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Productivity Commission – Price Regulation of Airport Services

Hastings Funds Management (Hastings) is making this submission as a specialist infrastructure fund manager with extensive experience in the airport sector. Hastings manages over $500 million in airport assets including a 10 per cent equity interest in Melbourne Airport, an 85 per cent equity interest in Perth Airport, a 60.9 per cent equity interest in NT Airports through its own funds and a 24.4 per cent equity interest in Coolangatta Airport through a fund managed by Hastings.

Hastings is an active manager of 25 infrastructure assets amounting to over $2 billion across 9 infrastructure sectors. Its executives are actively involved as directors on the majority of these companies and numerous investment sub-committees. In this capacity, Hastings has influence of what capital is invested across sectors and companies and will apply capital to those companies and projects which will maximise returns for its shareholders having regard to a variety of risks, of which regulatory risk has become a significant concern recently.

Funds managed by Hastings have made a substantial investment and contribution to the Australian airports sector. Investments were made on the basis of certain Commonwealth undertakings. Fundamental to this was the regime of CPI-X regulation to aeronautical charges in the first five years post-acquisition and the indication that this regime would fall away allowing airports and airlines to negotiate commercial outcomes. At the time of investment, it was also assumed that car-park business would not be regulated. The institutional, wholesale and retail investors in the Hastings funds also regard this certainty and consistency as critical to their ongoing support and investment in the airport sector.

In summary, our submission focuses on regulatory risk and demonstrates that the ACCC has regulated airports in an inconsistent manner, in a process which has lacked transparency and increased perverse outcomes where airlines are unwilling to negotiate with airports because they know that if they collectively disagree to a particular proposal, then it is likely that the proposal will be rejected or reduced by the ACCC. In light of this

evidence, we argue that prices oversight arrangements will promote better outcomes as the airports' potential to abuse market power can be counterbalanced by airlines.

Introduction

In January 2001, the Productivity Commission released an Issues Paper setting the outline for an inquiry on whether there is a need for prices regulation of airports, and the appropriate form of any prices regulation. Our submission relates to some fundamental problems rising from prices regulation of airports.

To the extent possible, we have kept our comments to questions raised in the Issues Paper.

1. Why regulate prices of services provided by airports?

As the Productivity Commission is aware, the three principle statutes governing the economic regulation of airports are: the *Airports Act 1996*, *The Prices Surveillance Act 1983* (PS Act) and the *Trade Practices Act 1974* (TP Act). The current regulation reflects the ACCC view that airports possess significant market power in certain aeronautical and aeronautical related activities and the mere evidence of market power justifies regulation. Evidence of the ACCC approach can be found in the most recent decision on Sydney Airport pricing, in which the ACCC has regulated aeronautical related revenues (eg. Aircraft refuelling, freight equipment storage sites, car-parking etc.) which it was only required to monitor under the PS Act.

1.1 Do airports have market power?

There is no doubt that airports have some market power. The sources of their market power arises from the strong airline preference for concentration of services on a limited number of airports to capture the benefits, including to passengers, that can arise from economies of scale and increased service frequencies. Economies of scale increase as traffic grows within a single airport, until the point when additional capacity needs to be brought on stream.

However, economies of scale or the mere fact that airports have market power does not mean that they abuse this power. Increasingly, competition among airports to attract new long haul services means that they have to be price takers in the market for landing charges. For example, Melbourne Airport does not see its market just as

passengers arriving into Melbourne or Victoria, but for international and long-haul transfer passengers travelling to Tasmania, South Australia, the ACT and New South Wales. In 1998 almost 500,000 people whose principal origin or destination was in Victoria entered or left Australia through other airports. 80 per cent of these were through Sydney. This is clear evidence of a market segment in which there are substitutes in terms of routes. Travellers going to and from Tasmania and Canberra can easily substitute Sydney and Melbourne as their point of departure or entry. Likewise, developing route networks through Melbourne provides South Australian travellers with options beyond those provided by services direct from Adelaide.

Aggressive pricing action by airports may tip the balance in airline decisions whether to add an additional service at one airport or use an alternate airport. Successful airports have demonstrated that they can compete for passengers choice of routes and carriers by exercising their control over key factors such as minimum connect times, transfer systems, baggage systems and passenger services. This competition is also exercised through reliability of services (eg. clear runways and taxiways, efficient security, professional ground handling) and, in other ways, for example, efficient and high quality terminal transfer facilities.

The development of all of these features depends overwhelmingly on good long range planning. Such planning is a core competence in airport management. Airport managers must take significant risks when adding new capacity as investments to expand airport capacity are periodic and large, of necessity increasing effective capacity by more than is needed in the short term. If the planning decision depends upon a regulator, there is a material risk that the investments will be poorly timed, poorly judged and detrimental to the strategic development of an airport's long term vision (see Section 2.4).

1.2 Do users of airport services have sufficient countervailing power?

For clarity, we have divided this section into air-side users and land-side users.

1.2.1 Air-side users:

Approximately 80 per cent of Melbourne Airport's aeronautical revenue comes from four airlines. These same four airlines account for 45 per cent of the airport's total revenue. At Launceston airport, Qantas and Ansett account for 98 per cent of

aeronautical revenue. By contrast, airport charges amount to about 4 per cent of airline costs[1]. Domestic landing charges account for less than 1 per cent of a full economy return fare between Sydney and Melbourne, a route that accounts for 43 per cent of Melbourne Airport's domestic market and 20 per cent of Australia's domestic market. This is not to say that airports do not possess market power but rather, it is a demonstration of the countervailing market power possessed by airlines.

The break-up of the FAC significantly reduced the bargaining power of Australia's airports as a group whilst at the same time enabling individual airports to compete with each other in ways described above. At the same time, airline ownership and operations have become more concentrated. In recent times, significant cross ownership arrangements have developed between major carriers. Coupled with these have been the development of joint services agreements (Qantas and British Airways and Singapore Airways, Ansett and Air New Zealand) which have required authorisation under s90 of the TP Act because of their potential anti-competitive impacts. The development of the Star and Oneworld alliances further concentrates airline activity. The countervailing power of airlines would remain strong as long as cross-ownership rules remain in place for Phase 1 Australian airports.

In addition to these arrangements, when considering the question of airline countervailing power, one should consider the bargaining conduct of airlines. The International Air Transport Association (IATA) has long been authorised under the TP Act to act on behalf of its members who are competitors. In practical negotiations, Ansett, Qantas and the Board of Airline Representatives of Australia (BARA), representing international carriers (including Qantas and Ansett), are encountered together. The starkest example of this are the actions currently in the Federal Court being brought against Sydney Airport by the airlines. There are two identical actions being brought by 20 and 2 airlines respectively.

The overseas experience is similar. Our analysis indicates that competition to attain and maintain hub status is fierce. London Heathrow, Frankfurt, Paris and Amsterdam Schiphol all have their own plans to strengthen their hub status and cater for growth. As an example, up to three daily flights (two of them operated by 747 aircraft) now operate between Detroit and Amsterdam with 70 per cent of the

[1] IATA, *International Airport Review, 1998*.

traffic connecting at both hubs. Transfer passengers represent approximately 45 per cent of passenger throughput at hubs such as Frankfurt and Copenhagen. When Air Rianta made presentations for the development of new routes to Continental Airlines in 1997, the airline indicated that Ireland was in competition with ten other gateways for one of four available aircraft in 1998.

1.2.2 Land-side users:

The other aspect of an airport's monopoly are land-side services. In areas such as office space, terminal lounges, freight facilities and car parks, airport owners would seem to possess market power of a similar degree to that possessed by a hypermarket or a 'shopping town'. To date Melbourne Airport has concluded a number of successful negotiations in relation to international lounges and freight facilities with no charges of abuse of market power. Office rents have not been increased since privatisation despite a capacity to do so.

Overseas experience is similar. The deregulation of ground handling services at European airports, for example, is having a particularly significant effect. Since 1994, the EU has decreed that ground handling services with direct contact with the passenger (eg. Passenger handling, aircraft cleaning, freight handling and catering) should be fully liberalised with no limit on the number of suppliers. German airport authorities have been particularly hard hit by this move as, in some cases, ground handling accounted for up to 50 per cent of their revenues.

Where airport operators provide services within markets which are open to competition, such as ground-handling, car-parking or retailing, it would make no sense to regulate them in a manner appropriate to monopolies. Commonwealth policy is supportive of this view and Declaration No. 89 under Section 22 of the PS Act, in relation to price monitoring of aeronautical-related services clearly restricts the regulator from regulating car-parking. It is unfortunate therefore that in its draft decision on Sydney Airport, the ACCC has reduced Sydney Airport's aeronautical revenue by an amount equivalent to the difference between actual and 'normal' revenue from aeronautical related services (largely from SACL car-parks). In other words, the ACCC has implied that aeronautical related services are earning 'above-normal' revenues, which it has subtracted from the airport's aeronautical revenue. In doing so, the ACCC has effectively regulated those services which were subjected by Declaration No. 89 to price monitoring under Section 22 of the PS Act.

1.3 Are airports different from other industries?

The ACCC has taken the principle where the minimisation of costs to airlines is their sole objective. This principle is based on the regulation of utilities where large monopolies have hundreds of thousands of small customers with little or no bargaining power. However, airports cannot be compared to gas pipelines or electricity distribution companies. Airports have relatively few major customers – airlines – and these airlines are large companies, well-informed and well-staffed to press their position. In our experience, airlines have substantial countervailing market power, often greater than that of any airport, making mandatory regulation unnecessary.

We believe that airports should only be regulated when there is prima facie evidence of abuse of monopoly position in the provision of aeronautical services. To regulate merely because a notion of market power exists appears contrary to the thrust of the TP Act, which provides the threat of declaration a strong enough incentive for airports to curb their charges.

It is important not to jump from the proposition that the operator of, say, Melbourne Airport, has significant air-side market power, to the proposition that the operator can be expected to abuse that market power, because the market power of the airport is balanced by the concentration and collusive behaviour by the airlines.

2. What are the effects of current prices regulation?

The ACCC administers the current pricing arrangements on behalf of the Commonwealth. In our experience as a significant investor in various airports, its regulatory process has proven to be cumbersome.

2.1 What has been the experience of regulation for the different airports?

The current approach of public submissions and decisions is lengthy, time intensive and ultimately futile, because despite the concerns raised by airports and investors alike, the ACCC can impose its own preconceived decision.

The most recent example of regulatory discretion is the case of the ACCC draft decision for Sydney Airport pricing, where it included aeronautical services into the revenue requirement for aeronautical charges and regulated by proxy the services it was required to monitor. Our conclusion is that in doing so, the ACCC has exceeded its powers under Section 22 of the PS Act.

Clearly, if the Commission were of the mind that some or all of these services were earning 'above-normal' returns, it should have informed the Commonwealth and all interested parties of its intention to bring them under a regulatory arrangement. Without sufficient public debate and a clear change of policy direction from the Commonwealth, we cannot see how the Commission can begin to regulate aeronautical related services without exceeding its powers under the PS Act.

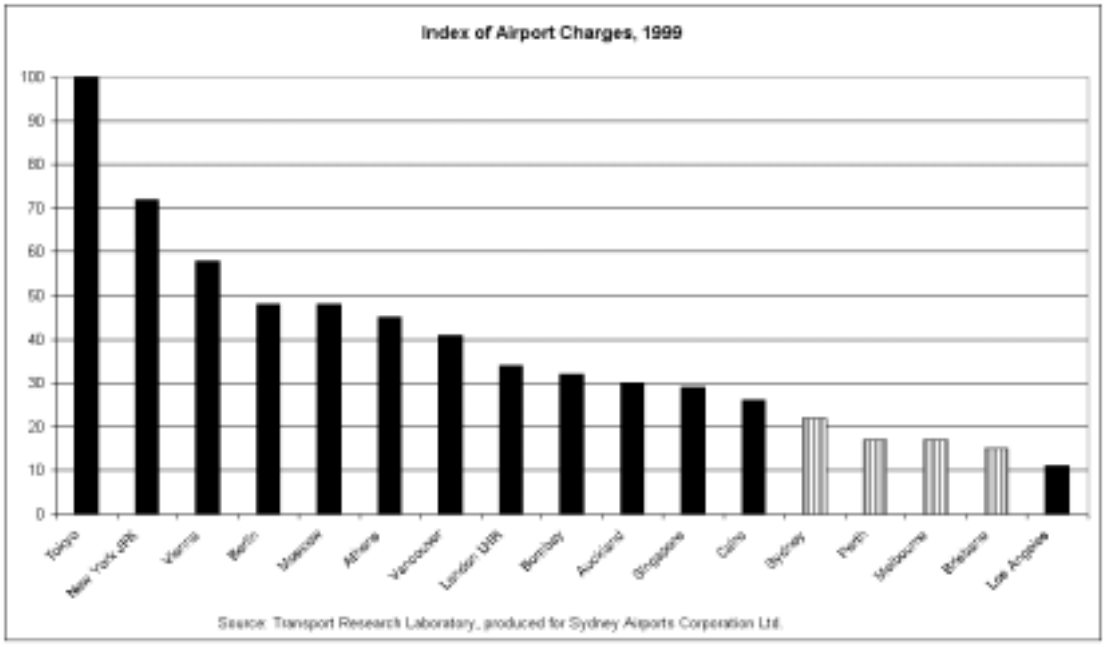
2.2 *Does the current regulatory and price regime encourage efficient pricing of available capacity?*

The current CPI-X regime is designed to keep aeronautical charges low. This type of regulation can lead to a situation where the pressure to reduce charges at busy, congested airports can result in lower prices for the most congested facilities, in turn increasing demand. This would either worsen congestion or increase the value of incumbent carriers' slots, which would have the effect of passing the economic rent from the scarcity of demand from airport to airlines.

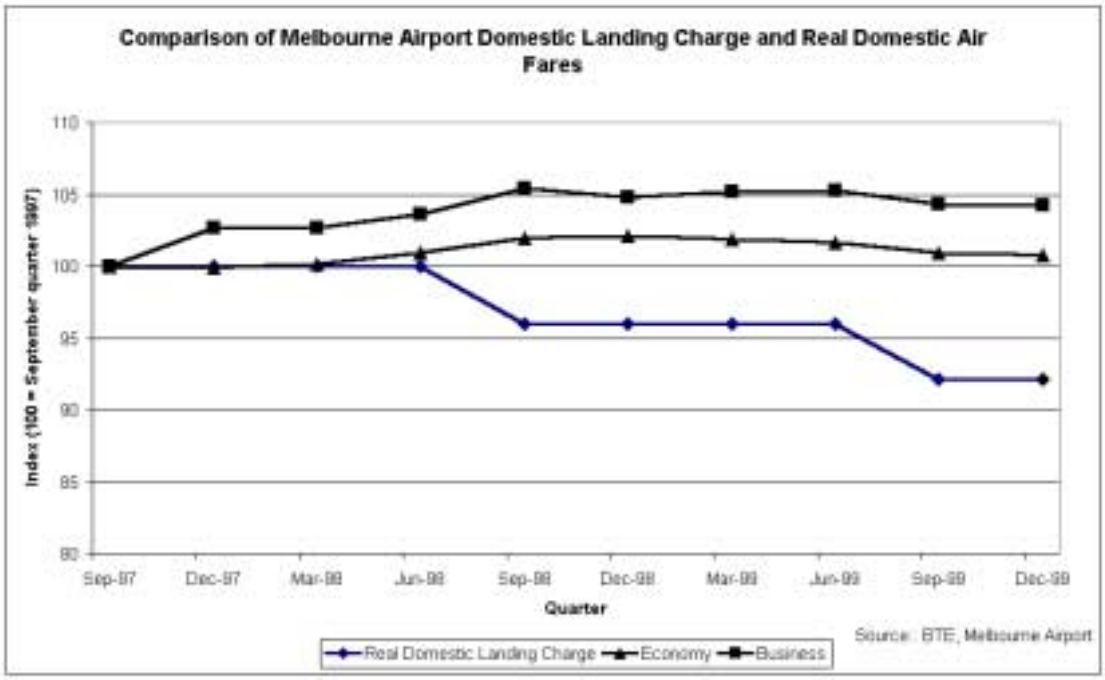
This situation already exists at Sydney Airport where slots during four peak hours every weekday are already rationed and most of the other available slots for peak periods will be exhausted by approximately 2002-03. Therefore, low, regulated aeronautical fees would only worsen the situation. Further, under the current regime or any other regulatory regime in which charges are set by administrative fiat, there will be no price signals to determine when the expansion course becomes preferable to adding additional users into existing capacity. Therefore, investment decisions, and their timing, are unlikely to be efficient as users will not be confronted with true costs. The same will be true of the other airports in Australia when they become congested.

2.3 *What has been the effect of current arrangements on airline prices to final consumers?*

It is clear from the following chart that airlines using major Australian airports enjoy some of the lowest charges in the world.



To date there is no evidence to suggest that the public have benefited from reductions in airport charges. Indeed whilst Melbourne Airport domestic landing charges have fallen by 4 per cent real per annum, indicator indices of domestic airfares have risen as evidenced in the following chart (the chart pre-dates the introduction of Impulse Airlines and Virgin into the domestic market).



It appears that the market power of large airports is frequently captured by airlines through their control of slots. Regulatory pressure to reduce aeronautical charges simply allows airlines to "capture the economic rent" and due to the scarcity of slots, lower airport charges are not passed to the consumer.

2.4 How have investment provisions operated in practice?

There is a strong impression among airport operators that the overriding objective of the ACCC is to lower prices (and thereby profits) to infrastructure owners. Evidence of this can be seen in the ACCC decision on the weighted average cost of capital and in particular the asset beta for Perth Airport. In spite of strong economic evidence by Perth Airport's advisers supporting a higher asset beta and rebutting all counter arguments by the ACCC economic adviser, the ACCC final decision on the asset beta remained unchanged from its draft decision.

The ACCC now scrutinises every investment decision airports make in relation to their aeronautical businesses for which a price increase is sought. This is in an environment where most airports have negative earnings (before interest and tax) and where they are positive, the ratio of those earnings to the assets involved is less than 3 per cent. The ACCC determines what expenditures are to be considered for price increases, whether those expenditures are acceptable and how prices are to be calculated. This has created a situation where the ACCC makes investment decisions on behalf of airport investors, and in doing so, pre-empts the management prerogatives.

It was indeed unfortunate that it was not until March 2000, nearly half way through the 5-year regulatory review that the ACCC released its interpretation of the term "Necessary New Aeronautical Investment" (NNAI). During the period that the airports prepared their bids for the airport leases and in the post-privatisation period to March 2000, airports were forced to make critical assumptions on the extent to which major expenditures needed to develop the airports would be recoverable from airlines. These assumptions were incorporated into the bids for the airports.

Consistent with bid business plans, Westralia Airports Corporation (WAC), the owner of Perth International Airport, applied for price increases to recover the costs of some 37 aeronautical projects. The ACCC subsequently approved only 12 of these projects, rejecting expenditure in respect of approximately $6.4m of projects.

These projects have had to be funded from other revenue sources, resulting in further degradation of returns to airport shareholders.

In defining NNAI, the ACCC has taken a position that denies recovery for certain maintenance capital expenditure, thereby creating a distorted incentive for airport operators to have a preference between maintenance and asset replacement. For example, overlays (and other similar expenditures such as terminal refurbishment) may not be so much maintenance but rather asset replacement since runway works improve capacity and grooving of runways which were previously not grooved, for instance, should be seen as an investment. Overlay, to the extent that it maintains existing services would be a maintenance item but if it increases access, then it should be deemed an investment. The boundary between maintenance and replacement capital expenditure is often blurred and therefore, the situation must be avoided where airport companies, airlines and the ACCC are bogged down in time-consuming arguments about what is new necessary investment.

Given the uncertainty of the overall investment process, we note that Melbourne Airport has been instructed by its board to seek pre-approval from the ACCC on all investment prior to making a commitment, which will create extra administrative costs and delays.

2.5 *To what extent has the current price regulation provided a basis for the development of a more commercial approach to pricing and investment decisions? Has it facilitated or hindered commercial negotiations?*

Under the current arrangements, airlines have a clear incentive to jeopardise commercial negotiations, in the knowledge that if they collectively disagree with a particular proposal, then it is likely that the proposal will be rejected by the ACCC. This was confirmed by the Chief Executive of BARA, at a meeting in Perth last year, who stated that there was no incentive for airlines to concede on any matter and were happy to let the regulatory process run its course.

The ACCC services are essentially free from the point of view of the airlines – the burden of proof is always put on airports to respond to airline claims no matter their merits and the ACCC has indicated it places great store on airline support for pricing proposals. This creates a clear incentive for airlines to indulge in regulatory gaming

which is not ultimately about benefits to consumers but rather about the division of rents to be found in the aviation industry as a whole.

The ACCC seems to have confused a failure to reach consensus with a failure to consult. Therefore some airlines seem to have no intent to be committed to the consultative process so long as they having nothing to lose by having expenditure reduced or excluded by the ACCC. They have flatly refused to meet and build productive working relationships with airports, preferring to use the ACCC to arbitrate a position.

As an example, in relation to the Melbourne Airport domestic express terminal, one of the airlines involved refused to provide Melbourne Airport with traffic forecasts which it had provided to the ACCC. The ACCC, despite its claims of transparency, did not release the numbers publicly.

Recent decisions by airlines to withdraw services from Perth, resulting in significant loss of revenue to the airport and loss of competitive choice to Perth travellers to a major overseas market were made without any form of prior consultation. Airlines are in most localities refusing to provide critical data on passenger numbers, some of which are used to determine aeronautical charges. They have also refused to pay aeronautical charges and passenger screening charges in some cases.

2.6 *Are the processes involved, including consultation and time allowed for a determination to be made, appropriate?*

Airports generally have established a reasonably constructive dialogue with the ACCC at officer level. Access to officers has been relatively straightforward and officers have shown a preparedness to listen to the airport's initial views. Unfortunately, the flow of information is a one way process, with little constructive feedback on matters presented at officer level. This has led to some surprises when ACCC decisions have been released.

For example, over the past few years, the ACCC and other state regulators have developed a methodology based on the Capital Asset Pricing Model (CAPM) for calculating the rate of return requirements of regulated assets. We have consistently argued that the approach has fundamental problems. Despite criticism, the regulators have continued to bias their calculation by using market data and

theoretical notions in a manner which has the effect of producing low rates of return. The ACCC has magnified this bias by introducing a highly subjective post-tax methodology, which it has imported from the electricity transmission sector. In doing so, the ACCC continues to err on the side of lower returns to ensure that monopoly profits are removed because it seems to believe that the mere suspicion of market power justifies regulation. On the other hand, the ACCC continues to ignore investor concerns that lowering returns paradoxically increases the cost of capital because investors do not have perfect foresight for all future regulatory decisions. Therefore, they are forced to increase their required rates of return to provide a buffer for uncertainty. The ACCC does not seem to appreciate this problem. In fact, comments allegedly made by Professor Fels[1] seem to suggest that his ACCC is dismissive, if not contemptuous, of investor criticism.

Moreover, the ACCC determination for Sydney Airport has not been transparent. We are unable to fathom how the ACCC arrived at its calculations except noting that it undertook a cash-flow analysis. The main lesson we have learnt from current regulation is that the process is not transparent, there is a continual risk of procedural uncertainty and the regulator has often issued decisions without consulting with airports.

A few examples would illustrate our point:

2.6.1 Refuelling Charges:

The Government's Pricing Policy Paper, released in November 1996 stated that "the ACCC will nominate those [aeronautically related] services to be subject to formal monitoring following consultation with users and operators." No specific reference was made to refuelling charges, or for that matter any other monitored charges in this paper. It was not until release of the Treasurer's Declaration No. 80 on 17 June 1997, after the Government accepted bids for the airports that the specific services subject to monitoring by the ACCC were clarified. This was confirmed by the ACCC Chairman, Professor Fels in a letter to the General Manager of WAC dated 26 June 1998, in relation to the fuel throughput levy. In this letter, Professor Fels stated:

"The Treasurer, the Hon. Peter Costello MP, has directed the ACCC under section 27A of the Prices Surveillance Act 1983 (Cth) to monitor a range of services, including aircraft refuelling, provided by an airport operator company at Perth

Airport. I understand that the Treasurer, at the time the direction was issued, advised you of the services to be subject to price monitoring".

To the best of our knowledge, no consultation occurred with the airport operators, prior to declaration of the services. It is understood that most bidders for the airport leases factored new revenue from the fuel levy into their bid for Perth Airport, on the basis that pre-existing contracts allowing for the fuel levy had been entered into by the FAC and agreed with fuel companies prior to the airport sale. Moreover, the opportunity to implement the fuel levy was specifically referenced by the Commonwealth Government in the Information Memorandum.

Accordingly, airports which acquired the benefits of these contracts have merely exercised their rights to charge the fee. It should also be noted that the reasonableness of this fee has been confirmed by an independent expert appointed in accordance with the lease. In fact, he concluded that the fuel companies would be getting a "free ride" if they did not contribute to the airport's development by paying the levy. The independent expert examined similar fees that are in place at many airports throughout the world in making this conclusion.

We find it extraordinary that the ACCC could have concluded, despite the evidence presented, that airport operators have taken advantage of market power in the provision of aircraft refuelling services. We see the debate about the fuel levy as a distributional issue – involving the relative profitability of airlines, oil companies and airports, rather than a social welfare issue impacting on airfares.

2.6.2 Land-side roads:

On the same note, the ACCC has asserted that charges for land-side roads related to passenger processing were declared services and have remained constant since the bidding process for the airports began.

In interpreting that ground transport charges introduced by Brisbane and Perth International Airport are in fact access charges for land-side roads and therefore form part of the declared service of passenger processing, the ACCC has arbitrarily drawn a distinction between these services and those provided for car rental and car parking operations, which are not part of passenger processing facilities.

We have consistently maintained that charges for ground transport are in fact not charges to access the land-side roads (as would be the case, for example if a toll was placed on the road), but a concession fee for the right to conduct business by taxi and bus operators.

The business plan submitted to the Commonwealth Government by the bidders for Perth Airport explicitly included new revenues from ground transport charges, on the basis of representations made by the Commonwealth in the Information Memorandum to allow such charges.

The effect of the ACCC interpretation is again a redistribution of wealth from airport shareholders to airline shareholders, which stand to benefit by the further reduction in aeronautical charges. This interpretation stands at odds to the government's intentions, as stated by DOTRS.

3. Options for future airports prices regulation

3.1 What have been the implications of the current arrangements for prices of declared, monitored and other airport services?

Currently, airports are subject declarations under the PS Act, section 192 of the Airports Act and for major international airports such as Sydney, Melbourne, Brisbane and Perth, general declaration under Part IIIA of the TP Act. As access is generally not the issue, this means there are effectively three ways in which prices at airports can be controlled. Not only is this unnecessary, it is confusing and unclear and therefore acts as a disincentive to investment.

The problems with the PS Act and the Airports Act are as follows:

3.1.1 PS Act:

The ACCC's interpretation of its powers under the PS Act in relation to Sydney Airport is potentially damaging to airport investors as it aggregates the profitability of monitored aeronautical related services with aeronautical charges and recreates the single-till which was clearly prohibited by the Pricing Policy Paper issued by the Department of Transport and Regional Development. The effective regulation of aeronautical related services presumes firstly, that market power exists and has

been abused to deliver 'above-normal' returns and secondly, that the ACCC has the authority to enforce regulation on monitored services without adequate consultation. Since the legislative instruments regulating the leased airports are very similar to those applying at Sydney, there is nothing preventing the Commission from regulating 'above-normal' returns for the aeronautical services at leased airports, should they remain regulated after 2002. This sort of regulatory discretion is at odds with Commonwealth policy, and is creating a sovereign risk in our minds relating to future investment decisions at Australian airports.

3.1.2 Section 192 of the Airports Act:

No airport subject to this regime has had an access undertaking approved. Some may present this as evidence of the avarice of airport operators. Others may present it as a reflection on the inflexibility of the ACCC and its processes and its desire to extend the scope of regulation well beyond that intended by the Parliament.

In relation to Melbourne Airport, APAC entered into discussions with the ACCC that proceeded up to the point of the ACCC publishing a Draft Determination in May 1998. APAC did not persist beyond that point as they had formed a view that any undertaking that would be acceptable to the ACCC would actually leave them in a worse position than if they were to be subject to declaration and subsequent arbitration.

APAC have also had experience of the process where the ACCC determined what was and what was not an airport service. This was in relation to an application to the ACCC by Delta Car Rentals for drop off points on the terminal kerb side at Melbourne Airport. Without going into the details of the matter, it was again questionable whether this matter would have passed the national significance test contained in Part IIIA.

Section 192 of the Airports Act provides a significantly weaker test for declaration than is contained in Part IIIA. Moreover, it is less accountable not only because the arbitrating body effectively is the declaring body, with the only recourse to the ACCC declaration decision being to the Parliament, not the Australian Competition Tribunal (ACT).

There appears to be no compelling reason why the access test should be lower for airports than other essential facilities and why airports should have lesser rights of appeal than other facility providers. As such, we support the APAC position and feel it would be appropriate for the Commission to recommend that Section 192 of the Airports Act should be repealed. As a minimum, its scope should be reduced to only major airports and the definition of the declared services refined to cover only those airports which have significant market power. If the declaration remains, a more appropriate appeal mechanism should be put in place.

3.2 Should regulation be specifically tailored to the airport sector?

We understand that some industry participants have made comments supporting a specifically tailored "single-till" approach for Sydney Airport. In our view, the introduction of a "single-till" will worsen the congestion problem facing Sydney. It will force charges below market clearing levels, causing further congestion. As more volume is squeezed through the airport, retail revenues will increase, and with the single-till enforced, the aeronautical charges will be reduced at a time when economic efficiency would require them to increase. The same will be true of the other Australian airports when they become congested.

The other problem with "single-till" is that retail and property activities become subject to regulation, which means that these activities could become subject to regulatory risk and inefficient investment incentives. We have already experienced the complications in the regulatory approach that requires the ACCC to determine an airport's cost of capital for NNAI. The inclusion of retailing and property into the assessment would inevitably complicate the exercise and increase the potential for delay and error.

The recent ACCC draft decision regarding Sydney Airport is potentially damaging to airport investors as it aggregates the profitability of monitored aeronautical related services with aeronautical charges and essentially creates a modified single-till which was not the intention of the Pricing Policy Paper.

Further, we note that it is up to the Productivity Commission to recommend to the Commonwealth what approach should be taken to price regulation of airports post 30 June 2002, and it is up to the Commonwealth to implement a policy in that regard. On page 161 of the SACL Draft Decision, the ACCC has put forward that its

pricing should apply for five years, ending 30 June 2005. We query whether it is for the ACCC to decide the term beyond June 2002, as it would effectively be making government policy rather than administering it. At the least, it would severely restrict the Commonwealth's policy options in regard to the sale of Sydney Airport.

Finally, we observe that the CAA is currently reviewing BAA's airport charges in the UK. It is undertaking a fundamental review of the current regulatory structure, including a potential change from a single to a dual till. It would be ironic indeed if a country where single till has been tried and tested finally moves away from it and the regulator in Australia introduces it in one form or another.

3.3 What is an appropriate approach for any airport-specific pricing regulation?

In the light of the evidence presented here, we consider that the market power of airport operators is not substantive and is sufficiently countervailed by airlines. Rather than link the implementation of economic regulation to the mere possibility of market power, it would be preferable in our opinion, for the regulator to hold reserve powers which are put into effect only when there is evidence that market power is being exploited.

Our investors in airports and other prospective investors in the sector view the ACCC approach as inconsistent with Government policy and philosophically lacking in rigour.

It was the government's stated intention that over time, airport operators and their customers are encouraged to negotiate directly and resolve prices. There are a number of precedents to demonstrate that this is a viable model. The two principal airports in Scotland, Glasgow and Edinburgh were not regulated by the UK government under Section 40 of the 1986 Airports Act because there was no evidence of abuse of monopoly position or inefficiency. Both airports achieved high levels of profit and rates of return but the government was inclined to disregard profitability as a singular reason for regulation. When announcing its decision, the government added that it believed the threat of regulation provided a strong incentive for the airport owners to control their charges. Similarly, in New Zealand, privatised airports are subject to reserve powers of price control under the Commerce Act. In such a regime, it is important that the scope is clear, and the

decision as to which services may be subject to the regime should be subject to appeal to a body such as the ACT.

On the basis of the evidence presented, it is our view that when the current pricing arrangements at all core regulated airports end on 30 June 2002, they should be replaced by negotiated agreements between individual airports and their airline customers. If regulation is to be maintained, then it should be a price surveillance regime, related strictly to the abuse of market power exhibited by an airport, recognising the different degrees of competition, with the regulator's discretion substantially curbed and limited solely to the activities where there is an evidence of abuse under the TP Act.

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[1] 'Even if Father Christmas set the prices it wouldn't be generous enough for the gas pipeline owners', reported by P. Gosnell, 'Pipeliners, ACCC clash over red tape,' The Daily Telegraph, 21 October 2000.