

Productivity Commission Inquiry

Submission by Regional Express

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1. Background about Regional Express

1.1. **Regional Express** was formed in 2002 out of the collapse of the Ansett group, which included the regional operators Hazelton and Kendell, in response to concerns about the economic impact on regional communities dependent on regular public transport air services previously provided by Hazelton and Kendell.

1.2. Regional Express Holdings Limited was listed on the ASX in 2005. The subsidiaries of Regional Express are:

- Regional Express Pty Limited (**Rex**), the largest independent regional airline in Australia and the largest independent regional airline operating at Sydney airport;
- **Air Link** Pty Limited, which provides passenger charter services and based in Dubbo NSW,
- **Pel-Air** Aviation Pty Limited, whose operations cover specialist charter, defence, medivac and freight operations; and
- the Australian Airline Pilot Academy Pty Limited (**AAPA**) which provides airline pilot training and the Rex pilot cadet programme.

1.3. Rex has regularly won customer service awards for its regional air services and in February 2010, Rex was awarded “Regional Airline of the Year 2010” by Air Transport World. This is only the second time that an Australian regional airline has won this prestigious international award, the previous occasion being in 1991 when this award was won by Kendell. It was also ranked (second year in a row) as the Top Performing Regional Airline

2010 by PriceWaterCoopers in a survey of all listed carriers in the world based on 19 financial indicators. Domestically it has been rated by Choice magazine as the best or second best Australian carrier in terms of customer satisfaction in the last 4 surveys conducted.

1.4. This submission mainly focuses on the issues experienced by Rex and Pel-Air in relation to Sydney Airport, but also addresses some issues experienced at other airports. Sydney Airport is not only Australia's main aviation gateway and an essential transport hub for NSW but the experience of Rex and Pel-Air in dealing with Sydney Airport is that achieving successful commercial outcomes is almost impossible for smaller users (contrary to the assertions of the Department of Infrastructure and Transport in its submission). Smaller users face a lack of transparency and heavy handed tactics, there is little they can do about decreased service and increased charges, and it is clear that Sydney Airport has no fear of bad publicity or criticism.

1.5. The Productivity Commission has asked the fundamental question about this Inquiry: *At a broad level, is there value in continuing the monitoring of aeronautical services and/or parking prices? Is there evidence that the current light-handed approach has not been successful in addressing market power concerns, and if so, what alternatives are available?*

1.6. Section 2 of this submission provides a high level response to this fundamental question and answers the assertion by the Department of Infrastructure and Transport that there is no problem with the current approach. Sections 3 - 6 provide supporting evidence about specific issues with respect to aeronautical charges and rents at Sydney Airport. Section 7 comments on the proposal by the Australian Competition and Consumer Commission (ACCC) for an alternative approach to Sydney Airport involving a deemed declaration of aeronautical services at Sydney Airport under Part IIIA of the Competition and Consumer Act. Section 8 discusses issues with other airports and provides some examples of positive airline-airport relationships. Section 9 contains conclusions.

2. High level response to the Inquiry

2.1. The key issue the Productivity Commission has been asked to look at is the appropriateness of economic regulation of airports. This begs the question as to what is meant by "appropriate" and the reasons why Governments regulate monopoly facilities.

2.2. The starting point is the assumption that, in a competitive environment, commercially negotiated outcomes are the best outcomes to drive investment and efficiency. It allows markets to find the 'right' price for both buyer and seller and allocate risks to those best placed to bear them.

2.3. However, market power can mean that this does not work as it should because a business with market power will behave differently to how it would behave in a competitive environment.

2.4. So, the key reason for regulation is that there is a market power problem that is affecting other markets upstream or downstream. The way it affects them could be to impede investment in those other markets, to make those markets less competitive or less efficient, to make prices higher than they should be, etc

2.5. This is why Governments tend to regulate where there is clear evidence of a market power problem (eg evidence of a business not behaving as it would in a competitive environment with visible impacts).

2.6. So, in this public submission, Regional Express has focused on the following in relation to Sydney Airport, noting that Regional Express has also provided confidential feedback to the Productivity Commission:

- providing illustrative examples of how the market power problem at Sydney Airport affects smaller users such as Rex and Pel-Air and how Sydney Airport behaves differently to the way an airport would in a competitive environment;
- demonstrating via these examples that mutually satisfactory commercially negotiated outcomes are not possible due to the uneven bargaining power of Sydney Airport and that “naming and shaming” Sydney Airport makes no difference to its behaviour; and
- concluding from these examples that current processes and remedies are inadequate to resolve suspected market power issues and protect smaller users.

2.7 Regional Express has also experienced issues with some regional airports and some recent issues with Melbourne Airport. In contrast, Regional Express has had some positive experiences of airports focusing on their airline customers and encouraging use and investment by airlines, which is how a business would behave in a competitive environment. This provides a helpful point of comparison in terms of identifying specifically how market power affects airport behaviour.

2.8 In contrast to the specific evidence provided by Regional Express, the Department of Infrastructure and Transport has argued for the continuation of the current regime of price monitoring (with some enhancements to the data captured in the monitoring) on the basis of asserting that there is no evidence of a market power problem.

2.9 The Department’s view is based on the premise that airlines have been able to negotiate mutually satisfactory commercial arrangements with airports, so there is no real

problem – and thus any stronger regime (including making access to ACCC arbitration easier) will create uncertainty and dampen airport investment.

“Airlines continue to express dissatisfaction from time to time with the quality of particular services provided by some airport operators, but nevertheless airlines have, as far as the Department is aware, been able to settle long term commercial contracts on pricing and service levels.”

“The experience to date is that disagreements on access to airport services and facilities are eventually resolved through commercial negotiations, despite sometimes difficult negotiations.”

However, this is simply not true for smaller airlines such as Rex. As explained in detail in this submission, Rex’s experience with Sydney Airport has shown that mutually satisfactory commercially negotiated outcomes are not possible for smaller airlines – see section 5.

And even for the larger carriers, it appears to Rex that it is nonsensical to point to the existence of long term commercial contracts as being proof that there is no abuse of market power or efficiency impact downstream. Major carriers, not being able to simply stop using Sydney Airport, could be signing such contracts under duress or as the “least worst option” with consequent efficiency impacts.

2.10 The Department clearly believes that the ACCC monitoring reports are sufficient to hold the exercise of any market power in check:

“Scrutiny of the potential receipt of monopoly rents by airports, along with the threat of re-regulation, is an appropriate deterrent to the abuse of market power.”

However, as the ACCC itself has noted, airports do not really take any notice of the ACCC monitoring reports and the prospect of being “named and shamed” has made no difference to Sydney Airport’s behaviour and tactics – see section 6.

2.11 The Department also suggests the process in Part IIIA of the Competition and Consumer Act 2010 is an adequate safety net for when commercial negotiations reach an impasse.

“While the Department supports commercial negotiations as the best means of setting efficient aeronautical charges, should negotiations fail it is still possible for airlines and other airport users to seek arbitration through the National Access Regime in Part IIIA of the Competition and Consumer Act 2010.”

“As evidenced by the October 2002 application for the declaration of aeronautical services at Sydney Airport, such processes can be lengthy and expensive. But the

successful conclusion of negotiations after the declaration (without needing recourse to final arbitration by the ACCC) indicates the value of the Part IIIA processes where serious differences exist.”

However, it is inconsistent for the Department to say this, given that it took from 2002 to 2007 for Virgin Blue (now Virgin Australia) to achieve a commercial resolution from Sydney Airport. It was only after all avenues for objection to declaration had been exhausted by Sydney Airport, and Virgin Australia had finally been able to actually initiate an ACCC arbitration that a commercial resolution emerged. That is the point of the ACCC’s recommendation about deemed declaration.

2.12 There is no basis for asserting that making it easier to initiate an ACCC arbitration will create uncertainty or delay or impede investment. The ACCC has clear powers under Part IIIA to terminate an arbitration at any time if the dispute is trivial, vexatious or the party who initiated the arbitration has not engaged in negotiations in good faith (section 44Y). Further, the protections in sections 44W and 44X ensure that investment will not be deterred, and as the ACCC has noted, its regulatory experience in other industries – eg energy – has shown efficient investment to be actively encouraged.

2.13 The Department also suggests that there is a further protection in that the Minister can initiate an ACCC inquiry *“should the ACCC monitoring report or other evidence indicate that an airport warrants further investigation for its pricing behaviour, the Minister retains the discretion to recommend a formal inquiry under the Competition and Consumer Act.”*

However, the last ACCC monitoring report clearly indicated that further investigation of Sydney Airport’s pricing behaviour was warranted, and Rex has provided detailed evidence to the Minister in support of a formal inquiry (which has been provided to the Productivity Commission on a confidential basis). In addition over 3,000 stakeholders, both elected members and normal constituents, have written to the Minister to support an ACCC inquiry into Sydney Airport. Yet, this has not been acted on by the Minister.

2.14 Ultimately, the Department simply denies any evidence of a problem:

“Airlines do continue to suggest that the major airports enjoy more market power in these negotiations and that recourse to compulsory arbitration mechanisms should be considered. The Department is yet to see convincing evidence that the current approach is not working in terms of pricing and quality of service outcomes.”

“And airlines have not, at least in the period since the last Productivity Commission Inquiry in 2006, sought the active intervention of the ACCC in these negotiations.”

However, again this is not true for smaller airlines like Rex. Rex actively sought the intervention of the ACCC in relation to the massive aircraft parking increases which Sydney Airport sought to impose in 2010, as discussed in section 6.

2.15 As implicitly recognised by the Productivity Commission in 2002, one of the dangers in taking the experimental path of a light-handed regime for airports is that views about its success will tend to involve subjective judgements. This makes it very important to build in safeguards to ensure that assessments of the regime are objective and evidence-based. The comments quoted above suggest to Rex that the Department has not adopted an objective evidence-based position on this matter. This may be understandable given the Department's historic involvement in the establishment of the original privatisation and regulation of airports. However, it makes it even more vital that the Productivity Commission place significant weight on the views of the independent regulator (the ACCC) and the objective evidence presented to it in this inquiry.

3. Evidence of problems with Sydney Airport

3.1. There is a market power problem at Sydney Airport, which is affecting Rex and Pel-Air through degradation of service, price increases, delays and uncertainty in processes which impact on investment and efficiency for smaller airline users.

3.2. The following examples illustrate some of the problems Rex and Pel-Air have experienced:

Example: decreases in service to regional airlines since 2002

3.3. Since 2002 service levels to Rex have decreased reflecting the fact that regional air services are a low priority use for Sydney Airport even though revenue to Sydney Airport from regional charges has increased without a commensurate increase in cost to serve.

3.4. For example, since 2002 Rex has been pushed further away from the terminal fingers and aerobridges, and is required to tow aircraft to park in the GA area (allowing Sydney Airport to increase revenue from higher paying users).

3.5. Sydney Airport has an operational system for deciding where aircraft park each day. As part of this system, Rex is given designated parking bays but these are all common user bays and usage is subject to Sydney Airport's daily directions. Rex and other users are required to give Sydney Airport one day's advance notice of which aircraft they will be using for which services. Sydney Airport then manages aircraft parking throughout the day according to what is most efficient and profitable for the airport.

3.6. What maximises profitability for the airport may make an airline less efficient or add cost or reduce the quality of service to the airline's passengers. Without competition or

regulatory oversight, there is no 'check and balance' on this and whether it amounts to pushing certain types of users out of an essential transport hub.

3.7. Rex aircraft are typically parked for turnarounds in the bays marked as 'Regional Stand Off Parking' on the map attached (Appendix 1). Passengers and bags need to be moved out to these areas for boarding. Rex's crew room is below Gate 39 and Gate 47 is where all Rex passengers are bussed to and from. However, if Sydney Airport requires the terminal bays used by Rex for another more profitable use, it will direct Rex to park aircraft in the GA area (marked on the map). This necessitates towing the aircraft between the bays and the GA area. It requires 2 engineers and can take up to an hour to move a plane between the GA area and the terminal bays.

3.8. This has a number of consequences for Rex:

- it makes Rex have a less efficient and more costly operation – for example, the general 'minimum' turnaround time for Rex aircraft parked on terminal bays at Sydney Airport has progressively increased from 30 min to 45 min since 2002 and Rex has to incur approximately \$1m of additional cost bussing passengers to and from aircraft;
- it introduced a new parking cost for Rex – namely the \$60 per day GA parking charge; and
- it also places Rex, as an independent regional airline, at a disadvantage to regional services operated by Qantas (which has its own facilities at Sydney airport).

3.9. Rex's commercial driver is to make money from flying its planes; it doesn't make money having them sitting idle on the ground. Rex tries to turn around aircraft as quickly as possible, but the way Sydney Airport manages parking makes it increasingly harder for Rex to achieve a quick turn around, because Rex is being pushed further away from its single departure and arrival gate. The single departure and arrival gate also creates further aircraft turnaround time constraints due to the necessity of managing departure and arrival clashes for the efficient flow of passengers and coordination of remote passenger bussing. In addition, some parking bays designated for regional services are being upgraded to 737/A320 size aircraft bays and so will no longer be as available for regional services

3.10. Sydney Airport (in its 2010 price notification to the ACCC) argued that increasing parking charges will improve incentives and encourage an efficient use of scarce airport assets. However, (as Rex explained in its submission to the ACCC on the 2010 price notification), this cannot operate as an economic signal for Rex to change its usage (as Rex has no control over Sydney Airport's operational management) and it won't result in a more efficient use of airport resources; it just increases Rex's costs.

Example: GA price increases

3.11. Both Pel-Air and Rex pay GA aircraft parking charges (Rex for the reasons described above). In 2010 Sydney Airport increased its GA aircraft parking charges by 67% which was well in excess of CPI. It also flagged further hefty price increases in the next two years. The ACCC found that Sydney Airport should have notified these GA parking increases in relation to regional airlines (which led to Sydney Airport withdrawing the increases for Rex) as discussed further in section 6. However, the full increases were applied to Pel-Air.

3.12. Shortly after the new charge was put in place Sydney Airport proposed that an extra 43% increase be applied to pay for apron lighting works. This proposal meant a total increase of 138% was applied to GA parking charges by Sydney Airport.

3.13. GA operators find it hard to deal with such increases given the markets in which they operate. For example, the increases highlighted in 3.11 and 3.12 above would have seen Pel-Air's costs increase by \$105k per annum. As a result Pel-Air has had no choice but to cease its Sydney based activity.

Example: failed attempts at initiating dispute resolution processes on rent increases

3.14. Sydney Airport has a practice of notifying rent increases based on surrounding rents which are properties where it has itself set the 'market rate'. This gives it the ability to push rents up to a level not possible in a competitive environment.

3.15. Regional Express has twice been notified of a 30% rent increase on this basis to which it has objected arguing that a CPI increase is more appropriate.

3.16. On the first occasion dispute proceedings as per the standard Sydney Airport lease agreement were initiated to allow adjudication by an independent party. This involved Rex incurring some needless expense as Sydney Airport subsequently declined to take part in the process. On the second occasion the lease agreement had expired and Rex was forced to simply refuse to pay the increase and risk eviction. After Rex's refusal to pay the initial 30% increase the lease was never renewed and Rex has not had tenure for its hangar site for some years as a result. Because of the lack of tenure, Rex has found it difficult to make certain investment decisions – precisely the type of situation which typically requires a regulatory solution (see 2.4 above).

Example: passing on all costs as NNI with total cost recovery

3.17. Sydney Airport passes on all costs associated with infrastructure investment and maintenance from renewing carpet or lighting up to major runway upgrades. Such costs are classified by Sydney Airport as 'Necessary New Investment' (NNI) even when they are maintenance items or other types of expenditure and Sydney Airport insists on total cost

recovery for these items which is done through a levy on the PSC (Passenger Service Charge). Sydney Airport also requires a ROI (Return on Investment) for such items.

Just a few examples of the misapplication of the NNI principle are the T1 Arrivals Seating Upgrade, the T1 Arrivals Concourse and Aerobridge Flooring Upgrade and the T1 Arrivals Bathroom Upgrade. All involve the replacement of depreciated items and yet the entire cost is passed on under NNI allowing Sydney Airport to double dip. This is only possible through the existence of a monopoly and the fact that Sydney Airport does this as a matter of practice is clear evidence of Sydney Airport abusing that monopoly power.

3.18. Businesses in a competitive environment have to use their margin or borrowings to make such investments but Sydney Airport is able via its monopoly, to preserve its margin and pass all such investment activity directly to the operators via an increased passenger charge for each project, no matter how small. This also applies to all security charges, none of which are absorbed by Sydney Airport.

3.19. There is no incentive for Sydney Airport to become efficient if it can pass on all costs as NNI with total cost recovery and a ROI, even when they are things like maintenance, and preserve a margin which businesses in a competitive environment cannot do.

Example: the Sydney Airport Master Development Plan provides no certainty

3.20. The Sydney Airport Master Development Plan (MDP) provides no certainty as to timing or projects and Rex's experience in trying to (unsuccessfully) obtain Sydney Airport's approval to build its own hangar has shown how opaque Sydney Airport's processes are.

3.21. Rex has been told by Sydney Airport for over 7 years through the MDP process that its existing maintenance facility located at the GA parking area must be demolished and a new, re-located, facility at Sydney Airport must be provided at Rex's expense.

3.22. Rex is prepared to build a large hangar as the existing hangar cannot fully accommodate even a single SAAB aircraft and this severely constrains its maintenance activity at Sydney Airport. In 2005 Rex at considerable cost provided a proposal in partnership with a third party, at Sydney Airport's invitation, for a large facility that met all of Sydney Airport's criteria as acknowledged by Sydney Airport at the time. However due to lack of a clear and dependable process, this did not proceed. Instead Rex built a code-C hangar at Adelaide Airport which for Rex, Adelaide has approximately half of aircraft fleet numbers and flying activity as Sydney. Sydney Airport's handling of this matter demonstrates a degree of arrogance that reflects its monopoly status.

3.23. Rex does its heavy maintenance at Wagga (which is less efficient for Rex) as it has been unable to build this facility. However, with nearly half of all Rex's daily movements

occurring in Sydney there is a certain amount of line maintenance which needs to be undertaken at Sydney airport

3.24. Not only will a large hangar make the maintenance of Rex's aircraft more efficient, it will negate the need for aircraft to be parked in the GA area, attracting GA parking charges, while awaiting maintenance.

3.25. After 7 years Rex still has no clear idea of when, where, or even if, it will be allowed to build a new maintenance facility. On the other hand another larger carrier seems to have no difficulty in signing a contract for a similar hangar space in the last 6 months.

4. How an airport would behave in a competitive environment

4.1. In a genuinely competitive environment, market forces will put pressure on an airport's pricing to ensure prices reflect the cost to serve each type of user. At the same time, market forces will put pressure on an airport's costs to ensure they are economically efficient i.e: as low as possible. The result is dynamic pressure to push prices towards the lowest cost to serve.

4.2. An example of this is that, where economies of scale exist, in a genuinely competitive environment, increased volumes should result in lower charges.

4.3. The current ACCC monitoring regime provides data as to aeronautical revenue per passenger (as a proxy for pricing). The ACCC report for 2008-2009 showed that from 2002 to 2009 Sydney Airport enjoyed a steady increase in both passenger numbers and revenue. The aeronautical revenue per passenger (excluding security charges) increased by 31% indicating that no economies of scale were achieved. Over the same period the aeronautical operating margin (excluding security charges) per passenger increased by 76%.

4.4. Sydney Airport's published results also show an extraordinary EBITA revenue margin of 80 to 81% for the 5 years 2005 to 2009 inclusive. In the two years prior it was not much less at 75% and 77%. The growth in revenue since 2003 has meant an increase in EBITA margin from \$376m to \$689m or 54%.

4.5. This type of steady operating margin raises serious questions about Sydney Airport's costs and prices. With increasing passenger numbers one would expect that costs would fall due to economies of scale, yet Sydney Airport's revenue margin is increasing. The conclusion is that the cost efficiencies arising from economies of scale are not reflected in lower pricing and, on the contrary, prices are being increased.

4.6. The costs to Sydney Airport do not increase linearly with passenger numbers or indeed with increased aircraft movements. Both increased passengers and increased aircraft movements provide increased economies of scale. Thus, in a competitive environment one

would expect to see a sliding scale of charges that decrease with passenger volumes, which is what Rex sees with many regional airports that Rex services. In section 8.10 Rex has provided some examples of where regional airports have adopted the sliding scale or charges approach. This approach forms part of an over-arching partnership to co-invest in growing passengers to the mutual benefit of the regional community and the airline.

Example: use of larger aircraft and increased passenger numbers

4.7. Rex's steadily increasing passenger numbers over the last 7 years have greatly increased the revenue paid to Sydney Airport without a commensurate increase in cost to Sydney Airport. During this period, Rex has expanded its passenger numbers through Sydney Airport by 74% which has resulted in an increase in the revenue to Sydney Airport of 8% p.a. which far exceeds CPI over the same period. At the same time the number of Rex aircraft movements during this period has only increased by 35% reflecting greater load factors in addition to Rex phasing out the 19 seat Metro 23 aircraft and moving to the larger single fleet type with the 34 seat Saab 340 that it now operates.

4.8. These increased Rex efficiencies have resulted in the average Rex ticket price paid by Rex passengers travelling through Sydney Airport falling by 7% over the last 7 years. Rex has directly passed back these efficiencies to its customers and as a result Sydney Airport has benefited through increased total airport revenue. This pattern is reflected in other regional operators with QantasLink moving from 36 seat aircraft to 74 seat aircraft and Virgin Blue introducing jet aircraft with between 68 and 180 seats into regional operations. This has meant a great increase in revenue per movement and in overall efficiency when compared to the position assumed in 2002.

Example: check in and terminal use

4.9. When Rex moved to T2 in 2002 Rex was allocated 3 check-in counters with a fourth shared counter. This is the same today. As for the departure gate, Rex's 74% increase in passenger movements are still serviced by the one solitary departure gate. Overall it means that the component of the per passenger charge for regional air services has been given a 74% increase through efficiency brought about by Rex.

4.10. Instead of an increase of charges, Sydney Airport should have rebated the efficiency savings back to the carrier which is what an airport operating in a competitive environment would do. By comparison, Air Services Australia rebates customers at years end based on growth and their cost savings, effectively sharing the benefits of efficiency gains with customers.

5. Different deals for different users at Sydney Airport

5.1. Some aeronautical service charges are subject to 'commercial arrangements' with individual operators which is Sydney Airport's preferred method of negotiating charges. These include domestic terminal infrastructure charges, refuelling charges and aircraft maintenance facilities charges. This allows larger operators to negotiate a better deal than their smaller competitors.

5.2. The impact of Sydney Airport's pricing on competition between airlines was raised by the Competition Tribunal in December 2005. The Tribunal said that: *"...we are satisfied that Sydney Airport has misused its monopoly power by the manner in which, and the reasons for which, it changed the basis for its charge for providing the Airside Service in July 2003 from an aircraft's maximum take-off weight ("MTOW") basis to a charge on a per-passenger basis ("known as the Domestic PSC"). This change adversely affected low cost carriers such as Virgin Blue as against full service airlines such as Qantas."*

Example: the 2010 proposed increases to the regional per passenger charge

5.3. Sydney Airport acknowledged that the additional charges it was attempting to impose on Rex in 2010 would not apply to other airlines. A statement Sydney Airport put on its website on 7 July 2010 explained that: *"The full increase would not apply to QantasLink, Virgin Blue or Jetstar as these airlines have negotiated commercial agreements on a normal business to business basis with Sydney Airport"*. Such airlines have greater leverage to negotiate commercial deals with Sydney Airport (due to their other operations which are more profitable to the airport).

Example: allocation of shared costs

5.4. In its 2010 Decision on Sydney Airport's Price Notification for Regional Services, the ACCC said that: *"... there are reasons to question the basis of Sydney Airport's allocation of shared costs to regional air services"* and noted that it would *"...therefore expect that future proposed price increases would need to be supported by a more detailed analysis of costs, including the basis of allocation of those costs to regional air services."*

5.5. This raises issues about how difficult it is for users to obtain evidence about Sydney Airport's behaviour, because the data from the ACCC's monitoring activity is insufficient and Sydney Airport lacks transparency. There is no independent factual verification of the full range of fees and charges that different airlines must pay.

5.6. The need for this is particularly evident in comments made by the ACCC in its 2010 Decision on Sydney Airport's Price Notification for Regional Services. In assessing this notification: *"... the ACCC sought to understand how the specific costs, demand and revenues for the provision of aeronautical services to regional air services were likely to have changed."*

However, the information volunteered by Sydney Airport was inadequate and raised a number of concerns. In particular the ACCC noted that:

“... despite Sydney Airport’s justifications for its proposed increase to charges, the ACCC notes that Sydney Airport provided little information in its price notification and supporting submission to demonstrate what the increased costs, demand and associated revenues were. Sydney Airport also did not provide an explanation of how the proposed increased charges would signal more efficient use of assets. The ACCC advised Sydney Airport that it would need to provide this information.”

“... the ACCC considers that there are reasons to question the basis of Sydney Airport’s allocation of the costs for providing terminal, check-in, passenger security and bag screening, runway and apron parking services to regional air services.”

5.7. One of the typical justifications used by Sydney Airport for prices increases has been to encourage efficient use of scarce resources. However, serious questions have been raised about whether these efficiency arguments are valid. In its 2010 Decision on Sydney Airport’s Price Notification for Regional Services, the ACCC commented that:

“Based on the information that Sydney Airport has provided, the ACCC considers that Sydney Airport has not demonstrated in this case that scarce capacity exists, nor the opportunity cost of capacity currently used by regional air services. This includes taking into consideration the operation of the regional ring fence and curfew at Sydney Airport. The ACCC would therefore expect that future proposed price increases would need to be supported by a more detailed explanation of how the proposed prices would address concerns regarding efficiency of use of potentially scarce airport assets by regional air services.”

6. The ACCC price notification process

6.1. Although the price notification regime for regional air services at Sydney Airport is not within the scope of this Inquiry, the tactics used by Sydney Airport in this process are relevant to the matters being considered by the Productivity Commission.

6.2. Sydney Airport adopted a very heavy-handed approach in seeking to introduce increased aircraft parking charges in 2010. The dismissive way that Sydney Airport responded to Rex’s initial concerns about the magnitude of those charges and the need for notification to the ACCC, demonstrated the lack of commercial constraints to keep Sydney Airport’s behaviour in line and the massively uneven bargaining power between Sydney Airport and smaller users such as Rex.

6.3. Initially Sydney Airport attempted to argue that these charges were not covered by the notification regime and therefore did not need to be taken to the ACCC. Sydney Airport

made repeated statements that there was “no change” to regional access arrangements at Sydney Airport even while advising Rex about massive price increases. When Sydney Airport eventually notified a minor price increases to the ACCC, it sought to achieve its objective by stealth and through misleading statements, publicly announcing this apparently reasonable price increase while still pursuing a much larger increase behind the scenes.

6.4. The ACCC examined these additional parking charges Sydney Airport had not notified to the ACCC and agreed with Rex’s position that these other larger price increases should have been notified. It was only at this point that Sydney Airport agreed not to proceed with these larger price increases to regional airlines without notifying the ACCC (see the ACCC’s 26 August 2010 media release). While Rex was able to stave off this increase, it was at a huge cost to the airline in terms of the legal and administrative efforts that needed to be deployed. A small airline like Rex simply cannot afford to continually mount similar defences against such an avaricious operator and the capacity of even smaller operators to do this is non-existent.

Example: Sydney Airport’s tactics

6.5. Sydney Airport’s 2010 price notification proposed a 2.9% (CPI equivalent) increase to the \$4.50 per passenger charge, the runway charges and the security charge applicable to regional air services. Sydney Airport described this as a “modest” fee increase. Rex estimated this increase would have added \$130,000 per annum to Rex’s costs.

6.6. However, there were two other increases Sydney Airport sought to impose which were not notified to the ACCC. These were:

- the imposition of additional time-based apron parking charges after 45 minutes; and
- an increase in the GA parking rate from \$60 per day to \$100 per day.

6.7. Rex estimated that the financial impact of these two other increases would be over \$3 million per annum. Rex considered Sydney Airport’s public statements about “no change” to regional access arrangements and that it was merely pursuing “modest” price increases notified to the ACCC was both mischievous and misleading in light of this massive financial impact.

7. The ACCC proposals

7.1 The ACCC has put forward a proposal to bring airport services under the national access regime in Part IIIA of the Competition and Consumer Act via deemed 'declaration' of aeronautical services. Regional Express believes this is a sound proposal.

7.2. There are two practical aspects to this proposal that Regional Express has considered. These are:

- whether the services deemed to be declared would be sufficient; and
- how this would relate to the price notification regime for regional services at Sydney Airport.

7.3. It is assumed that the services to be declared would be “aeronautical services” as defined in tables 1 and 2 of regulation 7.02A of the current Airports Regulations. The concern of Regional Express is whether this definition would be sufficient to cover all issues which it has experienced. For example, would this cover property rents and hangar tenure? Alternatively would the regulation 7.02A definition need further expansion?

7.4. Regional services at Sydney Airport are currently covered by a declaration under the price notification regime in Part VIIA of the Competition and Consumer Act. There is no legislative impediment to having aeronautical services to regional airlines at Sydney Airport covered by both the new deemed declaration under Part IIIA and the current declaration under Part VIIA. This would mean that the ACCC would continue to be given prior notice of proposed price increases in relation to those services under Part VIIA. Meanwhile, a wider range of disputes (like the behaviour raised in the examples contained in this submission) could be taken to the ACCC for arbitration under Part IIIA.

7.5. Regional Express also agrees with the proposal to strengthen airport master development plans. In particular, Regional Express would like to see special priority and access given to regional aviation at Sydney Airport in the light of its special status in the conditions of sale of Sydney Airport and the Government’s White Paper - it is meaningless to ring-fence slots for regional aviation if Sydney Airport succeeds in making it so expensive or so inconvenient for regional operators that they are forced to stop operating there.

8. Other airports

8.1. While most of this submission has focused on Sydney Airport, Regional Express is also a user of Melbourne and Adelaide airports that are directly within the scope of the Inquiry. In addition, the Productivity Commission has noted that *“other airports come within the scope of this inquiry when assessing whether the coverage of the current regime is appropriate”*. Regional Express is a user of the following additional airports under consideration:

Albury, Broken Hill, Bathurst, Ballina, Burnie, Ceduna, Coober Pedy, Dubbo, Griffith, Grafton, Kangaroo Island, King Island, Lismore, Mount Gambier, Merimbula, Mildura, Moruya, Narrandera, Orange, Parkes, Port Lincoln, Taree, Wagga Wagga, Whyalla, Townsville and Mount Isa.

Example: Regional airports

8.2. The most prevalent issue for Regional Express with respect to these other airports is the unjustified increase in airport charge that do not consider the significant activity growth (passengers and aircraft activity) that by default has increased airport revenues significantly greater than CPI.

In FY10/11 alone Rex has encountered significant passenger head tax increases at Burnie Airport (20% increase), Mt. Gambier Airport (46% increase which followed a 9% increase and a 8% increase during FY08/09) and Mildura Airport (12 % increase). Such significant and unjustified increases in passenger head taxes (in spite of the fact that airport revenue have already risen significantly because of more passengers brought in by Rex) costs have a direct impact on ticket pricing and subsequent negative impact on demand. In regional environments where air services are already marginal, there is no ability to pass these costs on to passengers. As a result the increased costs are a direct impact to the airlines bottom line and affect the viability of continued air services to these communities.

8.3 Regional Airports are primarily owned by regional councils. In a competitive environment, regional airports should consider passenger growth (and subsequent improved airport efficiencies) rather than simply applying routine increases in accordance with traditional council methodology used in the setting of local government rates and charges. Airport charges should not be considered in the same context as the fees and charges for the local swimming pool or rubbish tip. Regional airports are a vital piece of community infrastructure and from a valuable community asset that is dynamic with ever changing passenger through-put and activity levels. Applying routine CPI or CPI+ increases is an approach that should only exist when all things are equal. The variability of passenger numbers and airline activity levels should be an essential component in the setting of future airport charges, yet too often regional airports / councils do not even consider the forecast activity levels which should be their starting point.

8.4 It is clear that many regional councils have not managed their regional airports responsibly since they were vested, at no cost (and often with a large lump sum to offset future maintenance costs) to them by the Commonwealth Government. Many regional airports have not placed any revenues into necessary sinking funds for the major capital investment that will be required in maintaining and upgrading the airport infrastructure. Instead many regional airports have channelled airport revenues into general council revenue and then years later seek to recoup this mismanagement through increasing airport charges to the detriment of both the regional airline operator and passengers. In another more worrying development, more and more councils are privatising their local airport with the consequent effect of an even more myopic and short-term approach to setting charges.

Example: Melbourne Airport

8.5 At Melbourne Airport, Rex has significant concerns that relate to security charges. Generally the capital city airports have a centralised security screening check-point for all passengers to pass through with the subsequent cost of security being spread equally across all passengers. However in Melbourne, due to the geographic layout of the terminal (Rex operates from concourse F) the departure security point for passengers is shared with Virgin passengers also departing from concourse F. There are two fundamental issues with this approach:

- There is no transparency as to the total throughput of departing passengers due to unfounded confidentiality reasons (total monthly passenger numbers to mixed destinations that are not of any commercial relevance to anyone) and;
- The efficiencies of a centralised security departure point are lost with duplication of manpower and capital resources that is required for multiple screening points.

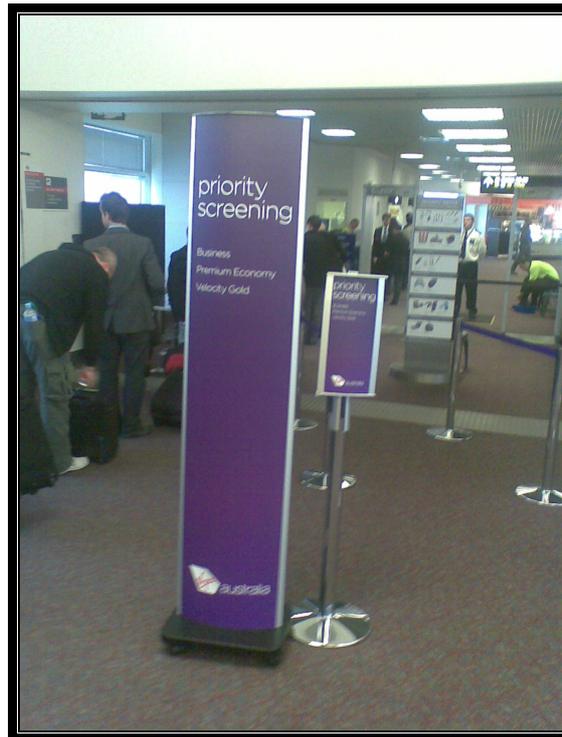
8.6 At Melbourne Airport there is also an issue with inwards passenger screening due to passengers arriving from un-screened regional airports into a secure airport. Prior to Virgin moving into concourse F, arriving Rex passengers could arrive into a non-sterile section of concourse F. This however came to an end when Virgin's growth resulted in Virgin pushing into concourse F. This meant it was no longer possible for regional passengers to arrive into a non-sterile section in the absence of being screened. As a result a new inwards screening point was established at the end of concourse F specifically for arriving regional (Rex) passengers into Melbourne. This has seen the introduction of a brand new inwards security screening charge that is solely borne by Rex and not shared with Virgin, the party that created the necessity for screening in the first place.

8.7 The inwards security for regional passengers (Rex) arriving at Melbourne Airport through concourse F is extremely inefficient. As a result Rex currently incurs a fixed monthly charge for inwards security screening at Melbourne airport of \$52,800.00 per month which translates into a significant \$633,600.00 per year. This is a massive impost on regional services that do not have the passenger volumes to support such high fixed costs. As a result the \$633,600.00 simply becomes an additional operating expense of operating into Melbourne Airport.

8.8 In addition, as the inwards security at Melbourne Airport is being levied as a fixed monthly charge, Rex has no ability to pass this cost through to passengers in the form of a per passenger charge or levy due to it not being administered on a per passenger basis. The passenger numbers are variable so the per passenger rate subsequently varies as a result.

8.9 Further to this, Rex has been informed that the inwards security is going to rise by 8.3% effective from 01st July 2012 which will add a further \$52,800 to the annual inwards security charge. All security related costs at capital city airports should be spread equally across all passengers as the airline has no control over where it has to operate from and hence has no control over the direct costs related to its operating location.

8.10 Another example of how blatantly Melbourne Airport flaunts its market power is shown in the picture:



Here we see Melbourne Airport doing a deal with Virgin to allow their priority customers to cut into a queue that services Rex passengers as well. Rex's position on this issue has been communicated to Melbourne Airport (see Appendix 2).

Positive examples from regional airports

8.11 Regional Express would also like to put on the record some examples of a good airport-airline relationship to inform the Productivity Commission's overall picture of airports. Positive examples of airports focusing on their airline customers and encouraging use and investment by airlines, which is how a business would behave in a competitive environment, provide a helpful point of comparison in terms of identifying specifically how market power affects airport behaviour.

Positive example: Parkes Airport

8.12 The first example of such a partnership relates to Parkes Airport in regional NSW where Rex, in partnership with Parkes Shire Council have grown passenger numbers from around 12,000 passengers per year to 32,000 passengers per year. The partnerships have involved setting passenger thresholds that, once exceeded, result in lower airport charges. This has provided Rex with the necessary incentive to undertake a longer term approach to grow the market through making significant additional investment that it otherwise would not have made under the more typical council methodology approach discussed in section 8.3. This has enabled Rex to transition the Parkes to Sydney route from the 19 seat Metro 23 aircraft to the 34 seat Saab 340 aircraft. This has resulted in increased capacity, improved flight schedules and affordable fares that are made possible through the improved efficiencies. At the same time the airport's revenue has grown with lower unit charges and significantly increased passenger volumes.

Positive example: Griffith Airport

8.13 Another partnership example relates to Griffith Airport in regional NSW. The partnership between Rex and the Griffith City Council has enabled the Griffith to Sydney route to grow from around 30,000 passengers per year to more than 60,000 passengers per year. Due to the partnership, Rex has invested in additional flight frequency and now has 3 Saab 340 aircraft allocated to the city of Griffith. Both Rex and the Airport benefit from the improved efficiencies and importantly the regional community benefits through an improved and more frequent flight schedule. The partnership involved the setting of agreed thresholds and when these thresholds are exceeded the passenger head tax levels are reduced, giving due consideration of the improved efficiency of the airport with increased passenger numbers. Importantly the airport's revenue continues to grow but with lower per passenger rates which keeps fares affordable and stimulates further growth to the benefit of all stakeholders.

Positive example: Wagga Wagga Airport

8.14 The third positive example relates to Wagga Wagga in NSW. In addition to the setting of agreed passenger thresholds as outlined in the two previous partnership examples, the partnership arrangements between Rex and the City of Wagga are quite diverse. The partnership arrangements have heavily contributed to significant passenger growth whilst at the same time growing airport revenues to record levels. But importantly the partnership arrangements have been extended to include much broader initiatives. The Rex decision to establish the Australian Airline Pilot Academy (AAPA) in Wagga Wagga would not have materialised in the absence of a meaningful partnership arrangement with the City of Wagga Wagga and through this significant decision Rex is assisting the City of Wagga in its vision for Wagga Wagga airport to be an "Aviation Centre of Excellence".

8.15 Both Rex and the City of Wagga Wagga are proud of the collaborative arrangements that have greatly contributed to Wagga Wagga Airport being awarded “Regional Airport of the Year 2010”. In addition it has been the underlying collaborative approach that has made possible a very unique 3-way partnership between Rex, the City of Wagga Wagga and Airservices Australia to facilitate the installation of an Instrument Landing System (ILS) at Wagga Wagga airport that is now servicing the needs of the regular air services in addition to the extensive pilot training conducted by AAPA.

9. Conclusions

9.1 The Productivity Commission has asked the fundamental question about this Inquiry: *Is there evidence that the current light-handed approach has not been successful in addressing market power concerns, and if so, what alternatives are available?*

9.2 The examples provided by Regional Express in this submission show that clear evidence of a market power problem exists at Sydney Airport. In particular:

- Sydney Airport behaves differently to the way an airport would in a competitive environment;
- Mutually satisfactory commercially negotiated outcomes are not possible due to the uneven bargaining power of Sydney Airport and “naming and shaming” Sydney Airport makes no difference to its behaviour;
- This is further aggravated by the “see no evil, hear no evil” relationship that Sydney Airport seems to enjoy with the Department; and
- Current processes and remedies are inadequate to resolve these market power issues and protect smaller users such as Rex and Pel-Air.

9.3 There is also evidence that Melbourne Airport and some regional airports behave differently to the way an airport would in a competitive environment. This can be seen by comparing their behaviour to positive examples of other regional airports which do focus on their airline customers and encourage use and investment by regional airlines such as Rex.

9.4 Regional Express believes that the alternative put forward by the ACCC to bring airport services under the national access regime in Part IIIA of the Competition and Consumer Act via deemed 'declaration' of aeronautical services is a sound proposal.

- However, the regulation 7.02A definition of aeronautical services may need to be expanded if this is to form the basis of what is deemed to be declared; and

- Services to regional airlines at Sydney Airport should be covered by both the new deemed declaration under Part IIIA and the current declaration under Part VIIA. There is no legislative impediment to having such an arrangement.

9.5 Regardless of whether the ACCC proposal is adopted, there should be an ombudsman system created for the smaller carriers that are not always able to carry out protracted legal battles with Sydney Airport.

Attachments

Appendix 1 (section 3.7): map showing aircraft parking at Sydney Airport

Appendix 2 (section 8.10): letter to Melbourne Airport on Rex's position regarding Virgin priority queue

APPENDIX 2



26 May 2011

Chris Woodruff
Managing Director and Chief Executive Officer
Australia Pacific Airports Melbourne Pty Limited

Sent by E-mail

Virgin Australia's Priority Screening Queue

Dear Chris,

I would like to draw your attention to the installation of Virgin Australia's priority queue at the security screening point of the foxtrot concourse in Terminal 3 at Melbourne Airport. (see attached photo). It is my understanding that Virgin Australia's premium business and frequent flyer customers are able to cut the queue at this point and be granted direct access through the screening point in front of the remaining passengers in line to pass into the sterile area.

As this is a multi user terminal whose use is not exclusive to Virgin Australia, Rex protests the establishment of a process that allows one airline's passengers priority access to the screening point over another especially as all operators pay the same screening cost.

APAM's and Virgin's actions clearly demonstrate a complete disdain and contempt for regional travelers and this is another example of the danger of letting private enterprises have unfettered control over capital city airports that are the lifeline for the regional cities. A further example of your disdain for regional aviation is the fact that your management did not even accord Rex the basic courtesy of prior consultation.

Given that APAM has tacitly acknowledged and accepted that Virgin Australia has priority access of the screening point, Rex feels that it should not be liable for the same rate of security screening fees. Hence we will be holding back 70% of the security screening fees as compensation for the degradation of service provided.

I would also like to raise the matter of increased inwards screening costs at the foxtrot concourse. Effective 1st July 2011 the fixed monthly charge is proposed to increase from \$52,800 to \$57,200 representing an 8.3% increase. Rex questions this significant increase as the Rex hours of operation have not changed. Rex needs to see full transparency and justification for this significant increase which effectively adds a 13th Month of inwards screening costs to our Melbourne Airport operations. In the meantime your increase is not accepted by Rex.

Yours Sincerely,

A handwritten signature in black ink, appearing to read "D Brooksby".

David Brooksby
National Airports Manager

Copy: The Hon. Anthony Albanese (Minister for Transport & Infrastructure), The Hon. Warren Truss (Shadow Minister for Transport, Mr Michael McCormack MP (Member for Riverina), The Hon. Daryl Maguire MP (Member for Wagga Wagga), Mr Greg Aplin MP (Member for Albury), Mrs Shelley Hancock MP (Member for South Coast), Mr Mike Kelly MP (Member for Eden-Monaro), Mr Don Pegler MP (member for Mount Gambier), Mr Patrick Secker MP (Member for Barker), Mr Peter Crisp MP (Member for Mildura), Mr John Forrest MP (Member for Mallee), Members for Braddon - Mr Sid Sidebottom MP, Mr Brenton Best MP, Mr Bryan Green MP, Mr Jeremy Rockliff MP, Mr Adam Brooks MP, Mr Paul O'Halloran MP

Productivity Commission, RAAA, Albury City Council, Wagga Wagga City Council, Bega Valley Shire Council, Griffith City Council, Mildura Rural City Council, Mount Gambier City Council, District Council of Grant, King Island Council, Burnie City Council

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