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Dear Mr Willett

VICTORIAN GOVERNMENT SUBMISSION ON THE ACTO APPLICATION FOR DECLARATION OF CERTAIN MELBOURNE AIRPORT INFRASTRUCTURE FACILITIES

The Victorian Government has prepared the attached submission for the National Competition Council's consideration as part of its assessment of the application by Australian Cargo Terminal Operators (ACTO) Pty Ltd for the declaration of certain Melbourne Airport services.

It is argued in the submission that the infrastructure facilities identified by ACTO are not natural monopolies and that it would not be appropriate to declare these facilities under Part IIIA of the *Trade Practices Act 1974*. The main issue with respect to the application appears to be the Federal Airports Corporation's practice with respect to licensing and other contractual arrangements for access to infrastructure services within the airport perimeter.

We trust this submission will be useful in the NCC's consideration of the ACTO application. If you wish to discuss the issues raised in this submission further, please contact Dr. David Briggs, Director of Reform Policy Branch at the Department of Treasury and Finance, on 9561 0915 or Mr Jamie Carstairs, First Assistant Secretary of Economic Development Branch at the Department of Premier and Cabinet, on 9651 0888.

Yours sincerely

Elizabeth Proust
SECRETARY

**Victorian Government Submission to the
NCC on the ACTO Application for
Declaration of Tullamarine Airport
Services**

March 1997

1. Introduction

This submission by the Victorian Government is prepared in response to the application made by Australian Cargo Terminal Operators (ACTO) Pty Ltd to the National Competition Council (NCC) for declaration of Federal Airports Corporation (FAC) infrastructure services at Tullamarine International Airport. This submission does not address the application for declaration of Qantas and Ansett's infrastructure services nor declaration of FAC infrastructure services at Kingsford Smith International Airport, Sydney.

At issue is whether Tullamarine airfreight infrastructure services are declarable for access under section 44G of the TPA. Consistent with section 44G, the infrastructure services to which ACTO are seeking access should only be declared where this would lead to substantial economic efficiency improvements. This is more likely to be the case where the following criteria are satisfied:

- the facility exhibits natural monopoly characteristics;
- relevant upstream and downstream markets are not already competitive; and
- there are no close substitutes in production or consumption.

The Victorian Government believes that the infrastructure services sought by ACTO for declaration do not exhibit natural monopoly characteristics. The existence of spare capacity in the production of passenger and airfreight services, currently unavailable for use by potential access seekers, does not appear to be due to a *structural* problem. Rather, the main issue appears to be the FAC's practice with respect to licensing and other contractual arrangements for access to infrastructure services within the airport perimeter.

To the extent that this is a conduct issue, and is not a structural issue, then the appropriate declaration outcome for airport services will depend critically on *ownership*, and in particular, how current management practices can be improved through incentives generated by private participation.

The Victorian Government anticipates that with the privatisation of Tullamarine Airport and hence the introduction of private sector ownership, there will be strong incentives for the new owner(s) to increase throughput to maximise profits.

- Due to high fixed costs (sunk costs) associated with airports generally, it is anticipated that private lease holders will increase throughput to lower unit costs of passenger and airfreight services. It is also anticipated that lease holders will adopt longer term strategies to attract related industries to co-locate within and around the airport perimeter to raise additional throughput capacity.

- This will necessarily generate opportunities for greater access to infrastructure services at the airport, as competition in upstream and downstream markets within the airport perimeter is encouraged.¹

2. Approach

ACTO seek declaration of three separate infrastructure services at Tullamarine Airport. They include:

- (1) freight apron and hardstand space within the airport perimeter to load and unload international aircraft (M1);
- (2) equipment storage facility space within the airport perimeter (M2); and
- (3) cargo terminal space within the airport perimeter (M3).

We will consider each of the infrastructure services separately against the section 44G(2)(a) and (b) declaration criteria. We will first examine criterion (b), since we consider the natural monopoly test embodied in this criterion is the test least likely to be met. In the submission, we do not take issue with the remaining criteria, in view of our conclusions with respect to declaration criteria (a) and (b).

In this submission, aspects raised in the NCC's Issues Paper of December 1996 and the Industry Commission's Submission to the NCC on the *National Access Regime: A Draft Guide to Part IIIA of the Trade Practices Act* of January 1997 are considered.

3. ACTO application for declaration of M1 infrastructure services

3.1 *Criterion (b) It would be uneconomical for anyone to develop another facility to provide the service.*

We understand that Qantas and Ansett currently provide ramp handling services on freight apron and hardstand spaces under contractual arrangements with the FAC. These arrangements apparently do not require Qantas or Ansett to pay the FAC directly for use of the freight apron facility.

We also understand that the FAC, as manager of Tullamarine Airport, controls access to freight apron spaces directly (through contractual arrangement) and indirectly (through controlling the issue of 'on airport driver's licenses' and control of access roads to freight apron spaces).

ACTO argues that it would be uneconomical to develop another airport in Melbourne to compete with Tullamarine Airport. Due to restricted access and the perceived natural monopoly characteristics of airports generally, ACTO argue that freight apron

¹ Monopolists tend to prefer competitive upstream and downstream markets for their services (where upstream and downstream markets are less than competitive, rents will be shared between the vertically integrated markets, thereby reducing the monopolist's profits in the intermediate market.

spaces *within the airport* should be declared for access. While we do not disagree with the assertion that it is uneconomical to jointly develop all services currently provided by Tullamarine Airport by another facility given present demand, we do not agree with ACTO's assertion that individual freight apron spaces are uneconomical to develop - freight apron spaces have already been developed for each passenger and cargo terminal within Tullamarine Airport. Indeed, *incremental* investment in freight apron space is planned for this year to meet an expected increase in demand (the FAC has recently announced that it will set aside \$4.2 million to expand freight apron areas).² This suggests it is technically feasible to develop additional infrastructure services in upstream and downstream markets to airport passenger and freight services within and around the airport perimeter.

The existence of multiple freight and passenger terminals, and thereby freight apron spaces, suggests that these spaces could potentially be allocated under a competitive tender process, which would allow for competitive provision of ramp handling services within and across freight apron areas. This suggests that perceived problems relating to access to facilities may be an institutional arrangement issue related to past commercial practice (*conduct*), rather than a natural monopoly (*structural*) problem.

This position recognises both the need to resolve true natural monopoly problems through workable third party access provisions, and the potential adverse consequences for infrastructure investment and resource management of obliging third party access to facilities which are not natural monopolies.

Prima facie, past development of freight apron space and scope for further investment in facilities, suggests that freight apron spaces do not exhibit natural monopoly characteristics, and are therefore economical to duplicate.

A second argument used by ACTO, despite FAC's claims to the contrary, is that there is considerable spare capacity available on freight apron spaces at Tullamarine airport and therefore the infrastructure service should be declared.

In our view, the existence of spare capacity on the freight apron does not, nor should it necessarily,³ imply that the freight apron space exhibits natural monopoly characteristics.

Rather, spare capacity on the freight apron which is presently unavailable to potential entrants appears to result from the contractual arrangements under which the FAC grants Qantas and Ansett access to the freight apron space, to the exclusion of other potential entrants.

- For instance, the FAC allocates valuable freight apron space to Qantas and Ansett through a quota arrangement, whereby neither operator pays FAC a user charge. ACTO asserts that this practice can continue since aircraft carriers effectively

² "FAC spends up to expand Vic freight", Daily Commercial News, page 1, 17/2/97.

³ In the case of a multiproduct natural monopoly, a more accurate test is whether the firm exhibits a strictly subadditive cost function.

cross subsidize Qantas and Ansett's activities through terminal parking fees imposed on them by the FAC. These inefficient pricing structures result in scarce apron space becoming artificially congested. It is likely that with the introduction of more efficient pricing structures, congestion would be reduced.

Because access appears to be restricted by commercial arrangements entered into by the FAC, Qantas and Ansett, essentially a *conduct* issue, and *not* due to *structural* characteristics of the freight apron space, the Victorian Government does not support the declaration of freight apron and hardstand spaces under Part IIIA of the TPA.

3.2 Criterion (a) Access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service.

To assess how competition will be 'promoted' from the granting of access to M1 infrastructure services it is necessary to identify the relevant market(s) in which competition may be promoted, and the existing level of competition in the market(s).

A market has been defined by the Trade Practices Tribunal as "...the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive".⁴ Section 44G(2)(a) requires the relevant market to be a market other than the market for the service. Competition can for instance be promoted in an upstream, downstream or other related market. This aspect is important because the fact that the market for the infrastructure service itself might not be competitive would not be a concern if there was already effective competition in the upstream and downstream markets.

In this submission it is argued that ramp handling services are *inputs* into the airfreight of *time dependent* export and import commodities.⁵ This is based on the view that ramp handling services are derived demands. That is, ramp handling services at Tullamarine Airport would not exist if exporters and importers did not require such services for dispatch of time dependent exports from production to final retail and wholesale markets.

Consequently, the upstream and downstream markets could include:

- production and final retail and wholesale markets of time dependent export and import commodities both Australia and overseas;

⁴ *Re Queensland Cooperative Milling Association Ltd* 1976 25 FLR 169 at 190, cited with approval by the High Court in *Queensland Wire Industries Pty Ltd v BHP* (1989) 167 CLR.

⁵ Time dependent goods are goods whose value is heavily dependent on the time taken for them to reach their final markets either due to perishability or need to satisfy immediate requirements to customers (eg perishables, international mail services and spare parts). As such, exporters and importers pay premiums for this service.

- intermediate freight services used to transport the commodities between production processes and the airport perimeter, and from the airport perimeter to final retail and wholesale markets both in Australia and overseas; and
- storage of time dependent commodities such as cargo terminal services (either on or off the airport perimeter) both in Australia and overseas.

It is in these markets which the NCC will need to be satisfied that access will promote competition. As discussed below, this will be unlikely to occur where there are available substitutes in production and/or consumption to airfreight ramp handling services.

It is suggested in this submission that the immediate market relevant to the M1 infrastructure service be defined as the ramp handling services market at Tullamarine Airport. We consider this market to be distinct from the market for cargo terminal services (ie storage) due to the absence of short or long run substitutability in production and consumption, and due to significant differences in functionality. Essentially, warehouse storage services are not highly substitutable for aircraft loading and unloading services.

If it is established that competition can be promoted in this immediate market, we suggest that the NCC broaden its market definition to include airfreight handling services at other airports, as well as freight handling services more generally (ie port, rail and truck handling services).⁶ By applying this two stage analysis, we can assess how sensitive the test for promoting competition in upstream and downstream markets is relative to broad and narrow market definitions.

While there do not appear to be any structural barriers to the entry of additional ramp handling service providers at Tullamarine Airport, freight apron space on which these services operate are characterised by spare capacity. This occurs because entry is restricted by virtue of the FAC's decision to grant access to the freight apron areas to Qantas and Ansett - to the exclusion of other potential entrants. Access could, in this instance, substantially promote competition in the ramp handling services market.⁷

However, will access promote competition in *broader* markets? We consider the broader market to potentially include the national market for airfreight handling services (eg, alternative ramp handling services at alternative local and interstate airports) and freight handling services more generally.

Under this approach it would be necessary to consider the current and expected availability of freight apron space at other airports such as Point Cook or Essendon airport for loading and unloading international commercial aircraft. According to ACTO's application, approximately 80% of airfreight is carried on passenger aircraft. The possibility that an effective *commercial* airfreight ramp handling service could be

⁶ If competition cannot be substantially improved in the immediate market it is unlikely to do so in any other upstream, downstream or related markets.

⁷ While some form of access may be considered desirable, the declaring of access under Part IIIA may not be the most appropriate approach.

conducted at Point Cook or Essendon airport may be considered further in the NCC's assessment. Indeed, there may be scope for substitutability in production and consumption of international passenger aircraft services for dedicated airfreight services at alternative airports. The NCC would consequently need to identify the level of competition (or contestability) in the provision of these services to assess the likely impact of access on competition.

Another consideration includes the operation of ramp handling services at competing interstate airports. Sydney airport ramp handling services are currently performed by the same operators present at Tullamarine airport. This suggests that the Tullamarine ramp services may not operate in competition with Sydney ramp handling services with regard to export and import of time dependent goods.

Airfreight services are often viewed as distinct to general freight services because airfreight services are typically inputs into the transportation of time dependent export and import commodities. It follows that where airfreight is not highly substitutable with non-airfreight, airport infrastructure services may not be substitutable for port, rail yard or truck yard handling services.

Theoretically, inbound international aircraft could choose to land in Sydney and transport airfreight by rail, road or sea to Melbourne rather than airfreight direct to Melbourne. In export markets, growers of produce in Victoria could choose to transport their produce by rail to Sydney to be loaded onto outbound international aircraft rather than export directly from Melbourne.⁸ Given sufficient price incentives, it could be argued that there is scope for substitution of airfreight for freight services.

Another important issue is whether the existence of inventory services within Australia may obviate the need for certain airfreight services. For instance, it may be profitable for distributors to order large overseas shipments of spare parts for capital equipment, enabling distributors to maintain an inventory service to supply customers immediately on demand. This suggests that there may be a degree of substitution between airfreight ramp handling services and port handling services for incoming shipments.

In summary, where access is deemed to promote competition in the immediate market, then to the extent the broader markets for airfreight ramp handling services at substitutable airports or general freight handling services are competitive (or potentially competitive), access to freight apron and hardstand areas will be less likely to promote competition in upstream and downstream markets.

⁸ A recent investigation by the ACCC into the airfreight industry using altimeters revealed that customers were not aware that airfreight was in fact being transported by land freight services. This suggests the scope for substitutability between air and land freight within Australia may be greater than initially recognized.

4. ACTO application for declaration of M2 infrastructure services

4.1 *Criterion (b) It would be uneconomical for anyone to develop another facility to provide the service.*

Facility spaces within the airport perimeter for facilities producing single outputs such as equipment storage services are not generally characterised by natural monopoly technologies. Therefore facility space for an equipment storage service - which may enjoy certain locational benefits from being provided near the freight apron - is potentially economical to develop outside the airport perimeter. If it was considered that such facilities were not economical to develop outside the airport perimeter due to the location constituting more than just a convenience factor, it is possible that space within the airport perimeter could become available were pricing structures more efficient to alleviate any prevailing congestion problem. Where it is technically and economically feasible to develop further facility space, the Victorian Government would not support the granting of access through application of Part IIIA.

4.2 *Criterion (a) Access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service.*

To assess how competition will be 'promoted' from the granting of access to M2 infrastructure services we will apply the same approach as taken in the previous section on access to M1 infrastructure services.

The downstream and upstream markets for M2 infrastructure services remain unchanged from those relevant for M1 infrastructure services - except that airfreight ramp handling services, both in Australia and overseas can also be considered upstream and downstream markets to equipment storage services.

While there do not appear to be any structural barriers to the entry of additional equipment storage service providers at Tullamarine Airport (the immediate market), space on which these services operate are characterised by spare capacity. This occurs because entry is restricted by virtue of the FAC's decision to grant access to these areas to Qantas and Ansett - to the exclusion of other potential entrants. Access could, in this instance, substantially promote competition in the provision of equipment storage services.

However, the NCC will need to establish whether a broader market exist. The national market for airfreight moving equipment storage services (eg, alternative services at alternative local and interstate airports) and freight equipment storage services more generally may need to be considered.

As noted in section 3.2, if access is deemed to promote competition in the immediate market, then to the extent the broader markets for airfreight moving equipment storage services at substitutable airports or general freight equipment storage services are competitive (or potentially competitive), access to airfreight equipment storage

services within the Tullamarine Airport perimeter will be less likely to promote competition in upstream and downstream markets.

5. ACTO application for declaration of M3 infrastructure services

5.1 *Criterion (b) It would be uneconomical for anyone to develop another facility to provide the service.*

Facility spaces within the airport perimeter for facilities producing single outputs such as cargo terminal services are not generally characterised by natural monopoly technologies (ie space for warehouses). Therefore facility space for a cargo terminal service - which may enjoy certain locational benefits from being provided within - is potentially economical to develop outside the airport perimeter. Indeed, ACTO currently operates a cargo terminal service outside the airport perimeter.

ACTO's application for declaration of airport space for a cargo terminal on airside would seem based more on a desire for *convenience*, rather than a reflection that cargo terminal operators are unable to operate from facilities in near proximity to the airport perimeter effectively.

5.2 *Criterion (a) Access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service.*

To assess how competition will be 'promoted' from the granting of access to M3 infrastructure services we will apply the same approach as taken in the previous section on access to M1 infrastructure services.

The downstream and upstream markets for M3 infrastructure services remain unchanged from those relevant for M1 infrastructure services - except that cargo terminal operations should not be treated as an upstream or downstream market. Instead, airfreight ramp handling services, both in Australia and overseas can be considered upstream and downstream markets to cargo terminal services.

With respect to the immediate cargo terminal services market, there do not appear to be any significant barriers to entry and exit to and from the cargo terminal services market. Although the FAC controls access to areas within the airport perimeter that could be used for cargo terminal operations, the spaces are potentially available under prospective private sector ownership. In addition, there is the potential for these services to be provided outside the airport perimeter where access is presently denied.

However, the NCC will need to establish whether a broader market exist. The national market for cargo terminal services (eg, alternative services at alternative local and interstate airports) and general freight cargo terminal services more generally may need to be considered.

In summary, where access is deemed to promote competition in the immediate market, then to the extent the broader markets for cargo terminal services at

substitutable airports or general warehouse storage services are competitive (or potentially competitive), access to cargo terminal spaces within the Tullamarine Airport perimeter will be less likely to promote competition in upstream and downstream markets.

6. Final comment

As a final qualification, our analysis of the application of the natural monopoly test has been based on the assumption that freight apron areas, equipment storage areas and cargo terminal areas can be treated separately from each other as stand alone single output facilities, rather than part of a larger multiproduct facility (ie the Tullamarine Airport). Were this latter assumption to be adopted by the NCC, then the existence of multiproduct natural monopoly characteristics would need to be identified.

7. Conclusion

In this submission, the Victorian Government argues that the main issue appears to be the Federal Airports Corporation's conduct, not the nature of the infrastructure itself. It has provided analysis that finds that the freight infrastructure services at Melbourne Airport do not meet the necessary declaration criteria under Part IIIA of the Trade Practices Act. As such, the NCC should recommend that they not be declared as essential facilities.