

16 May 2001

Carole Gardner-Trenberth  
Prices Surveillance Act Review  
Productivity Commission  
LB2 Collins Street East  
MELBOURNE VIC 8003

Dear Carole

Please find enclosed a copy of our comments on the Commission's Draft Report on the Review of the *Prices Surveillance Act 1983*. If you have not already received an electronic version, please let me know.

As I have previously indicated, I am keen to appear at the Commission's hearings on this matter and I look forward to hearing from you regarding the precise details.

Yours sincerely

*Dr Warren Mundy*  
**MANAGER STRATEGY**

# **Review of the Prices *Surveillance Act 1983***

**Comments on Draft Report**

**Australia Pacific Airports Corporation**

**May 2001**

## Introduction

Australia Pacific Airports Corporation (APAC) is a company that holds a 100% interest in the company that leases Melbourne Airport and a 90% interest in the company that leases Launceston Airport from the Commonwealth Government under the provisions of the *Airports Act 1996* (the Airports Act). As part of its long-term strategy of becoming one of the world's leading airport companies, APAC maintains an active interest in acquiring further interests in airports both in Australia and the region where it can leverage its airport management expertise.

Whilst the Airports Act contains a number of provisions (especially Section 192 and Parts 7 and 8) that could generally be seen to relate to economic regulation, and major airports such as Melbourne and Sydney have been subject to declaration under Part IIIA of the *Trade Practices Act 1974* (the TP Act), the main legislative instrument for economic regulation of airports has been the *Prices Surveillance Act 1983* (PS Act). Therefore, APAC is pleased to have the opportunity to comment on the Commission's Draft Report on the Review of the *Prices Surveillance Act 1983* (the Draft Report).

As the Commission is aware, APAC and its airports are also actively involved in the Commission's reviews of the National Access Regime and Price Regulation of Airport Services. This submission seeks to confine itself to issues related to the use of the PS Act as a regulatory instrument rather than broader issues of National Access policy or more general airport industry considerations (which are addressed at some length in Melbourne Airport's submission to the Review of Price Regulation for Airport Services).

APAC supports the thrust of the Commission's approach in this review and in particular, agrees with each of the Commission's findings. In general, APAC also supports the proposal put forward for reforming prices oversight (particularly abolishing notification and repealing the current Act with consolidation into the TP Act) but has some concerns as to the precise details.

As this submission is essentially a commentary on the Draft Report and brings forward relatively little new material, it is structured using the chapter structure in the Draft Report.

## Prices oversight in Australia

### *Operation of the PS Act*

APAC concurs with the Commission's description and analysis of the historic role and development of the PS Act. In particular, we agree with Finding 2.1 that price surveillance now has its primary focus on competition policy. As such, it is appropriate to have a statutory instrument that represents best practice for that purpose rather than one designed 18 years ago to deal with issues in prices and incomes policy.

The operation of the PS Act is now limited to a small range of services which, other than postal services and airport car parks, are intermediate products. Of the 22 firms providing declared services, two are government owned legislated monopolies (Airservices Australia and Australia Post) with the remainder being either airports or

towage operators. Further, the only services subject to monitoring not provided by firms already subject to notification are provided by recipients of stevedoring levy payments.

If appropriate arrangements were put in place under specific industry legislation, such as the Airports Act or the *Stevedoring Levy Act 1998*, there would be virtually nothing left to be regulated under the PS Act. In particular, Parts 7 and 8 of the Airports Act enable the Minister to make regulations for the collection and publication of financial and quality of service information by airports subject to that Act. The information specified in the regulations is to be provided to the ACCC within 92 days of the end of each financial year. The ACCC is empowered to publish this information.

There appears to be no reason why the information that the ACCC currently collects under the PS Act could not be collected under the existing provisions of the Airports Act with appropriate minor amendments to the existing regulations. Indeed, APAC's airports (and we believe other airport companies) provide the information required under both statutes in a single report and frankly, even the most informed observer would struggle to ascertain which information is being provided under each Act.

#### *Potential costs of price control*

Following on from the work of NECG submitted to the Commission's inquiry into the National Access Regime<sup>1</sup>, Melbourne Airport has further developed this thinking in its submission to the Commission's inquiry into Price Regulation of Airport Services<sup>2</sup>. This work shows that the long run welfare losses associated with regulatory under pricing are greater than those associated with over pricing by the same magnitude as a result of some form of abuse of market power, especially if demand is relatively inelastic. Melbourne Airport's work also suggests that a profit maximising firm with some degree of market power is likely to arrive at a set of long run prices closer to the efficiency maximising prices than a regulator.

APAC would therefore agree with the Commission's assessment in the Draft Report "that price control should only be implemented where there is strong evidence of sustained monopolistic pricing".

#### *Price control as a remedy of last report*

Australian trade practices law has as an underlying principle that intervention is only required when a firm with a degree of market power uses it in a way that is anticompetitive, or at least discourages competition in a market. This principle not only underpins Part IV of the TP Act but can be seen to flow through Part IIIA as well.

Prices surveillance, monitoring and control do, however, have another purpose. Indeed, that purpose can be seen in the original intent of the PS Act and it is to address the problem of firms with market power increasing prices in a way that may transfer wealth from end consumers to themselves and leads to welfare losses through a reduction in output. Familiar examples can be found in the regulation of the provision of utility services to households and petroleum. It is also possible for wealth to be extracted from end consumers and transmitted back up the value chain

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<sup>1</sup> NECG (2001)

<sup>2</sup> Melbourne Airport (2001). See especially Chapter 5.

to an upstream firm that exercises market power in an intermediate product market. Such uses of market power cannot effectively be constrained by the use of the TP Act as currently structured.

The first best solution is to pursue structural policies that reduce the potential for such market power abuse to arise in the first place. The cross-ownership rules in the Airports Act and the establishment of multiple electricity distribution businesses followed by retail contestability in Victoria are examples of such policies. Beyond that, careful analysis of the conditions of supply, including the countervailing power of immediate consumers (often arising from the availability of substitutes or some degree of monopsony) and the commercial incentive to use market power in an efficiency damaging way (through reducing output), must be a pre-requisite to the introduction, or sustaining, of any price control. It is the consideration of such matters that has led Melbourne Airport to submit to the Commission that price regulation of airport services need not continue beyond 30 June 2002.

APAC emphatically believes that price controls must be a last resort after market mechanisms and monitoring have led to the view, based on actual evidence and experience, that a firm's pricing capacity must be restricted. This is consistent with the idea that in relation to essential facilities, there must actually be an access dispute to resolve and more generally in trade practices law that an offence must be committed. By analogy it is the commission of the crime of murder that constitutes an offence, not the ownership of a kitchen knife.

Whilst the threat of re-regulation will always discipline the firms currently subject to the PS Act, it does seem that from a general public policy perspective, rather than a narrower competition policy perspective, that it may be desirable for there to remain a residual device to restrain "rogue" pricing increases arising from the abuse of market power similar to that found in section 24 of the PS Act. This matter is discussed further below.

## **Prices oversight as part of competition policy and law**

Putting government business enterprises to one side, the firms currently subject to both declaration and monitoring under the PS Act operate in markets characterised by conditions of imperfect competition, not pure monopoly. As the Commission and others correctly note regulation in such circumstances is fraught with problems. These problems are complicated in the case of airports by the fact that common facilities provide a range of services in a range of markets with varying levels of contestability. Indeed, the degree of contestability for a service may depend directly on the definition of the market in question<sup>3</sup> even though the service being provided is the same.

The imposition of price controls in such circumstances have the potential to inhibit the development of the sorts of competitive conduct that will ameliorate the potential for the pricing policies that price controls are seeking to prevent. Moreover, in the industries currently subject to price control, competition in downstream markets may

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<sup>3</sup> For example, the market for runway services within 30 kilometres on the Melbourne CBD for jet aircraft over 50 tonnes is much less contestable than the market for runway services for international aircraft coming in Australia. However, a 747-400 aircraft operating between Singapore and Melbourne can be seen as consuming services in both markets even though the service consumed in each is identical. Similar arguments can be made for stevedoring and towage services.

be obstructed if the supply of services from regulated firms is restricted in any way, and in particular by reduced infrastructure investment resulting from inappropriate regulatory price setting.

As such, APAC find itself in total agreement with Finding 3.1.

### *Public Inquiries*

APAC is generally concerned about the ability of regulators to create demand for their own services. For this reason, it has been a strong advocate of the review of Price Regulation of Airport Services being conducted by a body other than the ACCC.

Such an approach ensures not only that there is no apprehension of bias in the result of the inquiry but brings to what are serious public policy, as well as regulatory, issues a fresh perspective not jaundiced by the experience of the day to day issues faced by an industry and its regulator. Further, the skills required of an efficient, competent regulator are not necessarily those required to conduct and facilitate wider ranging public policy discussions.

That said, it is important that the views of regulators are made clear in such debates and are given due weight along side those of (potentially) regulated firms, consumers of the services in question and other interested parties. APAC also believes that it is vital that governments should make clear up front what their wider public policy objectives are so that these can be given proper consideration.

APAC supports the retention of an inquiry mechanism within the competition policy framework and its proposed reform, especially if it is part of a wider process designed to deliver good policy outcomes. However, APAC does suggest the Commission should explore further the consequences of the loss of the mechanism whereby prices are constrained during the course of an inquiry.

### *Monitoring*

As indicated above, airports are subject to a range of monitoring arrangements under different statutes and it is APAC's view that all the information currently collected could be done so under the Airports Act. Whilst APAC is generally comfortable with the information it is required to provide, the provision of that information is not costless. Of the conservative estimate of \$500,000 per annum that APAC spends on regulatory compliance (including quality of service monitoring) we would estimate that at least half of that would be associated with reporting<sup>4</sup>. The remainder is attributable to dealing with notification issues (predominantly relating to necessary new investment but also the price cap) and other access issues (such as section 192 of the Airports Act).

Obviously, these costs are much more burdensome for smaller airports than larger ones (and certainly those that are not part of a larger group) as is reflected by the fact that quality surveys are not required for smaller airports. Notwithstanding, the fact that each transaction undertaken by airports must be coded as aeronautical or non-aeronautical (or a combination of both) and that regulatory reports must be

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<sup>4</sup> Melbourne Airport (2001, p42)

audited leads to significant costs. Less costly approaches that do not reduce information quality may well be possible.

### *Price Notification*

In APAC's view, the notification provisions contained in section 22 amount to very little more than regulation by shaming. Indeed, that appears to be their intent. Whilst having some logic in the context of the Prices and Incomes Accord, they do not represent best practice regulation within the context of National Competition Policy. Indeed, they approach worst practice regulation. Decisions in relation to notification rest on even less well defined statutory principles and objects than those underpinning the National Access Regime. The Act leaves it open to the regulators to make arbitrary decisions that are not subject to independent review. Paradoxically, the decisions made by the ACCC in relation to notices are ultimately unenforceable.

Melbourne Airport's recent experience has also shown that even after a company has complied with the processes constructed by the ACCC under the PS Act, it can be subject to further action under other regulatory structures. The Commission is aware of the controversy surrounding the prices to be charged for use of the Domestic Express Terminal (DET) at Melbourne Airport. Having completed the facility and provided services in accordance with the ACCC's decision under the PS Act, Melbourne Airport has found itself having now to deal with an application to have the DET declared under Section 192 of the Airports Act, paving the way for arbitration under Part IIIA of the TP Act.

This is regulatory double jeopardy in action. Certainly, the development of the National Access Regime has rendered the notification provisions of the PS Act redundant wherever the regime applies. In the small set of cases where pricing may be of concern and the National Access Regime does not apply, it would seem that appropriate structural policies, coupled with the general provisions of the TP Act and perhaps with a revamped monitoring and inquiry regime would also be preferable to notification.

APAC supports the Commission's finding that price notification under the PS Act is not longer appropriate.

## **Evaluation of the Prices Surveillance Act**

### *Objectives*

Whatever the objectives of the PS Act were at the time of its enactment, these seem to be only passingly relevant to the purposes the PS Act is put to today. APAC supports the incorporation of revised monitoring and inquiry provisions into the National Access Regime contained in the TP Act. Clearly the objectives of what would be incorporated in to the TP Act would be aligned with those of the National Access Regime in general. Whilst not wishing to dwell on that issue, it is clear to APAC that the overwhelming objectives of the National Access Regime must be economic efficiency as set out in Proposal 5.1 of the Commission's Position Paper on the Review of the National Access Regime.

### *Separating policy and regulatory roles*

As indicated above, APAC is generally concerned about the ability of regulators to create work for themselves. For this reason, APAC endorses the suggestion made by the Commission to separate the inquiry function from day to day regulation.

It is not clear whether the ACCC is the appropriate body to undertake monitoring activities. Indeed, one might argue that some other body undertaking monitoring as well as inquiries best deals with the concerns indicated above. It seems that the skills required to collect, collate and publish data on industries is not a skill peculiar to the ACCC. Indeed, there is a long tradition in transport policy for such work to be undertaken by the Bureau of Transport Economics (in relation to waterfront productivity) or the Department itself (in relation to its AVSTATS program). If the intention of monitoring were to gather information for wider policy purposes, as opposed to the exercise of some form or quasi-judicial function, such an approach would be more appropriate.

The PS Act as currently structured places ultimate power in most matters in the hands of the Minister. Whilst acknowledging that this creates potential for political intervention, recent experience in the airports' industry has shown that occasionally it is necessary for government to act to ensure that regulators have proper regard to wider government policy. If something akin to the notification provisions is to remain, the processes by which regulators are required to have due attention to government policy needs to be revised. If only monitoring and inquiries are retained, this need is less great. However, a similar issue will arise more generally in relation to the National Access Regime.

### *Transparency*

In a footnote at the bottom of page 62 of the Draft Report, the Commission makes a comment about transparency concerns in the airports' industry arising mainly from the poor specification of regulatory instruments rather than ACCC processes per se. Whilst the specification of instruments has certainly been an issue in airport regulation, the ACCC's approach has been an equal contributing factor. Below are just two examples:

- The ACCC has generally been prepared to accept material from airlines on a commercial-in-confidence basis, thus denying airports the opportunity to comment on what has been said about their investment proposals and conduct. Whilst accepting that airlines may not want some information to be available to competitors, it is difficult to argue that transparent processes arise from a situation where entire submissions are made in confidence or that such basic information as a new entrant's expected traffic volumes is denied to regulated firms.
- Melbourne Airport has asked the ACCC on a number of occasions to provide full details of its analysis of airport asset betas that are a core issue in regulatory decision making. The ACCC has yet to do so, despite both airlines and airports having made their analyses generally available. Most recently, the ACCC has advised the information is not in a form that could be provided. If this is the case, one must question whether it is in a form to enable robust decision making.



### *Does the PS Act restrict competition?*

APAC believes that any set of arrangements that obstruct prudent investment in airport infrastructure obstruct the ability of airports to provide new capacity and services. This is precisely what the current regime constructed under the PS Act does<sup>5</sup>. Such a situation necessarily reduces the capacity of airlines to expand their services and in particular, obstructs the entry of new carriers on certain routes or the market as a whole. In such situations, the regulatory system entrenches the position of incumbents and necessarily reduces competition in downstream markets as well as the primary market subject to regulation.

## **Implementing light-handed prices oversight**

APAC supports Proposal 5.1 as an alternative to the Price Surveillance Act in most respects. In particular, the integration of the price monitoring functions into the more general provisions of the National Access Regime would go a long way to eliminate regulatory double jeopardy.

Below are listed (in no particular order) some issues that may warrant further consideration by the Commission:

- What would be the relationship between a monitoring program under the new provisions and other compliance programs constructed under statute law, such as those found in the Airports Act? Would it be appropriate for those arrangements to stand in the place (in a loose sense be “certified”) of the new arrangements proposed for the TP Act?
- Should there be some provision similar to section 24 of the PS Act that can be used to restrain prices during the course of an inquiry? Would it be appropriate to restrict it to those cases where the Minister orders an inquiry?
- How would CPI-X style regimes be implemented as consequence of the monitoring and inquiry processes as mentioned in the “Key Messages”? Would this be by way of some form of certified or authorised regime and if so in what way?
- If a firm is subject to monitoring, will it remain exposed to subsequent access applications during the monitoring period for the monitored services and/or other services that have not been subject to monitoring? In other words, does the imposition of monitoring act as an effective access regime for the purposes of Part IIIA of the TP Act?
- Should the broad range of information that can be included in a monitoring regime be specified in statute? If so, should that information be restricted to financial data or should it include information on such issues as quality, asset capacity and utilisation and productivity?

## **Bibliography**

Melbourne Airport (2001) *Submission to the Productivity Commission Review of Price Regulation of Airport Services*, Melbourne, March.

Network Economics Consulting Group (NECG) (2001) *Submission to the Productivity Commission Inquiry into Part IIIA*, Sydney, January.

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<sup>5</sup> See Melbourne Airport (2001), especially Chapter 4.