Economic Regulation of Airports

Submission to Productivity Commission Inquiry

28 November 2018

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1 Introduction

1.1 The National Competition Council (Council) is responsible for making recommendations to the designated Minister in relation to third party access to infrastructure services under Part IIIA of the *Competition and Consumer Act 2010* (Cth) (**CCA**) and for recommendations and decisions relating to access to natural gas pipelines under the National Gas Law.

1.2 This submission provides background information on the National Access Regime established in Part IIIA of the CCA, and the 2017 amendments to the declaration criteria in Part IIIA. It also responds to concerns raised by some submissions to the PC's Issues Paper[1] that the declaration mechanism under the National Access Regime is no longer a credible threat against the airports' exercise of market power because:

- Recent amendments to the declaration criterion (a) have raised the threshold for declaration too high such that declaration of airport services is unlikely
- The declaration process is too costly, long and uncertain, and that, as a consequence, a different regulatory approach should be considered to ensure that there is a credible regulatory threat, and
- Part IIIA does not adequately address monopoly pricing issues for non-vertically integrated infrastructure facilities.

1.3 This submission also provides the Council's views on submissions that a suitable alternative regulatory approach is to 'deem' certain airport services to be declared, thus circumventing transparent consideration of the statutory criteria. It also provides some background information on Part 23 of the National Gas Rules (NGR) which has similarities to some of the proposed 'deemed' declaration regulatory regimes.

1.4 For the reasons set out in this submission, the Council does not consider the suggested reforms to be necessary or appropriate.

[1] Productivity Commission, *Economic Regulation of Airports – Issues Paper*, September 2018.

2 The National Access Regime and the Council

2.1 The Council has been the Commonwealth body charged with application of Division 2 of Part IIIA since the National Access Regime was implemented in 1995.

2.2 The National Access Regime was introduced on the recommendation of the committee of inquiry into competition policy chaired by Professor Fred Hilmer (**Hilmer Committee**).[2] After considering the 'essential facilities problem',[3] the Hilmer Committee said that:

> [a]s a general rule, the law imposes no duty on one firm to do business with another. The efficient operation of a market economy relies on the general freedom of an owner of property and/or supplier of services to choose when and with whom to conduct business dealings and on what terms and conditions. This is an important and fundamental principle based on notions of private property and freedom to contract, and one not to be disturbed lightly.
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> The law has long recognised that this freedom may require qualification on public interest grounds in some circumstances, particularly where a form of monopoly is involved.[4]

2.3 The circumstances where such freedom should be disturbed must be carefully limited to minimise the risk that incentives for investment will be undermined[5]. The Hilmer Committee expressed the view that decisions about the creation of access rights, which rest on evaluation of important public interest considerations, should be made by a Minister through application of clear statutory criteria and upon the recommendations of an independent expert body so as to avoid the pressure on the Minister to declare a service to advance private interests.[6] These remain important principles that continue to guide the Council's consideration of the application of the National Access Regime.

2.4 The National Access Regime in Part IIIA substantially reflects the recommendations of the Hilmer Committee.

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2 Frederick G Hilmer, Mark R Rayner & Geoffrey Q Taperell, *National Competition Policy Report by the Independent Committee of Inquiry* (25 August 1993) (**Hilmer Report**).

3 According to the Hilmer Committee, '[i]n some markets the introduction of effective competition requires competitors to have access to facilities which exhibit natural monopoly characteristics, and hence cannot be duplicated economically. … Facilities of this kind are referred to as "essential facilities".' (Hilmer Report, p. 239).

4 Hilmer Report, p. 242

5 Hilmer Report, p. 248.

6 Hilmer Report, p. 250

2.5 Access regulation by declaration under the National Access Regime involves two stages: first a declaration stage and then a negotiate/arbitrate process if parties are unable to negotiate the terms and conditions of access and an access dispute is notified to the ACCC.

2.6 At the declaration stage, the Council considers applications for declaration of services before making a recommendation to the designated Minister.

2.7 The Council cannot recommend, and the Minister cannot decide, that a service be declared unless each is satisfied in respect of all of the declaration criteria set out in section 44CA of the CCA, which provides:[7]

> (1) The ***declaration criteria*** for a service are:
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> (a) that access (or increased access) to the service, on reasonable terms and conditions, as a result of declaration of the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
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> (b) that the facility that is used (or will be used) to provide the service could meet the total foreseeable demand in the market:
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> (i) over the period for which the service would be declared
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> (ii) at the least cost compared to any 2 or more facilities (which could include the first-mentioned facility)
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> (c) that the facility is of national significance, having regard to:
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> (i) the size of the facility; or
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> (ii) the importance of the facility to constitutional trade or commerce; or
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> (iii) the importance of the facility to the national economy;
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> (d) that access (or increased access) to the service, on reasonable terms and conditions, as a result of declaration of the service would promote the public interest.
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> (2) For the purposes of paragraph (1)(b):

[7] Section 44CA was introduced by the *Competition and Consumer Amendment (Competition Policy Review) Act 2017.*

(a) if the facility is currently at capacity, and it is reasonably possible to expand that capacity, have regard to the facility as if it had that expanded capacity; and

(b) without limiting paragraph (1)(b), the cost referred to in that paragraph includes all costs associated with having multiple users of the facility (including such costs that would be incurred if the service is declared).

(3) Without limiting the matters to which the Council may have regard for the purposes of section 44G, or the designated Minister may have regard for the purposes of section 44H, in considering whether paragraph (1)(d) of this section applies the Council or designated Minister must have regard to:

(a) the effect that declaring the service would have on investment in:

(i) infrastructure services; and

(ii) markets that depend on access to the service; and

(b) the administrative and compliance costs that would be incurred by the provider of the service if the service is declared.

2.8 Part IIIA initially did not have an objects clause, however following the recommendation of the PC in its 2001 inquiry, the Federal Government in 2006 introduced s 44AA into the CCA. Section 44AA provides:

> The objects of this Part are to:
>
> (a) promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and
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> (b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

2.9 The objects of Part IIIA reflect the balance that the Hilmer Committee identified would need to be struck between property rights, freedom of contract and investment incentives on the one hand and, on the other hand, the promotion of competition in markets upstream or downstream of bottleneck infrastructure.

2.10 As recognised by the Hilmer Committee,[8] and subsequent reviews by the PC[9] (2001 and 2013) and the Competition Policy Review (**Harper Review**)[10] (2015), access

[8] Commonwealth of Australia, *National Competition Policy* (Hilmer Review), August 1993, p.248.

regulation imposes significant costs and is an intrusive form of regulation. It overrides private property rights and requires that the facility owner or the service provider makes its assets available to third parties, and to do so on terms and conditions (including price) that may ultimately be determined by the regulator. Access regulation may distort dynamic efficiency and discourage infrastructure investment, given the risks associated with investment[11] and the possibility of regulatory errors[12] (of which inappropriately high or low access prices is one). Therefore it is important that it be applied sparingly, in response to a clearly identified market failure that is amenable to redress through access regulation.

2.11 The National Access Regime operates as a disincentive for service providers to refuse access and an incentive for parties to agree on the terms of access through commercial negotiation thus avoiding direct regulatory intervention. It therefore provides an important 'backstop' and avoids the need for ad hoc regulatory responses such as deemed declarations. The Council's views on deemed declaration in general, and in the specific context of airports, are contained in chapter 4 of this submission.

2.12 The declaration process in the National Access Regime is a safeguard that ensures that access regulation is applied only where it is necessary to promote competition and efficiency. Declaration allows for a case-by-case assessment against objective criteria through a transparent public process where submissions from proponents and those opposed to declaration can be fully considered. The recent amendments to the declaration criteria reinforce the importance of declaration as a threshold step before access regulation is applied.

2.13 The declaration criteria also provide a basis for removing access regulation where it is no longer appropriate. The Council is currently considering whether to make a recommendation to the Minister to revoke declaration of service at the Port of Newcastle. Further information on this matter is at paragraph 3.9.

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9 Productivity Commission, *National Access Regime*, September 2001, pp. 59-94; Productivity Commission, *National Access Regime*, October 2013, pp. 100-107 and 227-236.

10 Competition Policy Review, *Final Report*, March 2015, p. 424.

11 Productivity Commission, *Review of the Gas Access Regime*, June 2004, pp. 109-110.

12 Productivity Commission, *National Access Regime*, October 2013, pp. 7-8, 103-104 and 230-236.

3 Suitability of the National Access Regime for economic regulation of airports

3.1 Services provided by airport facilities may be declared if the declaration criteria are satisfied. Indeed a number of airport services have been the subject of applications for declaration. Of these, three services were declared.[13] Three services were not declared[14] and applications for four services were withdrawn. [15]

3.2 Despite this, several submissions to the PC's inquiry have asserted that the threat of declaration under the National Access Regime does not impose an effective constraint on the exercise of airports' market power. There are several claimed reasons for this:

(a) Recent amendments to the declaration criteria, particularly criterion (a) have raised the threshold for declaration to a largely unattainable level.

(b) The declaration process is too lengthy, uncertain and costly

(c) The National Access Regime is an inappropriate tool for dealing with monopoly pricing issues that arise in non-vertically integrated infrastructure facilities.

Declaration criterion (a)

3.3 Following the passage of the *Competition and Consumer Amendment (Competition Policy Review) Act 2017*, declaration criterion (a) set out in s44CA(1)(a) of the CCA reads:

> that access (or increased access) to the service, on reasonable terms and conditions, as a result of a declaration of the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service

3.4 Criterion (a) is concerned with promoting the opportunities or environment for competition in a dependent market in a **non-trivial way**[16] by, for example, lowering or

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13 Australian Cargo Terminal Operators' applications (1996) and Virgin Blue's application (2001).

14 Australian Cargo Terminal Operators' applications (1996) and Board of Airline Representatives of Australia Inc's application (2011).

15 Australian Cargo Terminal Operators' applications (1996), Virgin Blue's application (2001) and Tiger Airway's application (2014).

16 *Re Sydney International Airport* [2000] ACompT 1 (***Sydney Airport No.1***), paras 106-107; *Re Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2, para 17; *Re Virgin Blue Airlines Pty Limited* [2005] ACompT 5 (***Re Virgin Blue***), para 162; *Sydney Airport Corporation Ltd v Australian Competition Tribunal and Others* (2006) 155 FCR 124; [2006] FCAFC 146 (***Sydney Airport No.2***), para 57; *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2, paras 584, 106 and 1145.

removing barrier(s) to entry into a dependent market,[17] addressing anti-competitive conduct in the market (e.g. price fixing or predatory pricing),[18] improving the incentives for innovation,[19] increasing demand for services, lowering prices, or improving or enhancing competitive conditions more broadly as a result of declaration. In considering this criterion, the Council and the Minister are not concerned with the commercial interests of any particular party, including the party seeking to have a service declared. As noted by the Tribunal in *Sydney Airport No.1*,[20] "criterion (a) is concerned with furthering competition in a forward-looking way, not furthering a particular type or number of competitors".

History of criterion (a)

3.5 A brief history of the criterion, including how it has evolved over time as a result of judicial interpretation, policy reviews and legislative amendments is set out below.

(a) From the inception of the National Access Regime in 1995, the Council, the Tribunal and the Minister had interpreted 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" – as requiring that *declaration* would promote competition in at least one dependent market.[21]

(b) In its 2001 review, the PC raised concerns that this interpretation had set too low a threshold for declaration, as it meant that the criterion could be satisfied by a marginal or trivial increase in competition.[22] The PC considered that it would be appropriate to consider, at the next review, whether the criterion should be amended to read "access (or increased access) to the service would promote a 'substantial' increase in competition in at least one market (whether or not in Australia), other than the market for the service".[23]

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17 *Sydney Airport No.1,* para 107; *Re Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2, para 17; *Re Services Sydney Pty Ltd* [2005] ACompT7, para 132.

18 *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2, para 1062.

19 Ibid.

20 *Sydney Airport No.1*, para 108.

21 This approach ensured that regulatory intervention would not be applied where the dependent markets were already effectively competitive, or that there were other significant impediments unrelated to the existence of the bottleneck facility which would preclude additional competition in a dependent market.

22 Productivity Commission, *National Access Regime*, September 2001, pp. 190-192.

23 In the same review, the PC also recommend that an objects clause be incorporated into Part IIIA to explicitly recognise the efficiency focus of the National Access Regime and reflect short term and long term considerations (i.e. recognising the legitimate interests of users, consumer interests and long term investment dimensions).

(c) In response to the PC's 2001 review, the Federal Government amended criterion (a) to read "access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service".[24] The Government did not use the word 'substantial', as it considered that it may exclude situations where a small supplier would be prevented from gaining access to nationally significant infrastructure. Instead, it used the word 'material' to ensure that "access declarations are only sought where the increases in competition are *not trivial* (emphasis added)".[25] In a later matter, the Tribunal considered that the amendment did not change the existing law up to that point, as the Tribunal had already considered that the criterion required a non-trivial increase in competition.[26]

(d) In 2006, the Full Federal Court in *Sydney Airport No.2* held that 'access' in criterion (a) does not mean 'declaration'. The Court considered that 'access' required a comparison of the future state of competition in the dependent market "with a right or ability to use the service and … *without any right or ability* … to use the service".[27] This overturned the previous interpretation of criterion (a) by the Council, the Tribunal and the Minister, and significantly lowered the hurdle to satisfying the criterion.

(e) In 2011, the Full Federal Court in the Pilbara Railways matter[28] held that 'access' in criterion (f) is 'access on such reasonable terms and conditions as may be determined in the second stage of the Pt IIIA process.'

(f) In its 2013 review, the PC considered that the Full Federal Court decision in *Sydney Airport No.2* had set the threshold for the criterion too low,[29] and recommended restoring the interpretation of the criterion to the position before *Sydney Airport No.2*. That is, it should focus on the *effect of declaration* on reasonable terms and conditions (rather than access per se) in promoting competition in a dependent market.[30]

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24 *Trade Practices Amendment (National Access Regime) Act 2006* (Cth).

25 Government Response to Productivity Commission report on the review of the National Access Regime, 20 February 2004.

26 *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2, para 584.

27 *Sydney Airport No.2*, para. 83.

28 *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* (2011) 193 FCR 57; [2011] FCAFC 58, [112].

29 The PC considered that while access regulation was likely to generate net benefit to the community, its use must be limited to *exceptional cases*, where the benefits arising from increased competition in dependent markets would likely outweigh the costs of regulated access.

30 Productivity Commission, *National Access Regime*, October 2013, pp. 172-173.

(g) In 2015, the Harper Review agreed with the PC's recommendation but considered the PC should have gone further and set the threshold for criterion (a) even higher. It considered that the burden of access regulation should not be imposed on the operations of a facility unless access is expected to produce significant efficiency gains from competition.[31]

(h) In August 2017, the Full Federal Court handed down its decision in the Port of Newcastle declaration matter,[32] affirming the interpretation of criterion (a) as decided by the Full Federal Court in the *Sydney Airport No.2*. The Court held that the Tribunal below[33] had correctly applied criterion (a) and the criterion was satisfied in circumstances where the service is a natural monopoly, the service provider exerts monopoly power and the service is a necessary input for effective competition in a dependent market with no practical or realistic commercial alternative.[34] The Court acknowledged that its construction of criterion (a) lowered the hurdle from that put by the Commonwealth (represented by the Council). To that point the Council was of the view that 'access (or increased access)' in criterion (a) should be applied consistently with the interpretation given to that phrase in criterion (f) by the Full Federal Court in the Pilbara Railways matter.

(i) In October 2017, in response to both reviews, the Federal Government passed legislation to amend the declaration criteria largely in line with the PC's 2013 recommendation.[35] As explained in the extrinsic materials,[36] the intention behind the amendments to criterion (a) was to overturn the interpretation adopted by the Full Federal Court in *Sydney Airport No.2*, and re-establish the interpretation before 2006.

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31 The Harper Review's recommendation builds on the PC's recommendation. That is, in addition to the PC's recommendation to amend criterion (a) to re-focus the test on the specific effect of declaration, criterion (a) should also be amended to require that the dependent market (on which the competition effect is assessed) is nationally significant and that the increase in competition is substantial. See Competition Policy Review, *Final Report*, March 2015, pp. 73-74 and 432-433.

32 *Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal* [2017] FCAFC 124 (***PNO v ACT***).

33 *Application by Glencore Coal Pty Ltd* [2016] ACompT 6.

34 *PNO v ACT,* para 89.

35 *The Competition and Consumer Amendment (Competition Policy Review) Act 2017* amended the declaration criteria in Part IIIA of the CCA. These amendments took effect on 6 November 2017.

36 Explanatory Memorandum to the *Competition and Consumer Amendment (Competition Policy Review) Bill 2017*; and the Australian Government's response on the National Access Regime, 24 November 2015.

3.6 **Appendix 1** contains case summaries that illustrate the 'without and without declaration' approach to criterion (a) applied in the airports context before 2006.

Stakeholders' views on criterion (a)

3.7 Several stakeholder submissions, including the ACCC, Airlines for Australia and New Zealand (**A4ANZ**) and its airlines members,[37] have raised concerns that the 2017 amendments to criterion (a) have significantly raised the overall threshold for declaration (particularly for non-vertically integrated infrastructure services). They consider that it will be difficult for airlines to successfully obtain declaration of airport services under Part IIIA of the CCA. This, according to the submissions, reduces the effectiveness of declaration as a credible regulatory threat to constrain the exercise of airports' market power and facilitate genuine commercial negotiations.

3.8 For example, A4ANZ submits that under the current criterion (a), it could be difficult for airline applicants to satisfy the criterion where airports are found to be exercising market power (by charging monopoly prices), but that such conduct does not have a "**material** effect on competition in dependent markets (emphasis in original)".[38] However, A4ANZ's submission also states that the amended criterion is yet to be tested by the Council, the Tribunal and the higher courts.

The Council's views in relation to criterion (a)

3.9 The current Port of Newcastle matter is the first matter the Council has considered since the 2017 amendments to the declaration criteria. Following a submission from Port of Newcastle Operations Pty Ltd (**PNO**) in July 2018, the Council is considering whether it should recommend under s 44J of the CCA that the designated Minister revoke the declaration of the shipping channel service at the Port of Newcastle. The Council's consideration of whether to make a revocation recommendation in respect of the declared service (declared by the Tribunal in October 2016[39]) includes consideration of whether the declaration criteria (as amended in 2017) are satisfied.

3.10 The Port of Newcastle matter is ongoing and the Council has not come to any concluded views in that matter.[40] The Council considers that the 2017 amendments to

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37 A4ANZ's proposal is supported by Qantas and Virgin, Regional Aviation Association of Australia. The Australian Finance Industry Association also supports A4ANZ's submission.

38 A4ANZ's submission, Appendix D (legal advice from Johnson Winter & Slattery Lawyers), p. 10.

39 *Application by Glencore Coal Pty Ltd (No 2) [2016]* ACompT 7.

40 In that matter, the Council has received numerous submissions from interested parties on the appropriate approach to criterion (a). The Council will consider these submissions carefully before releasing its preliminary position paper before the end of 2018. Interested parties will then have a further opportunity to make further submissions on the Council's preliminary position before the Council finalises its consideration of whether to make a revocation recommendation.

criterion (a) return the focus of the criterion to the effect of declaration on dependent markets.

3.11 The form of the 2017 amendments to the declaration criteria flow from the deliberate and considered recommendations of the PC in its 2013 review (and to some extent the Harper Review), were subject to consultation with the public and States and Territories, and were subsequently agreed to and implemented by the Federal Government in 2017. The Council considers that the amendments to criterion (a) do not so much 'raise the threshold' to satisfying the criterion; rather, they restore the threshold to where it was prior to the 2006 Full Federal Court's decision in *Sydney Airport No.*2.

3.12 Access regulation under the National Access Regime has always been applied to both vertically-integrated and vertically-separated infrastructure services, and with the same economic rationale and objectives set out in s 44AA of the CCA; such was the approach affirmed by the PC in its 2013 inquiry. Given the declaration criteria were only recently amended, the Council considers it is premature to speculate whether any criterion may or may not be satisfied in any particular context.

3.13 Indeed, any calls for an airport-specific arbitration regime activated by deemed declaration of airport services (on the basis of perceived difficulty of satisfying the declaration criteria) should be viewed with caution, as there are no compelling reasons for treating airport services differently to any other services subject to Part IIIA. If particular airport services are found not to satisfy criterion (a) or any other criteria designed to evaluate the costs and benefits of access regulation and take account of public interest considerations, then it is difficult to see a need, or any sound basis for, introducing additional layers of regulation for the services.

Other remarks regarding criterion (a)

3.14 The PC has received submissions that airport services would be unlikely to satisfy criterion (a). The Council does not consider that such broad and general statements can be sustained. The term 'airport services' encompasses a broad range of services provided by different facilities.[41] Whether any particular service may be declared will depend on the nature of the service and the characteristics of the market in which the service is provided, and competitive conditions in dependent markets with and without declaration would need to be compared (with such an assessment also including the service provider's ability and incentive to exercise market power to adversely affect competition in dependent markets). These are matters that require findings of fact based on economic evidence and will vary according to the circumstances of particular cases.

[41] Facilities that provide aircraft-related services, passenger-related services (e.g. terminal facilities such as departure lounges, check-in counters and baggage systems) and non-aeronautic services (e.g. car park and retail operations).

3.15 The 2017 amendments to the declaration criteria were intended to 'reset' the criteria to ensure they remain effective and are better targeted towards addressing the economic problem that access regulation seeks to address. The Council considers that the amendments give the declaration criteria a clearer focus. It is critical to the effectiveness of the National Access Regime that the new law be given sufficient time to perform its role and be properly applied to new cases as they emerge in the future.

3.16 The call for deeming airport services to be declared simply on the basis of perceived difficulty with criterion (a), so soon after the recent amendments, does not consider the role and importance of other declaration criteria; nor does it have regard to the fact that the amendments to criterion (a) were intended to restore the interpretation of the criterion to its pre-2006 position before *Sydney Airport No.2*.

3.17 The Council notes that applications for declaration of certain airport services have been received[42] irrespective of the wording or interpretation of criterion (a). There is no reason to conclude that restoring criterion (a) to its intended state as it operated prior to 2006 removes the credible threat of regulation that remains from declaration. Following the 2017 amendments, the National Access Regime will continue to provide incentives for service providers to negotiate commercial access terms to avoid declaration and possible regulatory intervention.

3.18 Part IIIA gives primacy to private commercial negotiation, and arbitration is intended as a last option if the parties reached an impasse in their negotiations that cannot be resolved. It may also be that, the threat of declaration has been effective in encouraging parties to negotiate access terms and conditions without needing to resort to seeking declaration. The Council has observed that a number of parties withdrew applications for declaration or for review of declaration decisions after reaching commercial agreement with service providers. This includes Virgin Blue in 2002 (in relation to 'domestic terminal service') and Tiger Airways in 2014 (in relation to 'domestic terminal service'), as well as a number of other parties in non-airports context.[43]

Timeliness of the declaration process

3.19 Several submissions to the PC's Issues Paper, including A4ANZ and other airlines submit that the declaration process in Part IIIA does not constrain the airports'

[42] Applications for declaration of certain airport services were received by the Council in 1997, 2002, 2011 and 2014. The last application was Tiger Airways's application for declaration of 'domestic terminal services'.

[43] These matters relate to declaration applications from the following parties: Pacific National Pty Ltd (2010) (service ultimately became subject to a certified access regime); Portman Iron Ore Limited (2001); Normandy Power Pty Ltd (2001); Specialized Container Transport (February and July 1997); New South Wales Minerals Council (1997) (service ultimately became subject to a certified access regime); and Futuris Corporation (1996).

exercise of market power due to the significant time and costs required of an applicant to obtain a declaration. In particular, A4ANZ points to the Port of Newcastle matter, and argues that matter took almost 3 years from the initial application to the resolution of the matter (i.e. High Court dismissal of special leave application brought by PNO to review the decision of the Federal Court below), and the matter is still ongoing as PNO has lodged a submission that the Council should consider recommending to the designated Minister to revoke the declaration of the service.

3.20 In the Port of Newcastle matter, following lodgement of the declaration application, the Council made a recommendation to the Minister in 6 months, and the Minister made a decision (in accordance with the Council's recommendation) in 2 months.[44] The review proceedings that ensued – the merits review proceeding brought by Glencore Coal Pty Ltd in the Tribunal, the judicial review proceeding brought by PNO in the Federal Court[45], and the application for special leave to appeal to the High Court brought by PNO[46] – raised significant and complex issues regarding the proper application of criterion (a) (as worded before the 2017 amendments)[47]. It was only as a result of the passage of the *Competition and Consumer* Amendment *(Competition Policy Review) Act 2017* in October 2017, that criterion (a) was amended to give effect to the PC's recommendation to restore the criterion to its previous interpretation before 2006. Going forward, declaration applications will be considered on the basis of the amended criterion (a) as well as other declaration criteria.

3.21 A4ANZ also cites the observation that there have been few declaration applications since the Sydney Airport case in 2002 as support for this submission.[48] The Council considers that the number of applications made or the number of applications that resulted in declaration is a very limited indicator of the effectiveness of Part IIIA. The threat of declaration under Part IIIA operates as a disincentive for service providers to refuse access and an incentive for parties to agree on terms of access (including price) through commercial negotiation thus avoiding direct regulatory intervention. Thus merely counting the number of applications likely understates the actual constraining effect of the threat of declaration. While it is difficult to fully quantify the effects of these incentives, the Council has observed withdrawal of applications for declaration or for review of declaration decisions (mentioned in paragraph 3.18) in several cases following successful commercial negotiation, and believes that the

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44 The application was lodged on 13 May 2015. On 31 May 2016, the Tribunal declared the service, and made orders to that effect on 16 June 2016.

45 The Commonwealth, represented by the Council, and the ACCC, joined as parties to the merits review proceedings.

46 The Commonwealth, represented by the Council, as a party to the proceedings below, appeared at the hearing of the special leave application.

47 In particular, the meaning of 'access' in the criterion.

48 A4ANZ submission, p. 33.

potential for declaration remains a significant credible threat of direct regulatory intervention.

3.22 Nevertheless, to the extent that there are genuine and well-founded concerns with the timeliness of the declaration process, the Council considers the appropriate step would be to consider ways to streamline the process which applies to all services subject to the National Access Regime, rather than abandoning and bypassing the process by treating certain services in a particular industry as a special case for no apparent reason.

3.23 The declaration process was streamlined in 2010 with the introduction of binding time limits for the Council, the Minister and the Tribunal to make a recommendation/decision on an application for declaration of service.[49]

3.24 As **Diagram 1** below shows, under the current statutory timetable, an application for declaration should be determined within eight months in the first instance (180 days for the Council's recommendation and 60 days for the Minister's decision).[50]

3.25 As access decisions have significant implications for interested parties and the broader economy and raise issues of considerable economic and legal complexity, it would be counterproductive to further reduce the statutory timelines. The Council considers there is no basis for proposals to circumvent the independent and transparent declaration process for reasons of expedience by subjecting services to access regulation on an ad hoc basis without careful consideration of the declaration criteria. Indeed, such bypass could have the effect of deterring efficient investment.

Diagram 1

3.26 The Council is concerned that despite these changes perceptions remain that the timeliness of the declaration process reduces its effectiveness. In this regard, the Council remains of the view that the availability of merits review reduces the effectiveness of the National Access Regime and increases uncertainty and reduces the timeliness of the declaration process. It is neither necessary nor an efficient use

49 *Trade Practices Amendment (Infrastructure Access) Act 2010*.

50 The period may be extended by the Council 'stopping the clock' in some circumstances, such as when additional information is sought from an applicant.

of resources to provide two levels of inquiry and fact-finding in declaration matters. Instead, the process provides an opportunity for gaming and a 'second bite of the cherry'.

3.27 In line with its previous submissions, the Council continues to advocate that merits review of Ministerial declaration decisions be removed.

3.28 The Council considers that judicial review provides an appropriate level of oversight for declaration decisions. Judicial review ensures that ministerial decisions on declaration applications are made fairly and in accord with law without putting the Tribunal in a position where its opinions on a range of public interest and other issues arising in the declaration process potentially override those of a politically accountable ministerial decision-maker.

3.29 The Council considers that it is in the public interest that declaration decisions are made in a timely manner. However, given the significant consequences of access decisions for applicants, access seekers, service providers and the broader economy, expediting the decision making process must not be at the cost of consistent, independent and rigorous regulatory assessment. Doing away with the declaration process on an ad hoc basis risks raising perceptions of increased regulatory risk with attendant economic costs.

The National Access Regime and monopoly pricing

3.30 Monopoly pricing is the main justification for regulatory intervention in relation to airport services. Some submissions argue that the National Access Regime is not an effective regulatory constraint on airports' monopoly pricing because airports are generally not vertically integrated into dependent markets and are thus less likely to have an ability or incentive to exercise their market power to harm competition in those markets.

3.31 The Council considers that Part IIIA operates as a constraint on the extent to which airport operators can increase their aeronautical charges where such conduct affects competition and efficiency/output in a dependent market. In line with its objectives to pursue economic efficiency however, if there is no demonstrable improvement to competition or efficiency in any dependent markets, Part IIIA offers no remedy for any distributional concerns; indeed it does not, and is not intended to operate as a mechanism to redistribute economic rents between airports and airlines (or any other third parties).

3.32 The Council reiterates that the National Access Regime applies to both vertically integrated and non-vertically integrated infrastructure services. Whether or not *any* service provider will have ability or incentives to deny or restrict access to the services it provides through the bottleneck facility will depend on the facts of a particular case. While the vertical structure of the service provider's operations is

relevant in considering its incentives to exercise its monopoly power to deny or restrict access, it is not determinative (see the Australian Cargo Terminal Operator matter discussed in detail in **Appendix 1**). Instead, the focus is on whether the monopoly service provider has the ability and incentive to use its monopoly power in ways that harm competition in dependent markets and thus reduce efficiency and welfare.

3.33 In some circumstances, it may be profit maximising for a non-vertically integrated monopolist to promote competition in dependent markets and increase incremental demand for its services. If so, the service provider may be incentivised to extract monopoly rents and negotiate access terms in its favour but not disrupt competition in a dependent market. In that case, the Council is unlikely to recommend to the Minister to declare the particular service(s).

3.34 However, in other circumstances, a non-vertically integrated monopolist may have ability and incentives to set terms and conditions of access, including prices, in ways that harm competition in dependent markets.[51] Monopoly pricing by a non-vertically integrated service provider may adversely affect competition in dependent markets where it suppresses demand for services, lowers output, or raises barriers to entry or expansion in dependent markets. In such circumstances, declaration can promote competition by providing incentives for service providers to negotiate in good faith with the option for arbitration as a last resort if access terms that are acceptable to both parties cannot be negotiated.

3.35 As demonstrated in the Virgin Blue matter (discussed at length in **Appendix 1**), the Council and the Tribunal will look to monopoly pricing as evidence of the service provider's ability and incentives to exercise market power to adversely affect competition in dependent markets, as well as other relevant circumstances relating to the exercise of market power. These include, for instance, the service provider's history of conduct and likely conduct going forward, whether charges (imposed or restructured) are efficient and reflect their cost drivers, whether charges are discriminatory on users such that output and efficiency outcomes in the dependent markets are affected,[52] the effect of non-price terms and conditions, and whether the

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[51] See the Tribunal's consideration in *Re Virgin Blue*. In that matter, the Tribunal accepted economic evidence from Virgin Blue that a non-vertically integrated monopolist may not always have an incentive to increase the level of usage and competition in the dependent market. The Tribunal accepted that when the downstream market has a small enough number of large players, a monopolist can sometimes increase its own profits by restricting supply and lessening competition in the downstream market (para. 303).

[52] Following the Tribunal's declaration of Airside Service at Sydney Airport in 2005, it may be that ever 'non-discriminatory' 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

broader regulatory environment imposed any sufficient constraint on the exercise of market power.

3.36 The Council also notes that regulated access may also lead to efficiency losses, particularly in the provision of the service subject of declaration, including through dampening innovation and investment incentives (particularly due to the perception of regulatory burden and the risk of regulatory error). These potential losses also need to be considered and balanced against possible efficiency gains through the promotion of competition in other markets.

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. 'Non-discriminatory' refers to the application of charges as opposed to incidence, given that even uniform increases in aeronautical charges could likely impact low cost airlines versus full service airlines differently.

4 Should the National Access Regime be bypassed for regulation of airport services?

4.1 Several submissions to the PC's inquiry have suggested that the current approach to the economic regulation of airport services is not working and that a different approach is appropriate. One solution may be to 'deem' airport services to be declared for the purpose of Division 3 of Part IIIA (or by some other mechanisms), thus bypassing the declaration process and overcoming the perceived inadequacy of the threat of declaration as an effective regulatory constraint on airports' market power.

The case for more regulation?

4.2 The Council notes the ACCC's submission that the existing monitoring regime does not allow the ACCC to conclusively assess the appropriateness of airport profitability, and thus it may be unclear whether monitored airports are inappropriately exercising their market power.[53] The Council has not itself formed any views as to whether there is any general case for more economic regulation for airport services in addition to the current regulatory arrangements, including whether market power is enduring and/or has been exercised, and what detriments (if any) have resulted. In the absence of clear evidence of significant market failure (which could only be revealed through detailed assessments such as a declaration process, amongst others[54]), the Council would caution against undermining the current light-handed regulatory arrangements and revert to more heavy-handed regulatory approach by bypassing the declaration process and imposing an airport-specific arbitration regime.

4.3 In respect of the possible exercise of market power on services provided to airlines, the Council notes the ACCC's submission that there are reasons to believe that the deadweight loss from airports' exercise of market power is higher than previously considered. This is because airport charges are likely to reflect a material proportion of certain airfares, particularly in the case of low-cost fares and fares offered by low-cost carriers. The ACCC considers there is a risk that airport charges may have an impact on the take-up of low cost seats and the volume of low-cost services and may be an important factor for low cost carriers when considering whether particular routes are commercially viable.[55] The Council has not formed any views on whether these issues would arise in practice, but notes that arguments that pricing is impacting on economic welfare and efficiency are highly relevant considerations in any application for declaration of airport services, including whether criterion (a) is

53 ACCC submission, p. 13

54 For instance, a price inquiry conducted by the ACCC under Part VIIA of the CCA (no such inquiry has been conducted to date), or the current PC inquiry could unveil evidence of misuse of market power.

55 ACCC submission, p. 20

satisfied. While it cannot be pre-determined whether the declaration criteria would actually be satisfied in any case, the identification of these issues supports the potential effectiveness of the National Access Regime and is contrary to submissions that the threat of declaration is not an effective constraint in relation to airport services regulation.

4.4 The ACCC also submits that equity and distribution arguments should be carefully examined for policy relevance and the PC could consider whether any transfers to the shareholders of airports is from airline shareholders (presumably through negotiated outcomes) or the travelling public (presumably through the pass-through of excessive airport charges). If it is the latter, the ACCC considers this may raise further concerns about the harm from airports' market power as people on low incomes are likely to account for a higher proportion of the travelling public and therefore contribute to any transfer to the shareholders of the major airports.[56]

4.5 The Council considers that distributional outcomes are relevant in the context of an application for declaration if they impact on efficiency and welfare. However, a primary object of Part IIIA in providing for access to services (s 44AA of the CCA)[57] is the promotion of economic efficiency[58] for the purpose of improving competition in related markets, as opposed to other objectives such as equity or income redistribution. The efficiency-focussed objective of Part IIIA follow from the recommendations of the PC in its 2001 inquiry, and has been introduced in the CCA since 2006 and incorporated in many other industry-specific access regimes and undertakings. The Council considers that if access to airport services were regulated purely on the basis of any equity or distributional concerns with no effect on competition and efficiency, it would be fundamentally inconsistent with the objects of Part IIIA and undermines the role of Part IIIA to provide a consistent regulatory approach to access regulation across industries and other access regimes.

4.6 In the Council's view, the economic efficiency objective appropriately reflects the economic problem access regulation should be used to address, and ensures regulation is well-targeted and not applied unless there is a clear need for it and the benefits of regulation (promotion of competition in dependent markets) will likely outweigh the costs (e.g. adverse impact on long term investment incentives and dynamic efficiency due to regulatory burden and the risks of regulatory error).

4.7 Putting aside the objects of Part IIIA, the Council considers that any negotiate-arbitrate regulatory regime activated upon deemed declaration of airport services is unlikely to be the most effective way to achieve desired distributional or equity

56 ACCC submission, p. 24

57 The second objective of Part IIIA is to provide for a consistent approach to access regulation across industries.

58 That is, defined in terms of productive, allocative and dynamic efficiency in the infrastructure market for the service and competition in related markets.

effects between airports, airlines and the general public. This is because it is very difficult to determine the effect of regulated airport charges on airfares and to ensure that any pass-through of input cost changes is directed to the desired beneficiaries.

The Council's views on deemed declaration

4.8 The Council does not support proposals to circumvent the declaration process in relation to airport services and deem them as declared services. Such calls are not new, and have been considered and rejected by the PC in previous inquiries. Given the starkly opposed positions of the parties to negotiations, and their powerful economic positions and interests, the Council considers that it is of considerable public importance and interest to ensure that economic regulation of airports is fit for purpose having regard to the nature of the problem giving rise to the need for further regulation.

4.9 The Council considers that bypassing the declaration process increases the risk of regulatory error and creates ad hoc regulation that may or may not address any market failures and competition issues. In such circumstances there is no assurance that access regulation is being applied to services in circumstances where:

(a) Regulated access to services will materially promote competition in any upstream or downstream market, consistent with the efficiency objectives of Part IIIA

(b) Regulated services are provided by infrastructure facilities that are nationally significant, and have natural monopoly characteristics that confer enduring market power on the service provider, and

(c) Access regulation is affirmatively in the public interest, with a broad range of public interest issues able to be taken into account

4.10 Deemed declaration side-steps the checks and balances of the declaration process envisaged by the Hilmer Committee and enacted by Parliament. As the Council previously stated in its submissions to the earlier airport inquiries by the PC, if a service would not satisfy the declaration criteria, then it is difficult to see how imposing regulation by other means would not amount to the promotion of particular private interests rather than the promotion of effective competition in the public interest.

4.11 The declaration criteria and the declaration process provide a mechanism for ensuring that the establishment of an enforceable right to negotiate access serves the overall national interest and the interests of society in promoting competition in markets and efficient investment in infrastructure. In particular, access regulation is limited to service providers with enduring market power where the benefits of regulation exceed the costs. Deeming airport services to be declared would represent a lowering of the threshold for the creation of access rights, despite the absence of a clear case for increased regulation of airport services. This raises the likelihood of

regulatory over-reach and the potential for regulation to be applied inappropriately to service providers that do not have substantial and enduring market power, or do not have the ability and incentive to use that market power to earn monopoly profits to the detriment of competition and efficiency. This creates the potential for the costs of regulation to exceed the benefits.

4.12 In contrast to some submissions (e.g. from A4ANZ and Qantas), the Council does not consider that a negotiate-arbitrate regulatory model could be designed to be 'light-handed'. While a negotiate-arbitrate framework is not an ex-ante mechanism (such as full regulation under the National Gas Law (NGL) whereby the regulator sets the access terms and conditions up-front), it nonetheless significantly alters the environment in which commercial negotiations are conducted with the threat of arbitration, foreclosing the opportunity for commercially negotiated outcomes to be achieved in the current light-handed regulatory environment. The direct and indirect costs (e.g. regulatory gaming by seeking to enhance positions through arbitration rather than by negotiation, the costs of the arbitration and any associated appeals, and the distortion to efficient investment incentives due to the threat of arbitration and the possibility of inappropriate access prices) could be substantial, and particularly so if there is no prior declaration process to objectively inform the decision-makers on whether there is indeed a significant market failure that warrants such a regulatory response.

4.13 The Council is also concerned that rather than increasing regulatory certainty, deeming declaration on an ad hoc basis may indicate that regulation of third party access can be more readily achieved through lobbying rather than through the transparent, independent and accountable declaration process. The Council's view is that this is likely to reduce the overall transparency and predictability of access regulation.

4.14 The Council reiterates that if timeliness of declaration decision making is a genuine concern considerations should be given to further streamlining the declaration process (including possible removal of merits review) instead of bypassing the process for airport services on an ad hoc basis.

Part 23 of the National Gas Rules

4.15 Some stakeholders have likened the proposal regarding deemed declaration of airport services to the regulatory regime for gas pipelines under Part 23 of the NGR. The Council wishes to provide the PC with background information to Part 23.

4.16 Prior to 1 August 2017, coverage (regulation) of gas pipelines was granted on a case-by-case basis following a coverage determination process (similar to the declaration process in Part IIIA of the CCA). However, Part 23 was introduced to apply to pipelines that were not previously subject to any access regulation.

4.17 Part 23 has bypassed the coverage criteria (developed based on the declaration criteria) as a gateway to regulation and, in effect, 'deemed' the majority of previously unregulated pipelines[59] to be covered pipelines and subjected them to regulation by Part 23 (which bears some similarity to light regulation under the NGL). Unlike the coverage determination process under the NGL, there is no opportunity for a decision-maker to objectively and rigorously assess, on a case-by-case basis, whether regulation would be necessary and effective (in addressing the problem of lack of competition due to natural monopoly and achieving the desired competition benefits in dependent markets) or in the public interest (in evaluating the costs and benefits of regulated access). Instead, under Part 23 it is assumed that the majority of all previously unregulated pipelines have significant, enduring market power that is causing market failure such that regulation is required.

4.18 The Council understands that the impetus for Part 23 came from the ACCC's East Coast Gas inquiry (April 2016) and Dr Michael Vertigan AC's Examination of the Test for Regulation of Gas Pipelines (December 2016). Both considered that the coverage criteria were difficult to satisfy, and did not address or constrain the apparent monopoly pricing behaviour of transmission pipelines to the detriment of pipeline users. To this point, the Council considered that the evidence was not clear that all pipelines were monopoly pricing, and considered that the issue of monopoly pricing was relevant to the consideration of whether the service provider has the ability and incentive to use that market power to adversely affect competition in a dependent market.[60]

4.19 While the Council accepted the governments' decision to introduce Part 23 (and the negotiate-arbitrate regulatory model contained in Part 23), it nonetheless remains concerned about the needs and/or benefits of such a blanket approach to regulating access to gas pipeline services. The Council urges caution against following the example of Part 23 and creating ad hoc regulatory responses such as deemed declaration or bypassing the declaration process to mandate access regulation for any

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59 These pipelines include existing pipelines that are uncovered, greenfields pipelines subject to a 15-year no coverage determination granted by the Minister under the NGL, and any new pipelines that have not been subject to coverage. The only type of pipelines fully exempt from Part 23 is those pipelines that do not supply gas to third parties.

60 In its submission to the Gas Market Reform Group and later to the AEMC's review into the scope of regulation applying to covered gas pipelines, the Council noted that persistent monopoly pricing may trigger circumstances that could meet the coverage criteria. However, it was not clear to the Council whether the monopoly pricing behaviour observed by the ACCC in its east coast gas inquiry report (if, and to the extent that it was occurring) was permanent or transitory. In response to views that the coverage criteria could be hard to satisfy, the Council noted that there have been few pipeline coverage applications lodged with the Council to test that proposition. In any event, regulation has significant costs, and was never intended to be applied unless the benefits were substantial and could not be achieved by other interventions or waiting for transitory distortions to dissipate. These submissions are available on the Council's website.

particular industries or types of services, including for economic regulation of airports. Without a declaration process – with all its designed built-in checks and balances and evidence-based assessment of the need for regulation and the costs and benefit of regulation, including the public interest – there is a heighten risk of inappropriately applying regulation when it is not necessary, leading to the costly result of undermining investment incentives and diminishing long terms efficiency and welfare gains.

Appendix 1 – Application of criterion (a) before 2006 in relation to airport services

1. The following case summaries illustrate the application of the 'with and without declaration' approach to criterion (a) prior to 2006 in the airports context in light of the prevailing market circumstances at the time.[61]

Australian Cargo Terminal Operators applications, 1996

2. Australian Cargo Terminal Operators Pty Ltd applied to the Council for a recommendation to declare certain services provided by facilities owned by the Federal Airports Corporation (**FAC**) at Melbourne and Sydney international airports:

   a. Use of freight aprons and hard stands for loading and unloading of international aircraft

   b. Use of areas for storage of equipment used in the loading and unloading of international aircraft and to transfer freight from the loading and unloading equipment to and from trucks at each airport, and

   c. Use of an area to construct and operate a cargo terminal at each airport and provide other kinds of ground handling services

3. The applicant also sought declaration of freight ramp and cargo terminal operator services at both airports operated by Qantas and Ansett. However, the applications for those services were subsequently withdrawn.

4. Access to the services mentioned above was sought so that the applicant could operate its business of providing freight ramp services and cargo terminal operator services to international airlines. FAC was not vertically integrated into these relevant downstream markets, however it controlled the facilities[62] that enabled ramp handlers and cargo terminal operators to provide services to the airlines.

5. The Council recommended that the first two services at each airport be declared and that the third service not be declared at either airport. The Council considered that the third service did not satisfy criterion (b) as it was economic to duplicate the relevant facilities off-airport.

6. In respect of all three services, the Council concluded that criterion (a) was satisfied as declaration would result in improved competition in at least the markets for ramp

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61 While these cases were discussed in the Council's submissions to previous PC's airport services inquiries, the current submission provides some additional context compared to previous submissions.

62 These same FAC facilities could be used to provide other services, such as catering, baggage handling, engineering and cleaning, to international airlines.

handling services and cargo terminal operator services, due to the highly concentrated nature of those markets.[63]

7. In July 1997 the designated Minister decided in accordance with the Council's recommendation. Subsequently, the FAC (later succeeded by Sydney Airports Corporation Limited (**SACL**)) applied to the Tribunal to review the Minister's decision to declare the first two services at Sydney International Airport.

8. The Tribunal handed down its decision in March 2000 (*Sydney Airport No 1*) and upheld the decision of the Minister by declaring the first two services[64] at Sydney International Airport for approximately 5 years until February 2005.

9. Before the Tribunal, SACL argued that it had established a competitive tender process to select ramp handlers and other airport services licensees, and therefore declaration would not promote competition in the ramp handling market and criterion (a) was not satisfied.

10. The Tribunal disagreed with SACL's arguments above. The Tribunal considered that there was no certainty as to how the tender process might be used in the future,[65] and noted SACL's tendency to select only the major ramp handlers and exclude smaller niche operators.[66] In concluding that criterion (a) was satisfied, the Tribunal considered that "a future with declaration offers the opportunity for a range of competitive behaviour and outcomes that is superior in depth and variety than available without declaration".[67]

11. The Tribunal also considered that, while a new ramp handler would likely have other barriers to entry besides access (e.g. the need to build a sufficient scale to be viable), that did not mean that entry into the ramp handling market was not possible.[68]

Virgin Blue application, 2002

12. In October 2002, Virgin Blue applied to the Council for a recommendation that the following services at Sydney Airport provided by SACL be declared:

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63 The Council also considered that competition in the downstream markets could be enhanced by the threat of increased competition, which could include benefits such as: increased cargo volumes, increased efficiencies and lower costs (Council's Final Recommendation, *Applications for declaration of certain airport services at Sydney and Melbourne international airports*, 8 May 1997, p.28).

64 The Tribunal's declaration contained one additional element to the first service, namely, the service provided by the use of passenger aprons at the Sydney International Airport.

65 *Sydney Airport No.1*, para 144.

66 Ibid, para 145.

67 Ibid, para 149.

68 Ibid, para 185.

a. A 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 (**Airside Service**), and

b. A service for the use of domestic passenger terminals and related facilities to process arriving and departing domestic airline passengers and their baggage (**Domestic Terminal Service**).

13. The application for the Domestic Terminal Service was withdrawn by Virgin Blue in December 2002 following a successful commercial agreement with SACL on terminal access.

14. Initially the Council issued a draft recommendation that the Airside Service should be declared. However, after further consultation and receiving new information, the Council made a final recommendation not to declare the Airside Service. A key aspect of the Council's recommendation was that criteria (a) and (f) were not satisfied.

Council's key considerations in assessing 'promotion of competition' in criterion (a)

15. In its final recommendation, the Council considered whether declaration of the Airside Service would promote a more competitive environment in the dependent markets.[69] In doing so, the Council compared the future likely competitive environment in the dependent markets if the Airside Service was declared against that if the Service was not declared.

16. In assessing the future likely competitive conditions in a dependent market without declaration, the Council focussed on whether SACL had the ability and incentive to exercise its market power to adversely affect competition in a dependent market. The Council's key considerations were that:

a. SACL had an ability to exercise its market power to affect competition in the dependent market. The degree of countervailing power of national airlines was not sufficient to constrain SACL's ability to exercise market power to adversely affect competition.[70]

b. SACL had an ability to engage in monopoly pricing, however there was no clear evidence that charges were substantially above competitive levels for

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69 The principal market considered by the Council was the market for domestic passenger air transport services (**Domestic Passenger Market**).

70 This was because Sydney Airport was important to the national carrier network and airlines could not credibly threaten to bypass or withdraw from the Airport. (Council Final Recommendation, *Application by Virgin Blue for declaration of airside services at Sydney Airport*, November 2003, para 6.127.)

aeronautical services.[71] Monopoly power could also be exercised through the imposition of other terms and conditions of access. The Council considered that there was nothing constraining SACL from exercising its monopoly power by imposing other terms and conditions of access that resulted in it extracting monopoly returns.[72]

c. While SACL had an ability to exercise market power to raise prices above competitive levels, its incentives to do so were somewhat tempered by the potential impact on its non-aeronautical revenues and by the threat of re-regulation by government (i.e. price controls[73]).[74] The Council consequently considered whether that would have an adverse impact on competition.

17. In its draft recommendation, the Council had considered that increased Airside Service charges above competitive levels would adversely affected competition in the Domestic Passenger Market due to the disproportionate impact on low cost carriers such as Virgin Blue.[75] However, following further consultation and receipt of new evidence, in its Final Recommendation, the Council considered that while an increase to the Airside Service charge would affect low cost carriers such as Virgin Blue more so than full services carriers, the evidence did not clearly indicate that this would ultimately affect the demand for the Domestic Passenger Market. The Council stated:

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71 The Council observed that SACL's charging level and structure was substantially the same as that approved by the ACCC under the prices notification regime in 2001. (Council's Final Recommendation, *Application by Virgin Blue for declaration of airside services at Sydney Airport*, November 2003, para 6.222).

72 At para 6.134 in its Final Recommendation, the Council noted that, "for example, there is nothing constraining SACL's ability to change its charging structure unilaterally in a manner that may adversely affect competition in the dependent market".

73 At the time, the government accepted the PC's recommendations that the then existing price notification arrangements for the newly-privatised Sydney Airport should be replaced by a price monitoring regime for a period of five years. However the government reserved the right to conduct a review at the end of the 5 year monitoring period if there were unjustifiable price increases.

74 Council's Final Recommendation, *Application by Virgin Blue for declaration of airside services at Sydney Airport*, November 2003, para 6.227.

75 The Council considered that: the proportion of final passenger fares constituted by Airside Service charges was greater for low cost carriers than for full service carriers; low cost carriers were likely to carry a higher proportion of the more price sensitive passengers; and low cost carriers were likely to operate on lower margins per route (in order to offer lower fares) making them more commercially vulnerable to increases in airport charges. As a result increased charges could lead to exit or contraction in the number of services offered on Sydney routes such that competition on Sydney routes would be adversely affected. Given the importance of the Sydney market, an increase in charges for the Airside Service above competitive levels would adversely affect competition in the Domestic Passenger Market as a whole.

> *"…the impact of an increase in charges for the Airside Service by SACL is likely to fall more heavily on low cost carriers as overall the airside charge is likely to represent a higher proportion of airfares. It is not clear, however, that low cost carriers have less capacity than full services carriers to absorb a price increase or price discriminate in the way they pass on any cost increases to their passengers so as to minimise effects on demand. Consequently, it is unclear that the impact on low cost carriers will be greatly different from the impact on full service carriers. It is not clear … that even a significant increase in airside charges (100 per cent for example) would have such a material impact on demand as to lead to a possible exit or contraction in the number of services offered on Sydney routes such that competition on Sydney routes, and hence the Domestic Passenger Market, would be adversely affected*."[76]

18. The Minister accepted the Council's recommendation and in January 2004 decided not to declare the service.

The Tribunal's key considerations in assessing 'promotion of competition' in criterion (a)

19. In December 2005, following an application for review by Virgin Blue, the Tribunal set aside the Minister's decision and declared the Airside Service for 5 years to December 2010.

20. The Tribunal affirmed the Council's approach to considering criterion (a), noting that "in assessing whether increased access[77] would promote competition in the dependent market... This assessment involved comparing the future with declaration against the future without declaration, that is, a comparison of the factual and counterfactual."[78]

21. However, the Tribunal focussed more squarely on SACL's past conduct in deciding to implement a change to the structure of the Airside Service charge, which SACL knew Qantas preferred because it would be likely to have a detrimental effect on Virgin Blue's competitive position vis-à-vis Qantas. The Tribunal considered that:

    a. The change to the structure of the charge (from based on an aircraft's maximum take-off weight to a per-passenger based charge) did not reflect the efficient cost drivers for proving the Airside Service.[79] The issue was not that it increased SACL's revenue closer to its 'allowable revenue', rather it was that the charge was

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76 Council's Final Recommendation, *Application by Virgin Blue for declaration of airside services at Sydney Airport*, November 2003, para. 6.271.

77 The 'increased access' part was invoked because Virgin Blue already had access to the service, and was seeking different terms and conditions for accessing the service.

78 *Re Virgin Blue*, para 12.

79 Ibid, para 504.

discriminatory towards low cost carriers and affected their ability to compete against full cost carriers such as Qantas.[80]

b. Based on the evidence, the Tribunal accepted that airlines' ability to pass on increased charges to passengers was limited by the airlines' practice of yield management.[81] Low cost carriers were likely to suffer a greater relative loss of profitability as they had a greater proportion of highly price-sensitive passengers.[82]

c. The Tribunal did not accept SACL's proposition that, because it did not itself compete in the dependent market and because airlines and passenger traffic through Sydney Airport which airline generated provided revenue to SACL, its only incentive must be to promote competition in the dependent market.[83] The Tribunal accepted economic evidence that situations could arise where a non-vertically integrated monopolist supplying a small number of large buyers in the downstream market may have an incentive to restrict or affect competition in the downstream market.[84]

d. SACL had misused its monopoly power by the manner in which, and the reasons for which, it had changed the basis for charging for the Airside Service. The Tribunal did not consider airlines had any significant countervailing market power, or that SACL's monopoly power was sufficiently constrained by the threat of re-regulation or by non-aeronautic revenue.[85] Given its past conduct, and the lack of existing constraints upon SACL's market power, the Tribunal considered SACL would likely to continue to have an ability to exercise monopoly power to affect competition in the dependent market in the future without declaration. Similar outcomes were also likely regarding the *non-price terms and conditions* for the use of facilities and related services at Sydney Airport.

22. Subsequently, SACL applied to the Full Federal Court to review the Tribunal's decision. The Full Court (in *Sydney Airport No.2*) upheld the Tribunal's declaration of the service. However, the Full Court rejected the established approach of both the Council and the Tribunal to assessing criterion (a) which involved: (1) a consideration of the impact of regulated access (that is, declaration) under Part IIIA and; (2) the factual/counterfactual analysis, being a consideration of the future with and the future without declaration. In rejecting this approach, the Court agreed with Virgin Blue and found that 'access' was not synonymous with 'declaration'. The Court held

80 Ibid, para 532.

81 Ibid, para 537.

82 Ibid, para 538.

83 Ibid, para 311.

84 Ibid, para 301-311.

85 Ibid, para 515.

that criterion (a) required comparing "access and no access and limited access and increased access",[86] and "the future state of competition in the dependent market with a right or ability to use the service and the future state of competition in the dependent market without any right or ability or with a restricted right or ability to use the service".[87]

23. SACL unsuccessfully sought special leave to appeal the decision to the High Court.

24. During the period of declaration one access dispute was raised with the ACCC, although this was resolved commercially and no arbitration was required. No inquiries or applications were received by the Council in relation to declaration of the service for a further period.

Other relevant cases

25. Other matters in which the Council explicitly applied the 'with and without declaration' approach to criterion (a) include: Specialized Container Transport's declaration application (1997), Services Sydney Pty Ltd's declaration application (2004), Lakes R Us Pty Ltd's declaration application[88] (2004) and declaration application regarding services provided on the Tasmanian Railway Network[89] (2007)[90].

86 *Sydney Airport No.2*, para 81.

87 *Sydney Airport No.2*, para 83.

88 In that matter, the Council considered that declaration would not promote competition in the relevant dependent market because there were other impediments to effective competition (e.g. a fundamental change in the nature and scope of water property rights in NSW would have been required).

89 In that matter, the Council considered the outcome would have been the same whether it applied the 'with and without declaration' or the 'with and without access' approach to criterion (a). The Council considered that declaration would remove a significant barrier to entry, and would constrain the service provider's ability to deny access or price such services inefficiently particularly given the Tasmanian Government had agreed with the service provider on a pricing regime for access to the tracks and pricing methodology for access to associated infrastructure.

90 In its Final Recommendation (March 2012) regarding Board of Airline Representatives of Australia Inc's declaration application, the Council considered that declaration would not be likely to promote competition in the market for the supply of jet fuel at Sydney Airport for reasons including: the dependent market for the supply of jet fuel was not characterised by excessive prices; jet fuel supply infrastructure was undergoing change and investment and the market would likely become more competitive in any event, absent declaration; large portion of capacity was already reserved by existing users; supply reliability issues were being managed and pipeline capacity was expected to increase (it was not apparent that regulated access would necessarily enhance competition so as to improve reliability).