DEREGULATION – A FLIGHT OF FANCY?

AVIATION FREEDOM IS STILL IN THE AIR

By HUGH KING

In November the two-airline policy came to an end and the assumption was that Australia now had a deregulated domestic aviation industry. In fact, that depends on what you mean by the word.

Lawyers will always look for precision in the use of language. Where members of the media may happily use one word to describe a process or a situation, lawyers will occasionally want to use two or more. Now, the word "deregulation" by definition means the positive removal of all legal restrictions or obligations previously inhibiting or regulating behaviour. In a deregulated environment the citizen is free to follow his, her or its desires.

The partial economic deregulation of domestic aviation in Australia which we have been preparing for is much more specific and limited than the species of deregulation which have brought about such changes in aviation in the US since 1978 and in Europe since the Treaty of Rome.

The changes have their origin in a major policy statement by Senator Gareth Evans, then Minister for Transport and Communications, on October 7, 1987, in which he spoke not of "deregulation" but of "a new direction" and of "free competition" in domestic aviation.

Deregulation in Australia means only the economic deregulation of domestic interstate scheduled passenger airline operations between the major airports identified in The Airlines Agreement, annexed to the Airlines Agreement Act 1981. There will be no deregulation of safety matters; the new Civil Aviation Authority retains all its powers and resources on safety matters including navigation, air-traffic control and the like.

We have not seen the deregulation of intrastate airline operations. Nor has there been any deregulation of international airline operations into and out of Australia, or any increased access to Australian domestic operations for foreign carriers. The Australian version of deregulation does not amount to an "open skies" policy.

Any prospective deregulation of intrastate and international operations and access for foreign carriers to the domestic market are matters pertaining to micro-economic reform and the boosting of the important tourism sector. These wider issues have been raised frequently as possibly desirable corollaries to our economic deregulation, but they were not addressed or considered, except in the negative, by Senator Evans in his 1987 statement.

Throughout the post-war years, Australia has been in the unique position of having two "competing" airlines operating on the major domestic routes by reason alone of legislative fiat. It was a classic case of the regulators protecting the industry to the detriment of the consumer.

The fascinating and unique feature of these operations has been that Australia has, throughout that time and through successive changes of government, had a government-owned airline competing with a government-sponsored airline. From one the government derives all profit; from the other the private share-

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holders earn a profit ensured by the operation of a closed market, which could be said to amount to a government guarantee.

As a result, the two domestic airlines have not so much competed as agreed to compromise on standards and style of service, prices, timetables and virtually all other aspects of air travel, to ensure that both airlines operated smoothly and produce high and stable profit levels.

Because of the effects of regulation and the assured strong stream of passengers that must inevitably flow to the two airlines in almost equal numbers, the airlines have not been adventurous in expanding air travel in Australia. While earning good returns in a protected environment they felt no need to compete aggressively, or to lower fares, or to expand the horizons of air travel in Australia.

It may be, however, that the more liberal environment which began in November 1990 will in due course foster innovative pricing policies, exploration of additional routes, provision of a wider range of services and marketing of domestic holiday resorts which may entice a larger proportion of the Australian public to travel by air within Australia. It appears that a fairly static 8 per cent of the Australian population fly regularly and these are substantially business people.

Australia's geography is such that in many cases, there is no suitable alternative to air travel for the discretionary vacationer. If the price is too high, you just don't go, and then we are all losers.

A dynamic domestic aviation industry may arise from limited deregulation; that, at least, is the pious hope of some within the federal bureaucracy and the government. Much more must be done, however, to effect real freedoms in the domestic aviation sector and that does not appear to be on our horizon.

Leases of terminal facilities

One matter which remains unchanged is the strange situation created by the long-term leases of terminal facilities at the major airports and surrounding "expansion" land.

Given a successful capital-raising by the newcomer Compass Airlines, and the industry experience of other potential entrants, the chances for success against a fairly staid and perhaps comfortable established competition may appear substantial in theory. But very real practical impediments remain.

These [airport] leases effectively ... undercut the government's stated objective of creating freedom of competition in domestic aviation, and give the established airlines a considerable advantage.

The most obvious impediment to free competition in interstate air travel is the existence of long-term leases entitling both established airlines to virtually all domestic facilities at the major airports for 20 years (from 1988) with an option for a further 10 years.

These leases effectively continue the special privileges of the government-owned and government-sponsored airlines. They undercut the government's stated objective of creating freedom of competition in domestic aviation, and give the established airlines a considerable advantage.

The experience of deregulation in the US has taught the importance of retaining access to major airports. Multi-million-dollar takeovers of competing airlines have occurred with the stated objective of gaining committed passenger streams at certain hubs.

There has been considerable speculation about why the leases for such extended terms were settled by the Crown on the day before the Federal Airports Corporation came into existence. Whatever the reason at the time, one outcome has certainly been that the FAC, a semi-autonomous, government-owned corporation which is now the legal owner of the airports with an obligation to operate at a profit, has effectively had its hands tied by its sponsor. Not only do the leases provide for long-term occupation of the existing terminal space; they also provide in many cases for the exclusive development by the established carriers of the available adjacent land.

It is incongruous that such leases could be concluded by a government which two months earlier had announced a major policy objective of enabling domestic airline competition through economic deregulation.

Measures in the leases provide for some access to the terminal facilities for new entrants, but the government's act of encumbering the domestic terminal facilities for such a long period implies something much less than a clear and understandable approach to "deregulation".

The leases are difficult to interpret and apply in the legal sense. They do impose a definite obligation on the established airlines (the lessees) to enter into sub-leases with third-party carriers. However, the extent of the obligation is limited and the required terms of the sub-leases are very uncertain.

The lessees must either sub-lease a maximum two gates to a third-party carrier that requests them, or make available facilities for the handling of no more than two aircraft at any one time on a "common user" basis. Because of vague definitions, it could appear that the lessee's obligations may be met simply by providing an aircraft parking area connected by bus, or long walk, rather than an area reached by air bridge from a departure lounge.

At Sydney airport that involves the lessees granting access to about 15 per cent of their facilities. However, following the development of available space on the expansion land, the lessees would still be obliged to offer only the same two gates, which would represent less than 10 per cent of their facilities. In other words, the established operators are free to expand; the new entrants are not.

There are no provisions for the quality or the position of the facilities to be provided. One would hardly expect that new-entrant airlines in competition with the lessee will be provided with the closest, most convenient or prominent gate.

Having a competitor as a landlord obviously leaves open the

prospect of potential disagreement and litigation. One would expect the leases to have provided clearly for the terms and conditions that must be included in the sub-leases, but they do not. Two essential conditions are left in a vague and unsatisfactory state.

Term: The only obligation on the established airlines is to grant the sub-lease facilities for two aircraft for not less than one year, with only one option to renew for a similar period, on either an individual or common-user basis. There is no requirement for any further right of renewal for the new entrant. Thus the established airlines may be able to extinguish their obligations to a new carrier in two years.

It is interesting that the government has ensured the stability of the existing airlines by granting them 20-year leases (with options for 10-year renewals) while ensuring that new carriers trying to get established can rely only on two-year sub-leases.

Rent: The rent to be charged to the new carriers is rather uncertain. The expression used is "reasonable commercial terms" considering the rental paid for the head-lease. This is ambiguous and clearly something over which both parties may differ dramatically.

The obligations on the lessee airlines are not onerous but they are, even so, lessened by a provision that excuses the airline from the need to enter into a sub-lease if the new carrier has had a reasonable offer of facilities elsewhere at the airport. This provision does not take into account the preference of the new carrier or the standard of the alternative facilities, other than the reference to a "reasonable" offer.

The philosophy behind the leases does not appear to comprehend the prospect that there will be substantial viable operators, in addition to Compass Airlines, prepared to compete against the established airlines. The sub-leasing obligations, clearly of vital importance to all new entrants to the industry, contain sufficient ambiguity to lead a lawyer to conclude that disagreement and litigation are possible in the foreseeable future. Whatever the legal outcome, the commercial consequences appear to be very much against the new entrants.

If new entrants do obtain gate access, there are still clear commercial difficulties in using facilities belonging to a landlord competitor. If the passengers of a new entrant have to go through ticketing and embarkation in a terminal emblazoned with the logos and colour schemes of one of the major airlines, then problems of priority and quality of service must arise.

In the US, following deregulation, new entrant-airlines have been prevented from competing in all operational respects because of the lack of airport access. This was a prime factor in report by the Washington-based Economic Policy Institute, concluding that airline deregulation in the US has been a failure. The apparent main objective of Australia's new freedoms, the encouragement of competition on trunk routes, may be totally frustrated by this one, single difficulty— lack of airport access.

It may be that in the very act of concluding such lease agreements with the airlines, the government sowed the seeds of deregulation's destruction.

To return to the beginning, we really should try to define the term "deregulation" with some precision. Senator Evans, in 1987, announced the government's intentions in terms which were limited to the removal of the economic controls at the heart of the two-airlines policy; he undertook nothing more. That is what we got on November 1, 1990. □

COMPASS POINTS TO THE WAY AHEAD

Nothing made airline deregulation more real than the first commercial flights a few weeks ago of Brisbane-based Compass Airlines. Headed by Bryan Grey (the former owner of East-West Airlines until East-West became the property of Ansett), Compass is the first new national airline to start up in Australia since the 1947 launch of TAA (now Australian Airlines).

Grey, despite his experience in commercial aviation, took a huge gamble in deciding to confront the established major domestic carriers.

Deregulation had been touted as opening Australia's skies to full and free competition — but in reality the Big Two were left with considerable protection against newcomers (see other articles in this issue).

Market research and modern technology were the keys to Grey's strategic planning. He started with an assumption that the public believed fares were too high and used computer analysis to determine which routes, which frequency and which aircraft would deliver the economies needed to bring those fares down.

His computers told him that the right aircraft would be Airbus Industrie's wide-bodied A300 twin-engined jet. The plane enables Compass to fly 288 passengers at fares between 20 and 50 per cent lower than those of the established rivals.

The computer model even told him what sort of seats the passengers would like. While the Compass aircraft are one-class with few frills, the seating is as spacious as that in the business-class sections of Ansett and Australian. (In Europe, the equivalent A300 is crammed with up to 330 seats.)

Use of the capacious wide-bodied jets on the main trunk routes, mainly in the Eastern States, enables Compass to make the best of its limited gate access at capital-city airports.

Early booking reports suggest that Grey got at least some of the sums right. Even before the first of his chartered A300s arrived in Australia in November, reservations were flowing in at close to the airline's capacity.

However, after what seems to be a flying start, a real test will come for Compass as 1991 unfolds. March and April are traditionally a slack period for airlines, and the Big Two are likely to ignite a no-holds-barred discounting war in an attempt to hold back the competitor's growth. And if Australia's economic slowdown continues, the passenger market may decline rapidly despite the bait of bargain fares.

Bryan Grey will be watching his computer screen closely. □