Response to the NCC’s Draft Recommendation for Declaration of the Airside Service at Sydney Airport

1 Introduction

1.1 This memorandum sets out our comments on the draft recommendation issued by the National Competition Council in June 2003 in relation to the proposed declaration of the Airside Service at Sydney Airport under Part IIIA of the Trade Practices Act 1974 (“TPA”).

1.2 In our view, the Council’s reasoning and conclusions set out in the draft recommendation raise a number of significant concerns, particularly in relation to criteria (a) and (f) of section 44G(2) of the TPA.

1.3 In the interests of efficiency, we have limited our comments in this memorandum to the concerns raised by the Council’s interpretation of criteria (a) and (f). However, we should not be taken as necessarily agreeing with the remainder of the Council’s draft recommendation.

Criterion (a)

1.4 In the Council’s construction and application of criterion (a) - “that access (or increased access) to the service would promote competition ...” - the Council has failed:

- to apply the appropriate concept of “competition”;
- to allow criterion (a) to have any meaningful operation;
- to assess accurately the materiality of any impact on the promotion of competition; and
- despite its claims to the contrary, to confine its consideration to the promotion of competition, rather than the promotion of individual competitors.

1.5 In short, the Council has misinterpreted and misapplied the access provisions of the TPA, by mistakenly asserting that Part IIIA is about pricing at “competitive levels”, rather than about access or increased access which would promote competition in another market.

1.6 Part IIIA was designed to overcome a refusal or constructive refusal by the operator of a bottleneck facility to provide access, in circumstances where access is essential for competition in another market (eg, where the operator is vertically integrated and can use its control over the bottleneck to discriminate in favour of its own business in an upstream or downstream market).1 Under Part IIIA, price and non-price terms and conditions only fall for regulation in circumstances where access cannot be negotiated between the parties, and it is not a ground for declaration under section 44G(2) of the TPA that the

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1 National Competition Policy. Report by the Independent Committee of Inquiry (The Hilmer Report), August 1993 at pg 239. This position is confirmed in the NCC’s Guide to Part IIIA where the NCC states at page 61 that declaration is intended to be limited to services provided by a facility that exhibits natural monopoly characteristics and creates a bottleneck such that “access to the facility is essential to compete in any dependent market.”
terms of any access that is readily provided on a non-discriminatory basis might potentially be less than the terms that may prevail in a fully competitive market for access.

1.7 In the current application, no one is alleging that they cannot obtain access (or increased access) to the Airside Service at Sydney Airport. No one is complaining that they are unable to compete in another market by reason of any refusal or constructive refusal by SACL to provide access or increased access. No one is alleging that SACL has any interest in restricting competition in another market. No one is alleging that they have been unable to negotiate reasonable terms and conditions with SACL, whether as to price or other matters. In fact, the reverse is quite clearly demonstrated. In addition, and especially in light of the Council’s analysis (see paragraph 6.256), no one is able to claim that SACL’s pricing proposals will adversely affect competition in another market.

1.8 The Council has asserted that declaration can be made merely if it would result in “access on more efficient terms and conditions than those offered by the service provider” (paragraph 3.16). However, this proposition is neither stated nor implied in the TPA. In order to satisfy criterion (a), the application needs to be judged by reference to access or increased access, not the efficiency of pricing for access that is readily provided. Moreover, the access or increased access needs to promote the process of competition in a dependent market.

1.9 In our view, the Council’s draft recommendation has not properly demonstrated that “access (or increased access)” would “promote competition” in another market.

1.10 The Council has also confused alleged effects on Virgin Blue with effects on competition. It may be a good commercial tactic for Virgin Blue to argue that, because it has a low-cost business model, suppliers should provide it with services on more favourable terms. But this is not good competition policy. Even if Virgin Blue could not operate successfully without discrimination in its favour (and the evidence does not support this conclusion), competition policy dictates that inefficient competitors should improve their efficiency or exit the market.

Criterion (f)

1.11 The Council has also failed properly to construe and apply the public interest criterion contained in section 44G(2)(f) of the TPA.

1.12 In particular, the Council has:

- misconstrued the criterion by reversing the onus;
- improperly “presumed” public interest;
- applied a test which is too narrow; and
- come to a conclusion which is not supported by the evidence it found.

1.13 Accordingly, the Council’s draft recommendation has not demonstrated that either criterion (a) or (f) is satisfied.

1.14 Our specific comments in relation to the draft recommendation are set out below.
2 Criterion (a) - the promotion of competition

The statutory criterion and the concept of “competition”

2.1 In our view, the Council has erred by paraphrasing the statutory wording as it refers to promoting competition, and by then seeking to apply that re-expressed wording to Virgin Blue’s application. The Council has also, on a number of occasions, exacerbated this error by further defining the paraphrased wording, and then seeking to determine whether that further definition is satisfied.

2.2 By seeking to paraphrase and re-define the wording of the criterion contained in section 44G(2)(a), the Council has applied a test which is two or even three times removed from the actual words contained in the TPA.

2.3 For example, in paragraph 6.1, the Council variously defines criterion (a) in terms of whether “access is likely to enhance the environment for competition in a dependent market”, whether the “service provider can, in the absence of access regulation, use market power to adversely affect competition in a dependent market” and whether the service provider has “the ability and incentive to use its market power”. Paragraph 6.1 also suggests that regulated access may improve the environment for competition by “offering the prospect of tangible benefits to consumers, including reduced prices and better service provision”.

2.4 While each of these matters is a relevant consideration in the assessment of criterion (a), none of them (individually or collectively) provides a sufficient basis for forming a view about whether or not the criterion set out in the TPA is in fact satisfied. Criterion (a) is clearly not a test that is confined to the possession of market power or the propensity to use it. Rather, it is a test that is clearly related to securing the provision of access (or increased access) so as to promote competition in another market.

2.5 It is one thing to seek to explain what a statutory term means, but it is another to apply the explanation as though it is itself a statutory test. A number of court decisions, particularly decisions in relation to the interpretation of section 46 of the TPA, warn against placing undue emphasis on terms or expressions which do not constitute the actual statutory wording. In this regard, it appears that the Council has placed undue emphasis on factors which do not form part of the actual statutory criterion, particularly at paragraphs 6.2 and 6.3.

2.6 The landmark authority on “competition” in Australia is, of course, the Tribunal’s decision in QCMA. In that decision, the Tribunal stated that:

“Competition is a process rather than a situation. Nevertheless, whether firms compete is very much a matter of the structure of the markets in which they operate ....

Of all these elements of market structure, no doubt the most important is ... the condition of entry.” ((1996) ATPR 40-012 at page 17, 246)

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In that decision, the Tribunal focused on market structure, and particularly on barriers to entry, as the determinant of competition.

2.7 Applying the QCMA authority to criterion (a), declaration of the Airside Service would not lead to access (or increased access) which would promote competition in any downstream market, as access to the Airside Service at Sydney Airport is already available to anyone who applies. SACL does not restrict access or otherwise impose any barriers which would prevent entry to a downstream market. Accordingly, declaration would not remove any barrier which would “unlock a bottleneck so that competition can be promoted” (Sydney Airport Decision).

2.8 It is not to the point to suggest that, if access were offered at a lower price, the demand for access would increase as a result of increased sales in the downstream market. An increase in sales is not a promotion of “competition”, but merely an increase in the level of supply and demand (or an increase in the size of the downstream market). It does not, of itself, involve any improvement in market structure or in the process of competition.

2.9 This position is supported by the Tribunal in both the Sydney Airport Decision and the Duke Decision. In the Duke Decision, the Tribunal stated that:

“The Tribunal [in the Sydney Airport Decision] concluded that the TPA analogue of criterion (a) is concerned with the removal of barriers to entry which inhibit the opportunity for competition in the relevant downstream market. It is in this sense that the notion of promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial. We agree.’ (paragraph 75, emphasis added).

2.10 In addition, a fall in passenger numbers is not necessarily a sign that the process of competition has been adversely affected. An increase in aviation fuel prices may result in increased airfares and therefore a fall in passenger numbers. The Iraqi war and SARS have also caused a fall in passenger numbers. However, those events are not normally associated with an adverse impact on competition. Accordingly, the Council has mistaken a potential impact on passenger numbers as an adverse effect on competition.

**Criterion (a) must have a meaningful operation**

2.11 If no improvement in market structure or in the process of competition were required to be demonstrated as a pre-requisite to declaration under criterion (a), then that criterion would have no meaning. This is because, in any situation where access was sought for the purpose of a dependent market, it would always be open to the Council to find that the price of access could be lower (thereby “promoting competition” in a downstream market) or higher (thereby “promoting competition” in an upstream market).

2.12 The Council seeks to resolve this dilemma by introducing the notion of access at “competitive prices”, thereby wrongly converting criterion (a) into a criterion that depends upon the access provider (in the terms used by the Council) having the ability or incentive to supply access at prices in excess of “competitive prices” (see paragraph 6.180).

2.13 In our view, this cannot be correct. It is difficult to envisage any situation in which an owner of a natural monopoly facility would not have some degree of market power and, therefore, at least the potential to charge a price in excess of “competitive prices”.
However, this is not the issue. Criterion (a) clearly requires more than a finding that the relevant facility displays certain monopoly characteristics.

2.14 The Council also incorrectly asserts that “[i]n the absence of any constraints on SACL’s ability or incentive, the Council must conclude that SACL has the requisite market power to satisfy criterion (a)” (paragraph 6.113, emphasis added). This is expressed in even more absolute terms in later paragraphs, with terms such as “an absolute constraint” which would “completely negate” the exercise of market power, or “to totally eliminate” the ability or incentive (see paragraphs 6.197, 6.198 and 2.262).

2.15 In the absence of perfect competition in the market for the access service (or other totally effective price regulation), no constraint will be “absolute” and it will not be possible “to totally eliminate” the ability and incentive of the access provider to price in excess of “competitive prices”. However, if there were competition in the market for the access service (or other effective regulation), no application for declaration would be necessary (or possible) under Part IIIA of the TPA.

2.16 Accordingly, the Council has interpreted criterion (a) in a manner which effectively ensures that, if criterion (b) is satisfied, criterion (a) will also be satisfied. Based on this interpretation, criterion (a) would have no practical operation.

2.17 In our view, the Council must interpret criterion (a) in a manner which gives it meaningful operation.

**Any effect on competition would not be material**

2.18 The Council has also failed to provide any compelling reasons in its draft recommendation which support its preliminary view that any impact on competition in the downstream market would be material.

2.19 The Council has indicated that a price increase in the order of 100% would be likely to attract criticism from the ACCC and a risk of a regulatory response from the Government. The Council has further indicated that the threat of re-regulation may constrain SACL from increasing prices by something less than 100%. However, the Council does not appear to have obtained evidence or formed a view as to what actual margin of discretion SACL may have between 0% and something less than a 100% increase. Notwithstanding this lack of evidence, the Council states that it is of the view that “an exercise of market power by SACL up to the point at which the threat of re-regulation constrains it from doing so, will adversely affect competition to a degree that is material” (paragraph 6.207).

2.20 The Council does state that it believes the impact on competition in the dependent market would be material because passenger numbers would be expected to fall in response to “such a price increase”. However, in addition to the concerns raised by this analysis (see paragraph 2.10), the Council does not seek to quantify either the extent of the price increase or the fall in passenger numbers.

2.21 Even if Council’s pricing concern is relevant, the Council has failed to show that any increase in SACL’s prices would have a material effect on the process of competition in any downstream airline market. This is supported by the information set out in the economic report prepared by n/e/r/a.

2.22 It is also inappropriate for the Council to speculate that “there may be other important terms and conditions of access that SACL may impose in the exercise of its monopoly
power that may adversely affect competition” without identifying either those terms and conditions, the extent to which they would be likely to affect competition, or the likelihood that SACL would seek to impose them (see paragraph 6.160).

Criterion (a) is concerned with promoting competition, not competitors

2.23 Although the Council specifically acknowledges that criterion (a) is concerned with the promotion of competition, not competitors or a particular type of competitors (see paragraphs 6.125 and 6.126), the Council’s draft recommendation does not proceed on that basis.

2.24 For example, the Council states that in the present case, “it may be difficult to differentiate the effect of conduct on the market generally and on individual competitors specifically” (paragraph 6.127). By accepting that any increase in airport charges would have a disproportionate effect on low cost carriers (which is itself open to question) and that Virgin Blue is the only low cost carrier (or a typical low cost carrier), the Council has inappropriately confused a particular competitor (Virgin Blue) or a particular type of competitor (low cost carriers) with competition.

2.25 This error is illustrated by the Council’s statement that:

“... an increase in charges for the Airside Service by SACL could adversely affect the commercial operability of low cost carriers such as Virgin Blue. This is not only because the proportion of final passenger fares constituted by Airside Service charges is greater for such carriers than for full service carriers such as Qantas, but also because low cost carriers are likely to carry a higher proportion of the more price sensitive customers” (paragraph 6.145).

2.26 Taken to their logical conclusion, each of the assumptions set out in that passage also indicate that the price of any input (eg, any other service offered by SACL, aviation fuel or any other consumable) would have a greater impact on Virgin Blue than Qantas and therefore adversely affect competition. In other words, even if SACL were to charge “competitive prices” (and the evidence indicates that SACL is currently in fact charging below “competitive prices”), the impact of those competitive prices would be greater on Virgin Blue than on Qantas, thereby somehow adversely affecting competition.

2.27 In reality, competition is not being affected adversely. Virgin Blue’s concerns lie not so much with any exercise of market power by SACL, but with the different business models of Virgin Blue and Qantas. This highlights the real fallacy of Virgin Blue’s application. It is not about access or increased access. Nor is it about promoting competition. It is about regulatory gaming and achieving a level of pricing which favours or suits a particular business model.

2.28 This is further illustrated by Virgin Blue’s opposition to per passenger charging for the Airside Service. Any move from MTOW charges to charging on a per passenger basis is an alternative that would be likely to be available to SACL regardless of whether or not it faced competition from other airports. Per passenger charging is a form of non-discriminatory pricing and the fact that it may have a different impact on different airlines due to the way in which they have constructed their respective business models, does not constitute a relevant factor which the Council should take into account under Part IIIA of the TPA.
3 Criterion (f) - the public interest

The legal test under section 44G(2)(f)

3.1 In our view, the Council has misconstrued the relevant legal test by stating that it “must be affirmatively satisfied that the costs of declaration outweigh the benefits before it can determine that criterion (f) is not met” (paragraph 10.62). The legal test is not whether the Council can be satisfied there is a net public detriment. Rather, it is whether the Council is satisfied that access (or increased access) would not be contrary to the public interest.

3.2 By incorrectly paraphrasing the requirements of criterion (f), the Council has effectively reversed the onus involved in the criterion and materially altered the way in which that criterion is required to be applied.

3.3 In any event, the Council has stated that the cost of foregoing potential benefits of the price monitoring regime, combined with the direct and indirect costs of declaration, would be material. However, on the basis of the evidence available, the Council states that it is not able to quantify or judge the level of those costs.

3.4 It is not legally permissible for the Council to form the view that criterion (f) is satisfied in circumstances where it believes that there is a material issue, but has not been able to form a clear view in relation to that issue, whether for lack of evidence or any other reason. This is particularly the case where both the Productivity Commission (after conducting a comprehensive study of airport pricing regulation) and the Government have formed the view that there are clear benefits in providing the industry with the opportunity to develop improvements in pricing and investment approaches through commercial negotiation under the umbrella of prices monitoring and the threat of re-regulation. Section 44G(2)(f) of the TPA quite specifically provides that the Council cannot recommend declaration unless it is satisfied that declaration would not be contrary to the public interest.

3.5 Accordingly, the Council appears to have adopted a position that is inconsistent not only with the views of both the Productivity Commission and the Government but also with the requirements of the TPA, in circumstances where the Council is, by its own admission, unable to quantify or judge in precise terms the costs which would be incurred as a result of declaration.

3.6 There is a clear obligation on the Council to consider all relevant information and to rule out the possibility that declaration would be contrary to the public interest. It is imperative that the Council squarely addresses this very important matter before making a recommendation to declare. To assist the Council in making its final recommendation, the economic report prepared by n/e/ta contains further information in relation to the likely costs of declaration. The extent of those costs, compared with any likely benefits, is evidence that the Council must consider in determining whether declaration of the Airside Service would be contrary to the public interest.

The public interest “presumption”

3.7 In its draft recommendation, the Council cites the Sydney Airport Decision as authority for a presumption that declaration is in the public interest if criteria (a) to (e) are satisfied (paragraph 10.3).
3.8 In the *Sydney Airport Decision*, the Tribunal, after forming the view that declaration would promote competition in another market, simply stated that “it is in the public interest that competition be promoted in this market” (paragraph 219). The Tribunal did not make any specific statements in relation to a presumption that criterion (f) will be satisfied if it is established that each of the other criteria are satisfied.

3.9 In addition, the Tribunal, in the *Duke Decision*, emphasised that the public interest criterion:

“...does not constitute an additional positive requirement which can be used to call into question the result obtained by the application of [the other declaration criteria]... [The public interest criterion] accepts the results derived from the application of [those other criteria], but enquires whether there are any other matters which lead to the conclusion that coverage would be contrary to the public interest” (paragraph 145, emphasis added).

3.10 Accordingly, the *Duke Decision* makes it clear that criterion (f) is independent from, and should be applied separately to, the other criteria contained in section 44G(2) of the TPA. If the other declaration criteria are satisfied, the Council must address the separate and independent criterion contained in section 44G(2)(f). That is, the Council must consider whether there are any other matters which mean that it cannot be satisfied that access (or increased access) would not be contrary to the public interest. There is clearly no presumption that criterion (f) is satisfied simply because certain other criteria (which rely on the consideration of other matters) are satisfied.

3.11 To the extent that the Council has incorrectly relied on this “presumption”, the Council has incorrectly lowered the threshold for satisfying the criterion set out in section 44G(2)(f) of the TPA.

*The Council’s application of criterion (f)*

3.12 In addition to misconstruing the criterion and relying incorrectly on the presumption referred to above, the Council has also misapplied the criterion by applying it too narrowly. In particular, although the Council states that it takes a broad view of the types of matters which may raise public interest considerations under criterion (f) (paragraph 10.5), the Council immediately focuses on the costs of regulation and states that:

“...a recommendation not to declare where criteria (a) to (e) are satisfied would require that the costs of regulated access must outweigh the benefits of regulating natural monopoly services with substantial market power” (paragraph 10.6).

3.13 In addition to reversing the onus as explained above, this states the legal test contained in criterion (f) too narrowly, as criterion (f) requires the Council to establish that there are no matters which prevent it from being satisfied that declaration would not be contrary to the public interest.

3.14 Further, the statement referring to “the benefits of regulating natural monopoly services with substantial market power” is pejorative and the nature and level of those benefits needs to be at least quantified if the Council is to be satisfied that declaration would not be contrary to the public interest.
3.15 As the Council is unable to quantify the alleged benefits from access, and as there are significant costs and policy reasons why declaration may be contrary to the public interest, the Council’s draft recommendation does not support its preliminary conclusion that criterion (f) is satisfied. In short, the evidence does not support the Council’s draft conclusion in relation to criterion (f).

4 Conclusion

4.1 For the reasons set out in this submission, when correctly assessed against the criteria contained in section 44G(2) of the TPA, the matters referred to in the Council’s draft recommendation do not support a finding either that access (or increased access) to the Airside Service at Sydney Airport would promote competition in any downstream airline market or that access (or increased access) would not be contrary to the public interest.

4.2 Accordingly, based on the analysis set out in its draft recommendation, the Council may not lawfully recommend declaration of the Airside Service.

4.3 In relation to criterion (a), the Council cannot be satisfied that access (or increased access) would promote competition in any downstream airline market because access to the Airside Service is already available to anyone who applies, and the process of competition would therefore not be promoted by declaration of the Airside Service.

4.4 Put another way, declaration would not remove any barrier or “unlock” any bottleneck so that the process of competition can be promoted. The bottleneck is not “locked” and SACL has no interest (commercial or otherwise) in locking it.

4.5 By focusing on the effect of any potential price increases on Virgin Blue’s business model, the Council has failed to give proper consideration to the issue of competition or the materiality of any impact on competition.

4.6 Further, the Council has seriously underestimated the force of SACL’s significant commercial reasons for not refusing access (or constructively refusing access) to the Airside Service. SACL has clear and compelling incentives to facilitate competition between air carriers in order to maximise passenger throughput and therefore both aeronautical and non-aeronautical revenue.

4.7 The Council has similarly seriously underestimated the constraining effect of the threat of re-regulation which is an extremely powerful disincentive that prevents SACL from seeking to affect competition adversely in any other market.

4.8 To the extent that these constraints do not “absolutely” preclude SACL from increasing its charges for the Airside Service, the Council has provided neither evidence nor analysis to demonstrate that any such price increases would adversely affect competition in another market. Rather, by focusing on the possibility that prices might be set above a “competitive level”, the Council has misconstrued and misapplied statutory criterion (a).

4.9 The Council has also failed properly to apply criterion (f). It has failed to give adequate weight either to the costs of regulation or to desirable and necessary benefits that were foreseen by the Federal Government to flow from the regime of price deregulation and price monitoring deliberately and recently implemented by it.
4.10 Accordingly, based on the analysis set out in its draft recommendation, the Council may not lawfully recommend declaration of the Airside Service because it cannot be satisfied that either of the statutory pre-conditions to declaration set out in criterion (a) or criterion (f) have been met.

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