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Negotiate-arbitrate regulation of airport services: Twenty years of experience in Australia

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ABSTRACT

Negotiate-arbitrate regulation has played a role in the economic regulation of airports in Australia since the introduction of a national access regime in 1995. Over a twenty year period there have been three cases where negotiate-arbitrate regulation (NAR) has been applied to airport services, two cases where a decision has been made to not apply negotiate-arbitrate regulation to services provided and a case where an airline has sought to apply NAR and then withdrawn its application. The experience of the application of NAR to airport services is examined against a background discussion on issues associated with countervailing power in airport services. Based on the experience, some observations are made which reflect advantages and disadvantages of the application of NAR to airport services. NAR has provided a targeted approach to economic regulation of airport services in Australia, involving negotiated outcomes and limited intrusion into the aviation markets.

1. Introduction

In many countries major airports are subject to some form of economic regulation because they have been considered to have monopoly characteristics. Over time, the development of competitive influences, such as through the growth of alternative airports and modes of transport, has led to debate over the extent to which there is competition between airports, and whether economic regulation of airports is warranted. As an example, Kupfer et al. (2013) examine the case for economic regulation of Brussels Airport. They note that ex-ante regulation is quite complex and expensive. On this basis, and on the basis of competitive pressures on Brussels Airport, they support an ex-post approach to economic regulation where intervention is restricted to cases where the airport failed to reach agreement and where one of the parties involved has filed a legitimate complaint. Kupfer et al. envisage that, in this circumstance, abuse of dominance provisions in competition law should be the form of regulatory intervention.

In Australia, a National Access Regime was implemented in 1995 to regulate access to services provided by significant infrastructure facilities with natural monopoly characteristics, recognizing the difficulties and inefficiencies associated with the application of misuse of market power provisions contained in Australian competition law for this circumstance. The regime contains a general provision which allows the application of negotiate-arbitrate regulation (NAR) to infrastructure facilities in certain circumstances. This provision has been applied to airports on a number of occasions and can be considered as a form of light-handed regulation. Additionally, in New Zealand there is provision in competition laws for NAR, which could potentially be applied to major airports.[2]

In cases where airports are still considered to have significant market power, approaches to economic regulation which are light-handed, that is less interventionist, but which still provide a constraint on the use of market power are of interest. Traditional forms of economic regulation involving direct determination of prices, such as price caps and rate of return regulation, are often considered to discourage commercial negotiations between infrastructure providers and users and to be relatively complex and costly to apply. Price monitoring is another form of light-handed regulation, it was applied to airports in Australia after price cap regulation was removed in 2002.

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[2] Part 4 of the New Zealand Commerce At 1986, in particular sections 52G, 52I, 52K and 52L.

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This paper provides an extension on earlier work on light-handed regulation to assess whether NAR is an effective regulatory approach as an alternative, or complementary, form of light-handed regulation to price monitoring. Price monitoring involves regulation of information disclosure with a credible threat of stronger regulation. Information disclosure regulation applied to major airports in New Zealand has some similar characteristics. However, both these light-handed approaches to regulation have a number of deficiencies (Arblaster, 2014). The Australian approach is too minimalist to provide information that allows an assessment of the use of airport market power and lacks a credible threat of stronger regulation. The New Zealand approach, on the other hand, is information intensive and involves a high degree of analysis by the regulator, so that the approach is very close to direct price regulation.

The paper follows on from Littlechild (2012), which considered a dispute resolution approach to economic regulation of airport services in the context of airport regulation in Australia. Littlechild concludes that binding dispute resolution is an effective form of regulation of airport services which would strengthen the hand of airlines negotiating with airports with market power. There has, however, been little attention given in the scientific literature to the issues involved and the circumstances where a dispute resolution approach is likely to lead to improved economic outcomes. This paper evaluates NAR as a form of economic regulation which can be applied to airport services, drawing on twenty years of experience with the application of NAR to airports services in Australia. The collective experience of NAR in an airport context does not appear to have been examined in reviews of NAR to-date.

Under a dispute resolution approach to economic regulation users negotiate the terms and conditions on which they use facilities, and regulatory intervention only occurs when negotiations breakdown and there is a request for a dispute resolution process to be invoked. A dispute resolution approach, such as NAR, has been described as 'default regulation' in that regulation is only applied (through arbitration) when negotiations over terms and conditions of access to services have broken down. This form of dispute resolution is related to the initial contract formation process, and is separate from disputes over breaches, or interpretations, of contracts that are already in place.

In discussions in the literature of alternative forms of economic regulation that could apply to airports, price monitoring is commonly considered as a form of light-handed regulation. However, other light-handed regulatory approaches, such as NAR, are typically not considered in discussions of forms of economic regulation that could apply to airports. For example, Niemeier (2009), Gillen (2011), Adler et al. (2015) and ICAO (2013) do not consider NAR in surveying attributes of alternative forms of economic regulation. This can be explained by the limited experience of the application of NAR to negotiation of airport charges in the absence of direct regulation, experience which seems to be primarily restricted to Australia. Also, within Australia, it has not been considered the dominant form of economic regulation.

Under national legislation, NAR has been applied to services at some major airports in Australia. In addition, NAR has also been applied to services provided by facilities in other industries, including rail services, grain handling facilities at ports, sewage transportation pipes and connections, port services and natural gas pipelines. Over a twenty year period there have been three cases where NAR has been applied to airport services, two cases where NAR has not been applied to airports services and (at least) one case where an airline sought to have NAR applied but withdrew its application. There have also been a number of developments in this regulation over the twenty period. Airport specific access provisions, which were introduced when airports were privatized, have been repealed; the national access framework has been independently reviewed by Australia's Productivity Commission in 2001 and 2013; and the legislation was amended in 2006 and 2010.

There is debate in Australia over whether there should be increased application of NAR to major airports through reintroduction of an airport specific access regime. NAR of airport services is an approach favoured by airlines, as opposed to direct ex ante regulation of airport charges. Virgin Airlines, for example, has argued in favour of increased access to NAR at Productivity Commission reviews of airport regulation, and more recently called on the government to reintroduce airport specific access arrangements (Freed, 2014). Further, Australia's competition regulator, the Australian Competition and Consumer Commission (ACCC), has supported this approach in submissions to Productivity Commission reviews and in airport monitoring reports. (See ACCC 2015b for example.) However, reviews of the national access regime have recommended narrower rather than broader application access regulation (PC, 2013 and Competition Policy Review 2015).

This paper has the following structure. Section two provides background on economic regulation of airports in Australia, including NAR. Section three discusses the role of countervailing buyer power exhibited by airport users and its potential influence on negotiation of airport terms and conditions. Section four reviews the cases where NAR has been applied to airport services, or where application of NAR has been considered. Section five examines some performance aspects of airport regulation in Australia, NAR and monitoring, in order to identify advantages and disadvantages of NAR. A summary and conclusions are provided in section six.

2. Background on economic regulation of airports in Australia since privatization

2.1. Airports and airlines in Australia

Australia is a long-haul island destination for international traffic and, in addition, has long distances between major airports. Except in the case of Brisbane airport for some services, there is an absence of competitive secondary airports and poor substitutability of alternative modes of transport. As a consequence, the extent to which there is countervailing power of airport users is a key factor affecting the degree of market power held by Australia's major international gateway airports; Brisbane, Melbourne, Perth and Sydney. These airports have large shares of the international traffic serving Australia. In 2013-14 Sydney Airport accounted for 41%, Melbourne Airport 24%, Brisbane 15% and Perth 12% of international passenger traffic through Australian International airports (BITRE, 2014a). Over 50 international airlines (including five dedicated freight operators) operate scheduled services to and from Australia (BITRE, 2014a). Qantas, and its subsidiary Jetstar, have the largest share of the domestic and international airline markets. In the international market Qantas and Jetstar combined carried 24.2% of passengers and Virgin Australia 7.8% in the year ended December 2014 (BITRE, 2014a, p. 8). Four main domestic airlines, Qantas, Jetstar, Virgin Australia and Tigerair, serve the domestic market, with the Qantas-Jetstar group having the larger market share.

2.2. Regulation of airport services in Australia

The major capital city airports have been subjected to a variety of regulatory measures since they were privatized in 1997–98 and 2002 (in the case of Sydney). Regulation of airport services has included price caps on aeronautical services, price and quality of