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20 October 2006

Mr Gary Potts
Presiding Commissioner
Inquiry into Price Regulation of Airports
Productivity Commission
PO Box 80
Belconnen ACT 2617

Dear Mr Potts

Review of price regulation of airport services: comments on the draft report

This letter constitutes a brief submission by the National Competition Council in response to the Productivity Commission's draft report on the review of price regulation of airport services.¹ The letter provides the Council's views on:

- the extent to which Part IIIA of the *Trade Practices Act 1974* acts as a constraint on monopoly pricing
- comments by Virgin Blue (sub. 45) in relation to merits review of regulatory decisions

Part IIIA and monopoly pricing

In its initial submission, the Council noted:

Part IIIA is not intended to remove or reduce monopoly rents where such rent extraction does not diminish competition in dependent markets. While it is likely that declaration (and subsequent negotiation/arbitration) will restrict the ability of infrastructure owners to earn monopoly rents, this is a by-product of declaration rather than its principal objective (sub. 5, p. 15)

In its draft report, the Commission observed in regard to Part IIIA, that there are '*some uncertainties about its general applicability in an airports context where service providers and users are vertically separate*' (p. 112).

¹ Mr David Crawford, the Council's Acting President took no part in developing or considering this submission in light of his role as the Chairman of Westralia Airports Corporation.

While a vertical relationship between an airport and an airline would prima facie warrant closer scrutiny, the absence of vertical relationships does not exclude the applicability of Part IIIA. As the Australian Competition and Consumer Commission observed:

The Part IIIA provisions are designed to address the consequences of substantial market power held by the owners of significant infrastructure facilities and prevent distortions to competition in that or related markets that may result from the exercise of such market power. This includes the incentives of non vertically-integrated monopolies to use their market power to charge prices above competitive levels at the expense of consumers and economic efficiency (sub. 46, p. 3)

Rather than vertical relationships, the central issue relates to when even non-discriminatory² increases in aeronautical charges might damage competition in related markets. This, of course, depends on many considerations, not least of which are the characteristics of the related market(s). For example, the exercise of market power by an airport might manifest in a way that impacted adversely on the price elastic customer segment of the domestic airline passenger market. And, if airlines were constrained in their ability to price discriminate in a way that lessened the impact on demand from an increase in airport charges, then such increased charges could lead to a contraction in certain services — that is, competition would be adversely affected.

The Council reiterates that Part IIIA is not intended to strip all monopoly rent, but nonetheless does operate as a constraint on the extent to which airport operators can increase their aeronautical charges.

Merits review

The Council has long been concerned with the ability of applicants for, and respondents to, declaration applications to ‘game’ the process. While the Australian Competition Tribunal considers the same criteria as the Council/decision maker, it regularly does so on the basis of evidence and submissions, including from expert witnesses, which were not put before the Council. The prospect of having a body able to re-determine a matter on a new set of facts:

- undermines the role of the initial Ministerial decision maker and the Council by effectively turning the Tribunal into a first instance decision maker
- provides an incentive for parties to withhold information for use in a de novo rehearing
- adds to the costs for private parties making and defending applications for declaration and to time and cost of Tribunal proceedings
- leads to avoidable delays to the resolution of such matters.

If de novo rehearings were uncommon this might be of limited concern. However, with the exception of one appeal that was withdrawn, every determination of an application for declaration under Part IIIA has been subject to such a rehearing by the Tribunal.

² Non-discriminatory in application as opposed to incidence, given that even uniform increases in aeronautical charges are likely to impact differently on low cost and full service airlines.

Accordingly, in its initial submission (sub. 5) the Council endorsed the recent COAG decision to amend the Competition Principles Agreement to include a provision that, where merits review of regulatory decisions is provided, the review be limited to the information submitted to the regulator.

In response to the Council's submission, Virgin Blue contended that it was:

.. troubled by the NCC's support for a proposal to limit the material that can be referred to in any review of a regulator's decision in circumstances where the regulator does not have the necessary power to properly test the weight that should be accorded to the arguments advanced by interested parties. Virgin Blue submits that it is most important that the right decision be made on the basis of all the relevant information, even if that decision differs from the initial decision due to differences in the information that was (or could be) provided to the initial decision maker (sub. 45, p. 25)

The Council concurs that decisions should be subject to appropriate review/appeal mechanisms because this unequivocally leads to improved regulatory decisions. Moreover, while the Council considers that appeals should proceed on the basis of evidence submitted to it during the process of it making its recommendation (or otherwise before the decision maker), it does not seek to bar new evidence being put before the Tribunal in appropriate circumstances.

It would be appropriate to introduce new evidence in an appeal where the Tribunal determined that such evidence could not have been made available to the Council/decision maker. The Council considers that an appropriately formulated exception to a general rule requiring appeals to proceed on that basis of the same material as available to the decision maker would adequately address Virgin Blue's concern.

To this end, implementation of the proposed reforms agreed by the COAG should improve regulatory decision making, increase certainty, reduce incentives for 'gaming' and reduce the time delays and costs faced by all parties, whilst ensuring that the appeal mechanisms are not constrained in their capacity to deliver appropriate outcomes.

Yours sincerely

John Feil
Executive Director