AUSTRALIAN
AIRPORTS
ASSOCIATION

AAA SUBMISSION

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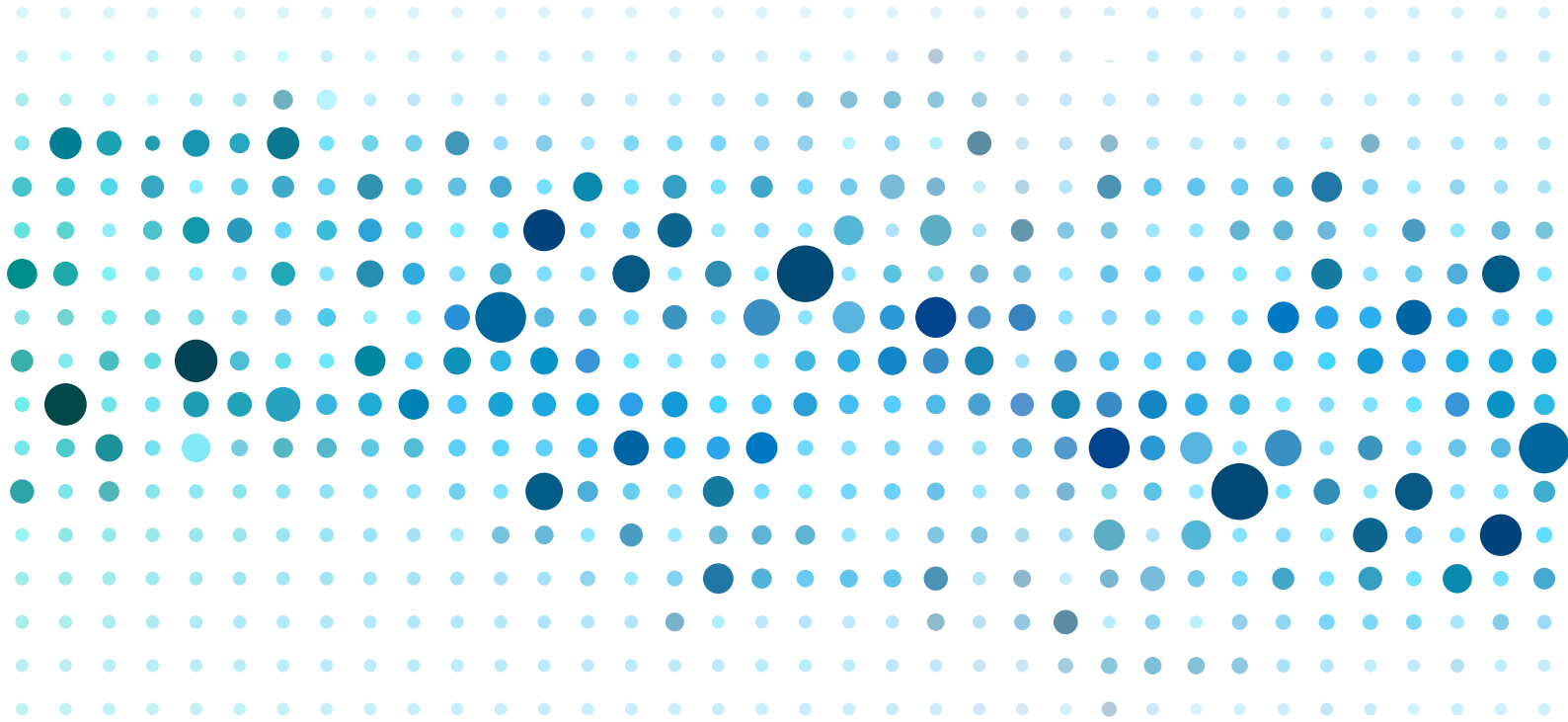

Productivity Commission inquiry into the economic regulation of airports

ABOUT THE
AUSTRALIAN AIRPORTS ASSOCIATION

The Australian Airports Association (AAA) is a non-profit organisation that was founded in 1982 in recognition of the real need for one coherent, cohesive, consistent and vital voice for aerodromes and airports throughout Australia.

The AAA represents the interests of more than 360 airports and aerodromes Australia wide – from the local country community landing strip to major international gateway airports.

The AAA also represents more than 160 aviation stakeholders and organisations that provide goods and services to airports.

The AAA facilitates co-operation among all member airports and their many and varied partners in Australian aviation, whilst contributing to an air transport system that is safe, secure, environmentally responsible and efficient for the benefit of all Australians and visitors.

The AAA is the leading advocate for appropriate national policy relating to airport activities and operates to ensure regular transport passengers, freight, and the community enjoy the full benefits of a progressive and sustainable airport industry.

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Introduction

The Australian Airports Association (**AAA**) appreciates the opportunity to make a submission to the Commission in relation to A4ANZ's submission on 8 May 2019. There is no new material in the A4ANZ submission other than the detail of a proposed arbitration regime. However, this further submission of A4ANZ effectively proposes a (poor) solution without a problem. Accordingly, the Commission should continue to focus on whether or not there is a problem before considering the appropriateness of alternate solutions. A4ANZ has proposed a poor, biased solution to an imaginary problem.

As outlined below, the AAA strongly disagrees with the five key contentions (or Practice Points) put forward by A4ANZ in its submission. In particular, the AAA considers that the type of regulatory intervention proposed by A4ANZ is not justified and fundamentally fails to meet the thresholds for regulatory change that have been clearly articulated by the Productivity Commission. Instead, as previously stated in its submissions, the AAA supports the Commission's draft findings and recommendations subject to some minor comments about emphasis and implementation, as set out in our submission to the Commission in March.

A4ANZ's proposed regulatory model is unjustified and untargeted in light of the market power issues it purports to address

It is a fundamental principle that any regulatory intervention must be both justified and targeted.[1]

A4ANZ proposes that its negotiate-arbitrate model be applied to 13 Australian airports.[2] Despite emphasising 'regulatory best practice' in its submission, A4ANZ has not sought to justify why it is necessary to impose any regulation on each of these 13 airports (let alone why such a heavy-handed approach is necessary).

The issue which the proposed regulation is supposed to address is an abuse of market power by Australian airports. However, A4ANZ has no regard to the extent to which the 13 airports listed even possess material levels of market power, let alone are likely to use it.

Non-monitored airports

The AAA submits that eight of the 13 airports to which A4ANZ proposes its negotiate-arbitrate model be applied (being, Adelaide, Gold Coast, Hobart, Launceston, Alice Springs, Canberra, Darwin and Townsville) possess low to negligible levels of market power.[3]

The most recent inquiries by the Commission have found that these eight airports do not possess any significant degree of market power. Each of the eight airports, except Canberra, predominantly service holiday markets, which are characterised by a high degree of destination substitution and customers who are highly price sensitive. In addition, Alice Springs, Launceston, Hobart and Gold Coast airports face competition from other nearby airports. Canberra Airport faces a high degree of modal substitution with road travel.[4]

A4ANZ has not put forward any evidence that the matters outlined above have changed, or that the overall conclusions by the Commission in its Draft Report (or previous reports) regarding the market power of these airports are incorrect.

The AAA also notes that these eight airports are currently subject only to a voluntary monitoring regime. Accordingly, A4ANZ's proposal to impose a form of heavy-handed regulation, being a negotiate-arbitrate model, would be a significant departure both from current practice and from the Commission's recommendation in its Draft Report that this current voluntary monitoring be discontinued (see Draft Recommendation 10.3)[5].

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1 Hilmer, Frederick, Mark Rayner, Geoffrey Taperell and Warrick Smith, *National Competition Policy (the Hilmer Review)*, 1993, pages xxix, 189, 248, 260; Harper, Ian, Peter Anderson, Su McCluskey and Michael O'Bryan QC, *Competition Policy Review Final Report*, March 2015, pages 24-25, 32; Productivity Commission, *Identifying and Evaluating Productivity Commission Regulation Reforms Research Report*, December 2011, pages XIII, 6, 9, 13-15; Productivity Commission *National Access Regime Inquiry Report No.66*, 2013, pages 8-10; and Australian Government, *Australian Government Guide to Regulation*, 2014, Principles 1-2 (page 2).

2 Sydney (Kingsford-Smith); Sydney West; Melbourne (Tullamarine); Brisbane; Perth; Adelaide; Gold Coast; Hobart International; Launceston; Alice Springs; Canberra; Darwin; and Townsville. These are referred to as the 'core regulated airports' in Section 192A(6) of A4ANZ's draft proposal (see page 26 of A4ANZ's May 2019 Submission).

3 *AAA Submission to the Productivity Commission*, 7 September 2018 (**September Submission**), 81; *AAA Submission Response to the Productivity Commission's Draft*, 18 March 2019 (**March Submission**), 4.

4 Productivity Commission, *Economic Regulation of Airports Draft Report*, February 2019, pages 11, 96, 105-6; Productivity Commission, *Economic Regulation of Airport Service Productivity Commission Inquiry Report* (No. 57, 14 December 2011) pages 81-82; Productivity Commission, *Review of Price Regulation of Airports Services Inquiry* Report (No. 40, 14 December 2006) pages 102-104; Productivity Commission, *Price Regulation of Airport Services Inquiry Report* (No 19, 23 January 2002) 133.

5 Productivity Commission, *Economic Regulation of Airports Draft Report*, February 2019, pages 11, 298.

Monitored airports

As previously stated, the AAA does not seek to dispute in this inquiry that the four major airports in Sydney, Melbourne, Brisbane and Perth have some degree of market power which warrants a price monitoring framework, coupled with periodic reviews by the Commission. However, the AAA submits that the negotiate-arbitrate model is completely disproportionate to the issue which that regulation would seek to address.

First, A4ANZ has no regard in its submission to whether the four airports would actually be likely to abuse any market power they do possess. A4ANZ completely disregards the market, legal and institutional constraints to which those airports are subject, which are outlined in section 5 of the AAA's initial submission.

As outlined below, these constraints mean that these four airports are unable to exercise the following behaviours which indicate the use of substantial market power:

» Restricting or denying access;

» Charging prices in excess of efficient costs;

» Maintaining prices but allowing quality to fall; or

» Allowing costs to rise over time.[6]

Very limited ability to deny or restrict access

The four airports in question have very limited ability to restrict or deny access to aeronautical services. The conditions upon which the airports are leased from the Australian government require the airports to provide access to all airlines. While an airport can deny access for non-payment or short-payment of charges in certain circumstances, unless there is a contract in place between an airport and an airline, or the airline has explicitly or implicitly accepted the terms set out in a conditions of use document (see section 5.4.3 of the AAA's initial submission), airports must institute litigation to establish what charges are owed to them by airlines (and, therefore, whether non-payment or short-payment of those charges entitles it to deny access).

Limited ability to charge prices in excess of efficient costs

The four airports are practically unable to charge prices above the efficient cost of supplying the aeronautical services for any sustained period. Airlines could simply refuse to enter into an ASA that contains such charges and can expressly reject Conditions of Use that contain such charges, secure in the knowledge that they could still obtain access due to the lease obligation.

Further, the demonstrated ability for airlines to access services but withhold payment (at least until a court has determined applicable charges) is a powerful bargaining tool in negotiations with airport operators on both the price and non-price terms contained in either an ASA or the Conditions of Use. An airport operator faces costs, delays and uncertainties in litigating non-payment or under-payment by an airline.

Limited ability to reduce quality of service or allow costs to rise over time

As outlined in section 5.3.2 of the AAA's initial submission, the contractual and regulatory arrangements surrounding the airport lease also constrains the airport operator from allowing the quality of services and infrastructure to deteriorate over the term of the lease. Compliance with these arrangements is actively monitored by the Commonwealth Department of Infrastructure, Regional Development and Cities.

6 See, for example, Productivity Commission, *Economic Regulation of Airport Services* (14 December 2011), page 88; ACCC, Airport Monitoring Report 2015-16 (March 2017), page 1.

As discussed in chapters 4 and 5 of the AAA's initial submission, airport operators have made significant investments in their facilities to ensure that the quality of services are maintained and costs are not allowed to unduly rise over time. There is no evidence that the quality of aeronautical services has reduced. Further, the Australian Competition and Consumer Commission's (**ACCC**) Airport Monitoring Report for 2017-18 stated that the four monitored airports (being Melbourne, Sydney, Brisbane and Perth) each received a rating of "good" for their overall level of service (out of possible ratings of very poor, poor, satisfactory, good and excellent).[7]

In addition, the contracts negotiated between airlines and airport operators are increasingly including strict KPIs in relation to quality of services and decision-making rights over capital investments.[8]

Other considerations

As outlined in paragraph 15 above and in detail in chapter 5 of our initial submission, airport operators also do not have a unilateral right to set prices for aeronautical services as is usual for firms with an ability to exercise substantial market power. Prices for aeronautical services must be agreed with airlines or, in the absence of agreement, determined by a court. Further, the dual till regulatory regime provides airports with the economic incentive to maximise passenger volumes. Especially for leisure destinations where airline passengers are price sensitive, the economic incentive to maximise passengers is inconsistent with A4ANZ's assertion that airports seek to charge excessive prices, which would dampen demand.

Lack of evidence of any systematic abuse of market power

The AAA disagrees with A4ANZ's contention that there is "existing, historical evidence that airports have already been exercising market power". There is no such evidence. Further, such abuse simply cannot occur (as outlined above, due to market, legal and institutional constraints).

In particular, the AAA responds as follows to the "evidence" of this exercise of market power put forward on page 7 of A4ANZ's submission:

- **Airport charges** - As outlined in chapter 3 of the AAA's initial submission, while Australian airport charges on average have risen modestly in real terms – and at some airports have decreased – since the Commission's last inquiry, the returns on aeronautical assets at monitored airports have actually generally trended down over the same period. This downward trend can largely be understood to be the result of substantial increases in capacity at the same time the cost of capital has fallen.
- **Landside charges** - Detailed reports have been prepared by HoustonKemp and submitted to the Commission which demonstrate that the monitored airports do not hold substantial market power in car parking services and, over the last five years, have not used substantial market power in the provision of car parking services and have not exercised substantial market power in relation to landside access charges. Merely pointing to increases in charges over a number of years does not discredit these conclusions.

Further, as outlined in chapter 4 of the AAA's initial submission, benchmarking of airport charges needs to be considered carefully. A number of peer airports are subsidised and/or have a single till regulatory scheme which may inefficiently suppress prices.

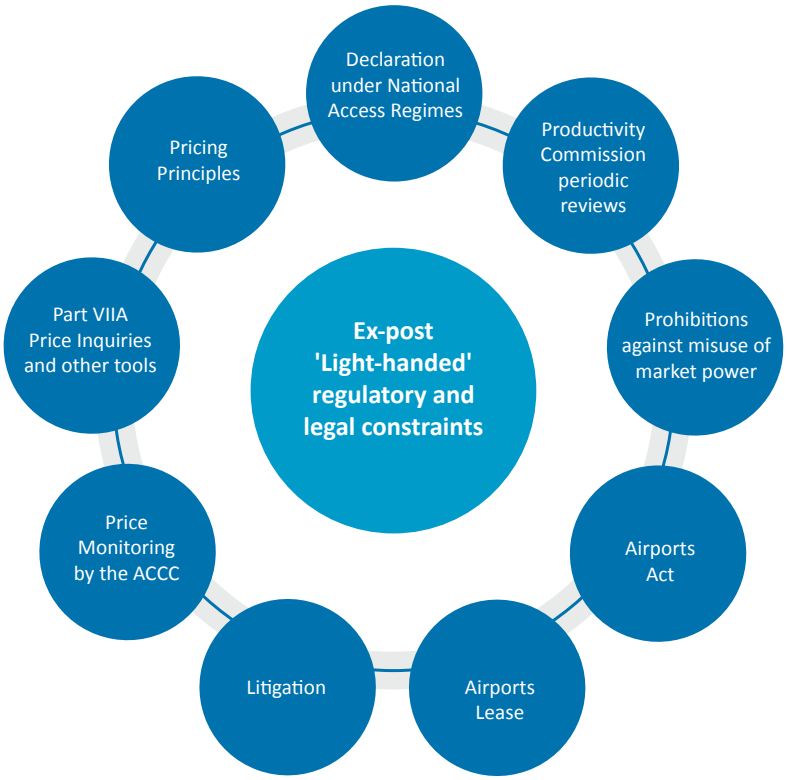
While the AAA agrees with A4ANZ's second contention that market power can be manifested in a number of ways, not just in pricing, it disagrees that Australian airports have carried out such behaviour. Non-price indicators such as service levels and investment to meet demand show that airports have not limited investment in order to restrict supply – a classic form of monopoly behaviour. Nor have they allowed service levels to degrade. Australian airports are recognised as appropriately striking the balance between investment to meet demand without undertaking speculative investment (that could be at the expense of incumbent airlines) – and this investment profile is a direct result of the existing regulatory regime.

7 ACCC, Airport Monitoring Report 2017-18 (February 2019), pages 1, 33.

8 Productivity Commission, *Economic Regulation of Airports Draft Report*, February 2019, page 115; Productivity Commission, *Economic Regulation of Airport Services* (14 December 2011), page 163; ACCC, Airport Monitoring Report 2015-16 (March 2017), page 11-12.

The current regulatory regime is effective and efficient

The current regulatory regime is represented below.



The AAA submits that the current regulatory regime is effective and sufficient in addressing any market power held by the four monitored airports.

Airports are already subject to an extensive degree of regulatory oversight under the current system. If an airport was to systemically abuse market power, such behaviour would put the airport at risk of the following measures:

- The ACCC reporting the behaviour in its regular and publicly available airport monitoring reports;
- The ACCC seeking, and/or the government itself ordering, a Part VIIA inquiry. Such an inquiry could prompt legal reform by the government;
- The Productivity Commission reporting on the behaviour and seeking a more heavy-handed regulatory approach;
- An airline seeking declaration of the service under Part IIIA;
- The government alleging a breach of the Airports Act or the Airports Lease;
- The ACCC or an airline initiating proceedings alleging a contravention of section 46 of the CCA.

As outlined in further detail below, each of these measures could have serious consequences for airports, and are taken very seriously by them.

Despite an extensive and fit-for-purpose light-handed regime, A4ANZ has asserted (without substantiation) that industry-specific arbitration will yield efficiency benefits. A4ANZ has produced no evidence that any airport is systematically abusing any market power (as outlined in section 1 above) and (as outlined in this section) no evidence that the current regime is not effective and sufficient. Rather, A4ANZ has provided a solution without a problem. A policy without the mischief.

Analysis of the current regulatory regime

Part VIIA of the CCA

As discussed in the AAA's previous submissions,[9] Part VIIA of the CCA provides a range of regulatory tools, including more intrusive price monitoring than the current regime, Part VIIA price inquiries and price notification regimes. These existing tools would involve significantly greater regulatory burden and, for this reason, are a credible constraint on airports.

A Prices Inquiry

The AAA disagrees with A4ANZ's contention that the threat of a Part VIIA Price Inquiry into airports is a "very weak" constraint.[10]

Such an inquiry can be requested by the ACCC and ordered by the government at any time.[11]

Such inquiries are frequently conducted by the ACCC[12], and are becoming an increasingly significant regulatory function for the ACCC.[13] During the period of a Part VIIA price inquiry the relevant firms are prohibited from raising prices which provides a further reason why such inquiries are not a weak constraint upon airport behaviour (Section 95N Competition and Consumer Act).

A4ANZ's suggestion that the ACCC's recommendations from Part VIIA price inquiries are not effective is incorrect. The ACCC is a high-profile authority and its recommendations from its recent Part VIIA inquiries have quickly prompted policy responses by government. For example the ACCC's report into the electricity sector made a suite of recommendations[14] including whole-sale reforms to reduce electricity prices.[15] Following the report's publication, the government announced that it was implementing many of the ACCC's recommendations,[16] and the Treasurer further directed the ACCC to hold a public inquiry to monitor prices, profits and margins in the supply of electricity.[17]

It is clear that the threat of a Part VIIA inquiry by the ACCC is significant. The wide scope of review available to such inquiries, the significant cost burden in participating in such an inquiry and the policy responses by government following such a review, provides a strong incentive to airports not to behave in a manner that could prompt such a review.

In addition to Price Inquiries under Part VIIA airports are also constrained by the threat of the Government declaring services at an airport to be subject to the compulsory price notification provisions under Part VIIA. Pursuant to the price notification provisions the firm is required to submit a price notification to the ACCC before increasing the price of the relevant services, and the ACCC is to decide whether or not to object to the price increase. Price notification declarations usually follow from the ACCC price monitoring reports and the findings in such reports.

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9 AAA's September Submission, page 83-84.
10 A4ANZ, Supplementary Response to PC's Draft Report, page 12.
11 Productivity Commission, *Inquiry Report No 57 : Economic Regulation of Airport Services*, 14 December 2011, p 179.
12 It is currently conducting inquiries into a range of industries including digital platforms, residential mortgage products, foreign currency conversion services, the Northern Australian insurance industry, dairy, electricity and gas.
13 ACCC, *ACCC and AER Annual Report 2017-18*, October 2018 (accessed 10 May 2019) <https://www.accc.gov.au/system/files/ACCC-%26-AER-Annual-Report-2017-18_0.pdf> 5; .
14 ACCC, *Restoring electricity affordability and Australia's competitive advantage Retail Electricity Pricing Inquiry—Final Report*, June 2018 (accessed 10 May 2019), https://www.accc.gov.au/system/files/Retail%20Electricity%20Pricing%20Inquiry%E2%80%94Final%20Report%20June%202018_0.pdf>, xvii-xxv..
15 ACCC, *ACCC releases blueprint to reduce electricity prices*, 11 July 2018 (accessed 10 May 2019) <https://www.accc.gov.au/media-release/accc-releases-blueprint-to-reduce-electricity-prices>.
16 Prime Minister, Treasurer, Minister for Energy, *A Fair Deal on Energy*, 23 October 2018 (accessed 10 May 2019) <https://www.pm.gov.au/media/fair-deal-energy>.
17 Scott Morrison, Letter to Rod Sims dated 20 August 2018 (accessed 10 May 2019) <https://www.accc.gov.au/system/files/EMM%20direction%2021%20August%202018.pdf> .

Price notification is a credible threat to the airports as currently aeronautical services and facilities to regional air services provided by Sydney Airport are subject to the price notification provisions in Part VIIA until 30 June 2019. Therefore, price notification is not a hypothetical risk, but a real and substantive threat to airports should the Government determine that pricing at an airport requires approval by the ACCC.

Declaration under Part IIIA

The November 2017 amendments to the access criteria, referred to by A4ANZ, do not make declaration unobtainable by airlines. Rather, they seek to reach an appropriate balance between access seekers and owners of monopoly infrastructure. The amendments reflect Parliament's intent to ensure that declaration is not erroneously applied, and follow on from recommendations for reform made in the Commission's National Access Regime inquiry[18], the Hilmer review[19] and the Harper review.[20] The amendments are consistent with the interpretation of criterion (a) at the time it was applied by the Competition Tribunal in declaring services at Sydney Airport. Importantly the low threshold to make an application (largely procedural and at minimal cost) has not changed. Hence the relative lack of applications is not evidence that Part IIIA is not effective, but is strong evidence that airports are operating well within the boundaries of behaviour that Part IIIA addresses.

To the extent that A4ANZ assert that declaration under the National Access Regime is too high a threshold, the reasons for this must be examined. Criterion (a) requires that declaration of a service would promote a 'material increase' in competition in a dependent market. The fact that A4ANZ consider this threshold to be insurmountable is inconsistent with their increasingly hyperbolic rhetoric that, contrary to the evidence and the Commission's Draft Report and previous findings, airports are in fact exercising market power. If A4ANZ was in fact confident that there was credible evidence to establish that airports were systemically exercising market power, then criterion (a) would not present a high hurdle.

In addition, findings have been made by regulators that criterion (a) in the current form has been satisfied in relation to other infrastructure. For example, the Queensland Competition Authority, in applying analogous access criteria for non-vertically integrated infrastructure service providers, in a 2019 draft declaration recommendation has found that criterion (a) is satisfied in relation to the Dalrymple Bay Coal Terminal[21] service and three railway lines operated by Queensland Rail.[22] Whilst one must be cautious in making factual comparisons between industries, this establishes that the access criteria are by no means insurmountable as A4ANZ asserts.

A4ANZ indicates that industry specific regulation is needed as the National Access Regime involves protracted decision-making processes which diminishes the degree to which Part IIIA is a credible regulatory constraint. These concerns are overstated, not least because A4ANZ does not provide any evidence the National Access Regime is in any way applied differently (either in outcome or process) to airports versus other infrastructure asset classes. Therefore the argument for industry-specific regulation on this basis is spurious. With some exceptions, the NCC typically hands down a declaration recommendation within six months of being notified of an application and the Treasurer typically makes a decision shortly thereafter. Making a declaration application to the NCC under Part IIIA is straightforward and relatively inexpensive, and the NCC, Minister and Tribunal (on review) are subject to statutory timelines for their decisions.[23] To the extent that subsequent appeals to the Competition Tribunal and judicial appellate bodies are resource intensive, these are processes ultimately designed to protect procedural fairness and ensure that significant economic decisions are lawful, rigorous and subject to scrutiny.

Part IIIA is a considered regime and there are no compelling reasons to justify implementing industry specific regulation for the economic regulation of airports.

18 Productivity Commission 2013, National Access Regime, Inquiry Report No.66, Canberra, pages 2, 7-14.
19 Hilmer, Frederick, Mark Rayner, Geoffrey Taperell and Warrick Smith, *National Competition Policy (the Hilmer Review)*, 1993, pages 248, 260.
20 Harper, Ian, Peter Anderson, Su McCluskey and Michael O'Bryan QC, *Competition Policy Review Final Report*, March 2015, pages 31, 73, 439.
21 Queensland Competition Authority, Part C - Draft Recommendation, page 102.
22 Queensland Competition Authority, Part B - Draft Recommendation, page 53, page 61, and page 69.
23 Sections 44GA, 44H(9) and 44ZZOA of the CCA.

Part IV of the CCA

A further ex-post regulatory tool available to airlines and the ACCC is the prohibition of the misuse of market power under section 46 of the CCA. The unilateral conduct prohibitions, including recourse to penalty provisions, are designed to deter firms which may possess a degree of market power from exercising it. The November 2017 amendments to section 46, following the Harper review and extensive consultation, has expanded its scope of application to prevent any unilateral conduct that has the likely effect of substantially lessening competition.

Further Productivity Commission inquiries

Inquiries by the Commission are a clear constraint on the behaviour of Australian airports. These inquiries are conducted regularly and are transparent and rigorous.

Litigation

Litigation does provide a means to resolve pricing disputes between airports and airlines in the ordinary course of business. However, it's these very characteristics that incentivise airports to reach commercial agreements with airlines. However, on the rare occasion that commercial agreement cannot be reached, then litigation may be sought by either party. This is not evidence of regulatory failure but in fact recognition that this 'backstop' is an integral part of the overall framework. Effectively removing this option via heavy-handed regulatory intervention would be counter to recognised legal precedent and would have adverse consequences, for example regulatory gaming.

Indeed, airlines have significant bargaining power when negotiating ASAs due to these characteristics of litigation and the obligation on airports to provide access to airlines except in very limited circumstances (see page six of this submission).

Other regulatory factors faced by airports

A4ANZ's latest submission on the efficacy of the current regulatory regime, in favour of other mechanisms, fails to have regard to other attributes of the light-handed regulatory regime which serve to constrain airport operators. Major airports in Australia are subject to:

- ACCC price and quality of service monitoring;
- Leases with the government; and
- The government's Aeronautical Pricing Principles

Price monitoring

The price monitoring regime applies at Australia's four major airports (i.e. Perth, Brisbane, Melbourne and Sydney). If the price monitoring indicates that airports may have misused their market power and further investigation is required, the government can direct the ACCC to undertake a public inquiry, potentially resulting in the reintroduction of stricter price controls at particular airports.

The ACCC stated in its most recent Airport Monitoring Report that:[24]

> Price monitoring provides some transparency over the airports' performance and allows for some general observations to be made regarding whether they are taking advantage of the lack of competition. This is most relevant for informing the Australian Government which may determine that some form of regulation is required to better protect consumers. Transparency of performance may also assist airlines in their negotiations with airports regarding prices and service standards.

Price monitoring is clearly intended to constrain an airport's ability, and reduce its incentive to exercise market power, in conjunction with the other regulatory factors.

24 ACCC, *Airport Monitoring Report 2016-17*, p 9.

No ACCC airport monitoring report has ever recommended broadening the monitoring regime, a Part VIIA inquiry or other forms of regulatory intervention.

Lease with the Commonwealth Government

As outlined above, leases with the Commonwealth Government impose obligations to provide access except in very limited circumstances. This has significant ramifications for airports in dealing with airlines.

Aeronautical Pricing Principles

The government has formulated Pricing Principles related to prices for aeronautical services and facilities (**Pricing Principles**). The government views the Pricing Principles as an important framework for establishing prices, service delivery and the conduct of commercial negotiations at airports and expects all airports and current and potential service partners to consider the Pricing Principles when negotiating airport services.[25]

25 Bradbury D (Assistant Treasurer) and Albanese, A (Minister for Infrastructure and Transport), *Australian Government response to the Productivity Commission inquiry into the economic regulation of airport services*, media release, March 2012.

A4ANZ's proposed negotiate-arbitrate model is biased and flawed

Even if the Commission is minded to consider a negotiate-arbitrate model (which, as outlined above, the AAA considers cannot be justified by the Commission's own tests), the AAA submits that A4ANZ's proposed model is biased, flawed. and wholly inappropriate.

A4ANZ proposes an "industry specific" negotiate-arbitrate regime based on the regime for non-scheme gas pipelines as set out under Part 23 of the National Gas Rules (NGR) and Chapter 6A of the National Gas Law (NGL).

The proposal to apply such a regime to airports is clearly inappropriate for two key reasons:

» The problem that the Part 23 regime seeks to address (that is, monopoly pricing for gas pipeline services) does not exist for airports; and

» Part 23 was designed specifically for gas pipeline businesses. There are key differences between the gas and aeronautical industries which mean that the Part 23 arbitration regime is poorly suited for application to airports.

A solution without a problem – the policy rationale for the Part 23 arbitration regime

On 14 December 2016, the COAG Energy Council agreed to the recommendations outlined in Dr Michael Vertigan's final report "Examination of the current test for the regulation of gas pipelines". The report recommended the establishment of a new commercial arbitration framework to apply to unregulated pipelines that provide access to third parties. This framework ultimately became the arbitration regime set out in Part 23 of the NGR.

Dr Vertigan's report was unambiguous in setting out the problem that the recommended arbitration regime was intended to address, the problem being that transmission pipelines were ***using*** their market power to engage in monopoly pricing:[26]

> In…the majority of transmission pipelines on the east coast are **using their market power to engage in monopoly pricing**" [emphasis added].

Dr Vertigan accepted that gas pipelines not only possessed market power, but that there was strong evidence that the gas pipelines were exercising market power to engage in monopoly pricing. This is in stark contrast to the situation currently under consideration by the Productivity Commission with regard to airports. As already discussed, the Commission has concluded in its draft report:

> Most indicators of airports' operational and financial performance are within reasonable bounds. In isolation, some indicators of performance could be cause for concern. However, **the evidence as a whole does not suggest that the four monitored airports have systematically exercised their market power** in a way that would justify significant change to the current form of regulation of aeronautical services at these airports.

Given this, Dr Vertigan's justification for introducing the Part 23 arbitration regime simply does not apply to airports. It is abundantly clear that without evidence establishing that airports are systematically exercising their market power to charge monopoly prices, the policy rationale justifying the implementation of the Part 23 arbitration regime is not relevant to airports.

26 Dr Michael Vertigan *Examination of the current test for the regulation of gas pipelines* (14 December 2016), at 41.

Issues with the application of the Part 23 regime to airports

Notwithstanding the lack of policy rationale for implementing an arbitration regime for airports, A4ANZ has requested that the Commission considers the implementation of an arbitration regime (set out in Appendix B of its May 2019 submission) which is based on the Part 23 regime.

However, A4ANZ has overlooked the fundamental fact that the Part 23 regime was designed specifically for the non-scheme gas pipelines. The gas and aeronautical industries are inherently different industries, with significantly different negotiation considerations. This being the case, the model proposed by A4ANZ is poorly equipped to deal with the highly complex commercial considerations at play in aeronautical service negotiations.

There are significant differences between gas pipeline and aeronautical services

Non-scheme gas pipelines provide a relatively simple homogenous service when compared to airport infrastructure. This is because:

- Non-scheme gas pipelines usually only have to negotiate with a small number of users.
- Negotiation is usually focussed on either gaining access, or on simple key terms such as access charges, contracted capacity, and the term of the agreement.
- Non-scheme gas pipelines typically only offer a single homogenous transport service, the charges for which are set on a simple basis of $ per unit of contracted capacity.
- The value to an airline of access to an airport varies depending on the airline's schedule. Demand is concentrated in well defined peaks, for example early morning weekday slots.

Expedient resolution of gas access disputes is important as there is no separate obligation on the part of gas pipelines to provide access.

Given the relative simplicity of the factors influencing negotiation for access to gas pipeline services, and the importance of gaining access in a timely fashion, the NGR provides for an expedient arbitration process under the Part 23 framework.

In contrast, the aeronautical industry is a far more complex beast. Negotiations for aeronautical services are complicated by a large number of factors, for example:

- Airports are complex, multiuser facilities. Efficient operation of an airport requires all users to comply with a common set of operating rules.
- Airports not only provide services to multiple airlines but also to millions of passengers.
- Security and safety are very significant issues for airport operations requiring compliance with policies, rules and regulations by all users.
- Airports provide differentiated services to airlines and not a simple homogenous service as provided by gas pipelines.
- The issues to be negotiated with an airline range from capital expenditure programs for terminal and airfield development (sometimes in the hundreds of millions of dollars), security upgrades, gate allocation, priority rights, service levels and charges. All these issues effect all other users of an airport and accordingly there is extensive interdependence between all potential issues which could be the subject of arbitration. Whereas gas pipeline negotiations are with respect a much narrower and simpler set of issues: price (including for any expansion) and interconnection points. Accordingly, gas pipeline negotiations are not multi-dimensional nor involving multiple parties.
- Airports need to implement investment programs that promote long term capacity growth for the benefit of all airlines and their passengers, while incumbent airlines may seek to restrict capacity to protect their market share. This increases the complexity of negotiations, particularly for airports moving to an increased focus on common use infrastructure through the development of integrated terminals. Whereas gas pipeline expansions are materially less lumpy than airport expansions and can be tailored to the meet the requirements of individual shippers. Accordingly, there is little opportunity for an existing shipper to be able to frustrate a pipeline expansion to accommodate the requirements of a competitor, as an airline could potentially do under the proposed arbitration regime.

Given the vastly more complex nature of aeronautical services the arbitration regime proposed by A4ANZ based upon the Part 23 regime is not fit for purpose and as a result is likely to (i) provide opportunities for gaming by airlines; (ii) generate inefficient outcomes; and (iii) materially increase risks for airport investment.

The AAA's position is consistent with the draft view of the Commission, being that a negotiate-arbitrate regime for airports risks being too complex and open to gaming and uncertainty.[27] A single airline pursuing an arbitrated outcome may do so simply to increase its position relative to competitors, and it is difficult to construct arbitration rules to prevent adverse outcomes on innocent parties. The AAA submits that the parties to the negotiation are best placed to assess their positions and arrive at a negotiated outcome, especially where there is no evidence that airports are exercising market power.

A single arbitrator cannot realistically make a robust access determination in 50 business days

The prospect that a third-party arbitrator could adequately assess the specific matter and determine appropriate terms and conditions of access to the service (relating to a wide range of factors), within 50 business days (as proposed by A4ANZ)[28] is simply not plausible.

For example, it is not practical to consider that within 50 business days a dispute about a terminal redevelopment including its design, configuration, cost and charging regime could be reasonably and properly determined without significant risk of error.

A recent case which provides some context is the arbitration of the Shipping Channel Service at the Port of Newcastle. In this matter, it took a well-resourced *team* of ACCC staff almost two years to reach a final determination.[29] This case clearly demonstrates that a 50-business-day arbitration process would almost certainly be inadequate.

The imposition of tight, arbitrary timeframes for any arbitration process would create a significant risk that the arbitrator would be unable to fully consider and understand the relevant issues. This would significantly increase the likelihood of errors on the part of the arbitrator, and increase the likelihood of gaming by airlines. In turn, this would seriously harm incentives to invest in airports and would lead to increased prices over the long term due to increased regulatory and commercial uncertainty.

An example of how this could seriously harm investment would be where a single erroneous determination relating to a major airline could delay or prevent investment in efficient expansions. This could occur where all but one airline agrees to fund the expansion of a terminal, but one major airline wins an arbitration determination which in effect stops the redevelopment. This would result in airport passenger volumes being constrained, with broader economic costs, and may prevent expansion by other airlines whilst entrenching the position of the airline that opposed the expansion.

A more fulsome process would be costly and complex, and is not justified in the circumstances

On the other hand, given the complexity of negotiations for aeronautical services, a full and proper consideration of the relevant issues by an arbitrator would be time consuming and extremely costly. Given that there is no evidence to suggest that airports are exercising their market power, there is no policy reason to justify the imposition of this significant burden.

27 Productivity Commission, *Econonomic Regulation of Airports Productivity Commission Draft Report*, February 2019, 25
28 With the ability to extend the timeframe (with the agreement of both parties) to 90 business days.
29 The ACCC was notified and requested to arbitrate the matter in November 2016 and made its determination in October 2018. See media releases at: https://www.accc.gov.au/media-release/port-of-newcastle-to-reduce-charge-for-glencore.

A4ANZ's proposed arbitration regime is clearly not fit-for-purpose and has not been designed with the unique challenges faced by airports in mind

The proposed arbitration regime put forward by A4ANZ has clearly had little thought put into it. As Commissioner Paul Lindwall noted in a recent speech:[30]

> Ideally regulation should be carefully designed for a particular purpose — and it should be calibrated to meet that objective in the least burdensome way.

This has clearly not occurred in the development of the arbitration regime put forward by A4ANZ, which is little more than Part 23 of the NGR, with the term pipelines replaced with the term airports. This is particularly evident in provisions that have been included that are relevant to the gas industry, but have absolutely no relevance to airports. For example:

- Proposed rule 9.07 provides that certain access disputes regarding trading of secondary capacity (ie, pipeline capacity) will be excluded from being referred to arbitration.
- Proposed rule 9.13(2)(d) provides that the arbitrator may take into account the value to the service provider of interconnections (ie, pipeline interconnections) to the airport, the cost of which is borne by another person.

These simple examples demonstrate that little consideration has been given in the proposal put forward by A4ANZ to the real, industry-specific factors that would need to be considered in designing further regulation of airports.

30 Commissioner Paul Lidwell *Speech delivered to the Infrastructure Partnerships Australia Industry Lunch in Sydney* (19 March 2019).

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