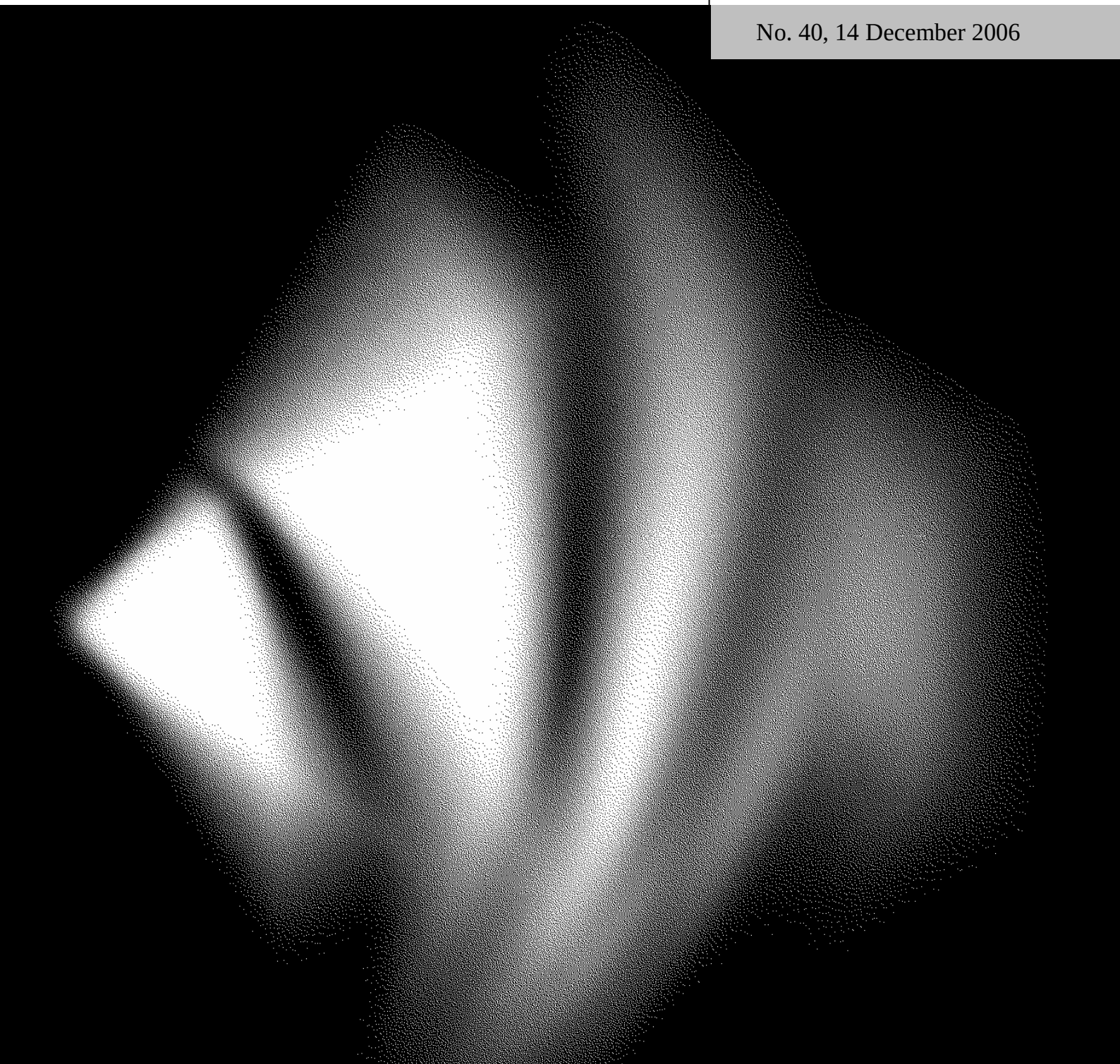
Australian Government
Productivity Commission

Review of Price Regulation of Airport Services

Productivity Commission Inquiry *Overview*

No. 40, 14 December 2006



OVERVIEW

Key points

- Price monitoring, as part of a light handed regulatory approach, has delivered some important benefits.
  - It has been easier to undertake the investment necessary to sustain and enhance airport services in the face of growing demand for air travel.
  - Airports' productivity performance has been high by international standards, and service quality has been satisfactory to good.
- Moreover, though it is too early to fully judge the effectiveness of the light handed approach in constraining airport charges, price outcomes to date do not appear to have been excessive.
- However, some non-price outcomes have been less satisfactory and commercial relationships between certain airports and their customers have been strained.
- More generally, some of the 'market' constraints on airports' behaviour — such as the countervailing power of airlines — have not been as strong as was envisaged. Also, some 'systemic' shortcomings have detracted from the effectiveness of price monitoring and the light handed approach as a whole.
  - Policy guidance on the valuation of airport assets for pricing purposes is lacking.
  - There is no clarity on when further investigation of an airport's conduct is required, and no process for initiating such investigation.
- These systemic shortcomings can be addressed without sacrificing the benefits of a light handed approach. Hence, a further period of price monitoring would be preferable to a reversion to stricter price controls, with all of its attendant costs.
- However, a recent Federal Court decision that potentially makes the Part IIIA national access regime a more intrusive regulatory instrument, has raised questions about the sustainability of the light handed approach for airports and poses risks for investment in infrastructure more generally. A 'remedial' legislative amendment to Part IIIA should be considered.
- Provided that Part IIIA does not come to 'supplant' the light handed approach, price monitoring should be extended for a further six years when the current arrangements end in 2007. This new monitoring regime should:
  - apply to Adelaide, Brisbane, Melbourne, Perth and Sydney Airports;
  - embody a new process for triggering further investigation of an airport's conduct where there is prima facie evidence of significant misuse of market power; and
  - exclude revaluations to airports' monitored asset bases made after 30 June 2005.
- Though introduction of an airport-specific arbitration mechanism would be counterproductive, the parties should be expected to negotiate and resolve disputes within an appropriate commercial framework, and be assessed accordingly under the new oversighting arrangements.

Overview

In 1997, the Australian Government commenced the privatisation of airports then operated by the Federal Airports Corporation. In doing so, the Government recognised that some had significant market power. Accordingly, it also introduced price regulation at all capital city and some regional airports.

However, following a Productivity Commission review in 2002, the breadth and stringency of this regulation was eased. Under this more light handed approach, direct regulatory 'involvement' in price setting is now limited to the monitoring of charges for aeronautical and related services at Adelaide, Brisbane, Canberra, Darwin, Melbourne, Perth and Sydney Airports (see box 1) — though these airports have been put on notice that stricter controls may be re-introduced if they misuse their market power. The monitored airports are also potentially subject to the Part IIIA national access regime.

This inquiry was established to assess how well the light handed approach has worked to date, whether it should continue after 2007 when the current price monitoring regime is due to end and, if so, what improvements might be made to it. (The full terms of reference are reproduced at the front of this report.)

What was light handed regulation intended to achieve?

Until 2002, charges for aeronautical services at the major privatised airports were determined primarily by the regulator, rather than on the basis of commercial negotiations between the parties. Indeed, even agreements reached between airports and airlines on appropriate charges for new infrastructure and the like were sometimes over-ruled by the regulator.

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.

Box 1 **How does price monitoring operate?**

Provisions in the Trade Practices Act (Part VIIA) and the Airports Act provide for the Australian Competition and Consumer Commission (ACCC) to monitor the prices, costs and financial returns relating to the supply of aeronautical and related services at Adelaide, Brisbane, Canberra, Darwin, Melbourne, Perth and Sydney Airports.

Though the service coverage of the two regulatory instruments differs slightly, in broad terms, the services subject to oversight are those related to: aircraft movements; passenger processing (including security); the provision of landside vehicle access to terminals; transport to and from an airport (such as car parking); and aircraft maintenance. Prices and profits earned by an airport from services such as retailing, corporate parks and factory outlets — or from the rental of space for the provision of such services by third parties — are not monitored under this 'dual till' approach.

The information assembled by the ACCC is intended to help inform judgements by the Government on whether there has been any misuse of market power by the monitored airports. If monitoring indicates that further investigation is required, then under Part VIIA, the Government can direct the ACCC to undertake a public inquiry. Potentially, this could lead to the reintroduction of stricter price controls at particular airports.

Quality of service monitoring

The ACCC is also required to report on service quality at the price monitored airports — in part to reinforce commercial incentives for those airports to maintain appropriate service standards. In doing so, the ACCC draws on information from several sources, including: airport operators; airlines; passenger surveys; AirServices Australia and the Australian Customs Service.

Part IIIA

In introducing price monitoring, the Government left open the option for airlines to seek 'declaration' of airports under the Part IIIA national access regime when commercial agreements cannot be reached. As discussed later, a recent Federal Court decision has potentially rendered Part IIIA a more 'accessible' regulatory instrument, with possible ramifications for both the sustainability of a light handed approach in the airports area, and for efficient investment in, and delivery of, infrastructure services more generally.

What have been the outcomes to date?

Some significant benefits

Against a number of performance indicators, the current arrangements have measured up well.

First and foremost, the light handed approach has made it easier for airports and airlines to agree on what new investment is required and the charges necessary to pay for it. For capital intensive airport services, investment plays a pivotal role in sustaining and enhancing service availability and quality. Thus it is not surprising that the removal of the regulator from investment decision making is widely viewed as a major advantage of the light handed approach. With a number of the airports looking to embark on major new upgrades, this more timely and responsive investment environment is likely to be a source of even greater benefit in the future.

In addition:

- the recent productivity performance of the monitored airports has been high by international standards — with one study suggesting that this may be partly due to Australia's less intrusive regulatory approach;
- service quality continues to be rated by the ACCC as satisfactory to good, with the monitored airports appearing to offer 'reasonable value for money' by international standards;
- for the larger monitored airports in particular, compliance costs have been quite modest; and
- at most of the monitored airports, commercial relationships between the parties have been developing — though some particular issues have impeded progress on this front (see later).

Price outcomes do not appear to have been excessive

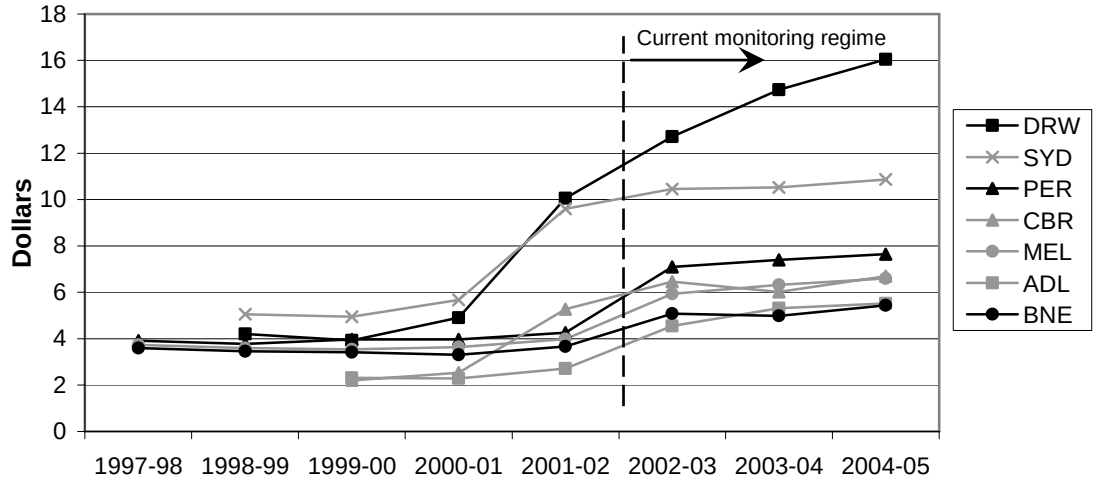
Airport charges rose substantially immediately prior to, or at the outset of, the light handed regime (see figure 1). But these increases were either formally approved by the ACCC, or closely followed its regulated pricing 'template'. Indeed, at the time, significant increases in the charges inherited from the days of government service provision were widely accepted as necessary to put airport operations on a sustainable longer term footing.

Since then, increases at most of the monitored airports have been relatively modest. Moreover, some of these subsequent price increases have been to pay for security upgrades, and/or for additional new investments. These factors — together with the continued unwinding of the previous charging regime — have been important at Darwin Airport, the outlier as far as recent price rises are concerned.

Any conclusion on whether charges at the price monitored airports are now excessive in relation to costs cannot rely on single, and inevitably imperfect, indicators. However, taken together, the following considerations suggest that charging outcomes so far have not been outside the boundaries that would have

been envisaged when the light handed approach was introduced — implying that there has been no systematic misuse of market power in this regard.

Figure 1 **Recent movements in charges at the monitored airports[a]**



a Measured as aeronautical revenue per passenger.

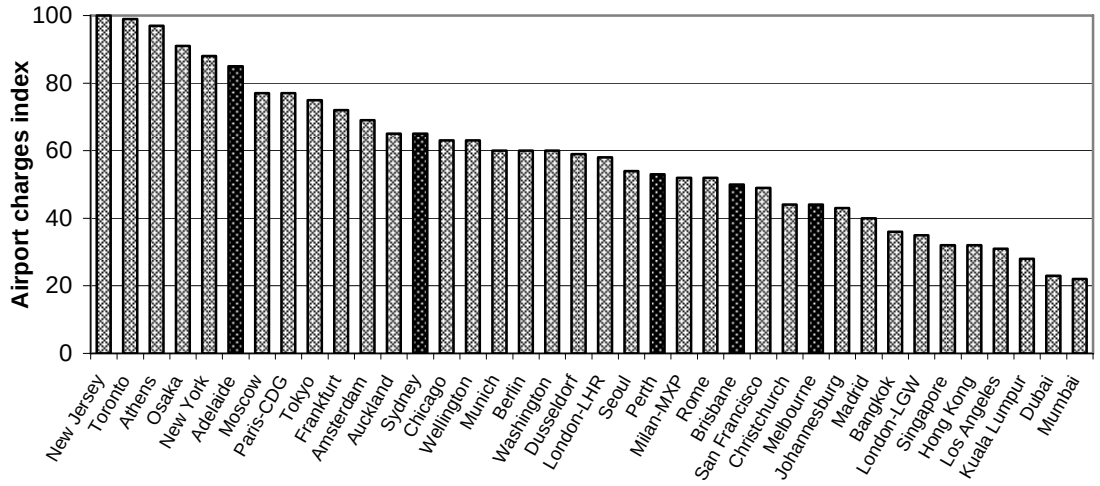
- Charges at Australia's major airports are, for the most part, mid-range by international standards (see figure 2). While it is important not to draw too much from such comparisons given the 'apples and pears' issues that arise, equally it is hard to dismiss the broad picture that emerges as irrelevant.
- As noted above, the approach used by the ACCC to determine allowable charging levels at Sydney Airport in 2001 had a major influence on the charges resulting from the first round of negotiated agreements at the other monitored airports. Hence, current price levels may not be all that different from those that would have prevailed had stricter controls been retained.
- Strong growth in aeronautical revenues, and generally high airport profitability by international standards, seem to have primarily reflected larger increases in passenger traffic than was anticipated when current charges were struck.

The latter two observations in turn highlight that the scope for price monitoring (and the other elements of the light handed approach) to constrain prices will be better and more readily judged once the next round of agreements has been concluded. Negotiations on a number of these agreements are currently underway.

But there have also been some negatives

While the light handed approach has delivered some significant benefits and price levels that do not appear to be excessive, there have been some problems.

Figure 2 **How do charges measure up internationally?[a]**



a Charges are for 2005 and for international aircraft movements. The difference in Adelaide Airport's ranking among the Australian airports compared to figure 1 reflects its low volume of international traffic and hence lesser capacity to spread specific infrastructure and security costs.

- The behaviour of airports as a group in regard to the determination of non-price terms and conditions has arguably been less satisfactory. These terms and conditions — which cover matters such as the allocation of gate and aircraft parking positions, and the right of an airport to vary its conditions of use — can be as important for airlines as the general level of charges.
- Relationships between some airports and airlines have been strained. At Sydney Airport, where the domestic airside service has been declared under the Part IIIA national access regime (see later), negotiations on both price and non-price matters have been protracted.

More generally, with the benefit of hindsight, it has become apparent that some of the 'market' constraints on airports' behaviour are not as strong as was previously envisaged. For example, airlines generally have only modest countervailing power in dealing with the major airports. Also, the negative impact of higher charges for aeronautical services on passenger traffic, and hence on airports' non-aeronautical revenues, does not appear to be significant.

Hence, price monitoring and the threat of re-regulation must carry more of the burden in preventing misuse of market power.

However, some 'systemic' shortcomings have detracted from the effectiveness of price monitoring and the light handed approach as a whole in performing this role.

- There is little policy guidance available to airports and their customers on how airport assets should be valued for pricing purposes. As discussed below, this has

been a major source of disputation between the parties and is impeding the development of commercial relationships.

- There is currently no clarity as to when further investigation of an airport's conduct should be undertaken, and no process for initiating it. While such investigations *may* not have been warranted on the basis of outcomes to date, it has not been possible to differentiate between 'determined' and 'passive' policy inaction. This gap in the current arrangements is contributing to perceptions in some quarters that the threat of re-regulation, if there is misuse of market power by airports, is not a credible one.

What should happen next?

A further period of price monitoring would be desirable

The effectiveness of the light handed approach in constraining misuse of market power by airports has yet to be fully tested.

However, as outlined below, the systemic weaknesses in the current framework can be addressed without sacrificing the benefits that the light handed approach has delivered. With the proposed modifications in place, a further period of price monitoring when the current arrangements end in June 2007 would be preferable to a reversion to stricter price controls.

A return to the previous arrangements would make it more difficult for airports to undertake the new investments required to cater for strongly growing demand for air travel. This in turn would impede the development of tourism and other Australian industries reliant on accessible and efficient airport services. Indeed, with several of the monitored airports now entering a new phase of the investment cycle, a return to a more heavy handed regulatory regime could be costly.

A reversion to stricter price controls would also put at risk the good productivity performance of Australian airports which seems at least partly attributable to the more light handed regulatory approach. Amongst other things, considerable managerial resources would once again be diverted into dealing with the regulator and seeking ways to 'game' the system.

But the potentially greater influence of Part IIIA complicates matters

As noted earlier, the Part IIIA national access regime was always intended to be an operative part of the light handed approach for oversighting airport behaviour — in essence, a mechanism of 'last resort' for resolving serious and protracted disputes.

However, a recent Federal Court determination upholding the Part IIIA declaration of the domestic airside service at Sydney Airport has the potential to render Part IIIA a more active regulatory instrument. Specifically, a new interpretation by the Court of the meaning of the 'promotion of competition test' — the key criterion in determining whether a nationally significant infrastructure service should be declared — is likely to make it easier to satisfy this criterion in future declaration cases (see box 2).

In turn, a more readily accessible Part IIIA regime could conceivably supplant price monitoring (and the underlying threat of re-regulation) as the operative regulatory instrument governing terms and conditions at the monitored airports. This might in practice be much the same as a reversion to explicit price regulation, meaning that there would be little point in continuing with monitoring as the information collected would be of no particular policy relevance.

Moreover, even if subsequent judgements reveal that the Court's interpretation has not substantially lowered the Part IIIA 'entry bar', the decision has introduced a new and undesirable source of uncertainty to the infrastructure policy environment.

An amendment to Part IIIA should be considered for wider policy reasons

The question marks over the sustainability of a light handed approach in the airports area could be resolved by a specific amendment to Part IIIA to ensure that it effectively remains a 'last resort' mechanism.

But the case for such an amendment is a general rather than airport-specific one. There are good reasons why the entry bar for declaration under the regime should be set at a high level and why the Government recently sought to raise that level further. Of particular concern is the potential for access regulation to deter investment necessary to sustain services over the longer term (see box 3).

There are factors militating against such a 'pre-emptive amendment'. Apart from any further developments ensuing from Sydney Airport's application for leave to appeal the decision in the High Court, immediate legislative action would raise concerns about prejudging how decision makers might respond to the changed Part IIIA landscape.

However, clarification through the judicial/decision making process is unlikely to happen quickly. The uncertainty thereby created may of itself impact adversely on investment in infrastructure services. Accordingly, the Commission considers that there is a case for a pre-emptive legislative amendment to ensure that the Part IIIA entry bar remains at a high level.

Box 2 **The Federal Court decision**

In October 2006, the full Federal Court dismissed an appeal by Sydney Airport against the Australian Competition Tribunal's decision to declare the airport's domestic airside service under the Part IIIA national access regime. This means that until December 2010, and subject to the outcome of Sydney Airport's application to the High Court for leave to appeal the decision, domestic airlines unable to reach agreement with the airport over charges or terms and conditions will be able to seek either legally binding private arbitration, or arbitration by the ACCC.

One of the key Part IIIA declaration criteria requires that access to a nationally significant infrastructure service must 'promote competition' in a related market. Prior to the Federal Court decision, this criterion had essentially been interpreted by decision makers as meaning that the act of declaration, and the access that would flow from such declaration, would promote competition. However, the Court found that consideration of conduct 'with and without' declaration is not a pre-condition for satisfaction of the competition test; all that is required is a judgement that the nature of the infrastructure service is such that access (or increased access) will promote competition. As most of the other declaration criteria focus on structural or factual matters, this interpretation has prima facie lowered the Part IIIA entry bar.

There is of course a need for caution in concluding at this juncture on precisely how the Federal Court's interpretation might impact on future declaration cases. Further developments ensuing from any consideration of the matter by the High Court (see above) are relevant in this context. So too are recent amendments to Part IIIA to strengthen the promotion of competition test and to require decision makers to have regard to an objects clause focussing on the efficiency implications of declaration.

Moreover, the Federal Court did not rule out the relevance of a service provider's conduct to the decision to declare.

But under the Court's interpretations, such considerations will seemingly now come into play primarily through the residual discretion available to Part IIIA decision makers. Hence, even if it transpires that the exercise of such discretion operates to limit the magnitude of any bar lowering, it will add to uncertainty about regulatory outcomes. As noted in the text, the effects of that uncertainty on investment may be little different from those resulting from a lowering of the entry bar.

A 'conditional' approach for post-2007 airport policy

In the light of the above, the Commission considers that there must necessarily be some policy flexibility in regard to the future of prices oversight at the major airports after the current arrangements end in June 2007.

In a broad policy sense, it is strongly of the view that the continuation of a (modified) light handed approach, backed by Part IIIA operating, in practice, as a mechanism of last resort, is the best way forward.

Box 3 **The impact of access regulation on investment**

Though it is very difficult to establish after the event precisely how investment might have differed in the absence of access regulation, it is widely acknowledged that potential exposure to such regulation can impede investment in essential facilities in two ways:

- It will increase the risks and thereby the costs of such investment — especially as assets, once in place, are largely sunk.
- Investment will also be deterred if prospective terms and conditions under regulated access are not seen as providing a sufficient return to infrastructure owners. A particular issue here is that the possibility of earning higher than normal returns on successful projects may be required to balance the possibility that some projects will fail. If regulatory pricing arrangements inadvertently appropriate upside returns on successful projects (so-called 'regulatory truncation'), then overall investment levels are likely to be reduced.

Some such investment impacts are unavoidable if efficient access to nationally significant infrastructure services is to be provided. But if access regulation is overly stringent, those impacts will potentially be significant and outweigh the offsetting benefits that appropriately configured access regulation can deliver.

However, in the absence of an amendment to Part IIIA, this relationship between the two instruments cannot be guaranteed. In these circumstances, though it would be premature to immediately terminate the light handed approach, there should be a readiness to do so in the future if it becomes clear that Part IIIA, left unamended, has become the operative regulatory instrument for the major airports and thereby rendered price monitoring redundant.

The foundations for the post-2007 light handed approach

The post-2007 price monitoring arrangements must continue to provide for a degree of latitude on outcomes if they are to foster commercial relationships between airports and their customers and thereby place reliance primarily on negotiations to set charges and terms and conditions.

Nonetheless, the Commission sees the need for some 'framework' changes to facilitate such negotiations and to enhance the credibility of the light handed approach as a means to constrain misuse of market power by the major airports.

A process for triggering further investigation of conduct

A key element of the light handed approach is the ultimate threat of re-regulation if there is significant misuse of market power by airports. As well as offering the prospect of remedial action if airports behave inappropriately, the threat is also designed to condition negotiations between the parties.

This in turn requires that there is an effective process for initiating further investigation of an airport's conduct in circumstances where there is prima facie evidence of significant misuse of market power. As noted above, there is no explicit process of this sort in the current arrangements. Accordingly, the Commission is recommending introduction of an arrangement whereby the Minister for Transport and Regional Services — drawing on price monitoring reports and any other relevant information — would be required to publicly indicate each year either that:

- for the period covered by the relevant monitoring reports, no further investigation of any airport's conduct is warranted; or
- one or more airports will be asked to 'show cause' why their conduct should not be subject to more detailed scrutiny through a Part VIIA price inquiry, or other appropriate investigative mechanism.

This requirement would remove the possibility of 'passive' rather than 'determined' inaction. In so doing, it would both enhance the credibility of the threat of re-regulation, and reinforce the notion that price monitoring is simply intended to be a screening mechanism — an initial step in the light handed regulatory approach. As such, the proposed new process should not put at risk the latitude on outcomes necessary to allow commercial negotiations to develop.

A circuit breaker on asset valuation

Since acquiring the leases, most of the price monitored airports have revalued their above ground assets, sometimes significantly, with the focus of revaluation now shifting towards land — especially at those airports located closer to city centres.

Such revaluations will not automatically or immediately be reflected in airport charges. However, one important effect is to provide a possible justification for higher charges over time. Not surprisingly, therefore, the revaluation issue has been a source of considerable dispute and tension between airports and airlines, with both sides in agreement that resolving the issue is a high policy priority.

From an efficiency perspective, the case for sanctioning higher charges based on changes in the 'optimised replacement value' of above ground assets, or the value of land in alternative uses, is weak.

- Airport assets are effectively sunk and, under the terms of the leases, land cannot be redeployed into higher value uses outside of the airport precincts. This means that continued provision of services is unlikely to be put at risk if higher charges based on asset revaluations are not sanctioned.
- Future investment at the airports is also unlikely to be discouraged — provided it is clear that, for monitoring purposes, new investments will be incorporated into the monitored asset base at their 'acquisition' values.
- In overall terms, the proportionate impacts on ticket prices — and therefore on demand for air travel — of any undercharging against an unconstrained 'opportunity cost' benchmark, are likely to be small. Hence, longer term decisions on airport location and the timing of capacity upgrades are unlikely to be materially affected.

However, the policy stance adopted on this issue will have implications for the profitability of the airports and the airlines.

Sanctioning asset revaluation practices that redistributed income from airlines and air travellers to airports would not be helpful in engendering public confidence in the light handed regulatory approach.

But especially in the early phases of the airport privatisation process, there was some ambiguity in the signals given to bidders about both appropriate 'starting' asset values, and the scope to raise charges based on periodic asset revaluations (including for land) without triggering a regulatory response. Hence, bids may well have been framed on the expectation that there would be some scope for revaluations and flow through to charges.

There is no easy solution. Yet a way forward must be found — both to render the post-2007 price monitoring regime credible, and to remove a major blocker to the further development of commercial relationships between the parties.

Significantly, most of the airports seem to have accepted that the practice of raising charges on the basis of periodic asset revaluations should not be sanctioned under a future price monitoring regime and, by implication, that a line in the sand on previous revaluations must be drawn. While such a line will inevitably involve an element of 'rough justice', the Commission considers that a cut-off date of 30 June 2005 for revaluations to the monitored asset base represents a reasonable compromise between the competing interests.

Better guidance on expected outcomes

When introducing the light handed approach, the Government specified a number of overarching 'Review Principles', intended to provide some broad guidance to the parties, as well as to this review, on appropriate outcomes under the new arrangements. Amongst other things, these principles specify that: at non-capacity constrained airports, prices should not be significantly above long run costs (including an appropriate return on assets); price discrimination that promotes the efficient use of airports is permitted; and that airports and airlines should operate primarily under commercially negotiated agreements (see the Terms of Reference at the front of the report).

In the Commission's view, some augmentation to, and elaboration of, the current principles could enhance their usefulness and thereby the credibility of the light handed approach, without unduly 'directing' the outcomes of commercial negotiations. Specifically, there should be three new principles:

- proscribing further asset revaluations as a basis for increasing airport charges;
- specifying that the parties should negotiate in 'good faith' to achieve outcomes consistent with the principles, including through the negotiation of processes for resolving disputes in a commercial manner; and
- providing for a reasonable sharing of risks and returns between airports and their customers (including those relating to productivity improvements and changes in passenger traffic).

This expanded set of principles would continue to provide guidance to the parties as envisaged when the existing 'Review Principles' were established. Under the proposed new price monitoring regime they would also have an additional role to play — namely, to provide some reference points for any triggering of the requirement for an airport to 'show cause' as to why its conduct should not be subject to further scrutiny (see above).

No airport-specific arbitration mechanism

As intended, the light handed approach has led to considerably more negotiation between airports and airlines.

However, many airlines have argued that the monitored airports negotiate from a position of strength and can therefore 'impose' outcomes on their customers. Given the cost and time involved in seeking to resolve disputes via the Part IIIA process, several airlines proposed that a future price monitoring regime be 'augmented' with an airport-specific arbitration mechanism.

It is obviously the case that the major airports have considerable bargaining power. Indeed, this is precisely why they continue to be subject to oversight.

But, in the Commission's view, introduction of an airport-specific arbitration mechanism could fundamentally undermine the light handed regulatory approach. That is, it is difficult to conceive of an arbitration mechanism that would provide both airports and airlines with strong incentives to engage in genuine commercial negotiations. Certainly, none of the proposals put forward by the airlines in response to an invitation from the Commission would embody such incentives. Rather, it seems likely that arbitration would come to be viewed by airlines as the default option, with negotiations increasingly centred in a narrow band around previously arbitrated outcomes. The net effect would therefore be a return to 'institutionalised' determination of charges and conditions for airport services, with its attendant costs.

As well, the 'framework' changes that the Commission is recommending to the light handed approach reduce further the case for an arbitration mechanism.

- Introduction of an explicit process for triggering further investigation of inappropriate airport behaviour should partly address users' concerns about the consequences of imbalance in bargaining power.
- Resolving the asset valuation issue should considerably narrow the negotiating divide between the parties.
- Augmentation of the overarching principles to make it explicit that the parties are expected to negotiate mechanisms for resolving disputes, should encourage the further development of commercial arbitration/mediation processes, tailored to the particular needs of individual airports and their customers.

With these changes in place, the key stakeholders should then be given the opportunity to show that through constructive negotiation they can deliver effective outcomes, with their performance judged accordingly under the new oversighting arrangements.

Implementing the new price monitoring regime

A smaller group of airports

There is no case for extending the airport coverage of the post-2007 monitoring regime. All of the larger non-monitored airports either face significant competition from other airports or other modes of travel, and/or must negotiate with airlines

which have considerably more bargaining power than in their dealings with the major airports.

The Commission also considers that monitoring of Darwin and Canberra Airports is no longer necessary.

- They are relatively small airports dealing with some major airlines that can withdraw services (and have done so), and hence have some countervailing power.
- Both face some competition from other airports and/or other modes of transport.
- And both have less passenger traffic than some of the larger non-monitored airports.

Moreover, though charges at Darwin Airport have risen steadily under the light handed regime, these increases appear justifiable in terms of the cost of new investments and security upgrades, and the unwinding of previously uncommercial charging arrangements.

A slightly wider group of services

The monitoring regime should encompass all services for which airports are likely to have significant market power. On this basis, the Commission considers that the coverage in the proposal from the Department of Transport and Regional Services to align the relevant parts of the two sets of regulations governing the scope of price monitoring, is generally appropriate. Amongst other things, this would see monitoring extend to:

- all, rather than only some, revenue streams associated with the provision of refuelling services — including those from fuel throughput levies;
- revenues from common-use check-in facilities and terminal space; and
- revenues from ground handling and airside freight handling services.

However, airports are unlikely to enjoy any significant market power in providing two services included in the Department's proposal — office space used by airline staff and telecommunications infrastructure. Hence, these services should not be encompassed by the new monitoring regime. Terminal space covered by long-term leases to airlines that were signed prior to privatisation, should also be excluded.

Adoption of the Department's proposal would mean that car parking charges, and charges imposed on taxis, would no longer be subject to monitoring. While airports have some market power in setting these charges, that power is constrained by the availability of off-airport parking, and by other options for travelling to and from

airports. A comparison of car parking charges at the monitored airports with those at central city locations where a premium is also paid for parking convenience, suggests that these constraints have been influential.

Streamlined monitoring of service quality

Some monitoring of service quality is necessary to guard against misuse of market power through either degrading service standards or 'gold plating' services. Quality monitoring can also help to put price changes in context.

However, the value added by some aspects of the current quality monitoring arrangements is questionable. There is also some duplication in the information collected from the various stakeholders.

A proposed amendment to the Airports Act currently before the Parliament will give the ACCC scope to streamline and rationalise the current arrangements. In doing so, the ACCC should give particular attention to the possibility of:

- dispensing with commentary and qualitative survey results from the Australian Customs Service and relying on other existing and less contentious indicators of airport performance in enabling provision of these services; and
- rationalising airline satisfaction surveys to remove quality matters included in passenger surveys, or covered by other quantitative indicators.

It should also consider whether greater use of comparative passenger satisfaction results from reputable international benchmarking exercises could help to enhance the usefulness of quality monitoring.

To further streamline current processes, and to help put price changes in context, the Commission is also recommending that price and quality monitoring reports be combined.

Duration and review arrangements

Unless 'supplanted' by the Part IIIA national access regime (see above), the new price monitoring regime should operate for six years ending on 30 June 2013. This would allow an end-of-period review to have regard to the outcomes of the scheduled 2011 review of the national access regime.

Continuing with a light handed approach is the best way forward

Though the light handed approach has not been without problems, there are good reasons for continuing with it; namely, to provide an environment that will facilitate investment, innovation and productivity improvement at the major airports, and encourage the further development of commercial relationships between the airports and their customers.

The Commission's recommendations seek to address some systemic deficiencies in the current arrangements, so as to make the light handed approach more effective in constraining misuse of market power by the airports. Thus the proposed changes should provide greater assurance to the community that any inappropriate behaviour by airports will be kept in check, while continuing to avoid the costs of more intrusive price regulation.

The Commission has also addressed, without making recommendations, some other relevant aspects of the regulatory framework, including the arrangements in place at Sydney Airport to ensure access for regional airlines, and charges for services provided at the major airports by government entities.

Recommendations

RECOMMENDATION 3.1

To ensure that the operation of the Part IIIA national access regime leaves open the option of using price monitoring and other light handed approaches for regulating major infrastructure provision (including at airports), the Government should consider amending Part IIIA to restore the prevailing interpretation of s 44H(4)(a) prior to the Federal Court decision upholding the declaration of the domestic airside service at Sydney Airport.

RECOMMENDATION 3.2

There should be a further period of price monitoring (see recommendation 5.5) at Australia's major airports when the current arrangements end in June 2007.

However, if it becomes apparent that Part IIIA has become the operative regulatory instrument governing charges and terms and conditions at major airports, and no corrective action is considered appropriate before the scheduled review of Part IIIA in 2011, then price monitoring should be discontinued.

In that event, the possible reintroduction of monitoring should be considered in the light of the outcomes of the review of Part IIIA.

RECOMMENDATION 4.1

Under the new price monitoring regime, the Minister for Transport and Regional Services, having regard to monitoring reports and other relevant information, should each year be required to publicly indicate either that:

- ***no further scrutiny of the conduct of the monitored airports is necessary; or***
- ***that one or more airports will be asked to 'show cause' why their conduct should not be subject to more detailed scrutiny through a Part VIIA price inquiry, or other appropriate investigative mechanism.***

RECOMMENDATION 4.2

Under the new price monitoring regime, the value of an airport's asset base for monitoring purposes should be:

- ***the value of tangible (non-current) aeronautical assets reported to the Australian Competition and Consumer Commission as at 30 June 2005,***

adjusted as necessary to reflect the proposed service coverage of the new regime (see recommendation 5.2);

- *plus new investment;*
- *less depreciation and disposals.*

RECOMMENDATION 4.3

In giving effect to this basis for valuation, the Australian Competition and Consumer Commission should consult with airports and airlines on how best to accommodate differences in statutory and regulatory reporting requirements within the new price monitoring regime.

RECOMMENDATION 4.4

Assessments of airport behaviour during the next period of price monitoring should be governed by an overarching set of principles. All of the current 'Review Principles' should be retained. In addition, there should be three new principles specifying that:

- *further asset revaluations should not generally provide a basis for higher charges for monitored aeronautical services;*
- *the parties should negotiate in 'good faith' to achieve outcomes consistent with the principles, including through the negotiation of processes for resolving disputes in a commercial manner; and*
- *there should be a reasonable sharing of risks and returns between airports and their customers (including those relating to productivity improvements and changes in passenger traffic).*

RECOMMENDATION 4.5

Neither an airport-specific arbitration regime, nor mandatory information disclosure requirements for airports, should be introduced at this time.

RECOMMENDATION 5.1

The new price monitoring regime should apply to Adelaide, Brisbane, Melbourne, Perth and Sydney Airports. Darwin and Canberra Airports should not be subject to monitoring once the current arrangements end.

RECOMMENDATION 5. 2

Price monitoring should apply to all of those services for which airports have significant market power. Consistent with this, the service coverage of the new monitoring regime should be that specified in the current proposal from the Department of Transport and Regional Services to align the relevant parts of the

Airports Act and the directions pursuant to the Trade Practices Act giving effect to airport price monitoring, subject to the exclusion of:

- ***office space used by airline staff; and***
- ***telecommunications infrastructure.***

Also, the definition of terminal space and related facilities in the Departmental proposal should be clarified to explicitly exclude dedicated terminal space, under long-term lease to airlines.

RECOMMENDATION 5.3

In examining opportunities to improve and streamline quality monitoring, the Australian Competition and Consumer Commission should give particular attention to:

- ***whether it remains necessary to report survey responses from the Australian Customs Service;***
- ***how best to eliminate overlap between the airline and passenger satisfaction surveys, and between these surveys and other quantitative indicators; and***
- ***whether greater emphasis should be placed on comparative passenger satisfaction results contained in authoritative international benchmarking exercises.***

RECOMMENDATION 5.4

Under the new price monitoring regime, price and service quality outcomes should be presented in a single report, published annually.

RECOMMENDATION 5.5

Unless 'supplanted' at an earlier date by Part IIIA (see recommendation 3.2), the new price monitoring regime should operate for six years ending on 30 June 2013. The new regime should be reviewed in 2012, with that review having regard to the outcomes of the scheduled 2011 review of the national access regime.