
# Supplementary submission to the Productivity Commission's inquiry into price regulation of airport services

August 2006

# 1. Introduction

The Australian Competition and Consumer Commission (ACCC) makes this supplementary submission to the Productivity Commission (PC) in relation to its inquiry into price regulation of airport services.

The submission covers two issues which arise out of other parties' submissions to the PC:

- application of Part IIIA of the *Trade Practices Act 1974* to airport services
- the decision of the ACCC to not object to Airservices Australia's proposal to restructure its aviation rescue and fire fighting (ARFF) charges.

# 2. Application of Part IIIA to airport services

In the ACCC's submission to the PC's inquiry, 'Option A', discussed as one option for future regulatory arrangements to apply to the price-monitored airports, involves reliance on Part IIIA of the Trade Practices Act to constrain the exercise of airport market power. While recognising that Part IIIA does have some limitations, the ACCC submitted that Option A has the potential to limit abuses of monopoly power and encourage efficient operations and levels of investment, consistent with the Government's objectives.[1]

## *Submissions to the PC inquiry*

A number of submissions to the PC's inquiry raise concerns over the application of Part IIIA to airport services. Comments concern the interpretation of criterion (a) in s. 44G(2) of the Trade Practices Act,

> that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service.

The National Competition Council (NCC) in its submission states that the purpose of criterion (a) is 'to limit declaration to circumstances where access would promote competition in dependent markets.'[2] While the NCC states that the objective of Part IIIA is to promote competition in dependent markets by preventing bottlenecks from otherwise restricting competition, rather than to remove or reduce monopoly rents where competition in dependent markets is not diminished, it states that this objective is achieved as a by-product of declaration.

It considers that Part IIIA should continue to apply to airports and expresses the view that

> Of the policies implemented to date, only Part IIIA ensures that access will be made available to participants in dependent markets on reasonable terms and conditions. It may be argued that an outright denial of access to airports is unlikely because s44 of the *Airports Act 1996*, by imposing a 5 per cent limit on airline ownership of an airport, effectively prohibits vertical

[1] Australian Competition and Consumer Commission, *Submission to the Productivity Commission's inquiry into price regulation of airport services*, August 2006, p. 92.
[2] National Competition Council, *Price Regulation of Airport Services Submission to Productivity Commission inquiry*, July 2006, p. 4.

> integration. However, it may still be possible for an airport owner to impose terms and conditions on access in ways that damage competition.[3]
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> …
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> In the Council's view Part IIIA provides an appropriate basis and scope for regulation of airports (and other infrastructure) that serves the public interest in avoiding uneconomic duplication of facilities and ensuring third party access to such facilities is permitted in appropriate circumstances and on appropriate terms.[4]

In relation to the PC's question in its issues paper of whether there would be value in developing a code of practice for commercial agreements governing access to airport services, the NCC states that

> only in exceptional circumstances should processes that deviate from the overarching national architecture of Part IIIA be contemplated. The Council suggests that it would be preferable to see how well the post-declaration negotiate/arbitrate process works before implementing a unique set of provisions for airports.[5]

However, other parties propose an airports-specific regime is required, because of their concern that criterion (a) would not be satisfied.

The Board of Airline Representatives of Australia (BARA) considers that Part IIIA does not align with the Government's objectives on airport pricing because

> Part IIIA is fundamentally about competition and not primarily the abuse of market power. One must prove both a market power and a competition issue under Part IIIA.[6]

Virgin Blue Airlines considers that

> there may also be some doubt about whether all airport aeronautical services provided at major airports in Australia (being those services in relation to which the airports have substantial market power) would meet the criteria for declaration under Part IIIA of the TPA.[7]

While the Tribunal in the Sydney airport case had found that criterion (a) was satisfied, Virgin considers that

> in relation to other services provided at other airports, the picture may not be as clear in relation to whether declaration would be likely to prevent the airport from misusing its market power. This may be because the airport has not yet misused its market power, or because evidence of its conduct (and its motivating purpose) will not be as readily available as was the case before the Tribunal in *Re Virgin Blue Airlines*.
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> This uncertainty is increased due to the proposed change to the test in criterion (a) under the Trade Practices Amendment Bill, which will require that access (or increased access) would promote a material increase in competition in the dependent market. While there are good arguments that this amendment should not have any significant impact on the way in which criterion (a) is applied, the amendment is yet to be considered by the Tribunal or a court.[8]

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[3] ibid., p. 14.
[4] ibid., p. 16.
[5] ibid., pp. 17-18.
[6] Board of Airline Representatives of Australia, *Submission to the Productivity Commission's inquiry into price regulation of airport services*, June 2006, p. 20.
[7] Virgin Blue Airlines, *Submission to the Productivity Commission from Virgin Blue Airlines*, p. 58.
[8] ibid., p. 59.

The Department of Transport and Regional Services (DoTARS) also speculates that

> a decision that one airport's service cannot be declared could be expected to set a precedent for all of the major airports. This could effectively exclude the large federal airports from the National Access Regime.[9]

This concern with the application of Part IIIA has led some parties to propose an industry-specific dispute resolution process for airports. In particular, Virgin Blue recommends automatic declaration of aeronautical services of aeronautical services at the major airports and also supports Qantas' proposal for access undertakings, backed by deemed declaration. DoTARS proposes clearer pricing principles, including covering asset valuation, with a binding commercial arbitration process which would be accessed prior to accessing Part IIIA. Melbourne airport recommends an industry-specific dispute resolution mechanism that exempts the five large airports from Part IIIA.

## *The ACCC's response*

The ACCC agrees with the view expressed by the NCC that Part IIIA provides an appropriate basis for regulating airports and ensures that third party access is provided on appropriate terms and conditions. The ACCC also agrees that it should be only in exceptional circumstances that industry-specific dispute resolution regimes that deviate from the overarching framework provided by Part IIIA be contemplated. Given the recent review of Part IIIA by the PC and legislative amendments resulting from that inquiry, the ACCC agrees with the NCC that it is preferable to see how the newly amended provisions operate before considering any unique airports-specific arrangements to address perceived deficiencies in Part IIIA.

The Part IIIA provisions are designed to address the consequences of substantial market power held by the owners of significant infrastructure facilities and prevent distortions to competition in that or related markets that may result from the exercise of such market power. This includes the incentives of non vertically-integrated monopolies to use their market power to charge prices above competitive levels at the expense of consumers and economic efficiency.

Prices substantially above 'competitive' levels for monopoly infrastructure services are inconsistent with effective competition in dependent markets. Therefore, the prospect of removing these rents via declaration is likely to promote competition in one or more of those markets.[10]

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[9] Department of Transport and Regional Services, *Submission to the Productivity Commission Review of Price Regulation of Airport Services, July 2006*, p. 12.

[10] See, for example, Ordover & Lehr [appendix 5 to NCC MSP final recommendation] @ p12-13:

"First, absent coverage or any other form of price regulation, the MSP may be able to set prices for transport services that substantially exceed its forward-looking, long-run economic costs. This would have the effect of increasing the delivered cost of gas in the NSW/ACT markets, which would, in turn suppress demand for upstream production from the Cooper Basin….

The combination of lower upstream and downstream margins from above competitive transport rates, will tend to reduce incentives to invest in both upstream and downstream markets and therefore could have an adverse effect on competition in both of these markets."

If in practice, Part IIIA is ineffective in applying in the case of owners of significant infrastructure possessing significant market power, the ACCC considers that amendments to the generic Part IIIA provisions should be considered in preference to introducing separate industry-specific regimes.

The PC recognised the advantages of a generic national access regime that applies to all sectors of the economy in its review of the national access regime. In particular, such a regime facilitates a consistent approach across infrastructure sectors, thereby enhancing predictability and reducing the risk that resource allocation will be distorted by the differing treatment of like cases. The PC's primary concern was to 'reduce the scope for unwarranted divergences across individual access regimes'.[11]

The PC also recognised that industry-specific arrangements have advantages in certain circumstances. In particular, where industry differences relating to access matters are substantial, industry-specific regimes are likely to provide greater certainty to the industry than a generic regime which relies more on interpretation in any particular circumstance.[12]

The ACCC agrees with the principle of avoiding departures from the general access regime unless they are clearly warranted. The ACCC does not consider that airports possess such unique features that warrant departure from the generic Part IIIA provisions. In particular, given the recent amendments to Part IIIA resulting from the PC's inquiry, the effect of these amendments should be given time to be observed before any specific measures to address perceived deficiencies in the Part IIIA provisions are considered.

# 3. Airservices Australia's price structure

In its submission to the PC inquiry, BARA is critical of the ACCC's decision to not object to Airservices Australia's proposal to restructure its ARFF prices. Melbourne airport supports BARA's submission on this issue. The purpose of this submission is to respond to some fundamental misunderstandings in BARA's submission.

## *BARA's submission on ARFF charges*

In its submission to the PC, BARA makes five main claims:[13]

1. The ACCC's decision taxes international airlines in order to subsidise airline operations to regional locations.

2. The decision overturns one of the key principles underpinning the reform of Australian airports and Airservices because it allows pricing which under recovers Airservices' incremental costs of providing ARFF services at regional locations.

3. A key pricing principle to be inserted into Part IIIA of the *Trade Practices Act 1974* is that prices should 'be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient

[11] Productivity Commission, *Review of the National Access Regime*, 28 September 2001, p. 122.
[12] ibid., p. 117.
[13] Board of Airline Representatives of Australia, *Submission to the Productivity Commission's inquiry into price regulation of airport services*, June 2006, pp. 12-14.

costs of providing access to the regulated service or services'. The implication is that the ACCC's decision is inconsistent with this principle.

4. The ACCC's decision is in conflict with the decision of the Australian Competition Tribunal in its decision declaring the domestic airside service at Sydney airport. BARA states that the Tribunal considered that Sydney airport did not structure its airfield charges based on a consideration of the underlying cost drivers and this had the effect of favouring some airlines over others. BARA claims that the ACCC has supported prices not being based on incremental cost and favoured some airlines over others; namely, domestic airlines operating to regional locations over international airlines.

5. The ACCC's decision in relation to Airservices' ARFF services implies that airport pricing more generally could be used to promote regional development objectives if direct price controls are introduced at Australian airports.

## *The ACCC's assessment of the structure of prices for ARFF services*

The ACCC's decision to not object to Airservices' proposal to restructure its ARFF prices:

- was made on the basis that the proposed price structure was more efficient than the previous price structure
- does not overturn key principles underpinning the reform of Australian airports and Airservices
- is not inconsistent with pricing principles in Part IIIA of the Trade Practices Act
- is not in conflict with the Australian Competition Tribunal
- does not imply that airport pricing should be used to promote regional development objectives.

### Background

The ACCC's decision to not object to Airservices' proposal to restructure its ARFF prices was made under the provisions of Part VIIA of the Trade Practices Act. Under these provisions, Airservices is required to notify the ACCC of proposed price increases relating to the provision of air traffic control and ARFF services. The ACCC is then responsible for assessing the proposed price increases and for deciding either to object or not to object to the proposed price increases. In assessing price notifications, the ACCC is required to have particular regard to the matters set out in subsection 95G(7) of the Trade Practices Act. The ACCC applies this legal framework according to the concepts and procedures outlined in its *Statement of regulatory approach to price notifications*.[14]

[14] ACCC, *Statement of regulatory approach to assessing price notifications*, July 2005, available at http://www.accc.gov.au

The ACCC examined the structure of Airservices' prices in its assessment of Airservices' 2004 price notification,[15] which covered all of Airservices' declared services for the period 2004–05 to 2008–09. In that decision, while the ACCC found that terminal navigation and ARFF services at regional and general aviation locations were subject to subsidies from other services and locations, the ACCC considered that this was not an immediate concern on efficiency grounds unless either competition was going to be introduced in the short term, or the level of the cross-subsidy was such that regional and GA airports were being kept open when the value of these airports to their users was less than the cost of these airports. The ACCC was not provided with any evidence to suggest that either of these conditions was applicable.[16]

However, the ACCC considered that the structure of ARFF charges (on the basis of aircraft weight, with a minimum threshold of 2.5 tonnes) was not likely to be efficient because the price charged appeared to be unrelated to the impact of some operators on Airservices' costs. The existing charging structure also was likely to have large impacts on particular user groups. The ACCC therefore considered that Airservices should address this issue before introducing long-term pricing arrangements.

In its review of the structure of ARFF prices, Airservices consulted with its stakeholders on a range of alternative pricing structures for ARFF services, ranging from a single location specific price to full network pricing. Based on this process, Airservices proposed a common base price for category 6 ARFF services (the basic level of service), with location specific increments for higher category services (categories 7 to 9).[17]

In making its decision to not oppose Airservices' proposal, the ACCC carefully considered all submissions made to it, including submissions from BARA. Its full reasoning and consideration of the arguments are contained in its reasons for decision.[18]

**The proposed price structure is more efficient than the previous price structure**

In assessing Airservices' proposal, the ACCC examined the nature of the costs of providing ARFF services in detail. It noted that the costs of providing ARFF services were to a large extent fixed for a given category of service because variations in activity levels do not influence the costs of providing ARFF services in the short term. Therefore, the marginal cost of additional landings at an airport appeared to be negligible within a given category of ARFF service. However, variation in the type of aircraft landing at an airport could influence the category of an ARFF service, and hence the cost of providing ARFF services.

With negligible marginal costs, Airservices' previous price structure recovered ARFF costs by applying a mark-up above marginal costs. The location-specific pricing formula resulted in relatively high prices at small airports and low prices at large

[15] ACCC, *Final decision Airservices Australia Price notification*, December 2004.
[16] See ACCC, *Preliminary View Airservices Australia draft price notification*, November 2004, p. 90.
[17] The category of an ARFF service depends on the category of aircraft using an airport. The category of aircraft is determined on the basis of factors such as length and width.
[18] ACCC, *Final decision Airservices Australia Price notification Aviation rescue and fire fighting services*, December 2005.

capital city airports. The proposed common basic service charge, by applying a common charge at all airports where an ARFF service is supplied is more efficient, given the generally higher price sensitivity of users at the low volume activity airports.

In addition, where changes in activity result in a higher category of ARFF service being required, the proposed price structure signals the cost of the new investment required to those users causing the costs to be incurred. This is more efficient than the previous price structure, which, for example, saw existing users of a basic ARFF service being forced to cover the cost of upgrading a service which was not due to their actions.

**The ACCC's decision does not overturn key principles underpinning the reform of Australian airports and Airserivces**

BARA quotes selected abstracts from the Industry Commission's 1992 inquiry into Intrastate Aviation. In its report, the Industry Commission sets out principles for efficient pricing at airports.

> In essence, users should pay for the marginal cost of the services they receive. However, the marginal cost of providing an extra service or accommodating an additional aircraft is relatively small. In some instances, the additional cost is zero. … In these circumstances, setting prices according to marginal cost would not allow all costs to be recovered.
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> Pricing strategies can be designed to overcome the revenue shortfall generated by airports pricing at marginal cost while maintaining many desirable attributes of marginal cost pricing. … Two pricing strategies of this kind are two-part tariffs and Ramsey pricing.
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> Under Ramsey pricing principles, landing fees would include a surcharge to generate sufficient revenue to cover all aeronautical costs. The surcharge would be in addition to landing fees based on marginal and external costs, and would differ between categories of airport users. To minimise distortions in the pattern of airport use, the surcharge would need to be highest for those aircraft which are least likely to alter their usage and lowest for those most likely to alter their pattern of airport use. For example, the surcharge could be greatest for large aircraft (which have the capacity to spread landing fees over a large number of passengers), for aircraft which travel long distances (involving relatively high fares and limited competition from alternative travel modes) and for aircraft using the airport at morning and afternoon peak periods (ie business passengers that are relatively insensitive to price changes).[19]

As explained above, Airservices' proposal is more consistent with these principles than the previous pricing structure.

**The ACCC's decision is not inconsistent with pricing principles in Part IIIA**

The pricing principle BARA refers to requires that prices should

> be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services.

[19] Industry Commission, *Intrastate Aviation*, 1992, pp. 148, 207-207.

This relates to the overall level of revenue generated from the provision of a particular service, rather than the structure of pricing used to recover that overall level of revenue and therefore is not relevant to BARA's arguments.

**The ACCC's decision is not in conflict with the Australian Competition Tribunal**

Rather than being inconsistent with the approach advocated by the Tribunal in relation to the structure of charging at Sydney airport, the ACCC, by considering the cost drivers associated with the provision of ARFF services, acted consistently with the approach suggested by the Tribunal.

**The ACCC's decision does not imply that airport pricing should be used to promote regional development objectives**

The ACCC's decision to not object to Airservices' revised pricing structure for ARFF services is not about promoting regional development objectives, but is the result of a careful consideration of the efficiency of the proposed price structure compared with the previous price structure.

In relation to BARA's claim that the proposed price structure unduly favours domestic airlines over international airlines, it is important to note that the primary reason that international airlines face higher charges is because they land large, high category aircraft, which has the biggest impact on the costs of providing ARFF services. Amongst other things, higher category aircraft require Airservices to invest in additional fire fighting equipment and fire trucks, and maintain larger minimum numbers of staff.

In addition, the ACCC's decision was made clearly on the basis that Airservices currently enjoys a statutory monopoly over the provision of ARFF services across Australia. The ACCC recognised that the proposed price structure may not be consistent with some models for introducing competition into the provision of ARFF services and that the price structure may need to be revisited in this event. The Department of Transport and Regional Services is currently consulting on this issue.[20]

[20] Department of Transport and Regional Services, *Aviation Rescue and Fire Fighting Services A Discussion Paper*, 7 July 2006.