BOARD OF AIRLINE REPRESENTATIVES OF AUSTRALIA INC.

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Mr Alan Johnston
The National Access Regime Inquiry
Productivity Commission
PO Box 80
Belconnen ACT 2616

Dear Mr Johnston

NATIONAL ACCESS REGIME INQUIRY

The Board of Airline Representatives of Australia (BARA) offers the following brief submission in relation to the inquiry into the National Access Regime. BARA represents the interests of 47 international airlines, including Ansett Australia and Qantas Airways, operating to and from Australia.

BARA's principal interest in relation to this Inquiry is the regulation of Australian airports. Potentially, many services provided by Australian airports are subject to the National Access Regime under Part IIIA of the *Trade Practices Act 1974* (TPA), as affected by section 192 of the *Airports Act 1996* (Airports Act). BARA is aware that the Productivity Commission (PC) also is conducting simultaneous inquiries in respect of:

- the *Prices Surveillance Act 1983* (PSA) (which regulates the prices of various airport services); and
- the regulation of the airport industry generally.

This submission presents a number of broad principles relating to the high level questions regarding the National Access Regime contained in the PC Issues Paper. The principles are presented in the context of the airport industry and address:

- the natural monopoly and bottleneck (or essential facility) characteristics of airports;
- the nature of the commercial problems that arise from airports as essential facilities;
- the types of regulatory responses that are required to address those problems; and
- improvements that might be made to the National Access Regime as it applies to airports.

(i) Natural monopoly and bottleneck (or essential facility) characteristics of airports

It is widely accepted by a variety of economic regulatory bodies that the major Australian capital city airports are natural monopolies. Firstly, they are characterised by large economies of scale and

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scope, relative to the size of the market, such that it would uneconomic to develop an alternative facility. Secondly, they represent bottlenecks for essential facilities, in the sense that they supply services that are essential inputs for the provision of aviation services. Thirdly, they are nationally significant infrastructure assets.

Furthermore, airlines (even major airlines) accessing the services of airport operators have little, if any, countervailing power in respect of the use of airport services. Countervailing power can only arise if the buyer has choices available to it. However, if a buyer has no choices other than to purchase goods or services from a particular seller, no countervailing power will arise, no matter how large the buyer is relative to the market. Airlines have no choice but to use the services of the major Australian airports. From a demand perspective, air transportation to a capital city is not substitutable for an alternate capital city. Even a major airline is not in a position to bypass or otherwise facilitate new entry into the provision of airport services for the major Australian airports. Airlines have no choice but to use the services offered by those airports.

It may be possible to argue that airlines may have a degree of countervailing power in respect of services that do not need to be supplied from the airport location, eg office space for certain administrative functions conducted by airlines. However, there are a large number of services that airlines must locate at the airport, either from physical or economic necessity. These services extend beyond landing, take-off, ground handling and basic terminal services and include land and buildings utilised by airlines to provide a range of enhanced services to air travellers, such as commercial and transit lounges and preferred parking facilities. From the airlines' perspective airports possess monopoly power in the supply of the required land and buildings in respect of these services because:

- there is a strong demand from air travellers for these services;
- these services can only practically and economically be provided at the airport location;
- downstream competition between airlines will continue to see these services developed and enhanced further.

In order for Australia to continue to develop an internationally competitive air transport industry, it is essential that airlines develop these enhanced services. The major Australian airports possess the monopoly power to determine whether and to what extent these enhanced services will be available to air passengers. It is unrealistic to suggest that airlines possess countervailing power in respect of these services.

The bottleneck characteristics of Australian airports are also readily apparent. There is a wide range of airport services that are an essential input to the supply of aviation services, including:

- airside facilities (runways, taxiways, aprons etc);
- international passenger processing areas (check-in desks, gate lounges, customs etc);
- refuelling facilities and sites for providing refuelling services;
- sites for providing ground handling services and ground handling equipment storage facilities;
- sites for light/emergency maintenance facilities;
- landside vehicle facilities.

All of the above services represent bottleneck or essential services in the sense that any airline offering aviation services requires those services and inputs.

(ii) Problems which emerge from airports as essential facilities

The PC Issues Paper tends to characterise problems that emerge from natural monopolies as either 'pricing issues' or 'access issues'. In practice, the problems that can arise are often more complex and pricing and access issues are often interlinked.

There appears to be little argument that airports give rise to monopoly pricing problems. However, access problems also arise at airports. These problems take one of two forms - either access is denied, or access is provided on unreasonable commercial terms (both price and non-price).

In this regard, it should be noted that the privatisation of Australian airports and the establishment of the access regulatory regime are relatively recent events. BARA believes that airlines and airports have not yet had sufficient time to establish a commercial approach (supported by the regulatory framework) in which to negotiate access and resolve access disputes. Accordingly, to date there is little experience of utilising the regulatory framework to resolve access disputes. However, it is BARA's view that the need for the regulatory framework to underpin commercial negotiations is essential.

There are a number of reasons why airports may deny or frustrate access to users of the airport.

First, contrary to many assumptions, the airport may hold a degree of vertical integration in an upstream or downstream market, or be contemplating vertical integration. In the conduct of their business, airports have a number of choices available to them. They may:

- merely hold land, leasing and licensing land to others;
- be primarily a development and construction business, constructing buildings and other infrastructure which will be leased or licensed to others; or
- be involved in business undertakings on the airport, for example, managing car parks and other services provided at the airport to either consumers or other business users.

The airport operator is free to make choices about the manner in which it will conduct its business. Furthermore, those choices may alter over time.

Even where the airport operator does not conduct a downstream business itself, it may be economically integrated with the downstream business. For example, the airport operator may decide to grant and exclusive lease of a car park to a car park operator. Through its pricing structure, the airport operator may be able to extract all economic rents from the conduct of the single car park. Effectively, the airport operator is economically integrated with the operation of the car park. Furthermore, it may have no incentive to encourage development of additional car parks. It may also decide to deny airlines or other persons the right to conduct their own car parks (for example the valet car parks currently conducted by airlines).

Secondly, the airport may deny access to a specific service to an airport user in order to gain a commercial advantage in other areas of its business. The airport may use the threat of access denial in order to resolve a dispute with the airport user, or achieve a commercial outcome (such as increased prices) in respect of another airport service.

Thirdly, if the airport service is suffering a degree of congestion, the airport may simply find it easier to deny access rather than establish mechanisms to deal with congestion and scheduling problems. In other words, the airport would prefer a 'quiet life'.

In all of the above examples, airports have the ability and potential to damage competition in upstream and downstream markets. Hence, a static analysis of vertical integration within the airport industry is not a relevant basis for applying or removing access regulation.

Airports may also refuse to provide access on reasonable and commercial terms and conditions (price and non-price).

In relation to price, there are many services that should be covered by an access regime, but which are not covered by PSA regulation. The PSA regulatory framework has a number of peculiar exclusions, including:

- aircraft refuelling;
- maintenance sites and buildings;
- freight equipment and storage sites;
- freight facility sites and buildings;
- ground support equipment sites;
- check-in counters and related facilities; and
- public and staff car parks.

In addition, PSA regulation also excludes any 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 FAC.

Most, if not all, of the above services would fall within the scope of section 192 of the Airports Act. In these and other areas, BARA members are subject to the monopoly pricing power of the airport.

In relation to non-price terms and conditions, BARA members have found that almost all airports provide services on the basis that the airport does not promise any specific level or quality of service provision. Accordingly, there is no commercial incentive or pressure for the airport to act efficiently or with quality considerations prominent in the supply of its services.

All of the above problems are characteristic of monopolies and result from the use of monopoly power. None of the above conduct would be sustainable in the absence of monopoly power. Furthermore, these problems are unable to be addressed merely through price regulation. BARA maintains that the problems arising from the monopoly power of airports can only be addressed through a regulatory framework that addresses both pricing and access issues and recognises the interlinked nature of the problems.

(iii) Appropriate regulatory responses to the essential facility problems

BARA does not believe that the pricing and access issues that arise at airports can be addressed solely by market forces and Part IV of the TPA. As noted above, most Australian airports have strong monopoly power and airlines do not possess countervailing power. Part IV of the TPA does not address monopoly power problems in themselves. Essentially, Part IV of the TPA prohibits various forms of conduct that have the purpose or effect of expanding or increasing market power. However, the mere use of market power, without the purpose or effect of expanding that market power, is not prohibited. Accordingly, a monopolist is entitled to increase its prices and reduce the quality or level of its services without contravening Part IV of the TPA. More specifically, it is only unlawful for a firm with market power to deny access (refuse to supply a service) if its purpose is to deter or harm competition in a market.

Furthermore, amending Part IV of the TPA to address access issues potentially raises more problems than it solves.

First, section 46 applies to a broad range of firms that have 'substantial market power'. In general, significant access issues only arise in a much smaller range of firms - those that exhibit natural monopoly and bottleneck characteristics. Accordingly, it would be undesirable to amend a competition provision that has generalised application in order to deal with a problem that exists in only a narrower category of firms.

Secondly, section 46 is only enforceable in the Federal Court of Australia. Access issues involve complex and interrelated commercial and economic issues. As a general observation, the Federal

Court is not well equipped to make determinations and assessments on a number of the issues arising from an access dispute, particularly pricing. This was noted in the Hilmer Report and was the primary reason for the formulation of Part IIIA.

BARA also maintains that price regulation is unable to address access problems. Price regulation does not deliver access. For example, if an airport does not wish to address congestion issues (and prefers a 'quiet life'), or alternatively is denying access to obtain a collateral benefit, price regulation will not further encourage or require the airport to provide access.

Secondly, price regulation often does not address the non-price terms and conditions on which access is provided. Price regulation cannot impose contractual non-price terms and conditions between the airport and users of airport services. This is an inherent weakness in price regulation.

Thirdly, the effectiveness of price regulation is to some extent dependent on the form of regulation and the services covered by the regulation. For example, the current price regulation of airports is undertaken by way of a price cap over a bundle of airport services. Within the price cap airports are free to alter prices charged for individual services. Airlines are unable to object to such changes under the PSA regulatory arrangements. Accordingly, there remains potential for airports to deny access to particular services through pricing strategies. The airport may price the service so high that it is an effective denial of access. This problem can only be addressed through an access regime that allows individual negotiation and arbitration of price for specific services.

(iv) Improving the access regime for airports

The National Access Regime is relatively new. So is the privatisation of most Australian airports and the enactment of section 192 of the Airports Act. To date, there has been very little airport activity under the National Access Regime. The activity has been confined to:

- the preparation of draft access undertakings by Melbourne and Perth airports, on which airlines provided comments to the ACCC - the undertakings were not accepted by the ACCC in the form lodged; and
- the consideration by the ACCC of whether the use of an access road at Melbourne Airport by a car rental company to drop off and pick up passengers was an airport service within the meaning of section 192.

Accordingly, there is very little direct evidence about the effectiveness of the current National Access Regime as it applies to airports. In these circumstances, BARA believes it would be unwise to make substantial alterations to the National Access Regime at this time. The commercial relationship between airports and airport users is continuing to develop. The existence of the National Access Regime provides an important counterbalance to the monopoly power possessed by airports and enables airlines to enter into realistic commercial discussions with airports. To date, there is no evidence that the National Access Regime has imposed unnecessary costs on airports, or is acting as a disincentive to investment.

Nevertheless, a number of small amendments to the National Access Regime, as it applies to airports, may be desirable. Amendments are recommended in the areas of:

- declaration criteria; and
- access undertakings.

The declaration criteria contained in Part IIIA of the TPA are appropriate in addressing the economic problems of essential facilities. BARA does not believe there is any evidence that the declaration criteria are inappropriate.

However, while the application of the declaration criteria is relatively straightforward to a large range of airport services, the procedural requirements under Part IIIA to demonstrate the criteria in each access application is burdensome and time consuming. The decision by the Australian Competition Tribunal in March 2000 to declare specific services at Sydney International Airport was made approximately 3 years after an application for access to the services was first made to the National Competition Council.

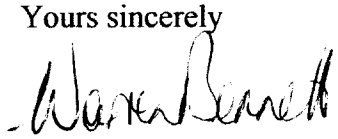
BARA maintains it is both unnecessary and administratively inefficient to demonstrate the applicability of the declaration criteria each time an access application is made in respect of an airport.

On the matter of access undertakings, BARA maintains they have a useful role in the National Access Regime. In the context of airports, an access undertaking enables the airport operator to put forward the basis on which airport users are able to negotiate and agree access terms and conditions.

Undertakings can provide a beneficial framework within which the monopolist can negotiate commercial arrangements with facility users. However, they also have the effect of overriding or replacing statutory rights under the National Access Regime. Accordingly, they should only be accepted by the regulatory authority where it is clear that the rights of users are protected to the same extent as the statutory rights. The primary focus of the undertaking should be on producing principles and procedures of access more directly relevant to the airport industry, but without taking away rights.

In conclusion, BARA maintains that both pricing and access problems exist at airports. Furthermore, these problems are interlinked. Further, BARA strongly maintains that airports have not fully exercised their monopoly power during the past few years, both as a result of existing regulation and the pending regulatory review. BARA believes that any lessening of the regulatory framework applying to airports will result in substantial increases in aeronautical charges.

Yours sincerely



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