

# **Productivity Commission Inquiry into the Economic Regulation of Airport Services**

## **Qantas Group Response to Draft Report**

**September 2011**



## **Qantas Group Response**

The Qantas Group (**Qantas**) appreciates the opportunity to provide comments on the Draft Report of the Productivity Commission's Inquiry into the Economic Regulation of Airport Services (**Draft Report**).

Qantas has already provided a comprehensive submission to the Productivity Commission. For this reason, this response only addresses outstanding key issues to Qantas. Qantas reiterates the factual matters contained in its original submission and encourages the Productivity Commission to take this information into further account before it issues its Final Report.

### **Circuit Breaker Mechanism**

Qantas is disappointed with the Productivity Commission's Draft Recommendation 11.3 which recommends against introducing an airport-specific arbitration regime through deemed declaration. This is despite evidence that airport operators consistently exercise their substantial market power to the detriment of airport users.

Qantas objects to the Productivity Commission's view that airport operators already engage in "commercially-focussed negotiation"<sup>1</sup>. Qantas' previous submission to the Productivity Commission described in detail multiple instances of airport operators exercising their monopoly power at the expense of airport users<sup>2</sup>. Commercially-focussed negotiation between airport operators and their customers are not typical. Instead, Qantas is repeatedly faced with agreeing to uncommercial terms by virtue of the monopoly position airports hold.

Further, in the Productivity Commission's opinion, an arbitration regime by virtue of deemed declaration would become the "default option"<sup>3</sup>. Qantas has previously explained to the Productivity Commission that such a regime would simply act as a 'circuit breaker' during commercial negotiations and would not be invoked in the vast majority of cases. This is because the threat of arbitration will incentivise airport operators to maintain a reasonable commercial position. It is important to remember that as long as airport operators act in a way which is consistent with a competitive market, there would be no need for airlines to invoke the circuit breaker mechanism.

The Productivity Commission notes that an airline could always initiate a Part IIIA declaration. Qantas agrees with the ACCC's submission to the Productivity Commission that without deeming a service to be declared under Part IIIA "the general provisions of Part IIIA do not present an effective constraint on the behaviour of the airports"<sup>4</sup>.

Qantas strongly agrees with the ACCC's view that:

*"Given the limitations of price monitoring and the uncertainty associated with the declaration process under Part IIIA, it is the view of the ACCC that deemed declaration is the most effective option for economic regulation of aeronautical services at the major airports"<sup>5</sup>.*

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<sup>1</sup> Draft Report, p 249.

<sup>2</sup> *The Qantas Group Submission, Productivity Commission Inquiry into the Economic Regulation of Airport Services*, April 2011 (**Qantas Group Submission**) pp 18 – 27.

<sup>3</sup> Draft Report, p 250.

<sup>4</sup> *Submission to the Productivity Commission's Inquiry into the Economic Regulation of Airport Services*, Australian Competition & Consumer Commission, March 2011 (**ACCC Submission**) p 8.

<sup>5</sup> ACCC Submission, p 16.

Ultimately, deemed declaration will encourage airport operators to engage constructively with their customers during commercial negotiations. This will have the benefit of returning the parties to a competitive marketplace, which can lead to significant improvement economically. As stated by the ACCC:

*“Encouraging outcomes that better reflect a competitive environment would result in lower prices, higher service-quality levels, more timely investment, and better use of the various transport options to and from airports. Ultimately, this could lead to increased consumption of air travel and place pressure the airports to operate more efficiently”<sup>6</sup>.*

For the above reasons, Qantas strongly urges the Productivity Commission to introduce a circuit breaker mechanism into commercial negotiations through recommending deemed declaration as the preferred outcome.

### **Code of Conduct**

Qantas is disappointed that the Productivity Commission in its Draft Recommendation 11.3 recommends against introducing a mandatory code of conduct or mandatory guidelines to assist parties in commercial negotiations.

As stated in its previous submission, Qantas advocates the following actions be taken:

- Develop a set of binding codes of conduct to facilitate commercial negotiations between Tier 1 and Tier 2 airports and airlines; and
- Develop and implement codes of conduct for regional airports to facilitate effective commercial negotiations, which would be less onerous than binding codes of conduct for the Tier 1 and Tier 2 airports<sup>7</sup>.

Failing this, Qantas submits that the Productivity Commission should recommend that a voluntary industry code of conduct be agreed between airport operators and their customers.

If a voluntary code of conduct is implemented, its effectiveness should be monitored. Following a later review date, if compliance with the voluntary code of conduct is poor or inconsistent, the code of conduct should be made mandatory if it is to achieve its purpose.

In response to the Productivity Commission’s specific information request<sup>8</sup>, Qantas’ preference is that a committee is tasked with developing a voluntary industry code, rather than guidelines being devised by the Productivity Commission and incorporated into the Pricing Principles. Qantas appreciates and welcomes the Productivity Commission’s suggestion that it form part of the committee.

### **Pricing Principles**

If the Productivity Commission recommends that the Pricing Principles should be evaluated and strengthened through amendment, Qantas would be willing to work with the Productivity Commission and any other relevant parties.

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<sup>6</sup> ACCC Submission, p 39.

<sup>7</sup> Qantas Group Submission, p 73.

<sup>8</sup> Draft Report, p 253.

## **Show Cause Mechanism**

Qantas supports the 'show cause' mechanism set out in Draft Recommendation 11.1. However, Qantas believes that deemed declaration under Part IIIA should be the preferred outcome as it will deliver superior competitive results at the same time as maintaining a light-handed regulatory approach. If however the Productivity Commission continues to support a 'show cause' mechanism, Qantas remains concerned that the mechanism may not necessarily achieve more effective regulation.

It is clear that the implementation of a show cause mechanism will be resource intensive. This mechanism will involve reviews, inquiries and discussions and additional resources when allegations of serious misbehaviour are made.

In order to deter airport operators from misusing their market power and to justify the intensive use of resources, the mechanism must provide sanctions in the event an airport operator is found to have misused their market power. Otherwise there is no guarantee that the show cause mechanism will change airport operators' behaviours and therefore be effective in correcting misuse of market power.

The Productivity Commission sets out in Draft Recommendation 11.1 onerous conditions that the ACCC must satisfy before they can issue a show cause direction.

Qantas is concerned with the following features of the conditions:

- Even if an airport operator misuses its market power in material way – for example, in failing to act commercially when negotiating new leases with airline customers – the ACCC will not be empowered to issue a show cause direction unless the airport operator has made an 'excessive' return;
- In the event of a downturn in passenger traffic, the ACCC again will be prevented from bringing a show cause direction against an airport operator even if they have consistently misused their market power; and
- If an airport operator's investment is only beneficial to certain airlines, the ACCC would similarly be unable to issue a show cause direction if other airlines at the airport, who are not receiving any benefit from the investment, are subject to consistently higher prices.
- Airlines often enter into contracts with airport operators that extend over several years. It may therefore be difficult for the ACCC to demonstrate that airport operators "over time" consistently overcharge.

In light of the above, Qantas questions whether the hurdles the ACCC must overcome in order to issue a show cause direction will be so high that it will not be used in practice and will not be an effective constraint on airport operators' monopoly behaviour.

## **Service Quality Monitoring**

While it is not clear to us how this process might be implemented, nevertheless, Qantas would support a move to opt-in service monitoring, as this would give airport operators an incentive to offer a baseline that provided robust service levels and meaningful compensation for service failure. Qantas would also support the publication of names of airlines that have or have not negotiated Service Level Agreements (**SLAs**) with each airport operator, as failure to negotiate with a very low frequency carrier may be taken as less of an omission from the airport operators side than having no SLA with a major carrier.

Qantas also supports the Productivity Commission's conclusion that mandatory quality of service monitoring of Domestic Terminal Leases (DTLs) should be treated with caution. Qantas strongly believes that the product it offers in the DTLs is already a significant driver of customer satisfaction and any mandated service monitoring would be redundant.

### **Regional Airports**

The Productivity Commission has requested information on the potential costs and benefits of extending Pricing Principles to regional airports.<sup>9</sup> While Qantas acknowledges that a full application of the Pricing Principles would be unnecessary, there is merit in applying some of the basic rules to regional airports. Providing a simplified set of principles may facilitate both sides in finding common ground in negotiations. Commercial negotiations, transparency of costs, consultation with airlines (particularly on time and scope of development plans) and some form of building block model would be the ideal minimum for these Principles.

### **Funding of Transport Infrastructure**

The Productivity Commission has requested input as to how land transport infrastructure should be funded<sup>10</sup>. In respect to transport infrastructure that is driven by aeronautical and associated activities, we believe that the responsibility sits squarely with local and state Governments for the long term planning, design and delivery of efficient transport infrastructure for the relevant city. Airport aeronautical activities deliver broad benefits to the local and state Governments and communities, including the following:

- Creation of jobs and contribution to the local and state economies;
- Underpin tourism, trade and regional developments;
- Deliver productivity benefits for passengers; and
- Deliver aeronautical capacity to support local and state growth, involving the investment of significant funds.

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<sup>9</sup> Draft Report, p 296.

<sup>10</sup> Draft Report, p 286.