PERTH AIRPORT

Supplemental Submission to

Productivity Commission

Response to the Inquiry into Economic Regulation of Airport Services

7 July 2011

OVERVIEW

The key points we are seeking to make in the submission are:

- There are some unanimous key conclusions that WAC considers arise from the submissions provided to the PC to date, namely:
    - Commercial negotiations are the best outcome and are to be preferred to any form of regulatory intervention.
    - There is no justification and absolutely no support for the imposition of any form of heavy handed regulation.
- The fact that no stakeholder in this review has put before the PC any probative evidence of a substantive problem justifying the continuation of the current light-handed regulatory regime or for the deemed declaration of aeronautical services proposed by some organisations.

As a result WAC submits that, for the reasons set out in WAC's 8 April 2011 Submission and this Supplementary Submission, there is no basis to continue with the existing price monitoring of Perth Airport given that in the 10 year "probationary period" since 2002 there is no evidence to suggest that WAC has exerted any alleged market power to such a degree to warrant the continuation of the regime.

KEY CONCLUSIONS

Upon a review of the submissions made to the PC to date two key conclusions emerge:

- Commercial negotiations are the best outcome and to be preferred to any form of regulatory intervention.
- There is no justification for the imposition of any form of heavy handed regulation.

Key Conclusion #1 - Commercial negotiations are the best outcome

All key stakeholders unanimously agree that commercial outcomes are the desired outcome. Importantly all key stakeholders recognise that commercial outcomes result in the most efficient outcomes for airports, airlines, other airport users and the travelling public. Accordingly, regulatory intervention is a clear second best alternative only justified when there is evidence that commercial outcomes are not possible or do not actually achieve reasonably efficient outcomes.

> *"The Qantas Group remains committed to a process of constructive engagement between airports and airport users in Australia. In order to provide the best and most efficient service to consumers, Airports and airlines must negotiate commercial acceptable arrangements for the provision of airport services." [Qantas, April 2011, 7]*
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> *"Virgin Blue has consistently stated that its preference is to commercially negotiate agreements with airports. Commercial negotiation is the most efficient and flexible method of setting the terms and conditions on which airports supply, and airlines acquire, airport services. [Virgin Australia, April 2011, [10.2(a)]*
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> *"Pricing arrangements for aeronautical services and facilities offered by airports to customers, particularly major customers such as airlines, are best agreed through commercial negotiations between the parties undertaken in good faith.....*

The experience to date is that disagreements on access to airport services and facilities are eventually resolved through commercial negotiations, despite sometimes difficult negotiations."[Department. of Infrastructure and Transport (DIT), April 2011, 10].

Key Conclusion #2 - No basis for heavy handed regulation

All stakeholders unanimously agree that there is no basis for a move to any form of more heavy handed regulation. This is a significant conclusion as there is clearly no egregious behaviour of airports to justify any form of more intrusive regulatory intervention in the commercial negotiations between airports and airlines.

"The current light handed regulatory framework has not proven to be sufficient to adequately regulate aeronautical assets in Australia. The re-introduction of heavy handed regulation could address these issues but it would also be accompanied by the risk that is implementation will have more costs than benefits. The Qantas Group's preferred alternative is to work within the current light handed regulatory framework....."[Qantas, April 2011, 76].

"As a possible alternative approach, The Commission's Issues Paper refers to the possibility of more heavy handed price regulation. Virgin Blue does not consider that such a response is necessary or appropriate....." [Virgin, April 2011, [10.1]]

"The ACCC would also conclude, on the basis of its monitoring experience, that there is little justification for a return to price controls."[ACCC, March 2011, 6]

"It [the Department] believes a move away from the current approach which is based on commercial negotiation with a safety net through the access provisions of Part IIIA of the Competition and Consumer Act 2010, could potentially introduce much greater regulatory uncertainty, lead to delays in reaching commercial agreements and act to dampen investment in airport infrastructure." [DIT, April 2011, 1].

No Evidence of Any Problem

WAC submits that not only is there no evidence to justify any form of heavy handed regulation there is also no evidence of any [material] problem to justify the continuation of the current light handed form of regulation. This is because airports such as Perth Airport have, or are putting in place, commercially negotiated agreements with airlines that, to the extent practical, that take into account individual airlines needs. These contracts are negotiated in good faith pursuant to consultative process with all airline users. All airlines have entered into these agreements voluntarily and without coercion.

It is important to appreciate that these negotiations, while prima facie bilateral, have a significant and unavoidable multilateral element to them. That is because airports are providing open access to all users and are a common user facility. As such the terms and conditions of use of the airport require some common provisions applicable to all users and, where practical, specific provision to accommodate individual requests of airlines. Accordingly, the negotiation of an agreement with an airline cannot be viewed in isolation of the agreements that airports have with all other users. This presents a unique challenge for an airport. Therefore, while airlines see the negotiations as bilateral and assess the efficiency and timeliness of outcomes of these negotiations against bilateral negotiations, the fact is they are not. Notwithstanding this difficultly Perth Airport is in the process of executing long term agreements with all major users of the airport which accommodate the specific needs and requests of the individual airlines.

WAC submits that the views of its customers as to the extent of any problem should be seen for what they are: customers seeking to gain any advantage that they can from a supplier; customers always want more from the bargain - that is the nature of the customer/supplier arrangement. Therefore, it is not surprising that airlines raise issues with the negotiation process. However, while the negotiation process may not be easy and involves normal commercial tensions, outcomes are reached to the satisfaction of both parties.

As set out above all stakeholders, including the airlines, agree that commercial negotiations are the best outcomes, and this is currently being achieved. As there are commercial agreements in place, and there continue to be new commercial agreements reached any market power of Perth Airport is mitigated to such an extent that there is no basis for any continuation of the current light handed regulation. Over the past 10 year "probationary period" of the current regulatory arrangement detailed and flexible commercial long term agreements have been put in place to the satisfaction of both parties.

WAC believes that the Department of Infrastructure and Transport accurately describes the dynamics of the negotiations between airports and airlines.

> *"Airlines continue to express dissatisfaction from time to time with the quality of particular services provided by some airport operators, but nevertheless airlines have, as far as the Department is aware, been able to settle long term commercial contracts on pricing and service levels. And airlines have not, at least in the period since the last Productivity Commission Inquiry in 2006, sought the active intervention of the ACCC in these negotiations. [DIT, April 2011, 1]*
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> *"While prices for aeronautical services have increased since privatisation, the Department notes that these have been negotiated with the airlines and reflect significant investment in aviation infrastructure as outlined in the previous section of the Submission. These agreements fix prices and services between airports and participating airlines for periods that typically range from three to five years and in some cases as long as 15 years.*
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> *The Department is aware that these commercial agreements have evolved to become increasingly sophisticated, for example often including clauses to deal with risk sharing and other matters of contention. This is a positive outcome.....*
>
> *The experience to date is that disagreements on access to airport services and facilities are eventually resolved through commercial negotiations, despite sometimes difficult negotiations. [DIT, April 2011, 10]*

ACCC Identified No Evidence of Any Problem

WAC agrees with the ACCC statement:

> *"The ACCC recognises that the existence of market power is not, of itself, sufficient justification for economic regulation. The principal rationale for regulation of airport services is the exercise of market power and the associated inefficiencies that can result." [ACCC, March 2011, 8]*

WAC submits that there is no probative evidence before the PC that airports exercise market power to such a degree to warrant any form of regulatory intervention, including the continuation of the current light handed regulatory regime. Without any such evidence regulatory intervention will only interfere with commercial negotiations and lead to less efficient outcomes.

Significantly the ACCC has found no evidence of that airports exercise market power to any significant degree.

The ACCC is the independent competition law enforcement body in Australia. It is the body that investigates and enforces competition law in Australia. It is experienced and skilled in investigating complex competition law breaches and making complex economic regulatory determinations in communications, energy and transport sectors.

The ACCC is staffed with specialists trained and experienced in the investigation of competition law issues. Its' staff includes expert economists, competition lawyers and investigative staff. Furthermore the ACCC has extensive powers not only under Part VII of the CCA but also under other provisions of the CCA to investigate competition law issues and compel the provision of relevant information from any person or body.

Notwithstanding the powers, experience and resources available to the ACCC it has not identified any *evidence* of a problem upon which it can *conclude* that there is a basis for the continuation of the existing light handed regulatory framework.

The ACCC has not been able to conclude that there exists any substantive issue requiring any regulatory intervention. Rather, all the ACCC has done is identify theoretical risks without any assessment of whether or not the theoretical risks actually have occurred or are even likely to occur

> *"the ACCC considers that the **risks** of the major airports exercising market power warrant a regulatory response". [ACCC, March 2011, 2][emphasis added]*
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> *"Monopoly behaviour by the major airports in the provision of aeronautical services **can** lead to a loss of economic efficiency, which **could** reduce living standards of members of the community (section 3). The airports **could** also use their market power to discourage competition in the downstream market for landside access, in which airports offer car parking services (section 4)." [ACCC, March 2011. 3][emphasis added]*
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> *"Monopoly behaviour by an airport **could** involve efficiency losses (section 3.1) and income transfers, which are of concern to Governments and the community (section 3.1.2). Although air travel may be insensitive to changes in aeronautical prices overall, it is still **possible** that the community will be significantly worse off as a result of the airports exercising their market power (section 3.1.3)." [ACCC, March 2011, 8][emphasis added]*
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> *"Therefore, it is the **view** of the ACCC that the airports with significant market power **could** have an **incentive** to delay investment and to allow quality to deteriorate in order to maximise their profits." [ACCC, March 2011, 11] [emphasis added]*
>
> *"The Government has directed the PC to consider the costs and benefits, and distributional effects of the current regime. The ACCC submits that the major airports' market power is not effectively constrained under the current regime, and that there is the **possibility** of inefficient outcomes due to monopoly pricing. [ACCC, March 2011, 13][emphasis added]*

At its most probative the ACCC finds that there are "*trends* that *indicate* the exercise of market power by some of the major airports"[1]. However, the ACCC goes onto state, "That said, there are limitations to the degree of conclusiveness of evidence that the current monitoring regime can be expected to provide in relation to the exercise of market power."[2]

[1] ACCC, March 2011, 1

[2] Op cit 4

If the independent competition regulatory cannot find any probative evidence of any substantial exercise of market power by airports after 10 years of price monitoring then in WAC's submission there is simply no basis for the need for the continuation of the current light handed form of regulation.

No Justification for Deemed Declaration

As there is no probative evidence of any substantive exercise of market power provided by airlines then there is no justification for the continuation of the current light handed regulatory regime, let alone more intrusive intervention arising from deemed declaration of aeronautical service under Part IIIA of the CCA.

Deemed declaration is a more intrusive form of regulation than currently exists and must be recognised by the PC as such. Accordingly, there will be costs arising from the imposition of this more heavy handed form of regulation than currently exists. Such costs are only justified when there is evidence that the commercially agreed outcomes that currently exist do not deliver reasonably efficient outcomes, and that the benefits of any intervention will exceed the costs.

Airside services at Sydney Airport were declared under Part IIIA until 2010. However, services at no other airport have been declared. Notwithstanding that there has been no other declaration, including at Perth Airport, commercial agreements have been reached with airlines and the ACCC has found no evidence of the exercise of market power at these airports. Accordingly, there simply is no basis for the imposition of any more intrusive form of regulation as deemed declaration.

The actual behaviour of all airports other than Sydney airport, in the absence of declaration, clearly establishes that deemed declaration is not required, let alone justified. Without declaration at these airports commercial agreements have and continue to be reached.

WAC agrees with the following comments of the Department of Infrastructure and Transport:

> *"While the Department supports commercial negotiations as the best means of setting efficient aeronautical charges, should negotiations fail it is still possible for airlines and other airport users to seek arbitration through the National Access Regime in Part IIIA of the Competition and Consumer Act 2010. Part IIIA establishes a legal regime to facilitate third party access to services of certain facilities such as airports that are considered critical to competition in related markets. However, as noted in the National Aviation Policy White Paper, access to Part IIIA is not designed to replace commercial negotiations, but to enhance incentives for negotiation and provide a means of access on reasonable terms and conditions where negotiations fail.*
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> *The Competition and Consumer Act sets out mechanisms by which access can be obtained to infrastructure services, including declaration and arbitration processes. As evidenced by the October 2002 application for the declaration of aeronautical services at Sydney Airport, such processes can be lengthy and expensive. But the successful conclusion of negotiations after declaration (without needing recourse to final arbitration by the ACCC) indicates the value of the Part IIIA processes where serious differences exist.*
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> ***The Department believes that the resort to external arbitration and determination through a body such as the ACCC should not be too easily accessed, to avoid undermining the commercial negotiation process**. The Competition and Consumer Act and the ACCC to, however, provide an effective backstop should negotiations fail." [DIT, April 2011, 11][emphasis added]*

Virgin and Qantas both argue that the lack of arbitration while Sydney Airport was declared is evidence that excessive arbitration will not occur if deemed declaration were put in place at all monitored airports. However, what that argument fails to mention is that Sydney reached a long term agreement for the declared services and once that occurred, no arbitration was necessary. Therefore, all this proves is that no intervention is required once long term agreements are in place.

Part IIIA is Effective

WAC agrees with the submissions of the NCC in its submission April 2011. In particular WAC agrees with the NCC in rebutting criticisms of the untimeliness of declaration under Part IIIA of the CCC made by airlines and the ACCC.

> *"Further, the two examples used by the ACCC in its submission arose prior to the recent amendments to Part IIIA that imposed binding time limits on the Council and limitations on the material to be considered by the Tribunal upon review. [NCC, April 2011, [4.5]]*
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> *"It is in the public interest that access decisions are made in a timely manner. However, given the significant consequences of access decisions for applicants, access seekers, service providers and the broader economy, expediting the decision making process must not be at the cost of consistent, independent and rigorous regulatory assessment. Doing away with the declaration process on an ad hoc basis risks raising perceptions of increased regulatory risk with attendant economic costs. [NCC, April 2011, [4.10]]*

Most critically to the debate about deemed declaration of aeronautical services, the NCC correctly identifies what the debate is actually about: promotion of the interests of airlines and not about the promotion of effective competition:

> *"If there are concerns about the operation of the Part IIIA declaration process, such as uncertainty of outcome or delay (which the Council considers are unlikely to be justified in light of recent amendments), then these concerns apply to all industries and all potentially declared services. It is not apparent to the Council why aeronautical services constitute a special case.* ***Indeed, if aeronautical services would not satisfy the declaration criteria, then it is hard to see how a deemed declaration would not amount to the promotion of particular interests rather than the promotion of effective competition*** *which is, after all, the fundamental object of Part IIIA as explicitly stated in s44AA...".[NCC, April 2011, [5.6]] [emphasis added]*