

13 June 2014

Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Re: Competition Policy Review – Sydney Airport submission

Sydney Airport welcomes the opportunity to provide a submission to the Competition Policy Review. Increased competition is key to improving economic performance, and Sydney Airport is committed to ensuring industry works with government to identify potential reform measures.

Within the aviation sector, a number of opportunities exist to maximise productivity gains through the promotion of pro-competitive practices, including reducing protectionist measures that limit international aviation activity and tourism growth, reducing competitive distortions that exist between airports and making improvements to the regulatory and operating environment.

Background

Sydney Airport is Australia's international gateway and premier airport, serving the Sydney region and surrounds. The airport is located 2km from Port Botany, 8km from the Sydney CBD, and less than 10km from the iconic Sydney Harbour and the southern beaches. Surrounding the airport is a network of light-industrial and tourism-related businesses that rely on or support the airport, such as freight/logistics, catering, engineering, vehicle rental businesses and accommodation businesses.

Sydney Airport does not just serve passengers travelling to or from Sydney; it is also Australia's largest transport and logistics hub. Some 34 international, 6 domestic and 6 regional airlines operate from Sydney Airport to 97 destinations, including 11 international and 8 regional destinations not served by any other Australian airport. Many passengers and large volumes of freight transfer between these flights.

As the heart of our national aviation network, more than two-fifths of all international visitors and more than one-fifth of all domestic passengers pass through Sydney Airport annually. In 2013, 38 million passengers travelled through Sydney Airport, more than 100,000 a day – making Sydney Airport the 27th busiest airport in the world. This is forecast to increase to over 74 million by 2033.

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A January 2013 study by Deloitte Access Economics into the economic impact of Sydney Airport quantified the benefits of these activities. Key findings of the study include that Sydney Airport generates or facilitates:

- Jobs. Direct and indirect employment of 283,700 jobs (equivalent to 8% of NSW employment), including 160,000 direct jobs, 28,000 of which are on-airport
- Economic activity. Direct and indirect economic contribution of \$27.6 billion, equivalent to 6% of the NSW economy and 2% of the Australian economy
- Household income. Direct and indirect contribution of \$13.2 billion. Additionally, at \$82,000 per annum, the average FTE wage of an employee working on the Sydney Airport precinct is 13% higher than the NSW average for all employees.
- Taxes. Direct and indirect taxes, including:
 - Substantial income tax and GST revenues to the Australian Government
 - Substantial payroll taxes to the NSW Government
 - Annual contributions, in lieu of rates, to Botany Bay, Rockdale and Marrickville Councils.

Using forward-looking modelling, the study also indicated that Sydney Airport's economic contribution will increase as the airport develops (refer to Figure 2.1). It is forecast that the economic activity generated or facilitated by Sydney Airport will increase from \$27.6 billion in 2012 to over \$42 billion in 2033 and total employment will increase from 283,700 jobs in 2012 to over 400,000 by 2033.

This study highlights that a relatively small development at Sydney Airport can have a potentially large economic impact on both the NSW and Australian economies. As an example, an additional daily A380 service from Dubai would, on an annual basis, contribute an estimated:

- \$342 million to Australian GDP
- \$206 million to Australia's household income
- 4,400 jobs (2,800 of which would be in NSW).

Similarly, an additional daily Airbus A380 from China would, on an annual basis, contribute an estimated:

- \$388 million to Australian GDP
- \$233 million to Australia's household income
- 5,000 jobs (4,000 of which would be in NSW).

In addition, the study highlights the significance of Sydney Airport within the local community. There are over 800 businesses operating on and around Sydney Airport with these businesses having a profound impact on local employment figures.

Competition between airports

Sydney Airport, like many other major airports around the world, operates in an intensely competitive environment. There are a number of competitive forces constantly at play across the global aviation environment and the impact of competition policy in the productivity and prosperity of the aviation sector is significant.

The development of what might be described as international low-cost network carriers, the emergence of the global network carriers in the Middle East and Asia, and the consolidation and diversification of the traditional network airlines have taken place concurrently. Asian and Middle Eastern airlines have replaced all of the continental European airlines that have flown to Sydney Airport. Yet Europe is better served for passengers than it was, with twice the one-stop destinations in Europe compared to a decade ago.

All these changes have increased the choices available to airlines when making route decisions and to passengers when making travel plans. Increasingly, airlines no longer serve primarily national catchments, but instead serve regional or global catchments. Examples of these changes are:

- The Middle Eastern carriers are able to fly directly to any airport in the world with the appropriate infrastructure. Emirates, for example, flies directly to every continent (except Antarctica) and to more than 130 destinations
- The Asian carriers benefit from being within the most highly populated and fastest growing region of the world, with the potential to also reach any airport in the world directly with the appropriate aircraft with little or no regard for national boundaries
- The LCCs optimise their route networks across multiple bases within geographic regions defined by the aircraft range rather than national borders. In Europe, for example, the larger LCCs such as Ryanair serve any viable city-pairing within Europe and North Africa. LCCs also run competitive processes to decide how to deploy their aircraft and where to establish bases, playing off offers from national and other levels of government
- The consolidation of airlines has increased the choice for the focus of growth and deployment of aircraft between more bases. The same choice has also been achieved by other airlines which have diversified their product offerings (for example, offering both full service and LCC products) and geographic location.

The route decisions of these airlines are affected by passenger demand, airport charges and incentives, bilateral air rights and government support.

These developments have dramatically increased the level of competition between airports for traffic, in Australia as elsewhere. Airports compete for larger aircraft, for increased frequencies, for new routes, and for selection as a base. The 'margin' is therefore best thought of as being most traffic growth. Whilst a

single year's growth is, in fact, only a small proportion of total passenger traffic, several years' growth represents a significant proportion of total traffic. For example, a 2% per annum increase in traffic growth over a decade represents a 22% increase in total traffic at the end of the period.

Moreover, given the high fixed costs (capital, operating and financing) of an airport a relatively minor change in passenger volumes can represent a much more significant change in returns to shareholders.

Whilst competition is at all levels, it is significant to note that, between 2002 and 2013, new airlines to Sydney Airport were responsible for 70% of the increase in international passengers and 17% of total international passengers.

Whilst some competition for airline seats may only affect timing, this is rarely clear to the airport and is subject to later events. Airline decisions frequently have longer term effects. For example, despite Sydney being a substantially larger city than Brisbane, Virgin Australia's Brisbane network was larger than its Sydney network for several years following its decision to be based in Brisbane – a decision which was supported financially by the Queensland Government.

The argument that airlines' sunk costs leave them open to monopoly rents needs to be seen in the context of LCCs and non-based airlines which routinely withdraw capacity and redeploy it elsewhere. In Europe, it is almost routine for LCCs to pull out completely of airports which are not successful and, conversely, Ryanair has cut capacity at some successful airports in Ireland, Germany and the UK to put pressure on government travel taxes, reallocating aircraft to other airports. In Australia, Tiger has similarly closed and recently reopened its operation at Adelaide Airport and has refocused its growth from Avalon Airport back to Melbourne Airport. Similarly, there are a number of airlines which have flown to Sydney Airport in the past decade which have subsequently stopped and redeployed services to other markets – for example, Sydney lost a daily service when British Airways decided to redeploy one of the Sydney aircraft onto the London-Atlanta route.

An argument might be put that Qantas in particular has no option but to remain in Sydney, Melbourne and other Australian airports. This is true – at least in terms of the existing traffic. However, the Qantas Group now includes Jetstar and Jetstar Asia and can therefore choose to deploy its new aircraft in a region much larger than Australia. Qantas traffic at Sydney Airport has, in fact, declined.

The above examples illustrate the true nature of competition between airports. All airports globally are competing for the new generation aircraft which are being delivered to airlines – deliveries which are predominantly to Asian, Middle Eastern and LCC airlines.

In contrast to an airline's largest fixed assets - aircraft, which are the most mobile of assets - airport infrastructure is completely immobile. The increased

flexibility of airlines, alongside lower sunk costs, has been the result of the new airline business models as well as the development of new technologies (for example, internet check-in, which substantially reduces staff-related sunk costs) and the provision of common-use domestic terminals.

Air services agreements

Unlike other trade agreements where free trade exists unless governments impose restrictions (such as protection tariffs or trade quotas), international air routes are restricted until two governments make arrangements to allow access.

Air services agreements (ASAs) are bilateral arrangements between two countries (or markets, in cases such as Hong Kong, Dubai and Abu Dhabi, for example) to allow air traffic (including seats, codesharing rights and air cargo access) between and beyond the two jurisdictions party to the agreement. At present, Australia currently has ASAs between more than 90 markets around the world.

Under the current ASA framework, the Department of Infrastructure and Regional Development negotiate on behalf of all Australian airlines and the tourism industry more broadly. However, little transparency exists relating to the negotiation priorities established by the Department when conducting negotiations. While a 'national interest' test exists, industry has little visibility over how this is determined.

Delays in bilateral capacity negotiations, which are running behind demand in many key growth markets, restrict the level of competition in the market from foreign carriers, preventing travellers from accessing Australia in the most efficient and cost effective manner. These delays also risk economic and tourism growth, which is highly reliant on inbound international visitation.

For example, the *Tourism 2020 Potential* released by the former Department of Resources, Energy and Tourism in 2010 sets a goal of total overnight visitor expenditure reaching \$115-\$140 billion per annum by 2020 (commonly framed as a doubling of overnight spend from \$70 billion in 2009 to \$140 billion in 2020). Additionally, the targets also call for an increase of 40-50% in international aviation capacity to support the required growth rates. However, slower than anticipated aviation capacity growth and other limitations in growth factors have resulted in the to-date progress falling below the lower limit of the 2020 potential. As of the end of 2013, the overnight visitor spend per annum was \$80.4 billion, approximately 5% below the lower limit.

Some contemporary examples of existing supply blockages include:

- The growth of various routes between Australia and Malaysia are prevented by the lack of capacity in the Malaysian bilateral. This has blocked an increase in foreign airline capacity into Australia, which has further limited competition between airlines. When the last Australia-

Malaysia ASA negotiation took place in June 2013, both AirAsia X and Malaysian Airlines immediately added capacity

- Philippine low-cost carrier Cebu Pacific has deferred its planned launch due to a lack of capacity to operate under the Australia-Philippine ASA. This has prevented the introduction of further competition on various routes between Australia and the Philippines, thereby reducing the availability of differing options for travellers between the two countries. As a result of this blockage, Cebu Pacific has reallocated the aircraft originally intended for the Australia market to services between the Philippines and Dubai
- Increased competition and capacity between Australia and China has ceased as a result of the Australia-China ASA reaching the artificial supply quota. This is despite the very high and increasing demand that exists for travel between the two nations. A number of Chinese airlines that do not currently serve the Australian market have indicated a willingness to commence services immediately should the limitation on capacity be lifted.

Sydney Airport supports a review of how ASAs are currently negotiated to place greater emphasis on the benefits of increased competition, including job creation, economic expansion and tourism growth. A more transparent and proactive manner must be adopted by the Department of Infrastructure and Regional Development when conducting negotiations, taking into consideration the benefits of free competition to both international visitors to Australia and Australians seeking to travel overseas. Industry should be allowed a greater level of involvement in the determination of Australia's priorities and ability to shape the ongoing strategy in negotiating ASAs.

Sydney Airport maintains the view that the economic benefits to the Australian economy and downstream tourism industries from increased international airline competition are significant. It is important that air services agreements deliver expanded capacity ahead of demand in a manner that delivers the maximum value to Australia at the earliest possible time.

Importance of capacity allocation ahead of demand

Where increased supply and competition is being considered, it is important that capacity levels allow Australian and foreign airlines to increase supply ahead of demand. At the very least, ASAs should provide no less than five years' worth of growth. Airlines make aircraft purchase and market development investment decisions years in advance and for Australia to be competitive relative to other destinations, airlines require longer term certainty in accessing air rights on Australian routes. At present, there are a number of markets that are at capacity and face significant limitations for growth. These markets include China, Malaysia, Hong Kong, Qatar, the Philippines, Turkey and Fiji.

Commercial imperatives

Sydney Airport believes that airlines should have the ability to make their own decisions as to which routes are commercially viable. Airlines require access to the most commercially sustainable markets to be able to provide certainty of service across a network. Airlines increasingly will only serve destinations that allow them to make a reasonable rate of return, otherwise they will be compelled to divert their services to other, commercially more attractive destinations.

Should foreign airlines fail to secure more access to Australia, the alternative is to deploy the additional capacity on other overseas markets, which will not be in Australia's best national interest. This will result in decreased competition, higher costs for travellers and significantly lower economic benefits for the entire Australian economy.

Competition

Capacity and access constraints act as a deterrent to competition and thus weaken growth in aviation and downstream industries, particularly trade and tourism. The interests of Australia are best served by facilitating sustainable competition between airlines based on price, product, destination and frequency which ultimately deliver value to the traveller.

Planned negotiation discussions

While Sydney Airport welcomes the Australian Government's efforts to continue its negotiation schedule, it is vitally important that the planned timeline for negotiations reflect existing market demand and current capacity limitations. As such, Sydney Airport feels it is important that the Department of Infrastructure and Regional Development consult more broadly with industry to determine order of prioritisation to ensure limited resources are allocated in the most effective and efficient manner.

Optimising Sydney Airport

To address Sydney's long-term aviation needs, the Australian and NSW governments established the Joint Study on Aviation Capacity for the Sydney Region (the Joint Study) in 2009 to develop an effective strategy for meeting the future aviation capacity needs for the Sydney region. The Joint Study report, released in March 2012, examined and recommended a number of solutions to Sydney's growing aviation needs. Key among these was maximising the use of Sydney Airport given the advantages it presents to business and tourism markets, improving the use of other existing aviation assets in the Sydney region, and selecting a site for a secondary Sydney airport.

The NSW Government is investing heavily to upgrade road and transport infrastructure in the vicinity of Sydney Airport as shown by its \$282 million package of WestConnex enabling works and the proposed WestConnex

Motorway itself. While Sydney Airport is also investing heavily in infrastructure and passenger experience improvements, the Joint Study, the NSW Visitor Economy Taskforce and numerous other reports generated over the last 15 years have highlighted the inefficiencies created by the numerous inflexible and, in some cases, out-dated operating restrictions designed to deliver positive environmental benefits to the community. However, the inflexible and outdated nature of the existing operational restrictions deliver suboptimal outcomes for the community compared to the outcomes that could be achieved by more modern regulations that reflect and incorporate technology improvements, while limiting Sydney Airport's true operating capacity.

The operating restrictions, in combination, are unique to Sydney Airport and include a curfew (11:00pm – 6:00am), a cap on hourly movements and slots (limited to 80 per hour), and a 'regional ring-fence' (ensuring intrastate air services maintain an allocated amount of all movements at Sydney Airport). In addition, the restrictions are compounded by the airport's unique noise sharing regulations – the Sydney Airport Long Term Operating Plan (LTOP). While it is accepted some of these restrictions achieve important public policy and environmental outcomes, it should be recognised that, in combination, they impose a significant competitive disadvantage on Sydney Airport in attracting tourists and businesses to Sydney and Australia, and restrict the ability to operate in a truly competitive environment, particularly in regard to long-haul international operations that often prefer late night or early morning arrival/departure times to meet connections at hub airports.

The movement cap, slot management scheme and curfew

The *Sydney Airport Demand Management Act 1997* (Cth) provides the framework for the regulation of aircraft movements (take-offs and landings) at Sydney Airport. Currently, arrivals and departures at Sydney Airport are restricted over an hour, with a maximum of 80 movements permitted, counted in 15 minute periods on an ongoing basis.

The current movement cap and slot management scheme prevent efficient use of Sydney Airport infrastructure, create competitive distortions between Sydney Airport and other non-restricted airports in Australia and contribute to delays and increased aircraft noise at particular points throughout the day. Due to the effects of high peak demand, as well as delays caused by weather and other circumstances (often originating at other major airports around Australia), aircraft are often unable to depart or arrive at their allocated slot time, with services being pushed into other time periods. The imposition of artificial constraints limit Sydney Airport's ability to compete effectively with other major international airports and limit the ability to accept services that are often diverted to non-restricted airports in order to enter the Australian market.

Weather plays a critical role in creating delays and inefficiencies across the national aviation network. Under the current 15 minute block count for aircraft movements, there is very limited opportunity to clear delays and recover from

periods of extended airborne or ground holding – most of which are weather related. The current structure of the movement cap and the curfew shoulder settings prevents Airservices Australia and Sydney Airport from being able to recover from major disruptions, often occurring many hours earlier and in other cities. This inability to recover effectively exacerbates the problem, pushing delays further into the day and at times beyond the commencement of the curfew at 11:00pm. Additionally, should weather impact operations at other locations, such as Melbourne where the volume of Sydney-bound aircraft traffic is high (the second busiest route in the world), Sydney Airport's ability to reduce pressure on the other locations and the entire national aviation network is significantly reduced.

These constraints present a significant opportunity cost to the Australian economy, the tourism industry and the federal government by limiting the airport and airline growth. In recent years, significant support has been received from residents, airlines, tourism and trade groups, and the NSW Government to explore reform and modernisation of the operating environment.

Enhancements to reflect technological and industry improvements that have occurred over the past decades, such as the development of quieter, new generation aircraft and precision air traffic management technologies, would improve operating efficiency of not only Sydney Airport but the entire aviation network – at almost zero economic cost.

Additionally, consideration should be given to a more flexible application and progressive increase in the hourly cap (Joint Study Recommendation 5), as well as a more flexible interpretation of the curfew legislation and adhering to the provisions of the *Sydney Airport Curfew Act 1995* (Cth) (NSW Visitor Economy Taskforce recommendation). This would significantly improve Sydney Airport's ability to respond rapidly to disruptions and reduce the economic impact created by delays and service cancellations. Further, increasing the artificially constrained capacity at Sydney Airport will improve the ability to compete on a more level playing field with non-restricted airports.

In December 2012, the NSW Government supported key recommendations made by the Visitor Economy Taskforce to reform current operational restrictions. Specifically, the NSW Government has said that current regulations restricting curfew shoulder movements should be increased to the level allowed by the *Sydney Airport Curfew Act 1995* (Cth). This would allow a further 11 morning landing slots and 14 take-off/landing slots every week. Consistent with the recommendations of the Joint Study, the NSW Government has also supported better utilisation of existing airport infrastructure through increasing the aircraft movement cap from 80 to 85 movements per hour during peak periods.

This could potentially:

- Inject more than \$1 billion each year in to the economy through alignment of the regulations with the legislation to allow new flights for quieter, next generation aircraft
- Create new opportunities for increased competition at Sydney Airport for regional, domestic and international airlines
- Improve on-time performance and reduce the impact of weather delays across Australia
- Increase the potential for noise sharing and create more predictable periods of respite
- Reduce circling in holding patterns, reducing both emissions and aircraft noise.

Airport planning environment

Planning approval requirements for projects that take place on-airport are significantly more onerous and complex than equivalent projects that are constructed off-airport, regardless of their complexity, size or cost. This creates a major competitive distortion between operators of airports and those conducting business outside of federally-leased airport land, leading to increased costs, greater administrative burdens and longer construction and development times for any major project. Further, the definition of a major project impedes airport operation, requiring a large, complex approval process for anything with a value greater than \$20 million.

Increase construction cost threshold for major airport development

When the *Airports Act 1996* (Cth) (Airports Act) was introduced, development on-airport of any kind with a construction value of \$10 million or more was categorised as 'major airport development'. This type of development requires the preparation of a major development plan (MDP), which is a complex, lengthy and costly exercise that is ultimately subject to Ministerial approval. In recognition of the potential for increasing construction costs to result in 'minor' developments requiring an MDP, the government amended the Airports Act in 2007 to increase the threshold to \$20 million.

In NSW, for most developments to be classified as 'major or state significant', the capital investment value must exceed \$30 million. To maximise consistency between Commonwealth and state planning regimes, it is proposed that the major airport development threshold be increased from \$20 million to \$30 million. To put this in context, Sydney Airport plans to invest around \$700 million over the next three years in new infrastructure to boost capacity and improve the passenger experience, much of which will be spent on developments categorised as major airport development.

When introducing the amendments to the Airports Act in 2007, the government also said that:

"An appropriate cost inflator will be included in supporting regulations so that the Airports Act does not have to be amended periodically to adjust the threshold."

No such cost inflator has been introduced. The Building Price Index (BPI) would be an appropriate cost inflator because it is the cost index recognised by government agencies for forecasting price movements in the building construction industry. It is therefore proposed that the \$30 million threshold be indexed annually to the BPI.

It is recommended that the construction cost threshold for major airport development in the Airports Act be increased to \$30 million and that it be indexed to the BPI every year thereafter.

The harmonisation between on- and off-airport planning approval requirements could create major competitive equity between commercial entities operating in both an airport and off-airport environment. This will allow businesses that operate in the aviation sector to reduce costs and increase investment, resulting in greater expenditure and increased job creation.

Review definitions of major airport development

Amendments to the Airports Act in 2010 introduced a number of new and vague definitions for major airport development. As noted above, the approvals process for such developments was already complex, costly and time consuming. These amendments exacerbated the situation and led to the furthering of competitive distortion that exists between businesses that operate on-airport and off-airport land.

For example, *"development of a kind that is likely to have a significant impact on the local or regional community"* is now major airport development. The vagueness of this definition is of concern because it has the potential to create significant regulatory uncertainty for airports and businesses who seek to conduct their operations on airport land in close proximity to aviation activity. Further, no definition is provided as to what constitutes *'significant impact'*.

If the Explanatory Memorandum of the *Airports Amendment Bill 2010* (Cth) is used as a guide to assist when deciding what constitutes a significant impact on a local community, airports are to ask themselves 'will the proposed development increase traffic in the immediate surrounds of the airport?' This has the potential to capture many developments that could not, on the basis of any reasonable objective criteria, be considered as 'major'.

For example, a minor extension to a terminal or airfreight handling facility, or the construction of a fast food outlet or service station could now be subject to the preparation and Ministerial approval of a MDP. This is because each would result in at least some increased traffic in the immediate surrounds of the

airport. As such, minor developments would be subject to the preparation of a number of MDP versions, a public comment period of at least 60 business days and, ultimately, the approval of a senior Cabinet Minister. Had that same development been proposed for a site across the road from the airport, it would likely be subject to a simple development application, a public comment period of between 14 and 30 days and approval by a mid-level town planner at the local council, probably acting under delegated authority. This is the essence of the major competitive distortion that exists between airports and the planning requirements off-airport.

Administrative guidelines released following enactment of the new provision have not completely resolved the vagueness. While they have assisted in understanding the complexity of the issue, the uncertainty remains, along with the unbalanced competitive environment.

It is recommended that the definitions of major airport development be reviewed (in consultation with airports and other stakeholders) with a view to increasing the certainty of their application, along with a process to commence harmonisation of on- and off- airport planning regimes under a unified joint Commonwealth and state framework.

Reduce approval timeframe for MDPs and reduce complexity

As noted above, the process for preparing MDPs is already highly complex and costly, and involves the preparation of four separate MDP versions: an Exposure Draft MDP, a Preliminary Draft MDP, a Draft MDP and a Final MDP. The preparation of an 'Exposure Draft MDP' is not required (or mentioned) in the Airports Act, but is a document that the Department of Infrastructure and Regional Development has advised airports to prepare in certain circumstances so it can be referred to the Department of the Environment for comment.

The following indicative timeframes apply for the preparation of each MDP version:

- Up to six months (and depending on the type of development, maybe longer) for the airport operator to prepare an Exposure Draft MDP. Administrative guidelines issued by the Department of Infrastructure and Regional Development indicate that this MDP version should be drafted in consultation with state government agencies, local councils, airlines and other stakeholders as necessary
- Up to six weeks for the Department of Infrastructure and Regional Development and the Department of the Environment to assess Exposure Draft MDP and provide feedback to the airport operator, who then amends this version to produce the Preliminary Draft MDP version
- At least 60 business days (around three months) for formal public exhibition of Preliminary Draft MDP. Those who were consulted

when preparing the Exposure Draft version are now consulted for a second time

- Up to three months for the airport operator to review and consider submissions. The airport operator amends the Preliminary Draft MDP accordingly, which is then submitted to the Minister for Infrastructure and Regional Development as the Draft MDP
- Up to 50 business days for the Minister to consider the Draft MDP (and all the submissions received during the public comment period). The Minister has the discretion to extend this period by 10 business days without reasons or longer if more information is required. If the Draft MDP is approved, it becomes the Final MDP.

The entire MDP process can therefore up to around 18 months to complete. For genuinely significant airport developments, such a timeframe would, of course, be appropriate. However, for less significant developments, the lengthy and complex approvals process can act as a commercial impediment to doing business on airport land. For most state and local governments across Australia, stakeholder consultation timeframes are between 21 and 28 days, even for major developments.

It is recommended that the MDP process be reviewed with a view to streamlining the production, consultation and assessment timeframes. A protraction of the existing framework will continue the current competitive distortion that exists between businesses operating in an on- and off-airport environment, and lead to businesses avoiding airport locations due to the regulatory burden associated with development approvals.

Airport regulation

Investment and commercial negotiation

In 2002, the economic regulation of airport services was changed from a regime in which the ACCC needed to approve all price changes, to a regime in which airports and airlines directly negotiated with financial and service quality monitoring by the ACCC. The Productivity Commission's recommendation, and the Australian Government's decision, to change the model of economic regulation was "*intended to facilitate investment and innovation by airports*". At the time, "*significant increases in the charges inherited from the days of government service provision were widely accepted as necessary to put airport operations on a sustainable longer term footing.*"

The Productivity Commission conducted reviews into the economic regulation of airport services in 2006 and 2011. These reviews noted that, under the light-handed monitoring regime:

- There has been a marked improvement in aeronautical investment, without the bottlenecks that have beset other infrastructure sectors
- Airports' productivity performance has been high by international standards

- Service quality has been satisfactory to good
- Airport charges do not point to the inappropriate exercise of market power
- Commercial agreements with airlines are becoming more sophisticated.

While airlines have identified significant price increases since 2000, this reflects the unrealistically low starting point, consistent with the 97% price increase at Sydney Airport approved by the ACCC in 2001. In 2006, the PC stated that:

- *“Price and rate of return outcomes are not outside the boundaries that might have been expected when monitoring was introduced. Prices have risen, but the bulk of these were endorsed by the Government in the move to a light-handed regime, in large measure, to ensure that future investment needs are properly addressed.”*

As you would expect in (or in preparation for) commercial negotiations, airlines argue that airports should have a low cost of capital – and in particular, argue that airports have low risk. In Sydney Airport’s experience, the airlines’ never present direct empirical estimates of the overall asset beta, but instead present theoretical or empirical arguments that relate to proxies for one element of systemic risk.

The empirical evidence (applied to long established financial theory and regulatory practice) demonstrates that the long term average asset beta of all listed global airports of ~0.75-0.80 is higher than:

- The long term average asset beta of all listed airlines of ~0.60-0.70. Airline returns are also significantly influenced by non-systemic risks. For example, airline returns can be materially impacted by individual airline decisions to compete for market share at the expense of profitability
- The asset betas agreed in the commercial agreements with airlines
- Materially higher than the long term average asset betas for utilities of ~0.30-0.40.

Commentary by airlines and the ACCC on airport profitability relies heavily on the financial information in the ACCC Monitoring Reports. Unfortunately, these reports are largely based on historical accounting and don’t reflect the relevant regulatory decisions and aeronautical agreements. As a result, reliable conclusions cannot be reached.

For example, Sydney Airport’s regulatory and commercial agreements have (since the ACCC Decision in 2001 that pre-dated both the introduction of the monitoring regime and privatisation) consistently used indexed asset bases in combination with a real WACC. By contrast, the ACCC Monitoring Reports report a historic cost asset base. In addition to other inconsistencies, this has resulted in significant differences between the reported financial results and the underlying results.

Over the past 10 years, Sydney Airport's return on capital employed has been below the commercially agreed WACCs.

Airport monitoring

Price and quality monitoring has been a key feature of the light-handed regulatory regime at Australian federally-leased airports and Sydney Airport supports its continuation. However, it is important that such monitoring is conducted appropriately and serves its policy purpose. Moreover, monitoring needs to respond to changing competitive and commercial circumstances, as the costs and benefits of monitoring are not static.

The key principles of effective monitoring should be:

- Consumer-focussed: the airlines and airports have commercial relationships to provide a joint product to passengers. Monitoring should be designed to support consumers, particularly passengers, who have varying relationships with businesses and government agencies (which are all part of performance assessment)
- Non-distortive: monitoring should not distort collaboration to improve performance or distort competition between airlines
- Focused: monitoring should concentrate on areas in which the airport has potential market power, should provide useful information concisely, and exclude extraneous information
- Robust: methodologies for obtaining, analysing and reporting data should be objective, unbiased, transparent and statistically robust
- Comparable: benchmarking should be against comparable airports in comparable circumstances rather than against each other where the only similarity is the national geographic context
- Timely and cost-efficient: monitoring should be cost-efficient and the results published quickly.

The *Airport Monitoring Report* published by the ACCC each year is intended to support the policy objective of light handed regulation. The report is also a high profile and influential document that can affect the financial performance of the airports being monitored. The effect on corporate reputation and brand is appreciable. That the report can influence the decisions of governments is demonstrated by the timing of the 2011 Productivity Commission review into the economic regulation of airport services, which was brought forward by at least a year in response to matters raised in the 2008/09 ACCC report. This decision is not cost-free to the government, the airports or the airlines, including both the direct costs of the review and the uncertainty introduced into investment decisions.

The monitoring reports are limited through the absence of useful, comparable and up to date information, and contain commentary that is based on incomplete information – some of which is contradicted by evidence presented.

Given the real costs that can arise from unreasonable criticism, a good policy process (and natural justice) requires compelling evidence before critical comments are made, and not mere suspicion – the caveats used in the recent ACCC reports are not sufficient.

The integrity and usefulness of the ACCC monitoring process would be supported if the airports were able to respond to the full draft report before it is published. This would allow airports the opportunity to correct errors or misplaced conclusions. The preparation of reports of the Commonwealth Auditor General follows this process, as do the Productivity Commission's own draft inquiry reports. The airports should also have the opportunity to incorporate within the ACCC report a response to any of the ACCC comments.

Additionally, the ACCC Monitoring Report compares survey results for the four very different Australian airports, but makes no attempt to compare the airports against their international peers. Sydney Airport's peers for comparison purposes would include international airports with similar levels of activity, and Melbourne Airport to some extent.

Most importantly, the monitoring reports should be compliant with the appropriate ISO standards – standards which are prepared by Standards Australia.

Finally, it should be noted that the recent monitoring reports are too long for most people to read and are published eight months after the reporting period ends, which further diminishes their public policy usefulness.

Conclusion

Sydney Airport would welcome the opportunity to provide further information on any of the issues raised above. While this is not an exhaustive series of recommendations for reform to competition policy in Australia, the above issues outline the most significant opportunities to improve the competitive environment across the aviation sector over the short to medium-term. Should you wish to receive a personal briefing on this submission or any other issues involving the aviation sector, please feel free to contact Mr Jon Stewart – Manager, Government Relations and Major Projects on (02) 9667 9288 or jon.stewart@syd.com.au.

Yours sincerely,



Kerrie Mather
Chief Executive Officer