PERTH AIRPORT

13 October 2006

Mr Gary Potts
Price Regulation of Airport Services Inquiry
Productivity Commission
PO Box 80
Belconnen ACT 2616

Dear Mr Potts

Price Regulation of Airport Services: Response to Draft Report

Westralia Airports Corporation (WAC) welcomes the opportunity to respond to the Productivity Commission's Draft Report on its review of the price monitoring regime that currently applies to airport services. I am pleased to submit WAC's formal response to the Draft Report.

Collectively, the Commission's package of proposals provides a very sound basis for the further development of the current price monitoring regime. The Commission's findings also fully recognise the need to build on the successes to date, and to avoid a return to heavy-handed regulation. On this basis, WAC fully supports the principal conclusions that underpin the Commission's Draft Report. However, there are some important matters where WAC would encourage the Commission to reconsider its current position. WAC's view is that addressing these matters, as described in the attached submission, would improve the future regulatory framework without affecting the Commission's core findings and recommendations in its Draft Report.

We look forward to speaking to the Commission directly at the public hearings and answering any questions the Commission may have in regard to the two WAC submissions.

Yours sincerely

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PERTH
AIRPORT

Submission to
Productivity Commission's Draft Report

Review of Price Regulation of Airport Services

13 October 2006

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1 EXECUTIVE SUMMARY

As the operator of Perth Airport, Westralia Airports Corporation (WAC) welcomes this opportunity to respond to the Commission's Draft Report on its review of the price monitoring regime that currently applies to airport services.

Overall, WAC strongly supports the Draft Report. WAC recognises that the Commission has sought to develop an integrated package of proposals, which contains four "core" elements:

- a new Review Principle relating to asset valuation;
- a new Review Principle relating to sharing of productivity gains;
- continuation of present dispute resolution arrangements, under which there is no airport-specific arbitration regime and no requirement that agreements between airports and airlines include provision for binding independent dispute resolution; and
- introduction of new monitoring arrangements that should clearly signal that more detailed scrutiny of an airport's charges will occur if there is strong evidence of significant misuse of market power.

WAC is also pleased that the Draft Report has properly recognised the following matters:

- The existing price monitoring regime has delivered substantial benefits compared to the previous CPI-X regulatory framework, especially in relation to investment levels;
- There is no evidence of systematic misuse of market power by airports in setting charges for aeronautical services;
- Commercial negotiations will be eased by addressing the key sticking points of asset valuation and service coverage; and
- There is a need to streamline the monitoring of service quality and reporting requirements.

Collectively, the Commission's package of proposals provides a very sound basis for the further development of the current price monitoring regime. The Commission's findings also fully recognise the need to build on the successes to date, and to avoid a return to heavy-handed regulation. On this basis, WAC fully supports the principal conclusions that underpin the Commission's Draft Report.

There are, however, some important matters where WAC would encourage the Commission to reconsider its position. WAC's view is that a reconsideration of these matters would improve the future regulatory framework without affecting the Commission's core findings and recommendations in its Draft Report. WAC's concerns principally relate to the following matters:

- The Commission proposes that new investment should only be added to the asset valuation if its value is agreed with customers. WAC is concerned that such an approach is likely to reintroduce the types of difficulties that arose in relation to the Necessary New Aeronautical Investment (NNAI) approach that applied under the CPI-X framework. WAC suggests that the requirement for customers to agree the value of new investment could be safely removed without affecting the efficacy of the new regime.

- The Commission proposes that quality monitoring should simply involve the ACCC seeking and reporting commentary from stakeholders — airports, airlines, airfreight operators and third party service providers — on service quality matters. WAC is concerned that if stakeholders are able to use the monitoring regime to ventilate complaints or make subjective observations regarding airport performance, the monitoring regime may fail to provide an objective, measurable assessment of performance.

- WAC does not agree with the Commission's proposed definition of aeronautical services, which is broader than the current definition and includes some service categories that are open to interpretation.

- The Commission proposes that clause 3 of Direction 27, which excludes pre-existing contractual arrangements from price monitoring, should be set aside. WAC seeks the Commission's confirmation that its proposed approach to Direction 27 would not be extended to include the Qantas Domestic Terminal lease in the definition of price monitored services. This would ensure that the commitments made by Government at the time of privatisation are properly recognised, and that the definition of the dual till is not eroded.

- The Commission's draft recommendation that the Government should consider separate monitoring of car parking services appears to be unnecessary especially given the recent history of car park pricing; the existence of competitive constraints; and the level of new investment in car park capacity at the airport. WAC also notes that car park prices are published on airports' web pages.

- WAC considers that introducing a further 5 year review runs the risk that insufficient time will be available for the Commission to form a definitive view on the effectiveness of the new regime. The prospect of periodic 5 yearly reviews of the kind currently being undertaken by the Commission prolongs uncertainty and may tend to cast a shadow over commercial negotiations. For these reasons, WAC suggests there is merit in allowing a longer period for the new monitoring arrangements to bed-down prior to conducting a further review. A seven or eight year period for review, for example, would have the benefit of allowing two further negotiating rounds to have been completed prior to the Commission conducting its next review.

In WAC's view, it is important for the Commission to address the above points in its Final Report. However, as already noted, WAC does not believe that resolving these matters will affect the overall direction of the Commission's Draft Report, which WAC fully supports.

2 INTRODUCTION AND BACKGROUND

In April 2006, the Productivity Commission (the Commission) was asked by the Australian Government to examine the effectiveness of the current regulatory regime for airport pricing. The review was foreshadowed in 2002 when the Government accepted the Commission's earlier recommendation that a light-handed price monitoring regime for airport services should be introduced.

The Commission's terms of reference for this review require it to assess how well the airport price monitoring regime has worked since 2002, whether the regime should continue after 2007 and, if so, what improvements might be made to it.

The Commission commenced the review with the publication of an Issues Paper in May of this year. Following the consideration of submissions, the Commission published its Draft Report[1] in September.

As the operator of Perth Airport, Westralia Airports Corporation (WAC) welcomes this opportunity to respond to the Commission's Draft Report.

This submission sets out WAC's response, and is structured as follows:

- Section 3 sets out WAC's overall response to the Draft Report.
- Section 4 provides WAC's comments in relation to dispute resolution processes;
- Section 5 provides WAC's comments in relation to the monitoring and reporting requirements;
- Section 6 provides WAC's comments in relation to the issues of service definition and coverage;
- Section 7 addresses the proposed monitoring arrangements for car parking;
- Section 8 addresses other issues, including the concept of sharing productivity improvements with customers; and
- Section 9 sets out WAC's position in response to each of the Commission's draft recommendations.

[1] Productivity Commission 2006, *Review of Price Regulation of Airport Services, Draft Report*, Canberra.

3 WAC'S OVERALL RESPONSE TO THE COMMISSION'S DRAFT REPORT

This section of the submission summarises WAC's overall response to the Draft Report by briefly recapping on each element of the Commission's "Key Points"[2], and then providing WAC's response on each Key Point.

3.1 Purpose of the price monitoring regime

The Draft Report commented that[3]:

> "Price monitoring was intended to maintain a constraint on misuse of market power by airports, while greatly reducing regulatory intrusion into their commercial dealings with airlines and other customers."

WAC agrees with the Commission's statement. WAC further believes that it is important for the Commission to recognise - as it has in the Draft Report - the original purpose and rationale for the price monitoring regime when formulating its final report. WAC's submission to the Commission's Issues Paper noted that the experience of operating under CPI-X regulation was far from satisfactory. The development of the price monitoring regime, and its focus on commercial negotiation rather than regulation, was an appropriate response to that experience.

WAC welcomes the Draft Report's recognition of the need to ensure that the price monitoring regime facilitates the achievement of the Review Principles - including constraining the misuse of market power - whilst also providing a framework for the development of effective commercial relationships between the airlines and airports.

3.2 Experience under the price monitoring regime

The Commission's Draft Report made the following comments about the performance of the current price monitoring regime[4]:

> "There have been a number of positive outcomes so far
>
> - there is no evidence of systematic misuse of market power by airports in setting charges for aeronautical services;
> - it has been much easier to undertake the investment necessary to sustain and enhance service provision in the face of growing demand for air travel;
> - airports' productivity performance has been high by international standards, with service quality rated satisfactory to good;
> - compliance costs have been lower than under the previous regime; and
> - some progress has been made in building commercial relationships."

WAC strongly supports the Commission's observations regarding the positive performance of the current price monitoring regime. WAC is particularly pleased that the Commission has

2 Ibid, page XII.

3 Ibid, page XII.

4 Ibid, page XII.

looked beyond the adverse comments made by some stakeholders to examine the actual performance in objective terms.

WAC's submission to the Commission's Issues Paper provided evidence of how WAC had responded positively to the challenges of volatile market conditions and world events[5] by working with airlines to negotiate increases in investment[6] and service enhancements[7]. WAC notes that this evidence provides a sound basis for the conclusions reached by the Commission. There is no doubt that investment and passenger numbers have increased very substantially under the price monitoring regime, and that this type of outcome is not consistent with systematic abuses of market power.

To some extent, the strength of adverse comments from some airlines may be surprising given the successes achieved under the current arrangements. However, the Commission's review process probably does not provide the best conditions for assessing the true health of the commercial relationships between the airports and airlines (given the opportunity that such reviews provide to the airlines to argue for regulatory changes that would tilt the negotiating tables in their favour).

In WAC's case, the airport believes that it has developed good commercial relationships with the airlines. The airport has already commenced price and service negotiations with the airlines for the new Prices and Services Accord, which is scheduled to commence on 1 July 2007.

3.3 Experience of negotiating non-price terms

The Commission's Draft Report made the following comments regarding its assessment of airlines' recent experience of negotiating non-price terms with airports[8]:

> "However, the behaviour of airports in relation to some non-price terms and conditions of access has arguably been less satisfactory and negotiations at Sydney Airport have been protracted. Also, some aspects of the monitoring process have not been well targeted to objectives."

WAC accepts the Commission's finding that the behaviour of airports in relation to some non-price terms and conditions of access has arguably been less than satisfactory and negotiations at Sydney Airport have been protracted. WAC also agrees with the Commission that some aspects of the monitoring process have not been well targeted to objectives.

WAC's submission to the Commission's Issues Paper commented that no form of regulation is perfect, including the current arrangement[9]. However, WAC's view is that the Commission should make incremental improvements to the current regime, without fundamentally altering

5 Westralia Airports Corporation, *Submission to the Productivity Commission's Issues Paper*, 14 July 2006, section 1.3.

6 Ibid, section 2.3.

7 Ibid, section 2.4.

8 Productivity Commission 2006, *Review of Price Regulation of Airport Services*, Draft Report, Canberra, page XII.

9 Westralia Airports Corporation, *Submission to the Productivity Commission's Issues Paper*, 14 July, page 65.

its nature, and in particular the primacy given to commercial negotiation. Specifically, WAC's view is that the overall design of the current monitoring regime rests on two propositions[10]:

- airports and airlines are capable of negotiating commercial terms; and
- the process of commercial negotiation is likely to be more effective than heavy-handed regulation in delivering outcomes that the airports and airlines find acceptable.

WAC strongly believes that a move towards regulated outcomes, and away from commercial negotiation, would profoundly and adversely affect the performance of the current regime. A return to heavy-handed regulation would result in many of the kinds of problems experienced prior to 2002[11]. It would also preclude innovative outcomes of the kind that have already been achieved by WAC and the airlines under the current monitoring regime[12]. WAC therefore broadly supports the refinements to the current regime which are proposed in the Draft Report. In particular, WAC welcomes the Commission's confirmation - in accordance with the Review Principles - that the airlines and airports will continue to operate under commercial agreements and in a commercial manner, and that airport operators and users will negotiate arrangements for access to airport services.

3.4 Effectiveness of price monitoring and Part IIIA of the Trade Practice Act

The Commission's Draft Report made the following conclusions regarding the overall effectiveness of the price monitoring regime in conjunction with Part IIIA of the Trade Practices Act (TPA)[13]:

> "Most importantly, it is still too early to judge whether price monitoring, in conjunction with the Part IIIA national access regime, will:
>
> - provide a reasonable constraint on misuse of market power by airports as the influence of the previous regulatory regime recedes; and
> - foster the attitudes, trust and commercial relationships between the parties that could, at some stage in the future, obviate the need for prices oversight.
>
> Thus, neither reversion to stricter price controls, nor dispensing with price monitoring and relying solely on Part IIIA, would be justified."

WAC generally supports the Commission's conclusions on these matters. WAC believes that ultimately, commercial negotiation in conjunction with Part IIIA should prove to be an effective regulatory framework, but WAC accepts that it is still too early to make this judgement.

WAC remains strongly of the view that commercial negotiation is the best process for delivering customer-focused investment, services and prices. Within this paradigm, regulation or arbitration should not be an every-day part of the negotiation process. Rather, such intervention should only apply in extreme situations where parties have sought to abuse their market power by taking unreasonable commercial positions.

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10 Ibid, page 77.

11 Ibid, section 1.4.

12 Ibid, Appendix 2: Case study - International Terminal Baggage Handling Project.

13 Productivity Commission 2006, *Review of Price Regulation of Airport Services*, Draft Report, Canberra, page XII.

WAC concurs with the sentiment underpinning the Commission's statement (cited above) that the design of the regulatory framework should aim to *"foster the attitudes, trust and commercial relationships between the parties that could, at some stage in the future, obviate the need for prices oversight"*. Developing effective and constructive commercial relationships is, of course, a matter for the parties, not for regulation. The challenge for policy makers is to put in place a regulatory framework that does not usurp or displace the need for the parties to build robust, productive and mutually beneficial commercial relationships.

On this basis, WAC strongly endorses the Commission's conclusions that neither reversion to stricter price controls, nor dispensing with price monitoring and relying solely on Part IIIA, would be justified at this time.

3.5 A new 5 year price monitoring regime should be introduced

The Commission's Draft Report made the following conclusions regarding the need for a further 5 year price monitoring regime[14]:

> "A new, five year, price monitoring regime should be introduced when the current arrangements end in 2007. This new monitoring regime should:
>
> - be configured to provide some latitude on charges and to give stakeholders greater opportunity to comment on the reasonableness of outcomes;
> - apply to Adelaide, Brisbane, Canberra, Melbourne, Perth and Sydney Airports;
> - encompass a slightly wider range of aeronautical services; and
> - streamline the monitoring of service quality and reporting requirements."

WAC supports a continuation of the price monitoring regime, and recognises the need to improve the scope of the existing arrangements. Whilst WAC supports the broad thrust of the Commission's findings as set out above, there appears to be a need for the details of the new streamlined arrangements to be developed more fully than they have been in the Draft Report. In particular, if stakeholders are able to use the monitoring regime to ventilate complaints or make subjective observations regarding airport performance, the monitoring regime may fail to provide an objective, measurable assessment of performance.

WAC also notes that introducing a further 5 year review runs the risk that insufficient time will be available for the Commission to form a definitive view on the effectiveness of the new regime. The prospect of periodic 5 yearly reviews of the kind currently being undertaken by the Commission prolongs uncertainty and may tend to cast a shadow over commercial negotiations. For instance, an impending review may present airlines with less incentive to settle commercial negotiations amicably, as the existence of an on-going dispute may influence the outcome of such a review. WAC acknowledges that all parties with a stake in the outcome of such reviews face incentives that may well elicit strategic behaviour in the lead-up to, and during periodic reviews. Under such circumstances, the focus on genuine commercial negotiation is likely to be lessened.

In view of these considerations, there would seem to be merit in the Commission allowing a longer period for the new monitoring arrangements to bed-down prior to conducting a further review. A seven or eight year period for review, for example, would have the benefit of

[14] Ibid, page XII.

allowing two further negotiating rounds to have been completed prior to the Commission conducting its next review.

It should be noted that WAC has a number of concerns regarding details of the scope of the monitoring regime and the definition of aeronautical services. These concerns are set out in sections 5 and 6 of this submission.

3.6 Existing and future asset revaluations

The Commission's Draft Report made the following conclusions regarding the treatment of existing and future asset revaluations[15]:

> "Revaluations made by airports up to 30 June 2005 to the asset bases submitted for price monitoring purposes should be allowed to stand. But any subsequent revaluations should be excluded."

WAC believes that the Commission has developed a reasonable, pragmatic approach in addressing the complex and difficult issue of asset valuation. Specifically, WAC's view is that the Commission's approach:

- provides workable guidance to the industry on the issue of asset valuation;
- takes account of the economic arguments presented by stakeholders, but also properly considers the reasonable expectations of investors at the time of privatisation;
- recognises that there is no single correct method for valuing assets, and therefore the approach adopted must ultimately reflect the exercise of judgment; and
- properly recognises that in a commercial negotiation, asset valuation is one of a number of inputs to be discussed, rather than a key determinant of prices (as is the case in a CPI-X price control framework).

In WAC's view, the alternative approaches to asset valuation suggested by the airlines were not reasonable. In particular, the work by Allen Consulting Group for Virgin Blue was based on the proposition that aeronautical charges at the time of privatisation were "correct", and therefore asset values for each airport could be deduced from the prevailing charges. However, as noted by the Commission's 2002 Inquiry[16], aeronautical charges at the time of privatisation were considered to be unsustainably low.

WAC therefore welcomes the Commission's findings in relation to asset valuation, especially as the Commission's proposed approach would ease future negotiations with the airlines. In particular, WAC concurs with the Commission's view that[17]:

> "The large divide on asset valuation, and on whether or not some particular services should be subject to price monitoring, has also slowed progress in relationship building — as has uncertainty about the future of price monitoring itself."

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15 Ibid.

16 Productivity Commission, *Price Regulation of Airport Services: Inquiry Report*, 23 January 2002, page XXXII. Also see WAC's submission to the Productivity Commission's Issues Paper, page 26.

17 Productivity Commission 2006, *Review of Price Regulation of Airport Services*, Draft Report, Canberra, page 109.

WAC notes that the Commission's draft recommendations regarding asset valuation and streamlining of the monitoring regime are intended to take the heat out of commercial negotiations, thereby providing a sound foundation for the further development of effective commercial relationships between the airlines and airports, without a mandatory dispute resolution regime. On this basis, WAC supports the Commission's proposed new Review Principle that future asset revaluations should not generally provide a basis for higher charges, in the context of the Commission's proposal that an airport-specific arbitration regime should not be introduced at this time.

WAC is concerned, however, that the wording of the Commission's recommendation 6.1 may create practical difficulties for the airports. In particular, recommendation 6.1 states:

> "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 draft recommendation 5.1);
> - plus new investment (<u>at values agreed with customers</u>) [emphasis added];
> - less depreciation and disposals."

The Commission's recommendation implies that new investment can only be added to the value of the airport's asset base if customers agree the value of that new investment. From an operational perspective it would be impractical to obtain the agreement of *all* customers prior to the airport making an investment decision. Furthermore, such an approach is likely to reintroduce the types of difficulties that arose in relation to the Necessary New Aeronautical Investment (NNAI) approach that applied under the CPI-X framework. WAC's submission to the Commission's Issues Paper commented on the operation of the NNAI approach in the following terms[18]:

> "WAC's submission to the Commission's 2002 Inquiry noted that the ACCC placed great weight on airline support when considering projects for approval. However, the ACCC's approach to this issue encouraged airlines to support NNAI initiatives only if it suited them to do so. WAC's experience was that airlines were principally focused on minimising airport charges and therefore were reluctant to support most initiatives put forward by Perth Airport – even where these initiatives were necessary in order to accommodate expected traffic demand."

In WAC's view, the emphasis on customer agreement in the Commission's proposed recommendation 6.1 creates a strong possibility of a return to arrangements that would deliver much lower levels of investment - such as those which occurred under the CPI-X framework. To avoid this difficulty, recommendation 6.1 should simply refer to the cost of new investment. In WAC's view, the airport's commercial imperatives, together with the detailed consultation processes that are already in place[19], should provide the Commission and other stakeholders with sufficient comfort that the airport will only undertake prudent and efficient investment that meets the needs of its customers. On this basis, WAC believes that it would be in all parties' interests if the wording of the proposed recommendation 6.1 were amended to remove the reference to customers agreeing the value of new investment.

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18 Westralia Airports Corporation, *Submission to the Productivity Commission's Issues Paper*, 14 July, page 27.

19 Ibid, section 2.2.1.

3.7 Airport-specific arbitration regime

The Commission's Draft Report made the following conclusions regarding the need for an airport-specific arbitration regime[20]:

> "It would be premature, and quite possibly counterproductive, to introduce an airport-specific arbitration regime at this stage."

WAC strongly supports the Commission's views. WAC believes that the price monitoring regime has delivered substantial success in its short period of operation. The introduction of an airport-specific arbitration regime would represent a reversion back towards more intrusive regulation with all of its attendant costs and disadvantages. Furthermore, the case for a sector-specific regime has not been made.

Section 4 sets out WAC's further comments on dispute resolution arrangements.

3.8 Concluding comments

Overall, WAC strongly supports the Draft Report. WAC also recognises that the Commission has sought to develop an integrated package of proposals, which contains four "core" elements:

- a new Review Principle relating to asset valuation (set out in the relevant sections of draft recommendations 5.5, 6.1, 6.2);
- a new Review Principle relating to sharing of productivity gains (draft recommendation 5.5);
- continuation of present dispute resolution arrangements, under which there is no airport-specific arbitration regime and no requirement that agreements between airports and airlines include provision for binding independent dispute resolution (draft recommendation 7.1); and
- introduction of new monitoring arrangements that should clearly signal that a more detailed scrutiny of an airport's charges will occur if there is strong evidence of significant misuse of market power (draft recommendations 4.1 and 4.2).

Given the inter-relationships between these four core elements, WAC considers that selectively modifying (or "cherry-picking") individual elements may inappropriately change the overall balance and integrity of the package as a whole. For example, the Commission makes the following comments regarding the link between its decisions on asset valuation and service coverage on the one hand, and the issue of negotiation processes on the other[21]:

> "Implementation of the Commission's proposals to address some of the key sticking points in current negotiations could make it easier for the parties to reach agreement in the future. That is, effectively taking asset valuation and some particular service coverage issues 'off the table' should reduce the negotiating divide."

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20 Productivity Commission 2006, *Review of Price Regulation of Airport Services*, Draft Report, Canberra, page XII.

21 Ibid, page 115.

Notwithstanding its broad support for the Draft Report, WAC considers that there are detailed aspects of the proposals set out in the Draft Report that could be improved or clarified. The remainder of this submission examines these points of detail, noting however that it is important to retain the integrity of the overall package of "core" elements presented by the Commission.

4 DISPUTE RESOLUTION PROCESSES

4.1 WAC's response to the Commission's position

The Review Principles reflect the Government's expectation that the airlines and airports will primarily operate under commercial agreements and in a commercial manner, and that airport operators and users will negotiate arrangements for access to airport services. In addition to having regard to the Review Principles, the terms of reference for this present review require the Commission to examine dispute resolution mechanisms at each of the price monitored airports and advise on improvements that would be consistent with the Government's Review Principles.

In considering this important aspect of the review, the Commission's Draft Report notes that:

- There have obviously been tensions and disputes between the airports and the airlines. But these will be part and parcel of any commercial negotiating environment. Indeed, given the major investments that both airports and airlines have in their businesses, it would be surprising if negotiations had not been intense and sometimes protracted[22].

- Implementation of the Commission's proposals to address some of the key sticking points in current negotiations could make it easier for the parties to reach agreement in the future[23].

- Experience in other sectors suggests that easy access to a sector-specific arbitration process can fundamentally undermine genuine negotiations, with parties who perceive they will get a better outcome from the designated arbiter simply going through the motions as a prelude to arbitration[24].

- Indeed, this is precisely why the Commission has considerable reservations about the introduction of an airport-specific arbitration regime. That is, it is not clear that it is possible to devise a mechanism that would retain strong incentives for all of the parties to negotiate outcomes. Accordingly, the most likely outcome of implementing the suggested arbitration mechanisms would be a return to heavy-handed determination of charges and conditions, with all of its attendant costs[25].

- In any event, even if a way could be found to retain strong incentives for negotiation, in the Commission's view, it would still be premature to move in this direction. In particular, the Commission notes that there is no evidence of systematic misuse of market power by the monitored airports in setting charges for aeronautical services[26].

- In the absence of compulsory binding arbitration, the Commission comments that negotiations and dispute resolution will continue to be conditioned by:

    - the guidance on efficient pricing of airport services set out in the Government's Review Principles;

22 Ibid, page 106.
23 Ibid, page 101.
24 Ibid, page 112.
25 Ibid, page 112.
26 Ibid, page 50.

- the option for airlines and other users to seek declaration and arbitrated access under the Part IIIA national access regime; and

- the potential for reversion to more stringent price controls if airports are found to have misused market power in setting charges for their services[27].

WAC concurs with the reasoning underpinning the Commission's position on the issue of dispute resolution arrangements. As already noted in this submission, it is most important for the regulatory regime to facilitate the development of effective and productive commercial relationships between the airports and airlines.

WAC agrees with the Commission that introducing compulsory dispute resolution provisions into the regime at this time would most certainly result in a serious undermining of the incentives for both parties to work toward the development of fully functional commercial relationships. In effect, such a move would indeed be a return to a more heavy-handed, interventionist form of regulation.

WAC also shares the Commission's concerns regarding the practical effectiveness of the various options that have been suggested for introducing airport-specific arbitration. It is extremely difficult to design a regulatory framework which fosters commercial negotiation of access on the one hand and which also provides a default option of compulsory arbitration on the other, without undermining the incentives for the parties to engage in genuine commercial negotiations. (WAC's response to the Commission's invitation to provide further comments on possible options for airport-specific arbitration arrangements are set out in section 4.2 below.)

As the Commission has correctly noted, it appears that all parties still have some way to go before accepting the need for an element of give and take that characterises genuinely commercial negotiations. The introduction of compulsory binding arbitration would provide parties with a ready means of avoiding the prospect of engaging in genuine commercial negotiations. In this light, commercial negotiation on the one hand and compulsory arbitration on the other, appear to be mutually exclusive options for the basic design of the regulatory framework within which terms and conditions for access are to be resolved.

The Government has determined that the better policy approach involves airport operators and users negotiating arrangements for access to airport services. This policy is clearly reflected in the Government's Review Principles, and has been vindicated by the superior investment and service outcomes delivered under the price monitoring regime following the cessation of price cap regulation in 2002.

In light of this policy, and given the reasoning set out in the Commission's Draft Report (summarised above) it seems very desirable to set a "high bar" for invoking compulsory arbitration of disputes over the terms and conditions of supply for airport services. WAC believes that the present arrangements under Part IIIA provide an appropriate and effective route for parties to seek resolution of intractable access disputes. Furthermore, WAC notes that recent legislative changes[28] are intended to reduce the costs and uncertainty associated with the Part IIIA process. The prospect of improvements to Part IIIA is further reason to conclude that it would be premature to introduce an airport-specific arbitration regime. As

27 Ibid, page 103.

28 The Trade Practices Amendment (National Access Regime) Bill 2006, which is intended to 'clarify the Regime's objectives and scope, encourage efficient investment in new infrastructure, strengthen incentives for commercial negotiation and improve the certainty, transparency and accountability of regulatory processes', received assent on 18 August 2006.

also noted above, the Review Principles themselves, along with the price monitoring regime (and its attendant threat of more stringent regulation in the event of market power abuse) will continue to condition the airports' approaches to commercial negotiation and dispute resolution.

4.2 Feasibility of options for compulsory dispute resolution

The Draft Report states[29]:

> "While not proposing to recommend that airport-specific arbitration be introduced at this juncture, the Commission is nonetheless interested in further input on whether a practical mechanism could be devised that would maintain strong incentives for all parties to negotiate. As noted above, it does not consider that any of the proposals so far put forward by participants would adequately meet this requirement…
>
> Indeed, the issue of practicality is critical to all of the possible options. Thus, the Commission is seeking ideas on specific and workable approaches, not simply on potential broad directions that might prove very difficult to implement in practice."

As already noted in section 4.1 above, WAC shares the Commission's concerns regarding the effectiveness *in practice* of any compulsory dispute resolution mechanism in a regulatory regime where commercial negotiation is intended to be the primary means for parties to agree the terms and conditions of access.

One approach canvassed in the Draft Report is the "final offer arbitration" approach. Notwithstanding the issues identified by the Commission[30], WAC acknowledges that on its face this approach may appear to provide a mechanism for moving the positions of two parties towards some middle ground. However, WAC does not consider that such an approach is consistent with an access framework which is founded on commercial negotiation. This is because in a negotiation bounded by a "final offer arbitration" approach, parties do not have an incentive to agree or to conclude the negotiation, as is the case in a normal commercial setting. Instead, the parties have an incentive to conduct themselves throughout the negotiation in way that they believe will enable them to convince the arbitrator that their position is more reasonable than that of the other party.

As already noted, in these circumstances, the negotiation process may well proceed in a way which is inimical to the basic goal of reaching agreement. For instance, one party may open negotiations with an ambit offer, and then later follow this up with a "more reasonable" offer. The purpose of this negotiating strategy would be to convince the arbitrator that the final offer is reasonable, rather than to elicit the best negotiated outcome from the counter party. If the counter party made a more reasonable opening offer, and subsequently moved little during the negotiations, the arbitrator may conclude that the counter party was less reasonable. It is apparent from this example that the arbitration process will affect the conduct of and outcome from the commercial negotiations.

These considerations highlight the considerable practical problems associated with mandating binding dispute resolution provisions within an access regime that is primarily founded on commercial negotiation.

29 Ibid, pages 116 and 117.

30 Ibid, page 116.

It is also useful to recap on the arrangements that WAC and its customers have already agreed in order to facilitate commercial negotiations. In particular, WAC's submission to the Commission's Issues Paper highlighted the following processes:

- WAC has put a framework in place to ensure that effective formal communication and consultation takes places with airport users. This framework consists of a number of different forums which meet regularly to address specific operational and/or commercial matters[31].

- Both the Prices and Services Accord and the Virgin Blue terminal licence agreement have dispute resolution or mediation provisions, neither of which have been activated to date[32].

Furthermore, WAC is continuing to work with the airlines to improve the current arrangements. For example, a new initiative has recently been discussed with airlines, under which disputes that remain unresolved at the officer level are elevated to the organisations' respective CEOs for resolution. WAC believes that this initiative will create further impetus to conduct commercial negotiations in a fair and reasonable manner.

4.3 Concluding comments

WAC concurs with the Commission's conclusion that it would be premature to implement airport-specific dispute resolution arrangements, in light of:

- the positive outcomes delivered to date under the price monitoring regime;

- the need for the commercial relationships between airlines and airports to be permitted to be further developed and consolidated; and

- the impending legislative changes to Part IIIA.

As noted by the Commission, there have been tensions and disputes between the airports and the airlines, but this is not surprising given the major investments that both airports and airlines have in their businesses. The Commission has proposed new arrangements (including additional Review Principles) to address matters that have been the subject of disputes between some parties, and this should facilitate more effective negotiations in the future.

WAC agrees with the Commission that there are considerable practical difficulties associated with implementing compulsory arbitration provisions, not least of which is the need to ensure the preservation of incentives for all parties to engage in genuine commercial negotiations.

The adoption of airport-specific arbitration provisions would be a retrograde step, as it would represent a move back to a more heavy-handed, interventionist form of regulation under which terms and conditions are not set through negotiation but rather through regulatory decision-making. WAC agrees with the Commission's assessment that such an outcome would entail substantial attendant costs. Moreover, such an outcome would be

31 Westralia Airports Corporation, *Submission to the Productivity Commission's Issues Paper*, 14 July, section 2.2.1, page 36.

32 Ibid, section 2.6, page 55.

fundamentally inconsistent with the policy stance underpinning the Government's Review Principles.

5 MONITORING AND REPORTING REQUIREMENTS

The Commission makes the following key points in relation to the new price monitoring regime[33]:

> "A new, five year, price monitoring regime should be introduced when the current arrangements end in June 2007. This new monitoring regime should be configured to:
>
> - encourage flexibility in pricing outcomes; and
> - give stakeholders greater opportunity to comment on the reasonableness of outcomes. Making such commentary available to the Government would render more credible the threat of stricter price control if there is costly misuse of market power by airports, while preserving a light handed approach to prices oversight."

The Commission also makes the following comments in relation to the proposed reporting arrangements[34]:

> "Monitoring of service quality should be re-focussed and streamlined. In future, it should be limited to the reporting of commentary sought from airports and their customers, and any information provided by them to support that commentary.
>
> To further streamline the reporting process, and to help put price changes in context, price and quality monitoring reports should be combined and produced every two years rather than annually as at present.
>
> The operation of the new price monitoring regime should continue to be governed by a set of overarching principles. These should be the current 'Review Principles', plus two new principles covering:
>
> - the sharing of the benefits of productivity growth at the monitored airports between airport operators and their customers; and
> - the treatment of asset revaluations for price monitoring purposes."

WAC concurs with the Commission's broad view that there is a need to configure the monitoring and reporting requirements to encourage flexibility in pricing outcomes, and to streamline the monitoring of service quality. However, WAC's view is that further careful consideration needs to be given to the question of how the re-configuration and streamlining of the present arrangements can be implemented so as to best facilitate the delivery of outcomes by the regime that are consistent with the Government's Review Principles.

In the remainder of this section, WAC sets out its views on the following aspects of the Commission's proposed monitoring and reporting arrangements:

- the duration of the price monitoring regime;
- the role of stakeholder comments;
- streamlined reporting;

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33 Productivity Commission 2006, *Review of Price Regulation of Airport Services*, Draft Report, Canberra, page 43.

34 Ibid, page 67.

- the role of the Review Principles; and
- financial reporting guidelines.

5.1 Duration of the price monitoring regime

As noted in section 3.5 of this submission, WAC is concerned that the proposed 5 year duration for the new monitoring regime is too short. In particular:

- the Commission's proposed changes to the current regime will take time to implement and bed-down;
- the prospect of the Commission conducting a review of the monitoring arrangements may adversely affect the ability of the parties to reach commercial agreements, as each party focuses on the broader regulatory review; and
- a 5 yearly review only allows for one further round of negotiations between the parties, and therefore the Commission's next review may also conclude that it is too early to judge whether the new regime is working effectively.

Given the above points, WAC believes there is considerable merit in allowing the new monitoring regime to operate for 7 or 8 years before its effectiveness is reviewed by the Commission.

5.2 Role of stakeholder comments

The purpose of price monitoring was expressed by the Commission in its 2002 Inquiry Report in the following terms[35]:

> "The impact of monitoring on firms' pricing decisions is through moral suasion, publicity, and the explicit or implicit threat of stricter forms of price regulation. Monitoring may also influence bilateral negotiations between airlines and airports because airlines will have access to the monitored data, while airports may not have as much information on the airlines. Thus, monitoring can be a less explicit or intrusive method for influencing prices than price caps or cost based regulation, though it may have similar effects on pricing and costs."

This statement describes three purposes for the price monitoring regime:

(a) To provide discipline on the airport charges through moral suasion and publicity;

(b) To provide a threat of stricter regulation if abuse of market power is apparent; and

(c) To provide information to the airlines to facilitate commercial negotiations.

Against this background, the Draft Report makes it clear that the price monitoring regime should remain light handed[36]:

> "The proposed new monitoring regime should continue to operate in a light handed way, consistent with the provision of some latitude and flexibility on prices and returns. Only if there

35 Productivity Commission, *Price Regulation of Airport Services: Inquiry Report*, 23 January 2002, page 315.

36 Productivity Commission 2006, Review of Price Regulation of Airport Services, Draft Report, Canberra, page 55.

> is some latitude can there be the sort of negotiations between the parties that characterise more contestable markets. Thus, the clearly stated expectation should be that the behaviour of airports would only be subject to more forensic scrutiny — including as appropriate through the inquiry provisions of the prices surveillance arrangements — if there is strong evidence of significant misuse of market power."

WAC strongly supports the Commission's reaffirmation of its commitment to a light-handed regime. In addition, WAC agrees with the Commission[37] that financial reporting is unlikely to be a good tool for detecting market power abuses. WAC further agrees with the Commission[38] that any attempt to introduce a precise set of triggers to identify market power abuses would inevitably require ongoing forensic assessments of outcomes. In summary, the reporting regime will not readily indicate if there has been an abuse of market power.

To address the shortcomings of financial reporting, the Draft Report suggests that the views of stakeholders might be a better barometer for indicating possible market power abuses[39]:

> "The monitoring process should be reconfigured to put much greater emphasis on seeking and reporting the views of the stakeholders. Those at the 'coalface' are in the best position to put the numerical outcomes of the monitoring process in proper context. As well, an opportunity would be provided for the parties to raise any more general issues pertaining to the effectiveness of price monitoring and related arrangements."

In WAC's view, the above statement incorrectly assumes that airlines are impartial and objective observers of airport behaviour. In fact, the airlines' commercial interests may tend to encourage less than fully substantiated negative comments and claims of market power abuses. WAC is therefore doubtful whether airlines are likely to provide an objective assessment of whether airports have abused their market power.

In considering the future direction of the monitoring and reporting regime, it is important to keep in mind the three purposes of the regime:

- Firstly, moral suasion and publicity *do* provide a constraint on airport behaviour. Therefore, whilst the publication of financial performance cannot provide a definitive view on whether market power abuses have occurred, it does provide a discipline on airport behaviour.

- Secondly, the threat of stricter regulation arises through the Commission's future review of the new monitoring regime. The reporting regime will provide data that will be scrutinised by the Commission, and used to inform the Commission's view as to the market conduct of the airports and the overall effectiveness of the regulatory arrangements.

- Thirdly, the availability of comparative information across airports may provide some assistance to the airlines in their negotiations with airports.

In considering the above points, it is not clear that the Commission's increased focus on stakeholder comments would provide a better basis for achieving the objectives of the monitoring and reporting requirements. WAC therefore suggests that the Commission should reconsider its view that the monitoring process should be reconfigured to put much greater emphasis on seeking and reporting the views of the stakeholders.

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37 Ibid, page 56.

38 Ibid.

39 Ibid, page 55.

5.3 Streamlined reporting

The Draft Report notes that airports have expressed concern regarding the usefulness of the quality monitoring arrangements. These concerns included:

- the mechanistic nature of the reporting process, which the airports claimed does not account for the practicalities and complexities of service delivery;
- the monitoring process effectively treats airports as responsible for some quality service problems beyond their direct control (such as in relation to Customs desks, for instance); and
- the inclusion in the ACCC's quality monitoring reports of 'unsubstantiated' commentary.

In the light of these concerns, and those expressed by other stakeholders, the Commission concluded that[40]:

> "On the basis of the evidence put to it, the Commission considers that the overall value added from the current quality monitoring process is very limited and that, in some cases, the reported information may actually be unhelpful in assessing the behaviour of the airports. Moreover, it doubts that the usefulness of monitoring would be improved by changing the indicators or adding to them. Put simply, the requirements of individual airport users, and hence their perceptions about the quality and suitability of particular services, will vary. High level indicators that aggregate a range of views are clearly unsuited to capturing such diversity."

WAC concurs with the Commission's views. WAC is concerned, however, that the Commission's suggestion for the post-2007 regime will also prove to be of limited value. In particular, the Commission proposes that[41]:

> "Specifically, and consistent with its suggested re-focussing of price monitoring, the Commission is proposing that under the post-2007 regime, quality monitoring should simply involve the ACCC seeking and reporting commentary from stakeholders — airports, airlines, airfreight operators and third party service providers — on service quality matters."

Whilst WAC appreciates that the proposed approach to quality monitoring will be a low-cost option, it is difficult to understand how stakeholders or the Commission will make use of the reported commentary. As noted earlier, WAC is concerned that such commentary may not be objective. In addition, it is not possible to derive any trends in service performance if written commentaries from customers provide the only indication of performance levels. WAC's strongly held view is that it is better to retain objective measures of service quality, rather than limit the quality monitoring process to the publication of subjective commentary or complaints. It may be timely for the Commission to review service quality measures in conjunction with airport stakeholders, noting that passengers and airlines may have different perspectives on quality issues and measures.

The Commission comments that prices and profits earned by an airport from non-aeronautical services such as retailing, hotel accommodation, corporate parks and factory outlets — or from the rental of space for the provision of such services by third parties — are not monitored[42]. WAC concurs with the Commission's view that under the dual till

40 ibid, page 79.

41 Ibid.

42 ibid. page 3.

arrangement, non-aeronautical services should not be subject to monitoring. However, in practice the ACCC has commented on non-aeronautical revenues in its reports[43]. WAC believes that it would be appropriate for the Commission to confirm in its Final Decision that the ACCC should confine its monitoring role to aeronautical services.

As part of its streamlining measure, the Commission proposes that the price and service quality reports should be integrated and published every two years, rather than annually. WAC supports the integration of the price and service quality reports, but questions whether there is likely to be a material cost saving in publishing every two years. In WAC's view, stakeholders may obtain greater assurance from a regime that provides for annual publication of the monitored information. Therefore, if stakeholders' submissions to the Commission indicate a preference for annual reporting of monitored information, WAC would be pleased to accept this approach. WAC intends to continue to conduct its own service quality monitoring at least annually in any event, as this monitoring provides detailed information that assists WAC in improving the standard of services and in ensuring that airport users' service needs and expectations are met.

5.4 Role of the Review Principles

The Commission made the following comments in relation to the role of the Review Principles[44]:

> "The operation of the new price monitoring regime should continue to be governed by a set of overarching principles. These should be the current 'Review Principles', plus two new principles covering:
>
> - the sharing of the benefits of productivity growth at the monitored airports between airport operators and their customers; and
>
> - the treatment of asset revaluations for price monitoring purposes."

The first of these two review principles is discussed in section 8.1 of this submission.

WAC notes that some respondents to the Commission's Issues Paper have advocated the establishment of a mechanistic monitoring and reporting regime to detect abuses of market power. As discussed in section 5.2 above, it is impractical to devise such a regime[45]. WAC therefore considers that the Commission would be ill-advised to embark on the development of a reporting framework that seeks to provide an annual or biennial "health-check" for airports against each of the Review Principles.

WAC interprets the Draft Report as recognising that the purpose of the Review Principles is to guide the overall regime - as well as the commercial conduct of the parties operating within the regime - rather than underpinning the structure and scope of the reporting framework. In this context, WAC notes and fully supports the Draft Report's description of the purpose of the Review Principles[46]:

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43 ACCC, *Airports price monitoring and financial reporting 2004–05*, February 2006, page 11.

44 Productivity Commission 2006, *Review of Price Regulation of Airport Services*, Draft Report, Canberra, page 67.

45 As noted on page 56 of the Draft Report, the ACCC's submission to the Commission's Issues Paper highlighted the substantial practical problems with establishing "regulatory triggers" within a light-handed monitoring regime.

46 Productivity Commission 2006, *Review of Price Regulation of Airport Services*, Draft Report, Canberra, page 81.

> "To provide guidance to the review of the next period of price monitoring, and to airports and their customers in the preceding period, the Government should again specify a set of overarching principles."

5.5 Financial Reporting Guidelines

As noted earlier, WAC supports Draft Recommendation 6.1 regarding the use of the 2005 asset values reported to the ACCC (as modified for any changes in the definition of aeronautical services) for future price monitoring. However, as highlighted by the Commission, this would result in an asset base for price monitoring that did not accord precisely with general financial reporting requirements. In WAC's case, the implementation of International Financial Reporting Standards ("IFRS") resulted in some adjustments in the asset values that were reported in the 2006 Regulatory Accounting Statements submitted to the ACCC at the end of September.

WAC has advised the ACCC on a number of occasions that it was of the view that the accounting values presented in the Regulatory Accounting Statements did not provide an appropriate basis for assessing aeronautical prices under the price monitoring regime. WAC's decision to book the valuation of its assets at 30 June 2004 was in part an attempt to move the accounting book value of assets to a more appropriate basis for price monitoring purposes.

Therefore, to allow for the implementation of Draft Recommendation 6.1, WAC suggests that the Commission specifically recommend that the ACCC Airports Reporting Guideline (last updated in March 2004) be amended to allow for asset reporting to diverge from generally accepted accounting principles.

6 ALIGNMENT OF AERONAUTICAL SERVICE DEFINITIONS

6.1 Changes to Definitions

WAC agrees with Draft Recommendation 5.1 that the services covered by the directions pursuant to the Trade Practices Act giving effect to airport price monitoring should be aligned with the relevant parts of the Airports Act. However, WAC is of the view that it would be more appropriate to align the Airports Act with the current definitions in Direction 27. Direction 27 would need minor modification to move check-in counters, land side terminal access roads and aircraft light and emergency maintenance sites and buildings from the aero-related category into the aeronautical category. The remainder of the aero-related category could then be eliminated as airports were considered by the Commission to have low market power for these services in the last report and there has been no evidence that this has changed. Similarly, DOTARS has proposed to include additional services to those listed in Direction 27, even though the airports have low to moderate market power in respect of these services.

Continually changing the definition of aeronautical services creates ongoing uncertainty for investment recovery and unnecessarily adds confusion to the negotiation process. Any other modification to Direction 27 definition should be limited to clarification of the relatively brief descriptions currently in the direction, but entirely new service categories should not be added.

For example, WAC has always assumed that revenues, costs and assets associated with environmental hazard control and compliance with environmental laws were part of the general operation of the airfield or terminal services as defined in Direction 27 to the extent they related to that part of the operation. Similarly, WAC would consider ground handling services generally to fall into the category of baggage handling and would group it as aeronautical accordingly. Conversely, office space in the terminals has always been treated as non-aeronautical under the definitions in both the Airports Act and Direction 27 and telecommunications infrastructure is vague as well as being outside the current definitions.

6.2 Direction 27 Exclusion

Clause 3 of Direction 27 excludes from the definition of aeronautical services "the provision of a service which, on the date the airport lease was granted, was the subject of a contract, lease, licence or authority given under the common seal of the Federal Airports Corporation." In WAC's case this clause has the effect of excluding the revenues, costs and assets from the Fuel Throughput Levy and the Qantas Domestic Terminal Lease from the aeronautical category in its regulatory reports to the ACCC.

In commenting on this exclusion from the price monitoring regime, the Commission made the following observations in relation to the Fuel Throughput Levy[47]:

> "The airports themselves did not dispute the proposition that they have some market power in negotiating leases with the oil companies. Rather, opposition to inclusion of refuelling-related revenues within the price monitoring regime was based on the argument that bids for the privatised airports had assumed that these revenue streams would not be subject to prices oversight, at least until the contracts negotiated with the FAC had expired. As well as referring to the exemption provisions for pre-existing contractual arrangements, airports also pointed to the lack of clarity in the signals given to bidders on the regulatory treatment of refuelling

[47] Ibid, page 71.

> services at the outset of the privatisation process. For example, they noted that not until after the sale of the Phase 1 airports did the Government (Costello 1997) explicitly indicate that refuelling services would be subject to price monitoring."

The Commission suggests that whilst the airports' argument would have 'considerable force' under a price cap regime, the case is much weaker in relation to the price monitoring arrangements. In particular, the Commission comments that[48]:

> "However, the arguments are seemingly of less relevance under price monitoring. As emphasised in chapter 4, monitoring is intended to provide airports with some latitude in setting charges. Hence, inclusion within the monitored net of revenue from fuel throughput levies and other charges for the provision of refueling services, would not automatically require offsetting reductions in charges for other services.
>
> In fact, information available to the Commission indicates that the increase in previously reported rates of return on aeronautical assets at Brisbane and Perth Airports, had revenues from their fuel throughput levies been included, would have been less than 1 percentage point. Such an increase could not of itself be reasonably construed as a trigger for more detailed scrutiny of those airports' charging levels."

WAC's view is that the Commission's position on this issue is partially correct. In particular, WAC agrees with the Commission that under the price monitoring regime a broader definition of price monitored services does not necessarily lead to a reduction in overall airport revenue. By the same token, however, maintaining the existing commitments made by Government through the Direction 27 provisions does not necessarily limit the scope of the negotiations between the airport and its customers. WAC's submission to the Commission's Issues Paper highlighted this point as follows[49]:

> "WAC will continue to consult with airlines in relation to future charging arrangements, including the application of the fuel throughput fee, which WAC recognises to be a controversial issue."

The Commission's Draft Report effectively argues that airports will not necessarily be disadvantaged financially under a price monitoring regime if the current Direction 27 provisions are set aside. WAC believes that the Commission's position could be debated on two grounds:

- It is not appropriate to set aside commitments made by Government at privatisation on the grounds that the airports are *unlikely* to be financially disadvantaged as a result; and
- Broadening the scope of price monitored services undermines the existing definition of dual till and therefore tilts future commercial negotiations in favour of the airlines.

WAC would appreciate confirmation from the Commission that its proposed approach to Direction 27 would not be extended to include the Qantas Domestic Terminal lease in the definition of price monitored services. In making this request, WAC notes that it would be inappropriate for the Qantas Domestic Terminal lease to be included in the definition of price monitored services because:

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48 Ibid, page 72.

49 Westralia Airports Corporation, *Submission to the Productivity Commission's Issues Paper*, 14 July, page 64.

- such an approach would broaden the scope of commercial negotiations to include revenues and costs that have previously been settled through long-term lease agreements falling outside the definition of the price monitored till; and

- in effect, there would be a re-opening of previous commitments made by Government and accepted by the airlines. It is likely that such a broadening of the scope of negotiations would have a detrimental financial impact on WAC.

Whilst WAC fully accepts the proposition that it should enter into commercial negotiations with airlines, the scope of these negotiations should be consistent with the concept of the dual till. It is clear that Direction 27 defines the dual till by excluding pre-existing agreements from the scope of price monitored services.

For the reasons set out above, WAC suggests that the Commission's final report should clarify that its proposed approach to Direction 27 would not be extended to include the Qantas Domestic Terminal lease in the definition of price monitored services. This would ensure that the commitments made by Government at the time of privatisation are properly recognised.

7 MONITORING OF CAR PARK PRICING

7.1 Current monitoring arrangements

In responding to the Commission's draft recommendation that the Government consider separate monitoring of charges for car parking, it is useful to briefly review the effectiveness of the current monitoring arrangements. Currently, car park services are monitored principally in relation to revenue and margin per passenger. Unfortunately, this type of monitoring may provide misleading indications of movements in car park prices and possible abuses of market power.

For example, the Australian Automobile Association's submission to the Commission's Issues Paper quotes the revenue, costs and margins from public and staff car parking in the ACCC price monitoring reports and notes that Perth had an increase in margin from this service over the period from 2002/03 to 2004/05 of 36%[50]. From this and similar statistics for the other monitored airports, the Australian Automobile Association seems to conclude that there has been a dramatic increase in prices charged to the end user, and that price caps should be considered by the Commission.

In reality, increases in revenue and margin per customer may reflect:

- improvements in car park services, which result in a higher ratio of vehicles to passengers;
- changes in product mix - for example as the proportion of customers using long-stay car parking increases;
- new products or improved product offerings that result in greater revenue per passenger; and
- substantial additional car parking spaces for charter and regional air services (where these passengers are excluded because services are not regular scheduled services).

The importance of these factors is illustrated by the car park pricing information included in WAC's submission to the Commission's Issues Paper. In particular, Table 4a on page 54 shows that charges for the first half hour increased from $3.30 in 2002/03 to $3.50 in 2004/05 (a 6% increase) and this was the first increase (other than for the GST) since 1999. Section 2.4.3 of that submission also highlights the increases in car park capacity since privatisation.

Ideally, effective monitoring of car park pricing would include information regarding capital investment, changes in product mix, productivity improvements and marketing initiatives that could affect revenues and margins per passenger. Importantly, however, WAC does not believe that such a detailed approach is warranted given the evidence provided by WAC in relation to the provision of car parking services and the on-going publication of car park prices on the airport's web page. In section 7.2 below, WAC further explains the competitive constraints on car park pricing that render price monitoring unnecessary.

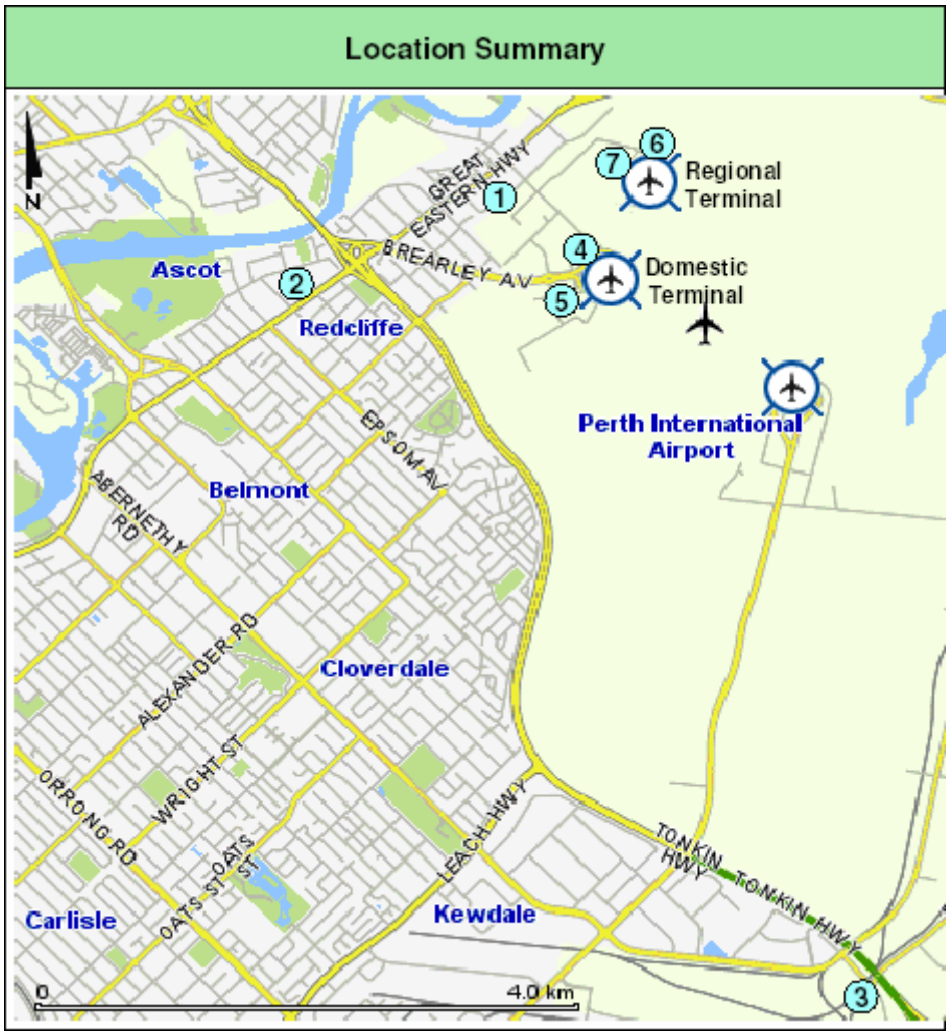
[50] Australian Automobile Association, *Submission to the Commission's Issues Paper*, page 2.

7.2 Competitive constraints

WAC's analysis has shown that WAC's parking rates compare favourably to CBD rates. The charge for 1 hour of short-term parking at the airport is approximately equal to 1 hour in the CBD (based on indicative medians from CBD pricing schedules). For longer term parking, WAC is approximately 79% of the median for parking for 12 hours in the CBD. Therefore, WAC believes that its car park pricing is justifiable compared to other areas where locational rents are available.

As noted in its submission on the Commission's Issues Paper, WAC is in the process of conducting a strategic review of car parking operations. While not complete, the review has highlighted that WAC has at least seven competitors for parking services.

As shown in the map below, the majority of WAC's parking competitors are located in relatively close proximity to the Domestic and Regional Terminals. WAC estimates that its competitors have close to 1,200 bays available. Whilst the number of bays currently represents a moderate proportion of WAC's facilities, the existence of alternative facilities and the prospect of further growth in competition provides a significant check on WAC's ability to exercise any market power in relation to these services.



In addition to direct competition for car parking, there is also competition from parking substitutes such as taxis, airport shuttles and kerbside drop-off/pick-up. WAC's internal

analysis suggests that WAC is very competitively priced compared to taxi services. For example, the cost for 3 hours of parking is only 11% of a two way CBD taxi fare[51]. Further, WAC's long term parking charge for a two week stay near the domestic terminal is only slightly more expensive than a two way taxi to the CBD and at the international terminal, a two week stay is only 77% of a two way taxi fare to the CBD.

WAC does levy a fee for taxis that covers the cost of facilities provided for the taxi drivers. This fee is approximately 3% of the cost of a two way CBD taxi fare, so it does not significantly influence the cost of taxi services to the end customer. Therefore, competition from taxi services also serves as a limiting factor on any market power that WAC may have in this area.

Kerbside drop-off imposes further constraints on WAC's car park pricing because to the extent that car park pricing is considered to be too high by the general public, (i.e. beyond what people are prepared to pay for the convenience and location) more people will tend towards kerbside drop-off or pick-up. This potentially creates considerable traffic management issues for WAC as well as safety concerns for the terminal forecourts. WAC takes careful account of these safety matters in setting car park charges.

WAC fully endorses the Commission's conclusion that[52]:

> "competition from off-airport service providers remains a sufficient constraint to warrant removal [of car parking]… from the coverage of the proposed new price monitoring regime."

However, WAC is disappointed to note that the above conclusion appears to be at odds with the Commission's recommendation that the Government consider separate monitoring of car park prices. WAC's view is that the monitoring of car park prices appears to be unnecessary - especially given the recent history of car park pricing; the existence of competitive constraints; the level of new investment in car park capacity; and the on-going publication of car park prices on the airport's web page.

51 CBD taxi fares derived from airport and tourism estimates.

52 Productivity Commission 2006, *Review of Price Regulation of Airport Services*, Draft Report, Canberra, page 76.

8 OTHER ISSUES

8.1 Sharing of Productivity Benefits

In draft recommendation 5.5, the Commission has proposed the following additional Review Principle:

> "The benefits of improved productivity at the price monitored airports should be shared between airport operators and their customers."

In developing this Review Principle, the Commission commented that[53]:

> "The greater pricing latitude under price monitoring should promote an appropriate sharing of the benefits of future productivity gains made by the airports. Indeed, as noted in chapter 2, the good productivity performance of Australian airports since 2002 appears to be at least partly attributable to the shift to light handed prices oversight.
>
> Nonetheless, in the Commission's view, it is important to incorporate the notion that productivity benefits should be shared in the overarching principles governing the operation of the new price monitoring regime. This would help to ensure that a monitored airport could earn 'above normal' returns if its productivity performance was consistently better than that of its counterparts, without being found to have misused its market power."

WAC endorses the Commission's view that the price monitoring regime should allow airlines and airports to share the benefit of productivity improvements in relation to aeronautical services. In fact, WAC believes that the 5-yearly price and service negotiation provides an appropriate mechanism for sharing productivity gains. In particular, WAC's submission to the Commission's Issues Paper highlighted the higher-than-expected passenger growth during the current 5 year period. However, WAC's submission also indicated that it had already shared some of the benefit of this growth with airlines and intended to take account of the higher passenger numbers in the renegotiation of aeronautical charges[54]:

> "In 2005/06 and 2006/07 WAC sought to share some of the benefits of unanticipated passenger number growth in recent years by voluntarily restricting its airfield charges to levels below those provided for by the Prices and Services Accord. WAC estimates that its decisions to reduce airfield charges in real terms have led to aggregate savings to customers of $0.89 million for the 2005/06 financial year and a further $2.14 million for the 2006/07 financial year, compared to the savings that would have been delivered through a strict interpretation and application of clause 4.8 of the Prices and Services Accord.
>
> The Prices and Services Accord will be re-negotiated for a further five year term from 1 July next year. During the forthcoming negotiations, WAC expects to take into account the impacts of passenger number growth during the current five-year pricing term."

WAC interprets the Commission's proposed Review Principle as requiring the airports to take action to share productivity gains in a manner similar to that outlined in WAC's submission (cited above). WAC's view is that the Commission should make it clear that the sharing of productivity improvements relates to the provision of aeronautical services, and that it would be inappropriate to include productivity improvements in relation to non-aeronautical services.

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53 Productivity Commission 2006, *Review of Price Regulation of Airport Services*, Draft Report, Canberra, page 82.

54 Westralia Airports Corporation, *Submission to the Productivity Commission's Issues Paper*, 14 July, page 61.

WAC also notes the Commission's comments that where an airports' productivity is consistently above its peers, its rate of return may also be consistently higher. WAC strongly endorses the thrust of the Commission's comments, but also cautions against drawing inferences regarding abuses of market power from financial data. It is noted, in particular, that during the current regulatory period the airlines and WAC agreed a charging arrangement that exposed WAC financially to passenger growth. In the event, higher-than-expected passenger growth led to higher rates of return for WAC. It would not be appropriate, however, for an inference to be drawn that WAC had abused its market power. Furthermore, it would not be appropriate for WAC to simply "hand back" the higher returns to airlines once the risk regarding passenger numbers had dissipated.

Subject to the comments and observations set out above, WAC endorses the Commission's proposed Review Principles.

8.2 Indexation of the asset base

As noted in section 3.6, WAC supports the Commission's conclusion that revaluations made by airports up to 30 June 2005 to the aeronautical asset values should be allowed to stand, but any subsequent revaluations should be excluded. The Commission's conclusion is reflected in draft recommendation 6.1.

WAC interprets the Commission's draft recommendation as requiring no subsequent revaluations of the asset base *in real terms*. In making this comment, WAC notes that the revenue models used by some airports to inform negotiations may apply a real cost of capital to an indexed asset base value. It is WAC's understanding that such an approach would be permissible under draft recommendation 6.1. For the avoidance of doubt however, it would be helpful for the recommendation to be revised to clarify that the indexation of asset values for CPI (in order to maintain the real value of the asset base over time) is permissible.

8.3 Qantas' experience with non-price access issues

Box 3.3 of the Commission's draft report outlines Qantas' experience with some airports regarding non-price access issues. WAC would again like to highlight the range of consultative forums in place at Perth Airport (which are described on page 37 of its initial submission). These forums provide all operators with the opportunity to provide feedback on operational issues. Given its market share in WA in both domestic and international markets, Qantas is WAC's single largest customer. As would be expected, most, if not all, of these consultative forums include Qantas representatives. Therefore, Qantas is in a strong position to influence operational decision making at Perth Airport. Given the size of Qantas' operations at Perth, it would be fair to say that their lack of cooperation could result in a project not proceeding.

Finally, while WAC's Prices & Services Accord ("PSA") does not provide for binding arbitration, it does allow for mediation of disputes. None of WAC's customers have used these provisions to resolve disputes, which tends to indicate that the negotiation process is working effectively. As noted in section 4.2 of this submission, WAC has recently discussed a new initiative with airlines, under which disputes that remain unresolved at the officer level are elevated to the organisations' respective CEOs for resolution. This new initiative should further enhance the negotiation process.

9 WAC's RESPONSES TO THE DRAFT RECOMMENDATIONS

The table below provides an overview of WAC's position in response to each of the Commission's draft recommendations.

No.	Recommendation	WAC's Response
4.1	A modified airport price monitoring regime should apply for five years from July 2007. • These new arrangements should clearly signal that a subsequent more detailed scrutiny of an airport's charges, including as appropriate through the Part VIIA inquiry provisions, will occur if the monitoring process reveals strong evidence of significant misuse of market power. • The monitoring process should also make explicit provision for airports and those using monitored services to comment on the reasonableness of charging and related outcomes, and require the Australian Competition and Consumer Commission to include that commentary in its monitoring reports.	As noted in sections 3.5 and 5 of this submission: • WAC is concerned that the 5-year period is likely to be too short. • In practice, it is not possible to establish a mechanistic monitoring and reporting regime to detect abuses of market power. Therefore, it is important to view the monitoring and reporting regime in a broader context, which includes a further scheduled review by the Commission. • WAC is concerned that subjective commentary from airlines is unlikely to provide an objective assessment of airport conduct and performance. Overall, WAC supports the broad direction of the recommendation, but further work needs to be undertaken by the Commission to develop the detail.
4.2	The new price monitoring regime should apply to Adelaide, Brisbane, Canberra, Melbourne, Perth and Sydney Airports. Darwin Airport should not be subject to monitoring once the current arrangements lapse.	WAC accepts this recommendation in relation to Perth Airport. WAC offers no comment on the application of this recommendation to the other airports.
5.1	The new price monitoring regime should continue to operate on a dual till basis. The services covered should be those 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.	WAC strongly supports the continuation of the dual till regulation. However, WAC questions whether the proposal from the Department of Transport and Regional Services is appropriate. In addition, WAC believes that it is important that existing Direction 27 exclusions remain in place. Please refer to section 6 of this submission for further discussion of these issues.

No.	Recommendation	WAC's Response
5.2	The Government should consider asking the Australian Competition and Consumer Commission to separately monitor charges for car parking and other landside vehicle services at the major airports.	WAC does not support this recommendation. As noted in section 7 of this submission, comprehensive information on car parking charges is already available on the airports' web-pages. On this basis, it is unclear what value would be added by requiring the ACCC to monitor car parking.
5.3	Monitoring of service quality under the new regime should be limited to the reporting by the Australian Competition and Consumer Commission of commentary sought from airports and their customers on overall quality outcomes and particular quality problems, and any information provided by them to support that commentary.	WAC does not support this recommendation. As noted in section 5.3 of this submission, it is important that service quality monitoring is objective. Whilst the thrust of the Commission's proposal to streamline service quality monitoring is welcome from the perspective of being low cost, WAC questions whether it will provide useful, objective information that can be used by stakeholders.
5.4	Price and service quality monitoring outcomes should be combined in a single report, published every two years. To align with the proposed end-of-period review in 2011 (see draft recommendation 5.5), the first of these reports should be published in early 2009 and cover outcomes during 2006-07 and 2007-08. To accommodate this new reporting arrangement, there should be no separate review of outcomes for the final year of the current price monitoring regime.	WAC supports the recommendation to combine the price and service quality reports. As noted in section 5.1 of this submission, WAC is less certain that there is a material benefit in publishing this information biennially rather than annually. If stakeholders wish to continue with annual publication, WAC would be pleased to adopt this approach. WAC will, in any event continue to undertake service quality monitoring at least on an annual basis.

No.	Recommendation	WAC's Response
5.5	The new price monitoring regime should be reviewed in 2011 to determine what arrangements should apply thereafter. Assessments under that review, and the operation of price monitoring in the intervening period, should be governed by an overarching set of principles. These should be the current 'Review Principles', augmented to specify that: • the benefits of improved productivity at the price monitored airports should be shared between airport operators and their customers; and • future asset revaluations should not generally provide a basis for higher charges (see draft recommendation 6.2).	WAC believes that there would be benefit in deferring the review of the new price monitoring regime until 2013 or 2014, for the reasons set out in sections 3.5 and 5.1 of this submission. WAC strongly supports a continuation of the Review Principles. WAC also supports the two further Review Principles proposed by the Commission, subject to the qualification set out in section 8.1 of this submission.
6.1	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 draft recommendation 5.1); • plus new investment (at values agreed with customers); • less depreciation and disposals.	WAC supports this recommendation, with the exception of the reference to "at values agreed with customers". Please refer to section 3.6 of this submission for further discussion. As noted in section 5.5, there will be a need to ensure that financial reporting guidelines are consistent with the draft recommendation, so that the asset base value used for price monitoring aligns with the 2005 ACCC accounts (and therefore may not necessarily conform to the statutory financial accounting rules). WAC therefore suggests that the Commission specifically recommend that the ACCC Airports Reporting Guideline (last updated in March 2004) be amended to allow for asset reporting to diverge from generally accepted accounting principles. As noted in section 8.2, the recommendation should also be revised to clarify that the indexation of asset values for CPI (in order to maintain the real value of the asset base over time) is permissible.

No.	Recommendation	WAC's Response
6.2	The principles governing the operation and end-of-period review of the new price monitoring regime should stipulate that, unless agreed with customers, further asset revaluations should not provide a basis for higher charges for monitored aeronautical services.	WAC fully supports this recommendation. Please refer to section 3.6 of this submission for further discussion.
7.1	An airport-specific arbitration regime, or a requirement that agreements between airports and airlines include provision for binding independent dispute resolution, should not be introduced at this time.	WAC fully supports this recommendation. Please refer to section 4 of this submission for further discussion.