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Australia Pacific Airports

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Dear Dr Salerian

I write in relation to the interim report on the Review of the *Prices Surveillance Act 1983*. Whilst I appreciate that this review is now part of a wider inquiry into access arrangements, the interim report does raise some questions which the Commission may find comment upon at this time helpful.

Before commenting on specifics, can I say that APAC generally agrees with the views expressed by the Commission in the interim report. Our view is that the PS Act is not designed for the purposes to which it is now put. Moreover, if the Commonwealth requires legislation to regulate industries, then it should either have well designed industry specific legislation or generic legislation that reflects current thinking on regulatory best practice. The PS Act is deficient for the reasons identified in the interim report but more over because its application virtually mandates cost of service regulation which in the broad sweep of current regulatory theory stands largely discredited.

We agree with the Commission's view about what a best practice regulatory system would look like. The problem with the PS Act in this regard is that the Minister not only determines if regulation is necessary but also acts as the appeal body for the regulators decisions. Given the ACCC's wide ranging brief, which has now been extended to the supervision of the introduction of major Government policy initiatives, it is possible to conceive of situations where the need to support the regulator in a wider public context may colour a Minister's views of any particular matter that the ACCC may seek a public inquiry under the PS Act. I must stress we are not aware of such a situation having arisen to date but clearly the risk exists. It seems to us that if the PS Act was to remain on the statute book, that there should be a right of appeal to a body such as the Australian Competition Tribunal as is the case in relation to a range of matters administered under the TP Act.

On page five of the interim report, there is a quote from Qantas' submission arguing that airports have to date considered the price cap to be binding. The implication of that quote is that this demonstrates the effectiveness of the PS Act. The Phase 1 and 2 airport lease transactions were undertaken on the clear understanding that there would be a price cap for five years after which time arrangements would move onto a more commercial footing. It is certainly APAC's view, and I believe the view of other airport companies as well, that our obligation to comply with the price cap, and in a number of cases to reduce nominal prices, is as much an obligation under the sale contract with the Commonwealth Government as it is to comply with the directions issued under the PS Act which are ultimately directions to the ACCC, not airport operators.

We are glad the Commission has sought to address the issue of the effect of investment of regulation and we fully appreciate the difficulties in establishing the *ceteris paribus* condition in any analysis of the impact of regulation on investment. A recent experience at Melbourne Airport (MA) may assist in this regard.

For a range of historical reasons, there are no domestic terminal facilities available at MA other than those operated by Qantas and Ansett. Through the course of the last months of 1999 and the early months of 2000 MA was involved in detailed negotiations with both Impulse Airlines and Virgin Blue to construct a common user terminal so that they could operate services through Melbourne. During the construction period, MA has provided temporary facilities through its international terminal but going forward these arrangements will not provide an adequate level of service or capacity for the operators and impact of international activities.

Without going into the details of the negotiations, MA reached a commercial agreement with Impulse Airlines on the price for terminal services and given the risk of new entrant failure and the potential for asset stranding, certain financial assurances were provided. Virgin Blue was offered identical terms but would not accept the price that clearly prevailed in the market.

As these services are declared for the purposes of the PS Act, MA notified the ACCC of the intention to charge the price agreed and instead of accepting the price agreed, the ACCC indicated it would accept a price some 23% below that which was agreed. It should be noted that at no time has the ACCC suggested any form of anti-competitive conduct and indeed, the agreement between Impulse and MA (which was well known to the ACCC) was not even mentioned in the draft decision despite the ACCC being advised of it.

Subsequent discussions between MA and the airlines have led to an acceptable outcome and the terminal will be completed. However, a number of points need to be made and there have been consequences from the ACCC's conduct. MA, on the basis of its commercial agreement with Impulse, proceeded to build the terminal. By the time the ACCC's draft decision available, most of the project funds were committed making terminating the project a difficult commercial decision but one that MA actively considered. Despite industry rumours, it is not clear whether MA's level of commitment had any impact on the ACCC's decision processes.

But two things are clear. The first is that the medium term availability of common use terminal capacity at MA is critical to increased competition in domestic aviation and without it, the viability of new entrant carriers would be even more tenuous. The second is that MA will now no longer accept regulatory risk associated with new investment. If the price contained in the ACCC's draft decision had of been known at the time of commitment to construction, MA would not have started works. Going forward, MA will now wait until it has a final pricing decision from the ACCC and if it finds pricing unacceptable, it won't invest. The Commonwealth Department of Transport and Regional Services has been advised of this decision.

If this approach had of been adopted in relation to the new terminal, it is unlikely it would have been opened until March 2001, rather than the expected November 2000 date significantly impacting on the development of competition in domestic aviation. Given that the ACCC takes about 4 months to deal with applications, new infrastructure and services will take significantly longer to deliver to a rapidly changing industry. Indeed, in some cases, pricing approval will be the most time

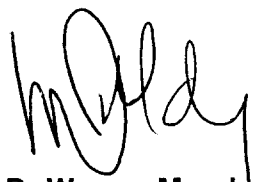
consuming part of the project process. The inability to respond on a timely basis will not only delay projects but is likely to lead to some simply not proceeding. In the cases where new capacity is involved, delays or abandonment will restrict the development of new services and the ability of MA to facilitate the activity of new entrants, thus entrenching the interests of the incumbents and restricting competition.

We are pleased that the Commission has acknowledged that the existence of countervailing market power may be a relevant issue in considering whether prices surveillance is required. We would suggest that there is a need to consider demand side characteristics more widely and in particular the potential for gaming behaviour and regulatory capture by users. The cost-based regulatory system that arises under the PS Act may be open to capture by incumbents seeking to restrict investment by infrastructure providers that facilitate entry by way of arguing against necessary price increases. In such situations where competition in downstream markets is the principal source of public benefits, different forms of incentive-based regulation may be more appropriate, if indeed regulation is required at all. We will address these questions more fully in discussions relating to the access arrangements, especially as it is not clear to us that Part IIIA of the TP Act deals with these issues either.

In relation to the Commission's inquiry into the national access regime, we would encourage the Commission to also consider the relationship between Part IIIA of the TP Act and other statutes, such as s192 of the *Airports Act 1996*.

We look forward to participating in the Commission's ongoing consideration of these important issues. If you would like to discuss and of the issues raised above, please do not hesitate to call me on (03) 9297 1368.

Yours sincerely



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