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Submission by RBB Economics to the Productivity Commission's review of the Economic Regulation of Airport Services

RBB Economics, 28 September 2011

1 Introduction

On 22 August 2011, the Productivity Commission ("the Commission") released a Draft Report (DR) on the economic regulation of airport services. The DR provided an opportunity for the Commission to review how airports have performed since detailed price controls were replaced with light-handed regulation in 2002. One of the Commission's main findings was that while light-handed regulation led to increased investment in airports and was popular with all parties, successive Australian Governments had "not acted on the regulator's concern that some airports might potentially misusing their market power".[1]

The Commission noted that the commercial negotiations that characterised the light-handed approach to regulation, were supported by airports and their customers and that neither party sought to return to regulatory price setting. Mindful of this, the Commission recommended the regulator should – by drawing on its monitoring role – be able to direct an airport to explain (or to "show cause") why its conduct should not be subject to a "forensic" price inquiry. The Commission suggests that when the regulator is dissatisfied with the response, then the Government should invoke such a price inquiry that is guided by the Aeronautical Pricing Principles. The implicit threat to airports is that such a price inquiry could recommend a return to "heavy-handed" regulation and detailed price control.

This short submission sets out our observations and comments on the recommendations concerning the potential misuse of market power by airports and the Commission's view that

[1] Productivity Commission 2011, *Economic Regulation of Airport Services*, Draft Inquiry Report, Canberra page xx.

economic efficiency could be improved by requiring airports to explain why the prices that they propose during commercial negotiations are not a misuse of their market power. It contains an economic assessment of the general policy approach envisaged by the Commission as well as a more detailed analysis of the issues involved when determining when prices may be excessive.

Our submission is structured as follows:

- Section 2 reviews the analysis undertaken by the Commission in the DR to determine whether airports had market power. The conclusion we reach is that any recommendations regarding the price regulation should be applied to airports only after a stringent market power test has been met, which gives more explicit recognition to the fact that price controls are a last-resort measure that should be applied only when competitive forces have demonstrably failed to operate effectively. We believe that the Commission agrees with this, but have found that its assessment of the airports that may have market power is inadequate and its conclusions unsubstantiated.

- Section 3 sets out the options available to the government to regulate the price of airport services and the nature of the Part VIIA remedy that is a key part of the Commission's recommendation regarding pricing. We question whether the instruments available under Part VIIA provide the right tools for the job; and if so whether the threat to apply such instruments will be fully effective. Our main comments are that the Commission's Draft Recommendation is aimed at shifting the balance of power in arrangements between airports and airlines and that this will encourage regulators to arbitrate in the distribution of gains in bargaining arrangements where efficiency considerations are not at stake, and where it would be more efficient to allow dynamic market forces to resolve the issues.

- Section 4 sets out the issues with Draft Recommendation 11.1. We believe that the resources required for the ACCC to issue a "show clause" request and for the airport to address it will lead to increased compliance and administrative costs with little offsetting benefits to economic efficiency.

2 Do airports have market power?

Chapter 4 of the DR discusses market power and attempts to identify the appropriate regulatory response to deal with any problems that it identifies.

2.1 Why does a finding that an airport has substantial market power matter?

The Commission recognises that the economic case for regulating airport services rests on the argument that, "left to their own devices, market forces are unlikely to lead to an economically efficient pattern and level of investment in, and/or use of, airports". It goes on to state that the primary area of potential market failure in relation to airports is the scope for them to abuse their market power and that:

> *"A firm can be said to have market power if it can sustain prices above the efficient costs of supply for a significant period of time. It is widely accepted that many airports are geographic monopolies or, at least, face insufficient competition from nearby airports to prevent them from exercising some market power".*[2]

The Commission's description of market power and monopoly is consistent with that found in any standard economics textbook and refers to the power that any monopoly supplier has to raise prices above costs and to earn profits in excess of the normal or competitive level.

Most economists would readily agree that public policy ought to be capable of dealing with excess pricing in cases where a severe market failure exists. But experience with regulation and competition policy also highlights the fact that regulatory micro-management of pricing is fraught with problems and should be used as a last resort. The Hilmer Report, for instance, found that:

> *"Regulatory solutions can never be as dynamic as market competition, and poorly designed or overly intrusive approaches can reduce incentives for investment and efforts to improve productivity. There are costs involved in administering and complying with pricing policies. Finally, from a government's perspective, resort to price control might be seen as an easy and popular way of dealing with what is in reality a more fundamental problem of lack of competition in an area. Since price control never solves the underlying problem it should be seen as a "last resort". For all these reasons, regulatory responses to monopoly pricing concerns must be approached with caution."*[3]

It is important, therefore, to be clear about what problem any regulatory solution is designed to address. In the case of airport services, there are two situations where the excess pricing identified by the Commission may occur.

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[2] Productivity Commission 2011, *Economic Regulation of Airport Services*, Draft Inquiry Report, Canberra page 46

[3] Commonwealth of Australia, 1993 *National Competition Policy*. A Review chaired by Professor Hilmer and referred to hereafter as the Hilmer Report, p 271.

The first situation is where an airport enjoys a legislated or natural monopoly and can therefore charge a monopoly price for the relevant services. A natural monopoly can be defined as a market where the entire output can be supplied by a single firm at a lower cost than by any combination of two or more firms.[4] Policy makers usually intervene in order to prevent excess prices in these sorts of markets and this concern is seen most starkly in the regulation of natural monopoly suppliers such as gas and electricity transmission networks. In these cases, price controls are usually required to ensure a fair deal for consumers.

The second situation which gives rise to excess prices is where markets are not subject to workable or effective competition. Competition may not be effective because barriers to entry may be high or because there may not be reasonably close substitutes. With regard to this form of market power, the Hilmer Report noted that:

> *"In these cases, in assessing whether prices charged by firms are "too high" it will be important to understand the underlying industry characteristics. What appears a "high" price may reflect no more than a competitive return on capital, given risk factors and pay-back periods. Firms without a legislated or natural monopoly rarely enjoy the capacity to charge excessive prices over a sustained period. Intervening to restrict prices can deter new investment, constrain productivity growth and dull the signal to new firms to enter the market. Nevertheless, there may be some poorly contestable markets where there is reasonable concern over potential monopoly pricing behaviour."*

In these sorts of markets, profits perform a dynamic function of rewarding success and providing incentives for investment and innovation and the connection between the simple static monopoly abuse and the law regarding misuse of market power is not straightforward. Prices may be high for a number of reasons and those high prices could even be good for competition. High prices could, for example, provide the signal that spurs innovation and risk-taking investment.[5] This is one of the reasons why there is no general prohibition against excess prices in Australia in the misuse of market power provisions (section 46) of the Competition and Consumer Act.

It is important to distinguish these two concepts of market power as the policy response can be quite different. The DR suggests that the concern over the market power of airports arises because competition may not be workable or effective rather than as a result of a firm being a natural monopoly. In Chapter 4, the Commission refers to its 2002 review where it noted that airports exhibit characteristics of natural monopoly, but only seemed to use that finding to argue (correctly) that these characteristics meant that marginal cost pricing will not provide a normal return on investment and, in the long-run, would be likely to result in a less-than-efficient expansion in the capacity of the airport.

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[4] ibid 269 footnote 1.

[5] ibid 269.

Chapter 11 of the DR provides a more definitive statement from the Commission regarding their concern around market power. While they do not conclude on the precise nature of the market power, they do suggest that airports are unlikely to be natural monopolies:

> *"In advanced economies, market failures are normally addressed in an ex post conduct context through general competition laws. Consequently, very few industries are subject to industry-specific regulation. Those industries are typically integrated network infrastructures such as electricity transmission, fixed telecommunications and gas pipelines – which are quite dissimilar to multi-product, stand alone entities like airports. Moreover, Commission consultations with infrastructure investors found that they generally regard airports as a riskier class of assets with greater exposure to shocks than say energy infrastructures, involving poles, wires and pipes."*[6]

The Commission, therefore, does not appear to have abandoned hope for competition and considers that airports are an example of a market where profits perform a dynamic function of rewarding success and providing incentives for investment and innovation. But if the Commission believes that appropriate response to the risk of excessive prices is to impose a threat that prices may in future be re-regulated, then they need to accept that regulators will face considerable challenges when trying to identify the "right" price level in such a risky and dynamic market.

But identifying the source of the market power is only part of the challenge. The next step is to determine precisely what that market power means. In other words, policy makers need to assess whether that market power means that airports are actually able to sustain prices to airlines significantly above the levels of efficient costs (somehow defined). The next section of our submission argues that the Commission has not done this in clear and systematic way and therefore lacks the basis for the policy recommendations that it has made. Indeed, the Commission itself does not seem to believe that airports are actually even able to exercise or misuse any market power that they have which raises the questions of whether there is indeed any need for any intervention in this market.

2.2 How robust is the Commission's assessment of market power?

Given that only a firm with market power is capable of sustaining prices above the efficient costs of supply, it is crucial to establish conclusively whether a particular airport does in fact have market power and the services that are subject to that market power concern. The approach that the Commission adopted to determine whether airports have market power was to seek views and evidence on the extent to which there had been changes in the overall market power of price monitored airports since the previous reviews.

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[6] Productivity Commission 2011, *Economic Regulation of Airport Services*, Draft Inquiry Report, Canberra page 235

In terms of changes since the last review in 2006, the Commission acknowledged that one of the key developments from an Australian perspective had been the continuing growth in market share of low cost carriers (LCC) aligned with an increase in leisure travellers. Evidence was presented to the Commission that these LCCs have in some instances, bypassed, or offered limited services to major city airports and used regional airports (such as Avalon in Victoria and the Gold Coast in Queensland). The Commission also noted that users of LCC have a higher elasticity of demand.

Another development noted by the Commission was the apparent emergence of increased competition between major airports in different states (and even different countries) to attract airlines and flights. This competition arises from international visitors exercising discretion over which airport they use to enter or leave Australia and also through the incentives offered by airports to airlines to use a particular airport. These incentives, the Commission notes, often have the backing of state governments and have led to "bidding wars" to secure business from new airlines. [7]

The Commission also discussed the role of an airport's ability to earn non-aeronautical revenue and requested further information on the extent to which those revenues provided an incentive to constrain aeronautical charges.

These factors, according to the Commission, mean that airports could have less scope to raise charges to airlines without risking loss of patronage. In other words, these factors could mean that those airports that were previously thought to have market power may now no longer have such power and would, therefore, no longer need to be subjected to any form of price regulation.

But while the DR indicates that the Commission is still considering the extent to which non-aeronautical revenues constrain aeronautical charges, but appears to have made up its mind that the growth of LCC and the increased competition between airports is not sufficient to constrain airports. The Commission simply discusses the developments that we have summarised above, and then concludes that:

> *"While acknowledging those recent developments, the Commission continues to consider that Brisbane, Melbourne, Perth and Sydney airports possess a high, or at least moderately high, degree of market power in domestic market. These airports' market power may be ameliorated to differing degrees by competition for international and LCC traffic but in the Commission's judgement, their market power remains significant and policy relevant".* [8]

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[7] Productivity Commission 2011, *Economic Regulation of Airport Services*, Draft Inquiry Report, Canberra page 55.

[8] Ibid.

The Commission's conclusion is important as it provides the basis for the recommendations they make regarding (the threat of) price regulation. But we believe that the Commission's conclusion raises two important "threshold" issues.

The first of these is that the Commission needs to be transparent about the assessment that it undertook in order to form its "judgement" that the market power of airports remains significant and policy relevant. The DR includes a discussion of the factors that are relevant to an assessment of an airport's market power, but absolutely no discussion of how the Commission weighed up all of these factors. Given that a finding of market power is the first step when determining whether (and how) prices need to be regulated, the Commission needs to do more than "acknowledge" the factors that it identified as part of its assessment. It needs to explain how it assessed the extent to which these factors constrain prices or why it believes they do not.

To what degree, for instance, does competition for international and LCC traffic constrain the market power of airports? Does this differ by airport? And how are those constraints expected to change over time? Similarly, how does the ability to price discriminate by airports and airlines affect the ability of airports to exercise market power? The Pricing Principles, for example, state that prices charged by airports for aeronautical services should allow multi-party pricing and price discrimination when it aids efficiency. Moreover, the Commission notes in section 4.2 of the DR that even though airports may have market power, the airlines themselves may be able to ameliorate much of the welfare effects (the deadweight loss) through price discrimination. Yet the Commission does not offer a view on the strength of this effect and whether it is able to balance out any concerns that it has on the market power of airports.

The second issue is the lack of clarity around what the Commission means when it finds that Brisbane, Melbourne, Perth and Sydney airports possess a "high" or "moderately high" degree of market power in the domestic market. The Commission needs to explain what it means by these different degrees of market power and discuss why it does not propose to use the concept of a "substantial" degree of market power to ensure alignment with the definition used in section 46 of the Competition and Consumer Act.

In Chapter 11 of the DR the Commission set out the factors that it believed were necessary to justify intervention in an airports context. It argued that a case must be made that:

- An airport is using its market power in a way that creates distortions that detract from community welfare;
- A regulatory response is the most appropriate response;
- It is feasible to devise a regulatory response that can address the market failure without imposing costs greater than those arising from leaving that market failure untreated.

Our view is that this framework is missing an important prerequisite which is that it needs to be established that an airport actually has "substantial" market power. Any recommendations

regarding the price regulation should be applied to airports only after a stringent market power test has been met, which gives more explicit recognition to the fact that price controls are a last-resort measure that should be applied only when competitive forces have demonstrably failed to operate effectively.

Instead, the approach that the Commission takes is to assume that some airports do have market power on the basis of a seriously inadequately assessment in Chapter 4 of the DR. A key finding such as this cannot be made through assertion based on the Commission's "judgement" but rather needs to be based on a transparent assessment that explains how the Commission (or another body) has weighed all of the relevant factors.

3 How can excessive prices be regulated?

Section 2 of our submission concluded that the Commission's Final Report needs to clearly establish whether there is a problem that needs to be addressed in this market and a stringent market power assessment can help in that regard. The next step for the Commission is to demonstrate that Part VIIA is an effective way of preventing excess prices in this market. In other words, the Commission needs to show that Part VIIA provides the right tools for the job.

3.1 Can Draft Recommendation 11.1 actually prevent excessive prices?

Draft Recommendation 11.1 states that the ACCC, on publication of its monitoring reports, should be empowered to issue a direction that an airport has six weeks to show cause why its conduct should not be subject to scrutiny under a Part VIIA price inquiry.

The DR does not clearly identify the problem that Draft Recommendation 11.1 is trying to address. The Commission does argue that at the margin, higher prices will have some effect on the demand for air travel or increase the cost faced by airlines' users, including business travellers and leisure passengers, but believes that "the evidence indicates that the concerns about aeronautical charges mainly reflect a distributional tussle between airports and airlines, rather than inefficient impacts on the demand for air travel by consumers."[9]

Despite these "distributional tussles", the airlines themselves are not calling for the re-regulation of airport services and pricing and have indicated that they have no interest in introducing a requirement for regulatory approval of all changes in prices. Instead, the Airlines are arguing that:

> *"...the current regulatory framework does not strike the right balance between providing incentives for airports to invest in airport infrastructure*

[9] Productivity Commission 2011, *Economic Regulation of Airport Services*, Draft Inquiry Report, Canberra page 236.

and ensuring that mechanisms are in place to prevent airports' unreasonable behaviour and excessive pricing of facilities and services."[10]

The Commission accepts that airlines and airports want to negotiate rather than have prices set externally, but believes that:

> *"Assessing the true state of commercial negotiation between airports and their customers is an exercise in sifting through conflicting accounts of the extent to which agreements have been negotiated in accordance with the Pricing Principles and the degree of genuine consultation and exchange of information".*[11]

Draft Recommendation 11.1, therefore, appears aimed at tilting the balance in the negotiations between airports and airlines towards airlines by requiring those airports with market power to justify (or "show cause") that its prices do not exceed its (efficient) costs. If the airport is not able to explain the prices it is charging, then it may be subject to a Part VIIA price inquiry.

One effect of this recommendation could be that airports face pressure to justify their negotiating arrangements to the ACCC leading to increased compliance and administrative costs. But more importantly, such a recommendation is generally inconsistent with a policy that relies on commercial negotiation. As Gary Banks, Chairman of the Productivity Commission argued in a slightly different context:

> *"A problem of using trade practices legislation to shift the balance of power in arrangements between big and small parties is that it may encourage firms to seek regulators (and then courts) to arbitrate in the distribution of gains in bargaining arrangements where efficiency considerations are not at stake. Such negotiating arrangements are ubiquitous in any thriving economy. Too easily wielded a regulation would invite bureaucratic and court intrusion into almost any commercial arrangement".*[12]

We agree with Mr Banks and believe that his comments apply to Draft Recommendation 11.1. These comments suggest that commercial negotiations between airlines and airports may not be equal and that governments should expect a tussle over how the gains will be distributed between parties. Such a tussle should not, without evidence of economic efficiency, require policy intervention, particularly when the policy intervention proposed is ill-suited to deliver clear benefits. There is a risk, therefore, that this will cause airlines (and other users of airport services) to adopt a culture of complaint rather than a culture of competition and encourage regulators to arbitrate in the distribution of gains in bargaining arrangements where efficiency

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[10] Productivity Commission 2011, *Economic Regulation of Airport Services*, Draft Inquiry Report, Canberra page 234

[11] Productivity Commission 2011, *Economic Regulation of Airport Services*, Draft Inquiry Report, Canberra page 239.

[12] Gary Banks "*The good, the bad and the ugly: economic perspectives on regulation in Australia*" Address to the Conference of Economists, Business Symposium, Hyatt Hotel, Canberra, 2 October, 2003. page 13.

considerations are not at stake. Such intervention increases the risk of regulatory failure that is worse than the underlying market imperfection.

3.2 Does a Part VIIA price inquiry provide the right tools for the job?

The DR surveyed the options available to regulators and to the government regarding price control. The two main remedies available in order to prevent airports from charging excessive prices are section 46 of the Competition and Consumer Act (CCA) and Part VIIA of the CCA.

Section 46 is the general prohibition against the misuse of market power in Australia. The problem with using Section 46 to regulate the prices charged by airports to airlines is that section 46 is not a general prohibition against excess prices. It only prohibits the misuse of market power for a proscribed purpose which is either to eliminate a competitor, to prevent entry into that or another market, or to deter a person from engaging in competitive conduct in that or any other market. So while a case could be made that an excessive price could have the effect or eliminating a competitor or preventing competition, section 46 is clearly aimed at exclusionary abuses rather than exploitative abuses (such as excessive prices).

So the Commission recognises that the only way of regulating the prices charged by airlines is through Part VIIA which deals with prices surveillance. Section 95E of Part VIIA states that the "object of this Part is to have prices surveillance applied only in those markets where, in the view of the Minister, competitive pressures are not sufficient to achieve efficient prices and protect consumers." Section 95F then provides for the Commission or another body to hold price inquiries in relation to the supply of goods or services. These inquiries may relate to the supply of goods or services by a particular person. If so, the person's ability to increase the prices of those goods or services during a particular period is restricted.

This remedy is currently available to the ACCC, although the Commission notes that the ACCC has not, however, recommended a Part VIIA inquiry and the relevant Minister has not instructed the ACCC or any other body to undertake one. The DR also includes comments by the Board of Airline Representatives of Australia who believed that the lack of recourse to potential sanctions has sent a signal to airports that behaviour outside the Pricing Principles will be tolerated.[13]Given the inability of section 46 to address any allegations of excessive prices by airports the Commission has recommended that the ACCC, on publication of its monitoring reports, should be empowered to issue a direction that an airport has six weeks to show cause why its conduct should not be subject to scrutiny under a Part VIIA price inquiry.

The lack of a general prohibition against excessive pricing seems to be behind the Commission's decisions to go down the Part VIIA road. But one should not embark on such a journey unless one is confident that the ultimate destination is the right one. In other words, the

[13] Productivity Commission 2011, *Economic Regulation of Airport Services*, Draft Inquiry Report, Canberra page 240.

threat of taking VIIA action is only likely to work well if it is seen that an exercise of that threat will be an efficient way to fix the problem.

In our view, Part VIIA can only lead to a price inquiry and the "stick" seems to be that the inquiry will find that "heavy handed" regulation such as price control may be needed. What is not clear is how credible such a remedy actually is. There are two reasons why we believe that this policy instrument may not be fit for purpose.

First, there is no general prohibition against excessive prices in Australia suggesting that governments in Australia have been tolerant of excessive prices even when charged by firms with substantial market power. This tolerance demonstrates a recognition of the role that high prices can play in increasing competition by providing a spur to innovation and encouraging risk-taking investment. Governments have been less tolerant of high prices in markets where the market power is the result of a legislated or natural monopoly (such as suppliers such as gas and electricity transmission networks). In these cases, price controls are usually required to ensure a fair deal for consumers. The Commission appears to be trying to apply the sort of price regulation that is appropriate for natural monopolies in markets where the competition concern is of a different nature. Draft Recommendation 11.1, therefore, can be characterised as an attempt to introduce a prohibition against excess pricing by stealth in markets where competition may not necessarily be effective, but where the firm in the relevant market falls short of being a natural monopoly.

Second, the credibility of the threat of a Part VIIA inquiry is that it will ultimately lead to heavy handed none of the parties in the Commission's inquiry have requested a return to more heavy-handed regulation and potentially to pre-2002 detailed price controls. This would be an outcome that none of the parties have requested.

In our view, the case for Draft Recommendation has not been made and it is unlikely to meet the Commission's objective. In addition, there are a number of details concerning the Draft Recommendation that need to be addressed and these are considered in the next section.

4 Issues with Draft Recommendation 11.1

Our comments concerning Draft Recommendation 11.1 are presented under the following questions:

- Which airports and services are actually captured by Draft Recommendation 11.1?
- What will be needed to "show cause"?

4.1 Which airports are actually captured by Draft Recommendation 11.1?

The scope of Draft Recommendation 11.1 needs to be made clearer. In particular, it is not clear whether the recommendation is limited to airports with "high" or "moderately high" market power or whether it applies to airports that have some element of discretion over pricing.

The Draft Recommendation does require the ACCC to form a view that there is prima facie evidence that an airport has, over time, demonstrated a consistent pattern of achieving aeronautical returns in excess of a reasonable band of outcomes. It is not clear whether this requirement is intended to act as a proxy for market power but even if so, it is unlikely to be a clear or effective filter. The Commission, for example, has recognised that efficient prices in this market will exceed short-run marginal costs and identifying the level at which prices will generate an excessive return is likely to be difficult. Section 2 above noted that the Commission's consultations with infrastructure investors found that they generally regard airports as a riskier class of assets with greater exposure to shocks than say energy infrastructures, involving pipes, wires and poles. Finding a band of outcomes that provides a sensible range in such an industry will not be straightforward.

In our view there needs to be a clear statement in Draft Recommendation 11.1 that the recommendation only applies to airports that have "substantial" market power. Moreover, such a determination needs to be established through a clear competitive assessment drawing on concepts that apply in Australian competition laws rather than by relying on the Commission's "judgement".

But even if a clear statement was added to Draft Recommendation 11.1 that it only applies to airports with "substantial" market power, it may not be effective at successfully limiting the scope to those airports. This is because Part VIIA is not actually limited to firms that have market power. Instead, Part VIIA can be applied "in those markets where competitive pressures are not sufficient to achieve efficient prices and protect consumers".

Although it is not clear what is meant by "markets where competitive pressures are not sufficient to achieve efficient prices", it seems that this would be a lower test than a ""substantial" market power test and could effectively extend the scope of Draft Recommendation 11.1 beyond those airports that are considered to have "substantial" market power.

4.2 What will be needed to "show cause"?

The DR is silent on what the airports will need to actually do in order to satisfy a "show clause" request, although the Commission seems to be suggesting that it may not be onerous. For example, the Commission states that:

> *"... the ACCC could make an assessment based on its interpretation of the price and service quality monitoring data that it collects. These long-term*

> *data series, which are supplemented annually, should be sufficient to enable the ACCC to issue a direction. After all, a show cause direction would not be a 'conviction' but only an indication that, without an adequate response, the matter might go to 'trial'."*[14]

This comment from the Commission understates the challenge that the ACCC will have in determining whether the prices charged by airports can be justified by reference to the airports' efficient costs and the difficulty that an airport will have in responding to such a request. The evidence from other jurisdictions that have prohibitions against excessive prices suggests that the Commission's hope that a "show cause" direction could be dealt with expeditiously may also be misguided. For example:

> *"A close analysis of the case law arising in the EC and UK demonstrates that there exists a troubling lack of clarity as to what an excessive price actually is. There is no discussion in the case law of the broad merits of applying the law to excessive pricing. While various tests have been advanced to determine when a price may be considered to be predatory, no such clear test has been advanced to determine when a price is "excessive" in the context of antitrust enforcement. In the case of excessive pricing, turning to the US experience for guidance is unhelpful – the Supreme Court has made it clear that an excessive price cannot constitute "monopolisation".*[15]

The challenges that the ACCC will face will be to identify a reasonable band of outcomes against which to assess aeronautical returns, consider the price paths proposed by the airports and determine how the quantum and timing of investment relates to outcomes and market conditions. Such a detailed assessment is largely equivalent to a competitive assessment undertaken to help it determine when an airport has substantial market power and whether that airport may have misused that market power.

A response by airports is likely to be costly and time consuming. And despite the Commission's comment that it is not a 'conviction' the evidence that it will need to collect to 'make its case' will not be dissimilar to that which it would prepare for the price inquiry that would be triggered by a Part VIIA referral. For example, the airport operator is likely to need to explain how it is allocating its costs across different services, justify its return, defend its depreciation policies, and argue that its operating costs and investment plans are efficient.

It is widely acknowledged that there is no single correct way for a multi-product firm such as an airport to recover its fixed and common costs across multiple transactions and customer groups. Yet the Commission's proposals could easily read as an invitation to individual users and special interest groups to complain about unfair or discriminatory tariffs in a context where not even a full time specialist regulator would be able to define a unique correct solution to how the airport should recover those costs.

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[14] Productivity Commission 2011, *Economic Regulation of Airport Services*, Draft Inquiry Report, Canberra page 243.

In short, the "show cause" requirement will mean that the parties will need to produce the sort of information that would be required in a full blown price inquiry envisaged by Part VIIA and will effectively mean that airport services and prices will be re-regulated. Such a review may be appropriate in order to determine whether a particular airport (or particular services) has market power, or even to assess whether excessive prices are being charged, but it is likely to be unduly onerous as a mechanism to resolve disputes. This is an outcome that neither airports nor airlines wanted.

5 Conclusions

A concern about excessive prices resulting from the misuse of market power is ultimately a competition concern and requires a detailed competitive assessment in order to ensure that any intervention is appropriate.

This submission has argued that any recommendations regarding the price regulation should be applied to airports only after a stringent market power test has been met, which gives more explicit recognition to the fact that price controls are a last-resort measure that should be applied only when competitive forces have demonstrably failed to operate effectively. We believe that the Commission agrees with this, but have found that its assessment of the airports that may have market power is inadequate and its conclusions unsubstantiated.

Moreover, we believe that the Commission's Draft Recommendation is not aimed at overcoming economic efficiency (which should be the main concern) and instead is aimed at shifting the balance of power in arrangements between airports and airlines. There is a risk, therefore, that this will cause airlines (and other users of airport services) to adopt a culture of complaint rather than a culture of competition and encourage regulators to arbitrate in the distribution of gains in bargaining arrangements where efficiency considerations are not at stake, and where it would be more efficient to allow dynamic market forces to resolve the issues.

Finally, Part VIIA does not appear to be well suited to preventing excess prices in this market. But the resources required for the ACCC to issue a "show clause" request and for the airport to address will mean that the parties will need to produce the sort of information that would be required in a full blown price inquiry envisaged by Part VIIA and will lead to increased compliance and administrative costs with little offsetting benefits to economic efficiency.

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[15] Mark Furse, 'Excessive prices, unfair prices and economic value' (2008) 4 *European Competition Journal* 1, 61.