

27 May 2010

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## BY EMAIL

Ms Tess Macrae  
Adjudication Branch  
Australian Competition & Consumer Commission  
Level 35 - The Tower - Melbourne Central  
360 Elizabeth Street  
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Dear Ms Macrae

### **Collective bargaining conduct notification CB00143 Response to Draft Objection Notice**

We refer to the Commission's Draft Objection Notice issued on 13 May 2010 to the collective bargaining notification CB00143 lodged by our client, Hertz Australia Pty Ltd (**Hertz**) on behalf of itself and Avis, Budget, Thrifty and Europcar (**Notification**).

This letter sets out our client's further detailed submission in response to the Draft Objection Notice. For the reasons set out below, Hertz submits that the likely benefits to the public from the notified conduct will outweigh any possible detriment from the proposed conduct and the Notification should be allowed to stand. Given the tight timeframes involved in this matter, Hertz seeks an expedited decision by the Commission in relation to this matter and waives its right to a pre-determination conference (in the interests of an early final decision).

On behalf of Hertz we have also retained Frontier Economics to provide an independent and detailed economic analysis testing the proposition that the Request for Proposal (**RFP**) process imposed by Westralia Airports Corporation Pty Ltd (**WAC**) is likely to provide an efficient mechanism for allocating scarce terminal space at Perth Airport. Part Restriction of Publication is claimed in respect of some elements of that Report as it refers to confidential information of Hertz. We attach as Annexure A the full confidential version of the report. Annexure B contains a redacted version for inclusion on the public register.

## 1. Summary of submissions

**There is no sound theoretical or empirical basis to conclude that the WAC RFP process will result in more efficient outcomes than the proposed collective bargaining process. In fact, there are a number of features of the WAC RFP process which are demonstrably likely to result in inefficiencies.**

**The collective bargaining process proposed remains a competitive negotiating process with any genuinely scarce services likely to be allocated, as between car rental companies wishing to operate at Perth Airport, on a competitive basis. The proposed collective bargaining process is in fact more likely to promote allocative efficiency than the flawed RFP process.**

**Collective bargaining enables the car rental companies forming the bargaining group to have meaningful input into all elements of the services they acquire at Perth Airport for the next 5 years, rather than having those terms dictated by the monopoly supplier. By facilitating a degree of countervailing power, the collective bargaining process has the potential to deliver public benefits in the form of more efficient and more favourable outcomes for car rental companies that are closer to the expected outcome from a competitive market.**

**There is no public detriment in curtailing a flawed tender process that is not likely to deliver efficient outcomes.**

**Any public benefits in the form of cost savings, improved efficiencies or ability to improve service offerings generated by the collective bargaining process are likely to be passed on to end consumers and should be given extra weight by the Commission.**

**The proposed collective bargaining process involves no proposal to engage in, nor any practical mechanism by which the parties could, exclude or competitively disadvantage Redspot or any other car rental company.**

**The likely benefits to the public from the notified conduct will outweigh any possible detriment from the proposed conduct and the Notification should be allowed to stand.**

## 2. Possible public detriment

### 2.1 Commission concerns

The Commission's central concerns as expressed in the Draft Objection Notice can be summarised as follows:

### **Allocative efficiency**

WAC's RFP process is likely to be a more efficient mechanism for allocating scarce terminal space than a collective bargaining arrangement.<sup>1</sup>

### **Damage to competitive tender process**

The collective process would result in explicit or implicit information sharing that would damage the integrity of the competitive tender process.<sup>2</sup>

### **Redspot competitively disadvantaged**

The collective bargaining process would put Redspot at a competitive disadvantage.<sup>3</sup>

## **2.2 Hertz submissions – allocative efficiency**

### **Summary**

**There is no sound theoretical or empirical basis to conclude that the WAC RFP process will result in more efficient outcomes than the proposed collective bargaining process. In fact, there are a number of features of the WAC RFP process which are demonstrably likely to result in inefficiencies.**

**The collective bargaining process proposed remains a competitive negotiating process with any genuinely scarce services likely to be allocated, as between car rental companies wishing to operate at Perth Airport, on a competitive basis. The proposed collective bargaining process is in fact more likely to promote allocative efficiency than the flawed RFP process.**

### **Submissions**

The question of whether one competitive process will be likely to result in an efficient allocation of resources, or a more efficient outcome than another competitive negotiation process, depends critically on design. As Frontier Economics notes: *'Whether a given tender will promote allocative efficiency will depend on a range of factors, including the nature of the products being bid for; the design of the specific tender process under consideration; and the structure of the market within which the tender is occurring'*.<sup>4</sup>

In Hertz's view there is insufficient analysis in either WAC's written submissions, or the Commission's Draft Objection Notice, to provide a proper foundation for a conclusion that the proposed RFP process meets the criteria for a process likely to promote efficient allocation of resources (either alone or vis-à-vis the proposed collective bargaining process).

<sup>1</sup> Draft Objection Notice, paragraphs 6.23-6.24. *'[The] outcome of the competitive tender is likely to be that the facilities, including premium counter and car park space, will be allocated to the car rental companies that value them most'*.

<sup>2</sup> Draft Objection Notice, paragraphs 6.44-6.45.

<sup>3</sup> Draft Objection Notice, paragraphs 6.50.

<sup>4</sup> Frontier Economics Report, p.15.

In Hertz's view, a detailed analysis of the actual design of WAC's RFP tender process clearly shows that there is no sound theoretical or empirical basis for a conclusion that WAC's RFP process is inherently efficient either on a stand alone basis, or relative to those outcomes that might be achieved under the proposed collective bargaining process. A full copy of the RFP tender documents issued by WAC are attached to the Frontier Economics Report in order to facilitate further detailed review by the Commission.

On close examination, WAC's RFP process is in fact a highly mechanised 'take it or leave it' one shot blind tender where the structure of and minimum levels of pricing are specified unilaterally by the monopolist supplier.

The Frontier Economics Report examines in detail the likelihood of the specific RFP process designed by WAC resulting in efficient allocation of resources in terms of:

- allocation of terminal floor space and land surrounding the terminal;
- allocation of counters and ready bays between different car rental companies; and
- allocation of demand risk between car rental companies and WAC.

Frontier Economics states that WAC's RFP process does not enable either of the first and third allocation issues identified above to be addressed, and in relation to the second issue, that the RFP process only enables allocation issues to be addressed in relation to a number of discrete issues unlikely to lead to material efficiency gains.<sup>5</sup>

Overall, Frontier Economics concludes that the RFP process is unlikely to lead to allocative efficiency at Perth Airport because:

- Many of the terms and conditions interested parties are required to include in their tender submission are not subject to bids or negotiation. Hence, the tender process will not be able to influence market outcomes via bidding on these terms and conditions.
- The terms and conditions parties can bid on are likely to lead to limited (if any) allocative efficiency gains.
- The RFP tender has design limitations that have the potential to limit the extent to which any allocative efficiency gains can be made.<sup>6</sup>

In fact, as set out in the Frontier Economics Report, the design of the WAC RFP process (as a single bid closed tender process):

- is consistent with what a monopolist would do to effect a monopoly market outcome that would involve a lower level of output and a higher price than that

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<sup>5</sup> Frontier Economics Report, p.13ff

<sup>6</sup> Frontier Economics Report, p.15

expected in a competitive market and which would involve allocative inefficiency;<sup>7</sup>

- is likely to increase the marginal cost for providers of car rental services at Perth Airport relative to existing licence conditions;<sup>8</sup> and
- will increase the final price paid by consumers of car rental services, which will not be in their interests.<sup>9</sup>

In comparison, the proposed collective bargaining process provides significant advantages in terms of potential to promote allocative efficiency. These include the following:

First, the collective bargaining arrangements are flexible and allow input from the major users of car rental inputs, including negotiation on both the structure and level of pricing for all elements of the proposed service offering from Perth Airport. As Frontier Economics notes: *'It follows, therefore, that the collective bargaining arrangements proposed by the collective bargaining group have the potential to influence the allocation of more scarce resources at Perth Airport than the RFP process proposed by WAC. Indeed, while the RFP process only addresses some of the allocation issues [identified in the Report], the collective bargaining arrangements have the potential to impact on all three sets of allocation issues.'*<sup>10</sup>

Secondly, the collective bargaining arrangements will permit a higher degree of transparency in relation to the willingness of car rental companies to pay for various elements of the services that might be offered by WAC. Hertz submits that permitting greater transparency in relation to price and demand between members of the bargaining group (ie information sharing in relation to their willingness to pay) will not lead to any public detriment in the present context. Rather, the converse is likely to be true.

As Frontier Economics notes, there can be no assumption that a 'closed tender' will result in more efficient outcomes than a 'public auction'. Indeed, for the reasons described at pages 25ff of the Frontier Economics Report, there are many theoretical advantages of open tender or auction processes which reveal parties' willingness to pay. Hertz submits that its proposed collective bargaining process, by revealing more information of this kind, in fact has the potential to increase efficiency. This is because the process facilitates transparency, but does not ultimately reduce competitive tension for genuinely scarce resources provided by the monopoly supplier. If the collective bargaining process reveals that some elements of the services offered are in fact scarce, or likely to be valued more highly by some users, there is no reason why those elements cannot be the subject of a supplementary competitive process within the framework of the collective bargaining process.

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<sup>7</sup> Frontier Economics Report, p.26

<sup>8</sup> Frontier Economics Report, p.28

<sup>9</sup> Frontier Economics Report, p.28

<sup>10</sup> Frontier Economics Report, p.17

In conclusion, Hertz submits that not only is there no theoretical or empirical basis for preferring the RFP process to the collective bargaining process on grounds of allocative efficiency, there are sound reasons for concluding that the collective bargaining process has the higher potential to deliver allocatively efficient outcomes.

## **2.3 Hertz submissions – damage to competitive tender process**

### **Summary**

**There is no public detriment in curtailing a flawed tender process that is not likely to deliver efficient outcomes.**

### **Submissions**

Hertz considers that the Commission's concerns in relation to 'damage to the integrity of the competitive tender process' are unfounded.

It is true that allowing collective bargaining will mean that WAC will not be able to as easily dictate the precise process or terms on which it wishes to negotiate. However, this would only be of concern if curtailing WAC's RFP process was likely to result in public detriment because that process was demonstrably more likely to deliver economically efficient outcomes than the alternative.

For the reasons set out above, Hertz is strongly of the view that this cannot be the case and therefore any concerns about 'damage to the proposed RFP process' cannot in and of themselves result in any public detriment.

## **2.4 Hertz submissions - Redspot competitively disadvantaged**

### **Summary**

**The proposed collective bargaining process involves no proposal to engage in, nor any practical mechanism by which the parties could, exclude or competitively disadvantage Redspot or any other car rental company.**

### **Submissions**

There is no element of the proposed collective bargaining process that is designed to exclude or competitively disadvantage Redspot, or which is likely to have that effect. The purpose of the proposed collective bargaining process is to seek to redress the imbalance in bargaining power between WAC and the members of the bargaining group, with a view to obtaining more favourable terms and conditions, the benefit of which will be passed on to consumers in the form of lower prices and/or improved services or innovation. At no stage has there been any intention to seek to exclude Redspot from operating at Perth Airport or otherwise competitively disadvantage Redspot.

As the Commission is aware, the parties have invited Redspot to join the collective bargaining group, should it wish to do so. While Redspot has declined to do so, Hertz submits that the parties' willingness to include Redspot in collective negotiations

powerfully demonstrate their bona fides lack of any intention to adversely effect Redspot.

Hertz further submits that there is, in any event, no practical mechanism by which the parties could exclude or disadvantage Redspot through their collective bargaining proposal. Hertz notes the following:

- It is common ground that WAC is a monopoly provider of car rental licences. No car rental company will or could be excluded from Perth Airport other than as a result of a decision by WAC not to grant that party a licence.
- There are currently 6 holders of licences to conduct car rental operations at Perth Airport and 6 proposed licences being offered by WAC. Redspot already holds a licence to conduct on-airport operations at Perth Airport (and at 5 other major airports). Absent a new entrant having successfully applied for a licence, it is likely that all existing car rental operators will have their licences renewed if they are willing to pay the WAC asking prices and terms.
- Should Redspot seek a different location or number of ready bays or counter space at Perth Airport, there is no limitation on it making its own offer to WAC in this regard (either separately or as part of the bargaining group if it chose to join the group).
- There is no logical reason why WAC would act contrary to its commercial interest and not accept the most favourable offer available (whether from Redspot, a member of the collective bargaining group, or another party) in relation to location of licensees' operations.
- Should Redspot exhibit a higher willingness to pay for a particular combination of services available at Perth Airport, it is highly likely to be awarded the right to acquire those services. It will be in WAC's commercial interest to ensure (whether or not a collective negotiation process is occurring with other car rental companies) that any company negotiating individually is provided with the opportunity to match or better competing offers.
- All other things being equal, if the collective bargaining group is successful in using countervailing power to obtain more favourable terms, Redspot has the opportunity to benefit also. In practical terms it can do so either by joining the group, or by benchmarking or referencing the outcomes achieved by the group in its own negotiations with WAC.

## **2.5 Hertz Submissions – other matters**

Hertz also notes the Commission's observations that one of the factors that may generally limit the anti-competitive effect of collective bargaining arrangements is if there are restrictions on the coverage and composition of the group.<sup>11</sup>

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<sup>11</sup> Mackay Airport Notification, paragraphs 3.30

Hertz submits that even though, as stated in WAC's submission, the collective bargaining group in the Notification *'make up a substantial proportion of the market for car rental services in Australia'*,<sup>12</sup> in the context of the voluntary nature of the arrangements and given the unquestioned monopoly held by WAC, the size and composition of the group should not be of concern to the Commission.

This is consistent with the Commission's approach in the recent Determination of Application for Revocation and Substitution of an Authorisation lodged by Board of Airline Representatives of Australia Inc, 14 May 2010, A91200 (**BARA Authorisation**).<sup>13</sup>

We also note that a group comprising the same members was not of concern to the Commission in its assessment of the collective bargaining notification lodged by Hertz, 7 December 2009, CB00138 (**Mackay Airport Notification**).<sup>14</sup>

### 3. Likely public benefits

#### 3.1 Commission concerns

The Draft Objection Notice does not separately identify concerns in relation likely public benefits independently of its assessment of public detriment.

#### 3.2 Hertz submissions – public benefits

##### Summary

**Collective bargaining enables the car rental companies forming the bargaining group to have meaningful input into all elements of the services they acquire at Perth Airport for the next 5 years, rather than having those terms dictated by the monopoly supplier. By facilitating a degree of countervailing power, the collective bargaining process has the potential to deliver public benefits in the form of more efficient and more favourable outcomes for car rental companies that are closer to the expected outcome from a competitive market.**

**Any public benefits in the form of cost savings, improved efficiencies or ability to improve service offerings generated by the collective bargaining process are likely to be passed on to end consumers and should be given extra weight by the Commission.**

##### Submissions

Given the submission made by Hertz above to the effect that its collective bargaining proposal is at least equal, if not superior, in terms of potential to promote efficient outcomes, Hertz considers that the following public benefits will arise if the Notification is allowed to stand.

<sup>12</sup> WAC submission, paragraph 2(b)(ii)

<sup>13</sup> BARA Notification, paragraph 4.106

<sup>14</sup> Mackay Airport Notification, paragraphs 3.41



The Commission has consistently recognised that collective bargaining with a monopolist supplier of airport services will provide purchasers with a degree of bargaining power that is likely to be reflected in more favourable terms and conditions being negotiated.<sup>15</sup> To quote the Commission's Determination in the recent BARA Authorisation (which also contemplated collective negotiation with monopolist providers of airport facility services):

*'The ACCC considers that collective bargaining arrangements can result in benefits to the public by facilitating improvements in the level of input a party has in their contractual negotiations. This improved input provides a mechanism through which the negotiating parties can identify and achieve greater efficiencies in their businesses, for example by addressing common contractual problems in a more streamlined and effective manner'.<sup>16</sup>*

Equally in the present case, collective bargaining is a way of redressing an imbalance of power in dealing with WAC, a monopolist supplier, to enable the parties to achieve a meaningful improvement in commercial outcomes that are more analogous to those which would be achieved in a competitive market.<sup>17</sup>

A collective process involving the same group and the operator of Mackay airport proceeded in an orderly and appropriate fashion and achieved significantly better terms than were initially proposed by the operator. The result is that consumers of rental car services at Mackay Airport will pay less to rent vehicles over the life of the collectively negotiated arrangement than if each group member had negotiated separately with the operator.

The participants in this proposed collective bargaining group compete in a highly competitive downstream market for the supply of car rental services to consumers. This appears to be generally accepted by the Commission<sup>18</sup> and is supported by Frontier Economics' analysis.<sup>19</sup>

Accordingly, any benefits obtained as a result of the proposed arrangements are likely to be passed on to consumers in the form of reduced charges and/or improved levels of service or innovation. Conversely, in the absence of collective bargaining, any monopoly rents extracted by WAC will also be passed on downstream to retail consumers in the form of higher prices and/or reduced access to car rental services. These propositions have in fact previously been accepted by the Commission in the context of the Mackay Airport Determination<sup>20</sup> and are supported by Frontier Economics' analysis in this case.<sup>21</sup>

In Hertz's view, any public benefits achievable under the proposed collective bargaining process should be given additional weight as, if achieved, they are likely to be passed through to consumers. This can be contrasted against a counterfactual

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<sup>15</sup> See Mackay Airport Notification, paragraphs 3.19 to 3.25, BARA Authorisation, paragraph 4.36-4.40.

<sup>16</sup> BARA Authorisation, paragraph 4.36.

<sup>17</sup> Mackay Airport Notification, paragraphs 3.19 to 3.21.

<sup>18</sup> Mackay Airport Notification, paragraphs 3.15 and 4.3.

<sup>19</sup> Frontier Economics Report, page 25.

<sup>20</sup> Mackay Airport Notification, paragraphs 3.16 and 3.25.

<sup>21</sup> Frontier Economics Report, pages 25-28.

where the RFP process results in the retention of monopoly rents by WAC, which will result in higher charges being passed on to consumers, and a reduced availability of car rental services at the downstream level.

If you have any questions in relation to this Notification or require any further information, please do not hesitate to contact myself or Celesti Hodgman of our office.

Yours faithfully  
**MINTER ELLISON**

**Geoff Carter**  
**Partner**

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Our reference:	CH RDM 30-6477567

enclosure

Restriction of Publication Claimed

**Confidential Annexure A**

**Frontier Economics Report – Assessment of allocative efficiency properties of  
Perth Airport's proposed tender process for car rental facilities, May 2010**

**FULL CONFIDENTIAL VERSION**

## **Annexure B**

**Frontier Economics Report – Assessment of allocative efficiency properties of  
Perth Airport's proposed tender process for car rental facilities, May 2010**

**PUBLIC VERSION**

RESTRICTION OF  
PUBLICATION OF PART  
CLAIMED



NON-CONFIDENTIAL VERSION

**Assessment of the allocative efficiency  
properties of Perth Airport's proposed  
tender process for car rental facilities**

A REPORT PREPARED FOR MINTER ELLISON

May 2010



# Assessment of the allocative efficiency properties of Perth Airport's proposed tender process for car rental facilities

<b>1</b>	<b>Introduction</b>	<b>1</b>
1.1	Background information	1
1.2	WAC's request for proposal	2
1.3	Hertz's collective bargaining notification	2
1.4	The ACCC's Draft Objection Notice	3
1.5	Structure of this report	4
<b>2</b>	<b>The nature of the allocation issues at Perth Airport</b>	<b>7</b>
2.1	Allocation of terminal floor space and land surrounding the terminal	7
2.2	Allocation of counters and ready bays between different car rental companies	8
2.3	Allocation of demand risk between car rental companies and WAC	9
<b>3</b>	<b>The design of WAC's tender process</b>	<b>11</b>
3.1	General aspects of WAC's tender process	11
3.2	Terms that are set in the RFP	12
3.3	Terms that interested parties can bid on	12
3.4	Comparison of previous terms and conditions with those set out in the RFP	13
<b>4</b>	<b>Is Perth Airport's tender process likely to promote allocative efficiency?</b>	<b>15</b>
4.1	The RFP tender cannot improve allocative efficiency for those terms and conditions that are fixed	15
4.2	Those elements in the RFP that can be bid on are likely to lead to limited allocative efficiency gains	17
4.3	The RFP tender is not designed in a way that guarantees allocative efficiency	22
<b>5</b>	<b>Impacts on consumers</b>	<b>25</b>
5.1	The structure of the market for airport terminal and car parking space at Perth Airport	25

## 5.2 Factors that will raise the price of car rental facilities at Perth Airport 27



# **Assessment of the allocative efficiency properties of Perth Airport's proposed tender process for car rental facilities**

## **Figures**

Figure 1: Monopoly market outcomes and allocative efficiency

27



# 1 Introduction

Frontier Economics has been asked by Minter Ellison to prepare a report that considers whether the tender process proposed by Westralia Airports Corporation (WAC) for allocating car rental facilities at Perth Airport is likely to promote an efficient allocation of these facilities.

## 1.1 Background information

WAC is the operator of Perth's domestic and international airports. During the 2009 calendar year, Perth Airport facilitated 10.1 million passenger movements.<sup>1</sup> Of these:

- 2.8 million represented international passenger movements (an increase of 9.0% on the previous year)<sup>2</sup>
- 7.3 million represented domestic passenger movements (an increase of 4.1% on the previous year)<sup>3</sup>.

Presently, there are six firms that operate car rental services on-site at Perth Airport. These are:

- Hertz Australia Pty Limited (Hertz)
- Kingmill Pty Ltd trading as Thrifty Car Rental (Thrifty)
- Budget Rent a Car Australia Pty Ltd (Budget)
- WTH Pty Ltd trading as Avis Australia (Avis)
- CLA Trading Pty Ltd trading as Europcar (Europcar)
- Redspot car rentals (Redspot).

WAC provides a number of facilities at its airport that enable car rental companies to provide retail services to consumers. These include:

- Space for terminal counters
- Car parking bays, which are referred to as "ready bays"
- Space to provide ready bay booths
- Way-finding signage that provides directions to car rental counters and ready bay areas.

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<sup>1</sup> Perth Airport, *Car rental - Request for Proposal*, 1 April 2010, at p. 3.

<sup>2</sup> *Ibid*

<sup>3</sup> *Ibid*

## 1.2 WAC's request for proposal

On 1 April 2010, WAC issued a request for proposal (RFP) for six on-airport car rental licences. The licences would apply for a five year period from 1 July 2010. The RFP specified:

- An annual fee for a terminal counter
- Annual fees for ready bay booths
- Annual fees for each ready bay
- A minimum percentage amount of gross turnover
- Minimum guarantees that a licence holder would need to pay WAC.

Interested parties were asked to bid on:

- The number of ready bays they would require
- The number of ready bay booths they would require
- The percentage of gross turnover they would pay
- The amount they would be prepared to pay for premium location terminal counters and ready bays.

## 1.3 Hertz's collective bargaining notification

On 3 May 2010, Hertz, on behalf of itself, Thrifty, Budget, Avis and Europcar (together the collective bargaining group), notified the Australian Competition and Consumer Commission (ACCC) of conduct under section 93AB of the Trade Practices Act (Act). In this respect, the collective bargaining group notified the ACCC of a proposal to engage in collective bargaining agreements.

The five parties forming the collective bargaining group represent five of the six companies presently providing car rental services on-site at Perth airport. While the other party providing car rental services at Perth airport (Redspot) was not included in the notification, we understand it has subsequently been offered the opportunity to join the collective bargaining group.

The notification of collective bargaining provided to the ACCC indicates that<sup>4</sup>:

The collective bargaining arrangements that are proposed entail the participants to this notification collectively retaining an independent third party (to be appointed), to negotiate on their behalf the price, term and other conditions at which the rental car companies will acquire airport facility services from WAC.

The type of terms and conditions of the licences expected to be negotiated in the collective bargaining agreement include price, term, maximum annual guarantee

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<sup>4</sup> Hertz Australia Pty Ltd, Form GA – Notification of Collective Bargaining, at pps 5 – 6.

payments, type and location of facilities. The licence fees for car parks (known as 'Ready Bays') at the international and domestic terminals of the Perth Airport are of particular importance to the participants in this collective bargaining arrangement, as WAC is proposing to increase these significantly ...

No dispute resolution process between the parties to this collective bargaining notification is proposed because each participant will be at liberty to withdraw from the collective bargaining process if it considers that its interests are not being served by the process.

The dispute resolution process between the parties to this collective bargaining notification and WAC during the collective process is proposed to be mediation followed, if necessary and appropriate, by arbitration or expert determination – this is also a matter to be negotiated with WAC.

The dispute resolution process between the parties to this collective bargaining notification and WAC during the term of the contractual agreements with WAC is also a matter to be negotiated.

WAC's proposed commencement date for the contractual arrangements with each party is 1 July 2010. Each participant will enter into a separate licence agreement with WAC. The expected duration of these contracts is 5 years.

The notification also noted that<sup>5</sup>:

The participants are not proposing to engage in conduct which relates to a possible exclusionary provision. In the event that an agreement cannot be reached with WAC, each party to the collective bargaining notification will unilaterally determine if it will, or will not, acquire airport facility services from WAC.

## 1.4 The ACCC's Draft Objection Notice

On 13 May 2010, the ACCC issued a Draft Objection Notice in relation to the collective bargaining notification lodged by Hertz on behalf of the collective bargaining group. In reaching its draft view, the ACCC concluded that:

- For car rental companies, there is likely to be limited substitutability between retail space and car parking space offered to them at Perth airport and that at other locations. This is because many customers hiring vehicles at the airport are likely to want to rent a car directly after arriving in Perth by plane and/or return a car directly to the airport before departing from Perth by plane<sup>6</sup>
- In the absence of the legal protection afforded by the notification, the most likely counter-factual to the proposed arrangements would be that each car

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<sup>5</sup> *Ibid.*

<sup>6</sup> ACCC, *Draft Objection notice in respect of a notification lodged by Hertz Australia Pty Limited*, 13 May 2010, at p. 6.

rental company party to the proposed arrangement would continue to negotiate individually with Westralia<sup>7</sup>

- Westralia has an effective monopoly at Perth airport<sup>8</sup>
- The value of car rental counter space and parking bays is likely to vary depending on their location, for example, because of its proximity to the terminal – in the case of parking bays; and arrival and departure gates – in the case of counter space<sup>9</sup>
- In these circumstances, a competitive tender process may offer a more efficient mechanism for allocating scarce terminal space than a collective bargaining arrangement. In addition, the outcome of the competitive tender is likely to be that the facilities, including premium counter and car park space, will be allocated to the car rental companies that value them the most<sup>10</sup>
- It is concerned that the proposed arrangements have the potential to damage the integrity of the competitive tender process if the collective bargaining notice comes into force while the tender process is still underway<sup>11</sup>.

## 1.5 Structure of this report

The focus of this report is on whether the RFP process established by WAC is likely to lead to an efficient allocation of resources at Perth airport. This is achieved by:

- Describing the nature of the allocation issues associated with the provision of rental car facilities at Perth airport (section 2)
- Outlining the design of WAC's RFP process (section 3)
- Considering whether the design of the RFP process is likely to improve allocative efficiency (section 4)
- Outlining the impacts on consumers we expect to follow from the RFP process set out by WAC (section 5).

For ease of reference and convenience, the following two documents are provided as annexures to this report:

- A copy of WAC's RFP for Perth Airport

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<sup>7</sup> *Ibid.*, at p. 7.

<sup>8</sup> *Ibid.*, at p. 8.

<sup>9</sup> *Ibid.*

<sup>10</sup> *Ibid.* at pps 8 – 9.

<sup>11</sup> *Ibid.*, at p. 12.

- A copy of Appendix VIII of Hertz's response to the RFP, setting out its bid on a number of key terms and conditions in WAC's tender process.

Both of these documents are confidential, and **restriction of publication is claimed** for these documents.

We have also provided both a confidential and non-confidential version of our report. Restriction of publication of part of the report has been claimed for certain of the material contained on pages 12-14; 17-22; and 25-28 of our report. Where this has been claimed, it is identified in the report and clearly marked in red.





## 2 The nature of the allocation issues at Perth Airport

When considering whether the RFP process designed by WAC is likely to lead to allocative efficiency, it is important to first understand the allocation issues that could be addressed via the terms and conditions for car rental companies at Perth Airport. In this section of our report we describe three main types of allocation issue:

- The allocation of terminal floor space and land surrounding the terminal between car rental facilities and other services
- The allocation of space and land devoted to car rental activities between different car rental companies
- The allocation of demand risk between WAC and car rental companies.

### 2.1 Allocation of terminal floor space and land surrounding the terminal

Floor space within Perth Airport could be used for a number of different purposes. These include the provision of arrival and departure services and forecourts; retail outlets; information services etc. The provision of car rental counters is one retail service that can be provided on the floor space within the terminal(s) at Perth Airport. An efficient allocation of terminal floor space would ensure that each square meter is devoted to a use that maximises the value to society of the floor space. This would involve consideration of how much floor space should be allocated to each possible use, and where within the terminal (taking account of proximity to departure and arrival gates, terminal exits etc) each use should occur.

Similarly, the land area owned by WAC that surrounds Perth Airport could be put to a number of uses. These include the provision of visitor car parking facilities; ready bays for car rental companies; bays for arrival and departure of taxi and bus services etc. Conceivably, land surrounding Perth Airport could also be devoted to other uses, such as providing hotels and conference venues. Again, an efficient allocation of land surrounding the terminals would ensure that each square meter of land is used in a way that maximises the value of the use of that land. This would involve consideration of how much land should be made available for each use, and where within available land each use should occur.

The RFP document released by WAC indicates that it intends to conduct significant work on re-designing and upgrading facilities at Perth Airport<sup>12</sup>:

Westralia Airports Corporation ("WAC") ... intends to consolidate both the Domestic and International Terminals within the International precinct, phased over ten years.

...

To facilitate aviation industry growth including car rental activity in the short to medium term, WAC has committed to significant investments to improve airport facilities including:

- Access to the domestic car rental ready bay area coupled with additional ready bays to create greater capacity
- Improved access between International and Domestic Terminals via a new link road to enhance operational efficiency
- Major improvements to the Domestic and International forecourt to improve the overall visitor experience
- Redevelopment and expansion of the International Terminal arrival and departure areas
- Redevelopment and expansion of the Domestic Terminal 3 departure lounge including a link to connect Qantas Terminal 2 with Terminal 3
- Investment and construction of Terminal WA to increase airport capacity and customer service.

Given WAC has indicated it intends to undertake significant redevelopment at Perth Airport, there is an opportunity to re-design the space used at its terminal(s) and the land around it to ensure an efficient allocation between alternative uses.

## 2.2 Allocation of counters and ready bays between different car rental companies

Where space is set aside in different parts of the airport for car rental counters, it is possible that the position of some terminal counters may be more valuable than others. This could be due to some counters being closer to departure gates and/or the location of ready bays outside the terminals. Allocative efficiency requires that the allocation of counters between different car rental companies will maximise the value of these counters.

Similarly, where there is a fixed number and location of ready bays that have been devoted to car rental purposes, allocative efficiency requires that these

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<sup>12</sup> Perth Airport, *op. cit.*, at p. 3.

facilities are allocated to car rental companies in a way that maximises value to society.

## **2.3 Allocation of demand risk between car rental companies and WAC**

The value of terminal space and land for car rental companies and WAC is largely derived from the revenue that can be earned from their use. In turn, the revenue is dependent on consumer demand for car rental and other services provided at Perth Airport. Such consumer demand is subject to risk.

For WAC, there is a risk that demand for car rental services may not turn out as expected, and that the space and land devoted to car rental services should have been devoted to other more profitable uses. There is also the risk that demand for airline services may fall (for example, in the event of major event such as a 9/11-type terrorist attack) such that revenues it can gain from the percentage of gross turnover for retail operators at its airport falls.

For car rental companies, there is the risk that demand for airline travel services may not be as high as expected, such that the number of consumers arriving and departing from Perth Airport is lower than anticipated. In turn, this would be expected to reduce demand for car rental services. There is also the risk that consumer preferences may change over time, with a relative increase in demand for taxi and other road transportation substitutes at the expense of car rental services.

It follows, therefore, that both parties are susceptible to demand-side risk – especially in relation to reductions in airline travel through Perth Airport. In these circumstances, it is not unreasonable that there should be some sharing, or allocation, of the risk between the parties. The way in which this risk is allocated can have significant impacts on pricing and output in downstream retail markets.



### 3 The design of WAC's tender process

The extent to which WAC's RFP process will lead to an efficient allocation of the factors outlined in section 2 will depend on the way it is designed. In this section, we set out key features of the RFP that will influence whether it will lead to an efficient allocation of resources. These features are divided into:

- General aspects of the tender process
- Those terms and conditions that are fixed in the RFP
- Those terms and conditions that are not fixed in the RFP – and therefore which interested parties can bid on.

Finally, this section compares the terms and conditions of the previous contractual arrangements between WAC and the car rental companies with the terms and conditions set out in the RFP.

#### 3.1 General aspects of WAC's tender process

The RFP issued by WAC on 1 April 2010 indicates that there are six licences available to operate on-airport at Perth Domestic and International Airport. The commencement date for the licences is intended to be 1 July 2010, and the licences would operate for 5 years.

The RFP specifies detailed information that should be provided in an interested party's submission, including in relation to:

- Broad company information on factors such as company background; ownership and management information; company financial information; ready bay booth design and operational strategies; pricing strategy; marketing strategy etc
- Details on key terms, including the fee to be paid for terminal counters; the number of ready bays a car rental company would like to acquire; whether (and how much) the car rental company is prepared to bid as a premium for preferred terminal counter and ready bay positions; a percentage of gross turnover licence fee; minimum annual guarantees etc.

Based on the material provided to us, it appears that WAC intends to run a single bid closed tender process. Interested parties will be unable to see the bids provided by other car rental companies, and will not be able to adjust their bids in light of observations they might make regarding bids lodged by other tender participants.

### 3.2 Terms that are set in the RFP

Appendix VIII of the RFP sets out the key terms interested parties should include in their submissions. While interested parties are offered the opportunity to bid on some terms and conditions in their bids, it appears that many other terms and conditions are fixed by WAC. In particular, it would appear that:

- The location of counters within both the international and domestic terminals is not subject to negotiation
- The location of the ready bays outside the terminals is not subject to negotiation
- The number of counters or ready bays available to interested parties is not subject to negotiation
- Interested parties are required to take one counter at each of the international and domestic terminals, and to pay **[Restriction of Publication of Part Claimed]** per annum for each counter
- The price per ready bay is fixed at **[Restriction of Publication of Part Claimed]** per annum
- Interested parties must offer a gross turnover fee of at least **[Restriction of Publication of Part Claimed]** per annum
- Interested parties must offer a minimum guarantee (MAG) of **[Restriction of Publication of Part Claimed]** of their forecast gross turnover fee in year one. In subsequent years, interested parties must pay the greater of the previous year's MAG or **[Restriction of Publication of Part Claimed]** of the prior year's actual turnover fee. It does not appear that the level of MAG is subject to negotiation.

In other words, allocation decisions in relation to these issues appear to have already been unilaterally made by WAC and are not subject to negotiation or bids in the RFP process.

### 3.3 Terms that interested parties can bid on

Appendix VIII of the RFP does, however, contain some terms and conditions that interested parties can bid on. These are:

- Whether interested parties would be prepared to pay WAC a percentage of their gross turnover greater than the minimum amount of **[Restriction of Publication of Part Claimed]** specified in the RFP
- The number of ready bays (and ready bays necessary to provide a ready bay booth) interested parties would like to acquire

- An interested party's preferred terminal counters, and any premium they are prepared to pay in order to secure their preference
- Any premium an interested party is prepared to pay on its ready bay fee in order to secure preferred ready bay locations
- The amount of forecast gross turnover, which impacts on the size of the MAG an interested party will pay WAC.

### 3.4 Comparison of previous terms and conditions with those set out in the RFP

The terms and conditions set out in the RFP represent a significant departure from the existing terms and conditions faced by car rental companies at Perth Airport. Based on data provided to us by Hertz, the RFP process involves:

- A [Restriction of Publication of Part Claimed] increase in the price of counters from [Restriction of Publication of Part Claimed] per annum to [Restriction of Publication of Part Claimed] per annum
- A [Restriction of Publication of Part Claimed] increase in the price of domestic ready bays from [Restriction of Publication of Part Claimed] per bay per annum to [Restriction of Publication of Part Claimed] per bay per annum. [Restriction of Publication of Part Claimed]
- .]
- A [Restriction of Publication of Part Claimed] decrease in the price of international ready bays from [Restriction of Publication of Part Claimed] per bay per annum to [Restriction of Publication of Part Claimed] per bay per annum. [Restriction of Publication of Part Claimed]
- .]
- An increase in the percentage of gross turnover fee from [Restriction of Publication of Part Claimed]
- The introduction of a MAG where no such guarantees existed before.

The changes in terms and conditions set out above will, in combination, greatly increase the fees a car rental company will pay WAC to use facilities at Perth Airport. In sum, these changes would have increased the counter and ready bay rental fee paid by Hertz in 2009-10 by [Restriction of Publication of Part Claimed] This is additional to the increase in the fee for percentage of gross turnover, and before Hertz might contemplate

paying a premium for its preferred locations for terminal counters and ready bays, or a higher gross turnover fee than the **[Restriction of Publication of Part Claimed]** minimum specified in the RFP.

Importantly, the increase in the minimum gross turnover fee and the introduction of a MAG both have the effect of increasing the marginal cost for car rental companies operating at Perth Airport. The implications of this are discussed in more detail in section 5 below.



## 4 Is Perth Airport's tender process likely to promote allocative efficiency?

In its Draft Objection Notice, the ACCC found that, in the circumstances:

... a competitive tender process may offer a more efficient mechanism for allocating scarce terminal space than a collective bargaining agreement. In addition, the outcome of the competitive tender is likely to be that facilities, including premium counter and car park space, will be allocated to the car rental companies that value them the most.

Based on information currently before the ACCC, the ACCC does not accept that the proposed collective bargaining conduct will, in this context, provide a more efficient outcome than the Request for Proposal process.

Competitive tenders and auction processes can promote an efficient allocation of resources in a number of circumstances. However, merely holding a tender process does not mean that improvements to allocative efficiency will necessarily occur. Whether a given tender will promote allocative efficiency will depend on a range of factors, including the nature of the products being bid for; the design of the specific tender process under consideration; and the structure of the market within which the tender is occurring.

In our view, there are three factors that tend to suggest the RFP process established by WAC is unlikely to lead to allocative efficiency at Perth Airport:

- Many of the terms and conditions interested parties are required to include in their tender submissions are not subject to bids or negotiation. Hence, the tender process will not be able to influence market outcomes (and therefore promote allocative efficiency) via bidding on these terms and conditions
- Those terms and conditions parties can bid on are likely to lead to limited (if any) allocative efficiency gains
- The RFP tender has design limitations that have the potential to limit the extent to which any allocative efficiency gains can be made.

Each of these issues is discussed in greater detail below.

### 4.1 The RFP tender cannot improve allocative efficiency for those terms and conditions that are fixed

Allocative efficiency is achieved where scarce resources are directed towards (or 'allocated' to) those uses where they will be valued most. Tender processes and auctions can help to achieve allocative efficiency by encouraging bidders to reveal their willingness to pay for scarce resources, and therefore how much they value

[Status]

Is Perth Airport's tender process likely to promote allocative efficiency?

those resources. Designed properly, this can assist in ensuring those parties that value a scarce resource most are able to acquire and use it.

Those terms that parties cannot bid on in a tender or auction process cannot, however, play a role in helping to efficiently allocate resources. For instance, if the price of a good is set up-front, all a tender process will tell you is how many bidders are prepared to pay that price. It will not, however, reveal which of the bidders has the highest valuation of the good, or to whom the good should be provided in order to maximise the value from acquiring the good. Similarly, if the number of goods on offer in a tender is fixed, the tender will only reveal how many parties value the good. The tender, of itself, will not reveal whether the resources used to provide the good would have been better devoted to an alternative use.

The RFP process proposed by WAC limits the number of factors that interested parties can bid on. In turn, this limits the extent to which the RFP process can promote a different (and therefore more efficient) allocation of scarce resources at Perth Airport. Having regard to the terms and conditions set out in section 3.2 above that have been fixed by WAC in its RFP process, it is clear that the RFP process will not address any of the allocation issues associated with how:

- Much terminal floor space, or how much of the land surrounding terminals, should be allocated to providing car rental facilities. That is, the RFP specifies the number (and position) of terminal counters and ready bays that will be available for car rental facilities, and does not appear to contemplate any changes to these factors.
- The allocation of demand risk between WAC and car rental companies. The RFP specifies the arrangements that will apply with respect to minimum guarantee payments, and does not appear to contemplate negotiation on these issues.

It follows, therefore, that the RFP process does not enable any of the allocation issues identified in sections 2.1 and 2.3 of our report to be addressed. While the RFP process does enable parties to bid in a way that will impact on some of the allocation issues identified in section 2.2 above relating to the allocation of counters and ready bays between different car rental companies, this is limited only to a few discreet issues discussed in section 4.2 below.

Importantly, and as discussed further in section 5.1 below, it cannot be assumed that the values set by WAC for these terms and conditions in the RFP reflect those that would generate an efficient allocation of resources at Perth Airport. As noted by the ACCC, WAC has an effective monopoly at Perth Airport, and there is likely to be limited substitutability for car rental companies between retail space and car parking space offered to them at Perth Airport and other locations. We would expect WAC has not been subject to competitive constraint when setting these variables. Instead, we expect it would have set these variables with

**Is Perth Airport's tender process likely to promote allocative efficiency?**

**[Status]**

the aim of maximising its own profits from operating Perth Airport, and not with a view to promoting allocative efficiency at its airport.

In contrast, the collective bargaining arrangement proposed by the collective bargaining group does not limit the terms and conditions that would be the subject of negotiation with WAC in this way. As indicated in section 1.3 above, the notification of collective bargaining provided to the ACCC indicates that<sup>13</sup>:

The type of terms and conditions of the licences expected to be negotiated in the collective bargaining agreement include price, term, maximum annual guarantee payments, type and location of facilities.

It follows, therefore, that the collective bargaining arrangements proposed by the collective bargaining group have the potential to influence the allocation of more scarce resources at Perth Airport than the RFP process proposed by WAC. Indeed, while the RFP process only addresses some of the allocation issues identified in section 2.2 above, the collective bargaining arrangements have the potential to impact on all three sets of allocation issues identified in sections 2.1, 2.2 and 2.3.

## 4.2 Those elements in the RFP that can be bid on are likely to lead to limited allocative efficiency gains

Clearly, there are some terms and conditions that interested parties can bid on in their submissions to the RFP process. These terms and conditions are set out in section 3.3 above. The extent to which bidding on these terms and conditions might be expected to influence allocative efficiency is discussed below.

### 4.2.1 Percentage of gross turnover

The RFP process requires that interested parties must pay a turnover fee of at least **[Restriction of Publication of Part Claimed]** of their gross turnover per annum. Interested parties are, however, able to offer to pay a higher percentage of their turnover if they wish.

It is not clear from the material what WAC is offering to interested parties that bid a turnover percentage higher than **[Restriction of Publication of Part Claimed]**. It does not appear that WAC will guarantee any particular benefit (such as preferred terminal counter or ready bay locations) to parties that offer a higher turnover fee percentage than their rivals.

We believe an interested party would only bid a turnover fee higher than the minimum of **[Restriction of Publication of Part Claimed]**

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<sup>13</sup> Hertz Australia Pty Ltd, *op. cit.*, p. 5.

.] In these circumstances, a car rental company may be prepared to offer a higher percentage turnover fee in order to secure one of the limited licences.

Presently, there are six rental car companies operating at Perth Airport (the five companies comprising the collective bargaining group plus Redspot). The RFP documentation indicates there are six on-airport car rental licences available as part of the RFP process. Frontier is not aware of any other car rental company that is seeking to acquire a licence to operate on-airport at Perth Airport. Similarly, the ACCC notes that:

The ACCC considers that there would be few alternative car rental service providers submitting tenders for a significant number of ready bays outside of the group members.

Further, we expect that a licence to operate on-airport is most valuable for car rental companies that operate at other airports around the country. This is due to the brand recognition and network effects that come from being able to offer consumers the ability to pick up cars at any airport in the country. We note that each of the collective bargaining group operates on-airport at 11 of the major airports around the country<sup>14</sup>. Redspot presently operates on-airport at 6 of these airports. We are not aware of any other car rental company that operates on-airport at any of these 11 airports.

#### **[Restriction of Publication of Part Claimed]**

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Based on the material before us, therefore, we do not consider the percentage of gross turnover fee term in the RFP process is likely to have a significant role in allocating any scarce resources at Perth Airport. **[Restriction of Publication of Part Claimed]**

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### **4.2.2 The number of ready bays required**

The RFP documentation asks interested parties to specify how many ready bays they would require at the price set by WAC. In that way, the RFP process is able

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<sup>14</sup> These are Sydney, Melbourne, Brisbane, Adelaide, Perth, Canberra, Coolangatta, Cairns, Townsville, Darwin and Alice Springs.

**Is Perth Airport's tender process likely to promote allocative efficiency?**

**[Status]**

to help determine how the overall number of ready bays being made available by WAC is allocated between interested parties.

It is not clear, however, on what basis ready bays will be allocated if interested parties require a different number of ready bays to those being made available by WAC. The RFP documentation merely notes that<sup>15</sup>:

... in the event that the number of ready bays are over subscribed, allocation will be at WAC's discretion.

In normal markets, a scarce good might be allocated on the basis of price (that is, whoever bids the highest price would be able to acquire the good at sale). In this case, however, the price of ready bays is pre-determined by WAC (at **[Restriction of Publication of Part Claimed]** per bay per annum). While it is possible that the amounts parties are willing to bid in terms of the percentage of turnover fee and the premium bids for locations might be taken into consideration when deciding how many bays to allocate to each interested party in the event the number of ready bays is over-subscribed, this is not clear from the material available to us.

Accordingly, it is not clear that bids around the number of ready bays interested parties require will ensure the RFP process leads to an allocatively efficient allocation of the set number of ready bays being made available by WAC at Perth Airport.

### 4.2.3 An interested party's preferred terminal counter

The RFP documentation offers interested parties the opportunity to nominate a preferred terminal counter (in both the domestic and international airports), and an amount they would be prepared to pay as a premium to secure this preferred location. The documentation also notes that<sup>16</sup>:

Should you wish to secure a location please insert the Premium Location reference as well as the bid amount in the table below.

The ACCC would appear to have placed some weight on this mechanism for allocating available counter locations in making its Draft Objection Notice<sup>17</sup>:

Different bays are likely to be valued differently by different car rental companies.

... the outcome of the competitive tender is likely to be that the facilities, including premium counter and car park spaces, will be allocated to the car rental companies that value them the most.

<sup>15</sup> Perth Airport, *op. cit.*, p. 27.

<sup>16</sup> *Ibid.*, at p. 28.

<sup>17</sup> ACCC, *op. cit.*, pps. 8 – 9.

Frontier accepts that where different parties have different valuations of a given good or service, a properly designed competitive tender process could help to ensure a more efficient allocation of the relevant good or service. However, we believe there are two factors that suggest such efficiency gains may not be particularly significant in this instance:

- A premium location is likely to be of value to a car rental company if it generates greater sales for it. This might occur if it leads to more “walk-up” sales from commuters disembarking from airplanes. If a particular counter is in a better location, it may be the first counter a traveller sees and therefore increases the likelihood of sales. We understand, however, that walk-up sales represent only a small proportion of overall sales for car rental companies providing services at Perth Airport. Data provided to us by Hertz suggests that only **[Restriction of Publication of Part Claimed]** of its transactions between January 2009 and May 2010 were a result of walk-up sales at Perth Airport. This suggests that most consumers choose their car rental company before they arrive at Perth Airport, and therefore that the location of a car rental counter would be unlikely to heavily impact on sales for car rental companies<sup>18</sup>.
- Close inspection of the RFP documentation shows that there is likely to be little difference in location between the available counters at Perth Airport. At the domestic terminal, five of the available counters will be grouped together and situated directly in front of two baggage carousels. While it is possible that one or more of these five grouped counters may represent a superior location to the others, this is not abundantly clear to us. The remaining counter (DC6) does appear to be situated further away than the other five, and may well be in a less favourable position. However, it does appear to be the counter closest to the location of outside ready bays. At the international terminal, five of the six available car rental counters are again grouped together. While it is possible that counters closer to the arrival gates would be more valuable to car rental companies, it is not clear to us that the difference in value would be significant. While the remaining counter (IC6) is located away from the other five, it is not clear whether this would represent a significantly better or poorer location for car rental companies.

#### **[Restriction of Publication of Part Claimed]**

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<sup>18</sup> Conceivably, repeat travellers to Perth Airport could be attracted to a particular car rental company if they remember one particular counter is easier to get to once they arrive at the airport. In this sense, pre-ordered sales could be influenced by the location of car rental counters. However, we have no data before us to confirm whether this is likely to be an influence on car rental sales at Perth Airport. Further, the close proximity of car rental counters to each other at Perth Airport discussed elsewhere in this report suggests this is unlikely to be a significant factor.

] If this is the case, it is unlikely much will be gained from having a competitive tender on this term. **[Restriction of Publication of Part Claimed]**

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#### 4.2.4 An interested party's preferred ready bay location

In a similar vein, the RFP documentation offers interested parties the opportunity to pay a premium above the specified ready bay price to secure ready bays in a preferred location. In this regard, the documentation notes that<sup>19</sup>:

The bids will be ranked by the bid amount and the successful Licensee in conjunction with WAC will select their locations in order of ranking.

It is conceivable that some ready bay locations would be preferable to others. We expect this would be the case if a certain ready bay location was likely to increase the volume of sales for a car rental company and/or lead to cost savings and improved productive efficiencies for one competitor over its rivals.

It is not clear to us, however, that the location of ready bays is likely to significantly impact on car rental sales at Perth Airport. We expect that the location of ready bays is likely to be even less significant for walk-up sales than terminal counters. While the proximity of a ready bay to the terminal exit may influence the convenience of choosing a particular car rental company, it is not clear that this would be a significant factor for passengers considering which car rental company to choose on arrival at Perth Airport. We expect many consumers would only seek to inquire about the location of a ready bay once they had made a decision to rent a car from a particular car rental company, and then required directions on how to get to it. Combined with the small proportion of sales that come from walk-up sales (as discussed in section 4.2.3 above), we expect the location of ready bays will have little bearing on car rental sales at Perth Airport. **[Restriction of Publication of Part Claimed]**

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] this aspect of the RFP process is unlikely to materially improve allocative efficiency at Perth Airport.

<sup>19</sup> *Ibid.*, at p. 28.

**[Status]**

**Is Perth Airport's tender process likely to promote allocative efficiency?**

#### 4.2.5 Forecast gross turnover and the MAG

The RFP process also requires interested parties to specify forecasts of their gross turnover for the five-year operation of a car rental licence. These forecasts are important for the RFP submission, because they impact on the MAG a car rental company will need to pay WAC if it is successful in securing a licence. This is because:

- The MAG in year one of the licence is **[Restriction of Publication of Part Claimed]** of the forecast Turnover Fee contained in an interested parties submission to the RFP
- The MAG in years two to five is the greater of the previous year's MAG or **[Restriction of Publication of Part Claimed]** of the previous year's actual Turnover Fee.

It follows, therefore, that the higher a car rental company's forecast turnover fee, the greater its guaranteed payments to WAC will be over the term of a 5-year licence to operate at Perth Airport.

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**[Restriction of Publication of Part Claimed]** it is unlikely that different bids with respect to forecast gross turnover will have a material impact in allocating any scarce resources at Perth Airport.

### 4.3 The RFP tender is not designed in a way that guarantees allocative efficiency

The previous two sections suggest that the RFP process designed by WAC is unlikely to play a significant role in any of the allocation issues identified in section 2 of this paper. However, even if the RFP process did allow interested parties to bid on terms and conditions that would have a material impact on allocation issues at Perth Airport, holding a tender process of itself would not ensure an efficient allocation of these resources. This is because the design of any tender process can undermine the prospects of a tender delivering an efficient allocation of resources. Holding a competitive tender process is not, of itself, sufficient to guarantee an efficient allocation of resources – a poorly designed tender process can still generate an inefficient allocation of resources. Further, while the design of a tender may improve the profits of a party seeking to sell a scarce resource by increasing competition for it, this is not necessarily the same thing as improving allocation of the resources from society's

Is Perth Airport's tender process likely to promote allocative efficiency?

**[Status]**



perspective. Maximising a seller's profit is not the same thing as maximising social welfare.

The economic literature contains many examples where the design of auctions and tenders can lead to poor outcomes for allocating resources<sup>20</sup>. In this instance, the RFP process proposed by WAC appears to be a single bid closed tender process. Under this method of allocating resources, interested parties are able to put forward a single bid, but are unable to see bids put forward by their rivals. This is different to an open tender multi-bid process, where parties can revise their bids once they have seen offers put forward by other parties.

The ability to revise bids based on observed offers from other parties can play an important role in allocating scarce resources. Where parties are unable to view bids put in by others, they are left to guess the valuation of a scarce resource that other parties might have. If one party under-estimates its rivals valuations' of a given resource, it may feel it only needs to offer a low bid in order to win the tender<sup>21</sup>. In these circumstances, a party may "under-bid" in a "one-shot" tender process and end up losing the tender to a party that actually has a lower valuation of the resource than it does. Such an outcome would not achieve an allocatively efficient allocation of the scarce resource.

To illustrate, suppose there are two parties bidding for a house in a single bid closed tender process. Person A values the house at \$200,000; while person B values the house at \$150,000. However, if Person A incorrectly assumes Person B values the house at only \$100,000, Person A may believe he only needs to bid \$100,001 to win the tender. If Person B bids anywhere between \$100,001 and their true valuation of the house, he will end up winning the tender despite having a lower valuation of the house. In these circumstances, a single bid closed tender process would lead to an inefficient allocation of the house, as the person who valued it most would be unsuccessful in winning the tender. This contrasts with an open tender multi-bid process where parties can revise their bids in light of bids made by other parties. Under this type of "ascending-bid auction", a more efficient allocation of resources can occur as parties will have an incentive to keep bidding until the price of a resource exceeds their valuation of it.<sup>22</sup>

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<sup>20</sup> For a survey of the literature on tenders and auctions, see Klemperer, P., *Auctions: Theory and Practice – The Toulouse Lectures in Economics, Nuffield College, Oxford University, Oxford OX1 1NF, England*.

<sup>21</sup> Parties naturally have an incentive to try to maximise their surplus from winning a tender process. Hence, they will try to offer the lowest amount possible they believe is necessary in order to win a tender process.

<sup>22</sup> Note, a closed tender/auction single bid process can still generate an efficient allocation of resources if the winner of the auction/tender is only required to pay the price offered by the second highest bidder. This type of process – sometimes referred to as a "Vickrey" auction – provides an incentive for interested parties to bid their true valuation of a resource as they know they will only need to pay the value bid by the second highest bidder if they win the tender/auction.

The RFP documentation does indicate that WAC may invite further proposals from interested parties<sup>23</sup>. In these circumstances, it is possible that WAC may try to elicit further and better bids on various terms and conditions once it has seen the bids of all interested parties. However, the RFP process does not guarantee that WAC would do this, or specify how it might seek revised offers from interested parties. It is by no means evident that WAC would seek to run a transparent tender process whereby parties were able to see the bids put in by their rivals, and adjust their own bids in response.

Based on the material provided to us, we believe the ACCC should be cautious before assuming the design of WAC's RFP tender process would be likely to generate an efficient allocation of scarce resources at Perth Airport.

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<sup>23</sup> See Perth Airport, *op. cit.*, at section 4.3(d)(iv) at p. 6.

## 5 Impacts on consumers

In this section of our report, we consider two factors that we believe will heavily influence outcomes for consumers under WAC's proposed RFP process. These are:

- The structure of the market within which the tender process is occurring
- Factors that will influence the marginal cost of car rental companies, and therefore the final price paid by consumers for car rental services.

### 5.1 The structure of the market for airport terminal and car parking space at Perth Airport

In its Draft Objection Notice, the ACCC notes that<sup>24</sup>:

... for car rental companies there is likely to be, at best, limited substitutability between retail space and car parking space offered to them at Perth airport and that available at other locations.

...

The ACCC agrees that Westralia has an effective monopoly at Perth Airport.

Frontier has no reason to disagree with these views. Based on material provided to us, it would appear that WAC is a monopoly supplier of car rental facilities at Perth Airport, and that there are six car rental companies that use access to these facilities to provide retail car rental services to consumers. At the retail level, there appears to be strong competition between these six service providers. Based on information provided to us by Hertz, it appears that **[Restriction of Publication of Part Claimed**

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At the outset, it is important to note that outcomes in the market for car rental facilities at Perth Airport are unlikely to reflect those one would expect in a competitive market. Like any monopoly supplier of goods and services, we expect WAC to set a price and level of output at Perth Airport that maximised its profits from providing car rental facilities at its airport. In other words, we expect WAC to be a "price maker", with the freedom to choose that level of price and output that will maximise its profits at Perth Airport.

In this regard, it is noteworthy that WAC appears to have unilaterally determined both the price and quantity for terminal counters and ready bays at its airport. It does not appear that it is open to negotiation with car rental companies on the

<sup>24</sup> ACCC, *op. cit.*, at pps. 6 – 8.

price and quantity of these services, or subject to competitive constraint from any alternative supplier of airport car rental facilities in Perth.

With regard to the level of output in the market for car rental facilities at Perth Airport, there is nothing in the tender process that could alter:

- The number of on-airport car rental licences at Perth Airport (and therefore the number of competitors in downstream retail markets)
- The number of terminal counters in both the domestic and international airports (indeed, it appears interested parties must take and pay for a counter in each terminal as part of the submission to the RFP)
- The number of ready bays provided at Perth Airport.

Further, the price of terminal counters and ready bays is fixed by WAC, and does not appear to be subject to any form of competitive constraint or negotiation with the car rental companies.

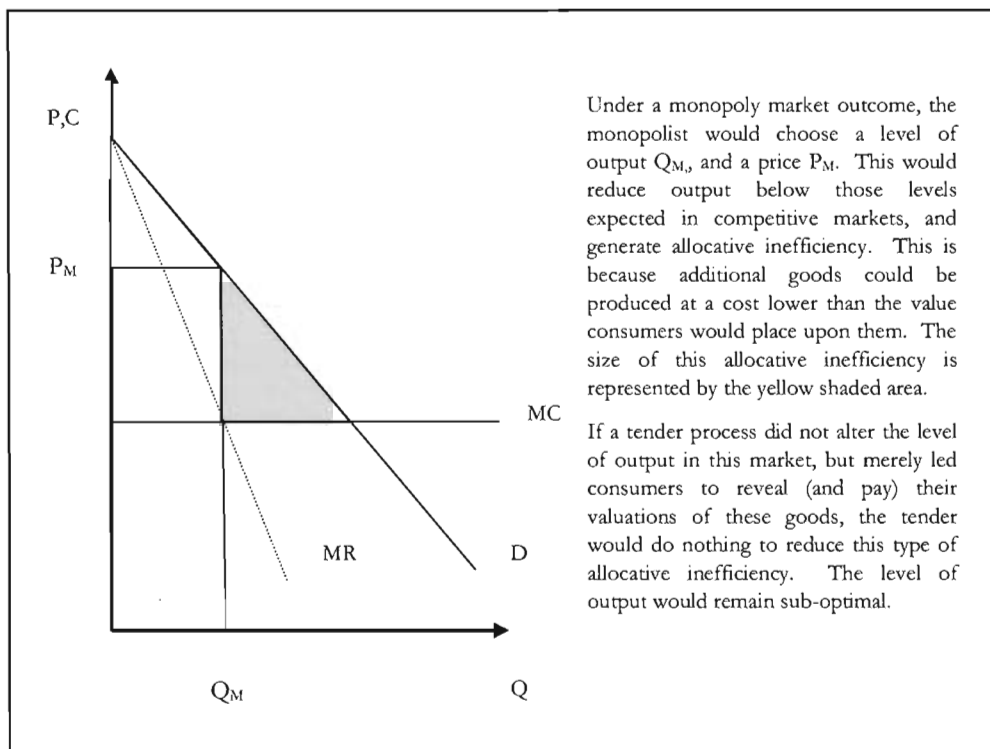
While the RFP process does enable car rental companies to offer premium bids to attain preferred counter and ready bay positions, these bids will not alter the number and position of these facilities. Were car rental companies to bid a premium for their preferred locations, this would not change the level of output in the market – instead, it would only have the effect of enabling WAC to extract a greater level of surplus from the fixed quantity of services it is providing to car rental companies.

We believe the type of outcome likely to be generated by the RFP process is consistent with a monopoly market outcome, where a monopolist would unilaterally set the price and level of output in a market in a way that maximises its profits. This is illustrated in the standard monopoly market outcome in Figure 1 below. This would involve a lower level of output and a higher price than that expected in competitive markets. It would also create allocative inefficiency.

In these circumstances, allocative efficiency would be improved if output were to increase closer to that which would be expected in competitive markets. This will not occur under the RFP process proposed by WAC. There is nothing in this process that will lead to a change in output in a way that would improve allocative efficiency. Instead, the RFP process only allows for the possibility that individual car rental companies may bid a premium above the price set by WAC to attain a preferred counter or ready bay location. **[Restriction of Publication of Part Claimed**

] we consider any allocative efficiency gains that might result would be minor, and a second-order issue compared to the broader allocated inefficiencies identified above.

Figure 1: Monopoly market outcomes and allocative efficiency



Source: Frontier Economics

## 5.2 Factors that will raise the price of car rental facilities at Perth Airport

Any factor that could change the marginal cost of providing car rental services at Perth Airport would be likely to directly impact on the price of car rental services for consumers. We also understand that car rental companies will charge different prices to consumers who collect cars at different locations. For instance, we understand that **[Restriction of Publication of Part Claimed**

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Our consideration of the material before us suggests there is nothing in the RFP process that would be likely to decrease the marginal cost for providers of car rental services at Perth Airport relative to the existing terms and conditions faced by car rental companies. Indeed, the comparison of existing licence arrangements with those contained in the RFP documentation in section 3.4 of this report suggests there are at least two ways in which the RFP process would increase the marginal cost for providers of car rental services at Perth Airport:

- The increase in the fee paid as a minimum percentage of gross turnover from **[Restriction of Publication of Part Claimed]** per annum to **[Restriction of Publication of Part Claimed]** per annum. In many ways, this is akin to a tax on income from providing car rental services at Perth Airport, and it increases the marginal cost to car rental companies of providing services.
- The introduction of a requirement for car rental companies to pay a MAG, where no such guarantee existed before. This has the effect of shifting a greater proportion of the demand risk of providing car rental services at Perth Airport from WAC to the car rental companies. Any increase in the risk for car rental companies will impact on their cost of capital for operating out of Perth Airport, and therefore be likely to raise their marginal cost of doing business at that airport.

We believe both of these factors will increase the final price paid by consumers of car rental services at Perth Airport, and will not be in their interests.

Anything that can help reduce the marginal cost of providing car rental services at Perth Airport would be likely to lead to lower retail prices, and therefore benefits, for consumers. To the extent that the collective bargaining arrangements proposed by the collective bargaining group allow for negotiation of both the percentage of gross turnover paid by car rental companies to WAC and the level of the MAGs, collective bargaining could generate lower marginal costs for car rental companies and therefore lower prices for consumers than might otherwise exist under the RFP process.

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