Australian Airports Association national convention 2007

The ACCC regulatory jigsaw puzzle and the parts that represent aviation

John Martin, Commissioner
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Introduction

Last month we watched with amazement as 500-odd tonnes of aviation ingenuity touched down gracefully at Sydney Airport. The A380's maiden commercial flight was a landmark achievement for an industry that finds itself in exciting times.

Not only are there a number of new commercial aircraft entering the Australian passenger market, new players in that market are announcing, almost weekly, additional routes, discounts or other improvements to services.

New carriers, or those with only small existing operations in this country, continue to look for possibilities to expand their services, especially in the increasingly competitive low-cost carrier market.

These are all encouraging signs of a healthy, competitive market that is responding to change with innovation in both products and services.

Those who stand to benefit the most from these developments are the Australian travelling public, both business and private travellers. This is good news for the Australian Competition and Consumer Commission, whose job it is to protect and promote the welfare of Australian consumers.

Today the topic of my talk is the 'regulatory jigsaw puzzle' which implies that there are a number of pieces. Perhaps these pieces could be seen in two broad roles that the ACCC has:

1. Firstly, as a monitor and a regulator of access to monopoly services;
2. Secondly, as a competition and consumer protection agency.

I would like to talk to you about these two roles and how the pieces of the regulatory puzzle comes together with the objective of promoting competition and fair trading, with protection for consumers.

The ACCC as Monitor and Regulator

I will start with the role which many of you here will be familiar – the ACCC's role in monitoring industry performance and regulating certain monopoly services.

Up until 2002, the largest airports were subject to price cap regulation, meaning prices on average could not increase above a certain rate set for each airport. In 2002 the Government opted to replace price cap regulation with a monitoring regime administered by the ACCC. The monitoring extends to the prices, costs, profits and quality of aeronautical services provided by the airports.

Monitoring is often referred to as a form of regulation, there is a careful distinction that needs to be made. The ACCC' monitoring of airport services is designed to provide information to the Government. It is up to the Government to then decide how it uses that information.

Monitoring does not involve intervention by the ACCC in the commercial decisions of the monitored airports. It is therefore quite distinct from the previous regime of price cap regulation where the pricing decisions of the airports were subject to constraints.

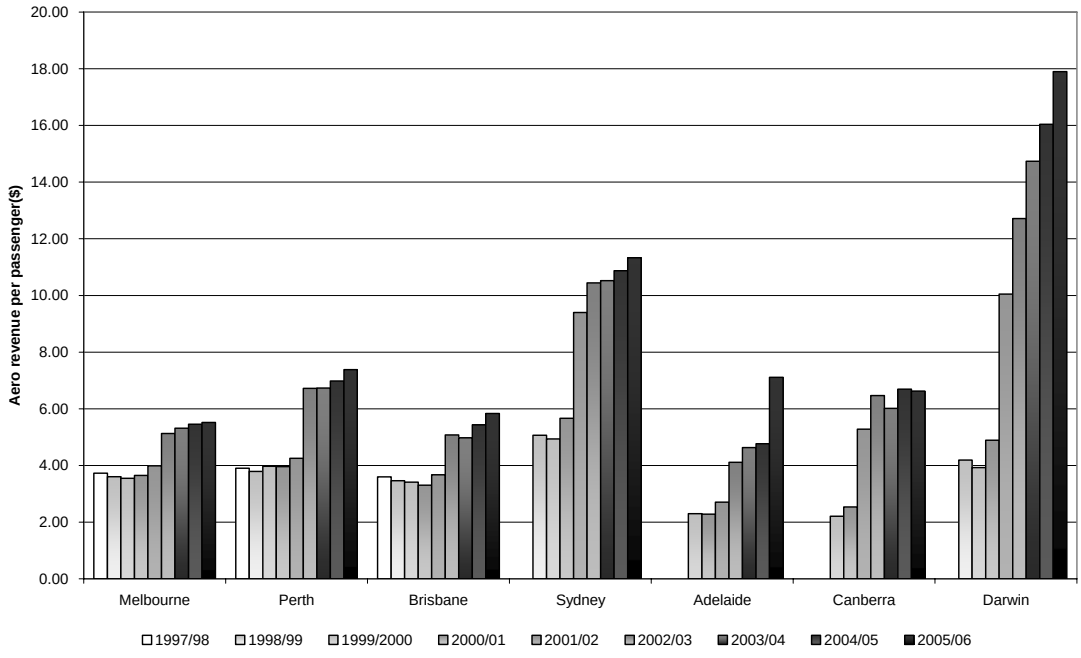
Monitoring involves the ACCC collecting information from the airports and other relevant sources, making some interpretation of that information, and presenting the results in ACCC reports.

Some results of the ACCC's monitoring

So what have those reports been telling us lately about the performance of the major Australian airports?

One thing we know is that results in these areas become more meaningful when reviewed over the longer term, rather than taking a snapshot of any particular year. The ACCC reports now present several years of data and some trends have emerged.

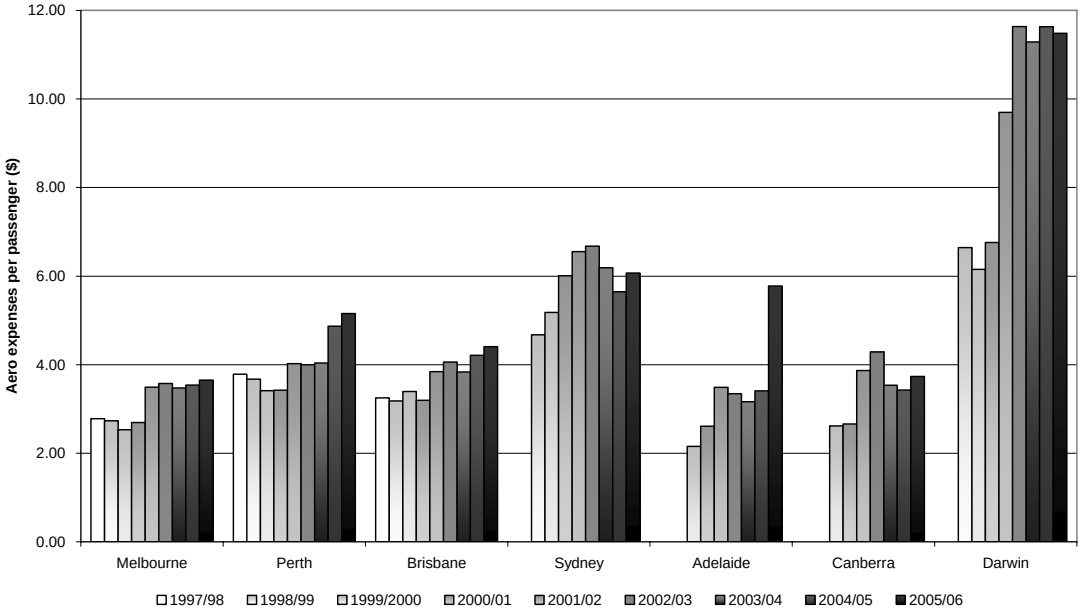
Show: Chart 2.2 from the 2005-06 prices report



Firstly, average revenue per passenger derived from aeronautical services has increased across the board. In particular we saw a jump in average revenues

(which can be interpreted as a proxy for prices) that coincided with the move away from price caps in 2002 to the light-handed monitoring regime that we have today.

Show: Chart 2.7 from the 2005-06 prices report



Secondly, average operating expenses per passenger associated with aeronautical services have also generally been increasing. At least some of the increases can be attributed to the airports taking on additional responsibility for domestic terminals following the demise of Ansett. We have also seen the costs of security per passenger grow at the majority of the airports.

Show: Table 2.1 from the 2005-06 QSM report

Rating	Rank	2002–03	2003–04	2004–05	2005–06
Good	1st	Brisbane	Brisbane	Brisbane	Brisbane
	2nd	Melbourne	Melbourne	Perth	Perth
	3rd	Sydney	Sydney	Sydney	Adelaide
	4th	Perth	Perth	Melbourne	Melbourne
	5th	Adelaide	Darwin	Canberra	Sydney
	6th	Darwin	Canberra	Adelaide	Canberra
Satisfactory	7th	Canberra	Adelaide	Darwin	Darwin

We have seen overall quality at all seven airports rated between satisfactory and good since 2002-03. We have also seen the effect of Adelaide

commissioning its new terminal, with a rise up the rankings from bottom place in 2003-04 to third in 2005-06.

PC Inquiry report into airport regulation

As many in this audience would be aware, the Productivity Commission conducted a review last year into the economic regulation of airports.

On the 27th of April this year the Government tabled the Productivity Commission's report into Price Regulation of Airport Services and shortly afterwards issued its response to that report.

The Government's response was to leave the existing arrangements largely unchanged and continue the light-handed monitoring regime for a six-year period, with some adjustments to:

- the airports covered,
- the services covered and
- provisions for drawing a 'line in the sand' regarding asset revaluations.

The Government also proposed an amendment to Part IIIA of the Trade Practices Act. Part IIIA provides for access seekers - such as airlines - to seek a right to negotiate access to services provided by owners of monopoly facilities - such as airports.

Implications of the new monitoring regime

The ACCC is currently preparing monitoring reports for the 2006-07 year. These will be the last reports under the old monitoring regime. This year's report will adopt the Government's view that the pricing and quality reports should be combined into a single report, unlike in previous years. The report will cover seven airports and we would expect to publish it early in the new year.
From 2007-08, monitoring will apply to only five airports – being Adelaide, Brisbane, Melbourne, Perth and Sydney. For the 2007-08 monitoring reports, the ACCC is currently reviewing three main areas:

- Price monitoring and financial reporting
- Quality of service reporting
- Car parking price monitoring

Price monitoring and financial reporting

The most prominent change in the financial reporting area has been the drawing of a 'line in the sand' for assets that provide aeronautical services. This change means for the purpose of monitoring, the value of these assets will be based on the values reported to the ACCC in 2004-05.

Significantly, this asset base will not be affected by any revaluation of assets that may have been undertaken by the airports after 30 June 2005. In order to consult on these arrangements, the ACCC circulated a draft of its proposed approach to the industry. The ACCC has received several responses from the industry, which are available on our website. We are now in the process of working through these responses and finalising a Guideline.

Quality of service

Secondly, the ACCC is undertaking a review of its approach to 'quality of service' monitoring. In going through this review we have revisited how we present the 'quality of service' information in our reports and we propose to make some changes beginning with the 2006-07 report. We are currently consulting with Treasury and the Department of Transport and Regional Services on the approach to 'quality of service' monitoring, and we would hope to be putting a paper to the industry for consultation before the end of the year.

Car parking price monitoring

Finally, the Government has asked the ACCC to monitor prices for short-stay car parking at the five airports being reported on. We are currently developing a methodology for this monitoring and we will be writing to the airports shortly to set out the information that the ACCC will require to undertake this task.

Part IIIA – Access to Services

As I mentioned earlier, the Government has also proposed to amend Part IIIA of the Trade Practices Act.

This part of the Act recognises that services provided by some facilities – such as certain aeronautical services at major airports – are essential national infrastructure. In the interests of promoting competition amongst those firms that depend on that infrastructure, it is deemed appropriate that users have the right to negotiate access to these services.

For instance, if say, use of refuelling infrastructure was deemed an essential service at a particular airport, and was declared under the Act, then any potential airline wanting to use those services would have the right to negotiate access to them.

These provisions exist to ensure competitors have the opportunity to enter what could otherwise be closed markets.

Where parties are unable to agree then either side can bring the dispute to the ACCC and the ACCC can act as arbitrator. As many of you may be aware, this arbitration process was tested earlier this year when Virgin Blue requested that the ACCC arbitrate a dispute that it was having with Sydney Airport Corporation regarding domestic airside services. About four months after commencing the process, Virgin Blue reached a commercial settlement with Sydney Airport and notified the ACCC that its role as arbitrator was no longer required. Once we received this notification the ACCC's role ceased. This illustrates that

commercial negotiations can proceed alongside the arbitration process under Part IIIA. It may also indicate that the arbitration process, with its emphasis on arriving at decisions in a certain time frame, may influence the timing of commercial dealings.

The Government's proposed change to Part IIIA refers to the criteria which the National Competition Council and the Minister refer to when deciding whether or not a particular service should be 'declared' under Part IIIA.

The proposed change is intended to provide greater certainty as to which services may be declared and therefore brought within the ambit of Part IIIA. I should note that the proposed amendments to Part IIIA have not yet become law.

The role of the ACCC as an arbitrator under Part IIIA will not change as a result of the proposed amendment. Part IIIA will remain a 'negotiate first, arbitrate second' regime. To this end I note recent comments from Sydney Airport CEO Russell Balding that the airport has recently reached commercial agreements with international airlines (through the Board of Airline Representatives) and, for domestic services, with Qantas and Virgin Blue.

The ACCC's ongoing role in price regulation

In addition to the generally light-handed approach to airports regulation, there remain a couple of areas of aviation where the ACCC administers price caps – namely, regional services at Sydney Airport and Airservices Australia.

Under the prices surveillance provisions of the Trade Practices Act, these firms are required to notify the ACCC of proposed price increases. The ACCC's role is to make an assessment of whether those price increases are appropriate based on economic efficiency – including whether they represent the taking advantage of market power. The ACCC then makes a decision to either object to or not object to those price increases.

A common thread with the ACCC's role as a regulator of access and monitor of performance is that there are areas where competition does not prevail – they are areas often described as natural monopolies. However, competition in other markets depends upon the monopoly service being provided on the basis of reasonable terms and conditions.

The ACCC's role in competition and recent TPA changes

Let me quickly summarise of the some of the most significant changes to the Trade Practices Act that have occurred recently.

Several years after they were first proposed in the Dawson Review, a number of significant recommended changes to the Act have largely passed. In particular, the penalties regime has been strengthened. For breaches of the competition laws, the pecuniary penalties payable by a body corporate are whichever of the following three amounts is the greater:

(i) $10,000,000

(ii) 3 times the value of that benefit obtained directly or indirectly and that is reasonably attributable to the act or omission. This of course applies if the Court can determine the value of that benefit

(iii) If the Court cannot determine the value of that benefit – the penalty is 10% of the annual turnover of the body corporate.

Voluntary Formal Merger Clearance System and New Merger Authorisation Process

Changes flowing from the Dawson Review also resulted in the introduction of a voluntary formal merger clearance system and a new merger authorisation process.

Prior to the Dawson Review changes, the system was primarily informal. This informal process continues today alongside the new formal processes.

The new merger authorisation process has also became effective as of January 1 this year. Under these arrangements, a merger that parties believe is likely to substantially lessen competition may be taken directly to the Australian Competition Tribunal. This is a particularly public authorisation process; in other words, parties will need to argue before the Tribunal that the acquisition will result in such a benefit to the public that the anti-competitive merger should be allowed to occur.

Collective Bargaining – Notifications Process

The Dawson Review also recommended changes to the collective bargaining process – allowing for small businesses to collectively negotiate with large businesses without breaching the Trade Practices Act. This immunity is available through a process of notifying the Commission and establishing that there is a public benefit.associated with that collective bargaining. These arrangements are voluntary in the sense that the Trade Practices Act does not require parties to lodge a notification. Rather it is up to the parties themselves to assess the need for such a notification. Not only has the new collective bargaining notification system been introduced, the ACCC has also streamlined its processes for authorisation of collective bargaining arrangements.

There have also been other changes to a number of small business provisions of the Act, such as those relating to unconscionable conduct.

The changes flowing from the Dawson Review also prompt the issue of possible further changes to the Trade Practices Act for cartel conduct that has attracted some comment in the current election campaign.

Cartels and Visy

I am not going to comment on the current political debate, but it is perhaps worth me noting the results of the recent cartel case against packaging company Visy. The Federal Court recently handed down a record penalty

totalling $38 million against Visy and its directors for its long-standing price fix with competitor Amcor.

In the context of this decision, the ACCC has again noted its view that hardcore cartel conduct should be made a criminal offence. This would allow the courts to send the worst offenders to jail and would provide a powerful incentive against those contemplating such arrangements. It would also bring Australia's penalties in this area into line with a number of our major trading partners including the US, UK and Canada.

The ACCC as a competition agency will continue to take action against anti-competitive activity in any industry.

Green marketing claims

As you may have noticed in recent press reports, the ACCC has been turning its attention to the area of green marketing claims. I note that this conference devoted yesterday afternoon to the topic of climate change and the future of aviation so such matters would appear to be of particular interest to this audience.

Most of the major airlines now offer carbon offsetting, or links to programs designed to offset the greenhouse gas emissions created by air travel.

Offsetting is by no means limited to airlines, it has become popular for a range of activities and industries, from carbon neutral events such as concerts, through to cars being sold that include offset quotas designed to compensate for some of the emissions they will create over their lifetime.

But the ACCC has received a steadily increasing number of complaints and inquiries around green marketing claims. This trend is consistent with the growing trend for business to green market their goods and services. There have also been questions raised overseas about the effectiveness of some of these programs and whether they are in fact leading to a reduction in overall CO2 levels.

As far as the ACCC concerned, whether a business is promoting their 'green' motor vehicles, 'green' flights, or 'green' toilet paper the Trade Practices Act consumer protection provisions apply.

What the Act says is that all businesses need to ensure they are not misleading their customers with such claims.

One of the reasons that businesses choose to market their green credentials is that it can give them a marketing edge over competitors or meet the demands of increasingly environmentally conscious customers.

Consumers across the spectrum are becoming more concerned and aware about the natural environment and hence businesses marketing goods with environmental characteristics will have a competitive advantage over businesses that do not.

To meet the demand of this current wave of green marketing claims a largely unregulated carbon-cutting business has sprung up selling 'offsets' which pay for projects elsewhere that neutralise an equal amount of emissions – planting

trees or fertilising oceans. This trade is currently estimated around $US100 million and growing. Consumers can carbon neutralise their car, their flight and most recently their household but are these claims too good to be true and do they truly deliver what consumers expect them to?

Dealing with carbon emissions is a difficult area, and there are issues about longevity and the amount of time, for example a tree takes, to offset the amount of CO2 it is credited with absorbing.

There are moves by international and domestic groups to introduce benchmarks in this new industry, and the ACCC will be monitoring developments to ensure customers are receiving the outcome they are paying for.

Conclusion

I have talked today about the ACCC's two roles as parts of a regulatory jigsaw puzzle. These two roles come together to form a complementary approach to enhance the welfare of Australians by promoting competition and fair trading and providing for consumer protection.

Where competition does not exist, the ACCC's role as regulator of access to services acts as to ensure that competition in related markets is promoted. Where competition does exist, the ACCC takes action to ensure that competitors do not act in an anti-competitive or deceptive way. By doing this, Australians have the best chance of enjoying the benefits of a free and open market.

Thank you.