance the monopoly market power of airports and ensure more efficient outcomes for the whole network.

To this end the RAAA recommends:

- any regulatory regime be extended beyond the five monitored airports to encompass regional airports;

- any regulatory regime be extended beyond airline passenger activity to encompass all aviation activity including non-airline and non-passenger related;
- any regulatory regime be extended beyond the scope of aeronautical services and facilities defined by regulation 7.02A of the Airports Regulations 1997 (Amdt 8) to encompass all services and facilities essential to the operation of civil air services including aircraft maintenance facilities, airside freight handling facilities, airside access provisions, employee access to the airport inclusive of parking and public transport, and essential administrative facilities;
- any regulatory regime must have some form of compliance or enforcement mechanism; and
- any regulatory regime must be readily affordable to and accessible by smaller players.

### **Two-tiered regulatory solution**

The RAAA proposes a two-tiered regulatory solution.

#### **Tier 1**

A negotiate/arbitrate model may offer an effective solution. However, the arbitration mechanism must be such that it is not so expensive or cumbersome that smaller players are precluded from using it.

The RAAA considers it desirable to provide airports and industry with a readily accessible and speedy regulatory mechanism for simple disputes involving relatively minor commercial implications. This would be particularly important for smaller industry players who may lack the necessary resources to engage effectively with other forms of arbitration.

This mechanism could be the Commonwealth Administrative Appeals Tribunal or a similar mechanism such as an appropriately resourced and knowledgeable Industry ombudsman or arbitrator supported by appropriate and relevant legislation.

Such a regime needs to recognise that smaller players inclusive of those who must be on-airport to conduct their businesses are failing, because of the monopoly power of the airports, to negotiate reasonable price outcomes similar to the larger players.

The RAAA submits that a model for resolution of this problem as suggested by the Victorian Civil and Administrative Tribunal in the case of Bema Gold (Australia) Pty Ltd and Moorabbin Airport Corporation under the Victorian Retail Leases Act 2003 is worthy of consideration. As recourse to the ACCC under Part IIIA of the Trade Practices Act is beyond the resources of small (and probably all but the largest) operators and is uncertain, a resolution mechanism through the Commonwealth Administrative Appeals Tribunal could provide an effective remedy where the market has patently failed.

## **Tier 2**

The RAAA strongly agrees with the ACCC view:

*“deemed declaration under Part IIIA to be the most appropriate regulatory option for constraining those airports that exercise market power in the provision of aeronautical services. This approach would encourage the airports to behave as if their activities were carried out in a competitive marketplace.”*

To this end the RAAA strongly agrees with the ACCC proposal to deem airports as declared under Part IIIA of the Competition and Consumer Act 2010 provisional upon the regulatory regime being extended to encompass airports other than the five major airports, non-airline and non-passenger related aviation activity, and all services and facilities essential to the operation of civil air services.

The RAAA shares the ACCC’s view that deeming airports to be declared avoids the very expensive and time consuming process of declaration application, and creates at the commencement of commercial negotiations a more equitable bargaining position for all parties.

The implication is both parties are likely to negotiate in good faith so as to reach a mutually fair and reasonable commercial outcome. ACCC arbitration and ACCC imposed rulings should be the fallback but are neither desirable nor preferred.

## **The need for a Regional Aviation Inquiry**

Given the fundamental importance of regional aviation to the national economy and given that it is essential transport infrastructure, as well as the particular challenges that include and go beyond the scope of this Inquiry, the Commission should consider recommending a more general Inquiry into Regional Aviation.

There needs to be a greater understanding of how regional development is inextricably linked to regional aviation and the myriad of issues and challenges threatening the long term viability of this sector.

Within such an Inquiry the RAAA encourages the consideration of initiatives to review the entire Government approach to the provision of relevant aeronautical services and the negative cumulative effect on industry.