



**Submission to the Productivity Commission's draft
report on the price regulation of airport services**

October 2006

1. Introduction

The Australian Competition and Consumer Commission (ACCC) makes this submission in response to the Productivity Commission's (PC) draft report on the price regulation of airport services.

In effect, the PC has recommended a regime for the future price regulation of airport services which is consistent with 'option A' proposed by the ACCC, in the context of the government's objectives in moving to a 'light-handed' regulatory regime for airports.

Under option A, the ACCC proposed reliance on Part IIIA of the *Trade Practices Act 1979* (the Act), whilst either removing the existing airport-specific monitoring arrangements or retaining them as a complement to Part IIIA.

As outlined in the ACCC's initial submission¹, reliance on Part IIIA of the Act is likely to be reasonably effective in constraining monopoly power, but its effectiveness may be limited by the cost and delay involved in seeking redress through these provisions. In the case of airports, this is heightened by the imbalance in bargaining power and, unless addressed, the asymmetry in information between the parties. In addition, generic problems associated with negotiate-arbitrate models may also apply in the airports context.

While retaining existing monitoring information is unlikely to provide all of the information necessary for making decisions under Part IIIA, it is nevertheless likely to provide some useful information. Such information may also address to some extent the information asymmetries between airports and airlines, thereby assisting airlines in their negotiations with airports.

The ACCC has carefully considered the PC's draft report, and has identified a number of issues that would merit the PC's consideration before finalising its findings. The ACCC also has some specific comments regarding the PC's recommendations on:

- the separate monitoring of car parking and landside vehicle access charges; and
- the streamlining and refocusing of the quality of service monitoring arrangements.

2. Concerns about particular findings

2.1 Price and rate of return outcomes

The PC contends that the substantial increases in charges at airports after the introduction of light-handed regulation were widely accepted as necessary. In this section, the PC notes that 'At Sydney airport, which was still publicly owned, a major increase in charges had been approved by the ACCC in May 2001...' ² and '...the

¹ ACCC, *Submission to the Productivity Commission's inquiry into price regulation of airport services*, August 2006, sub. 39, p. 105.

² Productivity Commission, *Review of Price Regulation of Airport Services*, Draft Report, 2006, p. 16.

increases in charges at the other monitored airports following lifting of price controls closely followed the pricing ‘template’ established by the ACCC in its Sydney determination’.³

The ACCC is unable to verify the claim that the other airports applied the pricing template established by the ACCC in the Sydney airport determination. Further, while the Sydney airport determination resulted in substantial increases in charges for aeronautical services, it is unclear whether the same outcome would necessarily have resulted for other airports, as the ACCC’s determination related only to the specific circumstances of Sydney airport. As such, the ACCC is unable to test the veracity of the justification put forward by the other airports and presented in the PC’s report.

The PC has also compared the airports’ rates of return in the 2004/05 financial year with the forecast rates of return determined by the ACCC in previous Necessary New Investment (NNI) pass-through decisions.

The PC contends that drawing strong conclusions from rate of return data on the reasonableness of airport charges is difficult, amongst other things, due to the critical dependence on the values ascribed by the airports to their aeronautical assets. Despite this, the PC has noted that ‘In most cases, the reported rates of return in 2004-05 were still below the benchmark rates determined by the ACCC for each airport under the previous regulatory regime, or proposed by the airports at the time of those determinations.’⁴

It appears inconsistent for the PC to compare forecast weighted average cost of capital estimates with actual rates of return given the PC acknowledges that the asset revaluations that have occurred will limit the value of these comparisons.

In the context of the significant asset revaluations at some airports, such a comparison does not yield information on the reasonableness of airport charges. As previously noted by the ACCC in its 2002/03 price monitoring and financial report, the airport operator’s valuation of tangible non-current assets will materially affect the measure of actual return. Furthermore, an economic approach to valuing assets may differ from the accounting values reflected in the accounts of the monitored companies. For example, in the case of airports, the value of land as well as specialised assets is complex and contentious.⁵

In its assessment of whether price and profit outcomes at the airports have been reasonable, the PC has concluded that ‘...there are several indicators that suggest that any misuse of market power at the price monitored airports has been neither systematic nor significant’⁶. In forming this view, the PC has had regard to the benchmarking of charges for international services and airport profitability at the price-monitored airports with international airports, and the benchmarking of charges for domestic services at the price-monitored airports with charges at non-price monitored airports.

³ Ibid.

⁴ Ibid, p. 21.

⁵ ACCC, *Price Monitoring and Financial Reporting – Price Monitored Airports 2002-03*, p. 93.

⁶ PC, op. cit., p. 25.

While the PC's analysis sheds some light on the extent to which the prices levied by the price-monitored airports are consistent with the principles established by the government for the review of pricing, it is not clear to the ACCC that the PC has conducted sufficient analysis to establish whether the airports have misused market power in setting prices. Further analysis and information would be required in order to form a conclusive view on this issue.

2.2 Regulation and investment

The PC has compared investment levels and processes under the previous price cap regime and light handed regulation. The PC has formed the view that '...there can be little doubt that investment levels have been higher, and the investment process more timely, than would have been the case had the previous price cap and NNI arrangements still been operative.'⁷

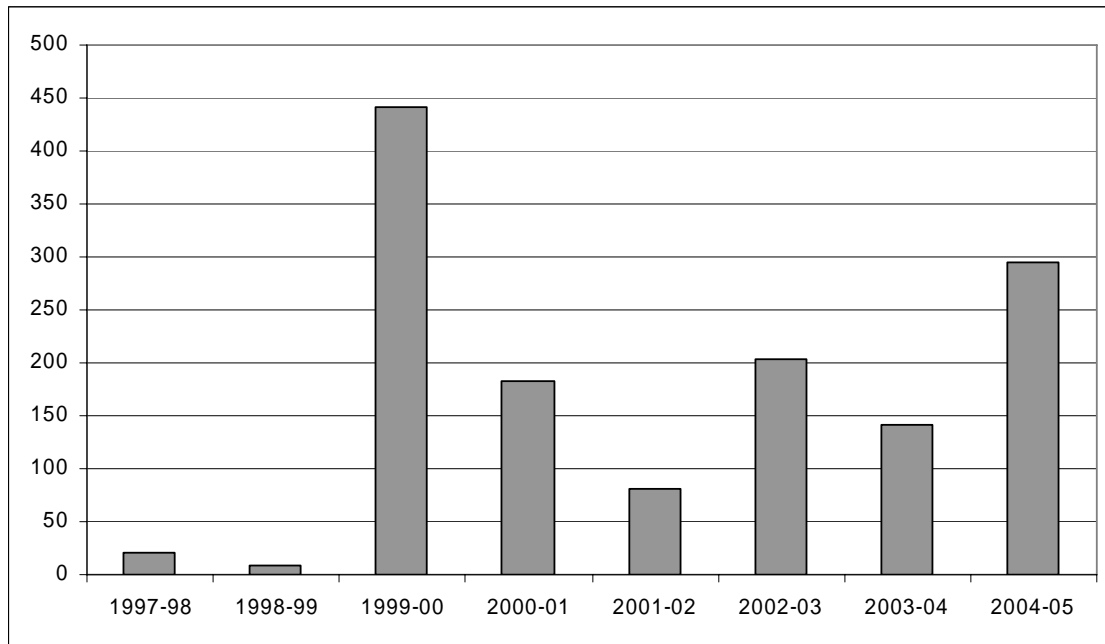
While the removal of the requirement to seek approval of price increases associated with investment proposals should have made the investment process simpler, it is not clear that the PC has made adequate assessment on whether investment under the current regime is higher than that which would have occurred had the previous arrangements continued to apply.

In forming its view on investment levels between the two regulatory regimes, the PC has had regard to information in the Australian Airports Association's (AAA) submission that indicates that average new investment during the price cap period was lower than average new aeronautical investment during light-handed regulation.

Chart 1 details total additions to tangible aeronautical non-current assets at the price-monitored airports during the period 1997-98 to 2004-05 from the regulatory accounts of the price monitored airports. Additions to tangible aeronautical non-current assets provide an indication of the level of new investment in aeronautical services.

⁷ PC, op. cit., p. 35.

**Chart 1: Additions to tangible aeronautical non-current assets 1997 to 2005
(\$ million)**



Notes: This chart details total aeronautical additions (excluding opening balances and transfers) at Brisbane, Melbourne, Perth airports from 1997-98 onwards and Adelaide, Canberra, Darwin and Sydney airports from 1998-99. The significant additions in 1999-00 were attributable to the SA2000 expansion project at Sydney airport.

While average aeronautical additions during the price cap period were lower than average aeronautical additions during the period of light-handed regulation, chart 1 shows that there has been significant variability in the level of new aeronautical investment across the period.

As an initial step, it may be informative for the PC to weigh new aeronautical investment at airports by their closing asset bases to ensure that new investment at the larger airports does not ‘swamp’ small airports in this assessment. Controlling for airport size in considering total new investment during the period may provide a clearer indication of how investment conditions have changed across all airports.

The ACCC does not consider that a comparison of average investment levels between the period of price cap and light-handed price regulation alone is sufficient information on which to form a view on the impact of the different regulatory regimes on investment levels.

The PC acknowledges that external factors will have influenced investment levels between the two regulatory periods. As noted by the PC, ‘Such growth in investment cannot, of course, be attributed solely to the move to more light handed prices oversight. Investment cycle effects will have also played a role.’⁸

⁸ PC, op. cit., p. 34.

However, there are clearly other factors, independent of the change in regulatory regime, that will have had a significant impact on investment levels during the two periods. These do not appear to have been factored into the PC's analysis.

The Asian financial crisis, the September 11 terrorist attacks and the Ansett collapse were all external events that had a significant effect on investment levels when the NNI arrangements were operative. These events resulted in a significant downturn in the aviation industry that created considerable uncertainty and would have dampened investment in aeronautical services.

The significant increases in traffic attributable to the success of the low cost carriers, and the widening of runways to accommodate the expected arrival of the Airbus A380, were external events that had a positive impact on investment levels during the period of light-handed regulation.

Further, the level of government ownership of airports during the period likely influenced levels of new aeronautical investment. Only the phase 1 airports (Brisbane, Melbourne and Perth) were privately owned during 1997-98, while Sydney airport was not privatised until late in the 2001-02 financial year. The approach that the government took to the investment in aeronautical assets at the airports would likely have been tempered by its differing objectives and the airport privatisation process.

It also seems unreasonable to expect the owners of the airports to have been in a position to commence significant investment in aeronautical assets immediately upon acquisition. The new airport owners would first have faced significant information asymmetries before acquisition that would have been resolved during the first few years of operation in 1997-98 and 1998-99.

The ACCC encourages the PC to consider undertaking further analysis, such as detailed econometric analysis that quantifies the effects of these factors on investment levels, to provide adequate support for its findings in this area.

In addition, in its assessment of whether price monitoring should continue, one of the PC's considerations is its view that light-handed regulation has provided a better investment environment than that which existed under the previous price cap and NNI arrangements.

While outcomes under the previous regime are clearly relevant to such an assessment, the PC should also note that investment provisions under any new price cap arrangements may have been better structured to avoid some of the problems in the previous regime.

As outlined in the ACCC's submission to the PC's 2001 inquiry, a lack of clarity over what new investment the government had factored into the X values to apply to the privatised airports created considerable uncertainty over what investment could be passed through under the NNI provisions. Negotiations between airports and airport users struggled because airport users argued that the investment proposals of the new operators had been factored into the X values, whereas the airports would not invest without a passthrough. The ACCC sought to mitigate this uncertainty in 2000 with the release of guidelines to clarify the coverage of the NNI provisions. In the submission

the ACCC identified some improvements that would have been desirable (were price cap arrangements to have continued) in its initial submission to the PC's previous airports inquiry⁹.

3. ACCC concerns about particular recommendations

3.1 Car parking and other landside vehicle charges

In its assessment of service coverage issues, the PC considered that '...in order for price monitoring to assist identification of any instances of inappropriate airport behaviour in setting charges, it should encompass all of those services for which airports are likely to have significant market power. Conversely, inclusion of services for which airport operators have little or no scope to exercise market power would add little to assessments of the reasonableness of their behaviour'.¹⁰

Despite forming the view that '...competition from off-airport service providers remains a sufficient constraint to warrant removal of car parking and other landside vehicle access charges from the coverage of the proposed new price monitoring regime'¹¹, the PC has recommended that the government should ask the ACCC to separately monitor these services.

The decision to monitor a service should depend on an assessment of market power. In the context of the PC's view on market power for car parking and landside vehicle access charges, the PC reasoning for recommending that the government establish a separate monitoring regime is unclear. The ACCC encourages the PC to further clarify its intentions in the final report.

As outlined in its submission to the issues paper, the ACCC considers that airports have a monopoly position in relation to the alternative forms of landside access, and control access as a 'bottleneck facility'. Hence, the airports have market power in the overall market for airport landside access. The extent to which off-airport alternatives provide an effective constraint on the abuse of market power is unclear, and is an area in which further analysis, including reference to empirical data, could be undertaken. Regard would also need to be had to related industry developments, such as the recently reported interest of Macquarie Bank in extending its involvement in the taxi cab industry.¹²

3.2 The replacement of the current quality of service monitoring regime with the reporting of stakeholder commentary

Monitoring quality of service is an important component of the price regulation of airport services. While the purpose of price monitoring is to ensure that airports levy reasonable prices for aeronautical services, quality of service monitoring is designed to

⁹ ACCC, *Submission to the Productivity Commission's Inquiry into Price Regulation of Airport Services*, May 2001, p. 102-109.

¹⁰ PC, *op. cit.*, p. 68.

¹¹ *Ibid.*, p. 76.

¹² Murray, L., *Bank eyes taxi takeover*, Sydney Morning Herald, September 21, 2006.

ensure that airport operators do not degrade service standards as a means to reduce costs and increase profit.

The PC has formed the view 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 behavior of the airports.’¹³

In forming this view, the PC considered that the ACCC’s submission had questioned whether the current arrangements provide much of a guide as to whether service quality is well targeted to the needs of users. While the ACCC did make the point that the existing quality of service monitoring regime does not explicitly address whether the level of quality provided at airports is at the level demand by users given prices, it did not express a general view on the extent to which the regime was targeted to users needs.

The PC has recommended confining the current approach to monitoring quality of service to the reporting of commentary from stakeholders – airports, airlines and airfreight operators. This would also enable stakeholders to provide the same sort of information that is supplied under the existing regime, but allows stakeholders discretion in deciding how much of this information is relevant.

The ACCC is concerned that while airlines will have an incentive to comment on airport service quality, the PC’s recommended approach will create an incentive for airport operators to disclose very limited information. This reduced level of transparency limits the likelihood that quality of service monitoring will identify whether airports are reducing costs through reductions in service quality.

While some of the aggregate measures in the current approach to quality of service monitoring are unsuited to capturing the diversity of stakeholder views on service quality, reporting of commentary is subjective and provides no means to reconcile opposing views to form overall measures of service quality. Further, reporting of stakeholder commentary would not be able to identify trends in quality of service at airports over time.

Therefore, the ACCC considers that it would be premature to abandon the current approach to monitoring airport quality of service.

The ACCC’s quality of service monitoring regime draws on a number of different sources of information, including passenger perception, airline and Australian Customs Service surveys, objective indicators of service quality, and information on runway performance from Airservices Australia. The current approach to quality of service monitoring provides information on the overall quality of service of the price monitored airports, and identifies trends in service quality over time. It also facilitates comparison of trends in service quality over time across airports.

As identified in the ACCC’s initial submission, some modification of the existing regime to better capture whether the level of quality provided is at the level demanded

¹³ PC, op. cit., p. 79.

by users to complement the existing measures of service quality, is likely to shed more light on whether airports are degrading service standards or ‘gold plating’ services.