QANTAS GROUP SUBMISSION ON HARPER REVIEW RECOMMENDATIONS

The Qantas Group appreciates the opportunity to comment on several of the aviation-specific recommendations in the Competition Policy Review.

AIR SERVICES AGREEMENTS

International air services are governed by a complex system of bilateral Air Services Agreements (ASAs) between countries established in 1944 by the *Convention on International Civil Aviation*. These arrangements contain provisions on various aspects relevant to the operation of international air services, including but not limited to traffic rights, capacity and designation, ownership and control. While there are recent examples of multilateral agreements, the majority of ASAs are agreed between two countries.

Australia is one of the most liberal aviation markets in the world. This policy approach has ensured that total capacity operated to Australia has comfortably exceeded demand and has delivered further long-term effects, as recently reported by the Productivity Commission, including:

- the real cost of international air travel has fallen by 60 per cent over the last four decades[1];
- international passengers carried between 1991-92 and 2013-14 increased by 260 per cent[2];
- seats offered increased by 220 per cent[3]; and
- the number of airlines operating to Australia increased by over 30 per cent[4].

The Panel's concerns that ASAs may be used to protect Australian carriers and restrict capacity are misplaced and not consistent with the available data. There is no evidence to support a suggestion of a bias towards Australian carriers. In fact, the Department of Infrastructure and Regional Development has continued to further liberalise Australia's ASAs with recent examples including a tripling of capacity under the arrangements with China, a 55 per cent increase in capacity under the arrangements with the Philippines and a doubling of capacity for services between Australia and Chile.

With record low air fares, record high levels of capacity in the international market, new carriers entering the market, and the increasing presence of Asian low cost carriers; the reality of the Australian market does not match the Panel's observations or describe a policy crisis.

CABOTAGE

Cabotage is the highly unusual right to carry domestic passengers and freight between cities within another country, with the domestic sector operated as an extension of a service that originates in an airlines' home country.

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[1] Productivity Commission (2015), *Australia's International Tourism Industry: Commission Research Paper,* Canberra, page 3

[2] Ibid, page 58

[3] Ibid, page 59

[4] Ibid, page 96

The removal of cabotage restrictions would give the ability to foreign carriers to operate domestically in Australia using foreign registered aircraft with foreign crews, both of which operate under the primary oversight of their home country safety regulators.

The Panel's cabotage proposal goes well beyond progressive liberalisation and is inconsistent with the Government's August 2013 Policy for Aviation, which provides the framework to strengthen Australian aviation in the interests of the Australian travelling public, the local industry and its 40,000 employees. The Government's long-term objective of addressing the challenges in aviation and tourism will be achieved by maintaining stable and predictable policies which provide certainty to long-term investment planning. The proposal would have far-reaching consequences and would destabilise the Australian aviation industry, even if it is initially contained to Northern Australia.

The Qantas Group is strongly opposed to any removal of cabotage restrictions for the following reasons:

- the granting of cabotage is unprecedented globally. No other developed economy, with the exception of a few comprehensive single aviation markets such as the European Union, allows cabotage in aviation, i.e. only member state carriers operating intra EU;

- there is no evidence to suggest that capacity and connectivity are constrained in Northern Australia. Load and yield indicators are below network averages for both the Cairns and Darwin gateways, as well as the wider Northern Australia network. As of May 2015, 11 airlines operate to Cairns (5 domestic and 6 international) and 10 airlines operate to Darwin (3 domestic and 7 international), with over 110,000 seats per week to 30 destinations and 52,500 seats per week to 20 destinations, respectively;

- regulatory and safety risks would be increased with the Civil Aviation Safety Authority (CASA) required to rely on supervision by foreign government regulators. Australian airlines which are regulated by CASA would compete with airlines operating under lower cost safety regimes with different standards;

- cabotage would undermine and disadvantage Australia's position in future air service negotiations. These rights, which are one of the most valuable assets in aviation, would be gifted to other countries with no request in return. Australia would also lose a seat at the negotiating table for any future ASEAN Single Aviation Market; and

- airlines require a clear measure of certainty around which they can base long-term investment planning. The proposal would cause uncertainty and unpredictability putting any future investment decisions by Australian and strategically important international hub airlines at risk.

The Qantas Group is a major investor in Australia's aviation and tourism and a key enabler of economic activity across Australia. The Group operates more than 1,300 weekly services to, from and intra Northern Australia with over 4,000 jobs linked to those operations. The commercial and operational viability of the Group's network in Northern Australia which is critical in connecting many regional centres and communities is put at risk through cabotage.

PART IIIA ACCESS REGIME - AIRPORTS

Airports are critical components of the national economic infrastructure. All sectors of the Australian economy rely directly or indirectly on the efficient movement of people and freight through airports.

Australian airports possess significant market power and are natural monopolies. Without effective regulation, there is no constraint on an airport operator's ability to exercise its market power.

In its annual Airport Monitoring Report for 2013-14, the ACCC found that despite relatively low passenger growth, monitored airports have continued to report substantial increases in aeronautical revenues and margins. This is despite no substantial increase in the overall average quality of service indicators.

Airlines, including larger network airlines such as Qantas, lack any real countervailing power in respect of the use of airport services at major airports. This is because airlines have no choice but to use the services of airports located in the destinations to and from which customers wish to fly. Aviation charges[5] represent a significant cost to the Qantas Group, constituting approximately 8-9% of total expenditure.

Despite Part IIIA and the light-handed regulatory regime (that in any event only applies to core airports), commercial negotiations between airports and airport users have tended to be difficult and extremely protracted. This is caused largely because an airline's only true leverage is the threat to reduce or cease flying to the airport. In most cases, an airline cannot afford to make good on that threat for a number of reasons including loss of business confidence, claims by passengers with bookings, loss of revenue, redundancy of aircraft assets, redundancy of airport investments and so on.

As a result, the airline has no alternative than to persist in its negotiation. While commercial terms are usually reached after much debate around the principles underlying the airports' pricing methodology, the terms ultimately reflect the market power of the airport with airports achieving a return on assets that is significantly higher than other comparable businesses (whether regulated or not).

Examples of monopolistic and economically inefficient behaviour by airports in Australia generally, including smaller airports in regional areas of Australia include:

- airports engaging in protracted, costly and unproductive negotiations with airlines in respect of substantial, unjustified price increases;
- lack of transparency and supporting justification from airports on key pricing inputs, including asset base, operating expenditure, aeronautical / non aeronautical allocation, capital expenditure detail and project delivery dates;
- airports arbitrarily increasing aviation charges by more than CPI, despite passenger activity growth being higher than CPI levels (an outcome which should ordinarily result in reduced, rather than increased, charges to airlines);
- airports commencing litigation to enforce unilaterally imposed price increases;
- airports commencing or planning infrastructure works in excess of demand, with the requirement that airlines pre-fund such development; and

[5] Aviation charges are defined as aeronautical expenditure expenses paid to the Airport Authorities and Airservices Australia. For this avoidance of doubt, this includes airport passenger charges (airfield/landing, terminal, security), route navigation charges (eg Airservices Australia), rescue and fire fighting and aircraft parking but excludes lease expenses paid to airports, Qantas operating costs at the airport, including within our DTL's and bussing costs and Qantas in-house airport security costs, where Qantas acts as the airport security screening authority.

- council owned airports citing artificially high asset valuations, or frequent asset revaluations, to justify price increases.

A fundamental change in the current regulatory regime is necessary to protect airport users from monopolistic behaviour and bring about constructive commercial engagement between airports and airport users. In this context, the Qantas Group welcomes the Harper Review's acknowledgement that:

- airports have typical monopolist characteristics;
- the privatisation of Sydney Airport was not handled well and the fact that Sydney Airport Corporation Limited (SACL) has the first right of refusal over a second airport in Sydney has anti-competitive effects; and
- although airports are subject to the current Part IIIA, the access regime is not well suited to addressing monopoly pricing by airports.

As well as being an inappropriate solution for the problem, Part IIIA (both as a process and as a credible check on an essential facility owner's monopoly power) is a cripplingly time-consuming and burdensome process.

In these circumstances, the Qantas Group is disappointed that the Harper Review has found that the current light-handed approach to regulation appeared *'to work generally well'* and that a move away from this approach would be appropriate only in respect of 'some' individual airports.

While this finding implicitly acknowledges that the light-handed regime does not address ongoing price increases and monopolistic behaviour by *certain* airports, it fails to recognise that airports *generally* need to be subject to an effective access and pricing regime.

In circumstances where the Harper Review has acknowledged the inadequacy of the current regulatory regime, the Qantas Group is particularly disappointed that the Harper Review concurrently recommended raising the threshold for declaration, by requiring that there be:

- a 'substantial' increase in competition in a dependent market as a result of declaration under criterion (a); and
- an affirmative promotion of the public interest through declaration under criterion (f).

The Harper Review has correctly identified the inherent weaknesses of the current access regime as it applies to airports, but has failed to articulate a solution to address monopoly pricing.

For over a decade Qantas has proposed that airports be deemed declared. A version of this proposal was also advocated by the ACCC in its 2011 submission to the Productivity Commission inquiry into the economic regulation of airport services.[6] This represents a simpler and more efficient way to deal with the problems that have been identified by automatically activating the arbitration mechanism under which the new Access and Pricing Regulator proposed by the Harper Review could intervene (if reasonable access and terms cannot be commercially negotiated).

[6] *Available at* http://www.pc.gov.au/__data/assets/pdf_file/0005/107087/sub003.pdf.