9 September 2003

Mr John Feil
Executive Director
National Competition Council
GPO Box 250B
MELBOURNE VIC 3001

Dear Sir

RE: COMMENTS ON SUBMISSIONS MADE IN RESPONSE TO DRAFT RECOMMENDATION TO DECLARE CERTAIN SERVICES AT SYDNEY AIRPORT

We are grateful for the opportunity the Council has extended to interested parties to make comments on the material provided to the Council since it released its Draft Recommendation. We have no new material to add beyond that contained in our submission on the Draft Recommendation, however, we do have a few comments on the import and interpretation of material presented by others. We have grouped these under three broad headings.

Arrangements under the previous regime

BARA has sought to present the ACCC's failure to properly assess SACL's efficient operating costs as evidence of "monopolistic behaviour" on the part of SACL. We would see this rather as compelling evidence of the fact that regulators can make significant errors in assessing efficient costs.

Further BARA seeks to associate improvements in operating costs at other major airports with the fact they were subject to a price cap whilst SACL was not subject to the same regime. Whilst SACL was not subject to the same regime as other airports during the period 1997-2002, the regime as administered by the ACCC closely resembled a CPI-CPI regime save and except for the pricing event of May 2001. We do not believe that the difference in regulatory regimes as the real cause of SACL's failure to pursue operating efficiencies during this period.

Rather, the explanation is to be found in the evidence BARA itself has presenting. In drawing on broker's reports BARA shows the effect that capital market scrutiny is bringing on SACL's owners and managers. BARA is correct when it says SACL was not subject to the same incentives as other airports for number of years. The incentives in question, however, are those associated with private ownership. That SACL since sale has embarked on a cost cutting drive provides further evidence of the previous inadequate incentives.

Criterion (a)

In our submission on the Draft Recommendation, we broadly accepted the Council's methodological approach to this criterion and demonstrated how the proper application of available market data to the Council's approach led to a conclusion that declaration was not warranted. Other submissions on the Draft Recommendation and, in particular that by Professor Forsyth, support those conclusions.
We have considered at length the arguments that have been put forward by SACL and their advisors in relation to the interpretation of this criterion. We find that analysis compelling and a much more appropriate framework for assessing this criterion in relation to a vertically separated industry such as aviation. Further, when the data we set out in our submission is applied to this framework, the only conclusion to draw is again that declaration will not encourage competition in the downstream market.

We also note the general incentive to encourage competition in downstream markets discussed by Professor Forsyth and suggest that that position is entirely consistent with the behaviour that has been evident in the Australian aviation industry since 1997, and particularly around the time of the entry of Impulse and Virgin Blue.

**Criterion (f)**

The submissions from the Productivity Commission and the Department of Transport and Regional Services, coupled with the evidence of price restraint shown by airports since July 2002, should allay any doubts that the Council may have about the effectiveness of the Government's policy. That being the case, it would seem clear that little if any benefit can be obtained from declaration whilst the costs as identified by ourselves, SACL and the Productivity Commission in particular would remain, that leading to a conclusion that declaration would not be in the public interest.

We would also note that recently, the South Australian Essential Services Commission indicated it was considering adopting a light-handed monitoring regime for the regulation of ports in that State. This supports the view of the Productivity Commission that the costs of regulation in vertically separated industries are likely to outweigh the benefits.

The detailed analysis by NERA provided by SACL provides a much more robust and plausible example of the likely costs and benefits likely to flow from declaration. However, we would stress again that the costs of declaration would flow beyond SACL onto other airports through the capital market. As such, NERA's analysis should be seen as partial with a conservative bias in relation to the assessment of the costs of declaration.

We hope you find these comments helpful. Please feel free to contact either myself or Christine Carter if you want to discuss these matters further.

Yours faithfully

Kirby Clark  
Chief Financial Officer