3 September 2018

BARA

Board of Airline Representatives of Australia Inc

Submission to the Productivity Commission – economic regulation of airports

Overview of BARA

The Board of Airline Representatives of Australia (BARA) is the industry body that supports the safe and efficient operations of international airlines serving Australia for the benefit of consumers, businesses and tourism.

BARA's members include many of the world's largest airlines, providing 90% of all international passenger flights, and carrying most exports and imports of freight to and from Australia. The Australian Competition and Consumer Commission (ACCC) has authorised BARA to undertake voluntary, non-binding negotiations on behalf of its members for international flights with major international airports, Airservices Australia and other providers of essential aviation-related services to improve the efficiency and safety of international aviation.

BARA's Vision and Outcomes

To guide BARA's work and clearly articulate its ideals, BARA's members have developed a Vision and outcomes for international aviation in Australia, available at www.bara.org.au. The vision for Australia's international aviation industry is 'High quality, adaptive and efficient'. Underpinning this vision, BARA has identified four key outcomes to boost the competitiveness and productivity of safe aircraft operations. These are:

Outcome 1: Timely and reasonably priced airport infrastructure

Outcome 2: Competitive supply of jet fuel

Outcome 3: Safe and efficient air navigation services

Outcome 4: Environmentally sustainable growth

The Australian Government plays a critical role in shaping the international aviation environment and fostering BARA's identified industry outcomes.

BARA's member airlines

AIRASIA X
AIRCALIN
AIR CANADA
AIR MAURITIUS
AIR NEW ZEALAND
AIR VANUATU
ALL NIPPON AIRWAYS
AMERICAN AIRLINES
ASIANA AIRLINES
CATHAY PACIFIC AIRWAYS
CHINA EASTERN AIRLINES
CHINA SOUTHERN AIRLINES
DELTA AIR LINES
EMIRATES
ETIHAD AIRWAYS
EVA AIR
FIJI AIRWAYS
GARUDA INDONESIA
JAPAN AIRLINES
LATAM AIRLINES GROUP
MALAYSIA AIRLINES
PHILIPPINE AIRLINES
QANTAS AIRWAYS
QATAR AIRWAYS
ROYAL BRUNEI AIRLINES
SINGAPORE AIRLINES
SOUTH AFRICAN AIRWAYS
THAI AIRWAYS
TURKISH AIRLINES
UNITED AIRLINES
VIETNAM AIRLINES
VIRGIN AUSTRALIA

Executive Summary

BARA welcomes the opportunity to contribute to the Productivity Commission's inquiry into the economic regulatory arrangements for Australian airports. In this submission, BARA:

1. Provides the position of member airlines about how well Sydney, Melbourne, Brisbane and Perth airports deliver services for international flights for the prices paid. These four airports account for over 90% of international passengers. Members also support the review of airports outside the four major international airports
2. Describes the underlying reasons for how the members assessed performance in the areas of investment and services proposals, pricing and financial exposure to service delivery capability, and contractual accountabilities
3. Articulates its desired commercial benchmarks that would best support the ongoing efficient provision of airport services to international airlines at reasonable prices
4. Canvasses reform initiatives to the economic regulatory arrangements in supporting the achievement of its desired commercial benchmarks and improved industry outcomes.

These four topics are covered under the seven sections of the submission. To help readers navigate through BARA's submission, each section is briefly summarised below together with a link to the section's content.

Australia's international aviation industry and airport services

Australia's international aviation industry has averaged over 5% annual growth, with real airfares falling by about 40% over the past 12 years. The airport operators best support the industry by providing airport services that deliver value for money.

What matters most to member airlines is that the airport operators have the service delivery capability to support their safe and efficient operations. Sound investment practices and contractual accountabilities underpin progressive industry outcomes. > READ MORE

Service delivery capability and value for money

The consensus position of member airlines is that the airport operators are not delivering value for money in airport services for international flights. There are underlying issues with management focus and the availability and quality of services for the prices paid.

BARA has surveyed its members about the quality of outcomes they receive for the prices paid. The survey covered airport management's approach to supporting their efficient operations, the availability and quality of services and the overall value for money received. > READ MORE

Investment and services proposals and information sharing

There are ongoing problems with the information and engagement that underpins investment and services proposals. BARA does not consider current practices are well aligned with delivering the promised responsive and innovative airport services.

Improved engagement based on a clear understanding of airline and passenger needs is necessary. Information sharing remains largely formative at most airports. Airport operators have developed or are implementing a key performance indicator regime. > READ MORE

Executive Summary

Airport pricing and financial exposure to service delivery

To BARA, the setting of prices by the airport operators for international airlines is viewed largely as an airport management and board process. The current arrangements are best described as the airport operators 'self-regulating' their profit levels.

The airport operators are strongly financially-insulated from their service delivery capability. An airline's commercial agreement for airport services has little value in the face of falling service outcomes, reducing their operating efficiency and increasing costs. > READ MORE

Contractual accountabilities and negotiations

Most commercial discussions with BARA still start with the airport operator offering unfavourable, largely ambit claim commercial terms. Where more commercially sound provisions are in place on issues, it benefits both the airport operator and airlines.

With some exceptions on certain issues, commercial agreements do not encourage continuous improvement in service delivery. The inability for airport operators to negotiate around reasonable commercial terms remains an ongoing problem. > READ MORE

Desired commercial benchmarks

Airlines seek a standard of service delivery capability that supports their ongoing safe and efficient operations at the airports. This requires higher accountabilities and performance benchmarks and acceptance of genuine financial risk for service delivery.

BARA envisages an environment where each airport operator accepts positive obligations and accountabilities to deliver good service outcomes to airlines, ground handlers and passengers. Investment practices and the commercial agreements would be modernised. > READ MORE

Achieving commercial benchmarks

BARA's desired commercial benchmarks will not be delivered under the existing light-handed economic regulatory arrangements. Member airlines do not consider that updates to the Pricing Principles or additional monitoring will address underlying problems.

Firmer economic regulation can deliver net benefits by encouraging the implementation of sound commercial arrangements. A new path to best support value for money and continuous improvement in the delivery of airport services is required. > READ MORE

Australia's international aviation industry and airport services

Following global trends, Australia's international aviation industry continues to experience growth. Drivers include rising incomes, improved travel affordability, tourism promotion and the goals of countries and airlines. The airport operators best contribute to the industry's success by providing airport services that deliver value for money. Sound investment practices and commercial agreements, which contain appropriate accountabilities and a fair allocation of commercial risk, are necessary. For member airlines, the merits of the light-handed economic regulatory arrangements for the major international airports are based on how effective they have proven in supporting value for money in airport services.

Competitive reform has delivered a growing international aviation industry to Australia's economic and social benefit. Deregulation, changes in the ownership structure of major airlines and the Australian Government's negotiation of bilateral air services agreements have established a competitive industry and allowed international airlines to offer the range of services available today.

Many stakeholders contribute to Australia's international aviation industry: airlines; ground handlers; fuel companies; travel agents; security service suppliers; caterers; and infrastructure service suppliers, including airports and air navigation services. The Australian Government also has a critical role in safety and security regulation and the economic regulatory arrangements for the major international airports and Airservices Australia (air navigation service provider).

Businesses that compete with others to be part of the industry are already subject to market forces that mean they give value for money (or leave the industry if they do not). For the 'sole suppliers', including the airport operators, the same market discipline to guide their activities is either weak or not present at all. Given the sustained growth in Australia's international aviation industry, they tend to assume they are delivering value for money.

In its submission, BARA reports how well Sydney, Melbourne, Brisbane and Perth airports have performed in relation to international flights by focusing on what matters most to airlines, namely:

- service delivery capability and value for money
- investment and services proposals and information sharing
- airport pricing and financial exposure to service delivery capability
- contractual accountabilities.

For the airport operators to be financially successful, they should be performing adequately on these key commercial items. Delivering value for money in airport services best supports the commercial viability of international air services to the benefit of passengers, freight forwarders and Australia's tourism industry.

For its part, BARA has been open in specifying the reasonable commercial expectations of its member airlines, as published in Timely and reasonably priced airport infrastructure. Further detail is contained in Airline Views, published quarterly. Member survey information is also provided to each airport operator. BARA's assessment is based against known commercial expectations.

Growing international aviation

Over the past 12 years Australia's international passenger numbers have increased by about 83%, or 5.7% annually, to nearly 39 million in 2016–17. Some 500 international flights to and from Australia are operated each day.[1] The average distance travelled one way by international passengers is estimated at about 8,300 km.[2] Volumes of air freight have also increased by over 40% to more than one million tonnes in 2016–17.[3] There is the potential for Australia's international aviation to more than double in passenger numbers over the next 20 years. An overview of Australia's international aviation industry is provided in Attachment A to this submission.

These outcomes reflect global trends in international aviation. Data from the International Air Transport Association (IATA) show global international aviation averaged about 6.8% annual growth in revenue passenger kilometres from January 2014 to December 2017. Within this, annual growth in the Asia-Pacific and Middle East averaged 7.9% and 10.5%, respectively.[4] International airlines are achieving high rates of growth across many countries, with aviation infrastructure services provided under a range of institutional and economic regulatory arrangements.

BARA estimates that average real international airfares to and from Australia (business and economy classes combined) have fallen by about 40% over the past 12 years. For economy class tickets, the reductions are 40–50%. Airfares to and from Australia are following global trends. IATA reports that global average yields in $US fell by about 25% from 2011 to 2018.[5] IATA's research shows the real price of air travel has closely followed the reduction in the real cost of providing the service for many decades.[6]

Industry growth drivers

BARA agrees with the information and discussion presented in the Commission's 2015 Research Paper, *Australia's international tourism industry*, that rising household incomes and lower travel costs remain the main drivers of inbound tourism into Australia. The same arguments equally apply to Australians travelling overseas. Within this, the tourism growth aspirations of countries and airlines also play a role, influencing the level of capacity provided. Effective expenditure on tourism advertising contributes to the aggregate growth in Australia's international aviation industry.

Many suppliers to the industry have a role in supporting safe and efficient international aviation, allowing airlines to best capitalise on the market opportunities available. The main drivers of growth, however, are not within the control of suppliers to the industry, including the airport operators.

BARA acknowledges that the airport operators contribute to the industry through activities such as working with tourism organisations and marketing their airport to airlines. Their primary role, however, remains to provide airport services to facilitate safe and efficient airline operations, good passenger experience outcomes and deliver value for money. This is the basis of BARA and its member airlines' assessment of the performance of the airport operators given the opportunities afforded to them under light-handed economic regulation.

[1] Bureau of Infrastructure, Transport and Regional Economics, 2018 International aviation statistics, bitre.gov.au/statistics/aviation/index.aspx.

[2] BARA estimate based on IATA PaxIS data and great circle distances.

[3] Bureau of Infrastructure, Transport and Regional Economics, 2018 International aviation statistic, bitre.gov.au/statistics/aviation/index.aspx.

[4] IATA, *Air passenger market analysis,* 2014 to 2017.

[5] See IATA (February 2018) Airlines financial monitor.

[6] IATA June 2013, Profitability and the air transport value chain, p.11.

Airport performance assessment framework

As BARA saw it, the reason for implementing light-handed economic regulation was to deliver more productive and responsive airport services. There were opportunities to deliver airport services that could better match the changing needs of airlines and passengers. As noted by the Commission in its 2002 Inquiry *Price regulation of airport services*:

> In removing such regulatory intrusion, the switch to a light-handed approach was intended to facilitate investment and innovation by airports – while retaining a constraint on misuse of market power in their dealings with airlines and other customers. By providing greater opportunities for the parties to negotiate and build commercial relationships, the ultimate objective was that provision of aeronautical services would be determined primarily through commercial negotiations. (p.XIII)

There are currently 56 airlines providing international flights to and from Australia, with BARA's 32 members accounting for 90% of these flights. An airport operator can engage both individually and collectively across its airline customers and this is seen as an important way of fostering innovation and responsive services outcomes.

BARA agrees that effective engagement and information sharing between all participants to Australia's international aviation industry underpins good industry outcomes. A prominent example is Airport Collaborative Decision Making (A-CDM) (see Box 1). Its development and application is gradually occurring in Australia and BARA continues to support its progress, including being a member of Airservices Australia's Industry Coordination Group for A-CDM.

If the airport operators were delivering on the intended benefits of light-handed economic regulation, then it could be expected that international airlines are well satisfied with the delivery of services and pricing by them. This includes a proactive approach to the effective management of common use infrastructure services across multiple airlines. All this would translate into ongoing improvements in the operating efficiency of airlines and good outcomes for passengers and freight forwarders.

Box 1. Airport collaborative decision making (A-CDM)

A-CDM can achieve the best operational performance from airport infrastructure and generate efficiencies in aircraft turnarounds. Up-to-date and accurate information is shared between Airservices Australia, airport operators, ground handlers and airlines for improved real-time decision making. A-CDM, underpinned by an efficient communications system, requires joint procedures and practices rather than Airservices Australia and the airport operators independently managing their area of operations.

The commercial negotiations

The essential element of light-handed economic regulation is for the airlines and airport operator to express their requirements and deliverables directly to one another.

A commercial negotiation would resolve:

- What are the services to be delivered?
- To what standard?
- What is necessary to deliver them?
- How should we measure success?
- What are the accountabilities for the airport operator and airlines?
- What are the legal rights and limitations?
- And finally, pricing.

By directly negotiating these issues, the commercial agreement and subsequent outcomes would be better than if determined by an economic regulator. Obviously, a strong theme here is that ‘commercial negotiations’ can generate greater industry productivity and performance. From BARA’s perspective, the commercial negotiations are one input into the pricing and delivery of service outcomes for member airlines. It is not assumed that undertaking such negotiations with airport operators necessarily leads to any desirable outcomes for international airlines in terms of the availability, quality or pricing of airport services.

Assessment items – what matters to international airlines

The light-handed arrangements for Sydney, Melbourne, Brisbane and Perth airports have now been in place for some 15 years. This has provided for multiple investment cycles and commercial negotiations. If satisfactory price and service outcomes are not being consistently delivered by now, then they are unlikely to do so under the existing economic regulatory arrangements.

For member airlines, the merits of the current arrangements are ultimately measured by whether they consider they receive value for money in airport services. Understanding value for money is a fundamental requirement for businesses operating in competitive markets and such a test is equally appropriate for the airport operators.

One contribution BARA has made to this inquiry is to ask its members to report on the quality and value for money in airport services they receive from the airport operators. BARA has surveyed its member airlines, seeking ratings and comments on the following four topics:

1. management approach to airline operations and service quality
2. representations, value and business culture
3. airline staff offices
4. overall view on value for money.

BARA’s survey did not ask members to rate different forms of economic regulatory arrangements, as these are ultimately inputs and processes to the pricing and delivery of services. The findings and consensus position of the member airlines are presented in the section Service delivery capability and value for money.

In understanding the value for money in airport services delivered to member airlines, it is necessary to investigate the foundations on which they are based. Three broad foundations underpin the delivery of airport services to BARA's member airlines, namely:

1. investment and services proposals and information sharing
2. airport pricing and financial exposure to service delivery
3. contractual accountabilities.

If an airport operator is doing well on these three foundations, it could be expected that member airlines would be generally satisfied with the overall commercial offering and ongoing delivery of services for the prices paid. Supporting the operating efficiency of airlines and delivering value for money in airport services also fits with supporting the best possible outcomes for passengers and freight forwarders.

If an airport operator has weaknesses in any of these foundations, they contribute to outcomes that fall below the expectations of airlines. In such circumstances airlines are not convinced the airport operator is delivering enough value for the prices they charge for their services. Under light-handed economic regulation, airport operators are afforded the opportunity to do well on these commercial items in delivering adequate returns to shareholders.

It is clear from the above list that BARA places limited weight or emphasis on the actual commercial negotiations by the parties. Whether the negotiations proceed relatively smoothly or are strained and protracted essentially depends on how the members view the quality of outcomes at the airport and the commercial offer.

BARA's objective is to support Australia's safe and efficient international aviation industry. Its voluntary, non-binding negotiations takes place openly and transparently with member airlines and the airport operators. They include surveys and regular briefings with members. Member airlines guide BARA's negotiation strategy, including deciding when to conclude negotiations.

BARA's input into the Commission's inquiry

BARA has provided a comprehensive description of the quality of the outcomes and commercial arrangements for its members' international flights through Sydney, Melbourne, Brisbane and Perth airports. In doing so, BARA has consulted members extensively as part of its ongoing engagement with them.

BARA has not documented its assessment of every negotiation with each of the airport operators. Instead, the general themes and common outcomes are covered. There are exceptions where outcomes have differed from the general case and individual outcomes of note are included. Specific comment on individual airport operators is provided on their overall performance, including the quality of engagement in developing investment and services proposals for consideration by airlines.

Based on a sound understanding of current performance issues, BARA articulates its desired commercial benchmarks that would best support value for money and continuous improvement in the delivery of airport services. The reform initiatives canvassed are evaluated in terms of their ability to lift industry performance by addressing the main concerns of member airlines and identified weaknesses in the commercial agreements.

'Tier 2' airports

BARA's ACCC collective negotiations authorisation also extends to Adelaide, Cairns, Darwin and Gold Coast airports. Most negotiations with these airport operators occur bilaterally with individual international airlines, which reflects the smaller number of airlines and flights through these airports.

These airport operators may advise BARA of changes to the 'rack rate' applied to member airlines and, if requested, BARA can facilitate discussions with member airlines. This recently occurred with Adelaide Airport in advancing terminal expansion works for international flights. As such, this submission provides limited comment on the outcomes for international flights outside the four major international airports.

BARA supports reform initiatives that would improve the efficiency and quality of services for international flights provided at Tier 2 airports in maximising the commercial opportunities for international airlines.

RETURN TO EXECUTIVE SUMMARY

Service delivery capability and value for money

For member airlines, the merits of the light-handed economic regulatory arrangements lie in how effectively airport management facilitates their efficient operations, provides good outcomes for their passengers and delivers quality services for the prices paid. BARA has already publicly stated that members do not consider they are receiving value for money in airport services. As part of its ongoing consultation, BARA has surveyed its members to provide the Commission with further information on where the main 'value gaps' lie in service delivery capability. Some commentary about individual airports is also provided.

For airport services, the airlines' 'value equation' extends beyond the physical assets at the airport, such as the runways, taxiways, terminals and access roads. It also includes how airport management proactively supports their efficient operations at the airport (eg aircraft turnaround times) and aids in their ability to deliver the service outcomes they are seeking for their passengers. As one example, an airport operator's understanding of how its baggage system interacts with other information systems and its business continuity plans for disruptions, is equally as important as the baggage system's stated 'capacity' in delivering good baggage outcomes for airlines and passengers.

Businesses that compete to provide services must have a deep understanding of customer needs to retain existing clients and win new business. BARA's member survey sought to understand the extent to which the airport operators, at both their corporate and operational levels, are effective at understanding their business needs.

An accurate representation of the availability and quality of services provided for the prices paid forms an important part of the business relationship between an airport operator and each airline. Airlines understand how the quality of the infrastructure services varies across the airport and that the impact of construction activities on operations must be managed. Nonetheless, airlines expect an accurate representation of the service outcomes they can reasonably achieve over the term of the commercial agreement they are expected to sign.

Survey design

BARA's member survey consisted of 26 questions about each airport operator for each airline that operated into Sydney, Melbourne, Brisbane and Perth airports. The survey was conducted in February 2018. For applicable questions, members were asked if they 'strongly agreed', 'agreed', 'disagreed' or 'strongly disagreed'. Survey scores were then generated from the completed surveys.

BARA received 70 individual responses from member airlines across the four airports. This has provided a sound sample for understanding how well the airport operators are performing on their core service delivery role for international airlines for the prices paid. In addition to comments provided by members in the survey, BARA held follow-up meetings with some airlines to ensure it accurately understood the airline's position based on its survey responses.

In calculating scores, 'strongly disagreed', 'disagreed' 'agreed' and 'strongly agreed' equal 25, 50, 75 and 100, respectively. An overall score of 75 therefore means that, on average, airlines are satisfied with the airport operator's performance. The results are calculated using the simple average of the scores across survey responses.

Summary of findings

The summary outcomes covering airport management, services and representation and value for money in airport services for Sydney, Melbourne, Brisbane and Perth airports, plus the average outcome across the four airports, are shown on the following page. It is clear from the results that the member airlines generally do not consider that they receive sufficiently consistent service outcomes in return for the prices paid to the airport operators. It is important to note there is some variation in outcomes across airlines and airports. While most airlines do not agree the airport operators deliver value for money, at least one airline at each airport is satisfied with its service outcomes for the prices paid.

Airport management approach to supporting efficient airline operations

Effectively supporting efficient airline operations is a critical component of successful outcomes for member airlines. Mature and successful commercial relationships require airlines to be confident the airport operators are as focused on supporting their operations, consistent with the practices of those suppliers that compete for the airline's business. Ultimately, airlines are assessing the performance of the airport operators against those suppliers operating in competitive market environments.

The management of each airport fell short of convincing airlines that it focuses enough on supporting their ability to operate without persistent significant delay or fostering an environment where their requirements are at least equal with other activities at the airport, including non-aeronautical retail in the international terminals. An average score of 67 for airport management across all airports is below the acceptable threshold of 75.[7] On average, 8 out of 10 airlines consider the airport operators are not proactively doing enough to support their efficient operations.

Airport management was rated the lowest (score 53) for its focus on ensuring service standards across airlines were maintained during the growing morning peak period. The strong growth in airline demands has occurred but the airport operators have not increased their service delivery capability sufficiently to effectively support this new, more complex and diverse operating environment. The revenue increases from this growth have boosted airport profitability but airlines have not seen the necessary reciprocal improvements to service delivery.

Airport management was also rated slow at addressing in-terminal issues that hampered the efficiency of airline operations. This reflects an overall concern of airlines that airport management can give greater attention and priority to retail activities. This is especially a problem when retail activities detract from efficient airline operations, increasing their costs of operation.

On a more positive note, the operational staff and duty managers generally scored better (score 73), which shows that airport staff are supporting airlines day-to-day as best they can with the resources made available to them. Airlines are also reasonably confident most airport operators have sought to ensure operational procedures are communicated to them.

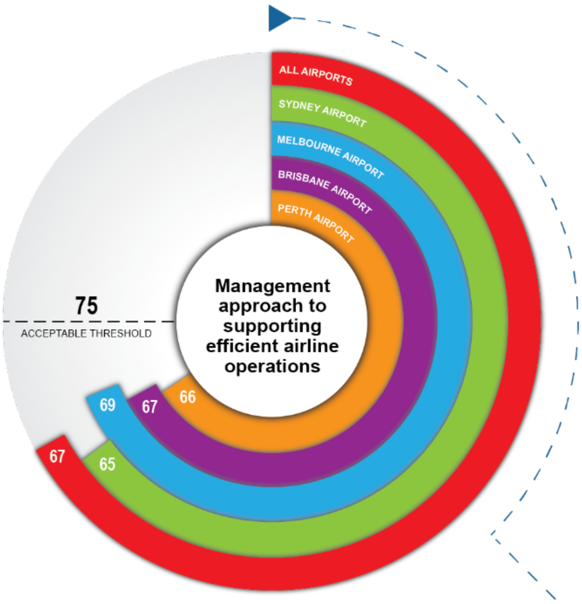
BARA has acknowledged airport management's efforts in supporting airlines when this has occurred. Two examples include Brisbane Airport's design for its new parallel runway and Sydney Airport's key performance indicator (KPI) regime implemented as part of the agreement reached in 2015. [8] Overall, however, the level of airport management focus and performance was assessed as being less than acceptable in supporting the operational efficiency of international airlines.

[7] A score of 75 means that, on average, airlines 'agree' airport management is sufficiently focussed on supporting their efficient operations.

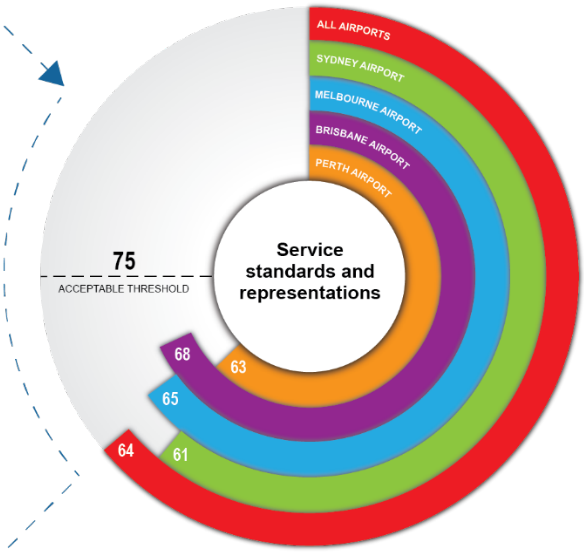
[8] See BARA's *Airline Views*, June 2017.

MEMBER RATINGS

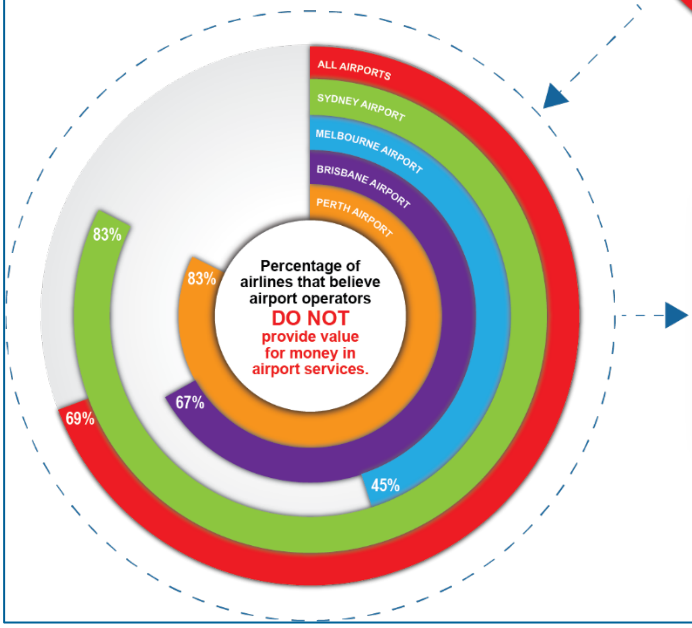
Airport management, services and value for money



Airport management not sufficiently focused on supporting efficient airline operations; airport operational staff supporting the best they can.



Service outcomes below minimum requirements; over-promising and under-delivering remains an issue.



It was found that over

69% of airlines

do not believe they get value for money in airport services.

Service standards and representations

The availability and quality of the airport services expected by airlines are below the acceptable threshold, with an average score across all airports of 64. The airport operators were rated lowest on the measures of retail activities negatively affecting efficient airline operations (score 58), the quality and cleanliness of the terminal (score 62) and service outcomes during the morning peak period (score 62).

Accurate representation of the availability and quality of services remains an issue with airlines (score 66). Over-promising and under-delivering by airport operators is straining the commercial relationship with some international airlines.

The availability of services scores were 65 and 75 for airlines that operated mainly during the peak and non-peak times, respectively. It is important to note that airlines interpret ‘availability’ as the practical ability of the infrastructure services to meet their needs and not whether a given number of service assets are ‘operational’ (available), which may be less than necessary given the aggregate level of airline demand.

Airlines that operated mainly in non-peak periods are therefore largely satisfied with service availability, which is an anticipated outcome. However, airlines consider that what poses a significant and growing problem is the inability of an airport operator to adequately support the level of demand it has accepted on its infrastructure during peak time use.

Value for money in airport services

Given the below par scores for airport management, services and representations, it is to be expected that some 70% of airlines across all airports do not consider the airport operators deliver value for money in airport services.[9] These are issues BARA has raised on behalf of its members with the airport operators for some years and should therefore not be a surprise to them. In the following sections, BARA details the underlying reasons why the value for money scores are less than acceptable by member airlines.

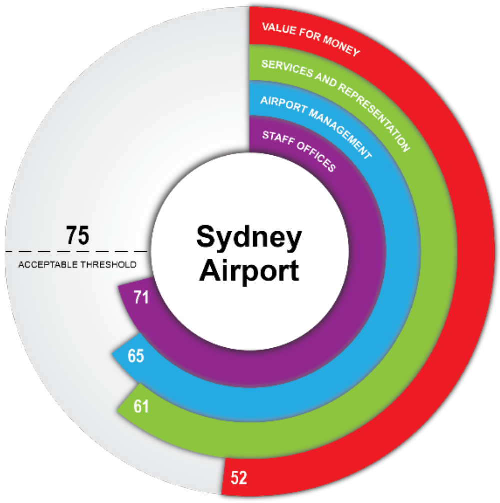
The survey results signal a significant disconnection between the performance assumed by airport management and the actual quality of services delivered to international airlines, including accurate representation of what will be delivered for the prices paid. BARA notes that it receives a steady flow of emails about airport operator achievements, awards and successes in delivering services to airlines and passengers. The rising airport revenues, profits and awards seem to have created a perception of superior performance even though airlines consider the outcomes they receive below that reasonably expected for the prices charged.

BARA considers the disconnection from actual performance stems from the fact the airport operators are financially insulated from their service delivery capability within a generous price-setting environment (see section Airport pricing and financial exposure to service delivery). The airport operators are obtaining the financial benefits of strong international passenger growth, but the commercial and operational challenges of this growth remain largely with airlines. It is to be expected that in a commercial environment where a supplier essentially receives the same price regardless of actual service outcomes, it will become disconnected from its own service delivery capability.

[9] For the results by individual airport on the following pages, the value for money rating is expressed as the score out of 100 rather than the percentage of airlines that do not consider the airport operator is providing value for money (ie less than 75).

Results by airport

Sydney Airport



Sydney Airport scored the equal lowest for value for money across the four airports (52). BARA would argue, however, given the concerns reported by member airlines in 2013–14, these low scores represent some level of improvement. Given the operational complexities associated with greater flights and passenger volumes, it is unlikely that Sydney Airport will be able to improve its scores under the existing pricing and service quality arrangements.

In 2013, it was clear to BARA there were major problems to which Sydney Airport needed to respond. Members and BARA were concerned about: the quality of cleaning and maintenance within the international terminal, especially the condition of the public toilets; no medium-term investment program known to airlines; the lack of any useful information sharing; and continued commercial arguments over price increases for investment projects, which had remained a source of dispute for a decade.

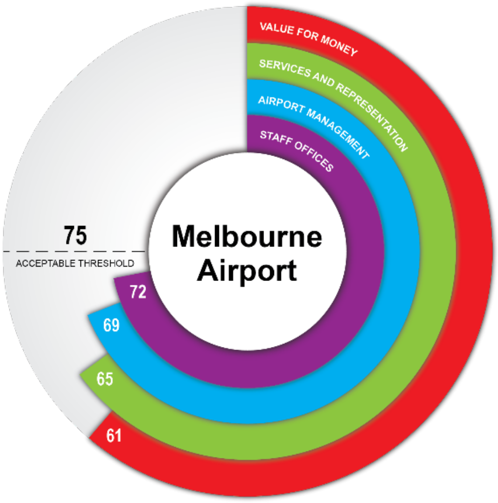
The negotiation of the 2015 aeronautical services agreement for international flights (2015 ASA) with Sydney Airport represents a commercial framework that sought to drive improvement in the fundamental elements of airport services provision. For its part, BARA provided considerable detail on what needed to change commercially at least 12 months before the new agreement began. This included the service level framework and new industry consultative forum. This was necessary to provide Sydney Airport with enough time to consider the move towards accepting some initial accountability over the delivery of services for the prices charged.

BARA has publicly acknowledged the improvements achieved under the 2015 ASA. The standard of cleaning and maintenance has lifted, and Sydney Airport has successfully established the key performance indicators (KPI) regime.

Sydney Airport, however, faces large challenges from growth that is occurring through a decline in average service outcomes for airlines on key services items, especially contact gates and bussing operations. Unplanned and greatly expanded bussing operations can at times be best described as chaotic for airlines, which are not considered fit for purpose for larger aircraft. Members also report ongoing concerns that Sydney Airport does not have enough understanding of how airlines conduct their operations at the airport. Adequate space for ground services equipment and airfield foreign object debris (FOD) are also key concerns for airlines.

The outcomes experienced by international airlines are in contrast to the representations made by Sydney Airport and their reasonable expectations that they would enjoy improvements in their operating efficiency over the term of the 2015 ASA.

Melbourne Airport



Member airlines have usually been the most positive about Melbourne Airport in terms of facilitating their efficient operations. It is now the case, however, that members are reporting a gradual but sustained lower assessment of Melbourne Airport given its new, more complex operating environment. This decline in assessed performance may well continue over the medium term.

BARA surveyed its member airlines serving Melbourne Airport as part of its early contribution to negotiating the 2018 Aeronautical Services Agreement (2018 ASA). Members' clear expectation was that Melbourne Airport would continue to find ways of delivering a 'higher quality/lower cost' service relative to the other major international airports. This was an ongoing position expressed by the then Managing Director and Chief Executive Officer to member airlines.

Members understand the difficulties of expanding capacity at Melbourne Airport in an orderly and cost-effective way, given the legacy issues of the existing terminal. While the terminal does allow for joint domestic and international operations within the one building, expansion within the existing terminal footprint is difficult. That said, members were quite taken aback at opening proposals that would lead to lower and less efficient service outcomes for them (eg increased bussing) at much higher prices, in stark contrast to the commitments previously made.

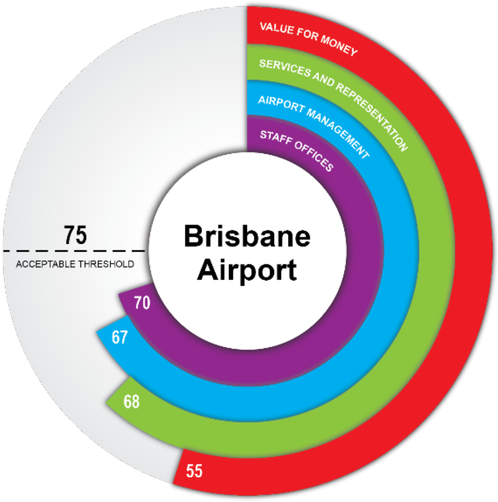
Melbourne Airport struggled to clearly explain the reasons for, and benefits of, its large and expensive proposed investment and services proposals. Airlines were generally not convinced the expensive investment and service proposals were of net value to them.

Improved efforts are now being made to provide additional information about proposed projects, more transparency for project costs and performance indicators outside the maintenance and availability of existing assets. It does provide for a firmer basis for more effective engagement in the future. It is clearly years behind its scheduled need in supporting the operational efficiency of airlines and in developing large and complex investment programs.

Operationally, members report that increased bussing operations are of greatest concern, as the current infrastructure regularly fails in supporting key airline targets, such as on time performance. The design and passenger flow from self-service check-in have also driven issues about customer experience when all the available zones are in operation.

There is a risk of further declines in service ratings by airlines over the medium term as the growth in the size and complexity of international operations at Melbourne Airport exceeds its ability to increase its service delivery capability.

Brisbane Airport



Brisbane Airport has previously provided satisfactory services and facilities for relatively uncomplicated international airline operations. The growth in the size and complexity of operations has, however, led to some sharp falls in assessed performance, as evidenced by a value for money score of just 55. Brisbane Airport is at a formative stage in developing, sharing and improving upon the service measurements necessary to lift its value score.

In 2016, BARA surveyed its member airlines over the quality of services and issues to be addressed in preparation for negotiating the 2017 Terminals Agreement. Most airlines ranked Brisbane Airport at the high end of 'Acceptable'. Airlines, however, also considered that Brisbane Airport's planning and processes needed to improve to maintain services during the growing peak period.

Airlines have reported to BARA that Brisbane Airport will face significant short and long-term challenges with regard to check-in counter availability, passenger and baggage connectivity and ground service equipment (GSE) storage availability. Members believe many of the current operational issues are due to a lack of effective consultation consistently across all airlines and coordination issues between the various departments within Brisbane Airport Corporation.

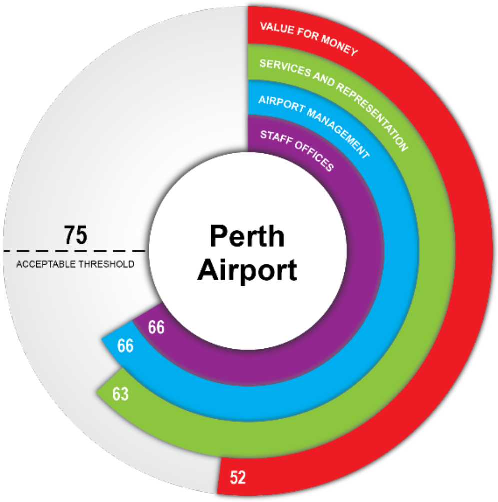
Due to the over-reliance on airlines' planned use of common use self-service check-in (CUSS) for both kiosk and automatic bag drop (ABD), and lack of consideration for the acquisition of hybrid ABD, airlines are having to share conventional check-in rows – sometimes as many as three airlines – on a daily basis, while some CUSS rows remain unused. This is impacting on efficient operations and the passenger experience.

Brisbane Airport's passenger and baggage connectivity strategy for within the international terminal and between terminals remains an ongoing issue. Airlines consider that Brisbane Airport needs to identify and focus on where the main issues to improved connectivity exist and develop operating and infrastructure solutions in response. As the volume of flights continues to grow, airlines report issues with adequate storage for GSE, impacting airfield efficiency.

On a more positive note, BARA considers the work done by Brisbane Airport and Airservices Australia on the airspace design for the new parallel runway to be high quality. BARA has participated in this process and has endorsed the proposed mature airspace design in supporting increasingly efficient safe aircraft operations. The development of the initial key performance indicator (KPI) regime for Brisbane Airport is also a positive initiative, noting it is still largely based on the maintenance of a given set of assets.

It is difficult to see Brisbane Airport improving upon its current low value for money score over the medium term, especially given the need for effective consultation with airlines and improved analysis and justification of capital projects.

Perth Airport



In 2014, Perth Airport's then Chief Executive Officer presented to the membership a progressive and modern services development and engagement model. Unfortunately, little eventuated in practice, which has clearly contributed to the low service rating scores. The lack of performance measurement has severely hampered progress on proposed major international terminal developments. There are positive signs Perth Airport is willing to work with airlines to address underlying problems and improve its service and value for money scores.

For international flights, Perth Airport's departures terminal is widely recognised as a poorly thought-out design put together hurriedly for the 1987 America's Cup. BARA staff can remember plans to rectify the situation being put to airlines some 20 years ago, yet the current legacy design remains.

Service outcomes for international flights vary widely across airlines and this has been a source of frustration and tension for those airlines that wear the lower services but are required to pay the same uniform price. Members also report a failure to consult adequately on some projects, leading to poor service outcomes, which then further increases costs in rectifying problems that could have been avoided though adequate consultation.

Members do acknowledge that changes to check-in and the creation of more suitable departure areas have delivered tangible improvements. The challenge is then for Perth Airport to evolve to become the provider of airport services rather than a property landlord. This will require sustained efforts at effective engagement with airlines and an ability to procced with and implement promised initiatives. Recent commercial recognition of the service outcomes problem across airlines, and some initial steps to address it, provide a firmer basis for advancing service issues.

Making progress with large and expensive projects to rectify the long-term legacy international terminal issues will prove challenging. Initial attempts have not convinced airlines that the proposed solution represented reasonable value for money given the estimated cost and their understanding of likely benefits. The development of a major terminal expansion project should not have proceeded without first comprehensively consulting airlines. Negotiating sound commercial arrangements that provide suitable incentives for Perth Airport to manage the project on time and within budget remains a high priority.

Only two of the surveyed member airlines consider that Perth Airport delivers value for money in airport services. There is scope over the medium term to improve upon these low scores but there is a large gap between the current circumstances and acceptable outcomes, which needs to be addressed.

Implications for light-handed regulation

The results of the member survey have identified underlying problems with the quality of airport services delivered for the prices paid. Member airlines are not convinced the airport operators are delivering on the intended benefits of light-handed economic regulation, including effectively adapting to growing and changing patterns of international aviation.

BARA is concerned with the significant disconnection between the performance assumed by airport management and the actual quality of services delivered to member airlines for the prices paid. For example, the Australian Airports Association recently claimed 'The current regulatory regime for Australian airports has served airlines, airports, Australian and overseas travellers and the broader economy extremely well' and ongoing investment 'has delivered improved efficiency for our airline partners and airport operations, it has also seen facilities and services upgraded to meet the evolving needs of passengers and changing technology'. [10] These claims do not fit with the declines in operating efficiency and increases in costs member airlines have experienced. The airport operators are unlikely to take issues raised by airlines seriously if they believe they are already supplying services to a very high standard and are supporting high levels of airline operating efficiency.

Countervailing market power

The low value for money ratings also highlights the lack of countervailing market power of international airlines. It has not been possible for member airlines to achieve acceptable outcomes by negotiating commercial agreements with the airport operators. BARA does not claim its voluntary, non-binding collective negotiations will achieve sound commercial outcomes for member airlines in the current negotiating environment.

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[10] Australian Airports Association 24 May 2018, Airline claims ignore benefits Australian airport industry has delivered to passengers, media release.

Investment and services proposals and information sharing

Sound investment and services proposals and information sharing underpin the effective long-term development of the airports. To be used successfully they require a deep understanding of customer needs plus a willingness to share performance data. Each airport operator also needs to follow up on and manage identified issues. The level of effective engagement by the airport operators with international airlines is below expectations and requirements, especially when major investments are inadequately justified. Performance data is generally shared only at a basic level or is still in early development. Sydney Airport has improved its engagement with airlines as part of its contractual requirements. Overall, these outcomes are well below what is necessary to deliver on the intended benefits of the light-handed economic regulatory arrangements.

BARA is not receiving investment and services proposals from the airport operators that demonstrate how airline and passenger needs will be met. It is usually not possible for BARA to clearly explain to members the merits of the airport operator's proposal based on the analysis and information provided. This creates considerable difficultly whereby airlines are being asked to sign agreements in which large capital outlays are included in pricing without a clear explanation of what service outcomes and improvements can be expected.

BARA acknowledges that the airport operators do consult airlines over their list of proposed capital projects. Indeed, it can extend to providing many hundreds of pages of planning information and measures and may also include some reference to service measurements developed by the International Air Transport Association (IATA). BARA has also invited airport operators to present at membership meetings. This gives the airport operator an opportunity to use one meeting to communicate to all member airlines its commercial position and value proposition about service delivery in return for the prices proposed.

Yet the problem is the airport operators largely engage with airlines from the viewpoint of capital projects rather than starting with service outcomes. Member airlines want to understand the benefits and service outcomes while the airport operator wants to deliver capacity increases based on pre-determined demand profiles, which implicitly embody some level of service outcome. Unfortunately, many of the planning measurements put forward to justify capital projects convey little in the way of solid information about service outcomes or demonstrate net value.

A distinct feature of the current economic regulatory arrangements is a lack of ongoing information sharing about existing performance at most airports. Where information is provided it generally covers whether existing assets are working and passenger survey scores. This is consistent with a 'landlord' approach to asset provision, which does little to support efficient airline operations.

BARA can report it was able to negotiate a key performance indicator (KPI) regime with Sydney Airport in 2015. The pressing need for a KPI regime and new consultative forum was carefully detailed by BARA and put forward as a central requirement to Sydney Airport. This has, through time, led to more substantial discussions between the airlines and Sydney Airport. The development of a suitable KPI regime is a positive move towards basic deliverables by an airport operator, albeit at least a decade behind its scheduled need.

Investment and services proposals

As part of the opening discussions with BARA over a new airport services agreement, the airport operator usually provides considerable information about its proposed list of capital projects. It is important to note that discussions generally start around a proposed projects list, with an opening focus on capital inputs, rather than the service outcomes airlines can expect to receive over the term of a new agreement.

After receiving a services and pricing proposal, BARA's first task is to summarise it and present to member airlines. As the proposal generally focuses on capital inputs rather than service outcomes, BARA seeks to repackage the information into a more useful format, drawing on service information where available. BARA also makes use of information sources including:

- on-time performance data for international flights
- mishandled baggage rates through the baggage system by source of bag
- service quality scores for key infrastructure services from the Australian Competition and Consumer Commission's Airport Monitoring Report
- results and priority issues for the airports as reported by members in BARA's surveys.

Recognising that members' first concern is the performance of existing airport operations, BARA has invested in understanding member needs in evaluating the merits of the airport operator's proposed services agreement.

After consulting members, BARA then provides feedback to the airport operator. In some instances the airport operator might find the feedback somewhat limited given the volumes of information initially provided. This is because BARA's initial feedback focuses on the strategic views of international airlines over service outcomes rather than detailed comment on each of the proposed projects. Individual airlines may also choose to enagage in a more detailed analysis of the proposed projects with the airport operator.

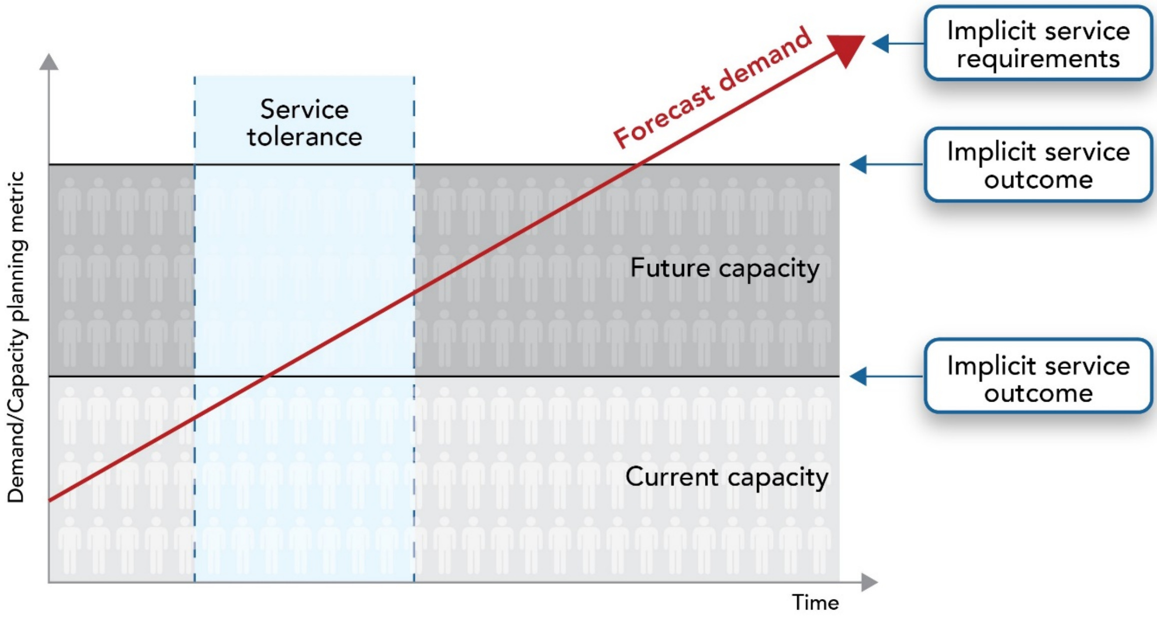
Planning framework – BARA's understanding of the process

The planning framework largely followed by the airport operators is best summarised as 'build capacity to a growth line' (see Figure 1). There is limited need for the airport operator to seek the views of any airlines in applying this framework. Aircraft and passenger numbers are demand inputs into assumed levels of capacity requirements. The implicit levels of service associated with the capacity requirements may or may not match the outcomes sought by airlines.

Various capital projects are then presented to meet forecast demand. The airport operator then seeks comment from airlines. This approach to investment and services proposals consults users as the last element of planning process. It does not require the airport operator to have developed an in-depth understanding of the needs, impacts and issues of individual airlines or to have fully consulted them over an extended period leading up to the development of the proposed list of projects.

In practice, more effective engagement with member airlines could have occurred if airport operators first held some structured meetings and workshops with them to discuss and understand their service needs.

Figure 1. Approach to the development of investment and services proposals



The various planning measures provided generally convey limited useful information on the merits of proposed projects. For example, a figure of 3,000 passengers an hour through the check-in hall (a typical broad airport design parameter) conveys little information about the outcomes members can expect to receive in terms of terminal congestion for passengers. A 'busy hour' gate demand statistic provides no information on the extent of peak operations at the airport, especially the number of hours and on what days. Without a starting reference of existing performance, it is difficult for airlines to gauge the merits of proposed projects, including the benefits that can be expected for the proposed costs.

Project justification – a need to modernise not fulfilled

BARA recognised the need to modernise the current approach to developing investment and services proposals to meet the needs of a growing and more complex operating environment for international airlines. BARA's 2014 policy document, Timely and reasonably priced airport infrastructure, stated:

> In assessing the merits of possible approaches to expanding capacity it is, therefore, necessary to agree on the value of improvements in outcomes to international airlines and passengers. Examples include the value of faster transiting times for passengers through security points and the benefit to airlines of reduced airborne and ground delays.
>
> Presently, these benefit assumptions may only be implicitly contained within a proposed investment strategy. As such, opportunities to develop more capital efficient investment strategies may be lost because the airport operator and international airlines have not explicitly agreed on the value of the benefits that must be obtained to justify the investment. (p.6)

Cost-benefit analysis, incremental or 'additional' cost calculations and understanding where the greatest challenges to expanding capacity exist are what underpin BARA's framework. It promotes sound investment proposals and continuous improvement in the delivery of airport services. It fits with finding efficient solutions in delivering airport services to member airlines.

The lack of a suitable business case process for large projects, demonstrating to airlines the value of the investment, remains a major impediment to effective engagement with airlines. Recognising that the airport operator is either not willing or able to undertake such analysis consistently, eventually some form of projects list is finalised given the need to complete negotiations. Airlines, however, cannot be confident the investments the airport operator makes represent an effective and efficient response to their service needs.

From the project justifications provided by the airport operators, there appears to BARA to be an underlying assumption that as soon as an issue related to operational performance or service standards arises in response to forecast growth, capital investment is required and becomes the obvious option. This prioritisation does not always match, at least initially, with the necessary focus on service improvements. A heavy reliance on capital solutions can be an inefficient response due to a lack of understanding of the underlying causes, or root cause of the issue with service standards. Capital investment is also often justified by peak demand without fully understanding or exploring the options or triggers to mitigate or defer the expenditure. This more thorough analysis requires an understanding of airport and airline operations with a view to meeting customer expectations.

It is also important to note that individual airlines may seek to engage with the airport operator at a more detailed level on specific projects. It means the processes and information BARA uses in the negotiations on behalf of more than 30 international airlines can differ from that provided to an individual airline. It should be expected, however, that the same sound approach to investment planning by the airport operator underpins the tailored information requirements sought by individual airlines.

A sample of BARA's feedback on the proposed project lists of airport operators is provided in Box 2. A clear theme is that while the airport operators are providing information and seeking to consult, it is usually not enabling effective engagement with international airlines. Where BARA can see some overlap with member expectations, this is acknowledged in the feedback provided.

Airport accountabilities under existing practices

There are important implications for the commercial agreements negotiated with the airport operators flowing from the current way investment and services proposals are developed. The approach limits the ability of airlines to link the prices charged to service outcomes and improve the level of airport operator accountability.

Airport operator accountability is set at a low level as there are no explicit service measurements available to incorporate into the commercial agreement. For example, a project to 'reduce passenger congestion', measured simply as the increase in floor area available does not mean passengers will face any less congestion. Without tangible measurements covering the specific issue being addressed, it is not possible to link the prices paid to the airport operator to whether a service delivery outcome is successful.

Box 2. Sample BARA feedback on investment and services proposals

Brisbane Airport (February 2017)

The Terminals pricing proposal reflects Brisbane Airport's past approach to commercial dealings with international airlines. It is basically a proposal to increase prices. It does not move towards being a 'services and pricing' offering consistent with promoting continuous improvement in the delivery of airport services to international airlines.

It is clear the Terminals pricing proposal incorporates little, if any, of BARA's early information and input. BARA does not accept that an 18-month agreement term provides Brisbane Airport with a valid excuse to not seek to incorporate the key service delivery improvements sought by BARA's members.

From a positive viewpoint, the table [of proposed investments] indicates that expenditure has been allocated to most of members' priority areas. However, Brisbane Airport has not provided enough details for BARA to understand the expected impact on service levels, including outcomes during peak and off-peak time of use by international airlines.

Melbourne Airport (February 2017 and September 2017)

Consistent with its policy document, *Timely and reasonably priced airport infrastructure*, BARA's members have sought to find more cost-effective and innovative solutions to meeting the forecast growth in demand at Melbourne Airport. In doing so, BARA considers there are likely options that achieve improved service outcomes for airlines at lower cost with shorter delivery timeframes. Such outcomes are to the benefit of all industry participants.

Melbourne Airport has also not satisfied a number of airlines over the scope, timing, cost and benefits of several airfield, landside and international terminal projects. This issue exposes international flights to undue pricing risk if these projects are included in pricing but ultimately do not proceed. The proposed capital reset mechanism only partly mitigates this pricing risk.

Perth Airport (November 2017)

BARA has produced a briefing note for member airlines summarising the online information. It is, however, difficult to engage in substantial discussions with members over the services Perth Airport intends to provide over the proposed term of the new agreement. This is because the online information focuses on Perth Airport's proposed inputs, with limited information on the outcomes international airlines can expect to receive. Without adequate information on the outcomes to be achieved, airlines cannot assess whether the proposed expenditures represent value for money and whether they are the most efficient and innovative way of delivering airport services.

If Perth Airport had, as promised, proactively engaged with airlines on service levels and quality the parties would now be in a sound position to negotiate a new agreement to begin on 1 July 2018. Instead, member airlines are being asked to endorse major planned expenditures within very short timeframes without the necessary information about service level outcomes. In BARA's opinion, this underlying lack of customer focus remains a considerable shortcoming of the current 'light-handed' economic regulation of Australia's major international airports.

Helping airport operators to effectively engage with airlines

BARA acknowledges there have been instances where an airport operator has made a genuine attempt to find the best solution to expanding capacity and improving service based upon useful service measurements.

An example is Adelaide Airport's recent project to increase the capacity and quality of service for international flights within the existing multi-user integrated terminal. The proposal, as endorsed by international airlines, was based on service outcome measurements such as queue waiting times, including the links between the different components of the passenger journey. As Adelaide Airport was willing to develop a proposal based on service outcomes, it was able to develop a sound proposal with BARA that members could review and endorse.

There are also other examples where an airport operator has sought to use data and information on outcomes to guide its investment and allocation of resources. Overall, however, the use of well-established frameworks, such as cost-benefit analysis, business case justifications, incremental cost calculations and scenario testing by the airport operators, is more the exception than business-as-usual. The standard of analysis and information provided is considered well below that expected by the Australian Government for the level of cost sought for proposed infrastructure projects.[11]

Cost justifications

The justification for the underlying costs, including the allocation of costs between non-aeronautical activities, forms a part of any investment and services proposal. It has been difficult to gauge the capital delivery efficiency of the airport operators based on the information provided and because BARA does not directly procure capital projects.

Projected increases for operating costs are generally based on the consumer price index (CPI), staffing numbers, passenger numbers and other assumed cost drivers. Without a clear link to service outcomes, however, discussions on operating costs generally revolve around asking questions about cost drivers. Limited value is gained by either party from doing so.

The allocation of costs between aeronautical activities is also important in determining overall costs for the services paid for by airlines, especially terminal expansion projects. BARA did seek some high-level confirmation of the basis of cost allocations from Sydney Airport after it had made large cost reallocations to aeronautical activities in the lead-up to the negotiations.

Sound investment and services proposals and industry growth

In its Issues Paper, the Commission raises the position that airlines may have the incentive not to support airport capacity expansions if they were to 'chip away some of the benefits of airline incumbency' (p.8). BARA would be concerned if its efforts aimed at supporting the development of sound investment and services proposals by the airport operators were interpreted as seeking to somehow support the incumbency of member airlines.

BARA's role is to support Australia's safe and efficient international aviation industry on behalf of member airlines. This role extends to seeking sound investment and services proposals from the airport operators that fit with delivering value for member airlines. Finding and implementing solutions at Australian airports that best support increasingly efficient safe aircraft operations remains a high priority for BARA.

[11] See for example, Infrastructure Australia March 2018, *Assessment Framework*.

Many of BARA's member airlines are actively seeking to increase capacity into Australian airports through additional flights or larger aircraft. There are also airlines that join BARA soon after beginning their operations into Australia, with an expectation they will increase their operations into Australian airports through time. This means any activity aimed at reducing the available market opportunities through seeking to stifle available common use airport capacity is counter-productive to member interests or their reasons for being part of BARA.

It is also open for any airport operator to lodge concerns about BARA's conduct with the Australian Competition and Consumer Commission (ACCC), which would have implications for BARA's collective negotiations authorisation.

Information sharing and performance management

When they start working at an Australian airport, a number of international airline station managers commented to BARA about the lack of information sharing as an impediment to understanding and addressing performance issues. Performance management is often based on ad hoc and informal arrangements. Individual airlines also bring information to the airline operators committee (AOC) at each airport as part of contributing to the understanding of the overall performance picture.

The importance of information sharing in delivering improved outcomes is well documented by the Commission in its 2017 Inquiry Report, *Data Availability and Use:*

> But better access to and use of data can also benefit business and government through improved operational processes and productivity. Examples abound of new found opportunities - in supply chain logistics, saving time and money; through more cost-effective infrastructure and machinery maintenance and planning; improved safety and efficiency in aircraft engines; and in the capacity to better respond to and manage emergencies. And data is critical to building the evidence base to underpin incremental improvements, allowing governments and businesses to offer products and services that are more customised, coordinated or timely. (p.4)

BARA's 2014 policy document, Timely and reasonably priced airport infrastructure, highlighted the need for information sharing to be a principal component of commercial agreements:

> Agreements need to contain provisions for ongoing information sharing and performance monitoring. Continual information sharing, ongoing monitoring of developments and service quality outcomes are critical to the successful implementation of an agreement. It is ongoing consultation that enables the airport operator and international airlines to refine outcomes and adapt to changing circumstances. (p.14)

For its part, BARA surveys its member airlines before it begins negotiations with an airport operator. Each survey seeks to obtain both positive points and issues of concern. It is important to note BARA conducts these surveys because the airport operator generally lacks an ongoing effective engagement model.

There is generally a lack of consistent or relevant historic or present-day data available at some airports, which accurately correlates to service standards expected by airlines. Rectifying underlying deficiencies requires a joint effort in relation to information sharing and a structured approach to consultation. These fundamental requirements to supporting efficient airline operations and good passenger experiences are not notable features of the outcomes delivered by the airport operators under the light-handed economic regulatory arrangements.

Key performance indicator regimes

Sydney, Melbourne, Brisbane and Perth airports have either established, or are now in the process of establishing, some form of KPI regime. The more successful approaches to date have engaged an external party to assist in development, as occurred with Sydney Airport. The often slow but gradual move away from ad hoc and informal arrangements to more formal structures of information provision and performance issue management is to the benefit of all parties.

BARA continues to devote resources to helping develop the KPI regimes, including ongoing engagement with member airlines and airport operators. It is understood that using a KPI regime to shine a light, as it were, on airport performance issues can be difficult for some airport operators on some issues. As such, the current and proposed range of performance issues at some airports largely follows the 'landlord' concept of service provision rather than service delivery outcomes. For example, the proportion of time contact gates are functioning rather than the availability of contact gates for use by airlines within a reasonable timeframe.

The scope and rate of progression of performance measurement is very modest given the commercial agreements can collectively amount to many hundreds of millions of dollars in annual payments for the services provided.

Where competitive tension in supply exists, as it does for certain security services that BARA collectively negotiates, the agreements contain KPIs focused on service outcomes combined with commercial consequences. Such agreements have fostered an approach that better fits with continuous improvement in service delivery. These outcomes have been achieved with contractual values being only a small fraction of the payments airlines make for airport services. This highlights to BARA the far lower average standard of outcomes it achieves with the airport operators compared to the commercial norms of competitive markets.

Overall, BARA continues to support the development of relevant KPIs. They have supported a more structured approach to understanding and addressing operational issues at the airports. The outcomes at most airports are well below those achieved in competitive supply environments involving far more modest contract values. Nonetheless, they represent the best BARA can achieve for member airlines given the current negotiating environment.

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Airport pricing and financial exposure to service delivery

Commercial discussions over pricing generally follow a simple process whereby the airport operator develops a pricing model and then decides if there is any merit to the position(s) put forward by airlines on the model's inputs. BARA considers this effectively represents self-regulation by the airport operator of its own profit level. The airport operators have little or no financial exposure to service outcomes or their own service delivery capability. This has extended to requiring airlines to collectively pre-pay for any financial compensation they receive from the airport operator for poor service. This financial insulation has meant an airline's commercial agreement has had no practical value when faced with declining service outcomes. For these reasons, BARA considers the current levels of profitability are excessive and not aligned with the intended outcomes of light-handed economic regulation.

BARA does not make any unrealistic representations to member airlines that it can achieve pricing outcomes with the airport operators consistent with the quality of services they will deliver. This is consistent with the overall low value for money scores recorded in the members' survey. Instead, BARA considers that simply from being part of the discussions, the airport operator will offer some reduction in its sought-after prices, generally estimated by BARA at about 3%.

BARA understands the airport operators offer discounts or other incentives such as marketing assistance to attract new airlines or encourage existing airlines to increase their capacity in either the frequency of flights or aircraft size. The extent of any such discounting or marketing incentives is unknown to BARA, as it is a bilateral issue between individual airlines and the airport operator. Any such discounting, however, has not been enough to drive consistent value for money in airport services across member airlines.

Current commercial discussions on pricing bear little resemblance to the commercial negotiations that occur when there is competition between suppliers, namely a price for a service outcome and links to delivering value. The process adds little commercial value to either party and the drawn-out affair should not be viewed as an extensive or 'robust' negotiation over the level of prices.

The airport operators have successfully limited the financial exposure of their shareholders to poor service delivery on their part. Extensive efforts are often made through the commercial agreement to severely limit the rights of airlines to financial compensation for poor service outcomes. This has allowed airport operators to lower average service outcomes across airlines, reducing their operating efficiency at the airport. This has occurred contrary to the representation made by airport operators in negotiating a new agreement and each airline's reasonable service expectations.

Solid accountabilities and exposure to financial risk make innovation and continuous improvement necessary to earn a commercial return, as occurs in competitive markets. This underlying financial requirement is lacking in the commercial agreements between the airport operators and airlines. The light-handed economic regulatory arrangements have not helped airlines achieve these necessary commercial outcomes.

Price setting – BARA's understanding of the process

Each proposal from the airport operator will be accompanied by a version of the standard 'building blocks' financial model as applied by economic regulators. The airport operator may or may not include an extensive report on the rate of return used in the financial model.

The discussions about pricing are not connected to service delivery. They are based on the calculation of a sought-after level of revenue divided by activity volumes. Some 'smoothing' or variations of the price path over the term of the agreement may occur based on a present value calculation. In some instances, a limited acknowledgment of varying service offerings may occur through a differential price. For example, bussing operations vs access to a contact gate, with prices set to achieve the sought-after level of revenue.

BARA generally provides limited comment on the rate of return parameters to the airport operator. The airport operator will usually offer BARA the opportunity to meet with the external consultants that developed the rate of return parameters. BARA, however, sees limited merit in extensive discussions with consultants over the technical detail of a rate of return report in the existing negotiating environment.

In discussions with BARA one airport operator has claimed that the external consultant's rate of return report represents an 'independent' assessment. BARA does not consider the process followed by the airport operator in developing its rate of return report represents the same process or outcomes that would be determined by an independent assessment. The consultant did not seek views from any airlines in preparing the position put to BARA.

More broadly, the airport operator's management has already set its commercial expectations with its Board over the prices that will be charged before it provides its proposal to BARA. The financial model is therefore best viewed as a formalisation of the prices the airport operator intends to charge, providing some cost transparency for airlines.

More recently, BARA incorporated the members' survey scores for the airport in putting a position back to the airport operator on pricing levels. In doing so, BARA is seeking to highlight the position member airlines have expressed about the quality of services and overall value delivered to them.

A modest list of proposed projects

For a short-term agreement of 12–18 months with a modest list of proposed projects, initial adjustments to the opening pricing offer will be marginal and based on some refinements to individual projects or operating costs. The airport operator then provides its 'commercial compromise' some months later.

It should be a short and straightforward process for the airport operator to set prices given a modest list of proposed projects. But even so, matters take longer than necessary to conclude. One reason is the often unfavourable commercial terms included with the pricing offer, which often leads to protracted negotiations in finalising the agreement.

A large and complex list of proposed projects

BARA generally finds that discussions over prices set by the airport operator containing a large and complex proposed list of projects are delayed because the proposal will require substantial reworking, as recently occurred with Melbourne Airport. After many months the opening price offer will change based on the revised cost inputs and updated passenger volume forecasts.

After a list of proposed projects is finalised and passenger volumes are updated, pricing discussions can conclude. After the airport operator has determined the prices to be charged and communicates them to BARA, negotiations with the airport operator are finalised. As noted earlier, BARA considers that by simply being part of the discussions, the airport operator will offer some reduction from its sought-after prices.

The commercial value of the current arrangements

The concept of a 'commercial bargain' would generally be thought to involve trade-offs and negotiating positions, with both sides seeking to meet the other party's expectations on their own terms. An integral part of developing a good bargaining position is to understand the issues that matter most to the other party and tailor the offer accordingly. When it comes to airport services, the airport operator has had many years to develop a sound understanding of customer needs.

These fundamentals of a commercial bargain are not present in the pricing discussions between the airport operators and BARA. The airport operators are not driving innovation and value in the pricing of airport services, at least not from the perspective of the airlines that pay for the services provided.

Level of returns – outcomes from effective self-regulation

Available evidence supports the proposition that the airport operators earn favourable returns on their investments given their risk profile relative to their infrastructure counterparts and businesses operating in competitive markets. For BARA, these favourable returns exceed those consistent with the quality of services provided, especially considering the lack of focus in supporting the efficiency of airline operations at the airport.

In developing its policy document, Timely and reasonably priced airport infrastructure, BARA provided some rate of return outcomes across infrastructure network and diversified logistic companies. This was to highlight that, on average, the airport operators earned the highest and most stable returns relative to other infrastructure and logistics businesses. Based on these pricing and profitability outcomes, BARA was seeking both a tempering of the returns sought and a modern and innovative basis for service delivery.

In its submission to the Commission's 2011 inquiry into the *Economic regulation of airport services*, BARA presented evidence of the attractive returns earned by the airport operators. Available evidence showed the major international airports were likely earning more than 20% annually on the actual investments made. These high rates of returns were underpinned by the estimated 'windfall' gains or economic rent transfers – collectively estimated to exceed $400 million for Melbourne, Brisbane and Perth airports – with the removal of the price caps.

Research published by the Grattan Institute also found the airport sector performs very well on profitability measures, stating that 'Nearly half of returns earned by airport operators were super-normal profits, on average, from 2010–11 to 2015–16'.[12] This evidence is consistent with BARA's

[12] Minifie, J, Chisholm, C & Percival, L 2017, Competition in Australia: Too little of a good thing? Grattan Institute, p.32.

ongoing discussions with various industry stakeholders over many years about the profitability of the major international airports.

In setting the prices for new agreements, some moderation or increases in the returns obtained by airport operators does occur with changes in interest rates, which influence the cost of debt and potentially returns to equity. Yet airport operators still maintain high returns relative to other infrastructure services providers. BARA considers such levels of profitability are particularly high given the lack of commercial accountabilities by airport operators in delivering good service outcomes to airlines.

The information on airport returns should be unsurprising as it is an expected outcome of what BARA considers to be self-regulation of profit levels. In competitive markets with consumer choice, earning attractive returns is achieved when the business is providing exceptional value for money in its products and services. Exceptional value for money in airport services is not a feature of Sydney, Melbourne, Brisbane or Perth airports.

Are these levels of return necessary?

The generous pricing and return outcomes the airport operators obtain from airlines cannot be considered necessary to support ongoing investment in airport services. This is because under a 'dual till' pricing framework, if the airport operator does not invest to expand capacity to grow passenger volumes, it will directly reduce potential non-aeronautical revenues, including retail spend and car parking. The dual till pricing framework separates the pricing of airport services to airlines from the non-aeronautical activities, but the profitability of the non-aeronautical activities still depends on passenger volumes. This dependence drives the commercial viability of ongoing investment in the airport services.

BARA, therefore, places little credence in any claims that the current levels of airport profitability have been necessary to sustain ongoing investment. The level of profitability the airport operators are obtaining is best viewed as an assumed entitlement rather than a necessary outcome.

Financial exposure to service delivery capability

In all current agreements negotiated through BARA, the airport operator accepts little to no financial exposure to its service delivery capability for international flights. Where some form of aggregate service quality arrangements exists, required outcomes are set at modest levels covering the maintenance of key infrastructure assets. It may also only extend to the airport operator being required to notify its maintenance contractor of deficiencies and seek restoration of deficient performance, therefore involving no financial consequences.

When there is no commercial requirement for the airport operator to focus on continuous improvements in service delivery, then in practice it will not be a high priority for them. This is not to say that initiatives to help international airlines never occur. BARA has seen efforts by the airport operators to listen to airlines and investigate the issues raised. But this is essentially a discretionary activity rather than a contracted commitment. BARA has repeatedly observed that projects to drive 'increased passenger retail revenues' and 'airport company corporate promotion' seem to gain the highest priority and resourcing. The operational efficiency of international airlines also needs to be consistently supported and given priority.

Rebate schemes for service failures

An airport operator’s lack of formal recognition of poor service delivery for individual flights means operational problems can persist for extended periods without the airport operator being aware of them. When poor service outcomes occur, a formal process for review should be available rather than have the airport operator respond to problems with informal or discretionary action. While informal and ad hoc arrangements may previously have been adequate, they are not suited to the increased operational complexity associated with industry growth.

BARA has therefore sought to include new provisions in airport agreements that allow airlines to raise poor service outcomes for individual flights, namely instances of significant delay. This is through a streamlined process for member airlines to lodge issues with the airport operator via its website, which also can attract a small level of compensation. While the amount of compensation set is small, it is considered an important part of formal recognition of service failures. While previous agreements may have included some scope for rebates to airlines, BARA considered them to be of little practical value and has therefore sought more useful arrangements.

The range of issues potentially covered by the rebate schemes is unfortunately restricted, as they are largely limited to the physical breakdown of assets, such as an aerobridge or the baggage system, subject to various other caveats. It does not extend to a delay that may have occurred because aggregate demand exceeds the practical service capacity of the service assets.

For individual rebates to airlines for non-performance covering a narrow range of service issues, Sydney and Melbourne airports have required the airlines to collectively pre-pay for any liabilities on their part. This is done by including potential compensation payments as an additional operating cost item, leading to higher prices. While it should be considered absurd, it will likely become the accepted norm under a continuation of the light-handed economic regulatory arrangements.

Service expectations over the term of an agreement

When reviewing a proposed agreement from an airport operator, each member airline forms a view about the service outcomes they can expect to receive over the term of the agreement. The overall expectation is that airlines will be able to operate reasonably efficiently and not experience persistent significant delay as a result of unavailable or substandard airport services. Airport operators have also made clear representations to BARA that they will deliver improvements in member airlines’ operating efficiency over the term of the agreement for the prices paid.

Unfortunately, however, no airport operator faces any serious financial consequences if representation about service delivery outcomes are not met, including a sustained deterioration in the average service outcome delivered across airlines. Airlines are now experiencing problems stemming from the airport operator not adequately responding to growth in passenger volumes and flights above that forecast. Actual demand is permitted to exceed the practical capacity of the assets during peak period use by airlines, which reduces their operating efficiency and increases their cost of operations at the airport. The requirement for the airlines to pay the airport operators the same price for the lower average standard of operating efficiency, however, remains unqualified.

One way this problem manifests is through the variable quality of airport services, such as contact gates vs bussing operations, including specialist equipment for passengers with reduced mobility. When actual traffic volumes exceed those forecast, the outcome to date is often more use of bussing services than anticipated, which reduces the operating efficiency of airlines and provides a lower quality passenger experience. An individual airline can thus experience an average decline in its operating performance consistent with the increase in the proportion of lower quality airport services provided.

This outcome may be inconsistent with the representations made by the airport operator, namely that the airline would enjoy improvements in their operational efficiency over the term of the agreement. Reductions in average service outcomes have been particularly problematic at Sydney Airport, which contributes to the low value for money scores airlines have given the airport.

If growth above that which can be adequately accommodated is occurring through eroding the service outcomes for individual airlines, it is clear each airline's commercial agreement with the airport operator has little or no commercial value in practice. If the airport operator retains the right to deliver lower average service outcomes while still requiring airlines to pay the price linked to higher service outcomes, then the basis of the agreement the airline signed is undermined. In effect, each airline only secures a set of prices over the term of the agreement and no certainty over its ability to operate reasonably efficiently at the airport.

When an airport operator effectively sets its accountabilities as a landlord of a fixed number of assets that it leases out to airlines, reduced service outcomes to airlines are not reflected in its own performance benchmarks. This is because the airport operator's responsibilities are restricted to maintaining a given suite of assets and do not extend to a consideration of the average service outcome delivered or the operating efficiency airlines. BARA considers this situation explains the significant disconnection between the performance assumed by airport management and the actual quality of services delivered to member airlines for the prices paid.

Pricing for service delivery

The Commission's Issues Paper (p.8) raises the issue of 'pre-funding' to cover the costs of future investments, with reference to BARA's policy document, Timely and reasonably priced airport infrastructure.

BARA's commercial desire is to link the pricing of services with the delivery of improved outcomes to member airlines, covering both capacity and quality. As explained further in the following section Contractual accountabilities and negotiations, the commercial position(s) put forward by some airport operators effectively transfer all delivery, construction cost and pricing risk of major projects onto airlines. This is not considered acceptable or in line with encouraging sound project management and efficiently delivering services to member airlines.

The most straightforward way of creating stronger accountabilities for project delivery of common use services is for airlines to start paying once the new service(s) are available for use at the agreed price. Under this approach, individual airlines are not required to enforce contractual rights for project delivery when they are paying for a service outcome they are not receiving. Instead, appropriate accountabilities are embedded in the pricing structure.

Provision and pricing of security services

The safety and security of Australia's international aviation industry remains the highest industry priority. The industry's long-term growth and prosperity will hinge on its ability to implement sound and effective security requirements and procedures. Underpinning this are institutional and governance structures that promote rigorous, risk-based and intelligence-driven approaches to aviation security. Effective consultation between all industry stakeholders must also underpin the development and implementation of security requirements.

As a general principle, BARA supports the harmonisation of Australia's security requirements with International Civil Aviation Organization (ICAO) recommendations and guidelines. BARA also notes, however, that in some instances Australia's individual circumstances may require modifying how the recommendations or guidelines are applied.

In response to the alleged terrorist plot disrupted in Sydney in July 2017, the Australian Government has announced a series of new security measures, including enhanced screening arrangements. Many of the necessary security measures for international flights are provided by the airport operators, especially passenger and checked bag screening.

Government-mandated security services are generally priced on a 'cost pass through' basis for operating costs. Capital equipment costs are included in the overall aeronautical asset base. It is important that the definition of 'Government-mandated security services', for cost-pass through purposes, is clearly understood and applied.

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Contractual accountabilities and negotiations

Commercial agreements embody the final outcomes of negotiations. They should provide a clear plan for both parties, with well-defined accountabilities that fit with continuous improvement in service delivery. The commercial agreement reached with Sydney Airport in 2015 represents an improvement from the previous very low commercial standards imposed. Unfortunately, it has still not protected airlines from average declines in service outcomes reducing their operating efficiency. Over the last few years, BARA has frequently presented members with unfavourable commercial terms, as proposed by Melbourne, Brisbane and Perth airports. The airport operators are not delivering on the intended benefits of the light-handed economic regulatory arrangements in seeking such unfavourable commercial terms.

One of BARA's core functions on behalf of its member airlines is to engage in voluntary, non-binding commercial negotiations with the operators of the major international airports. These negotiations cover the 'common use' services required by airlines, including runways, taxiways, aprons, gates and landside roads. BARA is not involved with 'airline-specific' products, such as airline lounges, which are negotiated bilaterally between the individual airline and airport operator.

Over the past 15 years BARA has conducted multiple negotiations with each of the airport operators. To support productive negotiations, BARA has been quite open about what it expects to deliver to member airlines. The information available to the airport operator includes our policy document, Timely and reasonably priced airport infrastructure, which describes five commercial principles to facilitate more productive and streamlined negotiations.

Given BARA's 15 years of experience in collective negotiations and its transparency over its reasonable commercial requirements, BARA would expect that the main terms of the commercial agreements with airport operators would now be largely settled. Commercially balanced agreements should be in place with each of the airport operators.

Unfortunately, however, this is not the case. BARA often still devotes its efforts towards the inclusion of basic airport operator accountabilities for member airlines. Unfavourable commercial terms typically underpin the opening offer by the airport operators.

BARA is surprised and concerned that it continues to receive unfavourable opening commercial offers from airport operators, which can only be described as ambit claims. It might be that the airport operators are signalling to airlines that they have the market power to impose quite unfavourable terms, and therefore airlines should be pleased with any modest concessions they are prepared to make as part of the commercial agreement.

One partial exception is the agreement negotiated with Sydney Airport during 2014–15, which is a 'transitional agreement'. This agreement, unfortunately, has still not protected airlines from declines in their average operating efficiency despite the representations made. The other airport agreements are a mixed bag of out-of-date concepts, limited commercial exposure and extensive legal drafting, together with some recognition of service delivery accountabilities.

Negotiation boundaries – or lack thereof

Under light-handed economic regulation the airport operator and airlines negotiate the provision and pricing of airport services. The obligations of, and risk allocation between, the parties therefore lies in the various clauses contained in the commercial agreement.

The expectation the parties will negotiate commercial agreements and operate commercially lies at the heart of light-handed economic regulation. There is no particular guidance as to what this means in practice for many non-price terms, especially accountabilities and the allocation of commercial risk. This is ultimately a matter for the airport operator and airlines, concerning their reasonable commercial objectives, and typically involving a range of business decisions.

One of the fundamental principles of Australian contract law is 'freedom of contract', under which parties are generally at liberty to strike whatever bargain they choose subject to limited qualifications. The law does not require that an agreement be balanced, fair or reasonable for it to be enforceable. [13]

Signed agreements with the airport operator do not mean the airlines have reached reasonable commercial outcomes. As acknowledged by the Commission in its 2007 Inquiry Report *Price regulation of airport services*:

> The fact that airport users may ultimately accept the conditions offered by the airports does not automatically imply reasonableness…it could simply reflect the strong bargaining position of the airports and the need for airlines to have access to services to continue to operate. (p.36)

The airport operators have market power in setting price and non-price terms for member airlines. BARA considers that the airport operators have been transferring the commercial risk of inadequate service delivery capability on their part onto international airlines. This transfer of commercial risk and accountabilities underpins the inadequate member survey scores.

BARA's commercial expectations and outcomes to date

Table 1 on the following page identifies the key commercial items BARA negotiates on behalf of member airlines. First identified is the poorest position(s) put forward by at least one airport operator in its opening offer. These are not terms just offered for ad hoc or occasional users but those an airport operator has sought to include in the agreement with BARA's member airlines.

BARA's position on a commercially-balanced outcome is then provided. This information is provided at a relatively high-level to highlight the underlying problems with the commercial agreements as to the certainty they provide to members over the services delivered for the prices paid.

The table demonstrates that BARA has persevered in dealing with the continual unfavourable terms put forward by the airport operators. It has not, however, been possible to achieve a consistent set of agreements that represent mature commercial outcomes that will support efficient airline operations and best meet the challenges of continued growth in international flights.

[13] There are laws in Australia to protect small businesses from unfair terms in business-to-business standard form contracts, which obviously do not cover agreements between the airport operators and international airlines. See ACCC 2016 Unfair terms in small business contracts: A review of selected industries.

Table 1. Summary of airport commercial agreements

Commercial item	Poorest opening position presented to BARA	BARA's position on reasonable commercial outcomes
Accountability for service delivery	Airport operator only obliged to maintain the physical assets and not required to ensure enough practical infrastructure to meet accepted levels of airline demands or to take reasonable steps to manage the availability of services Airline required to use the assets 'at their own risk' with maximum exclusion of any warranties over service provision 'Rebate' mechanisms for poor service delivery are convoluted processes that offer limited/no practical value to the airline Expansive definition of 'force majeure', covering 'third parties', including the airport's own contractors	BARA is seeking the degree of skill, care, prudence, foresight and practice which may reasonably be expected from time to time of a skilled and experienced operator of a large international airport. It includes the following practices by the airport operator: • co-ordination of operations at and around the airport to optimise local capacity • active liaison with all relevant parties to minimise disruption and to facilitate on time performance • co-operation with relevant authorities and all other parties having a guardian role for service delivery at the airport • development of comprehensive business continuity plans that are coordinated with airport users and other stakeholders
Allocation of commercial risk	Little to no effective commercial remedies available to airlines for poor service delivery outcomes. Airline agrees to waive standard (legal) commercial rights via small rebates being the 'sole remedy' available to the airline Airline agrees to waive airport operator's liability for disruption/delays from any 'unplanned' works (except for reckless acts), which may be the result of inadequate maintenance practices	Usual commercial remedies available to airline; that is, it can seek a legal (financial) remedy for substantial or ongoing breaches of the agreement by the airport operator Airport operator is accountable for its actions and those of its contractors Small, administratively simple rebates provided to the airline to formally recognise the airport operator's poor service performance that has significantly disrupted an international flight

Commercial item	Poorest opening position presented to BARA	BARA's position on reasonable commercial outcomes
Individual major project (+$600m) terms	Airlines accept practically all delivery, construction cost and pricing risk Agreement is essentially silent on the issue; project costs simply added to the proposed 'indicative' investment program Airport operator has the right to spend without limit, with monthly price increases passed through to airlines	Clearly defined deliverables and improvement in outcomes to airlines Airport operator shares accountability for delivering the project on time and on budget Plans and processes for minimising the impact of the construction works on airline operations form part of the project's commercial agreement
Performance and engagement	No requirement to provide consistent information about performance outcomes at the airport 'Complaints-based' approach by individual airlines to service delivery	The airport operator establishes a key performance indicator (KPI) regime covering performance measures in the areas of on time performance, baggage, safety and the passenger experience New consultative forum established that focuses on applying the commercial agreement and providing continuous improvement in service delivery Positive obligations on the airport operator to act in response to identified performance issues
Compliance with unseen and unprovided issues	Airline required to acknowledge and ensure no breach of unseen and unprovided issues at the airport, apparently specified in unprovided documents	Specific requirements and airline obligations identified
Unilateral right to amend	Airport operator's right to amend any agreement clause subject to consultation with airline	Both parties agree to any changes to the commercial agreement Airline operating requirements specified in operating manuals rather than the commercial agreement

Commercial item	Poorest opening position presented to BARA	BARA's position on reasonable commercial outcomes
Indemnities	Airline required to indemnify against all loss suffered by airport operator arising out of the airline's use of the airport, irrespective of fault. Airlines right to claim against airport operator for its own loss is restricted, even though the cost of the airport operator's insurance premiums are included in pricing No obligation on the airport operator to take reasonable steps to mitigate loss. Uncapped liability to indemnify, including for loss which is consequential	BARA acknowledges that it is appropriate to allocate some liability (for example liability for death and personal injury claims) on a no-fault basis but as a general rule, liability should be fault based The risk allocation should reflect which party is best able to manage the risk and should not go beyond what is necessary to protect the airport operator's legitimate business interests Liability for some risks should be mutual between the airline and airport operator
Releases	Airlines required to provide releases in favour of the airport operator and to hold airport operator harmless from liability, including for airport's own negligence	Release can undermine insurance cover BARA's preference is for mutual approach and coverage
Fair and reasonable terms (deeming clauses)	Airlines required to acknowledge the agreement is 'fair and reasonable'	Such 'deeming' clauses should not be included in the commercial agreements
Future agreements	Airline to accept any agreement published by the airport operator, including pricing, if a new agreement is not reached	Such clauses should not exist in agreements. Members should not be required to accept the price and (draconian) non-price terms published on the airport operator's website
Ordered and streamlined	Limited constructive order to the agreement clauses A 'belts and braces' approach to drafting that unnecessarily increases the length and complexity of the agreement	BARA has provided its sought-after ordering of clauses and wants to remove extensive and unnecessary repetition within agreements. For example, multiple clauses requiring airlines to 'abide by the law', drafted in different ways throughout the agreement

Accountability for service delivery – what are airlines buying?

There is a fundamental question about what an individual airline is buying when they purchase airport services. While the services are common use, the agreements are ultimately individual between each airline and the airport operator. This creates legitimate issues over what expectations an individual airline can have about being able to operate efficiently over the term of its agreement. This issue has become more prominent with the sustained growth in the number of international flights and passengers.

Probably the most commercially progressive of the early agreements reached in 2002–03 with the introduction of light-handed economic regulation were based around the 'property licence' approach to service provision. The airport operator provided some form of 'licence' for airlines to use the assets at the airport but limited accountabilities for the management of services or outcomes for airlines. These agreements have much in common with a commercial office rental agreement, where the airport operator is the 'landlord' of the airport assets and airlines the tenants.

The 2002–03 operating environment for international flights was generally characterised by surplus capacity at the airports, such as spare international contact gates and check-in counters. As such, assuming the existing assets were maintained to an acceptable standard, airlines could be reasonably confident enough services would be available for their operations.

Since 2002, however, the sustained growth in the volume of international flights and passengers has led to increasingly congested operations for airlines, especially at Sydney and Melbourne airports. Varying degrees of congestion for international flights might emerge at Brisbane and Perth airports in the future. Airlines, however, still expect that airport services will be available to support their efficient operations in return for the prices paid for those services.

Many of the commercial agreements put to BARA suggest most airport operators have come to expect that airlines should accept they will have no contractual rights to enforce any minimum standard over the availability of services, and no financial remedy if the services are either not available or sub-standard. This has included various terms for obligations of no more than to 'try' to provide the services, using best or reasonable endeavours. Yet on the other hand, the airlines' obligation to pay for the services, even if poorly provided, is unqualified. Based on this, BARA concludes the airport operators are obtaining the financial benefits of growing international passenger numbers but handing back the operational challenges of this growth to airlines.

This problem is not recent, and BARA has expressed its concern in this regard for some time. In the December 2016 edition of *Airline Views,* BARA commented:

> At the heart of the issue is what 'service' the international airlines are buying – is it the right to expect necessary infrastructure services to be available at the agreed time or merely the right to 'wait in the queue' for when services may or may not become available? Further, if an airport operator fails to deliver on its service delivery promises, however defined, to what extent should the airline have the right to seek financial compensation. Finding an appropriate balance between the commercial interests of the international airlines and airport operators will be necessary to support ongoing efficient international aviation.

For its part, BARA has proposed accountability clauses for agreements as shown in Table 1. These are based on the Airports Council International's (ACI) *Policies and Recommended Practices Handbook 2009* (seventh edition) and ACI Europe's position paper on *Ground Coordinator*. These provide some useful insights into a suitable accountability framework. As shown in Table 1, actual agreement clauses often still fall well short of the accountability benchmarks published by the ACI.

Outsourcing to a third party should not mean the business is no longer accountable for the delivery of the services based on the actions of its sub-contractors. As noted by the former Industry Commission in its 1996 Inquiry *Competitive tendering and contracting by public sector agencies*:

> The Commission agrees with numerous inquiry participants that, while responsibility to do certain things can be transferred, accountability for the results cannot. (p.4)

This issue has remained in some agreements with the airport operators. In particular, 'force majeure' definitions are sometimes drafted sufficiently broadly so as to include the acts of the airport operator's own contractors. Airport operators should not expect to be able to avoid liability simply because, for example, its maintenance contractor has failed to deliver the maintenance services in accordance with its contract.

Accountability for service delivery – common use obligations

With common use facilities, the actions of one airline may disrupt the availability of the facilities for another airline. For example, an airline dwelling on a gate for its own convenience, delaying arriving aircraft access to a contact gate. It has been suggested to BARA this is a 'force majeure' scenario, that is, 'outside the reasonable control' of the airport operator. BARA contends the airport operator's responsibilities extend to coordinating operations at and around the airport to get the most from local capacity.

Some efforts here by the airport operator have been less than helpful, such as a proposed fines regime on airlines for delayed departures without regard to circumstance. Such proposals show a lack of commercial acumen that undermines the confidence member airlines have in the airport operator's understanding of airline operations.

Where the airport operator has no direct control, it should strengthen its existing cooperation with those organisations and agencies that have a guardian role for service delivery (eg with the Australian Border Force). This level of accountability fits with the airport operator supporting the desired outcome of increasingly efficient safe aircraft operations.

Allocation of commercial risk

The allocation of commercial risk between parties is directly relevant to accountability for service delivery. If the agreement transfers all commercial risk to airlines, the airport operator ultimately has little incentive to invest in its service delivery capability.

Some airport operators have attempted to cap their liability for financial exposure for deficient performance or non-performance to a small amount from a small pool of funds set aside for this purpose. This is expressed as the 'sole remedy' available to the airline. BARA considers some readily available compensation to airlines is important to give formal recognition to service delivery failures but rejects that this represents the airport operator's total commercial liability. Nor should the rebate amounts simply be included as an extra operating cost, resulting in higher prices to airlines.

Unilateral right to amend

Some airport operators have proposed (insisted) they should have an unqualified right to unilaterally amend the terms of the agreement at their own convenience subject to some consultation with airlines. The proposal also deems that continued use of the services at the airport amounts to acceptance of any changes made.

Drafting of this kind serves to entirely defeat the purpose of consultation and negotiation as part of settling any agreement with airlines in the first place. Although it is standard practice for any infrastructure owner to have the right to update operational policies and similar documents, it is difficult to understand how the arrangement can really be described as an ‘agreement’ if the airport operator has the right to change any terms. It demonstrates to BARA that the airport operator takes little notice of the requirement to act in a commercially reasonable manner.

Fair and reasonable terms (deeming clauses)

Some airport operators have called on airlines to accept drafting that acknowledges and effectively deems the terms of the agreement as ‘reasonable’. If the proposed terms are actually reasonable, it is unclear why such a clause is needed.

BARA considers the Commission should not place any weight on the fact airlines have signed agreements with such deeming clauses. Requiring airlines to sign agreements that acknowledge the terms are reasonable does not mean they are or that the airport operator has acted fairly and reasonably in its dealings with the airline.

Indemnities and releases – making the airport’s problem the airline’s problem

An indemnity is an agreement to pay loss or damage suffered by another party in certain agreed situations. The objective of an indemnity is to alter the risk allocation that would otherwise apply in relation to that loss at common law or under statute. The usual statutory time limits for claims or usual duty to mitigate do not apply to claims involving indemnities. Indemnities can expand the range of liability to enable recovery of loss that would otherwise not be recoverable under common law, such as loss which is too remote or not foreseeable.

A release involves an agreement that relieves another party from liability, such as releasing any rights to claim loss arising out of a situation.

BARA has raised concerns about broadly drafted indemnities and releases that create a significant imbalance between the parties and where the indemnity and release goes well beyond what is reasonably necessary to protect the legitimate business interests of the airport operator. BARA does not accept that it is legitimate for the airport to impose an indemnity which requires the airline to indemnify the airport operator for all loss flowing from use of the airport, including loss caused by the airport’s own acts and omissions, even if the airport operator has been negligent. Such indemnities can operate unfairly where they permit recovery against the airline, irrespective of whether the airline is at fault or would otherwise be liable at law for the loss.

When considering whether the indemnities and releases are appropriate, BARA considers that it is reasonable to take into account that insurance is held by the airport operator to cover certain kinds of loss and the fact that the premium costs for such policies are included in charges paid by the airlines.

Ordered and streamlined agreements

Agreements are often characterised by being a collection of clauses rather than ordered in a way that provides a more logical structure. Repetitive drafting, which adopts a ‘belt and braces’ approach, also unnecessarily increases the length and complexity of the agreements. One example is multiple provisions stating the need for the airline to comply with the law, expressed in numerous ways throughout the agreement.

BARA has proposed to the airport operators that there would be value to airlines in adopting a standard approach to ordering clauses and stripping out unnecessary provisions that add no value. This would lower the cost to BARA and individual airlines in reviewing the agreements. It is not a great deal to ask but would show the airport operator is prepared to make some efforts in the legal drafting to reduce airline costs.

Some progress has been made with some airport operators in this regard but not with others. BARA will continue to seek these straightforward improvements with the airport operators to reduce airline costs.

The commercial negotiations

The length and complexity of the commercial negotiations with an airport operator reflect many underlying issues, including:

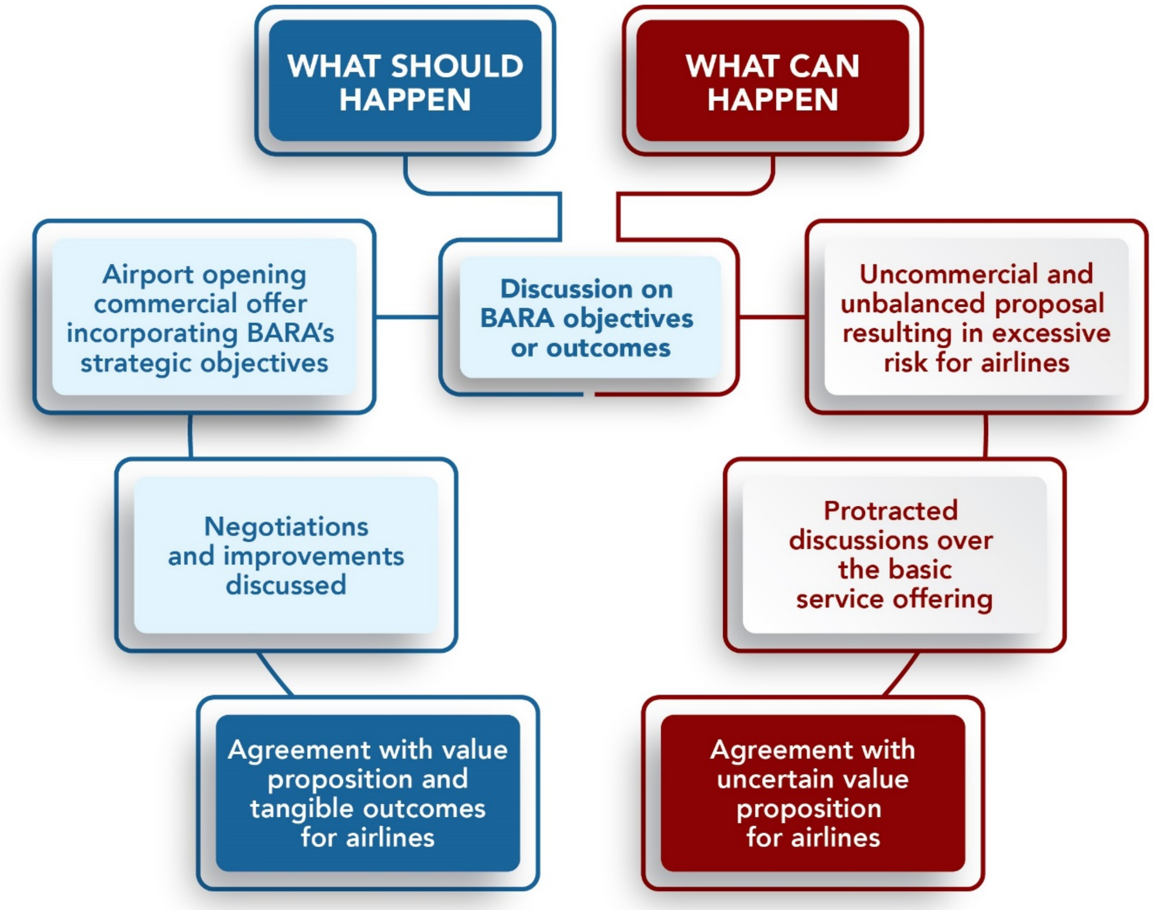
1. Challenges: The extent of the airline operating challenges at the airport, for example, does surplus capacity now exist and can it be expected in the future, or are increasingly congested operations likely?
2. Negotiation bounds: Is the airport operator genuinely open to discussing the strategic direction of service delivery or is comment only sought on the financial model and list of proposed projects provided?
3. Engagement: Whether the airport operator's ongoing engagement with airlines has been effective, such that its proposal fits with airline expectations?
4. Proposal quality: Is the information provided in the opening proposal understandable and explainable to member airlines?
5. Agreement modernisation: Is the airport operator open to modernising its existing agreement or making any amendments at all?

What this list seeks to demonstrate is that many of the key requirements of a productive commercial negotiation are determined by the airport operator before formal negotiations begin. These are long-term infrastructure services being provided to airlines, many of which have been operating to the airport for decades. As such, if there are unwelcome surprises in the commercial offer from the airport operator, they usually reflect underlying weaknesses in the airport operator's overall approach to service provision.

A simplified explanation of how the commercial negotiations should ideally proceed and how they often proceed is provided in Figure 2. An essential requirement for a productive negotiation is that the airport operator meets with BARA early in the negotiation to understand and discuss the strategic outcomes member airlines are seeking to achieve. If the airport operator is prepared to meet, listen and genuinely incorporate this early input before providing a formal opening offer, this will go a long way towards supporting ongoing productive negotiations.

BARA deploys a range of negotiating strategies depending on what is put forward for consideration. If member airlines consider the opening offer from the airport operator represents a solid effort at meeting their needs, BARA will try to make progress as quickly as possible and finalise the agreement. While there are always numerous legitimate commercial issues for both parties to resolve, this approach has the potential to lead to an agreement premised on the delivery of outcomes for airlines.

Figure 2. Possible negotiation paths



If, however, BARA is placed in a position where it considers its task is to dissect a sub-standard offer and unfavourable commercial terms, then strained and lengthy commercial negotiations can be expected. BARA has found that only through protracted negotiations has it been able to achieve some modest improvements to the commercial terms offered.

It is also important to note that presentations and personal representations about service commitments by the airport operator can only be of modest value. Ultimately, a commercial negotiation across multiple airlines is based on the terms of the agreement member airlines are expected to review and sign. There is little benefit in airport operators expressing a desire to work in partnership with airlines and be responsive to their needs if the commercial agreement describes a very different environment of limited airport operator accountabilities and excessive commercial risk transfer to member airlines.

In summary, BARA considers the formal commercial negotiations represent a modest aspect of the commercial relationship between the airport operator and individual member airlines. What matters most to member airlines is the quality of the foundations that the negotiations are based on. Numerous, unwelcome surprises in the commercial offer generally reflect weaknesses in the airport operator's service delivery capability, engagement and performance with member airlines.

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Desired commercial benchmarks

BARA's member airlines seek a standard of delivery and value for money in airport services that best supports their ongoing safe and efficient operations and good passenger experiences. It requires a sound basis for developing investment and services proposals. The level of returns on such investments would be set with reference to relevant industry benchmarks and the airport operators would face genuine financial exposure to service outcomes. The agreement terms would encourage continuous improvement in the delivery of airport services and protect airlines from declines in service outcomes for the prices paid. Achieving these commercial benchmarks would deliver efficiency and innovation in the provision and pricing of airport services.

BARA's policy document, Timely and reasonably priced airport infrastructure, proposed the basis for achieving productive negotiations and good industry outcomes to the benefit of industry participants, passengers and freight forwarders. It covered:

1. Industry productivity and planning, involving:
    a. consistent application of cost-benefit and business case analysis
    b. agreeing on the value of improvements in outcomes to airlines and passengers
2. Five commercial principles:
    a. pricing for service delivery
    b. reasonable investment returns
    c. efficient airport operations
    d. balanced and consistent agreements
    e. a service quality culture.

Unfortunately, member airlines have only gained a very modest amount of practical value from BARA's positive and proactive approach on their behalf. The airport operators have not been prepared to modernise and accept genuine financial exposure to their service delivery capability. They have not delivered on the intended benefits of light-handed economic regulation as reflected in low value for money ratings by member airlines.

There are efficiency gains in the delivery of airport services currently foregone that would benefit airlines, passengers and freight forwarders.

In this section, BARA outlines in more detail the commercial benchmarks for airport services it considers will best support the ongoing efficiency and productivity of Australia's international aviation industry. Such benchmarks would lift the service performance and value for money scores of the airport operators to acceptable levels. This would maximise the commercial opportunities for airlines, benefitting passengers, freight forwarders and Australia's tourism industry.

Investment and services proposals – framework

Cost-effective and innovative solutions to meeting potential growth, particularly during periods of peak use by airlines, are necessary. This will best support the operating efficiency of airlines and deliver better outcomes for passengers and freight forwarders. It is the airport operator's responsibility to invest in its people, processes and systems, which are all critical in enabling a sound approach to developing investment and services proposals. Current practices could be significantly improved through smarter and more collaborative interaction between the airport operators, airlines and government agencies in understanding and then addressing performance issues in airport services.

Greater collaboration and productivity in airport services are inherent in developing and measuring agreed service standards, including ongoing measurement and verification of proposed outcomes. Airport infrastructure capacity expansions should incorporate a 'guarantee' of improvement, either through service standard enhancements, operational efficiencies, or ideally both. Such service measures would be more detailed than the key performance indicator (KPI) regimes used to monitor the overall service performance of the airport.

A summary of the proposed framework is shown in Figure 3. Its elements are neither radical nor unexpected and represent a more detailed description of the outcomes described in BARA's policies for airport services.

The framework would allow individual airlines and BARA the opportunity to be involved as much or as little as they consider appropriate, depending on a range of factors, including the:

- scale and timing of the project,
- impact on airlines and the resources required.

It would enable airlines to understand the service level improvements and whether they are capable of delivering value. Even if an airline chooses to have little to no involvement, this framework ensures a baseline level of confidence in the options implemented. A brief description of the main elements of the framework follows.

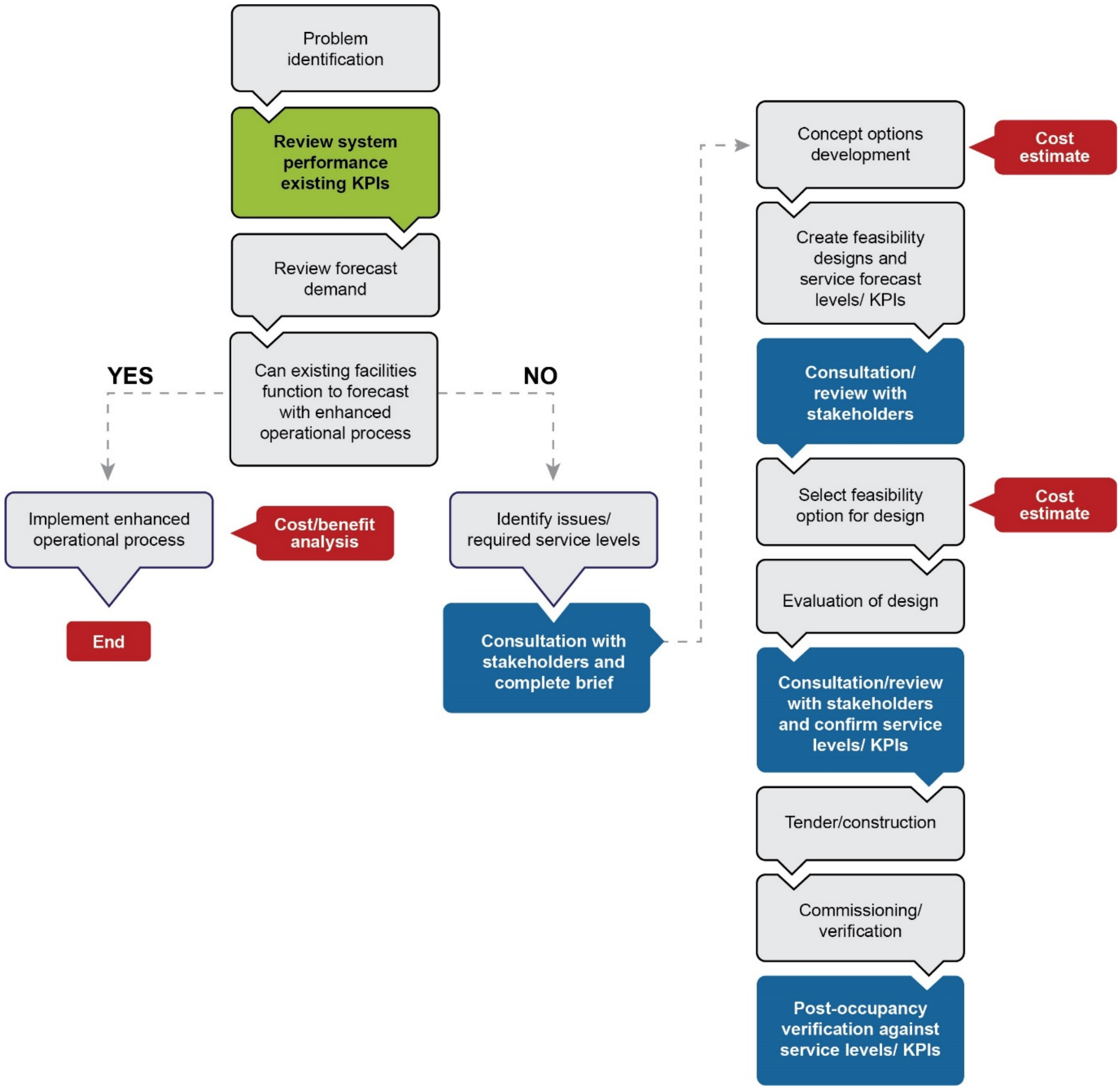
Issue identification and system performance review

Efficient and timely expansions to service capacity mean the airport operators need to fully appreciate the root cause of capacity issues and declining service standards. It is essential that the airport operators fully understand the:

- existing operations
- essential functions they perform for airlines
- impact of service standard variances on airline and passenger outcomes
- measures necessary to assess the performance of each airport sub-system (eg security queue waiting times and aircraft turnaround times).

Without such understanding and how it correlates with monitored performance, it is impractical to develop efficient and timely solutions or enhancements. The information collected and measured should correlate directly with the service standards that airlines require to operate efficiently.

Figure 3. Service outcomes collaboration framework



Once measures are established and verified, they can be assessed to identify:

- the way they affect service outcomes at a given point in time
- the estimated point of degradation that affects airlines
- the operational enhancements required to sustain or improve service levels
- the cost/benefit sensitivities, which, potentially, would support a business case for capital investment.

To document the necessary information and interpret the root cause and solutions means the airport operators must continually invest in technical knowledge/retention and employ skilled and experienced operational staff. It is also important to note the importance of effective consultation with the ground handling companies at each airport. The airport operations of many international airlines are outsourced to ground handling companies (see Box 3). Services delivered therefore need to be provided in close consultation with these ground handlers.

Box 3. Services provided by ground handling companies

A feature of Australia's international aviation industry is the increasing outsourcing of operations at the airport to ground handling companies. The services provided include:

- Cargo
    - terminal contact with freight forwarders
    - receipt and dispatch
    - delivery to/from aircraft
    - load and consignment documentation
- Check-in
    - all check-in staff
    - training
    - travel documentation, visa etc.
    - baggage receipt
    - schedules and security knowledge
- Ramp services
    - baggage delivery from check-in to aircraft
    - aerobridge management
    - load estimates for flight planning
    - passenger processing at gates
    - load control finals
    - aircraft services – water, toilet, cargo doors etc.

.

Forecast growth by airport sub-system

Forecast growth scenarios for each airport sub-system, such as contact gates, baggage make-up, security, should be developed through both the Master Plan process and ongoing consultation with airlines and ground handlers. Each part of the airport system can be tested to identify how potential growth will affect service outcomes, particularly in periods of peak demand.

Applying forecast growth to existing operations should allow an adequate review of whether service standards can be improved, as well as rectify deficiencies and identify any necessary operational costs, or the triggers for capital investment. An example here would be options to lower the rate of mishandled bags through the existing baggage system. This would identify the need for capacity expansion earlier than occurs currently, bringing the added benefit of improved communication with stakeholders.

It would also allow a project brief to be compiled, which would focus on required service standard improvements and outcomes, rather than airport operators unilaterally presenting single infrastructure solutions based on broad planning measurements.

Options development

Once operational enhancements can no longer maintain acceptable service standards, a focused project brief could be developed, which would include:

- a statement of needs
- project operational, business and financial drivers
- project deliverables
- net value to airlines.

The brief would allow the airport operator to develop a range of concepts, incorporating cost/benefit analysis, together with a direct correlation between investment and improvement to service levels. Airlines and stakeholders could then more readily identify the cost per additional passenger for a range of potential solutions.

Preferred solution

The preferred concept should be selected through the above process, with the agreed airline requirements clearly articulated. As the project progresses through the design phase, it is essential that any material deviation from agreed outcomes is highlighted and communicated to airlines for discussion.

Once the preferred concept's design is nearly complete, the cost, program of works, operational impact, service standards and outcomes would be verified against the project brief. Detailing how to efficiently manage the way the works will affect airline operations remains a high priority for BARA members.

Post-operation verification

When any new works are commissioned, they should be benchmarked against the original agreed service levels as the 'fit for purpose' test. An agreed timeframe to verify ongoing service levels should be implemented. Any shortfalls in expected service levels should be reviewed to identify the cause, together with options to rectify.

Airport pricing and financial exposure to service delivery

BARA has carefully considered the ways airport operators have consistently delivered service outcomes below the standard airlines expect in return for the prices paid. Given its numerous negotiations and reported outcomes by members over many years, BARA has accumulated extensive knowledge about how this occurs in practice.

The best way for the quality of airport services to match the prices paid is for the airport operator to face genuine financial risk over its service delivery capability. The goal is to ensure the airport's management and board can deliver adequate returns to shareholders based on delivering good service outcomes. Critically, this must extend to whether the infrastructure can adequately service subscribed levels of airline demands.

This requires a shift from the 'landlord' approach to service provision, based on the physical maintenance of a fixed number of infrastructure assets, to instead focus on meeting service outcomes. BARA has not implemented such a change, including a genuine financial exposure to service delivery capability, under any existing agreements with airport operators.

Level of prices and profitability

As the 'sole provider' of infrastructure services, it is acknowledged that the primary basis for discussing profitability and pricing with the airport operators will be some form of the standard building blocks model. These models do provide for some transparency for proposed cost inputs and the calculation of prices.

As with all economic regulatory decision-making, the rate of return or weighted average cost of capital (WACC) is an important driver of the prices sought. In regulated industries, suppliers clearly invest substantial resources in preparing WACC reports; such investments are also often a feature of the commercial offers from the airport operators.

Member airlines would be more amenable to accepting that the rates of return sought by the airport operators are not unreasonable if they were set with reference to relevant industry benchmarks. This could include, for example, guidance material on the rates of return afforded to relevant price-regulated infrastructure services in Australia and overseas, including network utility providers in Australia, overseas network utility providers and airports. Presentation of rate of return differentials between network utilities and airports would be most useful in discussing airport pricing.

To the extent an airport operator sought returns above the benchmark references, it would need to do so based on the superior service and efficiency outcomes they would deliver to airlines. Expressed another way, this would link higher profitability to greater value for money in airport services. This could provide for a more balanced and productive discussion about pricing and service outcomes than currently occurs.

Pricing and service quality framework

An airport services pricing and service quality framework for international flights should include:

<u>Pricing for different service outcomes</u>: The quality of the service assets, and how they affect airline operating efficiency and cost, can vary across each airport. The prices charged for different service outcomes should reflect this. One example is contact gates versus bussing from remote aprons. Differential pricing should apply, given that when demand is high, it is usually the poorer airport services that represent a greater proportion of overall service delivery. In such situations, the airport operator should charge a lower average price, consistent with the lower average service outcomes airlines receive and passengers experience.

<u>Services are available for use within a reasonable timeframe:</u> Subject to the airline meeting its operational requirements, an airline should be entitled to a rebate on charges for an individual flight if the necessary services are not available within a reasonable time or to the required standard. The rebate amount can be structured to increase in line with the delay experienced by the flight and be capped at 100% of the payable charge. A suggested 10% of an airport operator's projected total revenue could be subject to rebate claims by airlines in each year of the agreement. It would not be permissible for an airport operator to include any forecast rebate amounts as additional operating costs and charge higher prices. Instead, it would represent genuine financial exposure to service delivery capability.

Rebates would be subject to the airline achieving its operational obligations and force majeure events. They would be appropriately defined such that, for example, they do not include actions of the airport operator's own contractors but do include agreed external issues, such as delays caused by the air navigation system. The exclusion criteria, however, would not extend to where aggregate airline demands exceed the practical capacity of the service assets on the day, or are due to the actions of other airlines.

If the model in Australia is to be one of individual commercial agreements between the airport operator and each airline, then the agreement is of limited value to each airline if the actions of other airlines have primacy over its own ability to operate reasonably efficiently at the airport. The airport operator must take some accountability in delivering service outcomes to each airline for the prices paid under its commercial agreement with them. BARA is not advocating all responsibility should lie with the airport operators but they should have some financial exposure to the operating efficiency of airlines, as an incentive for continuous improvement in service delivery.

Price reductions if aggregate airline demands exceed the practical capacity of airfield and/or terminal services causing airlines persistent significant delays: Actual airline demands may exceed the assumptions used in developing the investment and services proposal. Airlines may then start to experience persistent significant delay and other operating costs with the airport operator having little or no practical ability to restore service standards for the remaining term of the agreement. As of now, airport operators are enjoying the benefits of rapid growth in international passengers and flights, but airlines are faced with increasing operational challenges, impacting their operating efficiency.

BARA considers that, where an airport operator has no practical ability to maintain service outcomes when actual growth exceeds that forecast, prices should be lowered to reflect this overall lower service standard environment. This could be through a pricing reset mechanism, where prices are lowered over the remaining term of an agreement to reflect the lower service standards if certain thresholds are met.

Under such arrangements, an airport operator is not restricted from permitting any level of international passenger and flight volumes given its level of service delivery capability. There is, however, a direct financial consequence to a permitted level of demand that exceeds its practical ability to deliver agreed service outcomes. This provides each airport operator with enhanced incentives to consider how service standards could be maintained if actual levels of passenger and airline demands exceed those used in developing investment and services proposals.

Proactive measures to restore in-terminal service outcomes: Services for passengers within the international terminals are measured by each airport operator through established quality of service measures. Acceptable score ratings should be devised for these measures, with an obligation on the airport operator to maintain the agreed standards. This would not involve rebates to airlines but instead place a positive obligation on the airport operator to quickly rectify service deficiencies experienced by passengers.

Clear definition of ‘government-manded security services’: An agreed and uniform definition of government-mandated security services priced on a ‘cost pass through basis’ is required. This will protect airlines from an airport operator redefining the scope of services provided in seeking to unjustifiably increase the allocation of costs included in security prices over the term of an agreement.

A package of measures not contained in existing agreements

Collectively, the pricing and quality framework should generate enough financial exposure such that each airport operator has the appropriate incentives to support value for money in airport services. They provide for a clear shift of emphasis from capital inputs to the delivery of outcomes, consistent with how member airlines strike commercial agreements with suppliers that must compete for the airline's business.

BARA's primary concern is that the airport operators will see any requirements for financial exposure to their service delivery capability as simply an 'add-on' to their current level of profitability. That is, airport operators have formed a position that the current pricing and profitability outcomes represent the base 'entitlement' as holders of the lease over the airport. To have commercial value to airlines and provide incentives to the airport operators, the framework must involve genuine financial exposure to airport operator service delivery capability.

Contractual accountabilities

Each commercial agreement with the airport operator should contain a set of clauses that promotes continuous improvement in service delivery and value for money in airport services. The key commercial items identified by BARA should not involve unfavourable terms but rather reflect a mature, commercially sound agreement. Individual agreements with each airport operator would be tailored to specific issues and challenges at the airport within a sound contractual framework.

BARA would prefer these commercially sound terms to be expressed in the opening offer from the airport operator, rather than starting with unfavourable commercial terms that are either removed or modified somewhat over many months of protracted negotiations. This would focus the negotiations on promoting good industry outcomes, saving time and resources.

Positive obligations to deliver good service outcomes

Each commercial agreement should contain clauses that express the intent of any business supplying services for fees received, that is, positive obligations to deliver outcomes consistent with the prices paid. For airport services, this critically needs to extend beyond the maintenance of the physical assets.

BARA's positive obligation principles are that:

1. Airlines should be able to operate reasonably efficiently and not experience persistent significant delay as a result of unavailable or substandard airport services
2. Airport operators should facilitate the safe and efficient journey of passengers through the airport.

Such general principles would establish a sound basis for commercially negotiating the provision and pricing of airport services. It would require an airport operator to carefully consider its service delivery capability for different potential future volumes of passengers and flights. It would also provide an enhanced platform for assessing an airport operator's performance in delivering airport services over the term of the agreement.

In addition to these general principles, BARA's suggested agreement clauses are based on benchmarks established by the Airport Council International. There could also be merit in each airport jointly identifying with airlines comparable overseas airports, or parts thereof, to benchmark the performance of the quality of services provided. This would require ongoing investment by the airport operator in its people and systems to maintain up-to-date information on the standards and initiatives being used at overseas airports.

Clearly defined airline accountabilities

In using airport services each airline must be expected to abide by reasonable operating requirements. For example, if an airline decides to dwell on a gate for its own convenience, this should be addressed through the operational requirements for the airline and would ideally be specified in an airport's operational manual. It may also require setting minimum standards for items provided by airlines, such as bag tags, to support the efficiency of the airport's service assets.

It is important to recognise that airlines already have strong financial incentives to operate to schedule and deliver good baggage outcomes to passengers. The costs associated with excessive delay and mishandled bags for Australia's international flights were estimated at $250 million in 2016–17 (see Attachment A: Australia's international aviation industry). In the competitive international airline markets, achieving good on time performance and baggage outcomes are central to meeting customer expectations and being commercially successful.

Airlines are investing billions of dollars each year in new aircraft to support their operational cost efficiency and deliver a range of service outcomes to passengers. It makes little commercial sense for an airline to reduce the value of these large investments in aircraft and other service technologies and initiatives by incurring unnecessary operating costs through its own inefficient practices at the airport.

'Boilerplate' clauses

Many of the terms in a commercial agreement cover the same issues across all airports. This includes indemnities and releases, insurance requirements, dispute resolution, termination and insolvency. BARA currently spends considerable time and resources working through differently drafted clauses across airports covering these standard issues. This includes airport operators seeking to redefine the basis of these terms in new agreements, which BARA considers simply an attempt to make them more unfavourable to airlines.

Many of BARA's member airlines would clearly benefit from commercially balanced standard contract clauses on common issues across airport agreements. Over time, it would reduce the costs they incur in reviewing airport agreements given the consistency in drafting. Individual airlines would still be able to negotiate outcomes tailored to their needs but for most international airlines, commercially-balanced standardised clauses would be beneficial.

RETURN TO EXECUTIVE SUMMARY

Achieving commercial benchmarks

The airport operators have not delivered on the intended efficiency and innovation in service delivery benefits of light-handed economic regulation. BARA is particularly concerned with the significant disconnection between the performance assumed by airport management and the actual quality of services delivered to passengers and airlines for the prices paid. BARA's desired commercial benchmarks would enable the ongoing delivery and pricing of airport services in a manner that best supports an efficient international aviation industry. There are net benefits to be obtained in applying firmer economic regulatory arrangements to allow the negotiation of commercial outcomes consistent with supporting value for money and continuous improvement in the delivery of airport services.

BARA's desired outcome from the economic regulatory regime is airport services that accord with value for money and increasingly efficient safe aircraft operations. Given the market power of the airport operators, however, the agreements negotiated are more in line with their interests and those of their investors. BARA contends that this has occurred at the expense of the intended benefits of the light-handed economic regulatory arrangements, as evidenced in the low value for money score ratings from the members' survey.

Based on the outcomes to date, member airlines do not accept that modest refinements to the Pricing Principles or additional monitoring will enable BARA to achieve its desired commercial benchmarks. Airport operators have argued that 'mature' commercial agreements are already in place with airlines and this supports investment that responds to passenger and airline needs, both of which are driving lower international airfares.[14] This reinforces the disconnection that members have with the airport operators' own assumed perception of performance.

Achieving BARA's desired commercial benchmarks must be pursued in the knowledge that the airport operators have the financial incentive to provide the minimum commercial offer in relation to the relevant regulatory requirements. As is now the case, airport operators earn more profit by ensuring they are financially insulated from their service delivery capability.

Genuine improvement requires a new path whereby the parties negotiate with a clear understanding of the commercial benchmarks they are legally obliged to achieve. If these benchmarks cannot be clearly demonstrated in the final offer the airport operator provides, airlines should have access to recourse to obtain the minimum required standards.

BARA has canvassed two reform initiatives. These are the negotiate–arbitrate framework and a 'progressive commercial principles' model. These reform initiatives offer the potential for improved industry outcomes by seeking to address the key weaknesses in the existing commercial arrangements with the airport operators. They focus on improving outcomes during agreement formation, which set the incentive structures governing the provision and pricing of services over the term of the agreement. These improved commercial agreements would deliver ongoing improvements in airport services delivery and pricing compared to current arrangements.

BARA has canvassed these reform initiatives in relation to the provision and pricing of airport services for international flights, including the fact that many member airlines individually represent a small part of the total volume of international flights and passengers to Australian airports.

[14] See for example, Australian Airports Association 24 May 2018, Airline claims ignore benefits Australian airport industry has delivered to passengers, media release

Existing monitoring arrangements

The existing monitoring arrangements are based upon detecting an abuse(s) of market power by an individual airport operator, which could then lead to some form of follow-up action. Unfortunately this offers little value in practice.

The annual monitoring report does stimulate a series of press releases by industry stakeholders each year. They range from apparently demonstrating what a success the economic regulatory arrangements are, to how they are occurring at the expense of passengers and the economy more generally. It gives member airlines little confidence the Australian Government has in place economic regulatory arrangements that will support their ongoing efficient operations into Australia's major international airports.

Limited value of monitoring arrangements

Light-handed economic regulation has not ensured satisfactory service outcomes in exchange for the prices paid by airlines, nor led to the airport operators embracing innovation in order to provide value for money in service delivery. Given the sustained growth in international flights and passengers, this service delivery problem now extends to the practical ability of the infrastructure assets to adequately support subscribed levels of airline demands during peak periods.

The airport operators' efforts to address deficient service outcomes remain largely discretionary and can be applied unequally across airlines. The airport monitoring reports can identify instances of sustained poor service outcomes, but ultimately they do not represent a practical requirement or incentive for the airport operator to rectify matters.

In negotiating new agreements, the Pricing Principles offer little value to airlines as far as the quality of the commercial offer provided. The Principles refer to important commercial issues, including risk sharing and reasonable expectations of service outcomes. But when BARA receives commercial proposals of the standard as described in this submission, either the Pricing Principles were not referenced, or they were, but the assumed commercial benchmarks are well below the reasonable commercial expectations of member airlines. In either case, the Pricing Principles are not supporting the negotiation of sound commercial agreements.

An example of sustained deficient performance

A practical example of the ongoing failure of monitoring arrangements to support good outcomes for passengers and airlines is Sydney Airport's baggage system for international flights, with the monitoring results since 2002–03 presented in Table 2 on the following page. The baggage system's performance has consistently been below acceptable standards, with a rating of 'satisfactory' for both availability and standard only achieved in two of the last 15 years. Baggage outcomes have been particularly poor since 2012–13.

The airline survey results are consistent with the baggage outcome data available to BARA, which showed sustained higher mishandled bag rates for international airlines and passengers through Sydney Airport.

Faced with consistently poor outcomes, BARA wrote to Sydney Airport about its baggage system's performance. It has also provided each of the four major airports with information on mishandled bag rates by the source of bags at their airport. For its part, BARA has been trying to highlight performance problems as a basis for encouraging better outcomes. This is necessary given individual member airlines lack enough practical contractual rights to obtain reasonable performance standards by virtue of their commercial agreements. An airline's commercial agreement may cover the physical 'availability' of existing baggage system infrastructure, but the system does not have to be capable of delivering passenger bags to the correct location at the airport in time for loading by ground handlers onto aircraft.

Table 2. Sydney Airport's international terminal baggage system, airline assessed performance

	Availability	Standard
2002–03	Less than satisfactory	Lower than poor
2003–04	Less than satisfactory	Less than satisfactory
2004–05	Satisfactory	Less than satisfactory
2005–06	Less than satisfactory	Less than satisfactory
2006–07	Less than satisfactory	Less than satisfactory
2007–08	Less than satisfactory	Less than satisfactory
2008–09	Satisfactory	Less than satisfactory
2009–10	Satisfactory	Satisfactory
2010–11	Satisfactory	Satisfactory
2011–12	Less than satisfactory	Less than satisfactory
2012–13	Poor	Poor
2013–14	Poor	Poor
2014–15	Poor	Poor
2015–16	Poor	Poor
2016–17	Satisfactory	Poor

Source: Derived from ACCC Airport monitoring reports

In contrast to outcomes experienced by airlines, the airport operators seem to claim that they consistently deliver good service outcomes, rendering service quality monitoring unnecessary. In its 2012 Inquiry Report into the *Economic regulation of airport services*, the Commission quoted Melbourne Airport's position:

> In the present situation where airports are not price controlled, airports have every commercial incentive to offer airlines the quality of service they desire for themselves and their passengers. Given the airlines are able to negotiate and mutually agree a reasonable price for providing service at the airline's desired standard, it is reasonable to present that there is no longer a regulatory need for quality of service monitoring. (p.217)

And the Commission further noted:

> Indeed, every monitored airport submitted that it felt quality of service monitoring by the regulator was not necessary as internal monitoring was required for their own commercial reasons. p.217

Sydney Airport's baggage system for international flights demonstrates that an airport operator can deliver substandard service outcomes for an essential airport service for many years. It has resulted in poor travel experiences for affected passengers and imposed additional operating costs on airlines. This has not led to the recognition of the need for a reasonable standard to be delivered through the airport monitoring regime. Instead, airlines will continue to work with Sydney Airport in applying potentially piecemeal solutions to rectify sustained deficient service outcomes that should not have occurred in the first place.

A credible threat

In its 2012 Inquiry Report *Economic regulation of airport services*, the Commission noted that 'the regime would benefit from a credible threat' (p.188) with recommendations for a 'show cause' mechanism. The Australian Government did not accept the Commission's recommendations on such matters (they were 'noted') in its formal response to the Commission's final report. The Australian Government's response was influenced by the Commission's underlying position that the light-handed economic regulatory arrangements were, on balance, working well.

BARA considers such outcomes have reinforced the airport operators' perception that the 'bar' for regulatory intervention is set so high as to have no implications, or consequences, in practice. The right to operate 'commercially' seems to be viewed by airport operators as an entitlement rather than an earned outcome. The lack of any credible threat of intervention likely explains the airport operators' substandard commercial offers as described in this submission.

It is worth noting that BARA represents the interests of more than 30 international airlines covering flights from many countries to Australia. BARA is providing briefing and analysis documents for members that continually highlight:

- the lack of effective engagement and analysis in developing investment and services proposals
- high pricing
- unfavourable commercial terms.

Based on a detailed understanding of the commercial terms, BARA is sending out a steady stream of information to international airlines about the low commercial standards they can expect from the providers of airport services in Australia.

<u>Show cause mechanism</u>

It is difficult to see how a show cause mechanism as described by the Commission in its 2012 Inquiry Report would help BARA achieve its desired commercial benchmarks. The show cause mechanism is based on outcomes and trends from the airport monitoring reports, which may or may not lead to follow-up action. BARA is seeking consistent benchmarks and agreement terms that member airlines could use to commercially resolve service delivery and other issues with an airport operator before they become major and ongoing issues for them.

For example, an airport operator may claim that increasing profits together with a fall in service standards, only represents higher than expected growth in the number of international flights and passengers. The problem for airlines is that its commercial agreement has not given the airport operator appropriate financial incentives to support its ongoing operating efficiency or charge a lower price for the lower average service outcomes. This problem should have been dealt with during agreement formation, rather than waiting for the outcomes at some point in the future to potentially trigger some additional level of review.

The negotiate–arbitrate framework

One way for achieving BARA's desired commercial benchmarks is some form of negotiate–arbitrate framework, as proposed by some participants in previous inquiries by the Commission and recently by Airlines for Australia and New Zealand.[15] BARA's position as to how such a framework could lift the quality of the commercial agreements between airlines and airport operators is discussed below.

Benefits of the negotiate–arbitrate framework

The benefit of the negotiate–arbitrate framework is that the airport operators would need to take the reasonable commercial expectations of member airlines more seriously in their negotiations with BARA. It would shift the emphasis from BARA seeking to improve upon the unfavourable commercial terms put forward by the airport operator through protracted negotiations to one where BARA could negotiate with the potential to achieve its desired commercial benchmarks.

On the level of prices, the negotiate–arbitrate framework would permit useful negotiations about the level of returns sought relative to relevant infrastructure service providers.

Another benefit of the negotiate–arbitrate framework is the airport operator would need to negotiate with BARA knowing it will be required to offer some genuine financial exposure to its service delivery capability. This will provide the airport operator with greater incentives to provide an accurate representation of the quality of services it can provide over the term of the agreement, as it will be financially accountable to deliver them.

It also means the airport operators will have incentives to find non-capital solutions or efficiency improvements in addressing deficient service outcomes over the term of an agreement, rather than allow substandard outcomes to persist until some capital solution is supplied in the future.

All the existing unfavourable and unjustified commercial terms would be removed from the commercial agreements. No airport operator would:

- retain the right to amend any clause of the agreement subject to some consultation with airlines
- include the actions of its sub-contractors as 'force majeure' events
- require airlines to accept any agreement published by the airport operator on its website, including pricing, if a new agreement is not reached before the existing agreement expires.

Such outcomes would be a positive improvement on the existing commercial arrangements and better align with the intended benefits of light-handed economic regulation.

Application for international airlines and compliance costs

For many international airlines, a key benefit of BARA membership is that they can participate in a collective approach to the provision and pricing of common use airport services. Many international airlines cannot commercially justify undertaking bilateral negotiations with the airport operators over these common use services. This reflects their relatively small market shares of international passenger, freight and flight volumes. Collective action is more efficient by allowing for streamlined negotiations between each airport operator and the international airlines.

[15] See Airlines for Australia and New Zealand (May 2018) The performance and impacts of Australia's airports since privatisation.

To increase the value of the negotiate–arbitrate framework for some member airlines, the ability for them to be part of a collective input into an arbitration process, if this becomes necessary, would be useful. Each airline's decision to act separately, join collective representation or not act, would be a commercial matter for each airline. The design of a negotiate-arbitrate framework, therefore, should occur with a consideration of the small market shares of many international airlines.

Compliance costs

Compliance costs under the framework should be low. Many member airlines have operated to the airport for decades and have been the basis of the airport operator's financial success. The airport operators, therefore, should be fully aware of their needs and commercial expectations. For its part, BARA has been open in specifying the reasonable commercial expectations of member airlines. BARA remains supportive of commercially-negotiated outcomes that show innovation and support ongoing improvement in service delivery.

The framework should also encourage the airport operators to provide more reasonable opening offers, reducing the costs of the commercial negotiations. As often occurs today, when BARA is placed in a position where it considers its task is to dissect a sub-standard offer and unfavourable commercial terms, then strained and lengthy commercial negotiations can be expected.

Under the negotiate–arbitrate framework it will be clear to the airport operators that the unfavourable commercial terms will not be accepted as reasonable by the airlines or an independent arbitrator. This should therefore encourage a higher standard of opening offers from the airport operators that BARA can seek to progress as quickly as possible and finalise negotiations.

Through time, it could be expected that the airport operators would no longer devote resources to drafting highly unfavourable opening commercial positions. Instead, the resources could be used to support effective engagement with airlines about providing them with services. This would represent another important benefit, where available resources are directed to activities that can add net value to the international airlines

Net benefits of a negotiate–arbitrate framework for BARA's member airlines

A negotiate–arbitrate framework would offer net benefits by providing a viable path for BARA to achieve commercial benchmarks that accord with delivering value for money in airport services. This will best enable airlines to maximise the commercial opportunities available in providing air transport services for international passengers and freight forwarders.

BARA sees net benefits for airlines moving to a negotiate–arbitrate framework for Sydney, Melbourne, Brisbane and Perth airports. Other airports serving international airlines should also offer competitive agreements consistent with BARA's desired commercial benchmarks. BARA supports initiatives that would improve the efficiency and quality of services provided at these airports in maximising the commercial opportunities for international airlines.

Progressive commercial principles

Another reform initiative BARA has considered is to make the achievement of specified commercial principles, in addition to the existing Pricing Principles, a required outcome of the commercial negotiations and agreements. This reform initiative involves making the commercial requirements for all parties more explicit than now occurs.

Progressive commercial principles

The commercial principles would need to be specified with sufficient detail and be measurable to be useful. BARA seeks commercial agreements that encapsulate the following high-level positive service obligations, namely:

1. Airlines should be able to operate reasonably efficiently and not experience persistent significant delay as a result of unavailable or substandard airport services.
2. Airport operators should facilitate the safe and efficient journey of passengers through the airport.

The agreements offered by the airport operators would need to demonstrate:

1. An investment and services proposal with supporting commentary on how it was based on:
    a. effective engagement with airlines
    b. service performance indicators used to justify investment projects
    c. cost-benefit analysis.
2. A desired rate of return established with reference to relevant industry benchmarks.
3. A pricing and service quality framework, including:
    a. pricing for different service outcomes
    b. services availability within a reasonable timeframe, including a specific proportion of revenue subject to genuine financial risk
    c. price reductions if aggregate airline demands exceed the practical capacity of airfield and/or terminal services causing airlines persistent significant delays
    d. proactive measures to restore in-terminal service outcomes.
4. Contractual terms as reasonably specified by BARA in Table 1 of the section Contractual accountabilities and negotiations, and where possible, standardised ‘boilerplate’ clauses. Removal of all highly unfavourable terms would also be mandatory.

The progressive commercial principles would still permit negotiations with each airport operator that allowed for tailored commercial arrangements given the issues and challenges at the airport. It establishes improved commercial terms during agreement formation, which set the incentive structures governing the provision and pricing of services over the term of the agreement.

BARA sees merit in the Australian Competition and Consumer Commission (ACCC) providing guidance material and evidence to the negotiating parties over suitable rate of return outcomes for airport services in Australia. The airport operator in consultation with airlines should also engage an external consultant to review and advise on the efficiency of proposed operating costs and investments, including possibilities for improvements in operating efficiency and investment practices.

Supporting implementation of the progressive commercial principles

Simply adding the commercial principles to the existing Pricing Principles within the existing light-handed economic regulatory arrangements is unlikely to generate useful improvement. This is because there is no credible mechanism by which an airport operator is held accountable for genuine compliance. As such, the commercial principles need to be supported by appropriate incentives for the airport operators to incorporate them in their agreements with airlines.

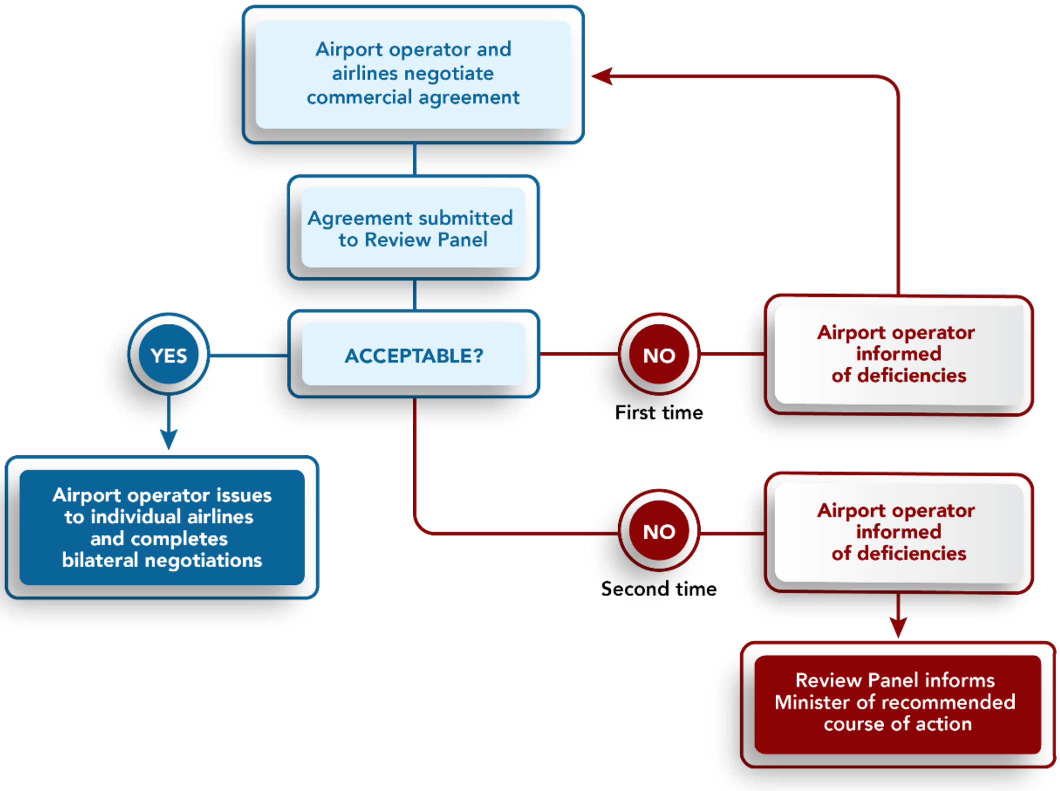
Option 1 – legislated principles

One option for encouraging the airport operators to apply the commercial principles in the agreements with airlines is to specify them in the *Airports Act 1996*. This could also include requirements for each airport operator to detail how it is complying with the principles in its annual report. This would not require an airport operator to make the commercial agreements with airlines publicly available but would require sufficient disclosure of the commercial basis of the agreements.

Option 2 – formal review of minimum terms offered

Another option for encouraging compliance is for a formal review of the minimum terms offered by each airport operator to the international airlines before being sent to them for final bilateral negotiations. Figure 4 shows how such a process could apply.

Figure 4. Formal review of minimum terms offered



Under the proposal, airlines and the airport operators would negotiate as they do today. Once the airport operator considered negotiations were complete, it would submit the minimum commercial offering to a review panel whose members would have suitable experience in procurement, infrastructure pricing and legal terms and conditions. The review panel could be established by the Department of Infrastructure, Regional Development and Cities.

Reviews would remain confidential and not receive submissions from any parties. A review should be concluded within about three weeks of lodgement assuming reasonable pre-notification is provided by the airport operator.

The review panel would examine the terms of the agreement 'at face value' against the specified pricing and commercial principles. It should only require a declaration from the airport operator containing the rate of return used in developing its proposed prices and that any potential rebate amounts for substandard service delivery have not been included as additional cost items. The review panel would have access to the ACCC's guidance material on rates of return in assessing the minimum commercial offer.

If the minimum terms offered are considered satisfactory by the review panel, the airport operator would then distribute the agreement to airlines to complete individual negotiations.

If the minimum terms offered are deemed unsatisfactory by the review panel, the areas of deficiency would be documented and sent to the airport operator. The airport operator would be afforded an opportunity to rectify the identified deficiencies in its agreement with airlines. After completing negotiations again, it would re-submit the minimum terms offered for review.

If the minimum terms offered were still found to be unsatisfactory by the review panel, the relevant Minister would be informed together with a recommended course of action. This could include:

- detailed review by the ACCC, with the review report made publicly available
- the airport operator's pricing being made subject to 'prices notification' by the ACCC under Part VIIA (Prices Surveillance) of the *Competition and Consumer Act 2010*.

The review component could therefore be implemented without legislative change and instead rely on existing legislative instruments. The airport operators would be required to participate in the review or result in an automatic move to prices notification for the airport operator concerned.

Net benefits of progressive commercial principles for international airlines

The progressive commercial principles reform initiative is another potential way of supporting the negotiation of commercial agreements with the airport operators that accord with delivering value for money in airport services.

This reform initiative would likely be of greater value to those international airlines:

1. with a small presence in Australia that presently participate little, if any, in bilateral negotiations with the airport operators over common use airport services
2. that do not consider they should have to invest considerable legal and other resources in pursuing improved outcomes over the provision and pricing of common use airport services through Australia's legal and regulatory frameworks.

Such airlines are likely to see greater value because the process does not require any additional investment in time and resources on their part compared with existing arrangements. This would allow them to focus on maximising their commercial opportunities in providing international passenger and freight services through Australian airports.

The annual airport monitoring report

Under the light-handed economic regulation, the annual airport monitoring report is the one item available to industry and interested parties that provides information on the performance of Sydney, Melbourne, Brisbane and Perth airports. BARA considers that:

- it has low compliance costs
- it is of little use in achieving BARA's desired commercial benchmarks
- it has general value to interested parties.

On this basis, BARA sees merit in retaining the annual airport monitoring report for another five years under any future economic regulatory arrangements, noting it is of no use in supporting productive commercial negotiations with the airport operators. It would benefit from metrics that aligned with passenger and airline outcomes, such as the rate of mishandled bags across airports.

The compliance costs are likely to be low as Sydney, Melbourne, Brisbane and Perth airports should all have the necessary systems and processes in place to produce the financial and non-financial information used to complete the report. For BARA's member airlines, it is a relatively straightforward task to complete the survey as now occurs, where it is distributed by BARA to its members.

The compliance costs are also likely to be very low relative to the revenues being received for the services delivered. Payments for airport services for international flights exceed $800 million annually, which can be expected to increase under current growth trends (see Attachment A: Australia's international aviation industry). When combined with payments for services covering domestic flights, the total cost of producing the annual monitoring report is likely to be a very small percentage of total annual payments to the airport operators.

The monitoring report adds little to BARA's ability to achieve its desired commercial benchmarks. It does, however, at least allow BARA to draw an airport operator's attention to instances of sustained deficient service outcomes. It also provides international airlines with an opportunity to directly comment on the quality of outcomes delivered for international flights.

In conclusion

BARA is seeking a way to negotiate agreements with the airport operators that would best support the operational efficiency of international flights and deliver good passenger experiences. Given its current interactions with the airport operators, BARA is not convinced that the improvements sought by its member airlines can be delivered consistently across Sydney, Melbourne, Brisbane and Perth airports under the current light-handed economic regulatory arrangements. This reflects the disconnections in perceived performance between the parties and the quality of the commercial offers provided by the airport operators.

BARA has canvassed the reform initiatives of a negotiate–arbitrate framework and progressive commercial principles model as ways of lifting the standard of the commercial agreements. BARA supports innovative approaches to service delivery that provide value for money to member airlines. This means BARA may see merit in alternative approaches put forward by other participants to this inquiry, or those developed by the Commission, provided such solutions are capable of facilitating productive negotiations and higher-quality commercial arrangements with the airport operators.

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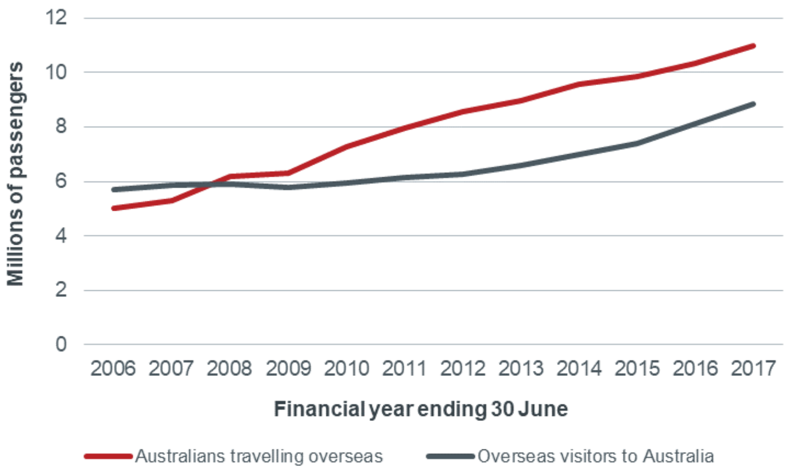
Attachment A Australia’s international aviation industry

All monetary values in this section are expressed in Australian dollars and at 2016–17 price levels.

Passenger number trends and economic and social contribution

ABS data show the changing composition of Australia’s international aviation industry and growth trends (Figure 5). High growth in the number of Australians travelling overseas (7.4% annual average) has increased this segment’s market share from 47% in 2005–06 to 55% in 2016–17. Overseas visitors to Australia have increased at about 4% annually, with particularly high growth of about 9% in 2015–16 and 2016–17.

Figure 5. Short-term passenger trips, millions, financial years



Source: Based on ABS 2017, Customised report

The passenger shares of these two market segments varies across airports. Sydney and Melbourne airports, reflecting their large market shares, are close to the market average, with Australians travelling overseas representing 52–55% of their international passenger numbers. Cairns Airport is characterised by a high proportion of overseas visitors – about 65% of its passengers – reflecting its proximity to the Great Barrier Reef. For Perth, Adelaide and Darwin airports, Australians travelling overseas represent 60–68% of their total international passenger numbers.[16]

Economic and social contribution

The economic and social contribution of Australia’s international and domestic aviation industries is well understood and documented.[17] This information is relevant as it highlights the importance of all suppliers to provide high quality and valued services, optimising the economic and social contribution of the industry.

[16] Based on ABS 2017, Customised report

[17] See for example, Oxford Economics 2011, *Economic benefits from air transport in Australia*.

In its 2015 Research Paper, *Australia's international tourism industry*, the Commission noted: 'Tourism is important to Australia's economy – people are travelling further, and more frequently for a range of reasons including leisure, business and education. In 2014, total tourism spending contributed almost 3 per cent of Australia's GDP – about one-third of this ($11 billion) was by international visitors. International tourism's share of total service exports was just over 60 per cent in 2014.' (p.3). The value of this contribution would have increased in recent years with the high growth in inbound tourism.

The international aviation industry is also generating large 'consumer surpluses' for Australians travelling overseas for business, to visit family and friends and to experience overseas countries and cultures. Based on econometric modelling of available data, BARA estimates the total consumer surplus for Australians travelling overseas was over $20 billion in 2016–17, reflecting the growth in passenger numbers at lower real airfares. The competitive international aviation industry is delivering ongoing large contributions to Australia's economic and social development.

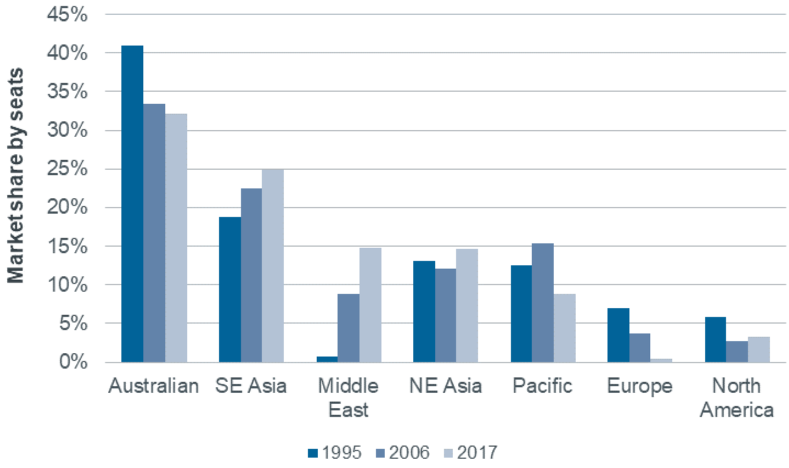
Airlines, airfares and industry revenues

The dynamic global aviation industry is characterised by ongoing changes in the range and size of airline companies. Operations to and from Australia reflect these global outcomes. Increasing airfare affordability remains a central feature of services both globally and in Australia.

Airlines

There are ongoing changes in the number and market share of individual airlines. Australia's international aviation industry has been characterised by the growth of airlines based in the Middle East, South-East Asia and North-East Asia over the past 20 years (Figure 6). Since 1995, these airlines have collectively increased their market share of seats from about one-third to over one-half.

Figure 6. Market share by airline operating to and from Australia



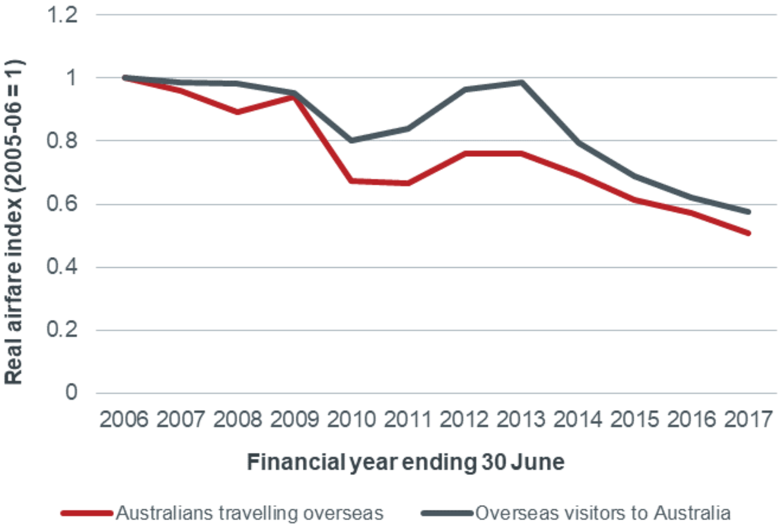
Source: Derived from Bureau of Infrastructure, Transport and Regional Economics statistics

International airfares

People in many countries are enjoying sustained improvements in airfare affordability. BARA estimates that average real international airfares to and from Australia (business and economy classes combined) have fallen by about 40% over the past 12 years. For economy class tickets, the reductions are 40–50% (Figure 7).

As examples, a return economy class flight from Sydney to London is estimated to have fallen from $3,594 in 2005–06 to $1,507 in 2016–17.[18] A return economy class flight from Melbourne to Vietnam is estimated to have fallen from $3,314 to $998 over the same period. These large airfare reductions underpin the estimated annual consumer surplus being delivered by Australia's international aviation industry.

Figure 7. Real international airfare indexes, economy class tickets



Source: BARA estimates (including all levied taxes and charges) based on IATA PaxIS and ABS 2017, Customised report

Airfares to and from Australia are following global trends. IATA reports that global average yields in $US fell by about 25% from 2011–2018.[19] IATA's research shows the real price of air travel has closely followed the reduction in the real cost of providing the service for many decades, and 'the industry on average have never managed to generate returns that meet what investors would normally consider the minimum for a competitive industry'.[20]

Industry revenues

BARA estimates that total airfare revenues from international passengers have remained constant in real terms at about $31 billion since 2005–06. Additional revenue growth could be expected from the increased use of 'ancillary' pricing by some airlines and the increase in the amount of air freight. Overall, however, the available data indicates the industry has expanded over 80% over the past 12 years and is doing so largely on the same real annual passenger revenue base.

Over 80% of all air freight to and from Australia is provided by scheduled international aircraft and about 16% by dedicated freighter operations.[21] IATA reports freight revenues represent about 9% of total international aviation industry revenues.[22] Member airlines have reported to BARA that air freight revenues can be a determining factor in the commercial viability of international flights. This highlights the importance of efficient freight operations at the airports in supporting commercially viable markets for their aircraft.

[18] Includes estimates of separately identified airport and security charges, fuel surcharges and the Passenger Movement Charge.

[19] See IATA February 2018, Airlines financial monitor.

[20] IATA June 2013, Profitability and the air transport value chain, p.11.

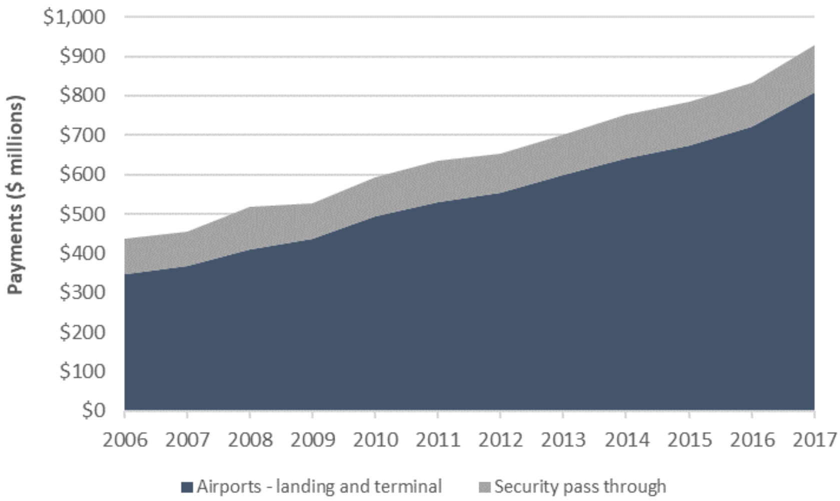
[21] Bureau of Infrastructure, Transport and Regional Economics 2017, International airline activity 2017.

[22] IATA 2018, IATA cargo strategy.

Airport costs

BARA estimates that the cost of airport and security services for international flights operating through Sydney, Melbourne, Brisbane and Perth airports has increased by about $490 million or 112%, or from 2005–06 to 2016–07 (Figure 8).[23] Of this, fees paid by airlines for airfield and terminal services increased by $463 million or 134% to just over $800 million in 2016–17.

Figure 8. Estimated costs, airport and security



Source: BARA estimates.

The costs for international airlines operating through Australian airports also include expenses incurred due to flights not being able to operate efficiently.

The total ground and airborne delay for international flights in 2016–17 above 15 minutes per flight is estimated at over 23,000 hours, costing about $230 million.[24] The estimated 83,000 international mishandled bags cost airlines some $25 million in reconnecting them to their passengers, while also reducing the quality of the passengers' travel experience and causing reputational loss to airlines. These additional costs represent over one quarter of the fees paid for airfield and terminal services.

Airlines also incurred the:

- additional operating costs associated with congested ground operations, including ad hoc bussing operations for flights and passengers
- cost of overnight accommodation for passengers who missed their connecting flights
- cost of replacing passengers' damaged bags.

These outcomes increase the cost of airline operations and reduced the quality of the travel experience provided to international passengers.

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[23] Estimate for all international flights based on BARA's pricing data, passenger numbers and data directly from suppliers.

[24] Estimate based on on-time performance data (Flightstats) and an assumed marginal aircraft operating cost of $10,000 per hour.

BARA's publications

BARA's Policies, Position Statement and quarterly *Airline Views* articulate the outcomes and reforms that will support a safe and efficient international aviation industry for Australia.

For these documents and more information, visit **bara.org.au/publications**