

# Economic Regulation of Airport Services Inquiry

Submission to the Productivity  
Commission on its Issues Paper dated  
January 2011 on behalf of a number of  
rental car companies

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8 April 2011

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# Executive summary

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This submission is made on behalf of the rental car companies trading as Hertz, Europcar, Thrifty, Avis and Budget.

Sydney, Melbourne, Brisbane, Perth and Adelaide airports each represent a strategic bottleneck in the supply of landside transport services, including rental car services. This unique position gives those airports a high degree of market power.

As a result of their market power, airports have the ability to impose costs on rental car companies, for access to inputs that are necessary for the provision of rental car services, that exceed efficient levels. Because the rental car services market is competitive, the effect of inflated input prices is that in the market at each airport for the provision of rental car services to end users, prices are higher and the level of services consumed is lower than they otherwise would be. This results in efficiency losses and is harmful to the economic welfare of society as a whole.

The empirical evidence that accompanies this submission supports the view that airports are exercising market power to the detriment of consumers, undeterred and unchecked by current regulation. The costs imposed by airports on rental car companies are high. They have increased significantly in recent years and appear high relative to the costs that the companies incur in securing access to similar facilities at international airports in other countries.

The current regulatory regime is ineffective in dealing with actual and potential abuses of market power by airports in relation to the provision of inputs for car rental services. Appropriate regulation of the provision of access to inputs for car rental services is warranted.

The parties submit that a negotiate/arbitrate regime should be introduced. Landside vehicle access services, including inputs for rental car services, should be deemed to be declared services for the purposes of Part IIIA of the *Competition and Consumer Act 2010*. Such a regime would have significant advantages. It would both facilitate commercial negotiations between the parties (either individually or collectively) and the airports, and provide an effective and targeted constraint on the airports' ability to exercise market power in the provision of those services. Most importantly, a negotiate/arbitrate regime would ensure that rental car operators, as well as other transport providers that provide alternatives to on-airport car parking, would have access to airport facilities on reasonable terms.

Amendments to the collective bargaining notification regime should also be made that would allow rental car companies to collectively bargain with airports 'as of right' (including removing the monetary threshold that currently limits the availability of the regime).

A negotiate/arbitrate regime together with a modified collective bargaining regime would provide both airports and rental car operators with incentives to reach negotiated outcomes. This combination of regulatory options would ensure that there is an effective, readily available arbitration process in the event that individual or collective negotiations fail to produce a commercially acceptable result for all parties. A negotiate/arbitrate regime is an appropriate regulatory option because the cost of regulation would be significantly less than the possible costs of direct price regulation, while still effectively deterring and dealing any exercises of market power by the airports.

Alternatively, if the Commission considers that price regulation of rental car services inputs is justified having regard to its costs and benefits, the parties would support such regulation. The parties' view is that price regulation limited to the setting of airport car parking charges is not appropriate, because airports would be likely to abuse their market power in relation to other landside vehicle access services to offset the regulatory costs to the airports. If price regulation is to be implemented, it must be in relation to all landside vehicle access services, including inputs into rental car services.

# Submission

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## 1. The parties

This submission is made on behalf of:

- Hertz Australia Pty Ltd (**Hertz**);
- CLA Trading Pty Ltd trading as Europcar (**Europcar**);
- Kingmill Pty Ltd trading as Thrifty Car Rental (**Thrifty**);
- W.T.H. Pty Ltd trading as Avis Australia (**Avis**); and
- Budget Rent a Car Australia Pty Ltd (**Budget**)

(the **parties**).

The parties on whose behalf this submission is made are all rental car operators. Each has rental car operations at Sydney, Melbourne, Brisbane, Perth and Adelaide international airports.

## 2. Request for confidentiality

The four Annexures to this submission, and the text enclosed in square brackets and highlighted in section 5.4 of this submission, contains information that is commercially sensitive and confidential to the party to which the information relates (the **confidential information**).

We request that the Productivity Commission (**Commission**) keep the confidential information strictly confidential, and not disclose any of the confidential information to any person outside the Commission without the prior consent of the relevant party. This includes publication of any part of that information on the Commission's website. A copy of this submission with confidential information redacted has been provided to the Commission for publication on the website.

We note that section 16 of the *Productivity Commission Act 1998* contemplates that the Commission will not make information available to the public where the person that provided it to the Commission has recorded its objection to the information being made public.

## 3. Scope of Inquiry includes car rental service inputs

The purpose of the Commission's Inquiry is to examine the effectiveness and efficiency of the current economic regulation and quality of service monitoring regime for airports. The Commission must make recommendations in relation to the requirement for future regulation and monitoring of services, and the scope and appropriate mechanism for the provision of greater transparency and accountability in airport infrastructure provision and services.

The Terms of Reference for the Inquiry specifically require the Commission to:

- focus on the provision of passenger transport services at and surrounding main passenger airports operating in Australia's major cities (paragraph 2);
- amongst other things, examine the provision and quality of land transport facilities providing access to the airports (paragraph 3);
- amongst other things, consider:
  - whether the existing regime is effective in appropriately deterring potential abuses of market power by airport operators;
  - whether the existing range of remedies is effective in dealing with potential and suspected abuses of market power;

- the effectiveness of the monitoring regime conducted by the Australian Competition and Consumer Commission (ACCC);
- whether the coverage of the current monitoring regime is appropriate;
- any improvements or enhancements that could be made to the existing regime;
- the appropriate future role of the regime;
- the adequacy and arrangements for the control of planning, operation and service quality monitoring of land transport access to major airports; and
- whether existing arrangements for the planning and operation of land transport linkages to the airports are effective (paragraph 5).

The Commission must therefore consider as part of its Inquiry the effectiveness of the current regulatory regime in dealing with the exercise of market power in the provision by airports of inputs for car rental services.

Under the Terms of Reference, the Commission must also have regard to the matters raised by the ACCC in its Airport Monitoring Reports, such as:

- landside access to airport terminals, such as car parking and its alternatives, and the cost and quality of car parking facilities;
- the extent to which monitored airports can act strategically to raise costs of on-airport car parking by controlling the conditions of landside access to terminal facilities (paragraph 6).

## 4. Background – airport regulation

In 1997 the Government commenced the process of airport privatisation and introduced price regulation of airports in recognition of the airports' significant degree of market power. The Commission undertook a review of regulatory arrangements in 2002, and recommended that a monitoring regime be implemented in place of the existing price-cap regime. The findings of that review are set out in the Commission's report *Price Regulation of Airport Services – Inquiry Report* (Report No. 19, 23 January 2002) (**the 2002 Report**).

In 2006, the Commission undertook a review of the price monitoring regime. The Commission found that the price monitoring regime had delivered important benefits and recommended that it continue. The Commission's findings are set out in the report *Review of Price Regulation of Airports Services – Productivity Commission Inquiry Report* (No. 40, 14 December 2006).

The ACCC has continued to prepare Airport Monitoring Reports for public release on an annual basis. The ACCC monitors (in relation to the five airports):

- prices, costs and profits in relation to the provision of aeronautical services;
- quality of service in relation to the provision of prescribed aspects of airport services and facilities;
- prices, costs and profits relating to the supply of car parking services that are provided directly by the airports to consumers.

## 5. The market power of airports

Although the parties acknowledge that the Commission's focus is on the provision of passenger transport services at and surrounding the airports in major cities, the parties consider that the comments made in this submission about the market power of the five major airports apply equally to the airports at Canberra, Cairns, Mackay, the Gold Coast, Darwin, Alice Springs, Hobart, and Launceston. Amongst other things, in the parties' experience, the operators of those

airports tend to take behavioural cues from the five major airports and use the decisions of those airports about costs and prices as benchmarks for their own decisions.

## 5.1 The supply of transport services at airports, including rental car services

The demand for transport services to and from both the major and second-tier airports is a 'derived' demand. It is derived from the demand for airline services, which is itself derived from the demand for travel that arises from a range of requirements, such as attendance at business meetings, taking holidays, visiting friends and relatives, migration, and events (eg concerts, theatre, and major sports events such as the V8 Supercars and Australian Open Tennis, amongst others).

Airline passengers and other airport users require access to the airport and its terminals. Airline passengers and airport users can choose the means by which they obtain this access, whether it is by way of private vehicle, rental car, taxi, bus, or in some cases train. Transport services to and from the airport are complementary to air travel.

The provision of transport services relies on the provision of vehicle access facilities by the airport. Only the airport operator can provide such access. Airports therefore occupy a unique position in relation to the supply of complementary transport services. Passengers wanting to use a complementary transport service, and operators wanting to provide a complementary transport service, must deal with the relevant airport in order to obtain what they require. In that regard, airports represent a strategic bottleneck in the supply of complementary landside transport services.

In relation to each mode of complementary transport services, a range of operators compete at each airport. For example, each of the parties has rental car operations at each of the five airports. There is some substitution between different modes of transport, although there is clearly an area of close competition comprised by the provision of rental car services.

The operation of complementary transport services markets is therefore both dependent on the provision of essential inputs by the airport to enable the provision of the service to passengers, and constrained by price and service competition from other providers of complementary transport services.

The essential inputs that the parties must purchase from airports in order to provide rental car services are:

- access to car parking bays outside the terminal (also known as 'ready bays'); and
- access to retail counter space inside the terminal.<sup>1</sup>

The parties also require 'backup' or service facilities for their airport operations (for vehicle maintenance, cleaning and servicing), which often need to be within the boundary of the airport. In such cases, access to service facilities must also be purchased from the airport.

The airports have such significant market power that they have the ability to effectively control the nature of rental car operators' access to rental car services inputs, as well as the terms on which that access is provided.

The ACCC's concerns about airports acting strategically to raise the costs of car parking by controlling the conditions of landside access to terminal facilities have been well-publicised. The ACCC's submission to the Commission dated March 2011 repeats its previous statements that the

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<sup>1</sup> Counter space may be negotiated with the airport operator or the relevant airline. For example, retail counter space in the Qantas terminal at Melbourne, Sydney, Brisbane and Perth is negotiated with Qantas, and retail counter space in the Virgin Blue terminal at Brisbane is negotiated with Virgin Blue. In both cases negotiation with the relevant airline is subject to the rental car company having a concession agreement with the relevant airport.

airports have an ability and an incentive to use their market power to favour their own on-airport car parking operations. The parties submit that this issue is not limited to just car parking services; the concerns are equally relevant to inputs for rental car services. The ACCC's submission states, "[m]arket power issues in airport car parking arise because airports can control access to airport land by off-airport parking operators *and other transport modes* as a bottleneck" (emphasis added) (see section 4 at page 26 of the ACCC's submission).

The ACCC's submission is also clear that airports can earn additional revenue by charging prices higher than those that reflect the unique location of airports, because of their monopoly position.

Airports typically charge rental car operators a form of rent for access to ready bays and counter space, as well as a concession charge by which airports require payment of a proportion of the rental car operators' turnover.

## 5.2 Market power in relation to inputs for car rental services

The parties consider that due to the unique position of airports in relation to the supply of car rental services, airports have a high degree of market power in the supply of inputs for car rental services. Airports are essentially monopoly providers of airside services to airlines in the geographic markets in which they operate. This gives them market power in the provision of access to a range of complementary landside services. As the ACCC's submission notes, the impact on air travellers is little different if the market power is exercised through raising the cost of landing aircraft or through increasing the cost of travelling to and from the airport.

Airports can profitably sustain prices above the efficient cost of supply for a significant period of time, because of the natural monopoly characteristics of airports which are reinforced by regulatory constraints. As the ACCC's submission notes, monopoly behaviour could lead to a loss of consumption and discourage the use of alternatives to on-airport car parking (see section 4.1 at page 26 of that submission).

This view is supported by the Commission's findings in the 2002 Report. The parties submit that the Commission's findings in this regard remain accurate.

The Commission found that Brisbane, Melbourne, Perth and Sydney airports possess a high degree of market power, due to their high proportions of business travellers and travellers visiting friends and relatives, and their status as the main international ports of arrival and departure in the country (section 5.4 of the 2002 Report).

The parties submit that both major and second-tier airports continue to have the ability and incentive to set prices above those that would be expected in competitive markets for the provision of access to car parking bays and retail counter space. Specifically in relation to inputs into the provision of rental car services, the Commission found in 2002 that:

- Although rental car operators (and other complementary transport service operators) in theory have a choice as to whether they operate at airports, the importance of airport-related business to their overall business influences to a large extent the degree to which airports can exercise market power in their dealings with them (section 6.5 of the 2002 Report).
- For airports with a moderate to high degree of market power, market power appears to be the most significant in relation to vehicle access facilities, including front-door access for transport providers (p XXVI, sections 6.5 and 6.14, and Finding 6.1 of the 2002 Report).
- Airports may have an incentive to deny or frustrate access to the airport by potential competitors, such as providers of transport services (p XXX of the 2002 Report).
- To the extent that an increase in access charges for competing modes of transport shifts demand for vehicle facilities to services provided more directly by the airport, such as car parking (and that raises the airports' overall revenue), there may be an incentive for an airport

operator to set excessive access charges. Thus, airports have, and may exercise, market power in the provision of vehicle access facilities (p 155 of the 2002 Report).

The Commission's findings in relation to market power are also supported by the fact that although airports are dependent on having at least one rental car company operating at each airport, they are not dependent on having any particular company agreeing to operate at the airport. This underscores the airports' significant bargaining power.

### **5.3 The effects of market power on airport rental car services markets**

In general, a major concern about the exercise of market power by airports is that prices will exceed efficient levels, thereby reducing consumption. A firm with market power will generally restrict the amount supplied and raise the price in order to increase its profits at the expense of consumers. Efficiency losses may result from the reduction in production and consumption below the efficient level (monopoly deadweight loss), or from a lack of competitive pressure resulting in a firm operating inefficiently by allowing costs to rise or allowing quality to fall.

The concerns just mentioned are borne out in relation to the exercise of market power by airports in relation to providing access to inputs into rental car services. The potential efficiency costs of abuses of market power by airports in this context are significant.

The market for the rental car services at airports is highly competitive. In setting the price at which cars can be rented and the quality of services provided, each of the parties is significantly constrained by the price and quality of the car rental services provided by each other operator at the airport and, to a lesser extent, by car rental services provided from off-airport locations and other land transport modes.

Because the rental car market is already competitive, any increases in the costs imposed by airports above competitive levels on the parties for rental car services inputs (such as the use of car parking bays and retail counter space, and concession charges) are highly likely to increase the prices paid by consumers of car rental services.

Ultimately, rental car companies have to pass on any increased costs substantially or in their entirety to end consumers of rental car services, which would ultimately have the effect of raising prices above efficient levels and decreasing consumption in the market for rental car services. In other words, the terms on which car rental companies acquire access to facilities from airports are likely to be reflected in the terms on which car rental services are offered to consumers at the airport.

### **5.4 Empirical data**

Empirical data has been provided by the parties to illustrate the exercise of market power by airport operators at the five major airports, which is contained in Confidential Annexures 1 (which relates to Hertz), 2 (Thrifty), 3 (Avis), and 4 (Budget).

Although the data provided by each company varies in scope and time period and is not comprehensive, it generally supports the view that the current regulatory regime is ineffective.

#### **Summary of Hertz confidential data**

- [Confidential information redacted.]

#### **Summary of Thrifty confidential data**

- [Confidential information redacted.]

#### **Summary of Avis confidential data**

- [Confidential information redacted.]

## Summary of Budget confidential data

- [Confidential information redacted.]

## 6. Current regulatory regime is ineffective in dealing with market power

The current regulatory regime is not effective in deterring or dealing with abuses of market power by airport operators in relation to the provision of inputs for car rental services. Relevant aspects of the current regime are discussed and evaluated in turn below.

The parties support the ACCC's submission that since the 2002 Report, systematic deficiencies in the current regulatory arrangements have become clear (see section 1 of that submission).

### 6.1 Price monitoring of aeronautical services and car parking

In relation to Sydney, Melbourne, Brisbane, Perth, and Adelaide airports, the ACCC currently monitors prices, costs and profits relating to:

- the supply of aeronautical services and facilities;
- the supply of car parking services.

The costs imposed by airports on rental car operators are not therefore within the scope of the price monitoring regime.

The ACCC's reports have shown significant increases in the monitored costs. The ACCC's reports show that the cost of aeronautical services has risen significantly in the last decade. The Commission records in its Issues Paper that immediately following the removal of price caps (in 2001-02 and 2002-03) there were significant increases in charges for aeronautical services, in some instances by over 100%. The Issues Paper also records that the subsequent increases in charges at the monitored airports have been more modest. From 2002-03 to 2008-09, aeronautical revenue per passenger at Sydney, Melbourne and Perth airports increased by 28%, 31% and 16% respectively.

The ACCC's reports also show that the cost of car parking at the monitored airports has on average increased at the monitored airports between 2004-05 and 2008-09.

Although the parties acknowledge that increases in costs observed by the ACCC is not a conclusive indicator of the presence or exercise of market power, the ACCC has nevertheless stated that 'the price-monitored airports have significant market power and the ACCC considers that the airports have the incentives and ability to exercise their market power' (p x of the ACCC's *Airport Monitoring Report 2009-10 (the 2009-10 Monitoring Report)*).

The 2009-10 Monitoring Report noted the ACCC's concerns that:

- Sydney airport earns monopoly profits from the services it provides to airlines; and
- Melbourne airport appeared to have reduced the ability of off-airport parking and private bus operators to compete with the airport's own car parking services, by imposing excessive access levies and controlling the available space. The ACCC noted that that affected the operators' own prices and convenience and therefore the attractiveness of those services to consumers. By reducing the ability of alternatives to compete, the ACCC said that Melbourne Airport can increase demand for its own car parking services, charge higher prices to consumers and therefore earn monopoly profits.

We note that although it is not explicitly covered by the price monitoring regime, the ACCC has recognised the potential of airport operators to exercise market power in relation to the provision of landside access facilities and services.

The parties' view is that although the ACCC has recognised the potential issue of the airports' market power in providing transport operators with access to airport facilities, insufficient attention has been paid by the ACCC to the costs imposed on rental car operators. This is unfortunate but not surprising given that such costs are not directly within the scope of the monitoring regime.

As outlined in section 5.4 above, the empirical data provided by the parties illustrates the exercise of market power by airport operators between 2000 and 2010 in relation to the provision of inputs for car rental services.

In relation to the provision of inputs for rental car services, the parties support the ACCC's submissions that:

- the airport regulatory regime, which is based on airport monitoring and the general provisions of Part IIIA, does not create an effective constraint on the major airports' market power; and
- monitoring has gone some way to identifying issues related to the exercise of market power by airports but has not facilitated the competitive process.

## 6.2 Service monitoring

The ACCC also monitors the quality of service in relation to the provision of prescribed aspects of airport services and facilities at the five major airports. The services within the scope of the monitoring regime do not include the provision of access by airports of inputs for rental car services.

## 6.3 Collective bargaining notification procedure

Section 93AB of the *Competition and Consumer Act 2010* (**Competition and Consumer Act**) entitles competitors that wish to collectively negotiate terms and conditions with a supplier of inputs to lodge a collective bargaining notification with the ACCC, and thereby obtaining protection from legal action unless the ACCC objects.

The ACCC may object (and remove the immunity provided by the notification) if it is satisfied that any public benefits from the proposed collective bargaining conduct would not outweigh the public detriments. In certain circumstances, before objecting the ACCC must also be satisfied that the conduct would substantially lessen competition.

There are three main prerequisites that must be met in order for the collective bargaining regime to be available:

- the contract must relate to the supply or acquisition of particular goods or services to or from a target of the conduct by the parties to the contract;
- the notifying party must reasonably expect that it will make such contracts with the target; and
- the notifying party must reasonably expect that the price of the goods or services to be supplied or acquired will not exceed \$3m in any 12-month period.

The collective bargaining regime therefore provides an option to the parties to collectively bargain with airports about the terms of access to inputs for car rental services, in an attempt to partially redress the imbalance in bargaining power that results from the airports' significant market power.

The most significant limitation on the usefulness of this regime is the \$3m threshold. In many cases the annual costs imposed by airports on the parties will exceed \$3m per year for each party, and in those cases the regime is not available. The \$3m threshold is an arbitrary limit. The parties submit that the significant market power of airports is present whether their annual airport costs exceed \$3m or not. There is therefore no sound basis for precluding them from taking advantage of the regime if the \$3m threshold is exceeded.

On two previous occasions the parties have lodged collective bargaining notifications with the ACCC in relation to negotiations with airports about access to inputs for rental car services. They have had mixed results.

The first notification was lodged in late 2009 by Hertz on behalf of itself and Thrifty, Avis, Budget and Europcar. They proposed to collectively negotiate lease and licence agreement terms and conditions with Mackay Airport, a regional airport in Queensland. The ACCC did not object to the notification, and found that the proposed arrangements would potentially result in some public benefits by providing the rental car companies with the opportunity to have greater input into their contract terms and conditions. The ACCC also found that given existing competition at the retail level, any benefits to the applicants as a result of collective negotiations were likely to be reflected in lower prices and/or improved quality of service for consumers. The ACCC considered that the potential for anti-competitive impact was limited given the voluntary nature of the arrangements and the fact that it did not involve potential boycotts.

The second notification was lodged in mid-2010 by Hertz on behalf of the same group of rental car operators. They proposed to collectively negotiate with the operator of Perth Airport about the price, terms and other conditions on which those companies would acquire airport facility services (car parks and counter space) at Perth Airport.

The ACCC objected to that notification, finding that the likely benefit to the public from the proposal would not outweigh the likely detriment to the public. In particular, the ACCC found that regardless of whether collective negotiations were conducted or what the outcome was, members of the collective bargaining group would be able to share information about matters such as their willingness to pay for car rental facilities at Perth Airport. The ACCC considered that this would reduce the competitive tension between the companies, and provide group members with a competitive advantage over rental car companies outside of the group. In addition, the ACCC found that fact that the proposed collective bargaining arrangements were voluntary meant that the claimed benefits were unlikely to arise.

The parties consider that the ACCC's decisions are inconsistent. On the face of the notifications it is not clear why the ACCC's assessment of the benefits and detriments of the proposed arrangements differed so dramatically in the two decisions, especially when the ACCC accepted that the airports in both cases had considerable bargaining power in negotiating with each rental car company. The main objection of the ACCC in relation to the proposed Perth Airport arrangements – that the group members would share competitively sensitive information – did not receive any mention in the Mackay airport decision.

As a matter of principle, in the absence of price regulation, the parties submit that the decision as to whether they should be able to negotiate with any of the airports on a collective basis should not be left to a regulator to determine on a case-by-case basis. In light of the significant market power of airports that has been recognised by both the Commission and the ACCC, it is not appropriate that:

- the parties should have to endure the burden of having to approach the ACCC on each separate occasion on which they wish to collectively negotiate;
- the regime is only available in limited circumstances, where the costs imposed on each airport will not exceed \$3m (particularly when the parties are facing rising costs), thereby effectively precluding its use at the largest airports where it is most needed; and
- the parties should have to endure the risk of the ACCC refusing to allow them to collectively negotiate when the market power of airports is well-recognised and understood.

## 6.4 General Competition and Consumer Act provisions – Part IIIA and Part IV

The Competition and Consumer Act contains provisions that have the potential to assist the parties to overcome problems associated with airports' significant degree of market power.

Part IV of the Competition and Consumer Act prohibits a range of restrictive trade practices, including a prohibition in section 46 on a corporation that has a substantial degree of power in a market from taking advantage of that power in that or any other market for the purpose of:

- eliminating or substantially damaging a competitor;
- preventing the entry of a person into that or any other market;
- deterring or preventing a person from engaging in competitive conduct in that or any other market.

Contravention of that provision exposes the relevant corporation to proceedings taken by a private party or parties or the ACCC, and to potentially significant penalties.

However, in practice, the prohibition is not sufficient to deter or deal with exercises of market power by airports. The data provided by the parties suggests that the airports have exercised market power despite the above prohibition. Not all of the elements of section 46 will be made out in relation to airports' conduct in rental car input negotiations. For example, the airports' purpose may simply be to extract monopoly profits rather than to prevent a rental car operator from competing. However, the harm to consumer welfare and efficiency would be just as great. In addition, even if section 46 could apply to airports' conduct, issuing proceedings for a contravention would be time-consuming, difficult and expensive.

Part IIIA of the Competition and Consumer Act is also unhelpful for similar reasons. Part IIIA establishes a regime that is designed to facilitate third party access to services of certain facilities that are considered critical to competition in related markets. It is possible for a party to make a request under Part IIIA to the National Competition Council to have a particular service declared. There is a statutory process that must be followed and statutory criteria that must be taken into account. The Council cannot recommend that a service be declared unless it is satisfied of all of the following matters (under section 44G of the Act):

- that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
- that it would be uneconomical for anyone to develop another facility to provide the service;
- that the facility is of national significance, having regard to:
  - the size of the facility; or
  - the importance of the facility to constitutional trade or commerce; or
  - the importance of the facility to the national economy;
- that access to the service:
  - is not already the subject of a regime in relation to which a decision that the regime is an effective access regime is in force (under section 44N of the Act); or
  - is the subject of a regime in relation to which a decision (under section 44N) that the regime is an effective access regime is in force, but the Council believes that since the decision was published there have been substantial modifications of the access regime or of relevant principles; and
- that access (or increased access) to the service would not be contrary to the public interest.

If an access seeker and provider cannot agree on the terms and conditions of access to a service that has been 'declared', either party may request the ACCC to arbitrate a dispute by making a final binding determination.

In practice, significant time, cost and uncertainty is involved in seeking to have a service declared or seeking to have an access dispute over a declared service determined. The parties agree with the ACCC's submission (at section 3.2.1 of that submission) that this limits the effectiveness of the threat of declaration under Part IIIA as a constraint on the airports' market power. These issues have been borne out in relation to the use of Part IIIA in the context of airport services by the Australian Cargo Terminal Operators. The ACCC also correctly noted two other deterrents to seeking declaration of a service in its submission – a potential free-rider problem, in that other companies could benefit from one company obtaining a declaration without contributing to the cost, and the risk that applying for declaration could damage the relationship between the applicant and the airport resulting in the applicant having a competitive disadvantage.

Neither Part IIIA nor Part IV is therefore effective in deterring or dealing with abuses of market power by airports in relation to the provision of inputs into rental car services.

## 7. Proposed regulatory solutions

Four possible regulatory alternatives to deal with abuses of market power by airports are discussed in turn below.

The parties accept that the overarching objective of regulation should be that it promotes the national interest by achieving outcomes that are more efficient than those achieved by the alternatives, including no regulation.

Other relevant considerations include whether regulation fosters market outcomes (if such outcomes are feasible), minimises the regulatory burden and compliance costs consistent with efficient outcomes, and promotes certainty.

The parties submit that the appropriate regulatory solution that should be adopted is for landside services, including inputs for rental car services, to be deemed to be declared services for the purpose of Part IIIA of the Competition and Consumer Act. The parties also submit that amendments to the collective bargaining notification regime should be made, in order to allow rental car companies to collectively bargain with airports as of right, including removing the monetary threshold that currently applies.

### 7.1 A negotiate/arbitrate regime

Under the negotiate/arbitrate regime proposed by the parties, car rental companies would negotiate the terms of access to inputs for rental car services with the airports as they do now. However, they would have the ability to seek binding arbitration of any dispute that cannot be resolved by negotiation from the ACCC.

This type of regulation is consistent with the stated objective in paragraph 1 of the Terms of Reference for this Inquiry to facilitate commercially negotiated outcomes in airport operations, while still effectively deterring and dealing with the exercise of the airports' market power.

A negotiate/arbitrate regime could be implemented in the manner suggested by the ACCC for aeronautical services; that is, by deeming landside vehicle access services including inputs for rental car services to be declared for the purposes of Part IIIA of the Competition and Consumer Act (see section 3.2.3 of the ACCC's submission). That would provide the rental car companies the immediate right to seek arbitration of an access dispute by the ACCC in the event that negotiations are unsuccessful. Such regulation would allow the parties, and other transport operators that provide alternatives to on-airport car parking, to access airport facilities on reasonable terms.

This option can be distinguished from the current Part IIIA access regime under the Competition and Consumer Act because it would not require any preliminary step to be undertaken in having the service declared before a matter on which negotiations had failed could be referred to a regulator for arbitration. Under the parties' proposed negotiate/arbitrate regime, if a reasonable attempt at commercial negotiations with an airport operator about the terms of access to inputs for rental car services failed, they would as of right be able to seek to have the dispute arbitrated. This option would provide an immediate discipline on the exercise of market power by airports.

The proposed negotiate/arbitrate regime is similar to the one that existed under section 192 of the *Airports Act 1996*, which set out an access regime under which airport operators could have an access undertaking accepted by the ACCC (which set out the terms and conditions under which access to services provided by essential airport facilities would be made available to access seekers). If the undertaking was not accepted, the Minister would determine that each 'airport service' at the airport was a declared service for the purposes of Part IIIA. Section 192 provided for the ACCC to determine whether a service was an airport service covered by the Minister's declaration. If a service was determined to be an airport service, then the airport operator was required to negotiate commercial terms with access seekers or submit to arbitration.

The key difference between the proposed regime and the section 192 regime is that arbitration would be available without the need for any previous steps such as having the airport submit an undertaking, having the relevant service declared, or having the ACCC determine whether a service in dispute is subject to a declaration.

A major advantage of a negotiate/arbitrate regime, as noted in the ACCC's submission, is that the regime would only be invoked where it is needed. This option would both facilitate commercial negotiations between the parties (either individually or collectively) and the airports, and provide an effective and targeted constraint on the airports' ability to exercise market power in the provision of vehicle access facilities. The parties (and other transport operators) could credibly threaten ACCC arbitration because the need to first have the services declared is avoided. As the ACCC submits, it is this threat that encourages the development of commercial relationships between the airports and transport operators.

The parties expect that the airports would be likely to understand the likely approach of the ACCC as an arbitrator of any dispute, and that the approach to assessing access terms and prices would be based on well-established regulatory precedents. The ACCC notes, in the context of airport/airline negotiations, that the building block methodology could be used to provide guidance on expected revenue levels to assist negotiations. The ACCC stated in its submission that an attempt by an airport to set prices substantially above those likely to be determined by the ACCC would provide an access seeker with an incentive to raise a dispute. This would allow the access seekers to place pressure on airports to set charges at a level more consistent with efficient prices. The parties expect that such a regime would improve the bargaining power of rental car companies in negotiations with airports.

The ACCC's view is that, rather than airports viewing arbitration as a default option, it is more likely that the threat of arbitration would create an incentive for parties to enter into constructive negotiations, and to engage in a realistic, practical and positive manner. Such negotiations would bring about a more efficient outcome than if arbitration was not available. The parties agree with the ACCC that this is supported by the commercial resolution of the access dispute between Virgin Blue and Sydney Airport in 2007, after Virgin Blue notified the ACCC of an access dispute with Sydney Airport of declared domestic airside services (see section 3.2.3 of the ACCC's submission). Overall, a negotiate/arbitrate regime would give transport operators and airports greater certainty of outcomes.

The parties note that the ACCC has proposed that airports be required to submit access undertakings in relation to landside vehicle access services, including use of terminal access roads,

kerbside standing areas and holding bays at the airport for the purpose of dropping off and picking up airline passengers at an airport and its terminals (see section 4.2.1 of the ACCC's submission). Although the parties support the need for the regulation of all landside access services, they consider that deemed declaration is a preferable approach for rental car services inputs because it is more likely to facilitate commercially negotiated outcomes.

## **7.2 Modified collective bargaining regime**

An option that should be adopted alongside a negotiate/arbitrate regime or price regulation is to amend the collective bargaining regime so that it would be a more effective alternative for the parties in negotiating with airports.

The regime should be made more useful by allowing rental car companies to collectively bargain with airports as of right. Under this option, the parties would not be required to satisfy the existing requirement that the price of services to be acquired would not exceed \$3m in any 12-month period, nor would they be at risk of the ACCC objecting to the notification in a particular case. That amount could either be increased to, say, \$10m, either generally or specifically removed for rental car companies in dealing with airports, to ensure that the regime is available in all cases in that context in which airports exercise market power. Alternatively, the monetary threshold could be abolished altogether, either generally or specifically for rental car companies in dealing with airports.

Under any proposed collective bargaining arrangement, the parties would be free to negotiate individually or collectively with the relevant airport.

## **7.3 Expanded price monitoring**

Another option would be for the current price monitoring regime to be expanded to explicitly include monitoring the costs incurred by car rental companies for the use of car parking bays and counter terminal space in providing car rental services at each of the five major airports.

Under a price monitoring regime, the airports would be required to provide information on the costs that they charge for access to inputs for rental car services, but there would be no direct regulatory control over those costs. The current regime would be expanded so that such costs were explicitly within the costs that the ACCC is required to monitor, and the ACCC would report on them each year.

Price monitoring may in theory have the advantage of moral suasion in that it may incentivise airports to avoid uses of market power to avoid stricter forms of price regulation. However, to date the ACCC's reports suggest that price monitoring has not provided a sufficient constraint on airport operators, which may mean it would continue to be ineffective in constraining uses of market power.

The parties consider that an expanded price monitoring regime is not likely to be effective. Airports will always price in order to maximise their level of profit. Although price monitoring may raise awareness of the prices airports charge and increase the risk that stricter forms of price regulation may be imposed, that appears to be an insufficient incentive to compel airports to price as if they were operating in a competitive market. Without more, under a price monitoring regime, the threat of further regulation is not sufficiently specific and imminent to change the airports' behaviour. The parties expect that even in an expanded price monitoring regime, there would remain a strong likelihood of continued excessive pricing by airports.

The parties agree with the ACCC's submission that further monitoring of airports is not likely to provide greater clarity or certainty in relation to the exercise of market power by airports (section 2 of that submission). An expanded monitoring regime for car rental service inputs is unlikely to assist in providing further evidence of the exercise of market power by airports.

In addition, because the rental car companies have insufficient countervailing power to influence the airports' behaviour, price monitoring is insufficient to address the market power problem. The ACCC accurately noted that providers of alternative transport services at airports – including rental car operators – have a lesser degree of negotiating power compared to the airlines, because they tend to be smaller and more fragmented. In particular, transport service providers negotiating power is lesser because they have less scope to use alternative airports, and because airports are vertically integrated with landside services through their car parking businesses.

## **7.4 Price control**

Market power could be controlled by up-front regulation of the prices at which airports provide services, potentially including inputs for car rental services. Under this option, prior ACCC approval would be required for the prices charged by the airports for those inputs. Criteria would be specified by regulation so that the ACCC could only approve prices that were considered to be efficient and competitive.

A major concern about the airports' market power is that the use of that market power will result in prices that exceed efficient levels and consumption that is below the efficient level. A firm with market power will generally restrict the amount supplied and raise the price in order to increase its profits at the expense of consumers. Efficiency losses result from the reduction in consumption (by creating monopoly deadweight loss), or from a lack of competitive pressure resulting in airport operating inefficiently by allowing costs to rise or quality to fall.

Given that the retail market for car rental services is competitive, any reduction in the input prices charged by the airports to rental companies as a result of price control regulation is likely to be passed on to end consumers in the retail market, thereby lowering prices and increasing consumption in that market. That would increase efficiency and consumer welfare. If regulation results in prices being set at the efficient level, this would be an effective way to prevent airports from using their market power to the ultimate detriment of consumers in car rental services markets.

However, the car rental companies acknowledge that price regulation is not costless. The ACCC notes that previous Commission reports have noted concerns that access regulation can lead to inefficient investment because uncertainty about how regulation is applied increases the riskiness of investment; regulators may be tempted to curtail high profits; and because of risks of mistakes made in applying regulation.

The parties acknowledge that in the 2002 Report, the Commission found that there were significant advantages in a more light-handed approach involving price monitoring given the Commission's view that airports faced significant commercial constraints and incentives that would moderate abuse of any market power.

If the Commission concluded that the benefits of price regulation exceeded the costs, and recommended that price control should be adopted, the parties submit that it would not be appropriate only to regulate the costs of some landside vehicle access services, because that would lead to greater monopoly charges being imposed by airports on the remaining services. For example, if car parking services were regulated, the parties consider that the airports would seek to recover lost monopoly rents from car parking by increasing charges for access to rental car services inputs.

## **7.5 Recommendation**

The parties consider that a negotiate/arbitrate regime, together with a modified collective bargaining regime to give rental car companies the automatic right (not the obligation) to collectively negotiate with airports – both the major airports and second-tier airports referred to in section 5 of this submission – would provide both airports and rental car operators with incentives to reach negotiated outcomes.

This combination of regulatory options would also ensure that there is an effective, readily available arbitration process in the event that individual or collective negotiations fail to produce a commercially acceptable result for all parties. In this way the regulatory regime would be specifically targeted at any exercise of market power by the airports in the provision of essential inputs into rental car services. It would effectively deal with the problems that the use of market power by airports causes, namely higher prices, lower consumption and reduced efficiency.

# Confidential Annexure 1 – Hertz data

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# Confidential Annexure 2 – Thrifty data

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# Confidential Annexure 3 – Avis data

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# Confidential Annexure 4 – Budget data

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