Address to the

Aviation Law Association of Australia and New Zealand

AVIATION AND THE ACCC

by

Commissioner John Martin

Australian Competition and Consumer Commission

21 March 2007
Melbourne

Table of Contents

INTRODUCTION

The aviation industry is one of the largest, most dynamic components of our national transport network. Ensuring the industry is allowed to become as efficient as possible while remaining within the framework of open competition and technical rigour is a high priority for regulators and governments alike.

The success of many elements of our economy, be it tourism, freight, commerce or employment are influenced in one way or another by the efficiency of our aviation sector.

As we all know, the aviation industry can be a high-stakes business which is regularly reinventing itself and has little mercy for those who fail to keep up with emerging trends. As a result, excessive meddling in the industry by governments can be potentially detrimental to allowing the sector to grow and respond as necessary.

But like other areas of transport, aviation does not always throw up a level playing field and there are times when regulation is required to avoid the formation of monopolies and artificial barriers that prevent competition from flourishing.

The constant search for efficiencies and synergies can be a boon for shareholders in aviation stakeholders, but may also work against the public interest if increased business returns are at the expense of consumer interests and the economy as a whole.

As airlines and infrastructure operators seek to reduce costs through working together, it becomes a fine balancing act between allowing arrangements such as mergers and acquisitions to go ahead that make sense and can lead to benefits for more than just the two parties involved, while opposing those that threaten to reduce the competition that delivers lower costs to Australian businesses and the flying public.

In the middle of this fine balancing act sit government regulators like the Australian Competition and Consumer Commission. A major review by the Productivity Commission looking at price monitoring at our airports is well advanced, providing an important opportunity to take stock and have a look at the way the industry is run in this country.

Today I'd like to talk to you about the role the Australian Competition and Consumer Commission plays in Australia's aviation sector, in particular some of the basic principles that influence the decisions we make in trying to secure good competition outcomes in the interests of consumers.

I'd also like to go through some of the recent authorisation cases we have been involved in, and try to explain our thinking and how we've applied that.

A brief look at the sector

Just when you think you've got a reasonable understanding of the aviation market, the industry turns itself on its head and reinvents itself into something completely different.

After years of a relatively stable dual carrier model, Australia has seen several airline models tested on the domestic industry, from exclusive 'business only' operations, through to ultra-budget lower cost operators and everything in between. With overseas airlines reported to be interested in our domestic market and existing players constantly refining the way they operate, it appears the market will continue to evolve.

In addition aviation's role in freight transportation continues to increase as supply chain linkages become more sophisticated. Some of the transport ownership changes of the past year – in particular the Toll acquisition of Patrick (and hence Virgin Blue) – have changed the landscape of intermodal transportation.

According to the Bureau of Transport and Regional Economics the number of aircraft trips continues to increase, despite talk of capacity strain at some of our largest airports. BTRE figures show there were 44.2 million domestic passenger movements in 2006, an increase of 6.4 percent on the previous year. That's an increase of more than 10 million movements over the last six years – quite an achievement considering some of the turbulence the industry has struck during that time such as the collapse of Ansett and the September 11 terrorist attacks in the United States.

Looking to our region, clearly there are changes underway affecting the Asian market. Aircraft manufacturer Airbus is estimating the Chinese mainland passenger fleet will triple in the next 20 years, seeing an additional 3000 new passenger and freight planes required by 2025.

What are the implications for the Australian industry? It means we are going to have to continue to apply world-leading practice to the management of our limited resources if we are to remain competitive. It means as demand for access to services increases, pressure will also increase to ensure fair and equitable access is available to all and to allow competition to grow.

THE ROLE OF THE ACCC

To understand where the ACCC fits in, let me give you a broad understanding of our role. The ACCC is an independent statutory authority with seven fulltime commissioners who oversee around 600 staff decentralised in state capitals.

The backgrounds of commissioners vary with a range of legal, economic, business and technical skills. Sitting as a commission we make all major decisions but we don't formally manage staff - operating like a Board. Consideration of issues and decision making occurs through a committee structure – which provides a transparent and rigorous process.

The ACCC's primary responsibility is to administer the *Trade Practices Act 1974*. The ACCC has strong investigation and evidence gathering powers but must take enforcement action by instituting in the Federal Court. However it also has the power to accept Court enforceable undertakings. Other ACCC responsibilities include prices monitoring, quality of service monitoring and collecting and publishing information on financial performance.

Under the TPA our key areas of responsibility include addressing:

- anti competitive conduct
- misleading and deceptive conduct
- safety net of unconscionable conduct

The ACCC enforces regulations prohibiting anti-competitive conduct under part IV of the Act, such as misuse of market power, and fair trading under part V, which includes misleading behaviour, warranties and pyramid selling, among others. The ACCC's case against Flight Centre, which resulted in the company agreeing to stop using the slogan "Lowest Fairs Guaranteed" is an example of our work in this area to protect the public from being misled.

Significantly for aviation, the ACCC oversees proposed mergers in all industries to ensure they are not likely to result in a substantial lessening of competition.

The ACCC also has the capacity to agree to authorise "anti-competitive conduct" as defined by the Act, where net public benefit outweighs the detriment. This provides the applicants with immunity from any form of prosecution.

THE AUTHORISATION PROCESS

A significant component of the ACCC's aviation work in recent years has involved considering applications for authorisation. A number of major matters have involved international airline alliances. The ACCC's assessment of those matters is conducted on a case-by-case basis, looking at the merit of each matter, having regard to the particular markets or routes concerned, the extent of the benefits claimed and the impact of the particular alliance on competition in the markets concerned. In fact, as I'll demonstrate in a moment with a couple of examples, the differing individual circumstances of such proposals can result in very different outcomes, even where some of the same players are involved in each application. How a market changes over time can also lead to the ACCC changing a previously held position.

Our starting point in looking at such authorisations is considering what the benefits to the public will be, and weighing those up against any potential detriment that is likely to result from authorising the behaviour that would otherwise be prohibited under the TPA.

Let me explain by way of a couple of recent examples.

Qantas- British Airways

Qantas and British Airways have had in place a joint services agreement, authorised by the ACCC, since 1995. It was renewed in 2000, and again more recently in February 2005.

The five-year authorisation of the agreement allows the two airlines to coordinate their pricing, scheduling, marketing, sales, freight and customer

services between Australia and Europe via a number of mid-points such as Bangkok and Singapore.

While allowing the two carriers to coordinate activities did represent a lessening of competition in the business passenger market to the UK, the ACCC was satisfied that there was sufficient competition from other mid-point carriers to maintain a strong level of competition in most markets.

Allowing the two airlines to work together meant they would be able to reduce costs through greater efficiency, and our inquiries indicated that on balance those savings were likely to be passed on to most passengers of the airlines, therefore benefiting the traveling public.

Qantas-Air New Zealand

Looking to the Qantas-Air New Zealand deal however, led us to a different conclusion. On 18 April last year, Qantas and Air New Zealand lodged applications for authorisation of the Tasman Networks Agreement. The agreement would have allowed Qantas and Air New Zealand to coordinate all of their flights on the trans-Tasman route and to meet regularly to determine schedules and prices.

Qantas and Air New Zealand had previously sought authorisation for a similar agreement in December 2002. That agreement involved the coordination of activities in relation to all flights into, within and out of New Zealand. The proposed alliance was considered by competition regulators on both sides of the Tasman, as well as the relevant appeal bodies: the Australian Competition Tribunal in Australia and the High Court in New Zealand.

While in Australia the Tribunal authorised the proposed alliance in October 2004, the NZ High Court dismissed the appeal. As Qantas and Air New Zealand were unable to secure authorisation in New Zealand, they were unable to implement the arrangements under the proposed alliance.

In its assessment of the new 2006 applications for the agreement, the ACCC considered developments on the trans-Tasman since the previous application.

The ACCC noted that Qantas and Air New Zealand remain the largest competitors on the trans-Tasman route and combined, they account for around 80 per cent of trans-Tasman passengers. Both operate wholly owned 'low cost carriers' (Jetstar and Freedom Air International) in this market. The ACCC also noted that Virgin Blue and Emirates have not expanded their schedule scope and frequency since the information before the Tribunal in 2004. The coverage and frequency of their schedules remain inferior to those offered by Qantas/Jetstar and Air NZ/Freedom Air. The ACCC acknowledged that Qantas and Air New Zealand would continue to be constrained on the trans-Tasman, to some extent, by Virgin Blue and Emirates. However, the ACCC also considered that these rivals face barriers to expansion on the trans-Tasman and would not replace the competitive dynamics that currently exist between Qantas and Air New Zealand.

In particular, the ACCC considered that under the agreement Qantas and Air New Zealand would not be effectively constrained in the time-sensitive segment and on certain key trans-Tasman routes where they would become

sole-operators. The ACCC considered that authorisation of the agreement would fundamentally change the competitive process on the trans-Tasman and lead to higher prices and reduced choice for consumers.

On balance, it appeared there were only limited potential benefits to the public which would not outweigh the significant potential downside of Qantas and Air New Zealand no longer competing with each other. In a draft determination in early November 2006, the ACCC proposed to deny authorisation to the TNA.

The applications were subsequently withdrawn on 17 November 2006. In light of the withdrawal, the ACCC did not proceed with its consideration of the applications and did not issue a final determination.

IATA

As I've already mentioned, the ACCC believes very firmly in the benefits of strong competition in any industry. Before authorising any two or more competitors to agree on prices, schedules or other areas of their business we need to be satisfied there are compelling arguments that justify removing some of that competition from a market.

In the case of the International Air Transport Association, the ACCC has been carefully reviewing for some time an indefinite authorisation granted to IATA in 1985 for most of its programs. These programs are conducted through IATA conferences and cover, among other things, the development and maintenance of standards and procedures used by the airline industry, the allocation of slots at congested airports, and the setting of IATA interline fares and rates.

With IATA reportedly representing 250 airlines which account for 94 percent of international scheduled air traffic, allowing its members to jointly determine many arrangements in the aviation industry, in particular the setting of IATA interline fares and rates, has the potential to raise competition concerns.

After IATA amended its application in August last year, the ACCC granted authorisation to the Association on a transition basis which will see a phased removal of the current indefinite immunity by the end of June 2008. Authorisation of certain programs has already ended.

The ACCC takes the view that there are potentially significant benefits in allowing IATA time to assess and adjust its conduct, and if necessary seek further authorisation from the ACCC before the current immunity lapses. The ACCC considers that allowing IATA more time through the transition authorisations can allow the Association to address concerns raised by both the ACCC and other parties.

MERGERS

Assessing mergers and acquisitions under section 50 of the TPA is only one part of what we do at the ACCC, but it receives the lion's share of attention from the media and the public.

The main question we ask when seeking information from the market or from our own investigations is whether allowing the merger to proceed will result in a substantial lessening of competition.

This is at the core of our merger assessment process, and is based on section 50 of the Act which prohibits mergers that substantially lessen competition in a market.

Of course the major aviation acquisition that will be of interest to you here today is the multi-billion acquisition of Qantas by a consortium of investors.

Qantas APA acquisition

On 1 March the ACCC announced its decision not to oppose the proposed acquisition of Qantas by Airline Partners Australia. After extensive investigations the ACCC made the decision on the basis that the proposed acquisition would be unlikely to substantially lessen competition.

One of the key issues was whether Macquarie Bank's partial interests in Qantas and Sydney Airport could lead to discrimination in favour of Qantas by Sydney Airport management, giving rise to a lessening of competition in downstream aviation markets.

Given that Sydney Airport can already exercise a level of market power and can discriminate between airlines for its own commercial reasons, the key question was whether the acquisition by Macquarie Bank of a minority shareholding in Qantas would increase its ability and incentive to discriminate in favour of the airline.

The ACCC conducted extensive market inquiries with interested parties, concluding that while there is a level of influence by Macquarie Bank over Sydney Airport, this influence is mitigated by a series of regulatory and corporate constraints.

Even if Macquarie Bank had some ability to influence Sydney Airport, the ACCC’s assessment of a variety of potential discrimination scenarios indicated that there were not clear incentives for Macquarie Bank to seek to actively discriminate in favour of Qantas.

Ultimately, the ACCC decided that it was unlikely that a substantial lessening of competition would arise as a result of the proposed acquisition.

It should be noted however, the ACCC’s assessment was only one hurdle required before the acquisition could proceed. The matter was also referred to the Foreign Investment Review Board and the Treasurer was still ultimately able to reject the deal should be have reasonable grounds to do so.

MONITORING PRICES AND PERFORMANCE AT AUSTRALIA’S AIRPORTS

As most of you here today will be aware, the Treasurer and Minister for Transport and Regional Services announced last year that the Productivity Commission would be undertaking a public inquiry into issues relating to price

monitoring at airports. A draft of the Commission's report was released publicly last September.

This review is in line with the commitment made in 2002 to review every five years the current practices and how effectively they are working.

In 2002 the Government opted to remove price cap regulation from Australia's seven largest airports and replace them with a system of price monitoring, which the ACCC administers. Our reports also look at the quality of services delivered at our airports.

The purpose of price-monitoring is to provide information to the Government. It should not be confused with regulation such as imposing price caps. Monitoring, as the name suggests, is about observing and gathering information and even where monitoring might point to a problem within a market, it does not automatically trigger action. It is up to the Government what it does with this information. Regulation on the other hand, is a form of intervention.

Those looking at our reports and asking if price increases are justifiable will be disappointed – our job is simply to present the information in a useful form, not to draw conclusions. It is also not part of our mandate to act or somehow 'police' the prices airports charge the travelling public – despite the occasional calls from media commentators for the ACCC to jump in and intervene on the public's behalf!

The PC review is looking at how effective the monitoring regime has been over the last five years and I do not wish to make any comment that may pre-empt that review.

What I can do, is share with you the details of our latest price monitoring report covering the 2005-06 period.

In general what we found was that prices, measured as aeronautical revenue per passenger, continued to increase at most airports during the year, although to a lesser degree than in previous years.

Prices ranged from a drop of 1.1 percent at Canberra to a rise of 49 percent at Adelaide, which is primarily the result of introducing a Passenger Facilitation Charge on the start of operations for the new Terminal 1.

Since price monitoring was introduced in the 2001-02 financial year, aeronautical revenue has increased between 21 percent at Sydney to 162 percent at Adelaide. Some of that rise can be attributed to the cost of increased security measures at our airports. Also of note is the increased revenue airports are making from related services such as carparking, taxi and check-in fees. Our report shows revenue from these services increased from 3 percent in Darwin to 16 percent at Canberra.

ACCESS TO AIRPORTS

Part IIIA of the *Trade Practices Act* recognises that some services or facilities such as pipelines or electricity networks are essential national infrastructure, and that in the interests of promoting competition, it may at times be necessary to legislate third-party access to those facilities.

The section recognises that it may be uneconomical for anyone else to duplicate the facilities and that allowing competitors fair access to the infrastructure is broadly in the public's interest.

At various times it has been argued that Australia's major airports represent such facilities, and should therefore be declared.

In May 2002 the government indicated that airport-specific access regulation would not continue to apply. Accordingly, s. 192 of the Airports Act was repealed on 6 September 2003 by the *Civil Aviation Legislation Amendment Act 2003.*

At present, Airports remain potentially subject to the general access provisions of Part IIIA of the *Trade Practices Act*.

The Government's preferred position is that access should be negotiated on a commercial basis. However, where access seekers are unable to come to an agreement, the ACCC can be called in to arbitrate under the Act.

In February this year Virgin Blue notified the ACCC of an access dispute with Sydney Airport Corporation Ltd.

The dispute relates to the method of allocating costs for access to declared airside services such as use of runways, taxiways, parking aprons and other associated facilities necessary to allow aircraft carrying domestic passengers to take off and land using the runways at Sydney Airport, and move between the runways and the passenger terminals at Sydney Airport.

The arbitration process is designed to be carried out in private, and it would be inappropriate for me to comment on it, other than to say that process has now begun.

CONCLUSION

Like all of Australia's industries, aviation in this country succeeds as the result of being part of a competitive environment, where anti-competitive conduct is relentlessly pursued and weeded out by the ACCC.

Regulation can become onerous when excessive, making it important to get the balance right between allowing aviation players to do what they do best – run airlines and associated services – while ensuring the gate to a level playing field is kept open for those wishing to compete and potentially offer increased services and better prices to Australian consumers and industry.

It would be a bold pundit indeed who today tried to predict what Australia's aviation scene will look like in five or 10 years from now.

But my hope is that what we will see is a thriving industry equal to the best in the world, one that has grown out of the foundations we have put in place so far entrenching the ideals of open access, transparent and fair regulation and the strongest possible competitive environment.