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8 august 2003

dear sir

the board of airline representatives of australia (bara) has reviewed the draft recommendation of the national competition council (ncc) in relation to the application by virgin blue for declaration of the airside service at sydney airport. bara would like to present the following comments in relation to the draft recommendation.

1. overview

bara endorses the draft recommendation that the airside service should be declared under part iiiia of the trade practices act (tpa). bara agrees with the ncc assessment that the application by virgin blue for declaration of the airside service meets all the criteria set out in s. 44g(2) of the tpa.

bara's endorsement of the ncc draft decision is related to the present circumstances under which sydney airport corporation limited (sacl) can set prices for the airside service. sacl is a monopoly supplier of the airside service and has the capacity to engage in monopolistic behaviour in setting prices. bara contends there is evidence to show that sacl has engaged in monopolistic behaviour in the past.

2. evidence of monopolistic behaviour

current prices for the airside service at sydney airport are based upon a decision in may 2001 by the australian competition and consumer commission (accc) on a pricing application by sacl. bara contends that the sacl pricing application was based upon inflated and inefficient operating costs.

the history of sacl's claims regarding operating expenditure throughout the accc's assessment process is instructive. in its draft pricing proposal in december 1999, sacl forecast its aeronautical operating expenditure as approximately $71 million for 2000-01. following a
review by airlines of SACL's forecast operating expenditure, SACL presented a revised pricing proposal in which it adjusted the operating cost base downward to $64.2 million for 2000-01.

SACL advised this adjustment reflected the non-recurring nature of some expenses, such as preparation for Y2K and bad debts.

Further scrutiny of operating expenditure ultimately resulted in SACL further revising its forecast of operating costs for 2000-01 downward to $56.4 million. This lower cost figure was used by the ACCC for the purposes of the pricing decision, but the ACCC commented that it did not have sufficient information to comment on what would be efficient levels of operating costs. The ACCC decision finally was predicated on real cost savings of approximately 4% per year for the following 5 years as a means of extracting some efficiency benefit for airlines using Sydney Airport.

At the time of the SACL pricing proposal to the ACCC, the airport operator was a Government corporate entity, not a private entity. Whilst it may be argued that government corporate entities may have higher costs due to more generous workplace arrangements and other institutionalised factors, both SACL and the ACCC could have adopted the privatised airports cost structures as models for determining "efficient" costs at Sydney Airport.

Further, it was generally acknowledged that SACL engaged in a substantive build-up in its workforce in the lead up to the Sydney 2000 Olympic Games. That staffing increase was reflected in the operating costs presented by SACL to the ACCC. Until the latest restructure at SACL, that labour force build-up had not been redressed to any significant extent.

During the ACCC assessment of the SACL pricing proposal SACL demonstrated reluctance to base prices for the Airside Service on “efficient” costs. Yet on 21 August 2002 a SACL media release reported a 40% increase in earnings at Sydney Airport, despite lower traffic volumes. A contributor to the increased earnings was a reported 8.9% decrease in operating expenses.

Further, in April 2003 an analysis by Credit Suisse First Boston (CSFB) identified benchmark cost savings of $40 million at Sydney Airport. About $25 million of the $40 million in savings relates to staff costs. The CSFB analysis identifies the reasons why Sydney Airport is inefficient. Current prices for the Airside Service have that inefficiency embedded in them.

The CSFB assessment is supported by a UBS Warburg (UBSW) analysis in July 2003. UBSW expect Sydney Airport operating expenses per passenger to drop from $5.04 in 2002-03 to $4.32 in 2004-05, a fall of 14%, as a result of the recently announced restructure by SACL.

BARA contends that SACL, through a lack of transparency regarding its cost base at the time of the ACCC assessment of its pricing proposal, has obtained from the ACCC an approval of prices for the Airside Service that are clearly inflated and unjustified by reference to efficient costs.

3. Pricing Arrangements at Other Major Airports

Following privatisation of the major airports, the aeronautical charges at the privatised airports were subject to a CPI-X price cap that offered an incentive for the airports to be more efficient and reduce costs. Towards the end of the CPI-X price cap the Government, via Direction 21, allowed the privatised airport operators to increase prices to recover most of the X factor price reductions. Nevertheless, during the time of the price cap most of those airport operators achieved significantly improved operating efficiencies.
Sydney Airport was never subject to a CPI-X price cap. As a government owned monopoly it was subject to prices surveillance under the Prices Surveillance Act. Therefore, it is arguable that Sydney Airport, during the period 1997-2002 was not subject to the same incentives as the privatised airports to minimise costs and operate efficiently.

Following the cessation of the CPI-X price cap for the major privatised airports on 30 June 2002, airlines were able to negotiate with those airport operators and enter into five year commercial agreements that address prices for aeronautical services, capital expenditure programs and service levels. Commercial agreements are now in place with the operators of Brisbane, Melbourne, Adelaide and Perth airports.

There are a number of key matters that are addressed by the contractual arrangements. For example, they:

(i) set out the commercial arrangements that will operate for a reasonable period of time, in each case five years - airlines expect some certainty regarding the operating framework that will apply at the airport;

(ii) establish the level of aeronautical charges that will apply for each year of the term of the commercial arrangement;

(iii) specify the expected capital expenditure program, in addition to expected maintenance and replacement capital expenditure, that will be undertaken over the term of the commercial arrangement;

(iv) set out the airport operational arrangements that will apply for the term of agreement;

(v) specify the airport operator's service charter and commitments with regard to service levels and performance;

(vi) provide for reasonable consultative arrangements between the airport operator and airlines - such consultation would be necessary in relation to major capital projects outside the scope of the agreement, disruption to service delivery as a result of such things as planned capital works, etc; and

(vii) set out agreed dispute resolution procedures.

BARA and its member airlines had the confidence to engage in negotiations with those airport operators for a commercial agreement because they had implemented significant cost efficiency measures under the CPI-X price cap and airlines accepted that their costs bases were reasonably efficient. While ever the operators of Brisbane, Melbourne, Adelaide and Perth airports act in accordance with the terms of the commercial agreements in place, BARA would have no incentive to seek declaration of aeronautical services at those airports.

Since before the cessation of the CPI-X price cap - and before the requirement by SACL to embark on a detailed Master Plan process and before the start of the planning for the current restructure - BARA and its member airlines sought to engage SACL in discussions regarding the development of a commercial agreement in a form similar to those in place at the other major airports. To date SACL has declined to enter into such discussions, despite there being time during 2001-02 for those discussions to occur. In the absence of a negotiated commercial agreement between SACL and the airlines, BARA maintains that aeronautical services at Sydney Airport should be declared.

4. Declaration of services for international airline operations

BARA is disappointed that the NCC chose not to extend consideration of the application by Virgin Blue to cover declaration of services provided by SACL to international airlines. As noted in BARA's submissions to the NCC, BARA believes that identical factors would apply to a
consideration of the use of the Airside Service, whether for carrying domestic or international passengers. BARA further contends that the actual facilities providing the service are identical, regardless of whether they are being used by aircraft carrying domestic or international passengers. The only exception to this is that, when carrying international passengers, aircraft would be using the taxiways and parking aprons (and, if applicable, other associated facilities) leading to the international terminal as distinct to domestic terminals.

BARA maintains that if it is justified for Sydney Airport to be declared for the purposes of the provision of aeronautical services to domestic airlines, then it is similarly justified for Sydney Airport to be declared for the purposes of provision of aeronautical services to international airlines. BARA's view on this matter is strengthened by the fact that SACL has not entered into discussions with airlines in relation to the development of a commercial agreement for the provision of aeronautical services to airlines. Consequently, there is no operative access agreement based on reasonable commercial parameters between SACL and international airlines. In the absence of bona fide negotiations between SACL and airlines for a commercial agreement, BARA would have to consider the option of making a separate application to the NCC for the declaration of Sydney Airport in relation to the provision of international aeronautical services.

5. Conclusion

BARA maintains that the present circumstances under which SACL can set prices for the Airside Service warrant declaration of Sydney Airport. SACL is a monopoly service provider and BARA believes there is evidence to show that SACL has engaged in monopolistic behaviour in the past. Through lack of transparency about its cost base it is arguable that SACL has been able to establish a pricing structure that is inflated and unjustified by reference to efficient costs.

Other airport operators in Australia have entered into commercial agreements with airlines to set out the terms and conditions of the provision of aeronautical services. SACL has, to date, not entered into discussions with airlines on this matter. In the absence of an operative access agreement based on reasonable commercial parameters and accounting for future gains in operating efficiencies, the best option to ensure efficient prices at Sydney Airport is declaration under the TPA.

Yours sincerely

Warren Bennett
Executive Director