Emerging transport policy issues: transport access regulation

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to

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1. *Introduction*

National competition policy provides a way of dealing with what have become known as ‘bottleneck’ facilities. These are facilities such as electricity transmission grids, rail tracks, ports and airports, which provide services which are a vital link in the supply chain . They occupy a strategic position in an industry where the services provided by the facility are essential for a business to be able to compete in an upstream or downstream market. Failure to secure access to these services, or securing access only under onerous terms and conditions, can choke competition in related markets.

The national access regime was established in 1995 to give businesses, individuals, or other organisations a legal avenue through which to share infrastructure services owned by another business. The objective of the regime is to promote competition in the related markets.

This morning I will limit my discussion to two industries – rail and airports – and some of the issues that arise in applying the national access regime.

2. *The National Access Regime*

I expect that most of you are familiar with the process for gaining access under the national access regime, so I will only summarise it briefly.

Access under the national access regime operates on the negotiate/arbitrate model. The Trade Practices Act offers three avenues for access:

- an undertaking to the ACCC
- certification of a state-based regime following a recommendation by the NCC; and
- declaration of a service, also following a recommendation by the NCC.

Access raises a number of difficult issues and there is tension between the infrastructure owners, the access seekers and the regulators. This tension has seen access cases before the courts and the Australian Competition Tribunal.

The Council's role is to process declaration and certification applications. Both have a number of criteria which must be met, including some threshold issues.

The Council's focus in considering the applications has been on those criteria which aim to ensure that regulation is invoked only where it leads to a furthering of competition and where development of infrastructure to provide the same service is not economical.

3. Rail

All three approaches to access have been used for rail.

- The ARTC has had an undertaking accepted by the ACCC for access to its track services.
- New South Wales, Victoria, Queensland, Western Australia and the governments of South Australia and the Northern Territory have all applied for rail access regime certification. New South Wales and the South Australia/Northern Territory regimes were certified. The others were all withdrawn.
- There have been eight applications for declaration of rail services. One, AuIron's application for the Wirrida to Tarcoola rail track has recently been declared. Some have been withdrawn before the Council made a recommendation (Portman), one has been deemed not to cover a service as required by the Act (Robe River), others the Council has recommended be declared but the relevant Minister has not

accepted the recommendation (SCT in New South Wales and New South Wales Minerals Council) while others have not been recommended for declaration (Carpentaria and Freight Australia).

Rail applications have covered both bulk haulage of freight – such as coal in the Hunter and iron ore in the Pilbarra – and long haul general freight as for the ARTC undertaking and the South Australia/Northern Territory certification.

Rail issues

One of the key issues for the Council in considering the rail declaration and certification applications has been the delineation of services that can be covered under the access regime. For example, in some of the declaration applications there has been a bundling of above and below rail services. Carpentaria applied for the declaration of a bundle (or cluster) of services – specifically, the transport and handling of freight by rail in Queensland. This included access to the track services as well as the above track services.

While the Council found that this was a service for the purposes of Part IIIA of the Trade Practices Act, the question arose as to whether it satisfied the criteria for declaration. In particular, did it satisfy the criterion that it would be uneconomical for anyone to develop another facility to provide the service?

The Council has generally found that the service which can be defined as the use of the rail track (and associated safety and operating infrastructure) is most likely to satisfy this criterion. In the case of the application by Carpentaria, the Council found that while it would be uneconomic to develop another track to provide the rail track services, rolling stock and the terminals could be developed to provide the above rail services.

In the Robe River case, however, the Federal Court ruled that the service that Robe River had applied to have declared – namely the use of the Hamersley Iron rail track – was not a service for the purposes of Part IIIA. The Court found that it constituted a production process and production processes are specifically excluded from coverage by the national access regime.

4. Airports

The Council's involvement in access issues at airports has been a bit different.

Following privatisation of the federal airports, it was the Airports Act, not Part IIIA of the TPA which provided the framework for access regulation of the privatised airports. The Airports Act determined the services which were subject to access regulation and set out the procedures for terms and conditions (including prices) to be set.

The Airports Act applied to the former federal airports which were privatised in 1998. The Act grouped the airports and applied slightly different regimes to the groups. Phase one airports – Melbourne, Brisbane and Perth were more tightly regulated that the phase two airports – the 14 smaller airports which were privatised. Of those 14 phase two airports, eight – Adelaide, Alice Springs, Coolangatta, Darwin, Hobart, Launceston and Townsville – have been subject to price regulation under the Airports Act.

Sydney Airport – leased in 1997 but not privatised – was not subject to the Act.

The four major airports – the three phase one airports and Sydney Airport – were subject to close pricing regulation. Sydney airport was declared under the Prices Surveillance Act and had to notify the ACCC of proposals to change prices, while Melbourne, Brisbane and Perth were subject to price caps for some services.

Last year, the Productivity Commission undertook a review of airport regulation. The government accepted the Productivity Commission recommendations on access and pricing. This means that:

- the sunset clauses in the Act will take affect and by 30 June 2003 all airports will be subject to the general access provisions in Part IIIA and
- price regulation has been wound back to prices monitoring at those airports with significant market power.

Until Tuesday, the Council had dealt with only one matter concerning access to services provided at airports – for Australian Cargo Terminal Operations (ACTO) to use facilities to conduct off-airport container terminal operations and to provide ramp handling services – that is to load and unload freight from aircraft.

The Council has now received an application from Virgin Blue Airlines for the declaration of access to services at Sydney Airport. I don't intend to comment much

about the new Virgin application, apart from noting that Virgin has applied for the declaration of

- *a service for the use of runways, taxiways, parking aprons and other associated facilities (Airside Facilities) necessary to allow aircraft carrying domestic passengers to :*

  i. take off and land using the runways at Sydney Airport; and

  ii. move between the runways and the passenger terminal at Sydney Airport;

and

- *a service for the use of the domestic passenger terminal and related facilities for the purposes of processing arriving and departing domestic airline passengers and their baggage at Sydney Airport.* (Virgin Blue Airline Declaration Application, p.6)

The Council will be examining the application in its usual way and will begin by releasing an issues paper shortly.

In the ACTO case, the Council recommended declaration of certain international air freight-related services provided through facilities owned by the FAC at Sydney and Melbourne International Airports. The Treasurer subsequently declared these services. The FAC sought review by the Australian Competition Tribunal in respect of the these services provided by Sydney International Airport.

On 1 March 2000, the Australian Competition Tribunal upheld declaration of these services at Sydney International Airport.

The Tribunal's decision has provided considerable guidance to the Council on defining the service, whether facilities can be developed to provide the same service and whether access would promote competition.

A key issue which arose in the ACTO case was the definition of the facilities to provide the service.

The Tribunal noted that the provision of services at the airport was frequently bundled. This is important for defining what infrastructure should be considered in deciding if another facility could be developed to provide the service.

In the ACTO case the Tribunal considered that delineating the set of physical assets that comprise a "facility" used to provide the airport service was "[a] key issue" because:

> *The more comprehensive the definition of the set of physical assets … the less likely it is that anyone … would find it economical to develop "another facility" within a meaningful time scale. Conversely, the narrower the definition of facility, the lower the investment hurdle and inhibition on development … (Sydney Airport decision, 40791).*

The Tribunal considered that the facility that provides the airport service is "*the minimum bundle of assets required to provide the relevant services subject to declaration*".

Airports comprise a combination of landside and airside facilities. Landside facilities include terminals and the infrastructure within them, such as flight information display systems, check-in counters, public amenities, and lounges for passengers. Terminals also provide space for offices and for commercial operations such as car hire, retail, and food and beverage activities. Landside facilities also encompass facilities outside the terminals, such as perimeter roads, car parks, and taxi, bus and rail points linked to terminals by walkways. Airside facilities include runways, taxiways and aprons, airfield lighting, aircraft parking bays, visual navigation aids, hangars, freight terminals and facilities for aircraft maintenance and refuelling, and in-flight catering.

As the Tribunal recognised in the ACTO case, problems arise in defining the facilities as a result of the highly interconnected or "bundled" nature of certain services that are provided by airport facilities. With regard to the application for access to ramp handling services, the Tribunal considered "the complete suite of physical assets necessary to service international airlines flying into and out of the Sydney region" meant that most, if not the whole, of the airport, including all the basic airside infrastructure (runways, taxiways and terminals) and related land side facilities were necessary for international aircraft to land at Sydney Airport, load and unload passengers and freight and depart, and essential to the services to which access was sought. Therefore, in practical terms the whole of the airport constituted the relevant facility within the meaning of Part IIIA (Sydney Airport decision, 40792).

Having identified the airport service and the facility needed to provide that service, the Council must consider whether it is uneconomic to develop another bundle of assets to provide the identified airport service.

If the facility providing the service in question is the airport *as a whole*, as it was in the ACTO case, then arguably, it would be uneconomic to develop another airport to provide that service. Airports exhibit natural monopoly characteristics. They arise from the size and sunk nature of the investment required, and the economies of scale and economies of scope in their operation. Once the basic infrastructure (runways, taxiways, control tower) is in place, the owner of the facility faces sharply falling costs of servicing increments of demand (economies of scale). By contrast, a new entrant would have to replicate this capital intensive infrastructure.

However, when the facility is defined much more narrowly than this, it is not so clear whether there is a natural monopoly or not.

In considering an application for declaration, the Council is also required to determine whether providing access would promote competition in another market. In other words, is access to the facility necessary for competition in a related market? Does the airport have market power that extends to another market? Is that other market already competitive?

Although an airport generally has market power in the *overall* market for airport services, it does not necessarily mean that it has market power in a dependent market in relation to a *specific* airport service. Therefore, in considering this criterion the Council will need to distinguish the downstream or upstream markets (usually by airport service) from the market for the service to which access is sought. It will need to consider the barriers to entry in that market (or, alternatively, the competitiveness of that market). This depends on the degree to which airport users, having made the decision to use an airport, have alternatives to the consumption of particular airport services. This in turn depends on the availability of off-airport substitutes, the availability of alternative on-airport suppliers and/or the strength of the demand preference for that service, that is the extent to which the service is required by users.

By way of illustration of the kinds of considerations the Council would take on board, the Productivity Commission analysis of the market power of Australian airports considered four main factors:

- the responsiveness of demand for air travel to that destination to changes in the price of air travel;
- alternative sources of supply for a particular airport's services;
- the proportion of airfares (or freight charges) and airline costs that airport charges comprise; and
- the supply response of other input providers, such as airlines, to changes in airport prices.

Using this analysis, the Productivity Commission classified the core regulated airports according to their market power. It found that smaller airports, catering mainly for the holiday market, and often with an alternative airport nearby had lowest market power. On the other hand, busy airports which catered mainly for business passengers and which had no substitute airport nearby had greatest market power.

The Productivity Commission also found that the highest degree of market power is held in facilities that are necessary to users and for which the supply-side substitution possibilities are limited. It appears that where airports have market power, that power is most significant in aircraft movement facilities, vehicle access, some forms of passenger processing facilities and aircraft refuelling. For aircraft refuelling, the Productivity Commission considered that market power is most significant at those airports, such as Perth, which have a high proportion of long-haul flights. It found that market power is least significant in facilities or services for which users have discretion over the quantity or quality purchased, or where there are significant supply-side substitution possibilities. These include aircraft heavy maintenance facilities, flight catering facilities, freight and ground equipment storage sites, freight facility sites and buildings, waste disposal facilities, administrative office space, and commercial and retail activities.

Constraints on the exercise of market power

There is some debate about whether the income airports derive from non-aeronautical services, such as retailing, car parking and food and beverage outlets, acts as a constraint on an airport's propensity to exercise its market power. The Productivity Commission argues that airports have an incentive to encourage passengers to the

airport to boost spending on non-aeronautical services. The Commission argued that the major capital city airports on average earned much more per passenger from non-aeronautical activities compared with earnings per passenger from aeronautical services. The Productivity Commission concluded that this means that airports are constrained from exercising their market power in airport services, and are encouraged to improve quality/capacity to encourage passenger growth and non-aeronautical revenue (not monopolistic behaviour).

The ACCC has argued that the Productivity Commission's empirical analysis does not stand up to scrutiny on this matter. The ACCC's own modelling for Sydney Airport indicated that in a genuinely unconstrained environment Sydney Airport would maximise profits by setting the departing passenger charge at $120 for domestic passengers and $510 for international passengers.

This compares with current charges of around $8 per passenger for domestic passengers, and around $35 for international passengers.

Another argument frequently raised in respect of airports exercising their market power is the effect of the countervailing power of the main airport users – the airlines. The Productivity Commission review elicited widely differing views – with proponents lining up in predictable fashion – the airlines claiming they have little countervailing power, the airports claiming airlines do have countervailing power.

I think the answer lies somewhere in the middle. At the smaller airports, which have less commercial clout and a greater reliance on the holiday market, airlines are likely to have greater market power. For domestic flights, the major capital city airports are important to the carriers and scope for airlines using countervailing power at these ports is limited. However, there is probably some scope for international flights to re-route but there is no clear evidence one way or the other. The immediate effect of the loss of international traffic after 11 September 2001 and the reduction in domestic traffic following the demise of Ansett the next day, may have altered the balance of power a little – but only in the short term.

Vertical integration offers incentives for the monopolist to extend its market power into the related market. This discrimination may take a number of forms – charging its affiliated customer lower prices or offering its services to non-affiliated customers on unequal or inferior terms. While vertical integration has been an issue in some of the

access matters which have come before the Council, the Council considers this is less likely to be an issue for Australian airports as they offer relatively few services directly to airport users.

Rather, Australian airport operators tend to provide and maintain facilities which allow other organisations to carry out their activities. In addition, the limits on airport ownership – particularly the 5 per cent limit on airline ownership and the 15 per cent limit on cross ownership of the major airport pairs, means that vertical integration is likely to be less of an issue for airports than other industries.

Conclusion

I have only touched on a few of the issues which access raises. I think it's clear that the inclusion of all airport services under the national access regime is likely to raise further complex issues.

Access is a complex area. We are still refining how the process works. While the outcome might not always be to provide access under the auspices of Part IIIA, access often occurs. Robe River was denied its application but now shares the rail track with Hamersley. SCT's application for access to the Western Australia rail track was eventually resolved through commercial negotiation.

While the process and procedures are set up to ensure a fair outcome, they may also offer an opportunity for some of the interested parties to delay the process – for example, to weary the access seeker, to send a message to others who may seek access and so on.

Part IIIA has not realised the private infrastructure owners' fears of an immediate threat to property rights suggested by some early commentators. For those seeking access, Part IIIA may not be the yellow brick road hoped for by some.

But after consideration of the outcomes over the seven years the national access regime has run we should note the leverage afforded by the very existence of the declaration process. Undeniably, experience to date has demonstrated that the "threat" – if I may put it that way – of declaration of essential infrastructure facilities, is that it has hastened the development of State based, sector specific, certified access regimes – and influenced the negotiations between access seekers and infrastructure owners.