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Inquiry into Airport Regulation
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

Dear Commissioners

Airports Inquiry

This letter is the National Competition Council's submission in response to the Productivity Commission Draft Report: Economic Regulation of Airport Services (**Draft Report**).

This submission has been prepared by the Council Secretariat and considered by the Council. However, in order to avoid any actual or perceived conflict of interest, David Crawford, the Council President, took no part in the Council's consideration of this matter.

The abbreviations and defined terms used in the Council's 8 April 2011 submission have been adopted in this submission.

Show cause

The Commission's Draft Recommendation 11.1 is that the ACCC, on publication of its monitoring reports, should be empowered to issue a direction that an airport 'show cause' why its conduct should not be subject to scrutiny under a Part VIIA price inquiry. The issuing of a show cause direction would be based upon the ACCC coming to the view that there is prima facie evidence that an airport has, over time, demonstrated a consistent pattern of excessive returns.

The Council supports the Commission's proposal that any show cause direction should reflect a multi-period assessment of airport performance. Single year snap shots cannot justify the issuance of a show cause direction, let alone a price inquiry under Part VIIA (with the attendant requirement that price rises during the inquiry period be approved by the ACCC).

More generally, the Council believes that a show cause process may enhance the consideration of whether to initiate a price inquiry—by requiring a more formal exchange of views between the ACCC and an airport before such an inquiry can be recommended—and thus reduce the risk of

inappropriate regulation. However, there is also a risk that once a show cause direction is issued, matters may inexorably proceed towards commencement of a price inquiry.

In the Council's view the desirability of a show cause process is not well made out in the draft report. In particular, the Council notes that in its draft report the Commission has said that:

- Australian airports compare favourably with overseas airports in terms of revenues per passenger, costs, profits and capital expenditure (Draft Report, pp xxxi-xxxii)
- 'overall the evidence indicates that the concerns about aeronautical charges mainly reflect a distributional tussle between airports and airlines, rather than inefficient impacts on the demand for air travel' (Draft Report, p 236)
- although monitoring has shown prices for airport services have risen substantially, 'whether such price increases constitute any misuse of market power is less clear, particularly when taken in the context of investment programs' (Draft Report, p 119)
- quality of service monitoring results on their own 'do not indicate any persistent trends that could raise concerns about the misuse of market power' (Draft Report, p 128)
- airports' pricing and financial information 'does not provide evidence of misuse of market power' (Draft Report, p 237), and
- the risks in price regulation are asymmetric in that
    - excessively stringent regulation [endangers] efficient investment and the welfare gains associated with it, but
    - insufficiently stringent regulation ... would not significantly imperil welfare; its primary effect would be distributional' (Draft Report, p 68).

Given these conclusions it is unclear why the Commission considers any enhancement to the regulation of airport services is warranted. In the Council's view it would be valuable for the Commission in its final report to more clearly explain its intention and the objectives behind the proposed show cause process and how such a process is intended to operate. For example is the process to be incorporated into the Competition and Consumer Act and is it envisaged that a decision to issue a show cause direction would be subject to judicial review.

The Commission has also sought comment on whether the ACCC should be responsible for both issuing show cause directions and conducting any subsequent price inquiry. While ideally responsibility for a show cause function might be separated from a price inquiry to avoid any perception of predetermination of the inquiry conclusion, the benefits of this need to be balanced against the need for suitable experience and expertise in conducting a price inquiry. On balance the Council considers that the ACCC is best placed to undertake both functions. The ACCC is more likely than any other body to have the necessary expertise and experience to undertake a price inquiry in a comprehensive and timely manner. In the Council's view this benefit is likely to outweigh any concern about the ACCC undertaking both functions. Further, the Council notes that the decision to initiate a price inquiry ultimately lies with the Minister who will undoubtedly also consider advice from departmental officers as well as the ACCC recommendation. There may be benefit in retaining

the current flexibility for a price inquiry to be conducted outside the ACCC but in the Council's view the presumption should be that most such inquiries will be undertaken by the ACCC.

Deemed declaration

The Council strongly agrees with the Commission's recommendation that deemed declaration of airports (or more correctly airport services) should not be introduced.

The Council's role is to advise the designated Minister as to whether statutory criteria are met in respect of a service and that the service should be declared such that access disputes in respect of it may be arbitrated by the ACCC.

The separation of functions between the Council and Minister on one hand, and the ACCC on the other, reflects the distinction drawn by the Hilmer Committee between the creation of access rights, which it saw as a decision for Government acting on independent advice, and the administration of the access regime, which it saw as the role of what is now the ACCC (Hilmer Report, Ch 14). To deem certain services to be subject to access regulation is to side-step the checks and balances of the declaration process envisaged by the Hilmer Committee and enacted by Parliament.

The National Access Regime applies across Australia and to all sectors of the economy other than communications services (which are dealt with in Part XIC of the CCA) and those services which are subject to approved access undertakings or certified state or territory access regimes. Within the National Access Regime the declaration criteria and the process for considering declaration applications provide a mechanism for ensuring that the establishment of a right to access serves the overall Australian national interest, and that the interests of society in developing competitive markets and achieving the efficient delivery of infrastructure services are properly balanced against the need for efficient investment. Deeming airport services to be declared represents a lowering of the threshold for the creation of access rights as a special case, despite there being limited justification in the Draft Report for increased regulation of airport services.

Deemed declaration is claimed to be justified because of perceived delay and uncertainty in the declaration process.

The Council addressed the issue of delay in its first submission to this Inquiry, noting among other things that the majority of applications are not reviewed and that the amended Part IIIA processes (which were designed to reduce delay) are yet untested. The Council also said that, to the extent that timeliness in making declaration decisions is an issue, this requires a general response rather than the adoption of ad hoc measures to bypass the process in particular cases. The Council maintains these views.

The Council is also concerned that rather than increasing regulatory certainty, deeming declaration may indicate that regulation of third party access can more readily be achieved through lobbying and ad hoc interventions than through the mechanisms set out in Part IIIA. In the Council's view this is likely to reduce the transparency and predictability of such regulation, not enhance it.

As a further step to improving the timeliness and certainty of decision making in relation to declaration of services under Part IIIA, the Council notes that in its 2010-11 Annual Report to Parliament, it has suggested that consideration be given to removing merits review of declaration decisions and relying instead on judicial review. The Council considers that such a change would be likely to assist in achieving timely decisions while retaining appropriate judicial oversight that

ensures that Ministerial decisions and the Council's recommendations are made fairly and in accordance with the law.

Pilbara Rail decision of the Full Federal Court

On 4 May 2011 the Full Court of the Federal Court of Australia (**Full Court**) delivered its judgment on various review proceedings relating to the Tribunal's decisions on declaration of the Hamersley and Robe River railways operated by Rio Tinto (*Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2011] FCAFC 58) (**Pilbara Infrastructure v Tribunal**).

A critical element of the Full Court's decision concerns the construction of declaration criterion (b), which addresses whether it is uneconomical for anyone to develop another facility to provide the service for which declaration is sought. The Full Court held that criterion (b) 'requires consideration of the possibility of someone in the market place... being able to develop a similar facility' (Pilbara Infrastructure v Tribunal, [59]). The Full Court's approach seeks to identify an individual who might profitably build a duplicate facility and where such a person can be identified the criterion cannot be satisfied. This contrasts with and overturns the approach to criterion (b) that the Council, decision-making Ministers and the Tribunal have all adopted since at least 1999, in which criterion (b) was seen as being concerned with whether a facility exhibits natural monopoly characteristics such that it would be uneconomical—from the point of view of Australian society as a whole—for the facility to be duplicated.

The Council has sought special leave to appeal the Full Court's decision to the High Court. Fortescue Metals Group has also sought special leave, although on a wider set of issues than the Council.

In the Council's view the Full Court's decision in general greatly raises the threshold for declaration. However, given the nature of airport facilities, it may be that the effect of the Full Court's decision on the scope for declaration of airport services is more limited.

In any event the consequences of the Full Court's decision are of general application and any response should address the broad implications of that decision and should not be confined to any particular sector or type of service.

Other matters

The Council considers that the suggestion that the Council and the ACCC have 'contradictory views' as to the performance of the light-handed regulatory regimes (Draft Report, pp xxiv-xxv) tends to overstate the Council's position. The Council wishes to make clear that it has not formed a view as to whether greater regulation is warranted and in particular whether the criteria for declaration under Part IIIA might be met in any particular case. Rather, the Council's position is that bypassing the existing protections in Part IIIA is undesirable and the creation of access rights should be predicated on an independent assessment against the statutory criteria. To do otherwise would undermine confidence in the National Access Regime.

Incidentally, the Council notes that there are now five declaration criteria, rather than six as suggested in the Commission's draft report (at page 27). Criterion (d) (that access could be provided without undue risk to health and safety) was repealed by the Amendment Act in 2010.

If it would assist the Commission, the Council is happy to appear at the public hearing in Melbourne on 6 October 2011.

Please do not hesitate to contact me if you wish to discuss this submission.

Yours sincerely

John Feil
Executive Director