PERTH
AIRPORT

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Price Regulation of Airport Services Inquiry
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Dear Mr Potts

Price Regulation of Airport Services: Productivity Commission's Public Inquiry

Following the recent public hearings in Melbourne and Sydney, and the Federal Court's decision in relation to Sydney Airport', Westralia Airports Corporation (WAC) would like to take this opportunity to make a further submission to the Commission's review of the price monitoring regime.

WAC would like to make two points in this submission, as follows:

1. A number of submissions to the Commission's inquiry have drawn inappropriate inferences for the Commission's review from the declaration of airside services at Sydney Airport and the Federal Court's subsequent decision; and

2. The submissions to the Commission's draft report and the public hearings have not provided any new evidence that should lead the Commission to revisit the principal conclusions and recommendations set out in its Draft Report.

Each of these points is discussed briefly in turn below.

Implications from the declaration of airside services at Sydney Airport and the Federal Court's decision

The litigation surrounding the declaration of airside services at Sydney Airport provides a detailed examination of the market conduct of SACL. However, WAC strongly disagrees with the view expressed by some parties that it is reasonable for the Commission to draw wider implications from this case regarding the conduct of other airports. In particular, Qantas has argued that the experience at Sydney Airport demonstrates that it is not possible to negotiate with *any* airport[2].

> "The behaviour of Sydney Airport is representative of experiences that airport users have at most major airports. The key differential for Qantas is its negotiation, or is the process consultation. The negotiation process between airport users and airports does not exist.

Sydney Airport Corporation Ltd v Australian Competition Tribunal [2006] FCAFC 146.

[2] Productivity Commission's Public Hearing in Sydney, 30 October 2006, page 106.

> Without constraint and its ability to exercise market power, commercial negotiations with a monopoly supplier, the airport, are not possible. Instead, airports consult with airport users and then impose price and non-price terms and conditions."

Contrary to Qantas' position, one reading of the Australian Competition Tribunal (ACT) decision in relation to Sydney Airport is that Qantas' preference for passenger-based charges strongly influenced SACL's choice of charging structure. In particular, the ACT concluded that[3]:

> "We are satisfied that SACL has misused its monopoly power in the past, and that, unless the Airside Service is declared, competition in the dependent market will continue to be affected. In particular, we are satisfied that SACL has misused its monopoly power by the manner in which, and the reasons for which, it changed the basis for its charge for providing the Airside Service in July 2003 from an aircraft's maximum take-off weight ("MTOW") basis to a charge on a per-passenger basis ("known as the Domestic PSC"). This change adversely affected low cost carriers such as Virgin Blue as against full service airlines such as Qantas. Further, the evidence disclosed that SACL chose a passenger-based charge "because Qantas preferred it". At the time the basis for this charge was altered, SACL knew that it would impact more adversely on Virgin Blue than on Qantas."

In addition, Qantas' view that the negotiation process between airport users and airports does not exist contrasts sharply with the views expressed by BARA[4]:

> "So generally speaking, for a majority of the airports we're probably reasonably confident that we can develop a sound commercial relationship going forward".

> "We highlighted some problems with Perth airport in our original submission. We didn't harp on that in our second submission largely because I firmly believe that the negotiations that we commenced with Perth airport towards the end of this month on a revised pricing agreement probably will proceed to a satisfactory conclusion. One of the sticking points at Perth airport remains the continued application of a fuel throughput levy which we vehemently opposed. But nonetheless I am reasonably confident that we can, through our discussions with Perth airport, come to a satisfactory conclusion."

In light of the above observations, WAC believes that some of Qantas' comments exaggerate the difficulties that it has faced in negotiating with airports, and overstate the extent to which airports are inclined to misuse their market power.

WAC further believes that Qantas has misinterpreted the extent to which the recent Federal Court decision on Part IIIA of the TPA has implications for the Commission's review of the effectiveness of the price monitoring regime. As a starting point, it is worth recapping on the assumption made by the Commission in its Draft Report regarding the effectiveness of Part IIIA in constraining the airports' ability to misuse their market power[s]:

> "Notwithstanding changes before the Parliament to improve the operation of the Part IIIA national access regime, it is likely to remain a costly and time consuming mechanism for resolving access disputes.
>
> Setting a high bar for invoking procedures that can lead to compulsory arbitration of such disputes is not of itself unreasonable. However, there is a more general issue of whether Part

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3 Australian Competition Tribunal, Virgin Blue Airlines Pty Limited [2005], Summary, 9 December 2005, paragraph 14.

4 Productivity Commission's Public Hearing in Sydney, 30 October 2006, page 58.

s Productivity Commission, Draft Report Review of Regulation of Airports Services, "Box 2" page XXV.

> IIIA will be particularly helpful in constraining misuse of market power by airports, given they are not involved in providing services in the downstream market.
>
> Specifically, one of the criteria that must be met for a service to be declared under Part IIIA, is that declaration would promote competition in a related market. In declaring domestic airside services at Sydney Airport, the Australian Competition Tribunal found that changes to the airport's charging structures had advantaged Qantas at the expense of Virgin Blue and thus reduced competition in this downstream market. But if an airport exercised market power by uniformly raising charges for all airlines, it is less certain that such behaviour would be construed as deterring downstream competition and hence justifying declaration. Whether the downstream 'market' was considered to encompass other transport modes would be one important consideration bearing on the likely outcome."

In summary, the Commission's Draft Report was formulated on the assumption that Part IIIA may not prove to be an effective constraint on market power. Since the publication of the Draft Report, the Federal Court decision in relation to Sydney Airport has explained the Court's interpretation of the declaration process under Part IIIA. Specifically, the Federal Court decision has been widely interpreted as "lowering the bar" in relation to seeking declaration of airport services. For example, Qantas and Virgin Blue make the following observations:

> "Based on this decision, it is clear that the prospect of airport services being declared under Part IIIA of the Act is greatly improved."[6]
>
> "The decision of the Full Federal Court has lowered the threshold for declaration under Part IIIA of the TPA." [7]

The statements made by Qantas and Virgin Blue indicate that Part IIIA should now be considered *a more* effective regulatory backstop than the Commission had assumed in its Draft Report. Nevertheless, both Qantas and Virgin Blue conclude (albeit using different reasoning) that the Federal Court decision now justifies the imposition of a heavier-handed form of regulation.

Contrary to the views expressed by Qantas and Virgin Blue, WAC believes that as a matter of logic if Part IIIA is a *more* effective regulatory backstop, it follows that the Commission's proposed regime is also a *more* effective constraint on monopoly power. Qantas' and Virgin Blue's position does not follow logically from the Federal Court decision.

The opinions expressed by Qantas and Virgin Blue regarding the Federal Court decision raise questions as to the relevance of price monitoring under Part IIIA. In view of this, it may assist the Commission if WAC briefly sets out its interpretation of the relationship between the price monitoring regime and Part IIIA.

WAC interprets the price monitoring regime as providing a discipline on the airports to negotiate with the airlines to seek a mutually satisfactory commercial outcome. This discipline takes the following form:

> In recognition of the market power enjoyed by airports, the price monitoring regime requires the airports to provide information to airlines and to abide by the Government's Review Principles (which the Commission proposes to enhance). It is noted that these constraints on commercial negotiation would not apply in a truly competitive market.

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[6] Qantas submission to the Productivity Commission, page 2, dated 19[1h] October 2006. Virgin Blue submission to the Productivity Commission, page 3, dated 27[th] October 2006.

• If an airport is unable to agree a commercially acceptable outcome then:

a. An airline can seek declaration of airport services under Part IIIA; or

b. If the airport's conduct has been inconsistent with the Government's Review Principles, the Commission is likely to conclude that a heavier handed form of regulation should apply when it conducts its scheduled review of the price monitoring regime.

Within this framework, the fact that the Federal Court decision strengthens the likelihood of airport services being declared does not render the price monitoring regime irrelevant or less effective. On the contrary, and as noted earlier, the Federal Court decision merely strengthens one of the disciplines on the airports.

More generally, WAC concurs with the Commission's Draft Report[8] in describing the price monitoring regime as operating in conjunction with the Part IIIA process. In WAC's view, the price monitoring regime should not be designed to replicate or replace the Part IIIA process.

Submissions have not provided any significant new evidence or information to the Commission

WAC acknowledges that the Commission has received a number of submissions that are critical of its Draft Report. However, practically all of the evidence submitted to the Commission in response to the Draft Report was also submitted to the Commission's earlier Issues Paper. The Draft Report properly noted the positive aspects of the current price monitoring regime, whilst also identifying areas for improvement and change. The Draft Report commented on the positive aspects as follows[9]:

> "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."

The Commission also noted the more negative evidence provided by some stakeholders, and concluded that the case for substantial reform had not been made. The Commission commented as follows[10]:

> "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.

8 Productivity Commission, Draft Report Review of Regulation of Airports Services, page XII. Ibid.

9 Ibid.

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> Thus, neither reversion to stricter price controls, nor dispensing with price monitoring and relying solely on Part IIIA, would be justified."

WAC strongly agrees with the Commission that there is insufficient evidence to change radically the current form of regulation. WAC further notes that the Commission's Draft Report invited stakeholders to propose a form of airport-specific arbitration that would not affect the parties' incentives to negotiate".

> "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."

Whilst a number of submissions have continued to advocate binding arbitration, WAC notes that no submission has responded positively to the Commission's invitation to develop a form of binding arbitration that would allow effective commercial negotiation. As noted earlier, Qantas and Virgin Blue argue that the better prospect of declaration under Part IIIA since the Federal Court decision implies that binding arbitration should now be introduced to the price monitoring regime. It appears to WAC that the focus of these submissions is on regulation through binding arbitration, rather than on commercial negotiation.

For these reasons, WAC considers that Draft Recommendation 7.1 (that 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) remains valid, and should be affirmed in the Commission's Final Report.

Yours sincerely,
David Crawford, Chairman

Westralia Airports Corporation

[11] Ibid, page 116.