Submission in Response to
the National Competition Council’s
Issues Paper

Virgin Blue Application Under Part IIIA Of The Trade Practices Act 1974
Requesting Recommendation that the Airside Service Provided By Sydney Airports Corporation Limited Be Declared

7 March 2003
1. **INTRODUCTION**

Virgin Blue provides this submission to the Council in response to the request made by the Council in its Issues Paper dated November 2002.

The criteria on which the Council has to satisfy itself under section 44G of the Act in order to recommend declaration of the Airside Service are:

(a) that 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;

(b) that it would be uneconomical for anyone to develop another facility to provide the service;

(c) that the facility is of national significance, having regard to:

   (i) the size of the facility; or

   (ii) the importance of the facility to constitutional trade or commerce; or

   (iii) the importance of the facility to the national economy;

(d) that access to the service can be provided without undue risk to human health or safety;

(e) that access to the service is not already the subject of an effective access regime; and

(f) that access (or increased access) to the service would not be contrary to the public interest.

Virgin Blue has asked Frontier Economics to comment on various issues raised by Virgin Blue’s Application and the Council in its Issues Paper, principally market definition and criterion (a) under section 44G(2) of the Act. Frontier has been asked to approach criterion (a) in the way adopted by the Council in its Issues Paper (including reviewing SACL’s ability and incentive to use market power) even though, as set out below, Virgin Blue does not accept that the Council’s approach to criterion (a) is correct. The report prepared by Frontier Economics is attached.

Defined terms in this document have the meanings set out in the Glossary in Attachment 1.
2. DEFINING THE SERVICE

2.1 The Elements of the Airside Service

In its Application, Virgin Blue defined the Airside Service as:

*a service for the use of runways, taxiways, parking aprons and other associated 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 terminals at Sydney Airport.*

In its Issues Paper, the Council states that the “other associated facilities” referred to in the definition of Airside Service need to be specifically described.

Virgin Blue believes that the best approach to this issue is to consider the Airside Service as the use of those facilities\(^1\) at Sydney Airport necessary to allow aircraft carrying passengers to:

(a) *take off and land using the runways at Sydney Airport; and*

(b) *move between the runways and the passenger terminals at Sydney Airport.*

Virgin Blue considers that these facilities would include, at a minimum, the following:

* the runways at Sydney Airport;

* the taxiways at Sydney Airport;

* the parking aprons at Sydney Airport;

* airfield lighting;

* airside roadways;

* airside lighting; and

* visual navigation aids.

\(^1\) The word “facilities” is not used here in section 2 of the submission in the context of defining the relevant facility for the purpose of answering criteria (b) and (c). As noted in the Application, Virgin Blue considers that the relevant facility for the purposes of criteria (b) and (c) is Sydney Airport.
However, Virgin Blue does not consider that this is an exhaustive list of the facilities required to provide the Airside Service and Virgin Blue also notes that the facilities required to provide the Airside Service may change over time. Virgin Blue does not believe that it is practicable or helpful to the analysis of the Airside Service to provide a comprehensive and definitive list of the assets currently used to provide the Airside Service.

In its Issues Paper, the Council also asks whether it is appropriate to bundle all of the elements of the Airside Service together for the purpose of defining the relevant “service” under the Act. Virgin Blue considers that it is appropriate to bundle these elements together because these elements are all complements – airlines providing domestic air passenger and freight services to and from Sydney require each of the elements in the bundle to provide those services.

Virgin Blue does not consider that the effect of declaring the Airside Service would be to provide any right of regulated access to passenger terminals at Sydney Airport. The passenger terminals are included in the proposed description of the service only to identify the boundary of the service provided. The service is intended to cover the movement of passengers up to the door of the passenger terminal but is not intended to cover access to the terminals themselves or to such facilities as air bridges.

Finally, Virgin Blue considers that there is no reason why the Airside Service should be limited to the use of facilities by aircraft carrying domestic passengers. Aircraft carrying international passengers also use the facilities at Sydney Airport to take off and land and move between the runways and the passenger terminals. Therefore Virgin Blue considers that the Council should consider recommending the declaration of a service which is not limited to aircraft carrying domestic passengers. Virgin Blue notes that many of the arguments set out below in relation to competition in the Sydney Domestic Market apply equally to the market in which aircraft carrying international passengers operate.

### 2.2 SACL Charges for the Airside Service

SACL currently imposes the following charges on domestic airlines for the Airside Service:

- **(a)** a runway charge of $3.78 per 1000 kg MTOW of the aircraft per movement inclusive of GST (ie either take off or landing). This charge is subject to certain minimum charges;

- **(b)** an additional security measure charge of $0.2565 per 1000 kg MTOW of the aircraft per movement inclusive of GST;

- **(c)** a counter terrorist charge of $0.66 per 1000 kg MTOW of the aircraft per movement inclusive of GST; and
(d) a charge of $38.50 per 15 minute block for apron parking.\textsuperscript{2}

However, Virgin Blue notes that SACL has advised Virgin Blue that it will increase the additional security measure charge from $0.2565 to $1.5403 (inclusive of GST) from 1 April 2003 to 30 June 2003.\textsuperscript{3} SACL states that after 30 June 2003 the additional security measure charge will be reviewed, although SACL has not stated that the increase will be removed. This is a significant increase in the charge for the Airside Service.

3. **THE FACILITY PROVIDING THE SERVICE**

Virgin Blue maintains that the relevant facility for the purposes of criteria (b) and (c) of section 44G(2) of the Act is the whole of Sydney Airport. Such a conclusion is supported by the approach adopted in *Re Sydney International Airport*, which is to find that the relevant facility is, in practical terms, all of Sydney Airport because this is the minimum set of physical assets required for aircraft to land at Sydney Airport, unload and load passengers and freight and depart in a safe and commercially sustainable manner.

The Council notes in its Issues Paper that:

- there may be some parts of Sydney Airport that may not be required for the provision of the Airside Service; and

- since the relevant service being considered in respect of Virgin Blue’s Application (the Airside Service) is different from the relevant service being considered in *Re Sydney International Airport*, then maybe the relevant facility in relation to Virgin Blue’s Application might be less than that which was found in *Re Sydney International Airport*.

Virgin Blue accepts that there may be some areas that form part of Sydney Airport that may not be necessary for the provision of the Airside Service. However, Virgin Blue does not consider that it would assist in the analysis of criteria (b) or (c) under section 44G(2) of the Act to attempt to identify those particular parts of Sydney Airport and the circumstances in which they may not be necessary for the provision of the Airside Service.

Virgin Blue notes that the Tribunal in *Re Sydney International Airport* did not attempt to engage in such a review of potentially unnecessary parts of Sydney Airport.

On page 19 of its Issues Paper, the Council questions whether it would be necessary to include the passenger terminals in the relevant facility, stating:

\textsuperscript{2} Virgin Blue notes that Sydney Airport charges a different amount of $35.00 per 15 minute block for apron parking for regional airlines at T2 under theRegional Air Services Price Notification Decision.

\textsuperscript{3} Letter to Virgin Blue from SACL dated 28 February 2003.
It may, however, not be necessary to include passenger terminals in the minimum bundle of assets making up the relevant facility as it may be quite feasible to disembark and board passengers without the use of air bridges linking aircraft with passenger terminals.

Virgin Blue agrees that it is quite feasible to disembark and board passengers without the use of air bridges, however, as noted above in section 2.1 of this submission, Virgin Blue does not consider that the provision of air bridges forms part of the Airside Service and Virgin Blue does not consider that the manner in which passengers enter or exit passenger terminals is relevant to the definition of the facility (such matters are the subject of terminal access arrangements). Nevertheless, Virgin Blue considers that passenger terminals need to be included in the relevant facility because they determine the boundary of the Airside Service and it is not practicable to use the Airside Service without them. Once an aircraft has landed, it is necessary to transfer the passengers to a terminal as this is the authorised and regulated interface between the airside and the landside. Obvious security concerns would arise if passengers were allowed to board and disembark aircraft without going through a terminal. Without a passenger terminal (or equivalent interface) at which to commence or terminate the Airside Service, airlines would not be able to provide passenger and freight air travel services on a commercial basis. Therefore the description of Airside Service provides for the movement of passengers up to the entrance to the terminal and passenger terminals should be included in the definition of the relevant facility.

Further, Virgin Blue does not consider that excluding the passenger terminals from the definition of the relevant facility would be consistent with the approach adopted by the Tribunal in *Re Sydney International Airport*. In that matter the tribunal found that the relevant services were:

(a) the service provided by the use of the freight and passenger aprons and the hard stands at Sydney International Airport for the purpose of enabling ramp handlers to load freight from loading equipment onto international aircraft and to unload freight from international aircraft onto unloading equipment; and

(b) the service provided by the use of an area at Sydney International Airport for the purpose of enabling ramp handlers:

(i) to store equipment used to load and unload international aircraft; and

(ii) to transfer freight from trucks to unloading equipment and to transfer freight from unloading equipment to trucks, at the airport.

Despite the fact that it would be quite feasible to load and unload freight from international aircraft without the use of any passenger terminals (whether domestic or international), the Tribunal did not consider that passenger terminals should be excluded from the minimum bundle
of assets making up the relevant facility in Re Sydney International Airport. This is because the Tribunal found that the facility was (at paragraph 99):

>a "facility" that comprises the minimum set of physical assets necessary for international aircraft to land at [Sydney Airport], unload and load passengers and freight and depart in a safe and commercially sustainable manner, that is, all the basic air-side infrastructure, such as the runways, taxiways and terminals and the related land-side facilities integral to the effective functioning of air-side services. This is, in practical terms, the whole of the airport.

Equally, Virgin Blue does not consider that it would be appropriate to exclude passenger terminals from the minimum bundle of assets making up the relevant facility in relation to the Airside Service. Instead, Virgin Blue considers that it is appropriate to adopt the same approach as that adopted in Re Sydney International Airport, which is to find that the relevant facility is, in practical terms, all of Sydney Airport because this is the minimum set of physical assets required for domestic aircraft to land at Sydney Airport, unload and load passengers and freight and depart in a safe and commercially sustainable manner.

Therefore, while the Council has asked for comments on the extent to which passengers and freight can be loaded and unloaded from points at Sydney Airport other than directly to/from the passenger terminals, Virgin Blue does not believe that this is a relevant factor in identifying the relevant facility for the purposes of criteria (b) and (c).

4. UNECONOMICAL TO DEVELOP ANOTHER FACILITY TO PROVIDE THE AIRSIDE SERVICE

Virgin Blue does not consider that there has been any development in the aviation or airport sector since the decision in Re Sydney International Airport, nor any other reason that might lead to the conclusion that:

- Sydney Airport no longer exhibits natural monopoly characteristics; or
- that it would be economic to develop another such airport.

5. DEFINING THE RELEVANT MARKETS

In its Application, Virgin Blue identified the relevant downstream market in which competition would be promoted as the market in which domestic (both interstate and intrastate) air passenger transport services are supplied to and from Sydney.

The Council in its Issues Paper has raised a number of issues in relation to whether the Sydney Domestic Market is an appropriate market in which to consider whether or not criterion (a) is
satisfied. The Council states that the Sydney Domestic Market may be too broad in many respects, and instead the Council considers that a more appropriate approach may be to consider a number of separate markets where:

- both passenger and freight transport is considered as part the product dimension; and
- each separate possible city pair route to or from Sydney is considered as a separate market.

Further, the Council also states that the relevant markets may also be delineated by reference to:

- passenger type;
- fare class;
- freight transport type; and
- whether the route is a direct route or a multi-stop route.

Virgin Blue sought the opinion of Frontier Economics in relation to the appropriate market definition for the consideration of criterion (a). As a result of the Frontier Report, Virgin Blue amends its original proposed market definition so that it includes both passengers and freight, but otherwise Virgin Blue does not consider that it is either appropriate or useful to consider a large number of separate possible routes from or to Sydney:4

In summary, defining separate markets for each city pairs leads to two problems. First, it makes no economic sense to analyse competition on one city pair independently of that of any other if there are strong complementarities in flying one city pair and another. If there are strong complementarities in supply, airlines that fly multiple city-pairs will have a strong competitive advantage over a hypothetical airline that attempted to specialise in only one city-pair. Secondly, it will lead to a costly duplication of words because the NCC will need to analyse the effect of the proposed declaration on each city pair. The most appropriate way to think of the market that is likely to be affected by declaration is the market for air services to and from Sydney.

For the reasons set out in the Frontier Economics Report, Virgin Blue considers that the relevant market is the market in which domestic (both interstate and intrastate) air passenger and freight transport services are supplied to and from Sydney (Sydney Domestic Market). Further, as set out in section 2.1 above, Virgin Blue does not consider that it is necessary to restrict the definition of

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4 page 18.
the relevant service to the use of the runways, taxiways, parking aprons and other associated facilities by aircraft carrying domestic passengers. Many of the arguments set out in this and the subsequent section of the submission apply equally to the market in which aircraft carrying international passengers to and from Sydney operate.

Nevertheless, Virgin Blue does not consider that, from its position, the adoption of a narrower market definition by the Council adversely affects the Council’s substantive consideration of whether or not competition is promoted in a dependant market. As the Council notes in the Issues Paper, Virgin Blue only has to show that competition would be promoted in just one dependant downstream (or upstream) market in order to satisfy criterion (a).

Therefore, Virgin Blue also addresses relevant issues for possible markets based on city pair routes below when examining whether competition would be promoted in another market.

6. PROMOTION OF COMPETITION

Criterion (a) requires the Council to satisfy itself that:

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.

6.1 Appropriate Test for Criterion (a)

In its Issues Paper, the Council states, in relation to criterion (a), that it must first identify the relevant market. Once this is done, it must then:

determine if access (or increased access) would promote a more competitive environment in those additional markets. This requires an assessment of:

- whether the incumbent has market power and the incentive to use that market power in those related markets; and

- if the requisite market power does exist, whether there are any reasons why access would not promote competition in another market. (emphasis added)

Virgin Blue accepts that, on the basis of Re Duke Eastern Gas Pipelines, the existence of market power is a necessary condition for the satisfaction of criterion (a). As the Tribunal noted at paragraph 116:

Whether competition will be promoted by coverage is critically dependent on whether EGP has power in the market for gas transmission which could be used to adversely
affect competition in the upstream or downstream markets. There is no simple formula or mechanism for determining whether a market participant will have sufficient power to hinder competition. What is required is consideration of industry and market structure followed by a judgment on their effects on the promotion of competition.

However, Virgin Blue does not accept that the three step process proposed by the Council is appropriate for criterion (a) under section 44G(2) of the Act. In particular, Virgin Blue does not consider that either the wording of criterion (a), or the interpretation that has been placed on those words by the Tribunal in either Re Sydney International Airport or Re Duke Eastern Gas Pipelines justifies a separate requirement that the Council must be satisfied that the operator of the facility has an incentive to use its market power in the dependant market.

The Council explains its approach in the Issues Paper (page 31):

While the existence of market power in a dependent market is necessary for the satisfaction of criterion (a), it is not sufficient. The Council, adopting the approach of Ordover and Lehr, considers it is also necessary to demonstrate that the service provider has the incentive to use its power to adversely affect the related market. This is because in the absence of such an incentive, competition will not be promoted through declaration. As such, in order for criterion (a) to be satisfied, it must be demonstrated that the service provider has the ability and the incentive to exploit market power in a dependent market. Once this is established, it is also necessary for criterion (a) to be satisfied, to consider whether declaration will promote competition in the dependent market. (emphasis added)

Virgin Blue has two comments on the approach outlined above:

(a) the last sentence in the passage contains the whole of the test under criterion (a). However, the Council describes the test in this passage as an additional consideration to the consideration of the existence of, and incentive to use, market power when it is in fact the only consideration; and

(b) the Council appears to be introducing a purposive element into criterion (a) by requiring a demonstration that the service provider has the incentive “to use its market power to adversely affect the related market”. There are two different ways in which this phrase could be interpreted:

(i) a requirement that the service provider have an incentive to use its market power for the purpose of adversely affecting the relevant market; or
(ii) a requirement that the service provider have an incentive to use its market power (say by charging monopoly prices and thereby maximising its profits) and that this have an adverse affect on the relevant market.

As there is no justification for the introduction of a purposive element into criterion (a), Virgin Blue has interpreted this phrase on the second basis set out above.

However, even accepting that there is no purposive element in the incentive requirement proposed by the Council, Virgin Blue considers that the approach outlined by the Council in its Issues Paper to criterion (a) proposes a series of conditions that have the cumulative effect of imposing an unnecessarily complex and incorrect test for the satisfaction of this criterion. Virgin Blue believes that this approach is at odds with the statements of the Tribunal in relation to criterion (a), especially the Tribunal in Re Sydney International Airport where the Tribunal stated in relation to criterion (a) that:

"The Tribunal does not consider that the notion of “promoting” competition in s 44H(4)(a) requires it to be satisfied that there would be an advance in competition in the sense that competition would be increased. Rather, the Tribunal considers that the notion of “promoting” competition in s 44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration."

Virgin Blue considers that Council’s view of criterion (a) as set out in the Issues Paper is tantamount to a requirement that competition in fact be increased in the dependant market.

6.2 Airside Service Meets the Council’s Test for Criterion (a) in Relation to Market Power

However, while Virgin Blue considers that the approach outlined by the Council in its Issues Paper adds unnecessary hurdles to the proper consideration of criterion (a), Virgin Blue considers that the Airside Service meets the requirements of the Council’s approach in that, whether the dependant market is defined as the Sydney Domestic Market or on a route by route basis:

(a) SACL has significant market power;

(b) SACL has the incentive to use its significant market power in the dependant market(s); and

(c) competition would be promoted in the dependant market(s) as a result of declaration.

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5 paragraph 106.
Virgin Blue requested Frontier Economics to comment on whether the Airside Service met the test proposed by the Council in relation to the existence of, and incentive to use, market power.

6.2.1 Existence of Market Power

As noted in the attached Frontier Economics Report, SACL has a substantial degree of market power in the market in which the Airside Service is provided.

SACL’s market power is clearly evidenced by its recent imposition of increased charges for the Airside Service.6 SACL has described this increase as being necessary to recover charges for terrorism charges it has previously under recovered. To pass on an increase in operating costs in the manner proposed by SACL is not conduct consistent with a firm operating in a competitive market. Further, only a firm with a substantial degree of power in a market can impose a charge on its customers for costs it had previously under recovered, particularly where it attempts to make up for the whole of this under-recovery7 in just three months.

Further, Virgin Blue notes that SACL has reported significant reductions in operating costs yet has chosen not to pass these savings on to its customers. Again, this is not conduct consistent with a firm operating in a competitive market.

6.2.2 Incentive to Use Market Power

SACL also has an incentive to use its market power in the market in which the Airside Service is provided with the effect of adversely affecting competition in:

(a) the Sydney Domestic Market; or

(b) separate city-pair route markets.

In the Issues Paper, the Council notes the view of the Productivity Commission that SACL has an incentive to increase passenger throughput rather than leverage its power to adversely affect passenger throughput due to the fact that, on a per passenger basis, SACL earned more money from non-aeronautical revenue than from aeronautical revenue. The Productivity Commission stated that this gave airports, including SACL, an incentive to.8

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6 See section 2.2 above.
7 SACL has described this under-recovery as having occurred over the past few years in a letter to Virgin Blue dated 28 February 2003.
8 Airport Regulation Report, p 188.
temper prices for aeronautical services (particularly additional services and new entrants), improve quality and/or increase aeronautical capacity to encourage passenger growth and non-aeronautical revenue.

The Productivity Commission concluded that there was not any need for strict price controls at airports (even those with substantial market power) apparently because the airports were “constrained by commercial pressures and opportunities”, of which this incentive to temper prices was the most important.10

However, a careful reading of the Airport Regulation Report reveals that the Productivity Commission did not conclude that airports with significant market power would not raise prices for aeronautical services above competitive levels. For example, on page xxix of the Airport Regulation Report the Productivity Commission states:

How far beyond their efficient levels or, indeed, whether aeronautical prices at airports with market power would increase in the absence of any airport-specific price regulation, no-one can say with any certainty.

Regardless of the view of the Productivity Commission, Virgin Blue does not believe that the incentive which may come from the desire to maximise passenger throughput so as to increase non-aeronautical revenues is sufficient to prevent SACL from exercising the market power it has in the provision of the Airside Service to charge prices above efficient levels for the Airside Service (being aeronautical revenues). As has been stated in a recent article on this issue:11

Contrary to the recent revelation by some transport economists, we find that a private, unregulated airport would set aviation user charges higher than a public airport would do, despite the fact that the unidirectional demand complementarities between traffic volume and concession revenue reduces the airport’s incentive for exercising monopoly pricing.

Virgin Blue also refers to section 3 of the Frontier Economics Report in relation to this issue, and also notes the position of the ACCC12 which also considered that the Productivity Commission’s

9 Airport Regulation Report, p xvi.
10 For a critique of the reasoning of the Productivity Commission in the Airport Regulation Report, see generally the ACCC Submission on the Draft Airport Regulation Report and also L Woodward “On a wing and a prayer – Productivity Commission says airports might not charge monopoly prices” ANZ Trade Practices Law Bulletin Vol 18, No 8.
12 ACCC Submission on the Draft Airport Regulation Report
conclusion was incorrect. The ACCC commissioned NECG to comment on this issue and NECG concluded that:13

\[E\]ven if an airport were motivated, for the sake of maximising profits from aeronautical and non-aeronautical services combined, to set aeronautical prices below the stand-alone profit maximising level, the new level is still likely to be well above the cost-reflective aeronautical price level which would result from either a workably competitive airport market or from cost of service regulation of airports. Consequently, the contention that a desire to maximise the combined profitability on aeronautical and non-aeronautical services would neutralise the allocative inefficiency arising from unregulated aeronautical prices, is not well supported by the evidence contained in the Draft Report.

6.3 **Competition Will be Promoted Through Declaration**

Virgin Blue considers that competition will be promoted through the declaration of the Airside Service.

Virgin Blue notes the Council’s prima facie position that declaration will promote competition in a dependant market where the requisite ability and incentive to exercise market power has been established.14

In the MSP Final Recommendations, the Council noted that the promotion of competition criterion does not require the Council to establish that more competitive outcomes will actually occur or will occur within a particular period of time (paragraph 7.51) and referred to the work of Ordover and Lehr:15

Because of other market frictions, entry may be slow in coming. Hence, criterion (a) cannot be taken to mean that coverage would rapidly induce entry relative to the no-coverage benchmark. Rather, we take the criterion to mean that coverage is justified if imposition substantially16 increases the overall competitive conditions in relevant market(s), including the likelihood of entry. Here, it is important to point out that the mere reduction in impediments to entry could stimulate competition among incumbent firms as the enhanced threat of entry forces the incumbents to act more competitively on

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14 Issues Paper, page 35.
16 Virgin Blue notes that the above quotation from Ordover and Lehr appears to require a *substantial* increase in the overall competitive conditions in the relevant market(s) in order for criterion (a) to be satisfied. There is no basis in law for requiring the increase to be substantial, and such a requirement would appear inconsistent with the approach in *Re Sydney International Airport* and *Re Duke Eastern Gas Pipelines*. 
all dimensions that matter to consumers (which includes price, conditions of sale, service, and so on).

In the absence of the regulated access to the Airside Service which would be provided by declaration, SACL is able, and likely, to act with detrimental effects on competition in the Sydney Domestic Market (or in particular city-pair route markets), particularly by:

(a) increasing the level of charges for the Airside Service above competitive levels; and

(b) changing the structure of charges for the Airside Service.

Virgin Blue refers to the attached Frontier Economics Report which concluded:\textsuperscript{17}

Although SACL’s pricing has been constrained in the past by its public ownership and price surveillance, these constraints have now largely been removed. It now has shareholders who expect it to maximise its profits. This is likely to entail substantially higher prices than it is currently charging and changes in the structure of its prices.

6.3.1 Competitive Impact of Increase in Overall Level of Charges Above Competitive Levels

Virgin Blue considers that charges for the Airside Service in excess of competitive levels:

(a) would hinder competitors, and therefore competition, in the Sydney Domestic Market (or the city-pair route markets); and

(b) otherwise detrimentally impact on competition in the Sydney Domestic Market (or in the city-pair route markets) due to the disproportionate impact such charges have on low fare carriers such as Virgin Blue compared with their impact on higher fare carriers such as Qantas.

Virgin Blue notes that the charges currently levied by SACL in relation to the Airside Service are (except as noted above in section 2.2) those charges which were approved by the ACCC in the Sydney Airport Price Notification Decision in 2001.

However, as noted above in section 2.2, Virgin Blue has recently been informed by SACL that it intends to increase charges for the Airside Service despite the fact that a 97% increase was approved by the ACCC less than 2 years ago.

\textsuperscript{17} page 27.
The charges imposed on airlines by SACL for the Airside Service are a significant component of airlines’ costs of operating on routes to and from Sydney. The charges imposed by airports for take-off and landing services can amount to up to 10% of Virgin Blue’s commonly offered ticket prices on certain routes into and out of Sydney. Currently, Virgin Blue pays SACL approximately $600,000 per month in respect of the Airside Service, which amounts to $7.2 million on an annualised basis.

If SACL were to increase its charges for the Airside Service, then airlines would have to either:

- pass on the increased charges to passengers in the form of higher ticket prices;
- absorb the cost of the increased charges (if this is commercially possible) and therefore suffer decreased margins on flights to and from Sydney Airport; or
- adopt a combination of these approaches and pass on some of the costs and absorb the balance.

Generally, airlines will adopt a range of positions along a continuum between the two extremes of absorbing all the costs or passing on all the costs.

To the extent that the increase in charges is passed on to consumers in the form of higher ticket prices, this will result in a drop in consumption of domestic passenger and freight air travel to and from Sydney Airport (whether analysed as a whole or on a route by route basis). This drop in consumption away from competitive levels represents a lessening of competition.

On the other hand, to the extent that the increased charges are absorbed by airlines then this will result in decreased margins and a reduced incentive for:

- existing airlines to expand their operations to or from Sydney;
- potential new airlines to commence operations to or from Sydney.

This drop in supply away from competitive levels represents a lessening of competition.

Airlines make decisions about commencing on a new route or increasing the number of flights on existing routes by comparing the incremental cost of that new route or flight compared with the estimated incremental revenue that could be generated from that new route or flight. The charges imposed by SACL for the Airside Service are an important part of the incremental cost of any flight to or from Sydney Airport, and increases in those charges may result in additional flights to or from Sydney Airport no longer being viable. Alternatively, airlines might decide that certain additional services should be directed to routes not involving Sydney Airport due to the more
favourable margins that could be earned on those routes given the increased charges by Sydney Airport for the Airside Service.

Further, in addition to the impact that an increase in the Airside Service charges would have on overall consumption and supply of domestic passenger and freight air travel to and from Sydney Airport (whether analysed as a whole or on a route by route basis) the increase would adversely impact on competition in the market because it would have a disproportionate impact on low fare carriers such as Virgin Blue.

Passengers on domestic flights to and from Sydney (as with all airline passengers) have varying price elasticities of demand. Some passengers may have very low price elasticity of demand (such as business travellers) and others may have high price elasticity of demand (such as leisure travellers). Low fare carriers such as Virgin Blue generally have a higher proportion of high elasticity passengers compared with “full service” carriers such as Qantas which, through a higher cost structure, offer additional services for price inelastic travellers such as business travellers (eg business class seating and business clubs at airports). Further, when low fare carriers review the feasibility of particular routes that are being serviced by full service airlines, they generally allow for an overall increase in the number of passengers on the route following their entry on the basis that the lower prices they offer stimulates demand by attracting those price elastic passengers further along the demand curve who would not otherwise have travelled.

Therefore, when airlines are forced to pass on increased charges for the Airside Service, the resultant fall in demand will be highest among the price elastic travellers, and there will be comparatively little fall in demand among price inelastic travellers, and this unequal fall in demand will impact more severely on low fare carriers than on other carriers. Therefore low fare carriers will suffer greater detriment than other carriers from this increase in costs above a competitive level and this in turn will adversely affect their ability to compete in the dependant market.

6.3.2 Competitive Impact of Change to the Structure of Charges

SACL has informed Virgin Blue that it is seriously considering changing the basis on which it levies its charges for the Airside Service from 1 July 2003, as well as increasing the overall level of the charges. SACL has informed Virgin Blue that it is considering moving from a weight-based method of calculating charges to a per passenger basis.

Virgin Blue notes that in August 2001 SACL also proposed to change the basis on which it charged for the Airside Service. As Sydney Airport was then subject to declaration under the PSA, SACL was required to notify the ACCC in respect of its proposal to change the basis upon which it charged for landing charges. SACL proposed to remove the existing MTOW-based charges and replace them with a Passenger Services Charge (PSC) of $4.00 per passenger
movement for embarking/disembarking domestic passengers (ie $8.00 for a return domestic flight). The ACCC objected to this proposal under the PSA and SACL did not proceed with the proposed change in relation to domestic airline services. The ACCC’s statement for the public register in relation to this objection states:\textsuperscript{18}

*Virgin Blue did not support the proposed domestic passenger charge. It argued that introducing the domestic charge would result in charges that do not reflect the costs of the services provided; would encourage inefficiency in airport users and would be anti-competitive and unfairly prejudice domestic new entrant airlines such as Virgin Blue.*

*Virgin Blue argued that passenger charges would promote inefficiency in airlines in that it would not encourage aircraft to carry the maximum number of passengers for the weight of the aircraft. Virgin Blue argued that, "[w]eight-based charges encourage airlines to use the lightest and fewest aircraft sufficient to meet passenger demand, and to configure aircraft to carry the maximum number of passengers for the weight of the aircraft. This promotes efficiency in aircraft and fuel costs and reduces the impact on runway facilities."

*Virgin Blue argued that the proposed charges were the opposite of Ramsey pricing, in that they would impact disproportionately on domestic new entrants and low-fare customers who are more price-sensitive than the established full-service airlines.*

*Virgin Blue also argued that it would be disproportionately disadvantaged because the proposed charges exclude transfer and transit passengers which Virgin Blue does not carry. Virgin Blue submitted that "any benefits resulting from this transparency in relation to international services do not outweigh the detrimental impact on domestic air travel arising from the per-passenger charge".*

*The Commission considers that Virgin Blue's submission raises important concerns about the impact the domestic passenger charge may have on competition in the domestic aviation market. It appears that the proposed restructure may disadvantage new entrants who carry more passengers per aircraft. However, these complex issues requires greater analysis than what has been possible in the PS Act's 21 day statutory period.*

*The Commission considers that it has not had sufficient time under the PS Act's 21 day statutory period to fully consider and analyse the effects of the proposed domestic charge restructure. As such, the Commission objects to the proposed passenger service charge for domestic passengers.*

For the same reasons advanced by Virgin Blue in 2001 which caused the ACCC concern, Virgin Blue submits that a change by SACL of the basis upon which it charges for the Airside Service will have a significant detrimental impact on competition in the Sydney Domestic Market (as well as on the individual city-pair routes which make up this market).

6.4 **Other Issues Raised by the Council in its Issues Paper**

There are a number of other issues raised by the Council in its Issues Paper in relation to criterion (a). Virgin Blue has asked Frontier Economics to comment on a number of these issues and these findings are contained in the attached Frontier Economics Report.

6.4.1 **Countervailing Power of Airlines**

As discussed in the Frontier Economics Report SACL’s market power is not constrained by any countervailing market power of the airlines.\(^\text{19}\) As noted by Frontier Economics, standard bargaining theory supports a conclusion that airlines have limited countervailing power. An airline cannot offer a truly national domestic network unless it flies to the capital cities of all States. In any negotiations with SACL, Virgin Blue cannot credibly signal to SACL that it would refuse to offer flights into and out of Sydney given its clearly stated business objectives.

6.4.2 **Existence of Effective Competition in the Dependant Market**

In its Issues Paper, the Council states that the barriers to entry in the dependant market are a relevant factor in its consideration of the existence of market power under criterion (a). If these barriers are low, then the Council considers that this may suggest that:

\[
SACL \text{ has little ability to exercise market power in the relevant downstream market.}\]
\[
Alternatively, high barriers to entry may suggest SACL has the requisite market power.\]

(page 33)

The Council appears to consider that high barriers to entry to the dependant market are required in order for SACL to have the ability to exercise its market power, such an ability being a necessary condition to the satisfaction of criterion (a) under the Council’s approach.

Virgin Blue does not consider that barriers to entry to the dependant market need to be significant before criterion (a) can be satisfied. There are many examples of industries in which one functional level may be competitive, with comparatively low barriers to entry, but competitors at that level are dependant for a critical input on a monopoly supplier. It was with some of these industries in mind that Part IIIA was introduced.

\(^\text{19}\) pages 8 and 9.
Therefore, Virgin Blue does not believe that low barriers to entry in the dependant market would be a relevant factor in considering criterion (a).

However, Virgin Blue does consider that there a number of barriers to entry to the Sydney Domestic Market (including if a route by route approach to market definition is adopted), including:

- access to, and the prices charged for, airport facilities including terminals and the Airside Service; and

- predatory behaviour of a dominant incumbent.

6.4.3 No Promotion of Competition Because of Prohibitive Barriers

The size of other barriers to entry in the downstream markets do not impact upon the analysis as to whether declaration of the Airside Service will promote competition. Frontier Economics noted:\(^{20}\)

…it is incorrect and inappropriate to assume that barriers to entry in the dependent market eliminate the benefit of declaring services. Competitive pressure can come both from outside a market (in the form of prospective entrants) or from other incumbents within a market. Even if entry to a downstream market is blockaded, competition within that market may be reduced by any method that reduces rivalry among the incumbents within that market.

6.4.4 Price Versus Cost of Providing the Airside Service

For the reasons set out in section 2.2 of the Frontier Economics Report, due to complementarities in demand and supply, the regulatory history of charges for the Airside Service and difficulties in accurately determining the actual cost of the Airside Service, there is little benefit in comparing the cost of the provision of the Airside Service to current charges for the Airside Service in any analysis of the market power of SACL.

7. ACCESS TO THE SERVICE IS NOT ALREADY THE SUBJECT OF AN EFFECTIVE ACCESS REGIME

In its Application, Virgin Blue considered both the slot management scheme and the Sydney Airport Lease and concluded that these mechanisms (either by themselves or acting together) did

\(^{20}\) at page 21.
not amount to an effective access regime, principally because they did not comply with clause 6 of the Competition Principles Agreement.

For completeness sake, Virgin Blue notes that Declaration 90 of the Minister pursuant to subsection 21(1) of the PSA provides that the supply of certain aeronautical services to regional airlines are notified services under the PSA. The effect of this is to place some restrictions on the ability of SACL to raise prices for Airside Services for regional services. Before it increases these prices it must first notify the Commission of such a price increase and must not increase the price of that service until the proscribed period has elapsed (21 days), or the Commission has provided notice that it does not object to the new price. This does not, however, constitute an effective access regime as it does not provide to any person a right of access, that is, it is not an access regime it is a prices surveillance regime.

On these bases, Virgin Blue does not believe that the Airside Service is the subject of an effective access regime.

8. DECLARATION NOT CONTRARY TO PUBLIC INTEREST

Virgin Blue notes that the wording of criterion (f) does not require the Council to satisfy itself that declaration would be in the public interest. Instead, it requires the Council to satisfy itself that access (or increased access) would not be contrary to the public interest. There is therefore a presumption that access would be in the public interest if the other criteria are satisfied.

Virgin Blue does not consider that this presumption is displaced in the case of the Airside Service. Virgin Blue considers that the competitive gains that would flow as a result of declaration of Airside Service would be significant, and would outweigh any costs of regulation of the Airside Service.

Virgin Blue notes that the revenue currently received by SACL for the Airside Service is significant. SACL’s revenue from aeronautical services for the 12 months ended 30 June 2002 exceeded $228 million.21 Further, the regulatory costs associated with declaration would be not be high and, in any case, would depend in part upon the extent to which SACL attempts to exercise its market power or otherwise behave in an unreasonable manner.

As the revenue from the Airside Service is significant, and the costs of regulation are low, there will be a net efficiency gain as a result of the declaration of the Airside Service.

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21 Australian Competition and Consumer Commission Regulatory Report Sydney Airport 2001/2002 dated January 2003. This amount includes revenue from sources other than the Airside Service including international services, check in counter revenue, domestic terminal infrastructure charges, parking infringement notices and any proceeds from the sale in relation to aeronautical assets.
In its Issues Paper, the Council asks whether the approach to price regulation taken by the Productivity Commission and the Government suggests that declaration of the Airside Service may be contrary to the public interest.

Virgin Blue considers that declaration could not be contrary to public interest on this basis for two reasons:

- Virgin Blue does not believe that the mere expression of the Government’s approach by the executive is sufficient to be determinative of public interest for the purpose of criterion (f); and

- even if this proposition were correct, the declaration of the Airside Service would in any case be entirely consistent with the approach taken by the Productivity Commission and the Government to price regulation of airports.

In relation to the first reason, if an expression of policy by the executive or by the Productivity Commission was allowed to be determinative of, or influential in the consideration of, criterion (f), then this would amount to granting the executive and the Productivity Commission the effective ability to determine that particular facilities were outside the scope of Part IIIA of the Act without any amendment to the provisions of the Act through parliament. All that would be required would be a statement of policy from the executive that the government’s approach in relation to a particular facility was to adopt “light handed” regulation.

Virgin Blue does not believe that this approach to Part IIIA is appropriate given that, under the provisions of the Act, even the decision of a Minister whether or not to declare a service under section 44H is subject to a merits appeal to the Tribunal.

In relation to the second reason, the Productivity Commission in fact positively recommended that Part IIIA of the Act continue to apply to airports, and the Government accepted this recommendation. Therefore the Government considers that the continued application of Part IIIA, and therefore the declaration of the Airside Service under Part IIIA, is consistent with its support of “light-handed price regulation” at Sydney Airport and its other policy objectives. The relevant recommendation of the Productivity Commission and an extract from the Government’s response is set out below: 22

> Recommendation 7: All airports should be subject to the generic provisions of the National Access Regime in Part IIIA of the TP Act. An airport-specific access regime should be considered only if procedural improvements, such as scope for multilateral arbitrations, are not made to the National Access Regime.

There is no compelling case made for the airports-specific access provisions to be continued and the Government agrees that all airports should be subject to the generic access provisions of Part IIIA of the [Act]. Part IIIA contains mechanisms for 'declaring' access to a service, and includes arbitration and enforcement mechanisms in the event that the access provider and seeker cannot agree on terms and conditions of access. Part IIIA also includes provision for access providers to submit undertakings to the ACCC that specify the terms on which access will be made available to third parties.

The declaration of the Airside Service, given the context of the Productivity Commission’s recommendations must have been in the contemplation of the Productivity Commission when it made its recommendation that Part IIIA continue to apply to airports, and in the contemplation of the Government when it decided to accept the recommendation of the Productivity Commission. The Airside Service is one of the most significant services provided by means of access to Sydney Airport.
ATTACHMENT 1

GLOSSARY

ACCC means the Australian Competition and Consumer Commission;


Act means the *Trade Practices Act 1974* (Cth);

Airport Regulation Report means the Productivity Commission’s Report No 19 *Price Regulation of Airport Services*, January 2002;

Application means the application made by Virgin Blue under section 44F(1) of the Act dated 1 October 2002 as amended;

Competition Principles Agreement has the meaning given to it in the Act;

Council means the National Competition Council;

Frontier Economics means Frontier Economics Pty Ltd;

MSP Final Recommendations means the Council’s Final Recommendations dated November 2002 in relation to the Moomba to Sydney Pipeline System: Revocation Applications Under the National Gas Code;

MTOW means maximum take off weight;

PSA means the *Prices Surveillance Act 1983*;

Re Duke Eastern Gas Pipelines means *Re Duke Eastern Gas Pipelines* [2001] ACompT 2;

Regional Air Services Price Notification Decision means *Sydney Airport Aeronautical Charges for Regional Users of Terminal 2: Decision and Statement of Reasons*, October 2002, ACCC;

Re Sydney International Airport means *Re Sydney International Airport* [2000] ACompT 1;

SACL means Sydney Airports Corporation Limited;
Sydney Airport Price Notification Decision means Sydney Airports Corporation Ltd Aeronautical Pricing Proposal Decision, May 2001, ACCC;

Sydney Domestic Market means the market in which domestic (both interstate and intrastate) air passenger and freight transport services are supplied to and from Sydney;

Tribunal means the Australian Competition and Consumer Tribunal;

Virgin Blue means Virgin Blue Airlines Pty Limited ACN 090 670 968.