Productivity Commission Inquiry into

Price Regulation of Airport Services

Response to Draft Report – Supplementary Submission

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Contents

Introduction

As the Commission will recall when Melbourne Airport participated in the public hearings in Melbourne the decision of the Federal Court (the Court) in relation to Virgin Blue's application to have certain services at Sydney Airport for the purposes of Part IIIA of the *Trade Practices Act 1974* (the TP Act) had only just become available.

Melbourne Airport has now had the opportunity to take advice on this decision and reflect upon its implications for this inquiry. In addition, there has been an opportunity to review the written and oral material that has been presented since the release of the Draft Report.

Melbourne Airport supports the continuation of the monitoring regime broadly in line with the recommendations of the Commission in the Draft Report. In particular, it is opposed to the imposition of a compulsory negotiate-arbitrate framework. To avoid gaming conduct, airlines should be required to demonstrate that a specific airport has not, or is likely not to, comply with the Principles before gaining access to arbitration.

Despite their rhetoric, airlines have failed to make out this case in relation to airports as a whole. As such any mechanisms to deal with unacceptable airport conduct should be limited in their application to the offending airport(s). However, it is clear that the means for dealing with such conduct (to date) lack credibility with airlines and are far too time consuming.

Melbourne Airport has always been of the view that for the monitoring regime to be credible and robust there should be a formal relationship between the Principles and dispute resolution – compliance with the Principles should be a threshold issue. The uncertainty surrounding the relevance of conduct (and by implication the Principles) has been exacerbated by the Court's recent decision.

The current airports policy has served the nation well. The evidence presented to the Commission in this inquiry does not demonstrate an industry in difficulty, and certainly not as a result of this policy. There is a case for reform of the policy details – there is no case for its abandonment as advocated by the domestic airlines other than unsubstantiated generalised appeals to the evils of monopolies.

The policy needs to provide certainty to both sides – the Court decision has reduced that certainty. Certainty can be delivered through a combination of more vigorous enforcement of the Principles by the Commonwealth and legislative amendment to ensure that compliance with the Principles is properly considered in decisions for declaration under Part IIIA.

1 Implications of the Federal Court Decision re SACL?

Melbourne Airport has now had the opportunity to take advice on the Court's decision and reflect on what it might mean for its business and the airports industry more generally. The implications of the decision are not as black and white as has been presented in some submissions to the Commission. Upon reflection it remains Melbourne Airport's view that taken as a whole the decision increases uncertainty generally about the application of Part IIIA and particularly about how the conduct of the service provider is to be considered by decision makers in determining whether a service should be declared.

The Commission itself has asked that if airports will just be declared anyway, what is the point of the monitoring regime? Whilst it is probably now less certain that an airport that complied with the Principles would not be declared this is by no means definitive. As such removal of the monitoring regime on the basis of this decision would be premature although as discussed below, if the law is not consistent with policy the Commission should advise the Government as to how to bring the law into alignment.

The decision does raise a number of issues which are discussed in turn below.

1.1 Interpretation of criterion (a)

Until recently amended, at various places the TP Act requires that a service should not be declared unless "access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service" – this is known as criterion (a).

The Court has preferred a much simpler construction of criterion (a) than that preferred by the Tribunal. Indeed, Melbourne Airport would suggest that this is a much simpler test than that which was in the mind of the Commission and most participants in its review of the National Access Regime, an issue we return to later.

Fundamentally, the Court see access to a service as simply as having the ability to use that service. The question to be asked is whether access (or increased access) to the service would promote competition in another market. Essentially, the Court's reasoning boils down to whether competition in the relevant markets for airline service is promoted by access to Sydney Airport. Clearly, no access to airports no airline markets so therefore the test is met.

It seems now that to satisfy criterion (a) it will be sufficient to show that the service is a necessary input to some downstream market and that it is provided by a facility that is uneconomic to duplicate (that is, one that satisfies criterion (b)).

This is of course very different to the test applied by the Tribunal in this matter which sought to compare:

- *The opportunities and environment for competition in the dependant market if the Airside service is declared; with*
- *The opportunities and environment for competition in the dependant market if the Airside service is not declared"*[1]

Melbourne Airport would suggest this approach was considered by many to properly reflect the policy intentions of Part IIIA.

The most important aspect of this change of approach for this inquiry is that whereas the Tribunal's approach clearly entertained the notion that the service providers conduct was relevant to the consideration of criterion (a), the Court's view is that conduct is not relevant to this criterion. In other words, in relation to this criterion, airports appear now unable to rely on compliance with the Principles as an argument as to why they should not be declared.

1.2 Potential relevance to criterion (f)

Criterion (f) also embraces the notion of access or increased access by requiring "access (or increased access) to the service would not be contrary to the public interest". The National Competition Council's (the Council) Guide to Part IIIA[2] sets out a number of matters which might be considered to relate to the public interest prior to:

- Net impact of declaration on economic efficiency (regulatory cost of declaration, administrative costs of compliance, costs of regulatory failure)
- Ecologically sustainable development
- Social welfare and equity considerations (including community service obligations)

1 *Virgin Blue Airlines Limited* [2005] ACompT 5 at [157]

2 National Competition Council (2002), *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*, pp 20-21.

- Government policy and policies relating to matters such as occupational health and safety, industrial relations and access and equity.
- Economic and regional development
- Interests of consumers
- Competitiveness of Australian businesses
- Efficient allocation of resources

Two of these points may be affected by the decision, namely the first and the last. It would appear in relation to the first, the Council had in mind economic costs that are typically associated with regulation which would be potentially encountered if declaration occurred. However, if access is given the meaning now ascribed by Court these potential costs are no longer relevant to the decision on whether to declare. Similarly, whilst access is likely to impact on resource allocation within the economy the meaning used by the Court is much less likely to impact on pricing outcomes than declaration.

It seems therefore that where before a well behaving service provider could argue that declaration could lead to the risk of regulatory failure that would be contrary to the public interest, under the Court's view of access such arguments would not be relevant to consideration of criterion (f).

1.3 The rise of administrative discretion

Under the approach previously adopted by the Tribunal (and as generally understood during the Commission's review of the National Access Regime), the factors set out in criteria (a)-(f) were arguably the main factors relevant to the Minister's decision as to whether or not to declare the relevant services. If the Minister is not satisfied of any one of the criteria, the Minister could not declare the relevant service. However, if the Minister was satisfied of each of these matters, then the Minister would be very likely to declare the relevant services because the residual discretion was thought to be extremely limited. The Tribunal expressly agreed with this position, stating:

> *We accept that we have a residual discretion to decline to make a declaration, but it is extremely limited. In* Sydney International Airport *the Tribunal said at [223], 40,796:*

> *"The Tribunal is prepared to accept that the statutory scheme is such that it does have a residual discretion. However, when one has regard to the nature and content of the specific matters in respect of which the Tribunal must be satisfied pursuant to s 44H(4) of the Act, that discretion is extremely limited. The matters therein specified cover such a range of considerations that the Tribunal considers there is little room left for an exercise of discretion if it be satisfied of all the matters set out in s 44H(4)."*[3]

The effect of the Court's approach, in relation to the Minister's decision as to whether to declare the relevant service, is arguably to:

- significantly increase the likelihood that the Minister will be satisfied of criterion (a);
- reduce the importance criterion (a)-(f) to this overall decision generally; and
- expand the scope of the Minister's residual discretion to take into account factors other than those listed in criterion (a)–(f).

This is not to say that conduct may not be relevant to future declarations but rather it appears now that it is relevant to the exercise of residual discretion. The Court has noted

> *That is not to say that what has happened in relation to the service, how the provider has behaved and the degree to which it can be said that monopolistic behaviour has or has not impeded the efficient operation of the market in question may not be relevant considerations attending the making of the decision. For instance, if it can be demonstrated that the service has been provided in a manner that can be described as fair, even-handed and in a way most likely to maximise vigorous competition in the downstream market, that may be a powerful and relevant consideration as to why no declaration should be made. Thus, it may be that a with and without declaration counterfactual (or some aspect of it) can be seen as relevant to the decision at hand. That enquiry is simply not mandated by the pre-condition of satisfaction in s 44H(4)(a)* [4]

3 [2005] ACompT 5 at [611]

4 *Sydney Airport Corporation Ltd v Australian Competition Tribunal* [2006] FCAFC 146 at [85]

The considerations to which the Minister (or indeed the Tribunal on review) may have regard under the head of residual discretion in deciding whether to declare a particular service are very broad and undefined, and therefore will be subject to considerable debate. It is this absence of any definition of the bounds of residual discretion which significantly increases the uncertainty surrounding the operation of the relevant provisions of Part IIIA and thus the uncertain outcome of an application for declaration of services following the decision of the Court.

1.4 Trade Practices (National Access Regime) Amendment Act 2006

As a result of the Commission's review of the National Access Regime the TP Act was amended by the *Trade Practices (National Access Regime) Amendment Act 2006* (the Amendment Act). Understandably, the Court did not have any regard to the effect of the Amendment Act as it had not been proclaimed at the time the Tribunal considered Virgin Blue's application.

The Amendment Act amended criterion (a) so it would be satisfied only if access (or increased access) would promote a material increase in competition. The word 'material' should be interpreted to mean 'not trivial'. This is evident from the Explanatory Memorandum to the Amendment Act which refers to the Commission's review of the national access regime and states that:

> *'In responding to the Productivity Commission's report, the Government indicated that while the current declaration criteria (such as 'the national significance' test) preclude declaration where the relevant infrastructure and subsequent public benefits are not significant, this does not sufficiently address the situation where, irrespective of the significance of the infrastructure, declaration would only result in marginal increases in competition. The change will ensure access declarations are only sought where increases in competition are not trivial.*[5]'

Arguably, this amendment offsets the effect of the Court's interpretation, but only to a minor extent, because:

- The effect of the Court's decision is to significantly lower the bar to criterion (a) being satisfied; but

[5] Explanatory Memorandum to Trade Practices Amendment (National Access Regime) Bill 2005, Item 23, page 25

- The effect of this amendment is to slightly raise the bar to criterion (a) being satisfied since the increase in competition must be more than trivial.

In any event it appears this amendment is relatively insignificant in the context of the Court's preferred interpretation. If the comparison is between no access to an essential upstream service and some access to that service then access is almost always likely to result in a significant increase in competition. As such it is largely irrelevant whether the test refers to the promotion of competition in the dependent market or a non trivial increase in competition in the dependent market.

It is important though to note the Amendment Act also introduced a specific objects clause for Part IIIA which decision makers must have regard. Obviously, however, how these new provisions will be interpreted is yet to be seen.

It is also interesting to note that in arriving at its view in this matter that the Court made some effort to review the Hilmer Report that gave rise to the insertion of Part IIIA into the TP Act in 1995. It is arguable that in any future consideration, especially in relation to the changes arising from the Amendment Act, that the Court may have regard to the Commission's review of the National Access Regime, the Government's formal responses to that review and the material surrounding the Amendment Act. A review of these materials may place a slightly different hue on the interpretation of Part IIIA than that one would reach from reviewing the Hilmer Report on its own.

1.5 Relevance of the Court's decision to this inquiry

What is clear from the Court's decision is that whilst conduct related issues are not relevant to consideration of criterion (a) they may be relevant to the exercise of the residual discretion of decision makers. Further, it seems unlikely that the recent amendments to Part IIIA are likely to significantly alter the position arrived at by the Court, at least in relation to criterion (a).

However, it does appear that the Court's decision increases the uncertainty associated with an application for declaration because it expands the role of the Minister's residual discretion without defining the basis upon which the Minister is to exercise this discretion. In the absence of positive legislative action, it likely that it will be a number of years until this matter could be resolved by the Court. Whilst some clarity on this point may be forth coming from the High Court when it hears Sydney Airport's appeal against the judgement of the Court, this is by no means certain.

Further, it does appear that the interpretation of the Court has effectively neutered the attempt of the Government, on the advice of the Commission, to raise the bar in relation

to criterion (a), if not declaration in general. Melbourne Airport does not believe that it was the intention of the Government in responding to the Commission's review of the National Access Regime to increase the scope and importance of discretion for decision makers – in fact its intention was the exact opposite.

Indeed, Melbourne Airport does not agree that the view formed by the Court in relation to the original policy intent expressed in the Hilmer Report. Melbourne Airport would hope that the relevant Commonwealth agencies will actively participate in Sydney Airport's forthcoming appeal to ensure that the Commonwealth's policy intentions with regard to the National Access Regime are properly understood by the High Court.

This is not a positive development from a policy perspective. One of the main thrusts of regulatory and infrastructure policy for many years now has been to narrow the discretion of decision makers to give greater certainty to both service providers and users. Even the Commission's recommendations to revise the Principles are directed to this end. This decision does exactly the opposite. Further, whatever uncertainty existed in the past about the relevance of the Government's airports policy to declaration under Part IIIA, it is now greater.

The response of investors to this will only be seen in the fullness of time. What is certain though is that as the owners of Australia's major airports consider major multi billion investment programs in the near future they will be much more comfortable with a positive policy response that supports the Government's airports policy than simply leaving the uncertainty created by this decision to be ultimately resolved by the courts.

2 Policy Framework

Melbourne Airport remains, as it always has been, a strong supporter of the underlying principle of the Government's policy namely commercial outcomes are likely to deliver better outcomes than regulatory outcomes. A corner stone to this approach has been compliance with a set of Principles set down by the Government in 2002. It has always been understood that the kernel of the Government's policy was that if an airport complies with these Principles then other than complying with the reporting requirements of the monitoring regime it should be subject to no further regulatory intervention. Further, it has been understood that Part IIIA remained in the background as a "back stop" or "fall back" position. This policy understanding is reflected in the recommendation of the Council (and its acceptance by the Minister) not to declare Sydney Airport.

The late Professor Snape described the monitoring regime as one where "the constable was in the cupboard". Melbourne Airport believes this was taken by both airports and airlines (and indeed the Commonwealth) to mean that consequences would flow for airports that did not behave in accordance with the Government's Principles. Whilst it is accepted that Commonwealth officers may have from time to time "had a word" with certain airports, the best that can be said is that to date the constable has only ever walked the beat in plain clothes.

Subject to one important issue of detail – starting asset values (and a raft of minor ones largely related to coverage definitions) – there seems to be a general consensus about the Principles as now proposed by the Commission. However, it is clear that as the situation stands today, airlines generally feel that the regime does not deal effectively with airports who do not comply with the Principles. Despite the excessive and inconsistent rhetoric that has issued forth from domestic carriers during the course of this inquiry, it is clear that there are legitimate grounds for concern arising from the conduct of some airports. As was noted in Melbourne Airport's comments at the Commission's hearings, failure to deal with such conduct is also a significant source of frustration and concern for those airports that comply with the Principles and have generally constructive and mature relationships with their airline customers.

The solution proposed by airlines generally is to move to a compulsory arbitrate-negotiate model. Qantas seems to favour commercial arbitration whilst Virgin Blue would prefer to see the ACCC undertake this role. It is not clear from either position what role, if any, the Principles would play in such arbitrations or what the coverage of these regimes might be. It does seem likely that either proposal would require legislative change.

Some participants in the inquiry, notably Qantas, have suggested that Melbourne Airport supports a compulsory negotiate-arbitrate model. This is not the case. Melbourne Airport's position is essentially that of the Commonwealth – that airports should not be subject to regulatory intervention (and that includes compulsory arbitration) while ever they comply with the Principles. Melbourne Airport does however believe that for the regime to be successful that airlines must be confident that where they have legitimate grievances that they will be addressed. This, however, does not necessarily involve compulsory arbitration.

That Melbourne Airport agrees there is a significant issue in relation to dispute resolution in this industry does not mean it supports a negotiate-arbitrate model and to suggest that it does is misleading.

The Commission has clearly been concerned, as it was during its review of the National Access Regime, that in general there is a significant risk of negotiate-arbitrate arrangements becoming *de facto* arbitration regimes because of a lack of proper incentives for access seekers to negotiate in good faith. The declaration process of Part IIIA does, and is designed to provide an incentive for access seekers to reach agreement with access providers by virtue of its cost and timeframes – it is not an easy route because it is meant to be. The Parliament wanted to set the bar high and has recently sort to move it higher. The proposals of both Qantas and Virgin Blue remove this incentive – they place the bar on the ground. Necessarily these proposal increase the risk of the conduct the Commission is concerned with. Clearly the challenge is to provide check on unacceptable airport conduct without removing the incentive for airline to enter into *bona fide* negotiations.

This is why Melbourne Airport suggested in its first submission to the Commission that to gain access to arbitration an aggrieved airline should first have to demonstrate that an airport had, or was likely to, pursue conduct that contravened the Principles. It was also suggested that there were options available to construct a policy driven framework using the existing provisions of Part VIIA of the TP Act that could in the short term give some confidence to airlines with perhaps some follow up legislation in due course. Melbourne Airport would note that this is the only proposal to be brought forward in this inquiry that could be implemented (at least in large part) without legislative change or recourse to extensive litigation.

As discussed in the previous section the decision of the Court has provided far greater clarity around the interpretation of criterion (a). The uncertainty surrounding the relationship between the monitoring regime and Part IIIA has not been resolved – if anything it has been made even less certain. What has changed however is that it appears now more likely that airlines will pursue applications for declaration at least

until the scope of decision makers discretion is clarified by the Court and that process, realistically, will take a couple of years unless clarified by the High Court in Sydney Airport's appeal. This will necessarily give investors cause to pause, particularly those such as the owners of Melbourne Airport who face significant capital programs in the next three to five years but need to commit to pricing and investment programmes in the next six months.

The Draft Report correctly concludes that there is no evidence of systematic abuse of market power in relation to setting prices and nothing that has been presented since should deter the Commission from that view.

The Draft report was a little more sanguine about non-price terms and conduct generally. At best, from the airport perspective, the evidence on this point is mixed. However, Melbourne Airport is very concerned about the very broad brush approach that domestic carriers have taken in describing the conduct of airports. To suggest, as Mr Moore of Qantas did, that "in all of the current and proposed agreements airports have the right to unilaterally impose charges"[6] is simply not true. Both written and oral submissions to this inquiry are littered with this sort of over-generalised falsehood and in a number of cases are contradicted by other comments in the same submission..

The Commission, at least in the Draft Report, has concluded that subject to some clarification of the Principles and the coverage definitions that the current policy should be persisted with. Indeed, this was essentially the view expressed by the then Minister in November 2005[7]. Nothing put to the Commission since the Draft Report, in Melbourne Airport's view, is likely to lead the Commission to form a different view. What has changed is the understanding the Commission has about the application of Part IIIA of the TP Act. It is fair to say that that view was not significantly different from Melbourne Airport's or that of the Tribunal, the Council or indeed the Government when it amended Part IIIA earlier this year.

The Commission cannot ignore the recent judgement of the Federal Court. Indeed its terms of reference specifically require it to consider it. However, Melbourne Airport respectfully suggests that the first task of the Commission is to recommend to the Government the best policy option available to it and on the basis of the Draft Report that appears to be the continuation of price monitoring. Such a recommendation would be entirely consistent with the most recent COAG agreement on infrastructure regulation.

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6 Transcript of Inquiry Hearings, p105.

7 Truss, Warren(2005) Media Release – *Review Confirms Privatised Airports Regime is Working,* Canberra, 14 November.

Melbourne Airport understands the general reluctance on the part of policy makers to create industry specific access regimes and to potentially bring forward further amendments to Part IIIA when the most recent reforms have only just been proclaimed. It also appreciates any legislative changes at the current point in the political cycle will be difficult – realistically, anything but a minor amendment to the TP Act will not be enacted in the life of this Parliament.

However, if the Commission is of the view that the recent Court decision creates uncertainty around the current policy (however modified) then it should advise the Government accordingly and in some detail including what changes to the law would be required to give effect to that policy. We would also encourage to Commission to give some thought to the broader issues that the Court decision raises and its potential to impact on the implementation of the most recent agreements of COAG regarding infrastructure regulation.

In its initial submission Melbourne Airport suggested that access to arbitration should only be available if the Principle's were not complied with. It is acknowledged that that approach required increased involvement from DOTARS and the creation of an industry specific regime.

In response to the Draft Report, on the basis of the law of Part IIIA as understood at the time, it was suggested:

> *a general amendment to Part IIIA that required all relevant Part IIIA decision makers (the NCC, the relevant Minister, the Tribunal and the ACCC) to have proper regard to any formally stated policies (such as the Principles), especially in relation to the assessment of the public interest, when considering firms that are subject to monitoring under Part VIIA*[8]

Given the current interpretation of access (or increased access) the words "especially in relation to the assessment of the public interest" would be removed. What remains is the minimum that must be done to provide some certainty for investors. It is Melbourne Airport's view that such an amendment could be enacted quickly. Further, such an amendment is consistent and indeed gives affect to the Commonwealth's commitments under the most recent COAG agreement on infrastructure regulation.

Further, if the Principles are to be given some greater legal standing, a reference should be included in them for airlines to negotiate in good faith and to seek outcomes

8 Melbourne Airport (2006), *Review of Price regulation of Airport Services – Response to Draft Report*, p19

consistent with the Principles. Indeed, these should be included in any event in order to reduce gaming conduct.

Further, and especially until such time as such legislative amendments were made or the law is clarified by the High Court, the Commission should recommend that the Government adopt a more vigorous approach to ensuring compliance with the Principles by making it abundantly clear that it will not hesitate if it becomes aware of conduct (or likely conduct) that contravenes (or is likely to contravene) the Principles to order a pricing inquiry by the ACCC under Part VIIA and if appropriate after such an inquiry impose formal price notification on the airport concerned.