Fair Trading Commission
Economics Department

Privatization of Sangster International Airport: A Competition Perspective

January 3, 2002

1. Introduction

The Government of Jamaica, through a Special Airport Task Force appointed by the Cabinet in December 1992 and a Project Unit established at the Airports Authority of Jamaica (AAJ), developed a proposed structure for the privatization and expansion of the Sangster International Airport (SIA). The Cabinet approved the proposal in March 1993.

On March 8, 1993, the Cabinet approved a proposal to privatize the terminal facility (landside) only, by way of a long-term lease, in order to "fast-track" the project. The Cabinet subsequently decided that the airside would be managed under contract by the same operator so as to provide a seamless operation at the airport. In this model, it stated, the Government would retain control of the airside and the responsibility for any future capital development.

In May 1998, however, the Cabinet approved the privatization of the entire airport facility in line with current trends in the airport industry rather than concluding a lease of the landside and a management contract of the airside. This followed a recommendation in a Note that was submitted to Cabinet on the privatization and expansion of Jamaica's airports

Cabinet also approved:

- The establishment of an Enterprise Team under the auspices of the National Investment Bank of Jamaica (NIBJ) which comprised representatives from the Office of the Prime Minister, the Ministry of Finance and Planning, the Civil Aviation Authority (CAA), the Airport Authority of Jamaica (AAJ)/SIA, the Attorney-General's Office and the Ministry of Transport and Works. The team was to manage the implementation of airport privatization. The Team was also authorized to include airside fees in the proposal for privatization, if feasible; and

- The construction of Phase 1A at the SIA to be funded by the Government of Jamaica through the Departure Tax Fund. The airport was also allowed to continue to benefit from this fund for one year from April 1, 1998 – March 31, 1999.

This paper analyzes the competition issues that may arise from the privatization of SIA and recommends safeguard measures against potential anti-competitive behaviour and abuse of dominance in commercial activities at the airport.

2. Competition issues in airport operations

There are several competition issues arising from the ownership and management of an airport. In particular, an airport operator will have a monopoly in a number of areas such as the following:

- Essential facilities for airlines such as slots for landing, parking and take-off, check-in desks, fuelling facilities, ground-handling services, VIP facilities, parking and other facilities for their staff;
- Essential facilities for air passengers who must go to the airports to check-in and board the aircraft;
- Essential facilities for airline services providers, for example, taxis, buses and coaches that provide transportation to the airport and caterers who need access to the aircraft parked in the airport.

In other words, the airport operator controls access to many essential facilities for those in the air transportation industry, such as airlines and service providers, and air passengers. In some areas, such as those mentioned above, there are no substitutes for the facilities that would be provided by the airport operator. In other areas, there may be some substitutes for these facilities. Car parking facilities is one such example – passengers may choose taxis to use or public transport instead of driving and parking their vehicles at the airport. Passengers may also shop elsewhere instead of at the retail outlets in the airport. In many areas, however, passengers, airlines and related service providers constitute a captive market for the airport operator. In other words, the Airport Operator has a dominant position, if not a monopoly, in the supply of many services provided at the airport.

The existence of dominance in any market brings forth the potential for the abuse of such dominance. In some cases, regulatory safeguards are put in place to curb the ability of an enterprise to abuse its dominant position – monopolist utility companies in Jamaica, for example, are price-regulated by the Office of Utility Regulation (OUR). In the case of the future Airport Operator at SIA, it will also face regulation in some areas by the CAA as stipulated under the Airports (Economic Regulation) Act 2001.

3. Economic regulation by the CAA

The CAA, which was established under the Civil Aviation (Amendment) Act 1995, is the agency responsible for the economic regulation of airports. Section 6(c) of the Act mandates the Authority to provide for, among other things, the economic regulation of air transport.

The Airports (Economic Regulation) Act 2001 establishes the legal framework, criteria and methodology of economic regulation of airports. This Act, modeled upon the UK

Airports Act 1986, sets out the functions of the CAA with regard to economic regulation to be as follows:

- To further the reasonable interests of uses of airports within Jamaica and to provide economic and reliable services to those users by establishing a system for the regulation of airports that takes account of those interests;
- To promote the efficient, economic and profitable operation of airports;
- To ensure compliance with such international obligations of Jamaica as may be notified to the Authority by the Minister;
- To create an enabling environment for potential investors in airports;
- To encourage investment in new facilities at airports in time to satisfy demands by users of the airports;
- To impose such restrictions on the airport operator as are consistent with the performance by the Authority of its functions;
- To further such vital public interests as may be notified to the Authority by the Minister from time to time; and
- To ensure that the airport is operated in accordance with performance standards and service levels consistent with best industry practices.

Even though the above functions of the CAA are varied and broad, its primary focus in relation to airport regulation is likely to be on the economic regulation of airport charges, i.e., the maximum amounts the Airport Operator may levy by way of airport charges. Section 7 of the Airport (Economic Regulation) Act 2001 states that no airport charges shall be levied at scheduled airports unless they are levied by the approved airport operator; and the Authority has granted permission for and has approved the levying of such charges.

Airport charges are defined as follows:

- Charges levied by the airport operator on operators of aircraft in connection with landing, parking or taking off of aircraft, including charges that are to any extent determined by reference to the number of passengers on board the aircraft, but excluding charges payable such as to Air Navigation Services; and

- Charges levied on aircraft passengers in connection with their arrival at, or departure from, the airport by air. For example, each airline may pay a fee to the Airport Operator for the maintenance of common facilities or towards future capital development. These are charges other than the departure tax.[1]

There are various means of setting airport charges such as the following:

- *Price-cap*—where charges are set for a period of time (normally five years). This provides price certainty and stability to the payees and gives incentives to the operators to increase efficiency and lower costs;

[1] In Montreal, for example, there is an Airport Development Charge of CA$10 per passengers.

- *Revenue control*—which is similar to the price-cap except that it is a fixed total revenue from traffic charges that is guaranteed. The operator, in setting prices, then splits the allowed total revenue among the forecast traffic for each year. While this provides security to investors, it dilutes the incentive for the operator to promote traffic development. The approach also has the unhelpful characteristic of imposing higher unit charges on airlines in times of low traffic, when their profitability is lowest. Effectively, revenue control passes the risk associated with fluctuating traffic levels from the airport to the airlines;
- *Rate of return*—this limits company profits to a specified target often specified as a rate on capital employed. Although it has the virtue of dealing directly with excess profits, this approach leads to a cost-plus mentality with limited incentives to promote revenue sources;
- *Hybrid approaches*—combine elements of price/revenue control with rate of return regulation.

The price-cap method has been the recommended method for regulating airport charges in Jamaica. It takes the form of a CPI (Consumer Price Index) minus X (CPI-X) where X is determined by the regulator in each regulatory review. The X factor is set, in principle, according to efficiency improvements that the operator is expected to be able to achieve.

In setting the price cap, the CAA is expected to adopt the "single till approach". This approach sets prices equal to estimated average accounting costs, taking into account the large part of the assets costs and revenues associated with all the activities of the airport, not just those directly linked to the regulated airport charges. Therefore, revenues from non-regulated commercial activities are also taken into account. It results in the lowest prices for users that are consistent with the airport operator earning an expected return across all its assets reflecting its estimated cost of capital

4. Competition in commercial activities in airports

Economic regulation by the CAA will therefore safeguard against the abuse of dominance by the Airport Operator in relation to airport charges. There are, however, other activities at the airport that will not be regulated. These activities are often referred to as "commercial activities" and include the following:

- Services to airlines for aircraft operations, check-in desks, hydrant refuelling, staff car parks, VIP facilities and staff catering facilities;
- Services to passengers such as left luggage facilities, shops, catering, banks, car parks, transport services (taxi, bus and coach);
- Non-operational services such as advertising and lost property facilities.

The Airport Operator would enjoy captive markets in most of these commercial activities, in the sense that certain parties cannot do without these facilities (see Section 2 of this paper). The fact that there are captive markets leads to the potential for abuse of dominance and other anti-competitive practices. The following highlights some areas with potential for anti-competitive outcomes:

- *Hydrant refuelling*—A monopolist operator of the storage and hydrant facilities for supplying fuel to the aircraft may be able to charge prices in excess of costs, to the detriment of airline operators and, ultimately, the passengers.

- *Ground-handling*—ground handling includes passenger handling, baggage handling, communications, documents and load control, cargo and mail, ramp services (such as loading and unloading of aircraft and positioning of steps or bridges), aircraft servicing, fuel and oil, aircraft maintenance, flight operation and crew administration, catering services and security. These services may be provided by contracts and licences. While many facilities (such as check-in desks and baggage systems) may be provided by the Airport Operator, others are operated by airlines or their agents, with payments to the Airport Operator by means of rents on the facilities used or, in certain cases, turnover-related payments.

  If there is no competition in the provision of these facilities, the service provider (be it the Airport Operator, airline or contractor) may be able to charge prices in excess of costs. If the provider is an airline, then there may also be scope for discriminatory behaviour against competing airlines.

- *Charges for airside licences*—these refer to licences for flight catering and aircraft cleaning. It is common for charges to be levied on third party (i.e., non-airline) suppliers of these services. Such fees may put an airline (or the third party supplier) at a competitive disadvantage compared with airlines that acquire these services internally, and provide 'windfall' revenues to the Airport Operator if airlines choose to provide such services externally. Such a levy is effectively a payment for the right to trade in the airport. The Airport Operator's monopoly position will open up the potential for excessive levies on such licences.

- *Car park charges*—If there is no competition in the provision of these facilities, the car-park operator may be able to charge excessively high fees for parking. The ability to do so, however, may be somewhat restricted to the extent that alternative means of transportation to and from the airport, for example taxis and buses, are available.[2]

The greater the competition, the less the scope for abuse of dominance and other anti-competitive behaviour. It is therefore imperative that competition exists, to the extent possible, in the commercial activities that would not be subject to economic regulation by the CAA. To this end, all activities at the airport that are not subject to economic regulation by the CAA must come under the jurisdiction of the Fair Competition Act.

5. Balancing competition with other considerations

It must be noted that, in promoting competition in the supply of commercial services at SIA, several factors must be taken into account. The first includes safety, security, capacity and available space constraints; the second is the single-till approach of regulating airport charges. Both are discussed in the following.

[2] In 1990, BAA, the owner and operator of seven airports in the UK, had to make undertakings to the Office of Fair Trading in the UK that car park charges at Heathrow would be raised by no more than the Retail Price Index (RPI) less 1% each year for a two year period.

5.1 Constraints on number of service providers

Safety, security, capacity and available space constraints may limit the number of service suppliers that can be accommodated at the airport. Where this is the case, the criteria for limitation must be relevant, objective, transparent and non-discriminatory.

In relation to this, the European Commission Directive 96/67 on Ground handling of October 15, 1996 aimed to introduce competition between carriers for ground-handling services at EU airports, is instructive. Under this directive:[3]

- Agreements for exclusive supply of ground handling services can be justified only under certain strict conditions;
- An airport may not use its position to obtain or keep a monopoly in the market for ground handling services, or to charge unfairly high prices or discriminate, whether in favour of its own ground handling operations or in favour of the national airline. If may not adopt discriminatory rules on which airlines may self-handle.
- Also, it is illegal for an airport that does ground handling to require an airline or an independent ground handling company to give it confidential information about its handling activities that it could use. It is also of course illegal for an airport or an airline to threaten to take action against any company that makes a complaint to the Commission.
- If more companies want to provide ground handling services than can operate at an airport, some non-discriminatory method (e.g. an auction or other open competitive tendering procedure) must be used to give them equal chances to become one of the companies allowed to handle there. An airport may not simply protect the incumbent ground handling companies from competition and refuse to consider applicants. If competition within the market has to be limited, there must be competition for entry into the market.
- If a Member State adopts a measure setting up a ground handling monopoly, the monopoly can be justified only if there is no less restrictive way of achieving the desired result. It is not a justification for a monopoly to say that it would find it difficult to compete with a competitor paying lower wages. An airport therefore cannot simply say that there is not enough business for more than one handling company, and then refuse to open the monopoly to tender. A monopoly should be open to tender at regular intervals, in accordance with the principle that when there are more applicants than places for ground handling companies, a non-discriminatory allocation method must be used.

The same principles should be applied in all commercial activities in SIA in accordance with the Fair Competition Act.

5.2 Cross-subsidization in the single till approach

As mentioned before, single till approach is likely to be used in the regulation of airport charges at SIA (see Section 3 above). This approach takes into account revenues generated by commercial activities at the airport. The effect often is a cross a cross-

[3] See http://europa.eu.int/comm/competition/speeches/text/sp1995_010_en.html.

subsidy between commercial activities and airport charges.[4] Consequently, as a result of the single-till approach, prices of these commercial services are in excess of cost, to the detriment of the consumers of these services (i.e., both airlines and passengers). However, airport charges would be lower than the otherwise would be in the absence of the cross-subsidy. This is to the benefit of airlines and, ultimately, passengers generally.

This view concurs with that of the Working Group appointed by the Enterprise Team that was established by the Cabinet to oversee the privatization of the Sangster International Airport which reported that—

> "It has been widely recognized that while airport charges should be related to the services provided, they are constrained by the need to encourage users. In this regard, the development of other commercial activities, such as car rental, shopping mall, conference facilities, casinos, concessions- duty- free shops, will help to ensure the sustainability of the airport as airport charges can be cross-subsidized in order to allow airport charges to become or remain competitive." [5]

Nonetheless, to apply the single-till approach would not preclude finding that the level of charges for any commercial activity was excessive and that the contribution from that activity (to lower airport charges) should be reduced. However, to prohibit the operator from generating revenues from commercial activities in excess of costs – in turn requiring that airport charges should fully cover their allocated costs – would have a substantial impact on airport charges.[6]

This view is also supported by the Working Group appointed by the Enterprise Team who reported as follows:

"the CAA will not directly regulate commercial activities, however to the extent that the revenues from those activities will be taken into consideration in the setting of the price-cap for airport charges, the CAA will have a monitoring role. The Fair Trading Commission will have direct responsibility for the general control of monopoly abuse in the areas of commercial (non-aeronautical) activities using its powers under the Fair Competition Act.

6. Conclusions and recommendations

In sum, the ownership and management of SIA by a single operator raise competition concerns, as the operator would be dominant in the market for many services that would be offered at the airport.

Airport charges, however, would be regulated by the CAA as set out by the Airport (Economic Regulation) Act 2001. Economic regulation by the CAA would ensure that there is no abuse of dominance by the operator with respect to airport charges. There are

[4] The Mergers and Monopolies Commission (now the Competition Commission) in the UK found that, in 1994/95 airport charges at three London airports – Heathrow, Gatwick and Stansted – would have to be 35% higher if there was no cross-subsidization from revenues from commercial activities.

[5] See Ministry of Transport and Works (1999), Paper on Economic Regulation of Jamaica's Privatised Airports, February 15. The Working Group was chaired by the Hon. Dr. Kenneth Rattray, O.J. Solicitor General.

[6] See Ministry of Transport and Works (1999), Paper on Economic Regulation of Jamaica's Privatised Airports, February 15.

other commercial activities, however, for which the Airport Operator will be dominant and that will not be subject to price regulation. This includes the provision of essential facilities to airport users, for example, ground handling facilities. It is necessary to ensure, to the extent possible, competition in all non-regulated activities at the airport. To this end, the FTC recommends the inclusion of provisions in the contract for the privatization of SIA, that would have the following effects:

- To unambiguously stipulate that all areas of commercial (non-aeronautical) activities at the airport, with the exception of airport charges that are subject to economic regulation by the CAA, will come under the jurisdiction of the Fair Competition Act; and
- To impose an obligation upon the Airport Operator to operate the airport in a way that ensures competition. If competition within the market has to be limited, there must be competition for entry into the market. Entry, in this case, should be determined according to fair, transparent and non-discriminatory procedures.