Regulation Impact Statement for the Government Response to the Productivity Commission Inquiry Report – *Economic Regulation of Airport Services*

March 2012

Background

Major airports are critical gateway infrastructure facilitating the movement of people and goods to, from and within Australia, and as such have a direct impact on national productivity. It is estimated that Sydney Airport alone supports more than 206,000 direct and indirect jobs (about 6 per cent of Sydney's workforce) and has ties to an estimated 650 local businesses involved in airport related activities.[1]

It is therefore prudent to periodically review the regulation of airports to ensure they are functioning well from the perspective of the wider community. The 2011 Productivity Commission (PC) inquiry into the Economic Regulation of Airport Services examined the services provided by airports, the effectiveness of the current economic regulatory regime, potential improvements to the regulatory regime, and the quality and effectiveness of land transport facilities providing access to airports.

The PC's public inquiry process involved the release of an Issues Paper and a Draft Report, public and private meetings with key stakeholders, a number of industry round table discussions, and 3 days of public hearings in Canberra and Melbourne. In addition to this consultative process, the Department of Infrastructure and Transport met independently with most of the key stakeholders and attended all of the public hearings.

Australia's leased airport arrangements remain at the cutting edge of models utilising the private sector to enhance and grow transport infrastructure and services. This outcome has largely been achieved under the current so-called 'light handed' price monitoring regime that has been in place since 2002. Between the start of privatisation in 1997 and 2002, the leased airports were subject to price regulation for aeronautical services (such as the fees charged to airlines for use of the runways, terminal facilities, aerobridges etc). Prices were capped and the Australian Competition and Consumer Commission (ACCC) approved any increases.

This regulatory regime changed in 2002, following a PC inquiry into the Price Regulation of Airport Services, with the removal of price regulation and the introduction of monitoring and reporting of aeronautical prices, car parking and the quality of service provided by the seven largest airports in Australia. Monitoring is carried out by the ACCC and the results are published in an annual Airport Monitoring Report. The monitoring and reporting is backed by the possibility that more stringent regulation could be introduced, or other appropriate action be taken if airports are found to be misusing their market power. The existing provisions of the *Competition and Consumer Act 2010* (the CCA) also continue to apply, including the mechanism for facilitating third party access to services provided by infrastructure of

[1] URS (2009) *Sydney Airport Economic Impact*. Quoted in Tourism and Transport Forum (2011) *Accessing our Airports* (February 2011).

national significance under Part IIIA (the National Access Regime) as well as the economy wide anti-competitive conduct provisions, including the prohibition on the misuse of market power within Part IV of the CCA.

A decision to continue the monitoring regime was taken in 2007, following a 2006 PC inquiry entitled Review of Price Regulation of Airport Services. Minor adjustments were made to the regime, including the removal of Canberra and Darwin airports from the monitoring program since they were found to possess limited market power. The 2006 PC inquiry recommended that the monitoring regime continue until June 2013, and that a review of the regime again take place in 2012 in order to inform future regulatory arrangements. This review (the recently completed 2011 PC inquiry) was brought forward to 2011.

The PC's 2006 inquiry also recommended that the next review of airport regulation (the recently completed PC inquiry) have regard to a review of the National Access Regime, which had been scheduled to take place in 2011. However, the review of the National Access Regime was pushed back and is now scheduled to take place later in 2012.

Since privatisation commenced in 1997, Australia's major airports have delivered relatively efficient pricing, high levels of productivity and operational efficiency in international terms while maintaining reasonable levels of quality of service. The 2011 Airport Performance Indicators[2] report shows that of a sample of 50 airports across the world, Australia's four largest airports (Sydney, Melbourne, Brisbane and Perth) all have aeronautical revenues per passenger less than the group average. The same report also noted that these airports consistently out-performed other benchmark airports in productivity and maintained low costs.

This success points to an underlying soundness in the current privatisation model for Australia's major airports. It follows that any adjustment to the economic regulation for airports should further support the continued success of the current regime.

This Regulatory Impact Statement considers the Recommendations 9.5, 9.8 and 10.1 of the PC's final report of the inquiry. These recommendations relate to an extension of the ACCC monitoring and reporting of aeronautical charges, car parking and quality of service until 2020. Sydney, Melbourne, Brisbane and Perth airports would remain in the monitoring program, with Adelaide Airport no longer monitored by the ACCC.

1 PROBLEM

What is the problem being addressed? How significant is it?

Privatised airports have the capacity to operate as natural monopolies, which can cause prices to be set above efficient levels, and quality of service and/or investment levels to be below the economically efficient level. Many passenger airports in Australia and overseas have limited or no competition for their services, are expensive and difficult to duplicate, and the larger airports have the capacity to exert significant market power. Economic regulation has been introduced to reduce the likelihood that these airports misuse this power.

[2] Leigh Fisher Management Consultants (2011) *2011 Airport Performance Indicators*.

The potential impact of the problem is medium to high. In the absence of effective regulation, natural monopolies have the ability and incentive to misuse their market power to extract prices and terms that would otherwise not be achieved in a competitive market. In Australia, as there are large distances between capital cities, and as most cities have only one airport with significant passenger capacity, the potential for airports to exert market power is real.[3] However, the capacity of airports to exercise market power is curbed to some extent, including through competition from other transport modes and incentives to maximise passenger throughput to achieve higher retail and commercial returns.[4] In some cases, airlines can exert countervailing power depending on their capacity to bypass or withdraw services from the airport.

The 2011 PC inquiry into airport economic regulation found that while new developments, such as the growth of low cost airlines and increasing competition from secondary airports such as the Gold Coast and Avalon, were reducing the potential for some airports to exert market power,[5] "Brisbane, Melbourne, Perth and Sydney Airports retain sufficient market power to be of policy concern".[6] The impacts of inappropriate prices and terms for airlines would likely be passed on to airline passengers through higher ticket prices and diminished service levels.

One of the key measures of market power is the availability of reasonably close substitutes. Sydney and Perth Airports do not have effective competition for air passenger services as they are the only airports with scheduled flights serving their cities. Canberra and Newcastle airports are not sufficiently close to provide any effective competition for Sydney Airport.

Melbourne Airport has competition from Avalon Airport, but mainly for the low cost air carrier market. Avalon has limited passenger facilities and would need significant investment to cater for the business travellers, for example, that currently use Melbourne Airport. Brisbane Airport has local competition from both the Gold Coast and Sunshine Coast airports. However, these airports, like Avalon, tend to cater more for low cost carriers and do not offer the same degree of transport linkages that Brisbane Airport has.

The market power of Sydney, Melbourne, Brisbane and Perth airports also derives from their position as the largest cities in Australia. As such, they generate significant domestic business and private travel which needs to be served frequently by airlines that offer a national network. They are also the main international entry points for the country, and while there is some competition between them for international travel, most traffic at all of these airports is domestic and so any competition for international traffic does not significantly reduce the potential market power of the largest airports.

A challenge for governments (as expressed by Starkie) is to balance the potential costs of imperfect competition against the cost of imperfect regulation. As noted above,

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[3] Peter Forsyth (2007) *Light Handed Regulation of Airports: the Australian Experience*. IATA Economics, April 2007.
[4] David Starkie (2002) *Airport Regulation and Competition*. Journal of Air Transport Management 8 (2002) pps 63-72
[5] Productivity Commission (2011) "*Economic Regulation of Airport Services*" Report No 57 p XLVI
[6] Productivity Commission (2011) p. 82

while there is potential for airports to exercise market power, some moderating influences exist, and when combined with the regulatory arrangements to date, they appear to have led to reasonable outcomes in terms of prices and quality of service.

Why is (new) government action needed to correct the problem?

The Government's policy stance, as outlined in the Government's 2007 response to the 2006 PC inquiry, is that the current system of airport price monitoring will cease on 30 June 2013.

In order to review the adequacy of the current regulatory system before it is scheduled to end, the Government asked the PC to conduct a 12 month public inquiry into the economic regulation of airport services. The PC has now completed its inquiry and has produced a final report with recommendations for Government consideration. It recommends the continuation of the current monitoring regime with some amendments to enhance its effectiveness. The PC suggests that the new regime should apply for seven years expiring on 30 June 2020, and that another review of the regulatory arrangements should take place in 2018.

Is there relevant regulation already in place? If so, why is additional action needed?

Yes. The current regulatory regime, incorporating price and quality of service monitoring, commenced on 1 July 2002. Direction 29 of 28 June 2007 issued under Part VIIA of the *Trade Practices Act 1974* (now the *Competition and Consumer Act 2010* (CCA)) stipulates that the Australian Competition and Consumer Commission (ACCC) monitor the prices, costs and profits relating to the supply of aeronautical and aeronautical-related services at Sydney, Melbourne, Brisbane, Perth and Adelaide airports. The Airports Regulations 1997 made pursuant to the *Airports Act 1996* require these airports to disclose to the ACCC their annual financial accounts and that the ACCC report on these accounts and airports' quality of service standards.

The Government decision following the 2006 PC inquiry was that the current monitoring regime was to cease on 30 June 2013. Therefore, additional action is needed to ensure that appropriate regulatory arrangements apply to airports with significant market power beyond 30 June 2013.

Also of relevance are the existing provisions of the CCA which would continue to apply. These include the mechanism for facilitating third party access to services provided by infrastructure of national significance under Part IIIA (the National Access Regime) as well as the economy wide anti-competitive conduct provisions, including the prohibition on the misuse of market power within Part IV of the CCA.

2 OBJECTIVES OF GOVERNMENT ACTION

What are the objectives, outcomes, goals or targets of government action?

The objective of government action is to ensure cost effective regulatory oversight of those Commonwealth leased airports with significant market power, while providing an environment that facilitates commercial relationships between airports and their customers to be further developed. The government action is also designed to create

regulatory certainty for stakeholders to facilitate investment, innovation and productivity improvement.

3 OPTIONS THAT MAY ACHIEVE THE OBJECTIVES

Identify a range of viable options, including non-regulatory options.

While the government decision in 2007 was to extend the regulatory regime to 30 June 2013, the Directions under Part VIIA of the CCA and the Airports Act clauses that require the ACCC to monitor and report on aeronautical services, car parking and airport quality of service do not sunset. Therefore, it is assumed that if the Government did nothing, the current system of economic regulation would continue and this is the status quo option.

Other options open to the Government are to cease the monitoring and reporting and rely on the existing provisions of the CCA, to continue with the current approach but modified in the light of the information provided in the course of the PC Inquiry, or to take a different approach to the regulation of airports. The ACCC suggested an approach that would see the major airports deemed declared under Part IIIA of the CCA, meaning that where airports and airport users could not achieve agreement in commercial negotiations, one party could seek arbitration by the ACCC.

The four options that are therefore used in this analysis are:

- Option A – No price or quality of service monitoring or other regulation (for example disclosure requirements);
- Option B – Continue with the current regulatory regime (the status quo);
- Option C – Adopt the regulatory regime as recommended by the PC with minor modifications; and
- Option D – Impose a regulatory regime with deemed declaration of aeronautical services and potential compulsory arbitration by the ACCC. This option was recommended by the ACCC in its submissions to the 2011 PC inquiry.

Option A – No price regulation

The legislative instruments under Part VIIA of the CCA and the *Airports Act 1996*, which set out the current monitoring arrangements, would be repealed and monitoring would cease. Aeronautical charges at airports with significant market power would be set without any industry-specific form of regulatory intervention or oversight. The existing provisions of the CCA would continue to apply, including the mechanism for facilitating third party access to services provided by infrastructure of national significance under Part IIIA (the National Access Regime) as well as the economy wide anti-competitive conduct provisions, including the prohibition on the misuse of market power within Part IV of the CCA.

Option B – Continue with the current regulatory regime

The ACCC would continue to monitor the prices, costs, profits and service quality outcomes of specified aeronautical services and car parking at five airports (Sydney, Melbourne, Brisbane, Adelaide and Perth) and publish annual monitoring reports.

The annual quality of service monitoring would continue to include surveys of border agencies and airports, and not reflect the technological change that has affected major airports in recent years in terms of check-in, information systems and passenger services.

Under this option, the existing provisions of the CCA would also continue to apply, including the mechanism for facilitating third party access to services provided by infrastructure of national significance under Part IIIA (the National Access Regime) as well as the economy wide anti-competitive conduct provisions, including the prohibition on the misuse of market power within Part IV of the CCA.

Option C – Adopt the regulatory regime as recommended by the Productivity Commission with minor modifications

The ACCC would monitor the prices, costs, profits and service quality outcomes of specified aeronautical services at four airports (Sydney, Melbourne, Brisbane and Perth but excluding Adelaide) until June 2020, and publish an annual monitoring report. This would require a new direction under the CCA and amendment to the Airports Regulations.

The ACCC could issue a draft monitoring report that could give airports the opportunity to provide additional information to the ACCC to clarify any ACCC questions before the publication of a final monitoring report.

The ACCC could also use the remedies available to it where monitoring reveals concerns about an airport's behaviour, including if appropriate a recommendation to the Minister responsible for competition policy that further action be taken.

It is important to note, however, that the ACCC is an independent statutory authority and it will ultimately determine the way that it conducts its monitoring role

The objective criteria for quality of service monitoring, as well as the coverage of monitoring, would be reviewed.

The current car parking monitoring would be extended to include reporting on ground transport access charges and associated revenues. This information will also be published on airport websites.

Under this option, the existing provisions of the CCA would also continue to apply, including the mechanism for facilitating third party access to services provided by infrastructure of national significance under Part IIIA (the National Access Regime), as well as the economy wide anti-competitive conduct provisions, including the prohibition on the misuse of market power within Part IV of the CCA.

It should be noted that the PC also recommended that a 'show cause' mechanism be added to the existing price monitoring regime. The mechanism proposes to give the ACCC the ability to nominate a monitored airport to show cause as to why it should not be subject to a price inquiry under Part VIIA of the CCA, in the event that the ACCC has evidence that an airport has, over time, demonstrated a consistent pattern of achieving aeronautical returns in excess of a reasonably expected band of outcomes.

However, an additional 'show cause' mechanism is not warranted at this time, as the ACCC already has the ability under the current regulatory framework to seek additional information from airports if the ACCC considers this necessary. The existing monitoring regime is arguably sufficient and the compliance costs borne by stakeholders associated with a show cause mechanism are likely to exceed the benefits of implementing such a change.

Where the ACCC has significant concerns as a result of its monitoring program, it can use its existing capacity to make a recommendation to the Minister responsible for competition policy for appropriate action under the CCA. The Minister will consider the information in the airport monitoring reports and any additional information provided by airports in deciding how to act on such a recommendation.

Option D – Impose a regulatory regime with deemed declaration of aeronautical services and potential compulsory arbitration by the ACCC.

This option was raised by the ACCC in its submission to the PC inquiry[7].

The current regulatory monitoring regime would be replaced by a deemed declaration of aeronautical services under Part IIIA of the CCA by way of amendments to the *Airports Act 1996* and the Airports Regulations. Under this approach, where airports and airport customers (in practice, mainly airlines) could not reach agreement on commercial terms, the ACCC would have the power to arbitrate under Part IIIA of the CCA.

The practical effect of this approach would be to deploy the threat of ACCC arbitration to induce parties to reach commercial agreements. To achieve this result, it relies on a discrete part of the Part IIIA process only, completely bypassing the threshold determination by the independent National Competition Council (NCC) as to whether aeronautical services should be the subject of declaration.

Under this option, the economy wide anti-competitive conduct provisions, including the prohibition on the misuse of market power within Part IV of the CCA, would continue to apply.

4 IMPACT ANALYSIS – COSTS, BENEFITS AND RISKS

Who is affected by the problem and who is likely to be affected by proposed solutions?

Airport customers (primarily airlines) who negotiate access to the airports' aeronautical services are most affected by the problem, but other customers (such as airline passengers) may also be affected by, for example, through higher prices. The proposed solution will primarily impact on those airports subject to price regulation.

[7] ACCC (2011a) *Submission to the Productivity Commission's inquiry into the economic regulation of airport services* Submission Number 3, March 2011

Identify the expected costs and benefits of the options

The benefits and costs of each option are set out below. The costs and benefits of the feasible options are primarily economic in nature. The options are not expected to have any significant social or environmental impacts.

Option A – No price regulation

Economic benefits

Under Option A, some economic efficiency benefits may be derived from allowing aeronautical price and non-price terms to be commercially negotiated without regulatory intervention or oversight, maintaining incentives for investment, innovation and productivity improvement. The economy wide anti-competitive conduct provisions, including the prohibition on the misuse of market power within Part IV of the CCA, would be relied upon to restrain the misuse of market power by airports.

In addition, airports would not bear any regulatory compliance costs and the administration costs borne by the ACCC in respect of monitoring may be lower.

However, these benefits could be reduced where outcomes are reached through processes that allow for a misuse of market power (see below). In submissions to the PC inquiry, airports generally accepted that they possess market power, although they noted that it can be overstated and that airlines often wield countervailing power.[8]

Economic costs

The economic costs of no price regulation or oversight are the potential for outcomes to be reached which reflect a misuse of market power. This is likely to include higher prices and less favourable conditions for airport customers, which could flow through to the prices charged and services made available to consumers.

As stated previously, airports exhibit natural monopoly characteristics. Economic literature argues that a monopolist will maximise its profits by reducing the total quantity of goods or services it supplies to the market, in order to increase the price charged. This leads to a transfer of some consumer surplus from consumers to the monopolist (that is, a change in the distribution of welfare), as well as a loss in the total welfare of society due to the fact some consumers are no longer willing to pay the increased price.[9]

It is difficult to accurately estimate the level of airport charges in a competitive market and therefore the economic welfare loss which results from airport charges being above this level. This is because the information required to determine the efficient cost of owning and operating airports is not publicly available, but is held privately by each individual airport (if indeed it is held at all). In its submission to the PC inquiry, Qantas presented modelling which estimated that a $1 increase in current

[8] As an example, see Melbourne Airport (2011) *Response to Issues Paper*, Submission No. 29 to the Productivity Commission Inquiry pps 44-54.
[9] Productivity Commission (2011), p. 71.

(but not necessarily competitive) charges would lead to a net welfare loss of $1.8 billion. It should be noted, however, that the PC considers that this estimate overstates the welfare costs of an increase in aeronautical charges.[10]

The risk of major airports misusing their market power to extract monopoly rents in the absence of regulation is considered high. Finding 5.1 of the PC report states that Brisbane, Melbourne, Perth and Sydney Airports retain sufficient market power to be of policy concern. This view is informed by a range of submissions to the PC inquiry; 'airlines and other airport customers typically argued that airports have market power and the ability and incentive to exercise it.'[11]

Another potential cost is that an airport's misuse of market power could act as a barrier to entry to potential access seekers and competitors in the airports' sector, affecting competition in the same market and other markets.

The competitiveness of airlines with respect to other modes of transport could be substantially reduced by excessively high pricing for airport services stemming from misuse of market power resulting in less efficient investment and consumption decisions.

Finally in the absence of any price regulation or oversight, airlines may seek to have airports declared under Part IIIA of the CCA. If services at an airport were declared under Part IIIA but a commercially negotiated outcome could not be reached, an arbitrator would be required to decide upon prices. There are costs associated with arbitration, and in submissions to the recent PC inquiry most stakeholders agreed that it is preferable to reach outcomes through commercial negotiation that are independent of the Part IIIA process.

Option B – Continue with the current regulatory regime

If the Government decided to continue the current monitoring regime, the following benefits and costs would occur.

Economic benefits

The PC Inquiry confirmed that the current regulatory approach was returning positive outcomes, including:

- significant capital investment (Finding 6.2);
- prices which do not indicate systemic abuse of market power (Finding 7.2); and
- quality of service results which do not suggest the misuse of market power. (Finding 7.3).

The PC found that under the current price monitoring regime there had been significant aeronautical investment to meet growing demand, service quality has been satisfactory to good, and commercial relationships between the parties have been maturing.

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[10] Qantas (2011) Qantas Group Submission 52 to the Productivity Commission p. 69
[11] Productivity Commission (2011), p. 75.

The latest ACCC airport price monitoring report[12] shows that the overall ratings for airport quality of service improved slightly for all monitored airports apart from Perth, despite steady growth in passenger numbers. While aeronautical revenue rose at all airports, operating margins fell at Melbourne and Perth airports, and increased by only 1.4 per cent at Sydney.

Price and quality of service monitoring is fundamental in establishing the information base necessary to determine whether there is a prima facie case of misuse of market power. It provides evidence of emerging issues without requiring airport operators to provide excessive detail on its prices, revenues, costs and profits. In the event that monitoring identifies a potential misuse of market power by an airport, the ACCC has the ability under the current legislative framework to recommend that the Minister responsible for competition policy take further action, such as initiate a Part VIIA price inquiry.

The threat of further action that results from monitoring is a moderating influence in airport price setting. It encourages the use of standard approaches to price setting such as the 'building block' approach, that are well understood by participants and used in the past by the ACCC.

The PC noted in its report that "the hurdle for monitoring to produce a net benefit is low." To illustrate this point, the five airports which are currently monitored had 102.1 million passengers in 2010-11.[13] As noted above, the monitoring program is considered to exert a moderating effect on price setting, supported by the remedies of the CCA. If the monitoring program only results in a price reduction of one cent ($0.01) per passenger movement, this would reduce the costs to the airlines by over $1 million. It is reasonable to assume that airlines would likely pass much of this on to passengers, resulting in an increase in total consumer welfare of over $1 million. This represents a very conservative estimate of the effect of monitoring on prices set by an airport.

Economic costs

There are compliance costs associated with continuing the ACCC monitoring regime. However, the PC found (Finding 10.1) these compliance costs associated with the current regime overall are low.[14]

Adelaide Airport noted that it 'has found the continuation of price and quality of service monitoring not to be onerous or overly expensive to comply with',[15] while Melbourne Airport submitted that 'the direct costs of complying with the ACCC's financial monitoring requirements and the nature of the information required to be made available to the ACCC do not, of themselves, present material issues'.[16]

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[12] Australian Competition and Consumer Commission (2011), *Airports Monitoring Report, 2009-10*, (January 2011).
[13] Bureau of Infrastructure, Transport and Regional Economics (2012) *Avline 2010-11* (February 2012)
[14] Productivity Commission (2011), p. 221.
[15] Adelaide Airport (2011) Submission 12 to the Productivity Commission, p. 2
[16] Melbourne Airport (2011) Submission 29 to the Productivity Commission, p. 7

In its submission to the inquiry, Brisbane Airport estimated its own costs of complying at between $150,000 and $200,000 in total per year.[17] As Brisbane is the third largest of the five currently monitored airports, and the effort required to undertake the work is probably similar for all airports, it is reasonable to conclude that this estimate represents an average for all the monitored airports. This results in an estimate of the total compliance costs for the five currently monitored airports between $750,000 and $1 million per annum.

It was also noted in the recent PC inquiry that there is an annual administration cost to the ACCC from monitoring, which although non-trivial, "is not so significant as to outweigh the benefits from the monitoring regime."[18]

The total cost of compliance of continuing the current regulatory arrangements would be greater than for Option C (set out below), as it would continue to apply to Adelaide Airport, which the PC concluded exercised a lower degree of market power than the larger monitored airports. The PC found that as Adelaide Airport had entered into long term contracts with airlines, it is in a weaker market position than the other four major airports and therefore ongoing monitoring at Adelaide was no longer necessary.

The PC pointed out that while the current regulatory system appears to be working well, there is scope for improvement, as outlined below in Option C.

Option C – Adopt a regulatory regime as recommended by the Productivity Commission with minor modifications

Economic benefits

Option C offers the same economic benefits of the current 'light-handed' regulation (as set out in Option B), with some added benefits.

Building on the current regime, Option C would strengthen the effectiveness of the oversight role through the provision of clearer guidance on Government's expectations regarding the role of the ACCC in monitoring airports. The proposed response notes that Government encourages the ACCC to use its existing powers to seek remedies under the CCA where the ACCC sees this as justified.

Adelaide Airport has limited market power because it has now completed its major investment program and has negotiated long term commercial agreements with airlines that have imbedded price paths. Option C therefore removes Adelaide Airport from the monitoring regime.

A similar analysis to that used in Option B can also be applied to assess the benefits of Option C. The four remaining airports for which monitoring is proposed had 94.8 million passengers in 2010-11.[19] If we again conservatively estimate that monitoring only results in a price reduction of one cent ($0.01) per passenger movement, this would reduce the costs to the airlines by $950,000, resulting in a

[17] Brisbane Airport Corporation (2011) Submission 40 to the Productivity Commission p 23
[18] Productivity Commission (2011) p. 221
[19] Bureau of Infrastructure, Transport and Regional Economics (2012) *Avline 2010-11* (February 2012)

similar increase in total consumer welfare and exceeding the likely costs of monitoring for the four airports as discussed below.

Put another way, if monitoring reduced the four airports' aeronautical revenues in 2009-10 by only 0.5 per cent, this would equate to a reduction of $4.9 million in aeronautical revenue (again, most likely resulting in a similar size reduction in passenger costs).

The removal of Adelaide Airport from the monitoring program would ensure that only those airports that continue to possess substantial market power are price monitored. This would reduce the overall compliance costs for the airport and administration costs for the ACCC. If we continue to assume (as we did in Option B) that the compliance costs to the airports are between $150,000 and $200,000, overall compliance costs would be reduced by between $150,000 and $200,000 per annum.

Other amendments to the current regime, including the review of quality of service reporting, should further reduce compliance costs for all airports.

Economic costs

The economic costs of Option C, as with Option B, include the compliance costs to airports of fulfilling the reporting requirements. Using Brisbane Airport's estimate, this would put the total compliance costs for the four airports at up to $800,000.

These costs are smaller than for Option B due to the removal of Adelaide Airport from the monitoring program, and some small reductions in compliance costs are also expected from streamlining the price and quality of service monitoring processes.

Any administrative costs to the ACCC from monitoring would continue to apply.

Option D – Impose a regulatory regime with deemed declaration of aeronautical services and potential compulsory arbitration by the ACCC.

Economic benefits

The economic benefits of this approach are uncertain. In its submission to the PC Inquiry, the ACCC claims that the threat of arbitration would create an incentive for all parties, including parties who might otherwise misuse market power, to negotiate fair and reasonable terms.[20] It could also be argued that this approach benefits from relatively low regulatory compliance costs. However, this would depend heavily on the proportion of cases in which commercial agreement is reached and the extent to which arbitration increases the costs for airports and airlines in the event that commercial agreement cannot be reached.

However, there are many other key factors which would offset any benefits derived from this approach (see below).

[20] ACCC (2011a) Submission 3 to the Productivity Commission p 23

Currently, the right to an arbitrated outcome may be achieved through the existing Part IIIA process if an airport user decides to seek the declaration of an aeronautical service.

Economic costs

The PC warns that a readily accessible airport-specific arbitration mechanism by the ACCC could reduce the incentive for parties to commercially negotiate in good faith.[21] Access seekers could view the arbitration mechanism as a default option, leading to unnecessarily heavy-handed determination of aeronautical prices. This would likely reduce the economic efficiency benefits that would accrue from commercially negotiated outcomes. In the PC's view:

> "*Having moved to commercially-focussed negotiations with at least some form of constructive engagement, it would seem retrograde to allow a reintroduction of heavy-handed regulation that could displace commercial negotiations and encourage gaming*".[22]

Deemed declaration would give access seekers a right to arbitrate commercial terms, which can be a substantial intrusion on the property rights of the aeronautical services provider. It is for this reason that the National Access Regime under Part IIIA includes processes and criteria to ensure that access decisions are not made hastily, and are only made where it is in the national interest to do so.

Deemed declaration would effectively remove the right of an aeronautical services provider to appeal a decision to impose access. One of the key risks of imposing regulated access rights where the criteria for declaration in Part IIIA are not satisfied is that it may undermine incentives for investment, such that it may be contrary to national interest. Given the economy-wide application of Part IIIA, this risk extends to all firms contemplating investment in nationally significant infrastructure, not just those contemplating investment in aeronautical services.

In its submission to the PC inquiry, the NCC expressed concern about bypassing the assessments and declaration criteria of the usual Part IIIA processes, and noted that a deemed declaration may not lead to the promotion of effective competition.[23]

A further concern about this approach is that it would encourage parties to use methodologies that they believe will be acceptable to the ACCC in the event that a negotiation process went to arbitration. The ACCC, airports and airlines could accrue significant administrative costs in preparing information and assessing the reasonableness of methodologies. This would lead to the ACCC being the key determiner of commercial outcomes – which could impose significant economic inefficiencies and costs on the sector.

Identify the data sources and assumptions used in making these assessments, and any gaps in data.

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[21] Productivity Commission (2011) p 202-203
[22] Productivity Commission (2011): p.203.
[23] National Competition Council (2011) Submission 21 to the Productivity Commission pps. 15-16

Data Sources

Adelaide Airport (2011) Submission 12 to the Productivity Commission Inquiry

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5 CONSULTATION

Who are the main affected parties? Who has been consulted? What are their views?

The main affected parties are the major airports and their customers. During the course of the PC Inquiry, the major parties have been consulted individually, in round tables and in public hearings, and have lodged written submissions.

Specifically, the airport operators consulted were the Australian Airports Association, Sydney Airport Corporation Limited, Melbourne Airport, Adelaide Airport Limited, Brisbane Airport Corporation, Canberra International Airport, Hobart International Airport, Northern Territory Airports Pty Ltd, and Westralia Airports Corporation (operators of Perth Airport).

The customers (and their representatives) who provided submissions include the Regional Aviation Association of Australia, the Board of Airline Representatives of Australia Inc, International Air Transport Association, Qantas Limited, Virgin Blue Airlines, Australian Business Aircraft Association, Overnight Airfreight Operators Association, and ground transport operators including the Australian Taxi Industry Association, the Bus Industry Federation of Australia and Airport Link Company.

There are contradictory views about the performance of the light-handed regulatory regime for airports. The major airports and the investors behind the airports believe the system has helped to ensure good investment outcomes to meet the growth in demand for air travel, and are generally in favour of a continuation of the light-handed regime or even lesser economic regulation. The airports' customers expressed a variety of views, but generally thought that the system favoured airports because of their market power and the lack of countervailing power from airlines and other customers. Some thought that the declaration process available under Part IIIA of the CCA was too lengthy and costly to be effective.

The ACCC considered that a system based on the threat of external arbitration if commercial agreements could not be made (the 'deemed declaration' approach) is preferable to continued monitoring, which it believes is not effective in curbing anti-competitive behaviour by airports. The NCC warned that a deemed declaration increased the risk of regulatory error through bypassing the independent assessment against the declaration criteria set out in the CCA, and also noted that the time frame for a declaration application had been shortened through amendments to the legislation.[24]

Ground transport operators are generally critical of the fees charged by airports for access to the airport. Some taxi operators felt that fees did not reflect the cost of services and facilities provided and would like to see greater transparency in the way fees are set. Other taxi companies appreciated the upgraded facilities such fees have produced. Private car hire companies in Melbourne consider access fees are too high and sought to return to the conditions enjoyed before privatisation.

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[24] National Competition Council (2011) *Economic Regulation of Air Services: Submission to the Productivity Commission Inquiry*. 8 April 2011

How have stakeholders' views been taken into account? What was the consultation process?

The Government Response that is the subject of this RIS is a response to a twelve month PC public inquiry undertaken from December 2010. As required by the inquiry's terms of reference, and in line with its normal inquiry procedures, the PC encouraged maximum public participation to obtain views on the current airport price regulatory regime. It placed advertisements in the national press and sent a circular to a range of individuals and organisations thought likely to have an interest in the inquiry.

The PC's consultation process included:

- An Issues Paper released in January 2011;
- An airlines roundtable held on 30 June 2011;
- An airports roundtable held on 21 July 2011;
- A draft Report released on 22 August 2011;
- An investor roundtable on 1 September 2011;
- Public hearings in Melbourne and Canberra on 5-7 October 2011; and
- An arbitration roundtable held on 28 October 2011.

In addition, it held informal discussions with all eight Australian capital city airports, the two major domestic airlines (Qantas and Virgin Australia), Rex (a regional airline), the Regional Aviation Association of Australia (representing regional airlines), the Board of Airline Representatives of Australia (representing international airlines operating to and from Australia), the Australian Business Aircraft Association and a number of Government agencies, such as the ACCC, Australian Treasury and the Commonwealth Department of Infrastructure and Transport, as well as several state government departments.

Independently, the Department of Infrastructure and Transport's Airport Economic Regulation Taskforce and senior executives met with key stakeholders during the course of the Inquiry. These included major airports and airlines, industry groups, the ACCC and the NCC as well as the PC. Departmental officers were present at all public hearings and presented a submission to the Canberra hearings.

Following the release of the Issues Paper, 82 submissions were received. A further 60 submission followed the issue of the Draft Report in August 2011 (See **Attachment A**). The submissions came from a wide range of interest groups, including a number of internationally recognised academics.

In February 2012 the Department of Infrastructure and Transport convened an inter-Departmental meeting to discuss the proposed response and to gain agency views on it. The agencies supported the response. Minister Albanese has also written to relevant Ministers seeking their views on the proposed response. All Ministers supported the approach.

Where consultation was limited or not undertaken, why was full consultation inappropriate?

Not applicable.

6 CONCLUSION AND RECOMMENDED OPTION

What is the preferred option? Why is this option preferred and others rejected?

Option C is the preferred option.

In light of the divergence of views of the major stakeholders about the effectiveness of the current regulatory system, it is prudent to conclude that while there does not appear to be excessive price outcomes, airports retain sufficient market power to be of policy concern, and a case remains to continue an economic regulation regime.

This means it is premature to abandon any form of airport-specific regulation and rely only on the National Access Regime (Part IIIA) and the economy wide anti-competitive conduct provisions (Part IV) of the CCA (Option A) while commercial relationships between airports and their customers are still developing and maturing.

On the other hand, international benchmarking indicates that the current regulatory system has resulted in reasonable outcomes in terms of prices and service levels and that Australian airports have higher staff productivity and lower costs per passenger than overseas counterparts.[25]

This outcome does not support the more heavy-handed regulatory approach of deemed declaration and the threat of compulsory arbitration by the ACCC (Option D). This could reduce the incentive of parties to negotiate in good faith, undermining the government's objective of encouraging the development of commercial relationships. This option also has unpredictable and potentially high costs, while the monitoring regime under Options B and C has relatively predictable and low compliance costs and is more in keeping with the objective of cost effective economic regulation. Finally, the uncertainty of outcomes under Option D could deter investors who prefer long term certainty about prices in order to justify the large investments at major airports.

Option C, the preferred option, offers a number of improvements to the system over the status quo (Option B) and can address some of the ACCC concerns about the monitoring process. Publishing a draft monitoring report will mean that airports would be able to provide additional information to support their activities should the ACCC express concerns, and some airport access charges will be more transparent. These measures would help provide public confidence in the operations of the airports. It is important to note that since the ACCC is an independent statutory authority, ultimately the decision to implement a number of the proposed enhancements is a matter for the ACCC.

When compared to airport price regulation regimes in other countries, Option C is considerably more light-handed than the approaches adopted in most other OECD countries (for example, a price cap or rate-of-return regulation applies in the United Kingdom, Ireland, the Netherlands, Austria, and Germany), with only New Zealand

[25] Leigh Fisher Management Consultants (2011) 2011 Airport Performance Indicators. August 2011 pps 161-164.

adopting a similar light-handed approach which does not involve monitoring but has extensive reporting requirements.

Option C meets all of the objectives of the necessary government action outlined earlier. It is cost effective, does not hinder the development of commercial relationships, and as it is similar to the present regime. Since it would continue monitoring for a further 7 years, it provides the regulatory certainty required by investors to maintain infrastructure development at Australia's major airports.

7 IMPLEMENTATION AND REVIEW

How will the preferred option be implemented?

To ensure a smooth transition to the new arrangements, the preferred option will be implemented in consultation with key stakeholders, namely the regulated airports, airlines and the ACCC. For example, the ACCC will be consulted to seek its consideration of the PC's recommendations around publishing a draft report and seeking additional information from airlines if required. There will also be administrative changes such as new Directions under Part VIIA of the CCA and amendments to Airports Regulations that will be carried forward by the Department of Infrastructure and Transport and the Treasury.

Is the preferred option clear, consistent, comprehensible and accessible to users?

The airports proposed to be subject to this regulatory regime currently operate with similar compliance requirements and have expressed their satisfaction with its clarity, consistency and general operation. In their submissions to the PC and in discussions with the Department of Infrastructure and Transport, several airports indicated that much of the information currently reported to the ACCC under price monitoring is also collected for internal planning and financial management purposes.

Is the preferred option sufficiently flexible to adapt to various situations and circumstances?

Yes, the preferred option is a light-handed approach and is sufficiently flexible to adapt to various situations as compliance is relatively undemanding and is familiar to stakeholders, who will be able to use existing compliance mechanisms. It also provides for a credible threat of a regulatory response in instances where an airport is shown to be misusing its market power.

How will the preferred option interact with existing regulation of the sector?

The airports sector is highly regulated in its various operations due to its significant safety and security dimensions. It is not considered that the arrangements regarding price regulation will interfere with these regulations. While Sydney Airport is also subject to specific arrangements regarding regional airlines' access (regional 'ring fencing' and price notification), these arrangements will be treated separately to the price monitoring regime.

What is the impact on business, including small business, and how will compliance and paper burden costs be minimised?

The compliance and paper burden costs would only affect airport operators and the ACCC — based partly on the views of the airports as noted in their submissions — it is concluded that these requirements are overall relatively low.

How will the effectiveness of the preferred option be assessed? How frequently? Is there a built-in provision to review or revoke the regulation after it has been in place for a certain length of time?

The new monitoring regime would end after seven years of operation, from 1 July 2013 ending on 30 June 2020.

The regime will be subject to a major independent review in 2018, with the Government reserving the right to bring the review forward if there is pervasive evidence of unjustifiable price increases, or other misuses of market power, at the price monitored airports.

Attachment A

Productivity Commission Inquiry into the Economic Regulation of Airport Services 2011

Submissions received by the Inquiry

Submissions are available on the Inquiry website <http://www.pc.gov.au/projects/inquiry/airport-regulation/submissions>

Submission

Commonwealth Government

Airservices Australia

Australian Competition and Consumer Commission

Department of Infrastructure and Transport

National Competition Council

Swedish Transportation Agency

Bureau of Meteorology

Airports

Australian Airports Association

Adelaide Airport Limited

Adelaide Airport Consultative Committee - Planning Coordination Forum

Avalon Airport Pty Ltd

Brisbane Airport Corporation Pty Limited

Canberra Airport

Darwin International Airport

Hobart International Airport

Melbourne Airport

Mildura Airport

Newcastle Airport Limited

North Queensland Airports

Perth Airport (Westralia Airports Corporation)

Queensland Airports Limited

Sydney Airport Corporation Limited

Sydney Airport Community Forum

Airlines

Board of Airline Representatives of Australia (BARA)

International Air Transport Association (IATA)

National Business Aviation Association

Regional Aviation Association of Australia (RAAA)

Regional Express (Rex)

QANTAS

Virgin Blue Airlines

Submission

State and Local Governments (cont)

Australian Local Government Association

Australian Mayoral Aviation Council (AMAC)

Council of Capital City Lord Mayors

Industry

Australian Logistics Council

Australian Services Union

Infrastructure Partnerships Australia

National Public Lobby

Overnight Airfreight Operators Association

RRB Economics

South Australian Freight Council

Sydney Business Chamber

Toll Group

Tourism and Transport Forum

United Voice

Universal Weather and Aviation Inc.

Village Building Company Limited

Transport Industry

Aerial Capital Group Limited

Airport Link Company Pty Ltd

Andrew's Airport Parking – Brisbane Airport

Andrew's Airport Parking – Melbourne Airport

Australian Taxi Industry Association

Barton Chauffeurs, Specialised Security Transport Pty Ltd and Omega Chauffeur Cars

Brisbane Airport Bicycle User Group

Bus Industry Confederation of Australia

EcoTransit Sydney

Hertz, Europcar, Thrifty, Avis and Budget

New South Wales Taxi Council Limited

SkyBus

TransAv (Margaret Arblaster)

Submission
Combined submission - Qantas, Virgin Blue, RAAA and BARA
Australian Business Aircraft Association
International Business Aviation Council (Canada)
State and Local Governments
ACT Chief Minister
Northern Territory Government
Government of South Australia
Government of Victoria
Brisbane City Council
Darwin City Council
City of Greater Geraldton
City of Melville
City of South Perth
City of Sydney
Parkes Shire Council
Perth Airports Municipalities Group Inc
Shire of Kalamunda
Queanbeyan City Council
South West Group

Submission
Academic
Dr Darryl Biggar
Professor Peter Forsyth and Professor Hans-Martin Niemeier
David Starkie
Stephen Littlechild
Financiers
Colonial First State Global Asset Management
Hastings Funds Management Limited
Industry Funds Management Pty Limited
QIC Limited
MAp Airports Limited
Individual
Norman Geschke
Tony Horneman
Keith McLaughlin
William Tyrrell
Eric Wilson
Tim Wilson-Brown