

## **Address to Melbourne Press Club:**

### **Professor Graeme Samuel AC, A4ANZ Chairman**

Thank you Adele, and thank you Mark Baker and the Melbourne Press Club, for the invitation to speak here today. I'm delighted to be here to speak on one of my favourite topics, my intense dislike for monopolies. As a former competition regulator at the ACCC, I learned a few things, but one is for certain: monopolies have the power to, and invariably do, gouge their customers.

It therefore shouldn't have come as a surprise to anyone to hear yesterday that Australia's monopoly airports are earning excessive profits. It certainly wouldn't have been a surprise to market analysts, who note that airport profit margins are growing and will continue to do so, at an even higher rate than they have done historically.

I spoke about this yesterday when Airlines for Australia and New Zealand, of which I am chairman, launched its report into the performance and impact of Australia's airports since

privatisation. While fiercely competitive, A4ANZ has brought together the airlines over shared policy challenges – in this case their issues dealing with monopoly airports in the current the regulatory environment.

You can see the members that make up A4ANZ in the booklet in front of you – covering both full service and low-cost carriers in Australia and New Zealand.



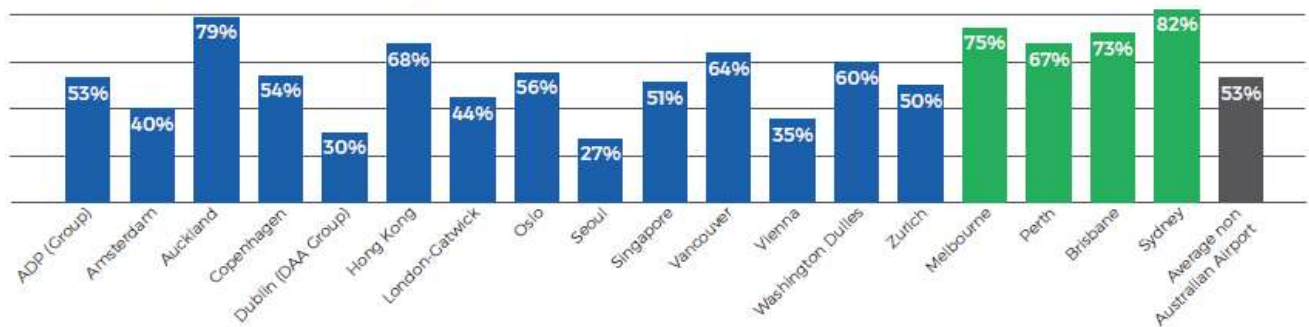
In forming A4ANZ last year, we brought Australia and New Zealand into line with equivalent international bodies, Airlines for America, and Airlines for Europe.

We have representatives from our membership here today, including the press club’s principal sponsor, Virgin Australia.

And so back to the topic at hand...

Despite the airports' claims that their charges are reasonable to cover costs, the evidence suggests otherwise. If you go to p.6 in the report, independent analysis undertaken by Frontier Economics confirms that the airports are using their monopoly position to earn excessive profits.

Figure 2: Comparison of EBITDA margins, 2008-2015



Source: Frontier Economics calculations 2018

In their response to our report today, the Australian Airports' Association has not denied this evidence. They instead attempted to run a distraction strategy, using cherry-picked data over a different time period to claim that Australia has a duopoly situation which is negatively impacting capacity and fares. This is simply not the case. For a start, a duopoly is not a monopoly, and Australia has an extremely competitive airline market. Consider that today, you can fly on either Jetstar or Tiger from Sydney to Melbourne for as low as \$49,

in a market with fierce competition, while it is more expensive to park your car at Sydney airport in a market with no competition – at \$73 for the day.

Over the past decade, Australian airports' margins have grown significantly higher – in some cases more than double – than those of other airports around the world operating in competitive markets or with greater regulation.

I know that the ACCC wouldn't have been surprised by this finding either. As part of the light-handed regulatory model under which our airports operate, the ACCC Airport Monitoring Reports documented the fact that the major airports are now collecting over 25 per cent more revenue for every passenger than 10 years ago, in real terms, as you can see on page 5 of the report and also on the infographic.



You can see that these increases have occurred all while fares have been declining – in real terms – by over 40%.

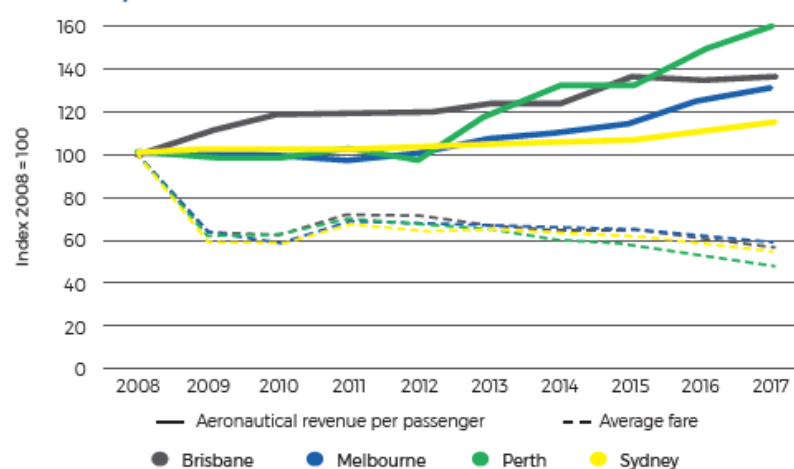
Also at the same time, passenger numbers have increased by nearly 20%, delivering an even bigger revenue boost for airports, yet – and this is the critical part - the ACCC found no commensurate increase in overall quality.

**Table 1: Evolution of Airport Charges and Fares, 2008-17 (Real terms, 2017 AUD)**

	AERONAUTICAL REVENUE / PASSENGER			AVERAGE AIR FARE		
	2008	2017	Change	2008	2017	Change
<b>Brisbane</b>	9.24	12.60	36%	514.14	290.73	-43%
<b>Melbourne</b>	9.47	12.44	31%	548.14	320.31	-42%
<b>Perth</b>	9.95	15.79	59%	801.25	383.83	-52%
<b>Sydney</b>	15.9	18.34	15%	666.11	366.35	-45%

Source: IATA Economics based on ACCC and PaxIS

**Figure 1: Evolution of Airport Charges and Fares, 2008-17 (Real terms, 2017 AUD)**

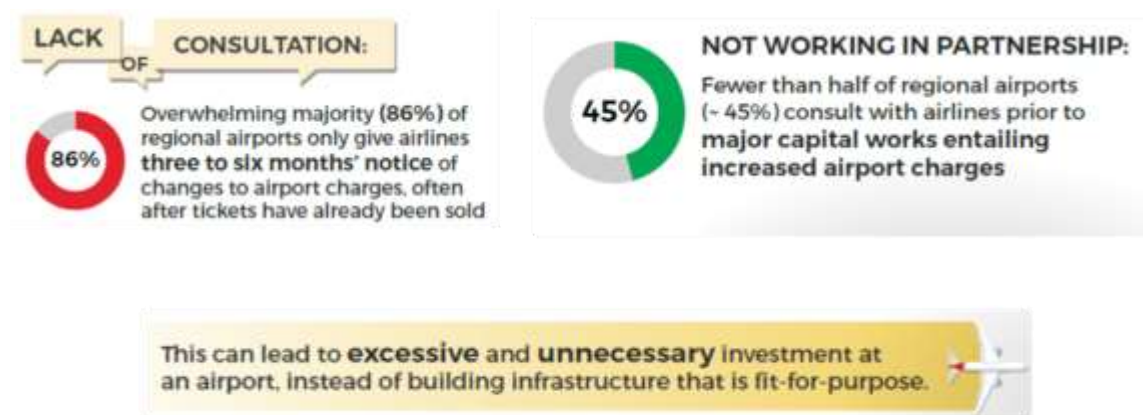


Source: IATA Economics based on ACCC and PaxIS

We ought to be surprised by this, shocked even, but it's become part of our passenger experience to park our cars at expensive car parks, walk through the shiny new facilities at the airport that are revenue generating, such as retail and food outlets, and then find our experience in bathrooms and other parts of the airports far less glamorous. One of my more memorable experiences, right here in Melbourne, resulted in me wanting to throw out my shoes!

It's not profitability alone, however, that demonstrates unconstrained market power. In fact, the absence of excessive profits does not mean market power does not exist. A reported 60% of regional airports are running at a loss, yet they are still able to exercise their market power in other ways. At both city and regional airports, aspects such as a lack of consultation on capital works which then result in increased charges is an example of market power.

You can see this illustrated on the infographic in front of you.



While investment is necessary given growth, A4ANZ believes that it must be fit-for-purpose, aligned with the needs of passengers using the facilities and demand for air services. Australia has numerous examples of what the International Air Transport Association (IATA) and Airports Council International (ACI) guidelines would rate as “overdesign”, such as creating international airports or additional capacity for larger planes where there is little current or predicted demand, or simply not ensuring that the existing asset is being used most effectively, which may be achieved through more modest increases in operational expenditure.

This situation has arisen because Australia's airports are indisputably, monopoly operators, and as such are able to use their market power to set prices that exceed costs, and have no incentive to consult on capital works that result in increased charges. Regulation is of course intended to ameliorate these effects. However, the current light-handed regulatory regime for Australian airports was built around a premise that just because airports have market power does not mean they will use or abuse it. I would put to you that this is simply not the case, and a couple of examples I'll give demonstrate this clearly.

Who else but a monopolist operator would park a car behind a plane, forced by bad weather to land at Canberra airport instead of Sydney, demanding the airline – their biggest customer - provide a credit card to pay an \$18,000 diversion fee, or be prevented from pushing back? This is all in the public domain and yes, it happened in Canberra, not in a developing country.



And who else but a monopolist airport owner – in this case Perth – would block an airline (Qantas) from operating a route to Johannesburg, because, in their words, another airline “had the route covered”. These anti-competitive actions are clearly those of a monopolist.

So forgive me for laughing when I’m told by bureaucrats and the Airports Association that, as big businesses, the airlines can go away and negotiate commercial agreements fairly with the airports. It’s a nonsense. Airports’ monopoly status gives them a natural bargaining advantage over customers – and that’s not just the airlines but other airport users like car rental companies, retailers (who incidentally pay rents much higher than Westfield) - which can lead to some of the following behaviours:

- Adopting a ‘take it or leave it’ position; the airlines can’t actually leave it if they have passengers wanting to fly to that destination.
- Delaying or refusing to disclose necessary background information or material facts, thus delaying settlement;
- In other ways protracting negotiations;

- Developing agreements that fail to provide contractual certainty or lack clarity and transparency;
- Using media to put pressure on airlines to accept deals – we’ve certainly seen that in Canberra in recent times; and
- Withdrawing unrelated services during negotiations and disputes. I heard a story yesterday from one of our airline members of a certain airport blocking the entry to their lounge in the middle of a dispute.

So the picture I’ve painted is not pretty and it’s the consumer who is ultimately the loser in all this. A4ANZ’s efforts are not just about trying to balance the ledger, however. A vibrant aviation sector will drive efficiency and innovation, which in turn is good for consumers and the economy. It is clear, however, that one part of the sector is capturing the majority of the benefits that this growth brings.

So what to do about it?

The current regulatory model under which the major airports operate is, by the ACCC’s own words, *“limited in its ability to address behaviour that is detrimental to consumers. In*

*particular, it does not provide the ACCC with a general power to intervene in the airports' setting of terms and conditions of access to the airports' infrastructure."*

The risk of an airport being restrained via the threat of declaration contained in the Competition and Consumer Act has clearly not been suitably high to act as a deterrent. It set a high regulatory hurdle and entailed extremely costly, lengthy processes. Furthermore, following amendments to the CCA41, the regime is now entirely missing a credible threat. Legal advice sought by A4ANZ confirms that there is now effectively no regulatory provision in Australian competition law that constrains a monopolist from exerting its power to extract monopolist rents, fees and charges for deficient services.

In practice, this means that there are limited (if any) incentives for airport operators to engage in good faith negotiations with users and provide access on reasonable terms and conditions in order to avoid the prospect of declaration.

More effective regulatory pressure is required to prevent excessive profits by airports and return more value to consumers and the economy. Unfortunately, however, the current regulatory system in Australia does not create the right environment for airlines and airports to work in partnership to ensure these gains can be achieved. Instead, they foster the monopoly power of airport owners - a power that enables increasing charges to be extracted from airport users.

Australia is clearly lagging behind. Greater oversight by regulators to encourage and, where required, force constructive, commercial engagement is needed to minimise the negative impact of the airports' monopoly powers.

There are a number of potential approaches to solving the problems identified with the current regulatory environment. Following consultation on both legal and economic implications, A4ANZ has formed the view that regulatory remedies based on minor modifications to the existing regime are unlikely to be effective as there would still not be

any credible threat to, or consequence for, monopoly airports exerting market power in airline-airport negotiations

However, to be clear, we are not advocating for the re-imposition of price control, as we agree with the expert view that the present situation provides no justification for that.

To address the issues outlined above, A4ANZ believes that the most effective regulatory solution and the one that is most likely to result in genuine commercial negotiations between airlines and airports to effect fair outcomes for airport users, is a negotiate-arbitrate model.

This contemplates a minor legislative amendment that empowers the ACCC to intervene where negotiations between airports and their major customers – not just airlines but the retailers, rental car companies, taxi and ride share operators – irretrievably break down.

The ACCC intervention would trigger an arbitration process – something the ACCC is well-skilled to do.

This could take the form of “final offer arbitration”, a method commonly used in various sectors in Canada and the United States. Using this method, a dispute between two parties is resolved by an arbitrator choosing between final offers of settlement made by each party to the dispute. The use of final offer arbitration in Canada is acknowledged to have been effective in fostering a more competitive negotiating environment.

In Australia, the adoption of final offer arbitration would be unlikely to require legislative direction but could be adopted by the ACCC through an amendment to its Guidelines, providing an indication to the parties as to its approach to arbitrations. Importantly, the existence of a credible ability to seek arbitration would encourage the development of commercial relationships between airports and their customers.

International experience suggests that concerns about invoking a system of independent dispute resolution are

unfounded, and in fact would take the current light-handed regulatory model forward. A4ANZ is not alone in suggesting that Australia could benefit such regulatory change, to emulate the effects of a competitive market. The Grattan Institute recently made similar suggestions, and amendments to New Zealand's regulatory regime are currently being considered; we need to catch up.

Our members are committed to building, maintaining and improving these positive, constructive relationships with airports. We also want to see airports, and the whole aviation sector prosper. It is not only in the airlines' interests, but in their passengers' interests, as well as the interests of Australian tourism and export sectors, and the broader economy for this to occur.