Westralia Airports Corporation Pty Ltd

Declaration of Airside Services at Sydney Airport

Submission to the NCC
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1. Introduction

Westralia Airports Corporation Pty Ltd (WAC) has prepared this submission in response to the National Competition Council’s (NCC) Issues Paper on declaration of Airside Services at Sydney Airport. The NCC paper requested submissions from interested parties on issues concerning the promotion of competition, effective access regimes and the public interest, as well as seeking specific comment from stakeholders on the definition of airside services and facilities to provide those services. This submission presents WAC’s views on these issues.

**WAC considers that the NCC should not declare the Airside Services at Sydney Airport as it is not in the public interest to do so.**

WAC has formed this view on the basis of the following:

- Declaration of Airside services would involve greater costs than benefits. In particular, regulatory control costs for the airport operator, Government and potential users would be significant;
- Community or individual business needs are likely to be disproportionately affected in the pursuit for lower prices for consumers;
- Declaration of Airside Services may undermine the environment necessary for new investment in airports, both for further expansions and through national precedent;
- Declaration of airside services will deprive the new owner or lessee of the opportunity to lodge an undertaking with the ACCC;
- Declaration of airside services will effectively deprive the new owner of the airport the ability to plan the most efficient use of airport land; and
- There has been insufficient time since the privatisation of Sydney Airport to determine whether or not its new owners are abusing the airport’s market power.

In this submission, WAC also provides commentary on the following issues raised by the NCC:

- Definition of ‘Airside Service’;
- The ‘minimum bundle of assets’ required to provide the Airside Service;
- Market power, countervailing market power and airline competition; and
- Duration of declaration.

WAC would welcome the opportunity to discuss our submission with the NCC. Should you wish to take up this offer, please call either Wayne Ticehurst or Brian Krause (08 9478 8888) at your convenience.
2. **Declaration of Airside Services at Sydney Airport and the Public Interest**

2.1 **The Public Interest Test**

WAC understands that the NCC intends to use the ‘public interest test’ to determine the net benefits of declaration of the Airside Service to the broader community.

It is understood that, in assessing the public interest, the NCC focuses on the effects of declaration on the welfare of the community as a whole. A key consideration within this focus is the net impact of declaration on economic efficiency. This encompasses the regulatory costs of declaration, including administrative and compliance costs for businesses, and the costs of regulatory failure. Regulatory failure can be said to occur when regulation itself undermines price signals, inhibits innovative activity or perverts incentives for investment.

The NCC considers a broad range of factors in its public interest test, as prescribed under the Competition Principles Agreements (CPA). The key factors include:

- Government legislation and policies relating to ecologically sustainable development;
- Social welfare and equity considerations, including community service obligations;
- Government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
- Economic and regional development, including employment and investment growth;
- The interests of consumers generally or of a class of consumers;
- The competitiveness of Australian businesses; and
- The efficient allocation of resources.

It is WAC’s understanding that the NCC considers all factors as equally important when determining where the public interest lies, and it is on this understanding that WAC has formulated its arguments on whether or not declaration of airside services at Sydney Airport is in the public interest.
2.2 Reasons why declaration of the Airside Services at Sydney Airport is contrary to the public interest

WAC considers, that according to the public interest test, declaration of Airside Services, will not be in the public interest because of the following factors:

- Declaration of Airside Services will lead to regulatory control costs that result in greater price increases to consumers, resulting in a net negative impact to consumers.

These price increases to consumers would be a result of a combination of cost influences, including:

- Direct regulatory costs, similar to that incurred by Sydney Airport, airlines and the ACCC in their most recent dealings on price determination. WAC conservatively estimates the total cost of the May 2001 Sydney Airport Corporation Ltd Aeronautical Pricing Proposal at around $10 million\(^1\) from all participants, or the equivalent of 5.5% of the allowable revenue determined by the ACCC for aeronautical services at Sydney Airport during 2000/01. Additional to these 5-yearly regulatory costs are annual economic regulatory compliance costs, which WAC has again conservatively estimated in the order of $2 to $3 million\(^1\) for all industry participants; and

- A reassessment of aeronautical charges upwards at Sydney Airport in the event of arbitration where access is still in dispute post declaration. WAC contends that any reassessment of allowable revenue for aeronautical services at Sydney Airport would likely result in a substantial increase over that previously allowed by the ACCC in its May 2001 decision, primarily as a result of the incorporation of land in the asset base at its true economic opportunity cost. That is, the ACCC in its May 2001 decision inappropriately adopted indexed historic cost rather than opportunity cost as the basis for valuing land at Sydney Airport. This had the impact of reducing SACL’s proposed value for aeronautical land, of $705 million, by over one-third, to $452 million. This lower land value led to average aeronautical price being approximately 8% lower than would otherwise have been the case, or approximately $15 million per annum in allowable revenue.

These combined costs, of approximately $20 million per annum, represent more than 10% of the allowable revenue for aeronautical services at Sydney Airport. WAC considers that these costs outweigh any perceived public benefit that would accrue to consumers as a result of declaration.

- Individual business needs, and potentially community needs, are likely to be disproportionately affected as a result of declaration.

WAC proposes that individual business needs, and community needs, be given equal consideration to that afforded to consumers by regulators. Our expectation of this equal

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\(^1\) Estimated by extrapolation from known costs and anecdotal evidence.
consideration is no different to the Commonwealth and State Government’s expectation of the role and function and economic regulation more generally. Several recent examples ratify this view, including:

- The recent Western Australia Supreme Court decision in the matter of *Re Dr Ken Michael AM; Ex Parte Epic Energy (WA) Nominees & Anor* [2002] WASCA 231 whereby the Court noted that the regulatory process is about mimicking the outcome that would typically be associated with workable competition, and not the theoretical state of perfect competition; and

- The recent statements by the Prime Minister John Howard and the National Party leader John Anderson who noted that small nominal gains for consumers can be at the cost of significant dislocation to an individual community, which would not necessarily represent a net public benefit.

**Declaration of Airside Services may undermine the current airport investment environment that has evolved since the adoption of the prices notification regulatory regime for aeronautical services introduced by the Commonwealth Government from 1 July 2002.**

Prior to this regulatory change, WAC contends that new investment activity in aeronautical assets had been stifled at most airports across Australia, including our own, due to the previous regulatory investment framework administered by the ACCC. WAC notes there were two inadequacies associated with this framework that, when combined, limit new airport investment. These inadequacies were:

- The Necessary New Investment (NNI) framework itself; and

- The administrative process adopted by the ACCC, and subsequently utilised by the airlines to stifle the process.

Fundamental to WAC’s concern is that declaration might reduce the incentive for access seekers to reach access agreements through (more cost effective) commercial outcomes. This is because any regulatory new investment assessment process administered by the ACCC will still likely result in it having an internal conflict of trying to achieve both consumer advocacy outcomes and economic efficiency.

If the services are declared, airlines will have an incentive to jeopardise commercial negotiations, in the knowledge that if they collectively disagree with a particular proposal, then it is likely that the proposal will be rejected by the ACCC.

The burden of proof is always put on airports to respond to airline claims no matter their merits and the ACCC has indicated it places great store on airline support for pricing proposals. This creates a clear incentive for airlines to indulge in regulatory gaming.

Market power of large airports is frequently captured by airlines through their control of slots. Regulatory pressure to reduce aeronautical charges simply allows airlines to

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"capture the economic rent" and due to the scarcity of slots, lower airport charges are not passed to the consumer.

In the past, the ACCC seemed to confuse a failure to reach consensus with a failure to consult. Therefore some airlines have had no intent to be committed to the consultative process so long as they had nothing to lose by having expenditure reduced or excluded by the ACCC. Under the CPI-X regime, airlines generally failed to build productive working relationships with airports, preferring to use the ACCC to arbitrate a position.

- Declaration of Airside Services will deprive Sydney Airport’s new owners of the opportunity to lodge an undertaking with the ACCC.

WAC considers that the loss of the new owners right to lodge an undertaking is contrary to the public interest. With members of the public now being shareholders in Sydney Airport, it is a matter of procedural fairness to allow an opportunity to lodge an undertaking.

- Declaration of Airside Services would effectively deprive the new owner of Sydney Airport the ability to plan the most efficient use of airport land.

Due to the controls imposed by the regulators declaration would have the potential to reduce the ability to manage the airport, the scope and nature of activities conducted on airport land and its ability to implement reforms. Sydney Airport is already capacity constrained and declaration would add to those constraints. WAC proposes that depriving the ability to plan the most efficient use of airport land is also not in the public interest.

2.3 Other relevant issues

WAC believes that there are other relevant issues, related to the public interest, that need to be considered within the declaration of Airside Services debate. These issues include:

- Agreeing on a consistent definition of public interest to be used when determining the effects of declaration on the welfare of the community as a whole. WAC supports John Anderson’s (the National Party leader) comment\(^3\) that a better definition of public interest is required to protect the needs of the community; and

- Allowing airports enough time under the new regime to develop an environment that encourages airports and airlines to negotiate commercial agreements. Some airports have already reached such commercial agreements and WAC is close to finalising a Prices & Services Accord, with all matters of substance agreed in principle with airline representatives.

The new regime has only been in place for 8 months, and should operate for the full five-year probationary period, recommended by the Productivity Commission, before assessing whether more regulation is required. However, the Commonwealth

\(^3\) The Age, *NP Wants Backdown On Competition Policy*, 27-03-02.
Government, in its response\(^4\) to the Commission’s report, said that it ‘reserved the right to re-impose price controls if it were found that airport operators were abusing their market power’. WAC considers this curbs any potential abuse of market power by airports.

WAC believes the Commission’s recommendations have not been given enough time to operate and prove conclusively that the airport’s market power is being abused under this regime. Further, WAC agrees with the Commission that there is an ever-present risk of regulatory failure, given the severe information problems confronting any regulator\(^5\).

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3. Commentary on other issues

3.1 Definition of ‘Airside Service’:
WAC agrees with the NCC definition of Airside Service as the service for the use of runways, taxiways, parking aprons and other associated facilities necessary to allow aircraft carrying domestic passengers to:

- Take off and land using the runways; and
- Move between the runways and the passenger terminals.

3.2 What is the minimum bundle of assets required to provide the Airside Service?
The NCC sought comment on ‘What is the minimum bundle of assets required to provide the Airside Service’. WAC considers the minimum bundle of assets required to provide airside services are the assets related to:

- Airside grounds, runways, taxiways and aprons;
- Airfield lighting and markings, airside roads and airside lighting;
- Airside safety and security;
- Nose-in guidance;
- Aircraft parking;
- Visual navigation aids; and
- Aircraft refuelling services.

3.3 Market power
WAC continues to hold the view that Australian airports are not likely to abuse their market power because of continuing under utilisation of existing aeronautical capacity, and the significant level of countervailing airline power that is in fact increasing as a consequence of structural change in the global airline industry.

In support of our ascertain, the Productivity Commission independently confirmed:

- There is strong evidence that the potential earnings from passenger spending on non-aeronautical services (including retailing, car parking and restaurants) provides airports with an incentive to encourage extra passengers to the airport\(^6\); and
- There is enhanced airline countervailing power in the current environment.

Further, the Productivity Commission found, that despite the major metropolitan airports such as Sydney, Melbourne and Brisbane having substantial market power, there was little prospect of airports using this power in a way that would produce large costs for the community or the economy. It argued that any attempts by airports to exercise their market power might be prevented by countervailing action by airlines, and that the reduction in demand for airport services since September 2001 is likely to have enhanced airline countervailing power, at least in the short term7.

WAC contends that the argument that threats by international airlines to withdraw services, or threats by domestic carriers not to increase services to an airport, carry significantly more weight than they did previously, and as such, airports in Australia remain captive in many respects to the market power of both international and domestic airlines.

3.4 What is an appropriate duration for any declaration of the Airside Service and why?

The NCC sought comment on ‘What is an appropriate duration for any declaration of the Airside Service and why’. WAC still contends that declaration of Airside Services at Sydney Airport is inappropriate. However, on the assumption that declaration were to occur, WAC suggests that its duration should be for a short period, expiring in time to give new owners of the airport the opportunity to lodge an undertaking. The duration of declarations could be set so that it expires after 12 months, allowing the new airport owners an opportunity to lodge an undertaking or otherwise reach a negotiated outcome with the airlines.