Australian
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"Role of ACCC in Promoting Competition in Aviation Industry"

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Australian Competition and Consumer Commission

Table of Contents

INTRODUCTION

I welcome the opportunity to talk to the regional aviation sector at this conference.

My topic is the role of the ACCC in promoting healthy competition in the aviation industry. I will look at the Commission's powers under the *Trade Practices Act 1974*, and *Price Surveillance Act 1983*, particularly as they apply to the airline and airport sectors.

The scene was set for competition in aviation with the general moves to deregulation, especially through relaxation of entry barriers, implemented by federal and State governments since 1990.

I assume there is general familiarity with the broader role of the ACCC. In brief the ACCC was formed in 1995 with the merger of the former Trade Practices Commission and the Prices Surveillance Authority. The ACCC not only is the competition watch dog it has also taken on the role as multi sector regulator for deregulated former monopoly utility sectors such as gas, electricity, telecommunications, rail and airports.

The Commission has six Commissioners including Chairman Allan Fels. It is a decentralised agency operating in all states and territories. We address our regulatory functions on a portfolio basis and one of my roles is chairman of the ACCC Transport and Price Monitoring Committee which is responsible for aviation matters such as airports and air services.

INTERACTION WITH AVIATION AND REGIONAL AUSTRALIA

Even where legal restrictions on entry are removed, aviation tends to be an area of natural monopolies and oligopolies, so that the ACCC now has an important role in regulating or promoting competition in this area. The ACCC uses its powers under several Acts:

- the *Trade Practices Act* - to constrain anti-competitive practices and regulate access;
- the *Prices Surveillance Act* (mainly used in the past) - to constrain prices where other competitive forces are inadequate; and
- the *Airports Act*, which includes some provisions for regulating access.

To illustrate the ACCC's role under various broad areas of these legislated powers, I will give some examples of recent ACCC decisions and inquiries in airlines, airports and air

navigation services. These relate directly to regional aviation in some cases, and in other cases indirectly through impact on interstate or international aviation. They should convey the ACCC's potential role in areas of interest to you.

The object of the *Trade Practices Act* is "to enhance the welfare of Australians through the promotion of competition and fair trading and provisions for consumer protection". The ACCC functions impacting on fair competition and informed markets permeate all aspects of business activity creating both protections and responsibilities for individual businesses.

Part IV of the Act deals with **restrictive trade practices**. These practices include anti-competitive agreements, misuse of market power, exclusive dealing, resale price maintenance and anti-competitive mergers.

The Act takes such offences very seriously as can be seen by the penalties that can be and are applied by the courts – up to $10 million per offence for corporations and up to $500,000 per offence for individuals.

And I would mention also the **Rural and Regional Program** which has been developed by the ACCC to ensure that people in rural and regional areas are better informed about their rights and obligations under the Trade Practices Act. The ACCC's Regional Outreach Officers (ROOS) organise regular seminars and local visits to provide trade practices information and to discuss any areas of concern. Information is also made available via the Internet, regional press and radio. We also have established a Regional Supporters Network which includes representatives of local government, small business and consumer associations as well as other relevant bodies.

Turning now to aviation, I note the recent background of turmoil which has affected industry structure, competition and prices.

AIRLINES

The passenger air transport market has seen a period of intensive activity in the domestic sector with the entry of Impulse and Virgin Blue, and the subsequent demise of Impulse and Ansett. There was related upheaval in regional markets, with the failure of Hazelton, Kendell, Skywest and Flight West, until re-formed under new owners.

The international air transport market was of course dramatically impacted by the events of September last year which had a significant effect on inbound and outbound travel and put

airlines around the world under severe financial pressure. Airport operators were also affected by the turndown in demand.

The simultaneous failure of Ansett provided opportunities to Qantas to redeploy surplus international capacity. Qantas emerged as one of the most financially sound airlines in the world and one of the few to achieve profitability in 2001.

We now have a domestic market dominated by Qantas, but with an opportunity for Virgin Blue to expand its low cost operation. There are also reports of possibly entry by a third party with international links. Nevertheless, the competitive situation is still fragile, leaving an important role for a competition regulator.

Merger Issues

I will turn first to the merger provisions of the *Trade Practices Act* as these have been very relevant in the recent situation of declining market demand and company failures. Section 50 prohibits acquisitions likely to result in substantial lessening of competition. Here the Commission has to balance the merits of allowing the development of larger stronger companies with their potential for gaining a dominant position in the domestic market which could be abused.

A notable case was the Qantas takeover of Impulse Airlines where Qantas sought advice as to whether the ACCC would oppose the merger. After careful consideration the Commission formed the view that the merger would not result in the substantial lessening of competition necessary to constitute a breach of the Act provided Qantas entered into undertakings which provided certain competitive safeguards. They were:

- Qantas making available to Virgin Blue a number of scarce landing slots at Sydney Airport in peak periods, and facilitating access to terminal space to a new entrant airline;

- Restrictions on air fare increases and assurances of maintenance of services on those routes operated only by Qantas and Impulse.

Other relevant factors in this case were that Impulse was a failing firm and no other parties were interested in taking it over.

More recently, the ACCC deterred Qantas from bidding for the former Ansett terminal at Sydney Airport, as its acquisition by Qantas would have posed clear problems for competition with other airport users.

Regional Airline Aggregation

Regional routes tend to be natural monopolies or highly concentrated, as was suggested by a study of regional aviation competitiveness by the Bureau of Transport Economics in 2000. The Bureau estimated that around two-thirds of route sectors support only a single operator and the remainder, although being serviced by multiple operators (typically two airlines), tend to have one dominant firm.

In such cases it is seldom possible or appropriate for regulators to force competition in a limited geographical area.

Even on routes where there is only one service provider, the threat of entry by other airlines tends to constrain the use of the incumbent airline's market power. Hence the Bureau of Transport Economics found that excessive prices and profits were unlikely to be widespread on regional routes. However, distinctly large profits appeared to be made on some routes exhibiting very specific passenger characteristics - mining and business routes.

However, in a broader case, the ACCC initially opposed the acquisition of Hazelton Airlines by either Qantas or Ansett, arguing that this would have, for example, given Qantas control of 60 per cent of the NSW regional air services market. Eventually the ACCC did approve the acquisition of Hazelton by Ansett after Ansett addressed the competition issues by giving up a substantial number of crucial take off and landing slots at Sydney airport[1].

Misuse of market power

Where a company has achieved a position of monopoly or market power (by whatever means), section 46 of the *Trade Practices Act* restrains the misuse of such power. It prevents a business from using its market power to eliminate, harm or deter competitors. A typical example of this would be predatory pricing, where a company with substantial market power cuts its prices below cost, so as to drive a competitor with less financial

[1] The main broad-based regional airlines are now QantasLink and Australiawide (trading as Regional Express - REX- taking over former Ansett subsidiaries Hazelton & Kendell), with many other more locally-based airlines; eg. Aeropelican & Horizon.

resources out of business. Of course we welcome lower prices for the benefit of consumers, but have to be watchful for those cases where the long-term effect is to drive off competition and raise prices when the competitor fails. Along with the history of new entrants to regional and interstate airline routes being forced out of business, there have often been complaints of predatory pricing, but regulators have seldom found a proven case of illegality.

Recently the Commission initiated action under s.46 against Qantas for its response to the entry of Virgin Blue on the Adelaide - Brisbane route last year. The Commission contends that Qantas misused its market power on the route by engaging in **capacity dumping** - significantly increasing capacity beyond expected demand. That behaviour would not have been rational or profit maximising except if done to eliminate or substantially damage Virgin Blue, or deter it from engaging in competitive conduct. This matter is currently before the courts.

A number of other allegations have been made about anti-competitive behaviour by Qantas since the demise of Ansett, which the ACCC has not found to be supported.

While on the subject of s.46 I might outline the Commission's views on how this section could be improved. In its submission to the Dawson review of the Trade Practices Act, the Commission recommended the addition of an "effects" test to the existing "purpose" test in s.46. This would cover anti-competitive behaviour by a firm with a substantial degree of market power which has the *effect* of damaging competition. At present the law requires proof of anticompetitive intent and behaviour for a breach of s.46 to be established.

It is argued this change could better reflect the overriding economic concerns of the Act and bring s.46 in line with the rest of Part IV. The addition of an "effects" test would also address the evidentiary difficulties of proving purpose under the current provision. Some businesses presentation have argued that an "effects" test could result in a "chilling" of competition.

The Commission also considers that the introduction of "cease and desist" powers would be useful. They would provide a means of stopping anti-competitive conduct quickly and avoid irreversible damage to markets while matters are fully investigated and pursued through the judicial process. Such powers would have special relevance to the aviation industry in Australia through providing a means of protecting new entrant airlines in the critical early stages of operation.

We now await the outcomes of the Dawson Review, expected towards the end of this year.

Anti-competitive behaviour & Authorisations

Section 45 of the Act prohibits contracts, arrangements and understandings to restrict competition. Examples are price fixing, market-sharing, primary and secondary boycotts, parallel conduct, collusive tendering, and exclusive dealing.

However, some flexibility is provided through the **authorisation** powers in Part VII of the Act. These allow the Commission to grant immunity on public benefit grounds for some types of conduct, including mergers, that might otherwise breach the competition provisions of the Act.

The ACCC has looked at several potentially restrictive arrangements in the airline industry. The authorisation procedures allowed the Commission to balance up any efficiency benefits from greater cooperation between firms against their anti-competitive effect.

- One example was the computer reservation systems for travel agents and airlines. This was authorised, but codes of conduct were insisted on to alleviate possible anti-competitive aspects.
- Other cases involved international airline alliances:
    - The Qantas-British Airways alliance made agreements coordinating scheduling, capacity and pricing. This was authorised, subject to undertakings about price caps and freight capacity.
    - The ACCC authorised the alliance between Ansett, Air NZ and Singapore Airlines in 1998.
    - These alliances have been re-authorised only up till 21 July 2003, in view of the uncertainties about the competition.
- The ACCC is currently assessing e-commerce schemes such as Zuji– a joint venture by major Asia-Pacific airlines for on-line ticket selling. The Commission is considering issues such as the impact of the venture on competition between travel agencies and airlines.

- The Commission has recently re-authorised IATA's travel agency program under which the world's international airlines determine the means by which air travel is distributed and sold through travel agents. The authorisation is conditional on IATA taking action in a number of areas including reviewing the conditions of accreditation for travel agents and facilitating the processing of ticket refunds.

Consumer protection Issues

The consumer protection provisions of the *Trade Practices Act* are embodied in Part V. Part V safeguards the position of individual and business consumers in their dealings with producers and sellers. It addresses a range of unfair practices, including misleading and deceptive conduct, product safety, country-of-origin claims and information standards.

The ACCC recently expressed concerns over the transparency of airline fares. The Commission considered that, given the significance of taxes and other charges that are added to basic fares these days, it is misleading to advertise fares net of such charges.

Virgin Blue and Qantas both made court-enforceable undertakings to the ACCC that they would advertise all airfares inclusive of taxes, levies and charges. Shortly after, all airlines and travel agencies were required to quote all-inclusive prices.

An earlier case involved misrepresentations about frequent flyer points. The ACCC obtained undertakings from Singapore Airlines in 1999 to correct misrepresentations of availability of Global Rewards frequent flyer points.

The pro-competition provisions I have been discussing are important as there are no price controls on airlines. The last use of federal powers in relation to airfares was the monitoring of airfares by the Prices Surveillance Authority from 1991 to 1996, to check on whether gains from deregulation were being passed on to consumers.

AIRPORT REGULATION

The regulatory situation with airports has been somewhat different to airlines, as a local monopoly situation is typical for airports, and price regulation has been prevalent until recently. The larger airports in Australia have considerable market power so, as real competition is not feasible, regulation under the *Prices Surveillance Act* was used to restrain companies from setting excessive prices and profits.

Until July 2002 aeronautical charges at major airports were regulated under the *Prices Surveillance Act* so that proposed price increases had to be notified to and assessed by the ACCC. For the major privatised airports, the ACCC administered price caps which limited price increases to "CPI minus X". That is, the increase allowed over the price at a starting date was the rate of increase in the Consumer Price Index minus a target rate of productivity increase, X. There were specific provisions to pass through the costs of "necessary new investment" into allowable price increases.

In the special case of Sydney airport which was only privatised this year, the ACCC approach was to approve only price increases based on efficient costs, with a reasonable rate of return on capital. This rate of return was based on market benchmarks.

Removal of Airport controls

These price controls for airports were generally removed from July this year, in line with a recommendation by the Productivity Commission. This was contained in the PC's review of airport regulation, coming several years after the round of airport privatisations. The decision may also be seen in the context of this year's sale of Sydney airport by the government. The winning bid by the Macquarie Bank consortium of $5.6 billion exceeded most expectations, and would have been positively affected by expectations of a more light-handed regulatory regime.

Although the Productivity Commission accepted that the major airports had substantial market power, it argued that other factors would restrain prices rises. These included the threat of re-imposition of price controls and the incentive airports have to maximise revenues from non-aeronautical services. The argument is that if airport landing charges go up then airline ticket prices go up, resulting in fewer passengers and in turn lower spending on airport services such as retail, car parks and the like. Since these non-aeronautical services are important sources of profit, the airport operators might be expected to constrain increases in landing charges.

The ACCC's own analysis, on the other hand, suggested that this was unlikely to occur, due basically to the low responsiveness of demand to airport price increases. The ACCC argued strongly in its submission to the Productivity Commission that price monitoring and negotiation over access are unlikely to provide adequate restraint against excessive price increases.

The outcomes following the removal of price caps from 1 July this year have been consistent with the ACCC's expectations. Landing charges at larger airports have risen substantially, reportedly by between 40% and 130%. Other charges such as taxi fees, car parking rates and check in counter rentals are also being increased.

Economic regulation of airports has been seen as an important aspect of the management of essential infrastructure both here in Australia and overseas. Major airports are price regulated in all developed countries now except Australia and New Zealand. Even New Zealand seems to be re-assessing its position. Its government has just released a detailed report from the New Zealand Commerce Commission which recommends re-introducing price controls at Auckland and possibly Wellington airports.[2]

Continued ACCC Monitoring

Although general price caps have been removed, monitoring by the ACCC of airport prices and service quality remains. The Government saw this as a more light-handed form of regulation which still applies some pressure through public scrutiny.

The Government reserved the right to re-impose price controls if it found that "airport operators were abusing their market power by unjustifiably raising prices". The Government set out the principles it would use for judging what are reasonable or efficient prices.

One principle is that prices should not be significantly above the long-run costs of efficiently providing aeronautical services, with a return on assets commensurate with the risks involved. Price discrimination and peak-period pricing that promotes efficient use of the airport would be permitted. These principles are in fact basically the same as the ACCC has been following in its cost-based price assessments.

It remains to be seen what has to happen with prices in practice before the government considers intervention is necessary.

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[2] New Zealand Commerce Commission, *Part IV Inquiry into Airfield Activities at Auckland, Wellington and Christchurch International Airports*, released 6 August 2002.

Regional air services at Sydney

Regional air services at Sydney airport retain some government protection from the pure forces of competition through ring-fencing provisions which reserve a certain number of landing and take-off slots for them.

Regional airline services at Sydney airport (meaning NSW intrastate public services) are also still regulated under the *Prices Surveillance Act*. They are subject to a price cap which restricts price increases to CPI, based on starting prices at 30 June 2002.

In September regional airlines moved their operations at Sydney airport from the Domestic Express Terminal to a new common use terminal, Terminal 2 - the former Ansett terminal. The ACCC approved a new charge for regional users at Terminal 2 which allowed users a choice between paying either:

i) the previous rates for the terminal facilities, apron parking and check-in counters, which had been set on the basis of costs at the Domestic Express Terminal, or

ii) a per passenger charge, approximately equivalent to the previous charges.

The Sydney Airport Corporation has foreshadowed that it may notify a future price increase for regional airlines using Terminal 2, based on its higher quality and higher costs compared with the Domestic Express Terminal. Regional users may be expected to carefully scrutinise the case for such an increase under the price cap rules.

Access to airports

In situations where competition is not practicable, access regulation is another way in which the ACCC may be involved - to allow users fairer terms and conditions of access to monopolised facilities.

- Essential facilities may be declared under Part IIIA of *Trade Practices Act.* Following this the provider can
  - negotiate a contract for terms of access, which has to be registered by the ACCC, or
  - if this approach fails, the ACCC can arbitrate the dispute.
- As an alternative to declaration, the provider may develop an access undertaking to be accepted by ACCC.

The price and terms of access can be an important issue, especially in cases such as Sydney where facilities are congested or existing users have tied up most of the facilities. Commercial negotiation is the approach favoured by the Government. But it must be remembered that negotiations may not be even-handed when one side holds substantial market power.

In this situation, recourse to arbitration is more likely. However, experience to date suggests that the declaration and arbitration provisions in Part IIIA result in substantial costs and delays. This can be a particular deterrent for smaller companies. Arbitration also has the disadvantage of producing confidential arrangements limited to the specific parties involved. By contrast the Commission found that the administration of price controls became fairly streamlined after the framework became well-known to the parties involved.

Access at Sydney

Access to terminal space is vital for operating a passenger airline, and this has been one of the stumbling blocks for new competitors in the past.

The availability of the former Ansett terminal as a common use terminal now is a step towards facilitating competition. But the number of gates are still limited, and high terminal access prices will affect the ability of Virgin Blue and any new entrants to compete effectively against Qantas.

Qantas has a long term lease for its domestic terminal site and the maintenance facilities adjacent to the site. The leases were locked in on favourable terms and conditions well in advance of the privatisation of Sydney airport. If necessary Qantas can extend its existing terminal using sites currently taken up by its maintenance facilities, and indeed is planning to do so. By contrast, Virgin Blue and any future new entrants must rely on Sydney Airport to provide access on reasonable terms and conditions. High terminal access prices will affect their ability to compete effectively against Qantas.

Virgin Blue applied to the National Competition Council in September to have the terminal facilities at Sydney airport 'declared' under Part IIIA. This would allow Virgin – and other parties - to seek arbitration by the Commission over the terms and conditions of access. However, this is a lengthy process and, even if successful, it could be a year or more before the Commission becomes involved. Any subsequent arbitration might then take a number of months to resolve, depending on the complexity of the issues at stake.

Airport services at the Phase 2 (smaller) airports are declared until July 2003, but there have been no arbitrations under these provisions.

AIRSERVICES AUSTRALIA

Charges for the aviation services of Airservices Australia are still regulated under the *Prices Surveillance Act*.

This is one of only three types of service that are price-controlled now, and we may note that two of the three involve aviation, that is

(i) regional airline services at Sydney airport, and (ii) Airservices Australia.

(The third is Australia Post.[3])

Earlier this year Airservices notified the ACCC of proposed price increases covering terminal navigation, fire-fighting and rescue, and en route navigation facilities. The crux of Airservices' case was that the downturn in traffic following September 11th and the collapse of Ansett had led to higher unit costs. On the basis of its financial analysis, the Commission accepted that this justified some increase in prices. However, we were concerned that the downturn in demand may be temporary and so would not justify price increases beyond June 2003.

In its final decision in July, the Commission approved price increases for the year 2002-03 averaging 5.1%. The ACCC does not have an explicit power to require a reduction of prices. But on the basis of Airservices' past practice of raising or lowering prices according to its position in particular years, and its public commitments, we accepted that Airservices would reduce prices if appropriate in July 2003.

CONCLUSION

It is hoped that the recent turmoil in aviation circles will settle down to a more stable environment. But this does not mean a return to the era of legislated stability like the two-airline policy.

[3] This has diminished greatly from about 15 years ago when there were more than 20 industries under price surveillance. With the generally more open and competitive economy we have now, price control is applied very sparingly.

Healthy competition carries overtones of creative tension, with the possibility of innovation, new entrants and failures ever present. The ACCC will continue to promote healthy efficient competition and protect consumers from unfair and misleading practices. We hope that the Commission's Rural and Regional Program will be of particular help.

Arrangements in the policy sphere also continue to evolve and display innovation, although it remains to be seen whether the experiment in removing price controls on airports will prove to be a success in the long term.

Ladies and Gentleman, thank you for your time and your attention.