AUSTRALIAN COMPETITION & CONSUMER COMMISSION

Submission for Infrastructure Committee

Date of meeting	31 January 2022
Paper number	IC2122/24
Title	For information – update on industry consultation for the 2020-21 Airport Monitoring Report and proposed report structure
Recommendations	That the Committee notes the update on the industry consultation findings for the 2020-21 Airport Monitoring Report. That the Committee notes the proposed structure of the 2020-21 Airport Monitoring Report.
Next steps	14 March 2022 – Present draft report to IC 30 March 2022 – Present draft report to Commission
Project staff	Matthew Lesich (presenting) (x6907), Gennady Kleiner (Director) (x1842), Olivia Tsang, Adele Teh, Sebastian Lavers
Responsible SES	Matthew Schroder (x6924)
Division, Branch and Office	Infrastructure Division (ID), Infrastructure and Transport – Access and Pricing (ITAP) Branch, Adelaide/Canberra/Melbourne
Legal/Economic input	Regulatory Economic Unit (Robert Albon, Patrick Wu, Su Wu) ☒ This paper contains confidential and privileged material (shaded)
Commissioner conflicts	Not applicable
Consultation with other branches, groups or divisions	Not applicable

1. Purpose

1.1. Staff seek to update the Committee on our industry consultation for the 2020-21 Airport Monitoring Report and proposed report structure.

2. Recommendations

2.1. That the Committee notes the update on the industry consultation for the 2020-21 Airport Monitoring Report.

2.2. That the Committee notes the proposed structure of the 2020-21 Airport Monitoring Report.

3. Background

3.1. On 6 December 2021, the Committee noted our proposed approach to conducting industry consultation to better understand the impact of the COVID-19 pandemic on the aviation industry. The Committee also noted our proposed approach to seek further information in relation to the concerns raised by airlines regarding airports' conduct when negotiating Aeronautical Service Agreements (ASAs).

3.2. We have sent surveys to the following parties:

- airports (the four monitored airports of Brisbane, Sydney, Melbourne, and Perth, as well as Adelaide, Canberra, Gold Coast, and Hobart)
- domestic airlines and airline industry bodies (for international and domestic airlines)
- commercial operators (for example, car rental providers and retail tenants)
- landside access operators, including off-airport parking operators.

3.3. As the Committee is aware, [redacted]

3.4. We wrote to [redacted]

4. Industry consultation

4.1. To date we have received 14 survey responses from:

- airports: [redacted]
- airlines and industry bodies: [redacted]
- commercial operators: [redacted]
- landside access operators: [redacted]

4.2. We are still expecting to receive responses from [redacted]

4.3. Based on responses to date, the key findings are:

- A significant fall in passengers due to the pandemic has caused financial challenges for all segments of the aviation industry.
- All market participants have taken steps to reduce costs during the pandemic, including reducing staff, inventory and operating hours.
- Airports and governments have offered significant financial relief to airport users during the pandemic.
- Airlines and other market participants are concerned that airports may seek to recover their pandemic losses through future increases in charges.
- Airports have told us that they have not sought to recover their lost profits or unrecovered costs[1] and do not intend to do so in the future.
- [redacted] have told us that they use BBM or something similar to inform their negotiations with airlines and have claimed that they provide sufficient information to airlines for the purpose of negotiations.
- [redacted] have told us that [redacted]
- [redacted]
- All market participants expressed concerns that the unpredictable nature of the pandemic and government border restrictions (both within Australia and globally) are making recovery more challenging.

4.4. This section sets out the findings from the consultation to date in further detail.

Impact of COVID-19 on the aviation sector

Airports

4.5. Since March 2020, border closures and travel restrictions suspended many flights, resulting in a fall in passenger numbers at all surveyed airports. [redacted]

4.6. Despite the fall in passenger numbers, airports incurred additional costs from COVID-safe and Occupational Health and Safety protocols, such as extra cleaning services, air filtration requirements, additional protective equipment for staff and passengers, security to enforce social distancing rules and extra signage.

[1] Lost profits: amounts in excess of efficient costs that the airport expected to earn during the previous ASA but which were unable to earn due to the COVID-19 pandemic. Unrecovered costs: Costs that the airport incurred under a previous ASA but which were unable to recover due to the COVID-19 pandemic.[1]

4.7. Some airports commented that Virgin's voluntary administration led to them being unable to recover the amount owed to them[2]. For example, [redacted]

4.8. Airports also reported that some commercial tenants closed, resulting in lost revenue, and these vacancies had yet to be filled.

4.9. The reduction in passengers also affected car parking activity, leading to closure of certain airport car parks. Some airports provided free car parking for COVID vaccination hubs and this further reduced their car parking revenue.

4.10. Overall, each airport reported that it suffered a fall in revenue across a wide range of activities, including aeronautical, commercial tenants, car parking and landside access. Compounded with additional costs incurred, this significantly impacted airports' profitability.

4.11. For 2020-21, out of the four monitored airports, Melbourne Airport recorded the worst operating margin for aeronautical service of -133% (a loss of approximately $170 million). This operating loss represented a drop of 185% compared to the pre-pandemic operating profit margin in 2018-19.

Airlines

4.12. For 2020-21, Qantas reported a drop in total revenue from the pandemic of $16 billion and a $2.3 billion operating loss.

4.13. International airlines have also reported that their passenger numbers have fallen by 97% and their revenue by over 80% since the start of the pandemic.

Commercial and off-airport parking operators

4.14. Retailers and car rental operators located at the airports have incurred additional costs in cleaning their facilities/ premises in line with health requirements despite low passenger movement.

4.15. The reduction in passenger numbers also led to commercial and off-airport car-parking operators suffering a decline in revenue and profitability.

- [redacted]
- [redacted]

<u>Responses to the pandemic</u>

Airports

4.16. Both monitored and non-monitored airports took measures to reduce costs during the pandemic, including reducing staff, reducing operating hours, closing terminals and car parks and renegotiating security and cleaning contracts (cost recovery is discussed below at the section under 'Security charges').

[2] For more details of Virgin's voluntary administration, see 'Airline competition in Australia – September 2020', p. 6

- [redacted]
- Perth Airport temporarily closed Terminal 1 Domestic and restricted operation hours in two terminals, placing some flights into a different terminal instead.

[redacted]

4.17. Perth Airport has started implementing contactless procedures for car parking activity and has incurred capital expenditure as a result.

4.18. Airports stated that they had provided relief to airlines, such as free aircraft parking, rent abatements, aeronautical pricing discounts, office, and lounge rent relief. [redacted]

4.19. All monitored airports provided various level of rent relief to commercial operators. [redacted]

- Car rental companies indicated that the airports had also waived their fixed annual payment.

4.20. Investment was impacted in various ways, with some airports delaying or reducing the scope of their projects, while some accelerated certain projects.

[redacted]

4.21. Several airports either provided discounted or free car parking during the pandemic. [redacted]

Airlines

4.22. Airlines have reduced their staffing levels in response to international and domestic border closures. Some international airlines report that they have reduced their staffing by 80-90%. Qantas has reported standing down thousands of its crew members.

4.23. Airlines have also received support from government. This support included the Australian Airline Financial Relief Package, the Domestic Aviation Network Support package, International Aviation Support package and other support packages Airports argued that government financial support received by airlines during the pandemic did not pass through to the airports.

Commercial and off-airport parking operators

4.24. Off-airport parking operators, retailers at airports and car rental companies indicated that they had to significantly reduce staffing numbers through redundancy.

4.25. [redacted]

4.26. Car rental companies did not mention receipt of any government support but indicated they also closed some booths and sold off their fleets.

4.27. [redacted]

Concerns and challenges surrounding recovery

4.28. Airports, airline industry bodies and commercial operators expressed concern that the unpredictable nature of the pandemic, combined with inconsistent and uncertain government border restrictions (both within Australia and globally), are creating significant uncertainties for the industry.

4.29. Some airports and airlines have indicated that these uncertainties are making recovery more challenging because they are impeding everyone's ability to plan ahead and denting traveller confidence.

4.30. Airports and commercial operators have indicated that additional costs associated with cleaning and additional protective equipment due to COVID-19 are likely to stay in place and become ongoing costs.

4.31. Airports also stated that they expected passenger demand for contactless technologies to increase over the coming years, necessitating further capital investment.

4.32. Some airports have stated that additional health and safety procedures are increasing processing times and affecting on-time performance. [redacted]

4.33. Several airports have stated that on-time performance is likely to be adversely affected once passenger numbers return to pre-pandemic levels, if the existing COVID-19 check-in procedures remain in place. [redacted]

4.34. [redacted] This can further impede airports' recovery by reducing the amount of rental income that they receive.

4.35. [redacted]

4.36. Some rental car companies expressed concern that airports may attempt to recover their operating losses from tenants in the future and/or return to a 'take-it-or-exit' negotiating position. These operators noted that any increase in charges or rent by airports will ultimately flow through to consumers.

4.37. Commercial operators and off-airport parking operators also noted that due to the uncertainties in the aviation and tourism industries, it would be difficult to rehire suitable employees as travel resumes.

4.38. Off-airport parking operators were concerned that heavily discounted outdoor parking at airports impacts the level of competition.

[redacted]

Charges

Recovery of lost revenue or unrecovered costs

4.39. All airports surveyed have asserted that they have not sought to recover lost profits[3] or unrecovered costs[4] from the airlines through aeronautical charges in new aeronautical agreements.

[3] Any amounts in excess of efficient costs that the airport expected to earn during the previous ASA but which were unable to earn due to the COVID-19 pandemic.

[4] Costs that the airport incurred under a previous ASA but which were unable to recover due to the COVID-19 pandemic.

Table 1: Airport responses on pricing negotiations

[redacted]

Security charges

4.40. Airports incur security costs for baggage and passenger screening and government mandated protocols. All or most of these costs are passed on to airlines. The government increased some security requirements during the pandemic which increased the costs incurred for equipment and staff.

4.41. The security charges that airports charge to airlines may include airfield security and terminal security and are often set per passenger.

4.42. During the pandemic the government has provided grants and rebates to airports and airlines for security charges:

- The Australian Airline Financial Relief Package (the program) from 1 April 2020 to 30 September 2020 provided a waiver on government charges for security charges.
- Domestic Aviation Security Charges rebate from 1 February to 31 December 2020: grant payments to airlines equal to the amount of reasonable airport security costs paid for domestic flights and other associated activity
- The International Airport Security Charges Rebate program provides security screening cost rebates for Australia's major international airports from October 2021 to March 2022.

4.43. The government grants and rebates are capped amounts that apply to specific security costs and may not have covered all airports' relevant security costs.

4.44. Some airports are seeking to partially recover past security costs through new or increased security charges.

- [redacted]

- [redacted]

4.45. [redacted]

Negotiation of aeronautical agreements

4.46. During the pandemic, some airports negotiated new long-term agreements with airlines while others rolled over existing agreements or had continuing agreements:

- [redacted]

Aeronautical Pricing Principles

4.47. [redacted]

4.48. [redacted]

4.49. The APPs[5] include principles relating to the following:

- prices for aeronautical services and facilities should be set to generate revenue to meet efficient costs
- good faith commercial negotiations
- principles relating to service levels

[5] The Aeronautical Pricing Principles are set out in the 2007 *Government Response to the Productivity Commission Inquiry Report – Review of Price Regulation of Airport Services*

- pricing regimes to reduce costs or otherwise improve productivity
- reasonable sharing of risks and returns including relating to changes resulting in over or under recovery of agreed allowable aeronautical revenue
- allow multi-part pricing and price discrimination when it aids efficiency; and
- peak period pricing allowed where necessary to efficiently manage demand.

4.50. The table below summarises the airports' responses to the following matters:

- Application of APPs
- Use of the BBM
- Whether sufficient information was provided to airlines in negotiations
- Use of commercial arbitration.

Table 2: Airport responses on pricing negotiations

Airport	*APPs applied?*	*BBM applied?*	*Information provided to airlines in negotiations*	*Use of commercial arbitration*
[redacted]				

[redacted]

[redacted]

Airports' further comments on pricing

[redacted]

[redacted]

4.51. In response to our question seeking information on the charges proposed in opening offers and final positions, [redacted]

Airports' additional comments

[redacted]

[redacted]

[redacted]

[redacted]

6. Proposed structure of the 2020-21 report

6.1. The 2019-20 Airport Monitoring Report contained a chapter discussing industry developments, a chapter presenting industry overview (comparing airport performance across industry segments and categories), and individual chapters on the four monitored airports (discussing aeronautical operational and financial performance together with limited quality of service results and pricing analysis on car parking and landside access).

6.2. As noted previously to the Committee, the 2020-21 report will not include quality of service as the airports ceased collection of that data during the pandemic.

6.3. We propose to re-structure the 2020-21 report to focus on industry segments, rather than individual airports. This year's report will include:

- a chapter analysing the overall performance and activity of the monitored airports
- chapters analysing each segment of the industry (i.e., aeronautical, car parking, landside, commercial), discussing short-term and long-term trends
- a chapter reviewing the application of APPs and analysing information provided by airports and airlines about their negotiations

- a chapter discussing investment projects completed or postponed by the airports during 2020-21, and investment trends over the long-term.

6.4. This approach will make it easier for us to describe the issues, compare airport performance, identify short-term trends and explain our views for each industry segment. The report will also aim to present longer term trends that are facing the monitored airports.

6.5. We appreciate that there are some parties that rely on us publishing data on individual airports. We will still publish the usual data for each airport in the appendices or in supplementary materials published on the ACCC website.

7. Next steps

7.1. We will bring a draft Airport Monitoring Report to the Committee in mid-March.

7.2. We will present the report to the Commission for consideration at the end of March.

7.3. The report is scheduled to be published in early April.

8. Attachments

[redacted]

[redacted]

[redacted]

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