

National Competition Council

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Airport Regulation Inquiry
Productivity Commission

Submitted via the Productivity Commission website

Dear Commissioners

Economic Regulation of Airports

The National Competition Council provides the attached submission in response to the Productivity Commission's Draft Report: Economic Regulation of Airports (**Draft Report**).

If the Commission would like to discuss any aspect of this submission, please do not hesitate to contact Richard York on _____ or _____.

Yours sincerely

Julie-Anne Schafer
NCC President

The Commission’s draft recommendation on the regulatory regime

1. The Council notes the Commission’s draft findings that the four monitored airports currently observed to have market power – Sydney, Melbourne, Brisbane and Perth – have not systemically exercised their market power; and the Commission’s draft recommendation that the existing light-handed regulatory regime in respect of these airports should continue.¹
2. The Council agrees that the annual monitoring regime administered by the ACCC and the periodic reviews undertaken by the Commission enable transparency, are a good mechanism for assessing whether airports have market power and have exercised such power, and deliver a credible threat of further regulation against airports found to be exercising market power to the detriment of the community.
3. The Council also supports the Commission’s draft recommendation to improve the ACCC’s monitoring regime where appropriate, and to provide the Commission an ability in future inquiries to request commercial agreements between airports and airport users on a commercial-in-confidence basis. The Council considers that these measures will strengthen the existing light-handed regulatory regime, and encourage discipline on the part of airports to engage in genuine commercial negotiations with airlines and other airport users.

Declaration as a threat to constrain the exercise of market power by airports

4. The Commission’s Draft Report also recognises that declaration under the National Access Regimes further imposes a credible threat of consequences and constrains the exercise of market power by airports. The Council agrees with this view of the Commission.
5. Earlier in the inquiry process, several stakeholders (including Airlines for Australia & New Zealand and the ACCC) expressed a view that declaration was no longer a credible threat against the airports’ exercise of market power as a result of the 2017 amendments to the declaration criterion (a), set out in section 44CA(1)(a) of Part IIIA of the *Competition and Consumer Act 2010 (CCA)*. These stakeholders considered that the amendments to criterion (a) significantly raised the bar for declaration (particularly for non-vertically integrated infrastructure services) to a largely unattainable level. They suggested that in order to overcome the perceived inadequacy of the threat of declaration as an effective constraint, airport services should be deemed to be declared and airport users should have automatic access to a negotiate-arbitrate framework.

¹ On the other hand, the Commission found that there may be little benefit in continuing monitoring in respect of second-tier airports (Adelaide, Cairns, Canberra, Darwin, Gold Coast and Hobart) considered to have little (or no) market power.

6. In the Council’s submission to the Commission’s Issues Paper, the Council outlined its views and approach to declaration under criterion (a), the history and application of the criterion, and reasons why the Council was unconvinced that the threat of declaration was no longer effective as those stakeholders claimed.²
7. One indication of the effect that the threat of declaration can have on commercial behaviour is the finding that some airport-airline agreements contain clauses that prevent airlines from, and/or penalise airlines for, lodging or assisting a third party to make a declaration application to the Council. The Council agrees with the Commission’s assessment that such clauses, which force airlines to not exercise their statutory right to seek declaration under Part IIIA, is contrary to the intent of Part IIIA and good public policy, and should be prohibited. Given the emergence of such clauses, the Council considers that claims that declaration does not pose an effective constraint on airports’ conduct should be viewed with caution.
8. The declaration pathway in Part IIIA is a ‘backstop’, and is often the last option for access seekers if they cannot successfully negotiate access terms and conditions with the service providers. The threat of declaration is a complementary tool to the other existing regulatory mechanisms available (annual monitoring by the ACCC and periodic inquiries by the Commission), which are all aimed at keeping the airports’ exercise of market power in check; as well as facilitating and encouraging voluntary commercial agreements between airports and airport users to deliver efficient outcomes for the community. However, in order for the threat of declaration to continue to be an effective constraint on the exercise of market power, airport users (and indeed all access seekers in other industries) must be free to seek it without constraint by access providers, as it is their right.

The importance of the declaration process

9. In its Draft Report, the Commission does not agree with the proposal to introduce an airport-specific arbitration regime based on deemed declaration of airport services. The Commission’s consideration is predicated on its draft findings, including that:
 - the monitored airports have not systemically exercised their market power to the detriment of the community (and this shows that the existing regulatory regime is working and more heavy-handed regulation is not necessary);
 - incumbent airlines could benefit if a negotiate-arbitrate framework led to lower aeronautical charges; however, that would not necessarily be a ‘benefit’ in an

² For a detailed discussion on these issues, please see the Council’s 28 November 2018 submission to the Productivity Commission’s Issues Paper: Economic Regulation of Airports, in particular chapter 3. This is published on the Commission’s website, and on the Council’s website at <http://ncc.gov.au/publications/C42>.

economic sense as it would simply entail a reallocation of profits from airlines to airports, with little incentive on the part of airlines to pass through the cost saving to consumers;

- the proposed approach would remove the ability of the decision-making Minister to assess declaration applications on a case-by-case basis, including the ability to consider whether the particular airports actually have any market power. Further, proponents have not demonstrated why an airport-specific negotiate-arbitrate regime is needed when the National Access Regime provides for declaration and subsequently access to arbitration by the ACCC if negotiations fail;
 - while commercial negotiations between airports and airlines have been challenging, on balance, the process and outcomes reached give rise to little cause for concern; and
 - the introduction of a negotiate-arbitrate framework would have substantial perverse effects that would harm the efficiency of the sector and negatively affect passengers. The risks would include regulatory gaming by airlines and a potential chilling effect on airport investment.
10. The Council supports the draft consideration of the Commission that the declaration process should not be bypassed with deemed declaration of airport services and introduction of an airport-specific arbitration regime. As stated in the Council’s previous submission, the declaration process and the case-by-case assessment it entails, reduces the risk of regulatory error, and ensures that access regulation is only applied in response to clearly identified market failure, and where it serves the public interest and the benefit of promoting competition in related markets and efficient investment in infrastructure.
11. It is apparent from the Commission’s Draft Report that its analysis includes a range of indicators in relation to monitored airports, as there are numerous ways in which market power can be exercised by airports. Having undertaken its analysis, the Commission’s Draft Report finds that certain second-tier airports in capital and regional cities have little (or no) market power, and thus regulation is not required.
12. In a similar way, the declaration process allows the Council to consider similar issues, including the various ways in which market power can be exercised (e.g. in considering criterion (a)³). The Council considers that deeming services as declared removes the ability to undertake an evidence-based process and to consider whether regulation is required on a case-by-case basis. This should not be supported in the absence of clear market failure and having regard to the rational objectives that are embedded within the

³ For further discussion on this issues, please see the Council’s 28 November 2018 submission to the Productivity Commission’s Issues Paper: Economic Regulation of Airports, e.g. para 3.35 of the submission.

declaration criteria. Those criteria should be tested before regulation is imposed. No such market failure has been demonstrated on the analysis presented to the Productivity Commission.

Markets for the supply of jet fuel

13. The Council notes that the Commission considers that the markets for the supply of jet fuel are likely to be characterised by high barriers to entry, due to the difficulty that third parties may face in obtaining access to services provided by jet fuel supply infrastructure owned by vertically integrated incumbent operators.
14. To improve competition in related markets, the Commission indicates in its Draft Report that it could consider recommending to the Treasurer or the Minister for Infrastructure to apply to the Council for a recommendation to declare the services, or recommending that an industry-specific access regime for jet fuel supply infrastructure to be established (such as the access regime for gas pipelines).
15. The Council understands that the Commission is currently seeking further information from industry participants to enable it to further analyse the issues affecting the relevant markets, as well as inviting consideration from interested parties on the two options outlined above. Part of the issues to be investigated includes the reason why there have not been any declaration applications since the 2011 application brought by Board of Airline Representatives of Australia seeking declaration of services provided by jet fuel supply infrastructure at Sydney Airport.⁴
16. The Council is not aware of the reasons why there have not been subsequent declaration applications in respect of services that are similar to those sought to be declared in that matter. While the Council cannot pre-determine whether any new applications would satisfy the declaration criteria (as amended in 2017) in any particular case, should new applications be made the Council will assess them in light of the current market circumstances and apply the current criteria.
17. The Council does not support the proposal for an industry-specific regime for jet fuel supply infrastructure to be established.
18. As mentioned in the Council’s submission to the Commission’s Issues Paper, prior to 1 August 2017 ‘coverage’ (regulation) of gas pipelines was determined under the National Gas Law (NGL) using a ‘coverage’ process similar to the declaration process in Part IIIA of the CCA. The criteria that apply in assessing whether coverage should be granted were

⁴ In that application, the Council made a recommendation to the designated Minister not to declare the services, as it considered that the declaration criteria (a) and (f) (as they were then worded) were not satisfied. The designated Minister decided in accordance with the Council’s recommendation to not declare the services.

modelled on the declaration criteria in Part IIIA (before the 2017 amendments). Following 1 August 2017, an information disclosure and commercial arbitration framework under Part 23 of the National Gas Law (Part 23) was introduced. In effect, this framework has bypassed the coverage process and the coverage criteria for the majority of previously unregulated pipelines in Australia (except for pipelines that do not supply to third parties), and have ‘deemed’ these pipelines to be subject to regulation under Part 23. Part 23 bears some similarity to one of the two forms of regulation that apply once a pipeline is ‘covered’,⁵ (i.e. light regulation), as it is also a negotiate-arbitrate framework.

19. This bypassing of the coverage process and the coverage criteria has meant that all pipelines subject to Part 23 have been assumed to have significant and enduring market power, and there is no opportunity for anyone to assess, on a case-by-case basis, whether that is in fact the case and whether regulation would be necessary, effective and positively in the public interest in the circumstances of particular pipelines. Part 23 may have created a situation where there is a potential risk of regulatory over-reach and inappropriately applying regulation where it is not necessary, with the potential costly result of undermining investment incentives.
20. This was, and continues to be, a concern for the Council. With respect to jet fuel supply infrastructure, the Council considers that if a similar proposal to bypass the declaration process and create an industry-specific access regime (predicated on a negotiate-arbitrate model) was implemented, it may lead to similar risks and adverse consequences.
21. Further, it should be noted that Part 23 regulation only applies to pipelines that are ‘third party access pipelines’.⁶ Pipelines that do not supply to third parties are fully exempt from the Part 23 regime. In order for access regulation to be applied to those pipelines, a coverage application in respect of the pipelines must be made to the Council, and the designated Minister must make a decision upon receiving a recommendation from the Council regarding coverage. Therefore, if the objective of the contemplated industry-specific access regime for jet fuel supply infrastructure is to facilitate access by third parties to services provided by the infrastructure, Part 23 does not provide a template to follow.

⁵ The two forms of regulation are full regulation and light regulation. Under full regulation, the pipeline service provider is required to provide an access arrangement for approval by the regulator upfront, which sets out the terms and conditions of access (including price), for at least one ‘reference service’ likely to be sought by a significant part of the market. On the other hand, light regulation is a negotiate-arbitrate framework, with no requirement on the pipeline service provider to submit an upfront access arrangement.

⁶ See rule 585, Division 6 of the National Gas Rules.

22. The Council notes that the Commission considers that an industry-specific regime should not be introduced unless there are special industry features that justify a different approach to that available under the National Access Regime, and that the costs and risks of bypassing declaration should be considered. The Council agrees with this view, and considers that consistency of regulatory approach (being one of the objects of Part IIIA) is important to ensuring the integrity of the National Access Regime.