PUBLIC VERSION

QANTAS AIRWAYS LIMITED

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QANTAS GROUP
SUBMISSION TO THE
PRODUCTIVITY COMMISSION

INQUIRY INTO THE NATIONAL ACCESS REGIME

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1. Introduction

Qantas Airways Limited (Qantas) welcomes the opportunity to make a submission to the Productivity Commission (Commission) in relation to its inquiry into the National Access Regime (NAR) under Part IIIA of the Competition and Consumer Act 2010 (CCA).

Qantas has first-hand experience with the operation of the NAR, both as a facility owner and an access seeker. For example:

- Qantas owns a number of domestic airport terminals and is also a participant in the Joint-User Hydrant Installation (JUHI) at Sydney Airport;
- Qantas requires access to airports to operate its domestic and international air passenger transport and freight businesses. Due to concerns involving access to the aeronautical services at Sydney Airport on reasonable terms and conditions, in 2002 Qantas supported Virgin Blue Airlines' application to have the 'airside service' at Sydney domestic airport declared under Part IIIA of the CCA. Qantas provided substantial evidence to the Australian Competition Tribunal (ACT) of the airport's conduct, and the service was ultimately declared in December 2005. The declaration expired in December 2010.

The Qantas Group airlines (comprised of Qantas, QantasLink and Jetstar) are the major users of services provided by Australian airports. Total payments by the Qantas Group to Australian airports now exceed [**start confidential** **end confidential**] annually, representing the largest business expense after fuel and salaries. Accordingly, the Qantas Group's customers – including but not limited to passengers and users of air freight services – are directly affected by both the price and non-price terms and conditions imposed by Australian airports.

In Qantas' experience, there is an important role for the NAR in the aviation/airports sector. As the Commission is aware, certain airports in Australia are currently subject to a 'light-handed' regulatory regime. This regime applies only to Brisbane, Melbourne, Perth and Sydney airports whereby they are subject to price monitoring arrangements and financial accounts reporting provisions. In addition, the Australian Competition and Consumer Commission (ACCC) monitors quality of services at these airports. Light handed regulation of core airports in Australia operates against a background where all incorporated airports in Australia are subject to the CCA, and Part IIIA in particular. Brisbane, Sydney, Melbourne, Adelaide, Perth, Darwin and Canberra airports were sold by the Australian Government with a CPI-X pricing regime and ACCC monitoring. Over the past decade the CPI-X regime has been removed and 'light handed regulation' now primarily consists of price and quality of service monitoring of only four of those airports. Potential declaration under Part IIIA therefore operates as the only real option available to airport users when negotiations with airports irretrievably break down and airports seek to rely on their monopoly power to unilaterally impose prices or other terms of access.

However, the significant problem with Part IIIA (both as a process and as a credible check on an essential facility owner's monopoly power) is the cripplingly time-consuming and burdensome process involved in having a service declared. An airport provider has no incentive to conclude the process quickly as, in the meantime, it can continue to restrict access on monopolistic terms and conditions and earn monopoly rents.

As discussed further in this submission, Qantas believes that there continues to be a need for the NAR as it provides the only avenue, where no industry-specific regulation exists, for access seekers to apply for access to essential monopoly facilities that exist today or that may exist in the future. The most significant problem with the NAR established under Part IIIA of the CCA is the often drawn-out process involved in applying to have a service declared. Qantas submits that, in circumstances such as those involving airports, where the particular facility and services clearly satisfy the declaration criteria, it should be deemed that the relevant services are declared. Such deemed declaration is necessary and appropriate, and would result in an improved environment for facility owners and users to negotiate a set of mutually beneficial agreements.

This submission broadly responds in turn to the issues raised by the Commission in its Issues Paper.

2. Why have an access regime?

The NAR was introduced in 1995 as part of the National Competition Policy which arose out of the 1993 report by the Independent Committee of Inquiry (Hilmer Committee) on the National Competition Policy Review.

The Hilmer Committee (and more recently the Commission) identified that providers of monopoly infrastructure services may have the monopoly power and incentive to restrict access and/or raise access prices unreasonably.[1]

The NAR attempts to mitigate this problem by providing a framework that empowers firms with a means to access (including on reasonable terms and conditions) particular 'essential' infrastructure in certain circumstances. The objects of the NAR include the promotion of the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets.[2]

The NAR is not designed to replace commercial negotiations between facility owners and access seekers. Instead, it seeks to enhance incentives for negotiation and provide a means of access on reasonable terms and conditions if negotiations fail.[3]

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[1] National Competition Policy Review, Independent Committee of Inquiry (Hilmer Committee), 1993, pg. 241; Review of the National Access Regime Inquiry Report, Report No. 17, Productivity Commission, 28 September 2001, pp. 39-40.
[2] *Competition and Consumer Act 2010 (Cth)*, s. 44AA.
[3] National Aviation Policy White Paper, Commonwealth of Australia, December 2009, pg. 176.

The need for a robust and effective NAR for access to essential infrastructure remains compelling. There has been a steady march towards the privatisation of infrastructure. For example, between 1997 and 2003, the operation of Australia's 22 federal airports was privatised by selling long-term leases over the airport sites to private operators. More recently, in October 2012 the Federal statutory body, Infrastructure Australia, released a report identifying approximately $200 billion of publicly-owned infrastructure assets that could be privatised.[4]

As part of the CCA, the NAR applies across industries, equally covering those essential facilities required in long-established industries and also those required in newly-emerging and developing areas. Simply because the criteria for declaration are not satisfied for a particular service or facility today, does not mean that the particular service or facility may not be declared at some point in the medium to long term, if facts change. For example, the fuel pipeline servicing Sydney Airport which is owned and controlled by Caltex (Caltex Pipeline) and the jet fuel storage facility and jet fuel hydrant pipeline network facility (Sydney JUHI) were recently the subject of an application for declaration. The National Competition Commission found that these services did not satisfy the declaration criteria, and recommended that the Minister not declare the service. However, this does not mean that if the facts change the Caltex Pipeline can never be the subject of a successful application for declaration – for example, once the upgrade of the Caltex Pipeline is complete and if Caltex constructively restricts access to the pipeline by refusing to allow access seekers to access available capacity.

Due to the range of essential facilities that are not currently subject to industry-specific or any other regulation, the NAR plays (and will continue to play) an important role in seeking to modulate the very real incentives of providers of infrastructure services to restrict access and/or raise access prices unreasonably.

Airports – demonstrate the need for a NAR in Australia

Airports are a good example of essential infrastructure services that have a well-established ability and incentive to restrict access and/or raise prices unreasonably. Airports are critical components of the national economic infrastructure and all sectors of the Australian economy rely directly or indirectly on the efficient movement of people and freight through airports.[5] At the same time, it is widely accepted that Australian airports possess significant market power and are natural monopolies.[6] Without effective regulation, there is no constraint on an airport operator's ability to exercise its market power.

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[4] Australia's Public Infrastructure – Part of the Answer to Removing the Infrastructure Deficit, Infrastructure Australia, October 2012, *available at* http://www.infrastructureaustralia.gov.au/publications/files/Australias_Public_Infrastructure-Part_of_the_Answer_to_Removing_the_Infrastructure_deficit.pdf.

[5] National Aviation Policy White Paper, Commonwealth of Australia, December 2009, pg. 154

[6] This conclusion has been recognised by a variety of economic regulatory bodies including the Prices Surveillance Authority (Report No. 48, 1993); the ACCC (Draft Guide to Section 192 of the Airports Act and Submission to the Productivity Commission dated May 2001); the Australian Competition Tribunal (*Sydney International Airport* [2000] ACompT 1 and *Virgin Blue Airlines Pty Limited* [2005] ACompT 5); the National Competition Council (Final

The economic regulation of airports in Australia is limited to the NAR (although no airport services are currently declared under the NAR). While Sydney, Melbourne, Brisbane and Perth airports are also subject to annual price and service of quality monitoring by the ACCC which publicly reports on their prices and profits, the ACCC in its 2010-11 Airport Prices Monitoring report noted that price and service quality monitoring does not effectively deal with airports' market power.[7] Instead, the ACCC is limited in its scope to providing information about the airports' performance, which is not a substitute for effective regulation.

Airlines, including larger network airlines such as Qantas, lack any real countervailing power in respect of the use of airport services at major airports.[8] This is because airlines have no choice but to use the services of airports located in the destinations to and from which customers wish to fly. As a general rule, airlines do not have alternatives available to them – there is usually only one airport which can service customers who wish to fly to or from a particular destination. To carry passengers from Sydney to Perth, Qantas must fly a plane from Sydney's Kingsford Smith Airport to Perth Airport and utilise the airport services supplied by the operators of those airports. Even in cities where there is more than one airport, these airports often suit different customer needs, for example Avalon may be seen as an alternative to Melbourne Airport, but it does not have the network of connecting flights or the facilities that business travellers demand.

Despite the NAR and the light-handed regulatory regime that applies to core airports, commercial negotiations between airports and airport users have tended to be protracted. While pricing is usually agreed after much debate around the principles underlying the prices, the pricing often reflects the market power of the airport over the airlines. Airports often achieve a return on assets that is significantly higher than other comparable businesses (whether regulated or not).

Because the market power of airports is not effectively constrained by the NAR or the light-handed regulatory regime, airports have little incentive to engage in a commercially constructive way with airport users. In a competitive environment a supplier has economic incentives to engage constructively with customers. However, given the monopoly nature of the supply of airport services in Australia, other incentives are necessary to bring about constructive commercial engagement between airports and airport users.

A robust access regime to help ensure an effective commercial relationship and negotiations between monopolistic infrastructure owners and users is <u>essential</u> for the broader Australian economy. This is particularly so in the aviation industry which relies fundamentally on airport services, and in locations where aviation is relied upon heavily compared with other forms of transport.

Recommendation on the application from Virgin Blue for declaration of the airside service at Sydney Airport, January 2004) and the Commonwealth of Australia (National Aviation Policy White Paper, December 2009, pg. 174).

[7] ACCC – Airport Prices Monitoring Report 2010-11, March 2012, pgs XV and 24.

[8] Productivity Commission Report – Review of Price Regulation of Airport Services, April 2007, pg. XVII and 45.

The NAR is not, and should not be, confined to infrastructure that is owned or operated by service providers who are vertically integrated. Suppliers of infrastructure who are not necessarily vertically integrated (e.g., airports) often still have the ability and incentive to raise prices or supply their service on anticompetitive terms and conditions, particularly in circumstances where the downstream market is characterised by large sunk costs (such as aircraft) that must be continuously operated in order to attempt to achieve a return on cost of capital.[9] In previous submissions to the Commission, Qantas has provided many examples of this having occurred at various airports throughout Australia.[10]

3. The Regime in practice

Declaration Criteria

Qantas regards the five declaration criteria which must be satisfied in order for a service to be declared under Part IIIA as appropriate. However, the procedural requirements under Part IIIA to demonstrate the criteria are burdensome, time consuming and potentially subject to gaming by infrastructure owners. For example, Virgin Blue Airline's application for declaration of the 'airside service' at Sydney Airport was submitted in October 2002 and was not settled until March 2007 when the High Court of Australia refused Sydney Airport's application for leave to appeal from the decision of the Full Court of the Federal Court, confirming declaration of the airside service. This meant that Virgin Blue could not initiate an ACCC arbitration until March 2007. The declaration then expired in December 2010.

The time consuming and lengthy process for applications for declaration under Part IIIA is clearly to the advantage of the monopoly service provider. The consequence for access seekers in the meantime is that the service provider's monopoly prices and behaviour must be accepted if the user requires the service for its business.

In previous submissions to the Commission, Qantas has proposed that it would be appropriate to allow a standing declaration that certain facilities (i.e., aeronautical services at capital city airports in Australia) satisfy the declaration criteria in Part IIIA and are therefore deemed to be declared.[11] This would be akin to a simple form of industry-specific regulation for airports and other infrastructure that clearly satisfy the criteria under Part IIIA.

This proposal was also advocated by the ACCC in its 2011 submission to the Productivity Commission's inquiry into the economic regulation of airport services.[12] According to the ACCC, the general provisions of Part IIIA do not provide an effective constraint on the behaviour of the airports given the considerable time, costs and uncertainty faced by airlines

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[9] See e.g., *Re Virgin Blue Airlines Pty Ltd* [2005] ACompT 5 (12 December 2005), ¶ 492, *available at* http://www.austlii.edu.au/cgi-bin/sinodisp/au/cases/cth/ACompT/2005/5.html?stem=0&synonyms=0&query=virgin%20blue.

[10] See e.g., Qantas' submission to the Productivity Commission's Inquiry into Current Arrangements for the Price Regulation of Airport Services, 21 July 2006, *available at* http://www.pc.gov.au/__data/assets/pdf_file/0015/21291/sub028.pdf; Qantas' submission to the Productivity Commission's Inquiry into the Economic Regulation of Airport Services, April 2011, *available at* http://www.pc.gov.au/__data/assets/pdf_file/0011/108020/sub052.pdf.

[11] Qantas' submission to the Productivity Commission's Inquiry into the Economic Regulation of Airport Services, April 2011, *available at* http://www.pc.gov.au/__data/assets/pdf_file/0011/108020/sub052.pdf

[12] *Available at* http://www.pc.gov.au/__data/assets/pdf_file/0005/107087/sub003.pdf.

seeking declaration.[13] Instead, deemed declaration of aeronautical services "*would amount to a continuation of current practice whereby airlines can negotiate access terms with airports. However, airlines could credibly threaten ACCC arbitration because the need to first have the services declared is avoided. Importantly, it is this threat that encourages the development of commercial relationships between the airports and their customers.*"[14]

Helpfully, for the purpose of declaration, the term 'aeronautical services' has already been defined as part of the light-handed regulatory regime[15] and subject to substantial review. The definition includes aircraft-related services (such as runways, taxiways, aprons and aircraft parking) and passenger-related services (such as public areas in terminals, departure and holding lounges, aerobridges and check-in counters).

As outlined by the ACCC in its 2011 submission to the Commission, declaration is appropriate for aeronautical services as there is a history of airlines negotiating with airports, a relatively small numbers of airlines, and vertical separation of the airport and airline businesses.[16]

The key difference between the current system and the ACCC's proposal of 'deemed declaration' is that as aeronautical services would already be declared under Part IIIA of the CCA, meaning that the time, cost and resources associated with airport access seekers satisfying the first step of the NAR process would be significantly reduced and improve the environment for commercial negotiations with airport owners.

Many infrastructure facilities in Australia are subject to industry-specific regimes which are akin to a national access regime that has been tailored to those industries. Telecommunications, postal services, gas and electricity infrastructure are regulated across Australia and rail, urban water and ports are regulated in some states. Airports in Australia share many characteristics with these 'natural monopoly' infrastructure facilities:

Characteristics	**Rail**	**Electricity**	**Ports**	**Telecom-munications**	**Postal**	**Airports**
Network facilities	√	√	√	√	√	√
Large fixed costs (and low marginal operating costs)	√	√	√	√	√	√
Infrastructure intensive industry	√	√	√	√	√	√
Uneconomical to duplicate	√	√	√	√	√	√

[13] ACCC's submission to the Productivity Commission's Inquiry into the Economic Regulation of Airport Services, March 2011, pg. 8, available at http://www.pc.gov.au/__data/assets/pdf_file/0005/107087/sub003.pdf.
[14] *Ibid*, pg. 21.
[15] *Airports Regulations 1997 (Cth)*, reg. 7.02A, *available at* http://www.austlii.edu.au/au/legis/cth/consol_reg/ar1997238/s7.02a.html.
[16] ACCC's submission to the Productivity Commission's Inquiry into the Economic Regulation of Airport Services, March 2011, pg. 2, available at http://www.pc.gov.au/__data/assets/pdf_file/0005/107087/sub003.pdf.

Nationally significant	√	√	√	√	√	√
Public/political opposition to duplication	√	√	√	√	√	√
Used by multiple users with little countervailing bargaining power	√	√	√	√	√	√

The deemed declaration of aeronautical services would result in an improved environment for airports and airlines to negotiate a set of mutually beneficial agreements. Under this approach the airports and airport users would continue to negotiate a commercial agreement as a first step. However, should an agreement not be reached, the airport user could invoke ACCC arbitration, without having to first apply to have the airport's service declared under Part IIIA.

As Qantas has discussed in previous submissions, a voluntary code of conduct could also be useful either as a supplement or alternative to deemed declaration of airports under Part IIIA. The voluntary code would outline an approach for airports and airlines to reach agreement and would provide a basis for constructive commercial negotiations. Further detail is available in Qantas' 2011 submission to the Commission's Inquiry into the Economic Regulation of Airport Services.[17]

Promoting efficient investment in, and operation and use of, infrastructure facilities

The Commission has requested comment on what makes the declaration criteria successful in promoting investment in, and ensuring efficient operation and use of, infrastructure facilities.

The declaration criteria tries to achieve a balance between allowing third parties to negotiate access or increased access to a service and providing infrastructure providers with the certainty needed to invest in and improve their facilities.

Experience has shown that the existence and general application of the NAR has not had any negative impact on investment in essential infrastructure. Using airports as an example, there has been significant capital expenditure at all of the major Australian airports, with more forecast in the near to medium future. Detail on this expenditure is provided in section 4 below.

The encouragement of investment is one of the bases on which infrastructure owners seek to resist regulation and justify raising the bar on the declaration criteria. Care must also be taken to also consider the impact of the declaration criteria on the efficient operation and use of essential infrastructure facilities. Some of the proposed changes to the declaration criteria discussed in the Commission's Issues Paper would make the declaration criteria more

[17] *Available at* http://www.pc.gov.au/__data/assets/pdf_file/0005/107087/sub003.pdf.

complex and more difficult, costly and/or time-consuming to satisfy, for no real change in likely investment behaviour. Care must be taken to ensure that the declaration criteria are not set so high that it is practically impossible to declare facilities other than in a few very limited circumstances. This is particularly the case where the mechanism for achieving declaration is already so demanding on time and resources that it is virtually out of the reach of most airport users.

Criterion (a) – the promotion of competition test

The Commission has requested comments on whether it should be necessary to demonstrate access (or increased access) to the service would lead to benefits for end users in order to satisfy criterion (a).

Assessing benefits for end users is not an appropriate test for criterion (a) (or any of the other declaration criteria). While there may be benefits for end users as a result of declaration, such benefits are likely to be hard to quantify and demonstrate at the application stage, and will unnecessarily divert the inquiry away from the better test of whether competition will be increased in a market other than the market for the service.

The Commission has also requested comments on whether any problems have arisen in defining 'another market', and if so, how it should be defined to ensure that the economic efficiency objective of the NAR is met.

Qantas is not aware of problems having arisen in defining 'another market'. The concept of 'another market' is generally understood and would not benefit from specific definition.

Criterion (b) – the uneconomical for anyone to develop another facility test

The application of this test would benefit from greater clarity around what is meant by 'uneconomical to duplicate'.

Criterion (c) – the national significance test

The Commission has requested submissions on the key issues when looking at how effective criterion (c) has been in striking an appropriate balance between guarding against declaration of 'trivial' facilities and enabling declaration of facilities that are important.

The current five part test for declaration ensures that 'trivial' facilities are not declared. There are several review bodies which assess the application of the test (the National Competition Council (NCC), the designated Minister, and if an appeal is made, the ACT and courts). Applicants or facility owners who believe that the application of this test or any of the other tests has been incorrectly applied have several avenues of appeal, including merits review to the ACT.

Criterion (f) – the public interest test

The Commission has sought comments on the appropriate level of transparency regarding the Minister's determination of the public interest if this becomes the key element in a facility being declared or not.

In *Pilbara Infrastructure Pty Ltd and Anor v. Australian Competition Tribunal and Ors,*[18] the majority of the High Court noted that the public interest assessment by the ACT must be informed by the public interest findings of the Minister, and that it is not expected that the ACT would '*lightly depart from a ministerial conclusion about whether access or increased access would not be in the public interest. In particular, if the Minister has not found that access would not be in the public interest, the Tribunal should ordinarily be slow to find to the contrary.*'[19]

However, in circumstances where (if the Minister does not publish his or her decision on the declaration recommendation within 60 days after receiving it from the NCC) the Minister is deemed to have decided not to declare the service,[20] no reasons are published.

Therefore, in circumstances where there is a deemed decision not to declare a service, there is no transparency for the parties or the ACT regarding the Minister's conclusion regarding the public interest test. Considering that declaration necessarily leads to greater transparency as to the management of nationally significant assets by the involvement of the ACCC, public policy should demand that the failure of the Minister to publish gives rise to a deemed decision to declare the service.

Regardless of the decision to be made, Qantas submits that the Minister should be required to make a positive or negative decision regarding declaration.

Undertakings

The Commission has sought submissions on the effectiveness of the undertakings path.

Access undertakings are desirable and have a role to play in the NAR. However, as they have the effect of overriding or replacing statutory rights, they should only be accepted by the ACCC where it is clear that the rights of users are protected to the same extent as statutory rights.

The negotiate-arbitrate framework

The Commission has sought submissions on evidence that the negotiate-arbitrate framework has been successful at resolving access disputes.

From 2005 to December 2010, the domestic airside service at Sydney Airport was declared, and therefore subject to the provisions of the negotiate-arbitrate framework. From 2000 to 2005, cargo handling services at Sydney International Airport were also declared. Qantas'

[18] [2012] HCA 36.
[19] *Ibid* at 42.
[20] *Competition and Consumer Act 2010 (Cth)*, s. 44H(9).

experience with the declaration of these services was that they were successful. Commercial negotiations continued; there were no arbitration decisions and no 'race' to the ACCC. (Only Virgin Blue commenced arbitration with respect to the airside service, but this was settled between the parties prior to any decision being made).

It should not be assumed that a deemed declaration of aeronautical services at Australian airports would increase costs for the parties or decrease investment in the airports. Commercial negotiations between airport users and owners would still continue, but the framework would provide a pathway to resolution if one was required. As recognised by the ACCC in its 2011 submission to the Commission's Inquiry into the Economic Regulation of Airport Services, it is the "*threat that encourages the development of commercial relationships between the airports and their customers.*"[21]

As discussed above in section 2, true commercial negotiations between airports and airport users have been the exception, not the norm. There is no readily available mechanism under the current regime which allows airport users to refer access disputes to a third-party decision-maker. This leaves airport users exposed to situations where an airport operator can adopt a 'take it or leave it' approach rather than constructively engage with its customers. Deemed declaration of this essential infrastructure would provide a circuit breaker when there is a breakdown in negotiations and attempts by airports to exploit their monopoly position. In this way, deemed declaration would foster the negotiate-arbitrate model, which is the objective of the NAR.

4. The costs and benefits of the National Access Regime

As discussed above, the NAR plays an important role as one of the only potential checks on the exploitation of monopoly power by owners of nationally significant facilities. However, a significant drawback of relying only on the NAR in the airport sector is the burdensome and time-consuming procedural requirements to demonstrate the declaration criteria in each access application for each major airport, where it is generally accepted that the declaration criteria are met.

As outlined above, airports share many important characteristics with other infrastructure facilities that are subject to industry-specific regulation, and it would be appropriate for some type of airport-specific regulation to be introduced – for example, by way of a deemed declaration or potentially a code of conduct.

Efficient investment in infrastructure

The Commission has previously analysed investment in Australian airports, and has found that aeronautical investment at Australia's major airports compares favourably with

[21] ACCC's submission to the Productivity Commission's Inquiry into the Economic Regulation of Airport Services, March 2011, pg. 21, available at http://www.pc.gov.au/__data/assets/pdf_file/0005/107087/sub003.pdf

investment in other infrastructure.[22] The Commonwealth Minister for Transport has stated that almost $9 billion of investment is planned at major airports in the next decade.[23]

Therefore, based on its experience with airports, Qantas does not believe that the existence of the NAR has had a negative impact on investment by infrastructure owners in their facilities. The four largest Australian airports all have major development plans underway. Sydney has announced the Sydney Airport New Vision, while Melbourne, Brisbane and Perth airports are all at varying stages of planning for additional runways and new terminal facilities.

Below are confidential details of planned common-user aeronautical capital expenditure for major airports between FY12 and FY17.

[Confidential table]

For Sydney Airport, the capital expenditure for FY15 onwards will become clearer as the New Vision takes shape, but the capital requirements of the transformation will be significant.

The details for Melbourne Airport do not include capital for planned Southern Precinct Terminal expansion or a possible additional pier at International Terminal. Melbourne Airport has announced plans for a new runway which they expect will be needed between FY18-FY22.

The information provided for Brisbane Airport includes early works for a planned third runway at a very significant cost (although Brisbane Airport and airlines are still in dispute regarding the appropriate time and funding mechanism for these works).

The information for Perth includes a new Terminal 2 for regional operations (open early 2013), but does not include planned works at Terminal 1 for both Virgin Domestic and the International common user terminal expansion. It does not include the additional runway currently under discussion.

Has a singular focus on investment resulted in inefficient outcomes?

Major airports have a history of pricing for substantial capital investment, then delaying and overspending on infrastructure without consultation or agreement from users. Qantas provided examples of this type of behaviour in its submission to the Commission's Inquiry into the Economic Regulation of Airport Services in April 2011.[24] The higher than market rate of return on assets encourages investment expenditure without any required deliverables.

[22] Economic Regulation of Airport Services, Productivity Commission Inquiry Report, No. 57, 14 December 2011, at 97.

[23] Australian Airports Investing and Growing, Speech by Anthony Albanese , Minister for Infrastructure and Transport, Australian Airports Association – Melbourne, 13 November 2012, *available at* http://www.minister.infrastructure.gov.au/aa/speeches/2012/AS38_2012.aspx.

[24] Qantas' submission to the Productivity Commission's Inquiry into the Economic Regulation of Airport Services, April 2011, pgs. 32, 33 & 35, *available at* http://www.pc.gov.au/__data/assets/pdf_file/0011/108020/sub052.pdf, ,

There is little incentive for efficient investment or operational expenditure when airports directly pass on costs to users. (This issue is not limited to airports, but also exists in other regulated industries, such as electricity, where power companies have been identified as "gold plating" their networks to enable higher returns).[25]

The prices in airports' long term pricing agreements tend to incorporate high cost capital plans and above-market weighted average cost of capital (WACC) rates into the revenue calculations, which means that the timing of the capital spend has a material effect on the revenue collected. Airports have often substantially under-spent in the early years of the agreement and then over-spent in the later years. This shift in capital timing results in airlines materially prefunding the airports' return on and of capital. For example, at Brisbane Airport between 2007 and 2012 airlines paid [**start confidential** **end confidential**] for the return on and depreciation of assets that were not built.

<u>Brisbane Airport Capital Spend: Planned vs. Actual 2008-2012</u>

[**Confidential table**]

[**start confidential** **end confidential**]

In recent times the nominal risk free rate as calculated from the 5 or 10 year government bond rate in the Australian economy has fallen substantially from 6-7% in 2007 to 2.5-3.5% in 2012. However, unlike fully regulated or otherwise competitive industries, airports have been reluctant to incorporate these lower rates into their price calculations. In pricing negotiations currently in progress, airports have been substituting the spot risk free rate for 'long-term' or 'forecast' risk-free rates. In one case an airport has claimed that the 'forecast' risk free rate in their WACC will change depending on the passenger forecast that Qantas agrees to. As a result the WACC returns being sought by airports are about 200 basis points above recent regulatory decisions such as 2.95% in the recent Australian Energy Regulator's (AER) decision on the Roma to Brisbane Pipeline.[26] Given the total sum of aeronautical assets for

[25] See e.g., Gold Plating the Power Grid, Michael West, July 5, 2012, *available at* http://www.smh.com.au/business/goldplating-the-power-grid-20120705-21iv5.html.
[26] APT Petroleum Pipeline Pty Ltd, Access arrangement final decision Roma to Brisbane Pipeline 2012–13 to 2016–17.

the five major airports was estimated by the ACCC to be valued at $5.5 billion for 2010-11,[27] this alone results in an additional $110 million per annum in above-market returns to airport owners and their shareholders at the expense of airlines, the travelling public, businesses and the national economy.

No airport in Australia has been subject to a regulatory review of WACC returns, but in New Zealand, Wellington Airport's pricing proposal was recently reviewed by the New Zealand Commerce Commission (NZCC). The NZCC has no power to enforce review findings, making it comparable to Australia's light handed regulation policy.

In its report, the NZCC observed that *"[b]ased on our analysis, Wellington Airport is likely to earn a return of 12.3% to 15.2% for PSE2 and beyond, which is significantly higher than the Commission's estimate of the appropriate level (7.1% to 8.0%). . . . In dollar terms, from 2013 to 2017, we expect Wellington Airport to recover at least $38 million to $69 million more from consumers through prices than it needs to make a reasonable return."*[28]

The ACCC estimates that airlines generate a 3.5% return on assets with a variability of 4 standard deviations compared with airports of close to 9% return on assets with a variability of 0.5 standard deviations.[29] Such results clearly show the risk profile to be substantially lower than that calculated in most airports' stated WACC. Currently the regulated market supports a WACC of between 7 to 8.5%, however airports are calculating aeronautical prices based on 10.5% to 12% as outlined in Qantas' April 2011 submission to the Commission. The recent decision by the AER on the Roma to Brisbane Pipeline was for a 7.31% WACC for a business in which (unlike an airport's dual till system) there is no diversification of revenue sources.

Investment companies acknowledge that regulation is an important factor when considering the attractiveness of airports, and consider the Australian market to be highly attractive to investors compared to that in other regions. For example, according to Colonial First State, "*Australian Airports are dual till [and] are operating in a less competitive region compared with Europe, thus a double boon for Australian Airport investors".*[30]

As discussed above, the major airports in Australia have significant infrastructure planned in the coming decade. Airlines support timely construction of infrastructure and a fair return to airport operators, but the power imbalance under the current light-handed regulation framework is not a sustainable situation for airlines, the travelling public or the economy. Several major Australian airport operators have sought to protect this imbalance by seeking legally binding undertakings from airlines not to use the NAR to seek access to services during the term of a contract. This power imbalance is not in the public interest, particularly in

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[27] Australian Competition & Consumer Commission – Airport Prices Monitoring Report 2010-11, March 2012, pgs XV and 24.

[28] Commerce Commission New Zealand, Report to the Ministers of Commerce and Transport on how effectively information disclosure regulation is promoting the purpose of Part 4 for Wellington Airport, 8 February 2013, pg. *available at* http://www.comcom.govt.nz/assets/Airports/s56/WIAL-Final-report/Wellington-International-Airport-Limited-Final-s56G-Report-8-February-2013.pdf.

[29] Australian Competition & Consumer Commission – Airport Prices Monitoring Report 2010-11, March 2012, pg XII

[30] Flying high: A review of airport regulation in Australia, Colonial First State, April 2010, *available at* http://www.cfsgam.com.au/uploadedFiles/CFSGAM/PdfResearch/100430%20Aust%20Airport%20Regulation.pdf.

Australia where the land size, location, primary industry and population distribution makes air travel key to economic development.

5. Institutions and processes

The Commission has sought submissions on measures that could improve the flexibility and reduce complexity, costs and time for all parties involved in facilitating access to essential infrastructure.

As discussed above, Qantas believes that these goals could be achieved in the aviation context through deemed declaration of aeronautical services, or industry-specific regulation (such as codes of conduct).

Deemed decisions

As discussed above, a significant drawback of a deemed ministerial decision not to declare a service is that the Minister does not publish any reasons for his or her 'decision'. This is particularly significant for the question of whether declaration of the facility is in the public interest.

The ability under Part IIIA of the CCA for silence on the part of the Minister to constitute a 'no' decision would become even more problematic if the merits review by the ACT was no longer available. For example, it is difficult to base an application for judicial review on a decision for which there are no reasons.

Is merits review appropriate?

Merits review of ministerial decisions by the ACT is important for a number of reasons.

The ACT is a specialist review body with significant experience in this area. As the Future Fund increases its investment in airports, and the ability for a monopoly service provider to dictate the terms and conditions of access is so significant, it is necessary for access seekers to have an avenue for a review of the Minister's decision on its merits, beyond that provided by judicial review. According to the Administrative Review Council (a division of the Attorney-General's Department), the objectives of a merits review is to ensure "*fair treatment of all persons affected by a decision. Merits review also has a broader, long-term objective of improving the quality and consistency of decision-makers. Further, merits review ensures that the openness and accountability of decision-makers is enhanced*."[31]

Furthermore, merits review by the ACT requires evidence from the parties to be submitted on oath and tested (which is not the case for applications and submissions made to the NCC).

Again, the Administrative Review Council states that "*as a matter of principle, the Council believes that an administrative decision that will, or is likely to, affect the interests of a person should be subject to merits review…If a more restrictive approach is adopted, there is a risk of*

[31] What decisions should be subject to merit review? ¶¶1.4 - 1.5, Administrative Review Council, Attorney-General's Department. *available at* http://www.arc.ag.gov.au/Publications/Reports/Pages/Downloads/Whatdecisionsshouldbesubjecttomeritreview1999.aspx.

denying an opportunity for review to someone whose interests have been adversely affected by a decision. Further, there is a risk of losing the broader and beneficial effects that a merits review is intended to have on the overall quality of government decision-making."

For the reasons above, limiting the review of the Minister's decision under Part IIIA to judicial review is not appropriate under Part IIIA.

6. What should be the future role of the National Access Regime?

The NAR has an important function as a mechanism to empower users of nationally significant infrastructure to access it on reasonable terms and conditions. The NAR should continue with decisions by the designated Minister available to be reviewed on their merits.

One of the strengths of the NAR is its application to any infrastructure facility that satisfies the declaration criteria. This allows it to be dynamic and adapt to changing circumstances and technologies.

However, Qantas believes that competition in the aviation sector would benefit from more specific industry-based regulation which acknowledges that airports share many characteristics with industries that have their own regulatory regimes.