



**Australian Airports Association
Airports & Aviation Outlook 2005**

**14 November 2005
Graeme Samuel, Chairman**

The author of the Hitchhiker's Guide to the Galaxy, Douglas Adams, once noted that "It is no coincidence that in no known language does the phrase 'as pretty as an airport' appear".

Of course, that was written some years back now, probably well before the current fashion for disguising airports as shopping malls took off and airports changed from being fairly simple, drab arrival and departure terminals into glitzy designer showrooms.

I've no doubt travellers welcome these improvements, and the chance to spend more of their money on last minute guilt shopping for absent friends and family.

The fact is, however, that no matter how good looking they are, or how many shops they contain, the reputation of an airport will ultimately be decided by how good they are at dealing with their core business – flying.

By this I mean how quickly passengers are checked in and collect their luggage, how good the security is, the availability and standard of gates for airlines and, importantly, what the cost is.

The ACCC has a role in monitoring the quality of service provided by the seven major airports in Australia—Sydney, Melbourne, Brisbane, Perth Adelaide, Canberra and Darwin—and these are the sort of factors we monitor against.

Today I'm releasing the latest quality of service monitoring report and I will talk about that in more detail later, but the headline result is that over the last three years, the overall results for the seven airports have been satisfactory to good.

The ACCC's current roles in relation to aviation infrastructure are monitoring of the service quality and prices of airports and assessing price increases proposed by Airservices Australia.

It could also be that, depending on how events go with Sydney airport, the ACCC could be involved in arbitrating airport prices within the next few years.

I want to talk about that in some detail later, and about how the ACCC would hypothetically manage that situation, but first I want to turn to our current roles.

The ACCC's roles in aviation infrastructure services

The ACCC's involvement in regulating prices for monopoly aviation infrastructure services goes back to the early 1990s, when one of its predecessors, the Prices Surveillance Authority (PSA), regulated aeronautical charges set by the Federal Airports Corporation (FAC) and charges set by the Civil Aviation Authority.

Ownership and operational responsibility for 23 Australian airports, including all capital city airports, had been transferred from the Commonwealth Government to the FAC in the late '80s.

Similarly, Airservices Australia (Airservices) was formed in 1995 as a Government Business Enterprise, when the then Civil Aviation Authority was split into two bodies, Airservices and the Civil Aviation Safety Authority. The services of en route and terminal navigation and Aviation Rescue and Fire Fighting (ARFF) have been subject to price regulation since 1991.

In 1997, following the privatisation of the major airports, the ACCC was given the role of administering price caps for aeronautical services and monitoring of aeronautical-related prices and quality of service to ensure that the privatised airports did not abuse their market power with respect to aeronautical services.

Following an inquiry into the price regulation of airport services in 2001, the Productivity Commission recommended that airports with market power should now be subject to only a 'light-handed' approach to price regulation. In particular, the PC recommended that price notification and price caps under the (then) Prices Surveillance Act be discontinued for all airports (with the exception of regional air services at Sydney airport).

However, the Productivity Commission went on to recommend that price monitoring for Adelaide, Brisbane, Canberra, Darwin, Melbourne, Perth and Sydney airports be introduced for a five-year period and that a review be conducted at the end of the five-year period.

The Government outlined a number of 'review principles', against which it would judge whether an airport had 'unjustifiably' increased prices.

So, apart from regional air services provided by Sydney airport, airports are no longer subject to price caps and are not required to notify the ACCC before increasing prices.

In relation to both regional air services at Sydney airport and services provided by Airservices, the ACCC's role is to assess proposed price increases. Before increasing the prices of declared services, the ACCC must be notified under the provisions of the Trade Practices Act. The ACCC then has a responsibility to assess the proposed price increases and determine whether we think they are justified.

Airservices Australia

The ACCC has recently considered a long-term pricing proposal from Airservices for the five-year period to 2008–09.

This was the first long-term pricing proposal the ACCC had received from Airservices and it was prompted by the negative reaction to the previous short-term approach to pricing which had the effect of Airservices raising prices at times when flights were in a downturn.

Airservices devised its long-term pricing proposal in consultation with its users, including through the formation of an industry steering committee and working group and through separate consultations with regional and GA users.

The ACCC strongly welcomed Airservices' efforts in moving to develop longer-term pricing arrangements. The increased transparency and engagement of Airservices' customers has been roundly applauded. The approach resulted in a broad level of support on a number of aspects of the proposal which are usually controversial issues.

The ACCC decided not to object to the proposed price increases for terminal navigation services, and decreases for enroute services. However, we did object to the proposed increases for ARFF services. While not opposing the revenue estimates underlying the proposed prices, the ACCC was concerned that the pricing structure for ARFF services was not efficient and would have a large impact on smaller operators at airports where new ARFF services are being established.

The ACCC is currently in the process of assessing a proposal from Airservices relating to the structure of charging for its ARFF services. We will soon be releasing a preliminary view and will call for submissions from interested parties, which we will carefully consider before putting out a final decision before the end of the year.

'Light-handed' monitoring

The ACCC monitors airport prices, costs and profits under the provisions of Part VIIA of the Trade Practices Act, which were formerly contained in the Prices Surveillance Act.

The object of these provisions, as set out in section 95E of the Act, is 'to have prices surveillance applied only in those markets where, in the view of the Minister, competitive pressures are not sufficient to achieve efficient prices and protect consumers'.

It is worth asking the question at this point, 'What can monitoring of airports tell us?' The monitoring process is not a costless one; there are compliance costs on the part of the airports in compiling the regulatory accounts and quality of service returns, as well as other parties who provide information to us. And there is the cost in terms of ACCC resources in compiling the annual monitoring reports, which is not insignificant.

The ACCC's experience is that, in certain circumstances, monitoring is a useful process in identifying trends in prices, costs and profits. Trends can identify significant movements in prices, costs and profits and, for example, may identify whether expected price reductions from a particular reform eventuate and are passed through to consumers. Monitoring can also highlight significant movements in prices, costs and profits over time, which might lead to a more in-depth inquiry.

I'll turn now to the latest ACCC monitoring reports and what they do show.



Quality of service monitoring price-monitored airports

Key findings of the 2004–05 report

Quality of service monitoring

This Quality of Service Monitoring Report, which I am releasing today, is the third annual report which we have put out on the seven major airports, since price caps were removed. Originally, the quality of service monitoring role was designed to assist our role in regulating prices, to ensure that airport operators, who essentially control a monopoly, did not degrade service standards to reduce costs and increase profit.

Now that prices are no longer regulated, quality of service monitoring is an important complement to price monitoring. It can highlight whether airports are reducing or improving standards. It may provide information to airlines that will help them when negotiating commercially with airports, and makes the service standards far more transparent.

By providing comparative information on airport quality, quality of service monitoring can also provide an incentive (in addition to commercial incentives) to airports to maintain appropriate service standards.

Since 2002–03, the ACCC has reported on more measures of service quality. In particular, some 'objective measures' were introduced to complement the (largely subjective) surveys of airport users' perceptions.

Passenger perception surveys arranged by each airport provide information on passenger check-in, security clearance, government inspection, lounges, washrooms, baggage collection, signage, car parking, and vehicle access for arriving and departing passengers.

The ACCC has also surveyed airlines on their perception of the quality of facilities they use at the monitored airports. Airline surveys provide an insight into the quality of those high cost aeronautical services provided by the airport which are often provided 'behind the scenes' and out of the view of passengers. These services include runways, taxiways, aprons, aircraft gates, aerobridges, check-in and baggage handling facilities.

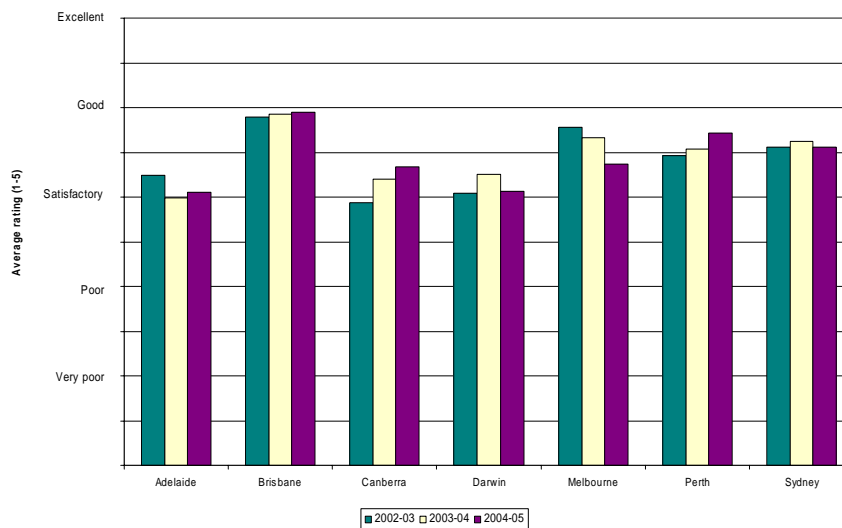
Airservices provides data to indicate the adequacy of airport runways to handle the traffic by recording peak-hour arrival performance monthly at Brisbane, Melbourne, and Sydney airports.

Finally, the Australian Customs Service (ACS) rates facilities provided by airports in the immigration arrivals and departures halls and baggage inspection or examination area.

The wide range of information sources collected helps to ensure that the true overall picture of airports' quality of service is presented.



Overall airport ratings



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This year's report found the overall ratings of the seven airports has ranged from satisfactory to good over the three-year period from 2002–03 to 2004–05.

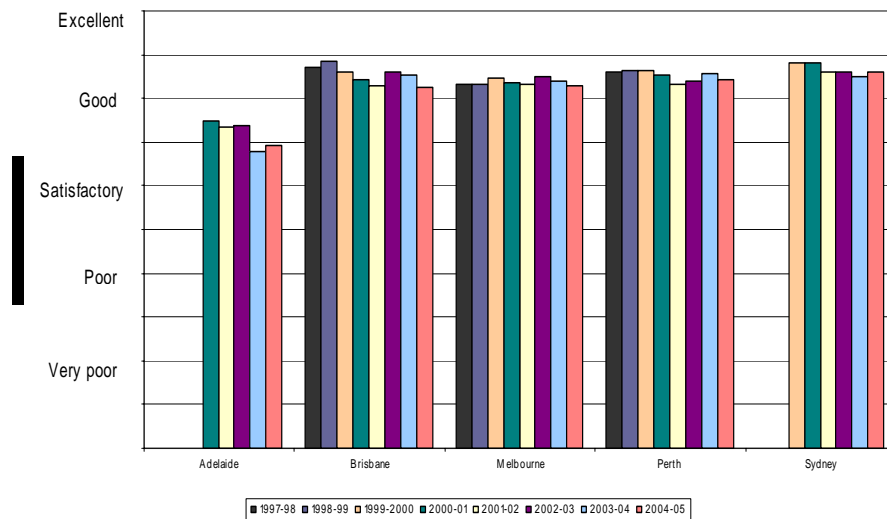
None have achieved the highest possible standard of excellent, but then none had been rated as poor or very poor either.

Over the three-year period, Brisbane has been the standout performer – rating as our top ranked airport every year, with an overall rating of good. Melbourne, Perth and Sydney airports have generally been rated between satisfactory and good, while Adelaide, Canberra and Darwin airports have generally been rated as satisfactory.

Melbourne airport’s rating has declined since 2002–03, with the decline mainly related to the availability of facilities, while Canberra airport’s rating has improved. However, Canberra airport does not provide information to enable the ACCC to derive objective indicators; therefore, its overall ratings are derived from a narrower range of indicators.



Average passenger ratings for international terminals

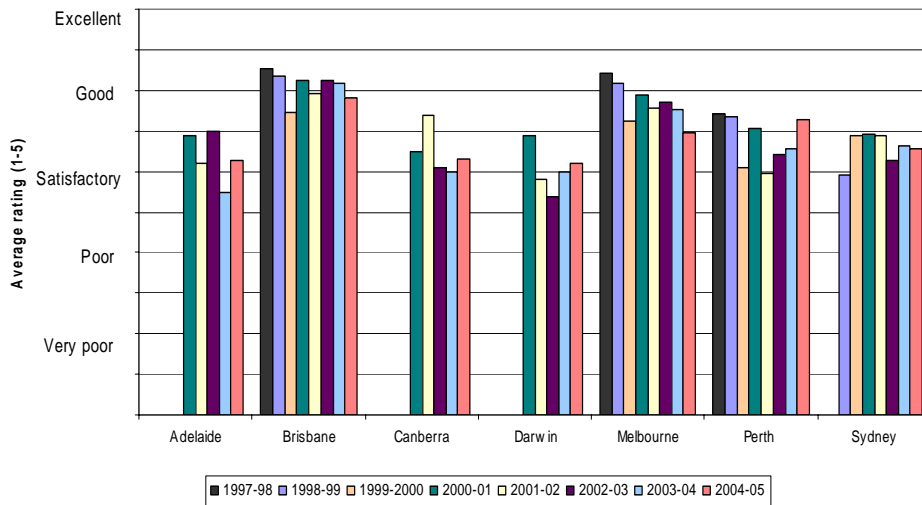


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Since 1997–98 passengers have consistently rated the international terminals at Brisbane, Melbourne, Perth and Sydney airports as good. Over a shorter time series, passengers have rated the domestic terminal facilities as good for Brisbane, Melbourne and Perth airports and as between satisfactory and good for Adelaide and Sydney airports.



Average airline ratings for airside facilities



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Since 1997–98 airlines have generally rated the airside facilities within the range of satisfactory to good and the international terminal facilities within the range of poor to good. Within these ranges, airlines have rated the facilities at Brisbane and Melbourne airports as better than those provided at other airports. Airlines have generally rated the domestic terminal facilities at all airports as satisfactory since 2002–03, except for Canberra airport, which was generally rated as good.

Since 1998–99, the ACS has rated airport facilities at all airports within the range of poor to good, with ratings being more variable compared with other survey responses. The ACS has generally rated Sydney as the best performing airport, rating its facilities as good over the period.

Monitoring of price of services provided by airports

As I mentioned earlier, the ACCC is also responsible for monitoring the prices, costs and profits of aeronautical and aeronautical-related services at Adelaide, Brisbane, Canberra, Darwin, Melbourne, Perth and Sydney airports.

Our report for 2004–05 is expected to be released early next year. Our most recent price monitoring report for 2003-04, released in February this year, showed that in the two years since the lifting of price caps, prices (as measured by aeronautical revenue per passenger) had increased significantly at all major airports.

While average airport costs have increased as a result of increased security requirements since September 11 2001, these were easily offset by price rises and, combined with increased traffic, airport profitability has therefore risen substantially over the period.

Aeronautical revenue per passenger remained relatively stable from 1997–98 to 2000–01 but then increased by between 46 and 201 per cent between 2000–01 and 2003–04. However, in 2003–04, increases in average revenue were less (up to 16 per cent) and, in some cases, average revenue fell.

Total aeronautical revenue generated by the price-monitored airports increased by 49 per cent to \$582 million between 2001–02 and 2003–04. Increases at individual airports over this period ranged from 24 per cent to 133 per cent.

Revenue from aeronautical-related services increased at all airports between 2002–03 and 2003–2004, with increases ranging from 5.8 per cent to 30.8 per cent. Increases in the operating margin for aeronautical-related services were over a similar range.

Difficulties encountered in monitoring ‘prices, costs and profits’

Aside from the issues I touched upon earlier, of what any monitoring regime is capable of showing, there are a number of difficulties in meaningfully reporting what the airports’ prices, costs and profits have been doing over time and these were highlighted in the 2003–04 report.

The first difficulty arises from the split of services into ‘aeronautical’, ‘aeronautical-related’ and ‘non-aeronautical’. While the Government has defined ‘aeronautical’ and ‘aeronautical-related’ in Direction 27, there are significant common assets and costs involved in the range of services supplied by airports, which means that relying on reported prices, costs or profits from ‘aeronautical’ services alone can be problematic. It is well known that there is a large degree of subjectivity and arbitrariness involved in making such allocations.

It is primarily for this reason that the ACCC also reports on total airport measures.

The ACCC has also faced difficulties in reporting on ‘profits’. While the ACCC generally uses return on equity measures in its regulatory roles, the unusual shareholder arrangements in place at the majority of Australian airports, when compared with publicly listed companies, mean that return on equity results do not give a true indication of airport profitability.

The ACCC has therefore also examined return on assets measures. However, this has the disadvantage of being reliant on the airport operators’ valuations of their assets and a number of airports have effected significant upward revaluations of their assets, which has the effect of lowering the reported return on assets.

While the ACCC can provide a degree of transparency in its monitoring reports, for example, by providing details of asset values over time, we have not attempted to evaluate the appropriateness of airport asset valuations. As stated in the report, asset valuation is often complex and contentious and is not something that can be resolved in a monitoring exercise.

Possible declaration of Sydney airport

I've been speaking about the ACCC's current role in relation to airports, which as I've explained, is a monitoring one. However, depending on the outcome of the Australian Competition Tribunal's decision on whether to declare Sydney airport, we might in the very near future have a role in arbitrating prices at Sydney airport.

I want to talk first about the process to date and how that highlights some of the problems with the economic regulatory framework that applies to essential infrastructure in Australia.

The process to date

Virgin Blue first applied to the National Competition Council for declaration of the airside service at Sydney airport in August 2002. The NCC released a draft report in June 2003 and a final report in November 2003. The minister ruled in January 2004, which was then appealed to the Tribunal and we still don't have a ruling on that.

If the Tribunal does declare the airport, there is then a negotiating process which could take six months to a year, and if there's no agreement the ACCC arbitrates, and anyone unhappy with our ruling can have that reviewed by the Tribunal. Oh, and every one of these steps is open to appeal in the Federal Court.

By my count it could be six or seven years to complete this process, by which time, say, Boeing has announced plans to design some new aircraft to compete with the new Airbus A380 and the whole process has to start again.

This is just one illustration of the need to look for ways to improve regulatory arrangements and practices to promote investment in essential national infrastructure in the long-term interests of the nation.

Reducing the time taken to make regulatory decisions is an important objective and related to this is the concept of pursuing the one perfect answer.

The framework in Australia allows processes to become very litigious, and hinders the opportunities to achieve effective outcomes within sensible timeframes.

On the subject of regulatory appeals processes, the Prime Minister's Infrastructure Taskforce recently concluded that:

... It is adversarial, cumbersome, complicated, time consuming, inefficient and subject to gaming by participants...

Extensive review processes means that time is taken up with the issues being rerun or re-heard by another regulator. It also means that the regulator can feel obliged to follow every rabbit down every hole 'just in case' some alternative argument can be found against the position that it intends to adopt. Yet, it is a fallacy to pursue a perfect answer for a regulatory decision.

Everyone wants quick decisions by regulators, but not everyone is happy to accept the umpire's verdict.

The Sydney airport case is not an isolated incident. In the Pilbara there is still no clear ruling on whether rail track services are covered by the Trade Practices Act and whether rival miners can have access to the services, eight years after the issue first arose.

There will always be a trade-off between delivering decisions quickly, and continually searching for a "perfect" regulatory outcome. As regulators, we could analyse regulatory issues to their nth degree, but in the interests of actually achieving outcomes, we must focus on the key goal of delivering decisions which promote efficiency, within the constraints of the framework prepared by policy makers.

I believe that there is a solution to the current impasse. The multiple levels of appeals must be amended. We should remove the requirement for re-hearing of decisions - that is for another regulator to re-hear and reassess the merits of all the arguments.

And so in the case of Sydney Airport, I would ask two questions in relation to that potentially long drawn out process.

Firstly, is it necessary or appropriate that a Minister's decision as to whether or not a service be declared should be subject to a complete re-hearing and assessment by the ACT?

And secondly, is it necessary or appropriate that the ACCC's determination on the arbitration of a pricing dispute between the airport owner and user airlines should be subject to a complete re-hearing and assessment by the ACT?

While we have, under the current process, obtained a "second opinion" from three individuals (a judge, economist and lay person) constituting the Tribunal, who is to say that this second opinion has any more merit than that of the responsible Minister or the 7 member (with economic, legal, financial, business and public administration expertise) ACCC?

This is not to suggest that regulators should not be accountable, or that errors or unreasonableness should not be subject to review. Review is an essential check and balance to the power of the regulator. However, reviews work best when the legislation very clearly sets down the principles that the regulator, vested with the decision making power, should take into account in making regulatory decisions.

Greater specificity in the legislation provides the regulator with more guidance - such as is now proposed for Part IIIA (access to services) of the Trade Practices Act, currently before Parliament. The proposed changes will give specific direction to the ACCC about the principles that should be taken into account when making a number of regulatory decisions.

And if parties to a regulatory decision are concerned that the principles laid down by Parliament in legislation have not been followed by the regulator, the concerned parties must have the opportunity to have the decision reviewed. Judicial review, generally undertaken by the Federal Court, enables this. But a judicial review assesses whether the regulator has adhered to Parliament's directions. It does not attempt to re-hear and second guess the merits of the regulator's decision.

At the moment we have both judicial review and so called merit review, which is effectively a re-hearing of the regulatory decisions regardless of whether or not there is error. This is inherently inconsistent with timely decision making.

Potential role of the ACCC

As I have said, if Sydney airport is declared, and the parties then cannot agree on the terms and conditions of access, either party may request the ACCC to arbitrate the dispute by making a determination.

So, while the ACCC is no longer involved in enforcing price caps at the airports, or assessing proposals to increase prices at Sydney airport, we would need to assess prices in the event that Sydney airport is declared and one party requests us to arbitrate.

The ACCC has not arbitrated under Part IIIA before, so I cannot draw on examples here to illustrate how we would do the job. But, once the Parliament has determined what changes will be made to Part IIIA, the ACCC will publish guidelines which will spell out the process we intend to follow in the event we are required to arbitrate.

The proposed amendments to Part IIIA would introduce pricing principles, which the ACCC would need to have regard to in arbitrating an access dispute. The pricing principles state that the regulated access price should:

- be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services; and
- include a return on investment commensurate with the regulatory and commercial risks involved.

The amendments also specify timeframes within which the declaration and arbitration processes are to be carried out. The NCC would be required to use its best endeavours to make a recommendation to declare or not to declare a service within 4 months. The ACCC, after being notified of an access dispute, would be required to use its best endeavours to make a final determination within 6 months.

It will still be open for parties to appeal the ACCC's decision to the Tribunal, but the changes would see the Tribunal having a target time of 4 months to review the ACCC's determination.

So, to sum up on Sydney airport, the process to date has been a long one and the road from here is also long and involves numerous avenues for

review and rehearing. In my view, it's not an ideal process to ensure we get efficient investment in infrastructure in Australia, but the ACCC would do all it can within our powers to make the right decisions in accordance with the legislative criteria and the economic merits of the case in a transparent and timely fashion.

Conclusion

As a Chairman of the Australian Competition and Consumer Commission who lives in Melbourne, attends meetings every week in Canberra, visits every capital at least once a year and frequently travels overseas, no regulator takes a keener interest in Australian airports than me.

For me, I can assure you, monitoring airport standards is not just a job, it's a personal dedication!

Our latest monitoring reports show, on the whole, the standard of Australian airports is satisfactory to good.

I hope all of you here will see that verdict as a challenge to further improve standards so that some time, in the very near future, I can release a monitoring report that proudly declares the standard of all the airports we monitor to be excellent.