



Australian
Competition &
Consumer
Commission

Submission to the Productivity Commission's inquiry into the economic regulation of airport services

March 2011



© Commonwealth of Australia 2011

This work is copyright. Apart from any use permitted by the *Copyright Act 1968*, no part may be reproduced without permission of the Australian Competition and Consumer Commission. Requests and inquiries concerning reproduction and rights should be addressed to the Director Publishing, Australian Competition and Consumer Commission, GPO Box 3131, Canberra ACT 2601 or by email to publishing.unit@accc.gov.au.

Key points

- The airports monitoring regime has enabled the ACCC to identify trends that indicate the exercise of market power by some of the major airports.
- Monitoring, however does not present an effective constraint on airports setting monopoly prices for aeronautical services and car parking.
 - Some airlines do not have effective countervailing power in negotiations with the major airports. Further, airlines face considerable costs, time and uncertainty seeking declaration under Part IIIA of the *Competition and Consumer Act 2010* to constrain airports' behaviour.
 - The airports control access to landside facilities, and can discourage competition to on-airport car parking.
- The ACCC considers that the risks of the major airports exercising market power warrant a regulatory response. Part IIIA offers regulatory options that appropriately address the risks, recognising that market power varies across airports, and within airports, in the provision of aeronautical and landside services.
- Deemed declaration of aeronautical services under Part IIIA would provide airlines with countervailing power where necessary, and facilitate the development of commercial relationships.
 - Airports and airlines would be free to reach commercial agreements. However, airlines could credibly threaten to raise a dispute if an airport attempted to set prices substantially above those likely to be determined by the ACCC.
 - Declaration is appropriate for aeronautical services as there is a history of airlines negotiating with airports, relatively small numbers of airlines, and vertical separation of the airport and airline businesses.
- For those airports with significant market power in landside vehicle services, mandatory Part IIIA access undertakings would allow transport operators, as alternatives to on-airport car parking, to access an airport on reasonable terms.
 - Undertakings are appropriate for landside services as the history of commercial negotiations is not as long as for aeronautical services, there are many businesses, and many of those are small and may lack resources to negotiate with an airport. Airports are also vertically integrated with car parking.
- Location rents are linked to the scarcity of land and monopoly rents are additional returns that can be extracted through the use of market power. The distribution of location rents does not necessarily affect economic welfare. However, monopoly behaviour could lead to a loss of consumption and discourage the use of alternatives to on-airport car parking.
- The Master Plan process could have regard to the adequacy of investment in on-airport car parking facilities to deter airports from withholding supply.

1 Introduction

The Productivity Commission's (PC's) 2002 review of price regulation of airport services, found that some of the major airports—Brisbane, Melbourne, Perth and Sydney—possess substantial market power.¹ Although some of these airports may face competition at the margin from secondary airports, it is assumed that the largest airports are essentially monopoly service providers. Since the PC's review, some systematic deficiencies in the current regulatory arrangements have become clear.

Moreover, the airport regulatory regime, which is based on airport monitoring and the general provisions of Part IIIA of the *Competition and Consumer Act 2010*, does not create an effective constraint on the major airports' market power. While monitoring has revealed some trends that suggest some airports are exercising market power, it is limited in its scope to constrain airports' exercise of market power (section 2).

Monopoly behaviour by the major airports in the provision of aeronautical services can lead to a loss of economic welfare, which could reduce living standards of members of the community (section 3). The airports could also use their market power to discourage competition in the downstream market for landside access, in which airports offer car parking services (section 4).

In light of the costs and expected benefits of continued monitoring, there is a need to consider alternative arrangements that respond appropriately to the identified risks. The Australian Competition and Consumer Commission (ACCC) considers that Part IIIA provides effective 'fit-for-purpose' regulatory tools for constraining that market power and promoting commercially negotiated outcomes once a service has been declared (section 5). Specifically, the Australian Government could deem aeronautical services to be declared, thereby enabling airports and airlines to carry on 'business as usual', but with the threat of ACCC arbitration in the case of a dispute.

In recognition of the specific characteristics of the market for landside vehicle access services, major airports could be required to submit access undertakings. This approach represents a relatively light-handed yet effective check on airports' market power, while providing certainty for airports and users in the longer term.

2 What is the problem?

At the time the Federal Airports Corporation airports were privatised from 1997, price regulation and quality service monitoring were implemented for capital city and certain regional airports in recognition of the market power held by those airports, and the potential for exercise of that power.

In 2002 following a recommendation by the PC, the price caps were removed and a monitoring regime put in place. The ACCC was tasked with implementing the regime, and has each year produced monitoring reports. The reports currently monitor prices, financial

¹ Productivity Commission, *Price regulation of airport services*, report no. 19, Canberra, January 2002, p. 134.

performance, and quality of aeronautical and car parking services at five of Australia's major airports.

The Government's intention in adopting the monitoring regime was twofold: to enhance market transparency to assist the competitive process without the need for heavy-handed controls, and to inform the Government as to whether further price regulation or re-regulation was required.² Although monitoring has gone some way to identifying issues related to the exercise of market power by airports, it has not facilitated the competitive process.

With regards to assisting the competitive process, monitoring has limitations in its scope to correct market failure when the causes extend beyond information asymmetry. If airport users do not have sufficient countervailing power, information in itself will not be effective in influencing the behaviour of those airports with market power. The monitoring experience has indicated that airport users have insufficient countervailing power to influence behaviour of the major airports.

To illustrate, the monitoring results indicate that, over several years (including the most recent year), the quality of service provided to airlines by Sydney Airport has remained less than satisfactory on average, while over the same period, the airport's average prices and profitability for those services have continued to increase.³ In their survey responses, airlines have consistently identified Sydney Airport as the least responsive of the airports with respect to service delivery and quality over a sustained period of time.⁴ This lends support to the notion that airlines have been unable to negotiate an acceptable level of service with Sydney Airport, despite paying higher prices. The other airports were rated satisfactory by the airlines on average over the last five years, although Perth Airport received a rating of poor in 2007-08 and 2009-10.⁵

In relation to the insights to airports' behaviour that the monitoring regime was expected to generate, the ACCC has found that it has been helpful in identifying trends in pricing and quality of service provision that constitute areas of concern. Broadly, it has been observed that prices and airports' profitability have increased over the period in which monitoring has been in place, while quality service monitoring has not revealed decisive increases in customer ratings (box 2.1). That said, there are limitations to the degree of conclusiveness of evidence that the current monitoring regime can be expected to provide in relation to the exercise of market power. The ACCC considers that further rounds of monitoring are unlikely to provide greater clarity or certainty in this respect.

² Anderson, J. (Minister for Transport and Regional Services) and Costello, P (Treasurer), 2002, Productivity Commission Report on Airport Price Regulation, Joint Press Release no.24, 13 May.

³ ACCC, *Airport monitoring report 2009-10*, January 2011, p. 47.

⁴ *ibid*, p. x.

⁵ *ibid*, p. 36.

Box 2.1 Findings of the ACCC's monitoring data

From 1 July 2002, price caps ceased to apply. Results are presented using 2001-02 as the base year to show outcomes under the monitoring regime.

The most recent airport monitoring report released by the ACCC incorporates data up to 2009-10. Results to that date show that between 2001-02 and 2009-10:

Price monitoring

- There has been an upward trend in passenger numbers at all of the airports.
 - Increases in passenger numbers over this period were between 43.5 per cent (Sydney Airport) and 116.5 per cent (Perth Airport). Sydney Airport had the highest number of passengers over the whole period (at 34.9 million in 2009-10).
- There has been a strong upward trend in aeronautical revenue per passenger (a proxy for average prices).
 - Increases in aeronautical revenue per passenger between 2001-02 and 2009-10 were between 49 per cent (Sydney Airport) and 332 per cent (Adelaide Airport), with the second highest increase being 154 per cent at Brisbane Airport. Despite having the lowest percentage increase, Sydney Airport had the highest aeronautical revenue per passenger over this period (at \$14.03 in 2009-10).
 - Importantly, in early 2001, the ACCC approved significant price increases at Sydney airport. Those prices were intended to recover the costs of providing aeronautical services at the airport. The effect of the increases was a 71 per cent increase in Sydney Airport's aeronautical revenue per passenger from 2000-01 to 2001-02. There has been no similar review of price levels and aeronautical costs at the other monitored airports.
 - It should also be noted that a significant proportion of Adelaide Airport's increase occurred following the opening of its new terminal and the introduction of charges associated with the recovery of its costs.
- The upward trends in passenger numbers and aeronautical revenue per passenger are reflected in increases in total aeronautical revenue of between 114 per cent (Sydney Airport) and 639 per cent (Adelaide Airport). The second highest increase was 327 per cent at Perth Airport.
- Aeronautical operating expenses per passenger increased by a lesser extent than revenues, reflecting increases in passenger numbers while costs remained to a large extent fixed.
 - Increases in aeronautical operating expenses per passenger over the whole period were between 18.7 per cent (Sydney Airport) and 86.7 per cent (Adelaide Airport). The second highest increase was 48.5 per cent at Brisbane Airport.
- These results contributed to strong upward trends in aeronautical operating margin per passenger at all airports. In 2009-10, margins ranged from \$3.29 (Perth Airport) to \$6.26 (Sydney Airport).
- Measures of rates of return across the airports do not provide economically meaningful information about the airports' profitability.

continued ...

Box 2.1 Findings of the ACCC's monitoring data (cont'd)

- The airports' approaches to valuing their aeronautical asset bases have differed. For example, Brisbane and Sydney airports' assets were valued at \$1.3 billion and \$2.6 billion respectively in 2009-10. Melbourne Airport's assets were valued at \$833 million, while Adelaide and Perth airports' assets were at \$373.3 million and \$279.7 million respectively in 2009-10.
- The airports' asset values are based on accounting data and the airports have a significant amount of discretion in valuing their assets for monitoring purposes.
- With the exception of Sydney Airport, a detailed review of the valuation of the airports' asset bases for regulatory purposes has not been undertaken.
- Sydney Airport's asset base was reviewed by the ACCC in 2001. Note, however, that the airport's asset base may include revaluations made by the airport since that time, which the ACCC has not assessed.

Quality of service monitoring

- On a rating scale ranging from very poor to excellent, the overall ratings of the airports were largely satisfactory.
 - Brisbane Airport was the only airport to achieve an overall rating of good over the whole period.
- Passengers consistently rated the airports as good or satisfactory, however the airlines and border agencies also provide services that can influence passengers' perceptions.
- Airlines' ratings of the airports' services were, on average, lower than passengers' over the same period.
 - Adelaide, Brisbane and Melbourne airports were consistently rated as satisfactory while Perth and Sydney airports both achieved ratings of below satisfactory.
- Border agency ratings ranged between poor and good.

In sum, the ACCC considers that the benefits of continued monitoring are unlikely to outweigh the costs. Although monitoring has played a role in problem identification, it is ineffective as a tool to address the problems it identifies. In recognition of the costs it imposes, there is little justification for its continuation. Indeed a continuation of monitoring might represent an unnecessary regulatory burden on airport businesses.

The ACCC would also conclude, on the basis of its monitoring experience, that there is little justification for a return to price controls. However, the existence of market power and the risks of associated inefficiencies remain. There is greater justification, instead, to look to regulatory arrangements that respond appropriately to the risks that have been identified, and can facilitate market based outcomes.

2.1 Market power is likely to vary across airports and services

Potential risks associated with the exercise of market power do not apply uniformly to all the major airports. Many factors, including geographical location and the characteristics of demand will influence the degree of market power held by any individual airport. This is relevant from the perspective that an appropriate regulatory solution would provide consistency and certainty to all airports, but at the same time apply only where needed.

Similarly, the ACCC considers that each of the major airports is likely to hold differing degrees of market power in the provision of aeronautical⁶ and landside services due to their distinct market characteristics.

Airlines, as customers of aeronautical services, will have relatively greater degree of negotiating power with airports than customers of landside facilities (that is, users of on-airport car parking and providers of alternative transport services or off-airport car parking). Airlines are comparatively larger customers, there are fewer of them, and they have demonstrated the ability to coordinate as an industry. They are typically experienced in negotiating with airports, and have a greater understanding of airports' costs for providing the various aeronautical services. Further, the airports are not integrated with the airline business.

By comparison, users of landside services, tend to be smaller and more fragmented, with less negotiating power (although it is possible that off-airport car parking operators, for example, could collectively negotiate with airports). Importantly, unlike (particularly international) airlines, they have less scope to use alternative airports. Finally, the airports are vertically integrated with landside services through their car parking businesses.

The PC undertook a comprehensive analysis of the risks and potential outcomes of the exercise of market power by the major Australian airports as part of its review of the price regulation arrangements for airports in 2002. It found that the existing price regulation arrangements were no longer required, and that airport prices should be monitored for a period of five years. In 2006, the PC reported mixed results. It found that it was too early to fully judge the effectiveness of the light-handed approach, and a continuation of monitoring regime for a further period was preferable to a return to the stricter price controls.

The ACCC considers the current review a timely opportunity to revisit the fundamental issues and risks relating to airports markets, given the benefit of the experience of these markets over time, and taking account of any changes that may have taken place. These are discussed separately for aeronautical services and car parking in sections 3 and 4 respectively. In recognition that the markets for these services have different characteristics and face different risks, the ACCC has considered the appropriate regulatory responses for each.

3 Risks associated with market power in the provision of aeronautical services

The major airports have a significant degree of market power in the provision of aeronautical services because of high barriers to entry, inelastic demand and users generally having limited alternatives. The ACCC recognises that the existence of market

⁶ Aeronautical services include aircraft-related services (such as runways, taxiways, aprons and aircraft parking) and passenger-related services (such as public areas in terminals, departure and holding lounges, aerobridges and check-in counters). The demand for aeronautical services provided by an airport is derived from the demand for airline services, which is driven by demand for air travel. Airports provide intermediate services that are essential to downstream service provision.

power is not, of itself, sufficient justification for economic regulation. The principal rationale for regulation of airport services is the exercise of market power and the associated inefficiencies that can result.⁷

It is the ACCC's view that not all airlines have countervailing power in negotiations with the major airports sufficient to constrain any exercise of market power. In addition, the general provisions of Part IIIA do not present an effective constraint on the behaviour of the airports given the considerable time, costs and uncertainty faced by airlines seeking declaration.⁸

A discussion of the risks associated with airports' exercise of market power is in section 3.1. The ACCC has also examined the effectiveness of regulatory tools available to the Government, including the application of Part IIIA in section 3.2.

3.1 Efficiency effects and equity concerns

Monopoly behaviour by an airport could involve efficiency losses (section 3.1.1) and income transfers, which are of concern to Governments and the community (section 3.1.2). Although air travel may be insensitive to changes in aeronautical prices overall, it is still possible that the community will be significantly worse off as a result of the airports exercising their market power (section 3.1.3).

3.1.1 Inefficient outcomes

A monopoly does not have an incentive to set prices at an efficient level because there is no competitive discipline on the firm's decisions. A monopolist does not need to consider how and whether or not other firms will respond to its prices. The firm's profits depend only on the behaviour of consumers, its cost function, and its prices or the amount supplied. This classic economic model of monopoly behaviour can be applied to the major airports.

An unconstrained airport can be expected to set excessive aeronautical charges, and the airport may deliver lower levels of quality, and delay investment. Also, an airport operator may undertake unproductive activities due to a lack of external pressures on the business (so-called X-inefficiency), and rent seeking behaviour. Finally, airlines may be reluctant to undertake sunk investments for fear of opportunistic behaviour by the airports.

These outcomes are not expected to occur in a competitive environment. Although somewhat abstract, competitive-market outcomes provide a useful efficiency benchmark against which the airports' behaviour can be compared. Competition generally places downward pressure on prices and can act as an impetus for cost reductions and quality

⁷ In this submission, an exercise of market power refers to the ability of a firm to profitably raise its prices above efficient long-run costs for a sustained period. The following analysis was not undertaken to assess conduct against the prohibition on 'misuse of market power' under s. 46 of the Competition and Consumer Act. Section 46 prohibits a firm from taking advantage of its market power (in that or any other market) for the purpose of: eliminating or substantially damaging a competitor, preventing entry, and deterring or preventing competitive conduct.

⁸ ACCC, *Airport monitoring report 2008-09*, March 2010, p. 39.

improvements. Also, a rise in prices above long-run costs—including ‘normal’ profits—will signal the opportunity for profitable investment.

Excessive aeronautical prices

To achieve persistently higher than normal profits for a significant period of time, it is expected that an airport would set prices for aeronautical services above the full cost of their provision. If demand is inelastic (that is, the response of quantity demanded to a price change is weak), the additional revenue gained by an increase in airport charges would more than offset any reduction in demand caused by increased costs to travellers.

This outcome could create so-called monopoly deadweight losses if the use of aeronautical services is below that which could be expected in a competitive market. In this situation, there are ‘units of output’ not being supplied for which the opportunity cost of supply is less than a user’s willingness to pay. This is not efficient as additional supply would confer greater benefits on users than the cost of its provision.

The significance of this efficiency loss will depend on a given airport’s cost structure, and the price responsiveness of demand. Assuming the airport does not price discriminate, the optimal price mark-up over cost will be inversely related to the price elasticity of demand.⁹

The PC previously found that the main market segments are likely to have relatively inelastic demand at the major airports.¹⁰ While this might suggest that any deadweight losses associated with monopoly pricing will be low (as most consumers will continue to use the services, albeit at higher prices), there is no simple relationship between elasticity of demand and the size of the deadweight loss. The PC found that, in order to make an assessment of likely efficiency losses from pricing consistent with market power, knowledge is required about the shape and slope of the demand curve.¹¹ For instance, elasticity of demand reflects the shape of the demand curve at a given price (and can therefore vary at different price levels), whereas the size of the deadweight loss depends on the shape of the demand curve over a region up to the efficient price and quantity.

The growth of ‘budget’ domestic air travel in recent years suggests that the market may have expanded to include demand that is more sensitive to the price of air travel. For example, Tiger Airways began domestic operations in Australia in late 2007 and has since expanded both in its aircraft fleet size and destination count. Higher prices for these travellers may influence their decisions to use alternatives to air travel, or indeed whether to travel.

⁹ Productivity Commission, *Price regulation of airport services*, report no. 19, Canberra, January 2002, p. 83.

¹⁰ Productivity Commission, *Review of price regulation of airport services*, report no. 40, Canberra, December 2006, p. 29.

¹¹ Productivity Commission, *Price regulation of airport services*, report no. 19, Canberra, January 2002, p. 83.

The ACCC considers it would be worthwhile for the PC's assessment to take account of the efficiency implications of airports overcharging in light of any changes in composition of the market for air travel since the previous review.

Reduced service quality and delayed investment

It is expected that a firm that faces competition would be less likely to reduce its quality below the socially efficient level without a compensating reduction in price for fear of losing existing customers to rivals. Of course, most airlines cannot make the credible threat to either switch to a competitor or suspend flights.

Lower levels of service quality could reflect cost-saving measures—such as reduced staff or inadequate maintenance—and/or a lack of investment. Over time, an airport may delay investment in order to maintain artificial scarcity and maximise profits.

The efficient level of quality is at the point where the incremental surplus that users derive from additional quality is just offset by the extra cost of increasing quality further.¹² If an airport reduces service quality to a level where average willingness to pay per 'unit of quality'—that is, the marginal benefit of consumption—exceeds marginal cost, there is a loss of consumer welfare.

An airport will not necessarily have an incentive to deliver less than the welfare-maximising level of quality. The airport's main incentive would be to increase quality up to the point where the incremental revenue from doing so just equals the incremental cost.¹³ In this sense, if user demand is more sensitive to changes in prices relative to quality and an airport can charge only a single price, the airport could have a stronger incentive to reduce quality to increase its profits. This may result in quality being under-supplied relative to what it might be in a competitive environment.

That said, to the extent that the airport can discriminate in pricing or differentiate services for different users, the incentive to delay investment or to allow quality to deteriorate will be weakened.

However, this exception does not seem to hold for the major airports. First, as found by the PC, price discrimination is rarely used by airports, either on the basis of airport user characteristics or on the basis of time of day.¹⁴ Second, the ACCC observes that the airports do not typically offer different users a choice on quality levels for individual services within the total 'bundle' of aeronautical services.¹⁵ This is consistent with anecdotal evidence that suggests airport operators usually offer access to airport services

¹² D Sappington, 'Regulating service quality: a survey', *Journal of Regulatory Economics*, vol. 27, no. 2, 2005, pp. 123–154.

¹³ At this point the marginal effect on the monopoly's profits is exactly zero and there are no profit gains available from improvements in quality.

¹⁴ Productivity Commission, *Review of price regulation of airport services*, report no. 40, Canberra, December 2006, p. 16.

¹⁵ ACCC, *Airport monitoring report 2008-09*, March 2010, p. 21.

as a set package, and that airlines frequently insist on ‘terms no less favourable’ than those offered to competitors.¹⁶

In particular, an airport may have an incentive to undersupply quality for common-user services¹⁷ for which airlines have distinct quality preferences.¹⁸ An airport has the incentive to cater to the specific needs of user airlines that are deciding at the margin whether or not to purchase the airport’s services. To the extent that the average valuation of quality by all user airlines is higher than the marginal valuation of quality by the marginal users of a common-user service, an airport will potentially have the incentive to supply a lower level of quality. The socially efficient level of quality equates the marginal cost of quality and the average valuation of quality by all users.¹⁹

Therefore, it is the view of the ACCC that the airports with significant market power could have an incentive to delay investment and to allow quality to deteriorate in order to maximise their profits.

The ACCC’s monitoring program found indications that Sydney Airport has increased profits by permitting service-quality levels to fall over a sustained period of time (2002-03 to 2008-09).²⁰ It seems that the timing of Sydney Airport’s upgrade of the international terminal, which was completed in 2010, might have been (inefficiently) delayed, and there was inadequate maintenance before this time.

Specifically, from 2002-03 to 2008-09, the quality of Sydney Airport’s international terminal was rated below satisfactory on average by airlines. Over the same period, average prices and profitability increased significantly. More recently, Sydney Airport announced that it had completed the expansion and upgrade of the departures level of its international terminal in June 2010. However, despite the increased investment in recent periods, the monitoring results do not indicate any significant improvement in quality of service provided to airlines at Sydney Airport’s international terminal. For example, between 2002-03 and 2009-10, the number of check-in desks available to airlines at the international terminal has not increased nor has the capacity of inbound baggage handling

¹⁶ In limited circumstances, an airport may be able to charge an airline for that airline’s preferred level of quality for terminal services, which would be expected to result in an efficient outcome. For example, in late 2007, Melbourne Airport offered the exclusive use of Terminal 4 (which was previously used by Impulse Airlines and Virgin Blue) to Tiger Airways. In coming to an agreement, it is likely that the terminal charges negotiated between the two parties reflect Tiger Airways’ specific quality preferences.

¹⁷ Common-user services include, for example, terminals that are managed by the airport operator and used (potentially) by a number of different airlines. All international terminals at the major airports are common-user terminals, as are some domestic terminals.

¹⁸ ACCC, *Airport monitoring report 2008-09*, March 2010, pp. 21–22.

¹⁹ M Spence, ‘Monopoly, quality, and regulation’, *Bell Journal of Economics*, vol. 6, issue 2, 1975, pp. 417–429.

²⁰ ACCC, *Airport monitoring report 2008-09*, March 2010, p. 40.

systems.²¹ It was also questioned whether this investment largely improved retail operations rather than aeronautical services provided to airlines.²²

Results for the other major airports over the five year period from 2005-06 were mixed with regards to price, quality and investment. For example, Adelaide Airport's quality of service remained stable and aeronautical revenues increased. Brisbane's quality of service remained satisfactory, and it undertook investment at the international terminal. However prices and margins increased significantly. Melbourne Airport's quality of service increased, while increases in prices and margins slowed. Perth Airport's prices and quality remained stable.²³

X-inefficiency and rent seeking

There is commonly a positive relationship between external pressures on a firm and effort by employees. For example, a lack of competition could increase the opportunity for an airport manager to operate inefficiently—for example, by exerting a lower level of effort or procuring excessive 'perks'.

There is also the possibility that an airport will not, as would occur in a competitive market, seek out new ways to improve operations and service quality, preferring instead a 'quiet life' by paying less attention to demands of users. This could result in dynamic efficiency losses, which would have the effect of increasing airport costs over time.

An airport may also incur expenses to acquire and maintain its monopoly position. Rent-seeking expenditures are socially wasteful as resources expended on rent seeking produce monopoly profits and no other socially useful by-product. The airport may be willing to incur costs up to the total value of the targeted rents.

An airport operator could have a strong incentive to engage in rent-seeking activities because of the uncertainty created by the current regulatory regime in terms of the difficulties associated with interpreting the monitoring results (see section 3.2.1 below). For instance, the airport would be expected to lobby the Government to persuade it that the regulatory regime is working effectively, and that the airport's conduct should not be subject to more detailed scrutiny.

Airlines may be reluctant to undertake relationship-specific investments

In most public utility industries, the users and consumers of the monopoly service must make substantial sunk investments that are only of value in their intended use. Airlines regularly undertake relationship-specific investments to extract the most value from an airport's services. For example, this investment could take the form of construction of customised facilities (such as customised terminals or maintenance bases), marketing of

²¹ ACCC, *Airport monitoring report 2009-10*, January 2011, pp. 45-46.

²² *ibid*, p. 47.

²³ *ibid*, pp. 38-42.

services to or from an airport, acquisition of take-off and landing slots, or the establishment of flight schedules, operating procedures and staffing.²⁴

Airlines could be reluctant to undertake relationship-specific investments for fear that, once the investment has been sunk, the airport would be able to expropriate the value of the investment by increasing prices or reducing service quality.

It is expected that an airport would weigh the benefit of expropriation—in the form of short-term profits—against the potential reputational effects of behaving opportunistically. Such a reputation may increase the perceived risk of expropriation by the airport, which could further affect future airline investment. Demand for airport services may subsequently be reduced, which could result in foregone airport profits in the long run.

One way the airlines may seek to reduce this risk is by negotiating long-term contracts. However, it could be difficult to contract against opportunistic behaviour by an airport. High transaction costs could mean that private contracts are incomplete. As discussed by Church and Ware:

Significant transaction costs mean that private contracts will necessarily be incomplete and private contracting will not necessarily be capable of eliminating the potential for opportunistic behaviour. In a world of incomplete contracts, the possibility of opportunistic behaviour gives rise to the following inefficiencies: (i) increased costs of contracting; (ii) costly renegotiation; (iii) resource costs to effect and prevent holdups; (iv) unrealized gains from trade due to inflexibility; (v) second sourcing; and (most importantly) (vi) underinvestment in specific assets.²⁵

Therefore, it is worth noting that the risk that inadequate contractual protection could give rise to under-investment in specialised equipment or knowledge. This could reduce the value of, and lower the demand for, air travel in Australia. This outcome has implications for the efficient use of airport infrastructure over time and, consequently, could result in dynamic efficiency losses.

3.1.2 Equity concerns

The Government has directed the PC to consider the costs and benefits, and distributional effects of the current regime. The ACCC submits that the major airports' market power is not effectively constrained under the current monitoring regime, and that there is the possibility of inefficient outcomes due to monopoly pricing. This is relevant not only from an economic welfare perspective, but also from an equity perspective, as it implies that all users of the airports' services will be paying more than they would otherwise pay in a competitive market. In addition, some user groups will be worse off than others. Such welfare and income distribution outcomes are of concern to the community and to governments, and are therefore important to this discussion.

The ACCC notes that it is relevant to consider changes in the composition of the market for air travel that have occurred in recent years. In particular, there has been growth in the

²⁴ D Biggar, 'Why Regulate Airports? A Re-Examination of the Rationale for Airport Regulation', November 2010, p. 3.

²⁵ J Church and R Ware, *Industrial Organization: A Strategic Approach*, McGraw-Hill, USA, 2000, p. 765.

number of ‘budget travellers’ serviced by low cost carriers. Overcharging for aeronautical services is likely to have a greater impact on this group. It is also likely to have a greater impact on the budget traveller’s decision to travel, and indeed whether to travel by air, than for the main market segments, which are traditionally less sensitive to price. This impact is relevant from both an efficiency and equity perspective.

3.1.3 The ACCC’s view on the appropriate regulatory options for airport services

Any regulatory intervention in the market needs to be carefully considered in terms of its costs and expected benefits, and it should represent a net benefit against all other options, including no intervention. Where the risks of market failure are present, an appropriate regulatory solution would be one which could be utilised on an ‘as needs’ basis to facilitate outcomes similar to those that would be achieved in competitive markets.

In its 2006 report, the PC stated that the consequence of any overcharging for aeronautical services on the efficient level of air travel is likely to be small. The PC found, instead, that the main effect will be a shift in profits between airports and airport users.²⁶ This is consistent with the view that demand for air travel is likely to be insensitive to changes in aeronautical prices overall.

However, there is still a risk that the efficiency effects from airports exercising their market power in the provision of aeronautical services are significant. Airport operators have both the incentive and ability to behave in ways inimical to competitive-market outcomes, as described in section 3.1.1 above. Moreover, higher airport charges could have a sizeable impact on budget travellers’ decision to travel, which seems to have become a larger segment of the market for air travel in more recent years. This also raises equity concerns as budget travellers may be disadvantaged disproportionately by overcharging given differences in income profiles.

The ACCC considers that it is better to guard against the potential for economic losses to the community. That said, the ACCC emphasises the need for a fit-for-purpose response in order to avoid potentially costly regulation that intervenes in airports’ price-setting decisions.

What is the likely impact of access regulation on investment?

Governments and regulators are mindful of the potential impact on investment in applying regulation to infrastructure. Previous PC reports have highlighted the concern that access regulation can lead to inefficient investment because of:

- regulatory risk—uncertainty about how regulation is applied increases the riskiness of investment
- asymmetric truncation—regulators may be tempted to curtail high profits

²⁶ Productivity Commission, *Review of price regulation of airport services*, report no. 40, Canberra, December 2006, p. 29.

- regulatory error—mistakes made in applying regulation.²⁷

As stated by the PC:

... investment impacts are unavoidable if efficient access to essential infrastructure services is to [be] provided. But if access regulation is overly stringent, those impacts will potentially be significant and outweigh the offsetting benefits that appropriately configured access regulation can deliver.²⁸

The potential impact of regulatory risk and asymmetric truncation is not a new issue. The ‘chilling’ effect of access regulation on investment in essential facilities was an important theme discussed by the Hilmer Committee in 1993, and has been argued at length by economists and finance experts. This debate has led to increased sophistication in, for example, the application of the building block model, which can be used to calculate the required revenue to incentivise the firm to invest.

The possibility of inappropriate or poorly-applied regulation is reduced by the ACCC in a number of ways. For example:

- The ACCC is an independent statutory authority, and is subject to public scrutiny and the possibility of independent review.²⁹ For example, provisions for judicial and merits review of regulatory decisions provide an avenue to reconsider regulatory decisions, as well as to provide clarification of the intent and meaning of the regulatory framework.
 - The ACCC is transparent and consistent in its processes and decision making to ensure the regulatory environment is predictable.
- Part IIIA specifically requires the ACCC, in making a final determination for arbitration of an access dispute, to take the legitimate business interests of the provider and the provider’s investment in the facility into account (among other things).

In regard to the concern that regulation is prone to error, the Australian Competition Tribunal recently found against this view:

For our part we see little likelihood of error. Legislation which authorises regulatory intervention for the most has the following features: (a) the decision-maker has relevant expertise; (b) the decision-maker has the means of obtaining the material facts; and (c) the parties have a right to be heard. While the decision-maker does not have a stake in the outcome, other than a desire to arrive at the correct decision, he/she has more information upon which to base his/her decision than the parties.³⁰

²⁷ Productivity Commission, *Review of the Gas Access Regime*, report no. 31, Canberra, June 2004, p. 102.

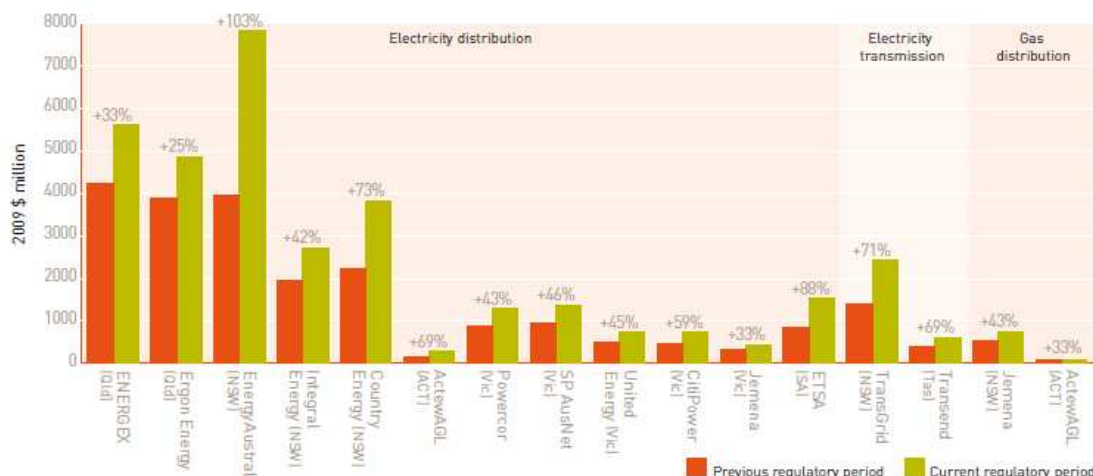
²⁸ Productivity Commission, *Review of price regulation of airport services*, report no. 40, Canberra, December 2006, p. 54.

²⁹ A high level of public accountability encourages regulators to act impartially, with appropriate regard for proper process and within the limits of their authority.

³⁰ Australian Competition Tribunal, *Fortescue Metals Group Limited [2010] ACompT 2*, para. 1290.

Finally, there is evidence that access regulation supports efficient investment outcomes. Under the gas access regime, for example, the ACCC observes that the design and *ex ante* application of regulation substantially mitigates the theoretical concerns regarding investment incentives. Efficient investment has been actively encouraged in regulatory regimes administered by the AER. The AER's recent decisions have enabled significant capital investment in the energy networks (figure 3.1).

Figure 3.1 Energy network investment - AER Determinations since 2009



Source: AER, State of the Energy Market 2010.

On the whole, the ACCC considers that the PC's concerns about more intrusive forms of regulation of airports have tended to overstate its potential costs relative to the social costs that could arise in an unregulated environment.

3.2 What is the appropriate regulatory response?

Market forces should be left to operate if competition is possible or there are significant constraints on market power. However, if no effective constraints on monopoly behaviour exist, regulation that moves a firm's decisions closer to the competitive-market outcome is likely to be the most efficient way to promote good economic performance.

Given the limitations of price monitoring (section 3.2.1) and the uncertainty associated with the declaration process under Part IIIA (section 3.2.2), it is the view of the ACCC that deemed declaration is the most effective option for economic regulation of aeronautical services at the major airports (section 3.2.3). More prescriptive forms of economic regulation would provide greater regulatory certainty for the airports (section 3.2.4), however the ACCC considers that deemed declaration represents an appropriate response given the risks that have been identified to date.

3.2.1 The effectiveness of monitoring

Monitoring can perform a role in problem identification, in that it can provide information on trends in pricing and performance, and service delivery over a period of time, that can inform policy makers about the need or otherwise for further regulation. Under the current

airport monitoring regime, the price monitoring results are based on regulatory accounts prepared under standard accounting principles (box 3.2).³¹

Box 3.2 The ACCC's monitoring methodology

The price and quality of service information in the airport monitoring reports is drawn from a number of different sources, including the monitored airports, airlines and border agencies.

Price monitoring information

- Airports provide annual regulatory accounting statements that include income statements, balance sheets and statements of cash flows. Information on the airports' prices, costs, and asset values is also provided.

Quality of service monitoring information

- Airports provide the results of airport passenger surveys that are conducted by airports in accordance with the requirements of the regulations and ACCC guidelines.
- Airports provide objective data related to the number or size and usage of various airport facilities.
- Airline and border agency surveys are conducted by the ACCC. Responses are reviewed and submitted by the respective head offices to allow for the results to account for commercial negotiations and reduce the potential for bias. The ACCC requires that any ratings of below satisfactory by the survey respondents must be supported with commentary.

Publishing the monitoring information

Quality of service indicators are published in the reports on a service-by-service basis. Indicators include the average ratings given by passengers, airlines, government border agencies, as well as objective data measures. To assist readers' understanding of the ratings, non-confidential commentary by survey respondents is also included.

A range of price monitoring indicators are also published, including (but not limited to) average revenue per passenger (as a proxy for average prices) as well as operating margins and rate of return measures as indicators of profitability.

The monitored airports have an opportunity to comment on their respective sections of the reports to ensure accuracy of the data. The ACCC incorporates these comments into the reports, particularly where they provide a possible explanation for changes in indicators.

continued ...

³¹ This is well established in the economic literature. For example, see: F Fisher and J McGowan, 'On the Misuse of Accounting Rates of Return to Infer Monopoly Profits', *The American Economic Review*, Vol. 73, No. 1, March 1983, pp. 82–97; P Geroski, 'An Applied Econometrician's View of Large Company Performance', *Review of Industrial Organisation*, 13, 1998, pp. 271–293; and J Kapler, 'Measuring economic rate of return on assets', *Review of Industrial Organisation*, Vol. 17, No. 4, 2000, pp. 457–433.

Box 3.2 The ACCC's monitoring methodology (cont'd)

Rating and ranking the airports for quality of service

The quality of service indicators that are published in the reports are aggregated to derive an overall quality of service rating for each of the airports. The airports are then ranked relative to each other based on these ratings.

The ratings and rankings are constructed by compiling information provided by the airports, airlines and border agencies, as described above. The ACCC does not include its own analysis in that process, nor does the ACCC apply any weightings to the information.

The methodology for deriving the airports' overall ratings is applied consistently across all of the airports. The airports' rankings are therefore an indication of their relative quality of service outcomes. The ranking is unlikely to be sensitive to alternative methods of aggregation.

The overall ratings and rankings, along with the price monitoring indicators, provide the ACCC with a means to communicate to users of the monitoring report some general observations about the airports' performance. Importantly, however, the airports' overall ratings and rankings are not used in the ACCC's analysis of the monitoring information in relation to market power.

Interpretation of the monitoring information in relation to market power

Trends in the monitoring information over time can raise questions about an airport's performance. However, the monitoring information cannot be used to conclusively determine whether or not an airport has used its market power to earn monopoly profits.

In its analysis of the airports' market power, the ACCC has specifically examined the relationship between the airports and airlines. It is the airlines that are the direct users of services under the airports' control. Other services use a combination of resources provided by the airports, airlines and border agencies. Therefore, the airline survey results provide the ACCC with an indication of the quality of service for which an airport is responsible.

The airline survey results provide the ACCC with an indication of whether or not an airport has provided quality of service at an efficient level. Consideration of the airline survey results in combination with the airports' price, cost and investment data allows the ACCC to identify where the airports may be earning monopoly profits from services provided to airlines. In making these observations, the monitoring information needs to be considered within the context of the airports' market power.

However, the monitoring information only provides partial indicators about an airport's performance, not conclusive evidence that an airport is earning monopoly profits. For example, comparison of an airport's revenues and profits with the available cost information provides a partial indicator of the 'reasonableness' of the airport's returns. However, because the price monitoring data is largely based on historical accounting information, it may not represent a reliable measure of the efficient long-run costs of providing these services—which is needed to more conclusively determine whether or not an airport is earning monopoly profits.

Monitoring can assist in bringing about transparency where there is information asymmetry. However, monitoring does not present an effective constraint on monopolists' market power.

At the time of the last PC review in 2006, it was thought that monitoring could be effective as a constraint on airports' market power if there existed the threat of re-regulation where a clear and significant abuse of market power by airports could be demonstrated. This would offer the prospect of remedial action if airports behaved 'inappropriately', and would condition negotiations between the parties.³²

To increase the transparency of the re-regulation threat, an annual 'show cause' process was proposed, which would have applied where there was *prima facie* evidence of 'serious pricing misbehaviour' by an airport. In such circumstances, the Government would have required the airport to demonstrate why its conduct should not be subject to more detailed scrutiny.³³

In consultation, the airports raised concerns that the proposed show cause process may impede their capacity to acquire loan finance because lenders believed that the process introduced uncertainty into the risk environment, upon which loans are predicated.

The difficulties experienced in designing the annual 'show cause' process suggest that it is unlikely to work in the way it was envisaged.

Future of the current monitoring regime

Price monitoring can be an appropriate way to provide transparency and inform stakeholders of any adverse effects following deregulation or other market reforms, until such time as a longer term approach can be determined. The ACCC considers that monitoring has been helpful in identifying areas of concern, and that its continuation is unlikely to bring greater clarity in this regard.

Moreover, given that monitoring does not act as a constraint on airports' use of market power, it represents an unnecessary burden on airport businesses. Price monitoring is not a costless activity. The *Airports Act 1996* requires the major airports to prepare and submit to the ACCC audited accounts and information about quality of service matters. The ACCC also bears the cost of preparing and publishing the annual airport monitoring reports.

For these reasons, reliance on the general provisions of Part IIIA is preferable to the continuation of the current monitoring approach as it would improve the predictability of the regulatory regime, and avoid the costs of monitoring.

3.2.2 Reliance on the general provisions of Part IIIA

The airports are potentially subject to declaration under Part IIIA. Part IIIA is not intended to replace commercial negotiations between facility owners and access seekers. Rather, it

³² Productivity Commission, *Review of price regulation of airport services*, report no. 40, Canberra, December 2006, p. 63.

³³ Department of Infrastructure, Transport, Regional Development and Local Government, *National aviation policy white paper: flight path to the future*, December 2009, p. 180.

seeks to enhance the incentives for negotiation and provide a means of access on reasonable terms and conditions if negotiations fail.³⁴

However, the effectiveness of the threat of declaration under Part IIIA as a constraint on the airports' market power is limited by the considerable costs, time and uncertainty associated with seeking declaration. Even with the new time limits in place, the declaration process can potentially involve several steps. As noted by the Tribunal:

The multitude of steps included in a Part IIIA application for access are: (1) NCC [National Competition Council] recommendation; (2) Ministerial declaration; (3) Tribunal review; (4) Appeals to the court; (5) Possible remitter; (6) Negotiations for access; (7) Arbitration; (8) Further Tribunal review; (9) Possibly more appeals to court. Getting through this process will inevitably take years: If a complex case was run in the fast lane, the earliest it will still take is 4 to 5 years to complete. The imposition of time limits on administrative decision-makers will reduce the time a little, but will not address the core problem.³⁵

For example, Virgin Blue applied to the National Competition Council (NCC) to declare the domestic airside services at Sydney Airport in July 2002. The declaration process lasted nearly five years, and the various decision makers—including the NCC, Tribunal and Federal Court of Australia—applied significantly different interpretations of elements of Part IIIA. Finally, in March 2007, the High Court of Australia upheld the Federal Court's decision to declare the domestic airside service at Sydney Airport for a period of five years. The declaration expired in December 2010.

An airline is likely to have further disincentive to incur the costs of applying for declaration under Part IIIA given that a potential free-rider problem exists. Other airlines could benefit from the declaration of an airport without contributing to the cost of an application for declaration. Indeed, if a service is declared, it is declared in respect of the provider and all, or any, third parties that seek access, and not merely the party to the application for declaration.

In addition, if an airline pays a high price at an airport (which may be only a small proportion of the airline's total costs), its competitors will be paying the same high rate.³⁶ An individual airline may not risk straining its relationship with the airport by seeking declaration, which could create a competitive disadvantage. These limitations of Part IIIA can be overcome by policy makers by deeming aeronautical services to be declared.

3.2.3 Deemed declaration of aeronautical services under Part IIIA

The current review presents an opportunity to assess the case for declaration, balancing the safeguards of the Part IIIA application processes with the barriers it poses to individual firms, to ensure the regulation is being appropriately applied.

³⁴ Productivity Commission, *Review of the National Access Regime*, report no. 17, Canberra, September 2001, p. XV.

³⁵ Australian Competition Tribunal, *Fortescue Metals Group Limited [2010] ACompT 2*, para. 1350.

³⁶ P Forsyth, *Replacing Regulation: Airport Price Monitoring in Australia*. In: *The Economic Regulation of Airports: Recent Developments in Australasia, North America and Europe*, Ashgate studies in aviation economics and management in assoc. with the German Aviation Research Society, 2004, pp. 3–22.

The ACCC considers deemed declaration under Part IIIA to be the most appropriate regulatory option for constraining those airports that exercise market power in the provision of aeronautical services. This approach would encourage the airports to behave as if their activities were carried out in a competitive marketplace. It recognises that each of the major airports operates in a different market, and enables a targeted regulatory response.

Aeronautical services, for the purpose of declaration, could be defined as services, provided by an airport, that are being used for the operation and maintenance of civil aviation services.³⁷ Deemed declaration could be effected by an amendment to the Airports Act to deem aeronautical services provided at major airports to be declared services for the purposes of Part IIIA. Such a deeming provision was previously included in the Airports Act under s. 192. Section 192 was repealed following a decision that airports should be subject to the general provisions of Part IIIA, which noted that it had been intended as a transitional measure.³⁸ This submission argues that a mechanism similar to the former s.192 can be used as a transitional measure in moving away from a regime based primarily on monitoring.

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

For example, the airports and user airlines would presumably understand that the likely approach of the ACCC (as the arbitrator) to assessing prices would be based on well-established regulatory precedent—such as the building block model, which could be used to provide guidance on expected revenue levels to assist negotiations. An attempt by an airport to set prices substantially above those likely to be determined by the ACCC would provide an access seeker with an incentive to raise a dispute. This would allow the airlines to place pressure on an airport to set charges at a level more consistent with efficient prices. As discussed by the PC:

In access negotiations, the access seeker is seeking a ‘low’ access price (that is, terms and conditions) and the service provider is seeking a ‘high’ access price. The negotiation process is an exploratory procedure which aims to determine whether there is an intersection of the ‘offer’ and ‘acceptance’ positions. The prospect of an arbitrated outcome conditions these negotiations.

Depending on the experience with a particular regime, it is almost inevitable that arbitrated terms and conditions will be less favourable to a service provider than its lowest offer price. This

³⁷ This includes all aircraft-related and passenger-related services and facilities within the boundary of the airport (as described in tables 1 and 2 of reg. 7.02A of the Airports Regulations 1997).

³⁸ Joint press release, Minister for Transport and Regional Services and Treasurer, 13 May 2002, <http://www.treasurer.gov.au/DisplayDocs.aspx?pageID=&doc=pressreleases/2002/024.htm&min=phc> (Accessed 23 February 2011).

strengthens the negotiating power of the access seeker—the threat of arbitration can be used as a bargaining tactic.³⁹

Similarly, in a recent study of Australian airport regulation, Littlechild supported the introduction of compulsory arbitration in the event of an unresolved disagreement between an airport and airline:

The possibility of independent dispute resolution would strengthen the airlines' hand in negotiating terms and conditions with airports. The contracts would presumably include such conditions as to investment or maintenance as airlines considered necessary or appropriate to address service quality concerns. This might include penalty payments (or compensating adjustments to their charges) if adequate service quality was not maintained. Arbitration, or the threat of it, could be expected to stimulate both greater and earlier responsiveness, and at lower cost, than, for example, the threatened re-imposition of price controls.⁴⁰

To provide parties with greater certainty and predictability about the expected outcome of arbitration, the ACCC could increasingly signal its likely position in a dispute through experience and the provision of guidelines. This would also facilitate commercially negotiated outcomes. As commented by the PC:

The longer parties have had to observe the behaviour of the regulator—particularly, its attitude to the price of access—or the greater the clarity provided by any pricing guidelines in the access regime, the greater will be the certainty about the outcomes of an access dispute. A higher degree of certainty, by reducing the 'room to manoeuvre', will generally strengthen the bargaining position of one of the parties.⁴¹

In 2006, the PC considered a regulatory option similar to deemed declaration under Part IIIA. In submissions to the PC, several airlines proposed that an airport-specific arbitration mechanism—with the ACCC as the arbitrator—is required to counteract the airports market power.

The PC was concerned that the introduction of an airport-specific arbitration mechanism could undermine incentives for the airports and airlines to negotiate outcomes:

... it seems highly likely that such a system would come to be viewed by airlines in particular as the default option, effectively leading to a return to heavy-handed determination of charges and conditions for airport services, with all of its attendant costs.⁴²

However, observations of the operation of Part IIIA over time suggest the airlines would not have the incentive to view dispute resolution by the ACCC as the 'default option'. For

³⁹ Productivity Commission, *Review of the National Access Regime*, Report no. 17, Canberra, 2001, p. 200.

⁴⁰ S Littlechild, 'Australian airport regulation: exploring the frontier', University of Cambridge, October 2010, pp. 14–15.

⁴¹ Productivity Commission, *Review of the National Access Regime*, Report no. 17, Canberra, 2001, p. 200.

⁴² Productivity Commission, *Review of price regulation of airport services*, report no. 40, Canberra, December 2006, p. 95.

instance, although domestic airside services at Sydney Airport were declared until December 2010, the ACCC was not required to make an arbitration determination.

Would arbitration be viewed by airlines as the default option?

In the view of the ACCC, for vertically-separated businesses such as airports, it is more likely that the threat of arbitration would create an incentive for parties to enter into constructive negotiations. Negotiated terms and conditions of access have some obvious benefits over an outcome determined by arbitration due to greater certainty and speed of outcomes, and transaction cost savings. As found by the Tribunal:

...declaration need not result in arbitration. The parties are free to reach commercial agreements and will have a clear commercial and financial incentive to do so.⁴³

...

We consider that the availability of a binding dispute resolution process provides an incentive for parties to negotiate in a realistic, practical and positive manner in an attempt to resolve differences which affect, and have a real impact on, their daily commercial activities. Indeed, we consider that the availability of a binding dispute resolution process will bring about a more efficient outcome than a situation where no such process is available. More particularly is this so where the arbitrator has to take into account the matters specified in s 44X(1) of the [Competition and Consumer Act].⁴⁴

This view is supported by the commercial resolution of the access dispute between Virgin Blue and Sydney Airport in 2007. Virgin Blue notified the ACCC of an access dispute with Sydney Airport following declaration of its domestic airside services. Subsequently, however, the parties reached a commercial agreement and the ACCC was not required to complete the arbitration process.

As stated by ACCC Chairman at the time, ‘the outcome of this arbitration illustrates that Part IIIA is working as intended, and that the regulatory framework provides a useful backdrop that supports effective commercial negotiations.’⁴⁵ No other disputes in relation to the declared services at Sydney Airport have been raised with the ACCC.

It appears that dispute resolution mechanisms have also been successful overseas. Based on the experience in the United States and Canada in energy regulation, and in the United Kingdom for airport regulation, Littlechild found:

... evidence continues to accumulate that parties in a regulatory framework are willing and able to negotiate settlements to the extent that they are allowed to do so. These parties effectively have the ability to trigger regulatory arbitration simply by declining to reach agreement. Nonetheless, they have not in general found it necessary or advantageous to do this.⁴⁶

⁴³ Australian Competition Tribunal, *Virgin Blue Airlines Pty Ltd [2005] ACompT 5*, para. 594.

⁴⁴ *ibid*, para. 604.

⁴⁵ ACCC, ‘ACCC welcomes commercial resolution of access dispute between Virgin Blue and Sydney Airport’, media release, 24 May 2007.

⁴⁶ S Littlechild, ‘Australian airport regulation: exploring the frontier’, University of Cambridge, October 2010, p. 21.

The success of the negotiate-arbitrate model in terms of the likelihood of a commercially negotiated outcome seems to depend heavily on the characteristics of the market. When an access provider of a bottleneck facility operates in a market in which the infrastructure service is a production input (that is, a vertically-integrated business), it often has an incentive to use its market power to favour its operations in the related market. For example, the access provider could refuse to supply the input or charge a higher access price to access seekers to inhibit competition.

This asymmetry of interests can be expected to give rise to more disputes relative to markets that are vertically separated. For example, the ACCC's experience in conducting arbitrations in relation to telecommunications services has been that market participants have exhibited a high propensity to seek arbitrated outcomes rather than engage in meaningful negotiations.

Finally, it should be noted that the ACCC is empowered to terminate an arbitration where it is vexatious, where the subject matter is trivial, misconceived or lacking in substance, or where the party notifying the dispute has not engaged in good faith negotiations, pursuant to s. 44Y of the Competition and Consumer Act.

Therefore, it is the view of the ACCC that it is more likely that the threat of arbitration under Part IIIA would create an incentive for parties to negotiate on a commercial basis. Nevertheless, if a dispute were to be referred to the ACCC, independent-binding arbitration is widely recognised as a cost-effective method of resolving disputes, and is consistent with competitive-market situations. As found by the Tribunal:

If arbitration were to occur, the arbitration process has the potential to be swift and relatively inexpensive. The powers of the ACCC are sufficient to ensure that any arbitration that does occur is conducted efficiently and expeditiously: see, for example, ss 44Y and 44ZF.⁴⁷

An advantage of deemed declaration is that regulatory intervention—in the form of arbitration—is determined by the airports to a large extent. If an airport undertakes commercial negotiations in good faith, ACCC arbitration is unlikely to be triggered and, therefore, regulatory intervention would not be required.

3.2.4 Alternative forms of economic regulation

Economic regulatory tools can be broadly distinguished by the degree to which terms and conditions are left to market players to negotiate. In addressing the perceived or potential market problem the regulatory tool needs to fit the purpose

A more prescriptive regulatory regime is one where fewer (or no) matters are able to be negotiated between access providers and access seekers. Governments recognise that the market power of firms in some markets means that commercial negotiation will not provide satisfactory outcomes for prices, investment and quality of service. In such circumstances, a regulatory regime will prescribe most of the terms and conditions of access and preclude negotiation. The National Electricity Rules, which set out the methodology by which the terms and conditions of access are to be determined, is an example of such a regime.

⁴⁷ Australian Competition Tribunal, *Virgin Blue Airlines Pty Ltd [2005] ACompT 5*, para. 593.

More prescriptive forms of economic regulation could provide the airports with a high degree of regulatory certainty. This option could ensure any investment undertaken by the airports would result in a reasonable rate of return for the business over the life of the assets. Such regulatory arrangements can also ensure businesses provide reliable services at efficient prices, while rewarding them for efficient investment and operating programs.

The current regulatory regime covering airports allows all matters (price, investment, quality of service) to be negotiated with users.

In between these two regimes, there are a range of options – including combinations of terms that are prescribed and terms that can be negotiated.

The ACCC considers that a more prescriptive form of economic regulation would be appropriate if, for airports that are deemed to be declared as suggested above, a high number of disputes are raised. In other words, if the airports do not actively facilitate commercially negotiated outcomes, the last resort would be to impose stricter controls on their behaviour. The ACCC expects that this ultimate threat would provide added incentive for the airports to negotiate with users in good faith.

Distributional effects

The PC has been asked to consider the economy wide costs and benefits as well as the distributional effects of the current regime. It is expected that this analysis will consider not only the efficiency outcomes of the various regulatory options for airports (including doing nothing), but the distributional effects in each case.

Any policy or regulatory reform should be guided by its overall expected economic welfare gains. That said, the distributional effects are relevant to the community, and it is important that the potential ‘winners’ and ‘losers’ can be identified, in addition to the likely magnitude of the impacts of a change on those groups.

As noted earlier, the ACCC has concerns that under the current arrangements, the airports’ behaviour is unconstrained, and there are both efficiency and equity issues associated with these conditions.

If regulatory arrangements were put in place to balance market power between airports and airlines, where airports had been charging monopoly prices, profits would shift from airports to airlines. Airports would be the ‘losers’ in this scenario, however, the excess profits would move into the more competitive environment (the airline market) where they have a greater likelihood of being competed away.

Given that the current review presents an opportunity to determine the most appropriate longer term approach to airport regulation, it would be appropriate to consider the distributional effects of all possible options, in light of any changes in the industry or composition of the market that may have taken place since 2002.

4 Market power in airport car parking

Passenger demand for ground transport to and from an airport is complementary to the demand for aeronautical services. In terms of the impact on most air travellers, it matters

little if market power is exercised through raising the cost of landing aircraft, or increasing the cost of travelling to and from the airport.

Market power issues in airport car parking arise because airports can control access to airport land by off-airport parking operators and other transport modes as a bottleneck.⁴⁸ This monopoly position allows the airports to earn additional revenue resulting from prices that are higher than those reflecting location.

To address public concerns about airports using their monopoly position to exert significant market power and charge higher prices, the Government directed the ACCC to formally monitor prices, costs and profits relating to the supply of car parking services at the five airports under the existing regime.⁴⁹

Even so, there are no effective constraints on the airports' market power in car parking under the current regulatory regime. Moreover, the information required to more conclusively establish if parking rates are excessive is beyond the scope of monitoring.

The ACCC considers that it would be useful for the PC in undertaking its assessment of market power in airport car parking to revisit the potential efficiency and distributional effects (section 4.1).

The ACCC has examined the effectiveness of mandatory access undertakings for landside vehicle access services under Part IIIA to facilitate competition in the market for landside access (section 4.2).

4.1 What are the potential efficiency and distributional effects?

Airport car parking charges set by the airport operators could potentially incorporate location and monopoly elements. Both types of economic rents represent benefits to owners resulting from raising prices above the cost of supply.

It is important to make the distinction between location and monopoly rents because of the different efficiency implications (section 4.1.1). While the distribution of location rents does not necessarily have an effect on welfare, monopoly behaviour could lead to a loss of consumption and discourage the use of alternatives to on-airport car parking (section 4.1.2). Alternative transport options include: off-airport car parking, terminal drop-off and pick-up, taxis, hire cars (that is, registered hire vehicles operated by an accredited driver), limousines, public and private buses, and trains at some airports.

4.1.1 Distinguishing between location and monopoly rents

Location rents do not result in the same efficiency losses as monopoly rents because in the former supply is fixed, whereas in the latter it is deliberately withheld. Location rents are based on the willingness of users to pay for greater convenience and do not generate inefficiencies.

⁴⁸ ACCC, *Airport monitoring report 2007-08*, March 2009, pp. 61–67.

⁴⁹ A. Albanese, Minister for Infrastructure and Transport, 'New watch on airport parking fees', media statement, 6 April 2008.

Location rents are derived from the limited supply of convenient parking

The major airports' market power in car parking arises because the land adjacent to these airports is highly valued for various activities that are related to the operations of the airport. Car parking can be provided close to the airport terminal, at some distance, or off airport land altogether. The airports' market power will be greater for the more convenient car parking areas because the substitution possibilities are less significant than for those areas further away.

The additional returns generated by this market power are termed location rents, the size of which depends on how scarce space is. For example, if there is plenty of land convenient to terminals for car parking, it is not expected that location rents would be as high.⁵⁰

Assuming consumers are willing and able to switch between transport options, the airports' ability to set charges for on-airport car parking beyond those resulting in location rents would be limited. For example, an offer of cheaper car parking at less appealing locations would induce some customers to substitute away from on-airport car parking, thereby constraining the returns the airport owners could achieve.

Monopoly rents can arise from restricting supply or restricting access to alternatives

Airports could have the incentive to limit, or delay investment in, the supply of car parking spaces to maintain artificial scarcity and, thereby, achieve higher prices. For example, the ACCC's monitoring work suggests it is possible that Brisbane Airport has been earning monopoly rents for airport parking as a result of inefficiently delaying investment. Although Brisbane Airport has recently undertaken considerable investment in multi-level car parking facilities, it is questionable why this investment was not undertaken sooner given a relative scarcity of car parking spaces at the airport. Brisbane Airport appears to have provided significantly fewer car parking spaces as a ratio of throughput relative to Melbourne, Sydney and Perth airports since at least 2002-03.⁵¹

In addition, the competitive outcomes brought about by the existence of alternatives to on-airport car parking are limited by certain factors. Airports ultimately control the conditions of 'front-door' access to terminal facilities and can, therefore, restrict competition to on-airport car parking.⁵²

Airports can act strategically to raise costs of car parking by controlling the conditions of landside access to terminal facilities. The airports have an incentive and ability to use their

⁵⁰ P Forsyth, 'Locational and monopoly rents at airports: creating them and shifting them', *Journal of Air Transport Management*, vol. 10, 2004.

⁵¹ ACCC, *Airport monitoring report 2009-10*, February 2011, p. 72-73.

⁵² The airports are free to decide whether or not businesses that rely on landside access are allowed to operate at an airport. There is no automatic right to be supplied and there is no statutory obligation on a supplier to justify its decision. There are limited circumstances for which a refusal to deal is prohibited under the Competition and Consumer Act, including instances of a misuse of market power (prohibited under s. 46) and exclusive dealing arrangements (prohibited under s. 47).

market power to favour their own on-airport car parking operations. In the context of airport car parking, monopoly rents are defined as the additional revenue resulting from prices that are higher than those reflecting location rents.

For example, the ACCC found that car parking prices at Melbourne Airport are of particular concern. Melbourne Airport seems to impose excessive levies on, and limit the service offering to, off-airport parking and private bus operators. The ability of these businesses—which transport a substantial number of travellers to and from the airport—to compete with on-airport parking would, therefore, be reduced.⁵³

In contrast, it is not apparent that Brisbane and Sydney airports’ access levies on off-airport parking and private bus operators are excessive based on the limited revenue and cost information provided to the ACCC. Therefore, the levies imposed by the airports may not discourage the use of alternatives to on-airport car parking in a way that inefficiently distorts travellers’ decisions about which transport option they use.

Further, it seems unlikely that the access levies would result in a substantial increase in demand for on-airport car parking at Brisbane and Sydney airports, because only a relatively small proportion of travellers appear to use off-airport parking and private buses. Moreover, information provided to the ACCC suggests that the passenger mode share of these transport options means that the potential for Brisbane and Sydney airports to induce a significant number of travellers to shift to on-airport car parking may be limited.

Adelaide and Perth airports do not impose charges on off-airport car parking operators, which means that these businesses can compete with the airports on a level playing field. It is expected that competition from off-airport parking can create a constraint on airport parking charges to some extent.⁵⁴

Airports may also levy excessive access charges or influence alternatives to on-airport car parking through non-price means, such as setting inconvenient locations for kerbside set-down and pick-up points. This would have the effect of shifting demand to on-airport services, which allows the airports to increase car parking prices and earn monopoly rents. That said, the airports’ aeronautical and retail operations would be harmed from less affordable landside access options if it results in lower passenger throughput (box 4.1).

⁵³ ACCC, *Airport monitoring report 2009-10*, January 2011, p. 72.

⁵⁴ *ibid*, p. 72-73.

Box 4.1 The airports' incentive to levy excessive charges or unreasonably restrict access to providers of alternatives to on-airport car parking

The airports' incentive to levy charges on competing alternatives to on-airport car parking, such as off-airport parking and other transport modes, derives from the additional revenue generated from access charges, and from the positive impact it could have on demand for on-airport car parking—other things remaining constant.

By increasing the costs of the alternatives to on-airport parking, these businesses would be forced to pass them on to customers in the form of increased charges. An increase in the price of off-airport parking, for example, could cause some customers to substitute to on-airport car parking. In addition, limited space allocated for kerbside standing areas can significantly increase the time taken for businesses that rely on landside access to transport their customers to and from the airport—especially in peak periods. In fact, users may be more sensitive to changes in convenience relative to price.⁵⁵

On the other hand, an airport may be able to increase revenue from airline charges and retail concessions if it could increase demand for these services by providing more affordable landside access options. The incentive to expand passenger throughput will continue until the marginal profit foregone from landside access (including car parking) operations equals the marginal profit earned from aeronautical and retail activities.

For example, the difference in aeronautical and car parking revenue at Adelaide Airport may be significant enough that the negative impact of higher charges for car parking services on passenger traffic could operate as a constraint on those charges (table 1). In contrast, at Brisbane, Melbourne and Perth airports, car parking operations contribute a relatively greater amount to airport profitability. Therefore, these three airports are less likely to have an incentive to moderate increases in car parking rates.

It is less clear if Sydney Airport would have an incentive to moderate price increases to encourage demand for aeronautical and retail services. Although margins for aeronautical services are significantly greater than for car parking services, it is expected that demand at Sydney Airport will be particularly insensitive to price changes given the airport possesses a high degree of market power. This means it would take a substantial increase in car parking rates to adversely impact aeronautical and retail revenues and, therefore, have any negative effect on overall airport profitability.

Table 1 Operating margin for aeronautical and car parking services for the year ended 30 June 2010 (\$million)

	Adelaide	Brisbane	Melbourne	Perth	Sydney
Aeronautical services	37.3	70.4	98.7	34.5	218.4
Car parking services	10.4	44.7	80.8	22.6	68.2

Source: ACCC, *Airport monitoring report 2009-10*, February 2011.

Note: Financial information relating to retail concessions is not readily available.

⁵⁵ ACCC, *Airport monitoring report 2009-10*, January 2011, p. 69.

The incentive to hinder potential competition would depend on whether or not there are close substitutes to on-airport car parking, which could differ from airport to airport. Airports offer car parking close to the airport terminals, which is a superior service in terms of time and convenience. Many airport users are prepared to pay a premium to use this service. Consequently, the substitution possibilities for short-term parking in particular may be limited, which would provide airports with considerable market power.

If changes in prices for on-airport car parking have little effect on, for example, the demand for off-airport car parking and other transport modes, the airports would have the power to set parking prices and the number of car spaces that they prefer. Of concern, the airports could have the incentive to limit, or delay investment in, the supply of car parking spaces to maintain artificial scarcity and, thereby, achieve higher prices.⁵⁶

It should be noted that the existence of substitutes to on-airport car parking at prevailing prices does not necessarily indicate the presence or absence of market power. The airports' market power may allow them to increase prices up to the point at which some alternatives to on-airport car parking become more attractive substitutes. In other words, high on-airport car parking prices may provide an opportunity for some, otherwise less viable substitutes to gain market share. However, because the airport controls the terms and conditions of landside access, it is unlikely to be constrained by most substitutes.

4.1.2 Possible economic effects from airports exercising their market power

If the supply of airport car parking facilities is constrained by an airport to profitably increase prices, there could be an efficiency loss as some consumers would not be served even though their willingness to pay exceeds the cost of serving them. Less obvious are the possible efficiency impacts from the airports' control over landside access.

Consequences of the airports' ability to control the market for landside access

If an airport levies excessive charges or unreasonably restricts access to providers of alternatives to on-airport car parking, there would be three main economic effects. It is unclear which of these effects will be most significant based on a qualitative assessment.

First, an increase in on-airport car parking charges would result in a transfer of surplus from users to the airport. As discussed above, some travellers are likely to be willing to pay a higher premium for options that provide the fastest transit times, and are unlikely to substitute to less convenient alternatives even for significant price changes. Put simply, these travellers would pay a higher price for the same service.

Further, alternatives to on-airport car parking may be in a position to derive higher revenue from access to an airport's customer base, which could allow them to earn additional profits.⁵⁷ In such circumstances, the airport operator may consider that those

⁵⁶ In a competitive-market situation, the lure of high profits would encourage firms to invest in capacity. It is expected that these profits would be competed away as capacity expands. In contrast, the airports' monopoly position means high profits can persist.

⁵⁷ P Forsyth, 'Locational and monopoly rents at airports: creating them and shifting them', *Journal of Air Transport Management*, vol. 10, 2004, p. 56.

businesses that benefit from the airport business should contribute to its growth. The airport may, therefore, attempt to extract any rents enjoyed by these businesses. As above, this is not necessarily an inefficient outcome if there is no change to economic activity.

Second, excessive access prices may distort travellers' decisions on which transport modes they use and, over the longer term, could impede investment and innovation in landside access services. Some travellers would be prepared to use alternatives to on-airport car parking given large enough price differences. But, if an airport unreasonably discourages the use of lower cost transport options, market prices of these services would not reflect their true economic values.

Third, more expensive transport options to and from an airport could result in a lower quantity of ground transport and, consequently, air travel demanded. This results in an unambiguous loss of consumer welfare because the total volume of economic activity would decrease.

The magnitude of such welfare losses depends on a range of factors. For example:

- Only a subset of overall demand for air travel would be highly sensitive to changes in the prices of ground transport options.
- Exogenous conditions that impact demand for air travel would be influential, such as the prices of airfares and broader economic conditions.
- The market characteristics—such as the distance between the airport and travellers' origin or destination, and availability of the various transport options—differ from airport to airport, which could influence the ability of operators of businesses that rely on landside access to create a constraint on the airports' market power.⁵⁸

In the view of the ACCC, it is possible that the airports' ability to control the market for landside access may result in substantial welfare losses. For instance, higher costs of car parking could have a sizeable impact on budget travellers' decision to travel, which seems to have become a larger segment of the market for air travel.

Under these circumstances, the ACCC considers there is good reason to consider regulation of the airports' landside access arrangements. However, a comprehensive evaluation of the market for landside access at each of the airports would be required to determine whether or not the problem warrants a regulatory response.

Information required to determine the significance of the efficiency effects

The PC's 2006 report did not take into account the efficiency consequences of monopoly rents in airport car parking because it considered that the alternatives would be influential and, thereby, constrain the airports' market power. However, as recognised by the PC in its 2002 report, the conclusion that the airports' market power in the provision of car

⁵⁸ ACCC, *Airport monitoring report 2009-10*, January 2011, pp. 66–68.

parking is low only holds if the airport does not use its control over airport access to stifle competition.⁵⁹

It is imperative that the PC recognises the airports' incentive and ability to restrict competition to on-airport car parking, and conducts a comprehensive analysis of the potential consequences—including an examination of the efficiency effects highlighted above. An evaluation of the market for landside access is required to estimate travellers' willingness to substitute between the various transport options to and from an airport. The PC would need to look beyond the number of apparent competitors.

An assessment of the terms and conditions on which each airport offers access to alternatives would be required to determine the significance of the potential impediments to competition in the market for landside access. For example, if it is found that an airport does not levy excessive access charges, the ability of the airport to impose charges above efficient levels for car parking services would be limited. Perth is the only major airport that does not charge access fees for off-airport car parking, or for public or private buses. The ACCC's assessment of the level of charges imposed by the remaining airports (other than Melbourne) is mixed. The ACCC has stated that the access charges for Sydney and Brisbane airports do not appear to be excessive, but it is difficult to draw definitive conclusions based on the information made available through the monitoring reports.⁶⁰

The PC's analysis could also examine the impact of higher charges for car parking services on passenger traffic and associated demand for aeronautical services and retail concessions. This analysis would indicate the extent to which these aspects of the business would operate as a constraint on car parking charges at each of the major airports. For example, if aeronautical and retail profits do not act to promote competition for on-airport car parking, it can only be because the throughput forgone does not contribute at least as much profit in aeronautical and retail activities, as what is gained by restricting competition for on-airport car parking.

Finally, consideration should be given to the adequacy of investment in car parking facilities. An important question is: have the airports reached capacity limits, especially for multi-level car parking close to the airport terminals? If not, and the expected rate of return for car parking operations exceeds the return for other investments, this suggests the existence of impediments and inadequate investment.

For example, the ACCC found it is possible that Brisbane Airport has been earning monopoly rents for airport parking as a result of inefficiently delaying investment.⁶¹ Although Brisbane Airport has recently undertaken considerable investment in multi-level car parking facilities, it is questionable why this investment was not undertaken sooner given a relative scarcity of car parking spaces at the airport. The other major airports appear to have been more responsive to emerging capacity constraints.

⁵⁹ Productivity Commission, *Price regulation of airport services inquiry*, report no. 19, Canberra, January 2002, p. 162.

⁶⁰ ACCC, *Airport monitoring report 2009-10*, January 2011, p. 72-73.

⁶¹ *ibid*, p. 73.

Figures 4.1 to 4.5 below contain data for each of the airports' car parking prices and operating margins.⁶² Generally speaking, operating margins and prices have moved in an upwards direction over the period 2005-06 to 2009-10. This could occur, for example, when a car park has consistently achieved greater throughput of the existing facilities over the period. It could also occur when the car park has achieved higher revenues through increased prices. It would be reasonable to expect that the costs associated with investment in additional capacity would be reflected in operating margins over time.

Figure 4.1 Adelaide Airport – Car parking prices and operating margins

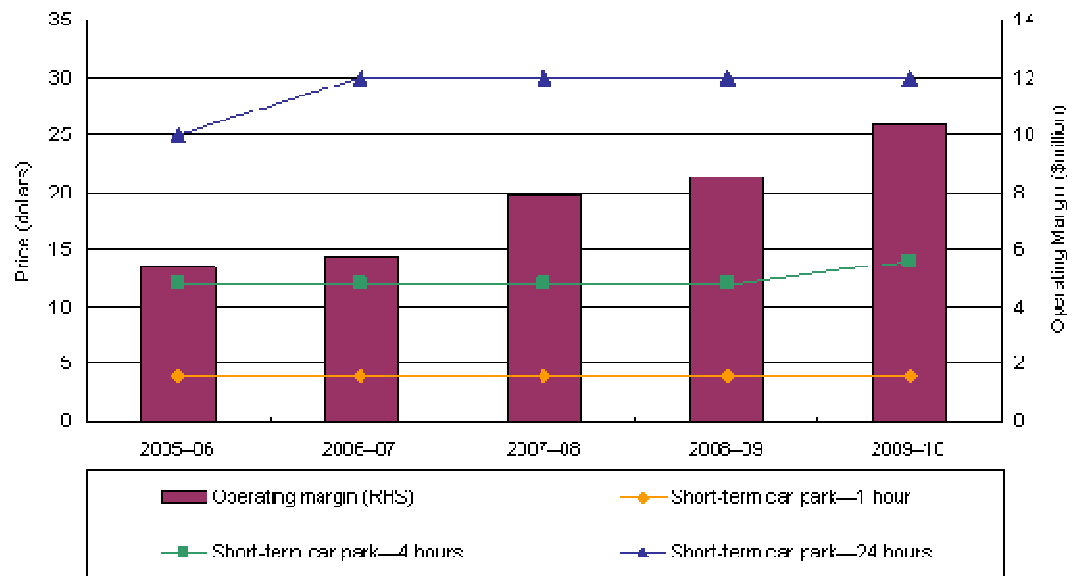
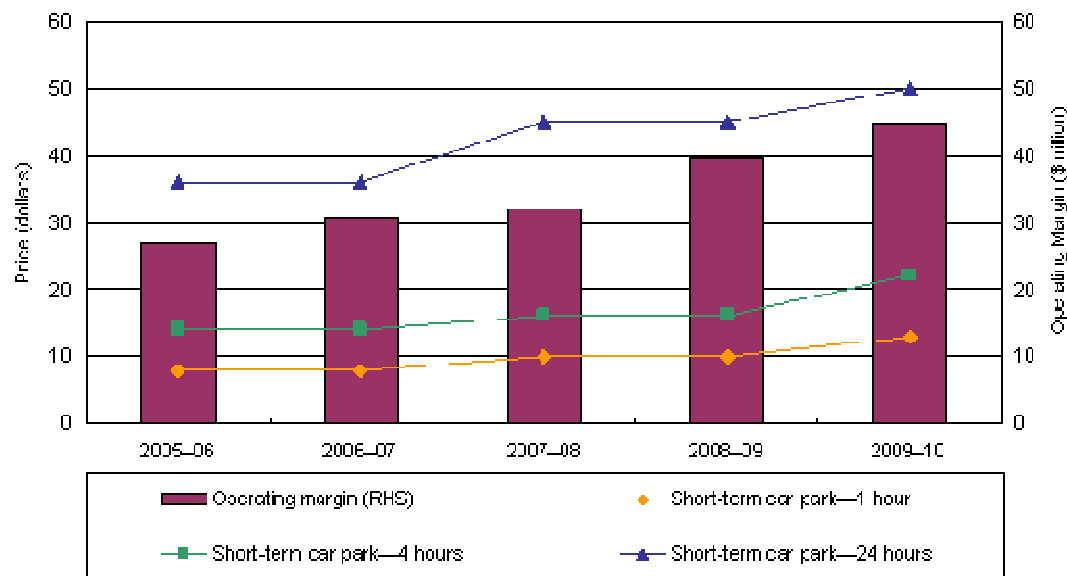


Figure 4.2 Brisbane Airport – Car parking prices and operating margins



⁶² Data sourced from ACCC, *Airport monitoring report 2009-10*, January 2011.

Figure 4.3 Melbourne Airport – Car parking prices and operating margins

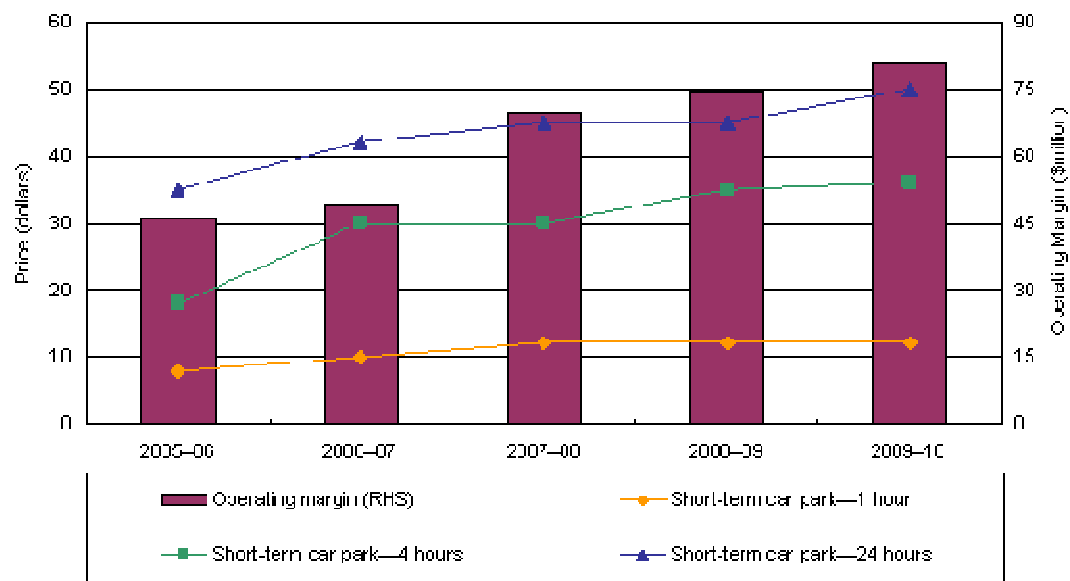


Figure 4.4 Perth Airport – Car parking prices and operating margins

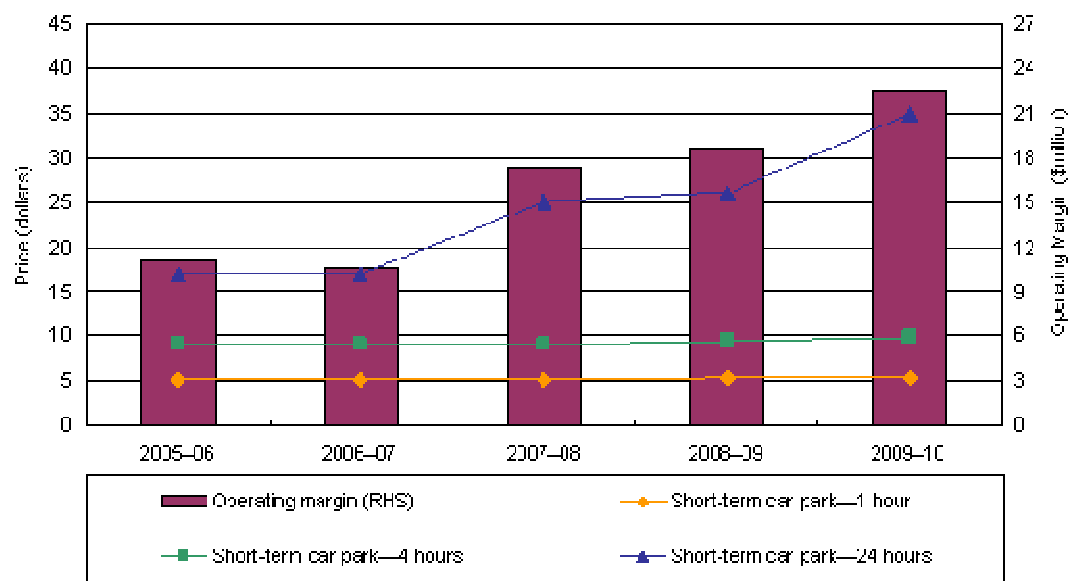
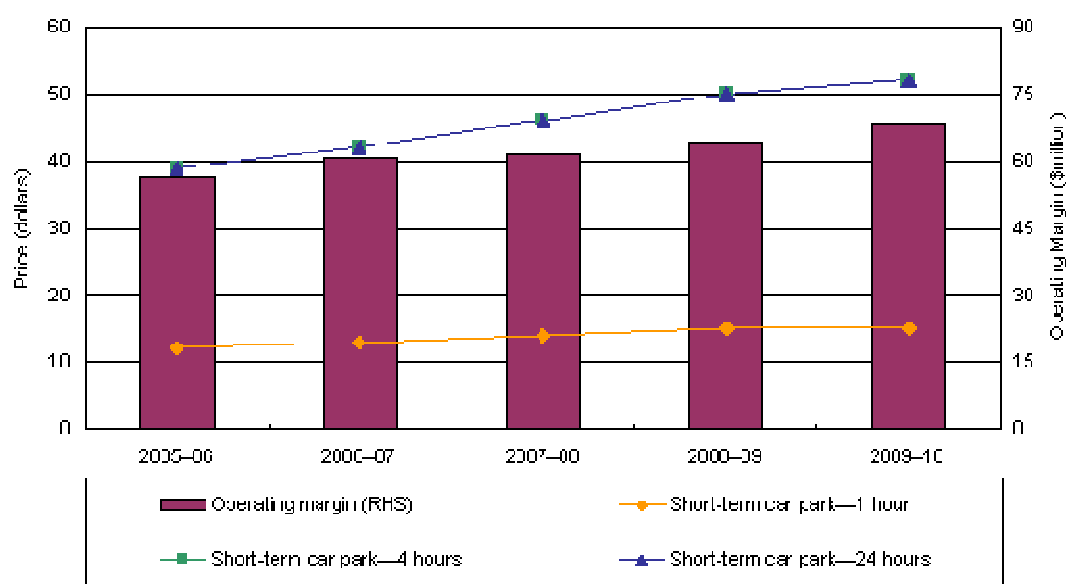


Figure 4.5 Sydney Airport – Car parking prices and operating margins



The PC previously compared levels and movements in car parking charges at airports with those at ‘high locational rent’ central business district (CBD) locations.⁶³ It is the ACCC’s view that CBD car parking rates are not comparable to airport charges. For example, the size of location rents depends on how scarce space is, which would differ between the CBD and airport land. Further, CBD rates can reflect levies by state governments designed to manage road congestion.

For any benchmarking exercise to be useful, it would be necessary to consider if the benchmarked services—including the regulatory environment—are comparable. Moreover, the success of benchmarking will depend on the accessibility, verifiability, and cost effectiveness of the data required.

4.2 What is the appropriate regulatory response?

As noted, degrees of market power are likely to differ from airport to airport, and across services areas. Analysis of the market for landside access at each of the major airports should have regard to characteristics such as:

- user preferences
- the supply of car parking services at the airport
- transport options available to travellers
- the location of an airport relative to the central business district
- property markets
- local planning regulations
- legislated security requirements on the landside.

⁶³ Productivity Commission, *Review of price regulation of airport services*, report no. 40, Canberra, December 2006, p. 172.

The nature and availability of substitutes to on-airport car parking, such as off-airport car parking and alternative transport providers, will be important in determining the appropriate regulatory response. Competition can constrain the airports' ability to exercise their market power in setting car parking charges because, in response to higher parking rates, some travellers would switch to alternative landside access services. In this environment, rents accruing to the airports are more likely to reflect location advantages rather than monopoly profits.

To encourage such competitive behaviour, mandatory access undertakings would provide businesses that rely on landside access at an airport some certainty regarding the terms and conditions of access, and a right to negotiate or arbitrate access drawing on the efficiency principles of Part IIIA (section 4.2.1). As an additional measure, the Master Plan process could have regard to the adequacy of investment in on-airport car parking facilities to deter airports from deliberately withholding supply (section 4.2.2).

To be clear, the ACCC does not suggest that regulation should extend to setting airport car parking charges. In practice, the information required to replicate efficient price structures in car parking would be too great. Distinguishing between location and monopoly rents is not an easy task. Further, if parking rates were not set to reflect the value in use of the land, airports would have an incentive to re-allocate the land to other economic activities over the long term.

4.2.1 Mandatory access undertakings

Access undertakings set out the terms and conditions on which the access provider is prepared to allow access to its facilities. As an alternative to declaration under Part IIIA, undertakings give infrastructure owners and operators greater certainty about the access conditions applying to their infrastructure. Once the ACCC accepts an undertaking the service in question can no longer be declared.

To ensure those airports with significant market power do not attempt to discourage competition to on-airport car parking, the ACCC considers that mandatory undertakings for landside vehicle access services would best facilitate commercial negotiations and limit transaction costs. Access undertakings would assist the alternative transport modes to on-airport parking, which may not have the same experience, expertise and resources as the airlines in negotiating with the airports, which could make deemed declaration less effective for these operators. Access undertakings also give the airports the opportunity to remove uncertainty as to what access conditions will apply to landside vehicle access services.⁶⁴

Landside vehicle access services, for the purpose of an access undertaking, could be defined as: use of terminal access roads, kerbside standing areas and holding bays at the airport for the purpose of dropping off and picking up airline passengers at an airport and its terminals.

The monitoring reports include data on charges and revenue that the airports obtained from users of landside vehicle access services. It is these services that the eventual access

⁶⁴ Once the ACCC accepts an undertaking, the service in question can no longer be declared—although the ACCC's decision on whether or not to accept the undertaking may be reviewed by the Tribunal.

undertakings would apply to. Table 4.1 provides a summary of the data collected for each of the monitored airports in 2009-10.

Table 4.1: Landside access charges and revenue for the year ended 30 June 2010⁶⁵

Airport	Information provided to the ACCC
Adelaide	<ul style="list-style-type: none"> No access levies imposed on off-airport car parking or public buses Per entry charge of \$2 imposed on private buses Per pick-up charge of \$2 imposed on taxis
Brisbane	<ul style="list-style-type: none"> Per entry charge imposed on private buses—\$840 000 airport revenue Monthly fee imposed on off-airport parking—\$128 000 airport revenue Per pick-up charge of \$3 imposed on taxis—\$2.6 million airport revenue Per pick-up charge imposed on hire cars and limousines—\$510 000 airport revenue Train corridor lease—\$140 000 airport revenue
Melbourne	<ul style="list-style-type: none"> No access levy imposed on public buses Per entry/per passenger charges imposed on off-airport parking and private buses—\$3.2 million airport revenue Per pick-up charge of \$1.32 imposed on taxis—\$2.0 million airport revenue Per pick-up charge of \$3 per 30 minutes imposed on hire cars and limousines—\$630 000 airport revenue
Perth	<ul style="list-style-type: none"> No access levies imposed on off-airport parking, or public and private buses Per pick-up charge of \$2 imposed on taxis—\$1.6 million airport revenue Hire cars and limousines charged \$2.20 per pick up—\$60 000 airport revenue
Sydney	<ul style="list-style-type: none"> Various charges applied to off-airport parking and private buses—\$440 000 airport revenue No access levies imposed on public buses Per pick-up charge of \$3 imposed on taxis—\$7.7 million airport revenue Charge of \$3.50 per 20 minutes (domestic) and 75 minutes (international) imposed on hire cars and limousines—\$770 000 airport revenue No access levy imposed on the train

While an undertaking would need to specify pricing arrangements, this does not imply that an undertaking cannot provide scope for negotiation. To cater to the specific requirements of potential third-party users, undertakings could allow for negotiation of terms and conditions by establishing procedures for negotiations and clearly defined boundaries to the negotiations. In terms of access pricing arrangements, prices can take the form of reference prices, or airports could specify maximum and minimum prices between which negotiation can take place. Irrespective of the approach used, the airport would be required to explain the basis for setting access prices and how they relate to costs.

⁶⁵ ACCC, *Airport monitoring report 2009-10*, January 2011, p. 70.

4.2.2 Strengthening of the Master Plan process

Under the Airports Act, each airport must submit a Master Plan to be approved by the Minister for Infrastructure and Transport. A Master Plan is relevant to the approval of major developments at the airport and must take into account public concerns. An airport must not carry out, or permit, a building activity without approval whereby non-compliance is an offence.

The Master Plan process is a useful regulatory tool to ensure the major airports do not either attempt to withhold the supply of on-airport car parking, or discourage competition in the market for landside access.⁶⁶ Recent changes to the Airports Act have strengthened the airport planning process by requiring that airport Master Plans include, for example, detailed information on proposed non-aeronautical developments. However, the recent amendments do not go far enough to safeguard against any attempts by the airports to use their market power at the expense of users.

In assessing the airport Master Plans, stakeholder groups⁶⁷ and the Government could give consideration to the adequacy of investment, which would have the effect of deterring airports from limiting or delaying the construction of multi-level car parking facilities. If the opportunity cost of land at an airport is high, but the airport could expand its car parking operations, this suggests that on-airport car parking capacity is being artificially restricted.

Additionally, the Master Plan process may be used to influence landside configurations to improve transport options to access airport terminals—such as the availability of kerbside drop-off and pick-up areas for private vehicles, and off-airport car parking and bus operators. The process could also be used to ensure that airports take advantage of congestion management measures that minimise the impact on alternatives to on-airport car parking, and comply with the minimum security requirements in a transparent way.

5 Conclusion

The PC's current review will be informed by greater practical observations of the airports' behaviour and of the operation of Part IIIA over time. With the benefit of experience and information generated by eight monitoring reports since the 2002 review, it is apparent that the market constraints on airports' behaviour are not as strong as previously envisaged. However, the limitations of the airport monitoring, either as a source of conclusive findings or as a regulatory tool in itself, have become clear.

The current regulatory regime does not effectively constrain the major airports' market power, which allows the airports to set monopoly prices for aeronautical services and car

⁶⁶ Under s. 71(5) of the Airports Act, the Airport Regulations may provide that, in specifying a particular objective, assessment, proposal, forecast or other matter, a draft or final Master Plan must address such things as are specified in the regulations.

⁶⁷ For example, on 18 February 2011, the Minister for Infrastructure and Transport announced that the Government would establish community aviation consultation groups to consult on a range of issues relating to community impact of airport operations, including ground transport and access issues.

parking. The ACCC considers that an appropriate regulatory response is required to mitigate the risk of substantial economic losses as a result of monopoly behaviour by the airports.

Part IIIA of the Competition and Consumer Act, offers fit-for-purpose regulatory tools that could be utilised to address the risks associated with the exercise of airports' market power as they apply in the markets for aeronautical and landside services respectively.

Specifically, deemed declaration of aeronautical services, which allows for binding dispute resolution, would create a strong incentive for parties to reach commercial agreements without actually resorting to arbitration. The threat of stricter controls on the major airports' behaviour would provide added incentive for the airports to actively facilitate commercially negotiated outcomes. Amendment to the Airports Act would be required for aeronautical services to be deemed.

To address market power problems in car parking, the major airports could be required to lodge access undertakings for landside vehicle access services. This recognises the more limited capacity of businesses that depend on landside access to exercise countervailing power. Undertakings can ensure alternatives to on-airport car parking can compete on a level playing field with the airport. As an additional measure, the Master Plan process could have regard to the adequacy of investment in on-airport car parking facilities to deter airports from deliberately withholding supply.

By invoking Part IIIA, the potential exists for significant welfare gains. Encouraging outcomes that better reflect a competitive environment would result in lower prices, higher service-quality levels, more timely investment, and better use of the various transport options to and from airports. Ultimately, this could lead to increased consumption of air travel and place pressure the airports to operate more efficiently.