

Applications Under Part IIIA Of The Trade Practices Act 1974 Requesting Recommendation that Services Provided By Sydney Airports Corporation Limited Be Declared

Virgin Blue Airlines Pty Ltd

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1 October 2001

1. INTRODUCTION

1.1 Applications

This document contains the written applications of Virgin Blue pursuant to sub-section 44F(1) of the Act asking the Council to recommend that two particular services be declared under section 44G of the Act.

Defined terms in this document have the meanings set out in the Glossary in Attachment 1.

2. BACKGROUND

2.1 Applicant's Business

The Virgin group announced the commencement of a low-fare airline in Australia in November 1999. Virgin Blue commenced operations on 31 August 2000. Virgin Blue's strategy is to price air travel at a level that is readily affordable for most people. Virgin Blue has sought to price its fares at levels that expand the overall demand for air travel by making it more affordable for those who otherwise could not afford to fly at all or as often. Virgin Blue does not offer any of the "frills" services offered by the other airlines to capture the premium price, high profit business, such as first-class and business-class services, "free" meal services, frequent flyer programs or club lounges. It achieves low operating costs by eliminating these services and avoiding the overheads required to provide them. It further reduces operating costs by operating a single class of jets, substantially reducing training and maintenance costs, and by many other means.

When Virgin Blue commenced operating in August 2000, it serviced the Brisbane-Sydney and Brisbane-Melbourne routes. Since that time, Virgin Blue has gradually expanded its business to the point where it now operates on the following routes:

Origin	Destinations
Adelaide	Brisbane, Gold Coast, Melbourne, Perth, Sydney
Brisbane	Adelaide, Cairns, Canberra, Darwin, Mackay, Melbourne, Sydney, Townsville
Cairns	Brisbane, Melbourne, Sydney
Canberra	Brisbane, Melbourne
Coffs Harbour	Sydney
Darwin	Brisbane

Origin	Destinations
Gold Coast	Adelaide, Melbourne, Sydney
Hobart	Melbourne
Launceston	Melbourne
Mackay	Brisbane
Melbourne	Adelaide, Brisbane, Cairns, Canberra, Gold Coast, Perth, Sydney
Perth	Adelaide, Melbourne, Sydney
Sydney	Adelaide, Brisbane, Cairns, Coffs Harbour, Gold Coast, Melbourne, Perth
Townsville	Brisbane

2.2 Terminal access declaration

In September 2001, Ansett was placed in voluntary administration and in March 2002 it ceased flying. Since the collapse of Ansett, Qantas has quickly moved to expand its domestic capacity through redirecting international capacity, short-term wet lease and other capacity arrangements and substantial additional lease and purchase commitments.

Qantas' capacity expansion has been so effective that it has been able to increase its market share from approximately 55% to in excess of 80% or more since the Ansett collapse.⁴

Virgin Blue considers that there is substantial scope for it to expand its operations and introduce competition on routes now dominated by Qantas. Virgin Blue also considers there is room for more than two operators in the Australian airline industry.

One of the factors that is currently hampering Virgin Blue's ability to expand its operations in relation to flights to and from Sydney is a lack of access to facilities provided by domestic terminals.

Qantas press release, "Qantas Moves International Jets to Domestic Operations", 26 September 2001; and *Australian Aviation*, "Room for Three Airlines", March 2002

See Qantas press release, "Qantas Welcomes A320 Wet Lease Decision", 20 September 2001, in relation to the wet-lease from the Ansett administrators of ten A320s with crew

See Qantas press releases, "Qantas buys Boeing 737-800s", 28 October 2001; and "Additional Aircraft to Boost Qantas Regional Services", 30 November 2001

Geoff Dixon, 7:30 Report, 11 December 2001; also David Robertson, "Qantas Leap" in Far Eastern Economic Review, 11 October 2001

In Sydney, Virgin Blue currently operates from the Domestic Express Terminal (**DET**) at Sydney (Kingsford-Smith) International Airport (**Sydney Airport**), but the DET is currently at maximum capacity, and Virgin Blue cannot operate any more flights from the DET during peak periods.

Domestic passengers at Sydney Airport can be processed through one of three terminals:

- (a) the DET (5 gates), which is operated by SACL and is currently at maximum capacity;
- (b) the Qantas Terminal (13 Gates) which is operated by Qantas and is also at maximum capacity; or
- (c) the former Ansett terminal (**Terminal 2**) (18 gates) which is operated by SACL. Following the collapse of Ansett, Terminal 2 was empty, however recently a regional carrier, Regional Express, has started operating from Terminal 2 and Qantas has announced that QantasLink would commence operations from Terminal 2 from 24 September 2002⁵. Even with the operations of Regional Express and QantasLink, Terminal 2 will still have substantial unused capacity.

Virgin Blue is of the view that it has an agreement with SACL (**Terminal 2 Agreement**) for the use of Terminal 2, however SACL has disputed the existence of this agreement and is refusing to provide Virgin Blue with access to Terminal 2 in accordance with the Terminal 2 Agreement. This dispute is currently the subject of litigation.

SACL is the owner of Sydney Airport and the lessee of the land upon which Sydney Airport is situated.

Virgin Blue's inability to obtain access to additional terminal space is severely limiting its ability to compete with Qantas in relation to the provision of domestic air passenger transport services to and from Sydney.

2.3 Airside services declaration

In October 2000 SACL submitted a *Revised Draft Aeronautical Pricing Proposal* to the Commission to increase certain aeronautical charges at Sydney Airport. SACL sought an increase of around 130 per cent. In May 2001, the Commission objected to the proposed increase, but did not object to a lower increase. The decision enabled SACL to increase its aeronautical revenue in 2000/01 from around \$93 million to around \$183 million, an increase of \$90 million or 97 per cent.

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⁵ Qantas media release dated 16 September 2002 "Qantas expands into Sydney Airport Terminal 2"

On 3 August 2001 SACL notified the Commission pursuant to section 22 of the PSA that it proposed to introduce new passenger services charges for services at Sydney Airport. These new passenger services charges were to be based on the number of passenger movements and would have replaced existing maximum take-off weight based charges. The proposed charges were:

- (a) \$19.31 (GST inclusive) per passenger movement through the international terminal (\$38.62 for a return international flight), and
- (b) \$4.00 (GST inclusive) per passenger movement for other embarking/disembarking passengers, excluding regional services (\$8.00 for a return domestic flight).

At the time, the effect of the proposed pricing structure would have been to increase Virgin Blue's landing charges by approximately \$2 million. If such a proposal were introduced today, the increase in Virgin Blue's landing charges would be significantly greater.

The Commission objected to the proposed domestic passenger charge but did not object to the proposed international passenger charge. The basis of the Commission's objection to the proposed domestic passenger charge was that it did not have sufficient time to properly consider the effects of the proposed charge.

On 1 July 2002, the Minister revoked his declaration under section 21(1) of the PSA that aeronautical services provided at Sydney Airport are notified services. This means that the only price regulation relating to aeronautical services is the obligation of the Commission to monitor prices for aeronautical services pursuant to Direction No 27 of the Minister. Accordingly, SACL does not require any regulatory approval to increase its prices or change the structure of its pricing.

Given the recent unsuccessful attempts by SACL to increase its prices and change the structure of its prices, Virgin Blue believes there is a real risk that SACL will attempt to introduce such changes in the future. Virgin Blue seeks declaration of the airside services described in these applications to ensure that in the event that SACL seeks to impose unreasonable charges upon it, Virgin Blue may dispute those charges and have that dispute determined by the Commission.

Virgin Blue requests that these applications be considered as a matter of significant public importance and urgency.

3. SERVICES

3.1 Description of Services

Virgin Blue asks that the Council recommend the declaration of the following services:

- (a) a service for the use of runways, taxiways, parking aprons and other associated facilities (Airside 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,

(Airside Service); and

(b) a service for the use of domestic passenger terminals and related facilities for the purposes of processing arriving and departing domestic airline passengers and their baggage at Sydney Airport (**Domestic Terminal Service**),

each a Service and collectively the Services.

Each of the Services are "services" within the meaning of section 44B of the Act as they are each services provided by means of a facility, principally through the use of that facility, and do not include the supply of a good, the use of intellectual property or the use of a production process.

3.2 No Undertaking

Sub-section 44G(1) of the Act provides that the Council cannot recommend declaration of a service that is the subject of an access undertaking in operation under section 44ZZA of the Act.

None of the Services are the subject of an undertaking under section 44ZZA of the Act.

4. DECLARATION CRITERIA

Sub-section 44G(2) of the Act provides that the Council must not recommend the declaration of a service unless it is satisfied of a range of listed matters (**Declaration Criteria**). This section sets out separately for each Service the reasons why Virgin Blue considers that Service satisfies each of the Declaration Criteria.

4.1 AIRSIDE SERVICE

4.1.1 Paragraph 44G(2)(a) - access (or increased access) to the service would promote competition in at least one market other than the market for the service

In Re Sydney International Airport, the Tribunal stated at paragraph 106 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 submits that access (or increased access) to the Airside Service would promote competition in, at least, the market in which domestic (both interstate and intrastate) air passenger transport services are supplied to and from Sydney (Sydney Domestic Market).

If a person wishes to supply domestic air passenger transport services in the Sydney Domestic Market, it must acquire the Airside Service.

There is no substitute for the Airside Service, as Sydney Airport is currently the only airport that offers services allowing for the landing or taking off of aircraft in Sydney that are suitable for use by a provider of domestic air passenger transport services.

While there are other airports located within the Sydney metropolitan area, even the largest of these, Bankstown Airport, is not a substitute for Sydney Airport for a supplier of domestic air passenger transport services to or from Sydney because:

- (a) Bankstown Airport cannot provide services allowing for the landing or taking off of aircraft of a size equivalent to a Boeing 737 or larger. Aircraft smaller than a Boeing 737 are not suitable for use on many domestic passenger routes due to higher costs of operation (on a per passenger basis) or because they lack the necessary range;
- (b) Bankstown airport does not offer the same suite of services that are offered at Sydney Airport, such as interconnection with other airlines. In this regard Virgin Blue notes the Tribunal's comments in *Re Sydney International Airport* at paragraph 85:

[M]any airports also benefit from economies of scale and scope generated by strong network effects associated with their geographical location and the absence of viable alternative transport modes. Passengers typically travel to destinations, not airports, and airlines will prefer to locate at one airport so that they may gain commercial benefits from interconnecting with other services and airlines; and

- (c) demand from consumers of domestic air passenger transport services for flights from Bankstown Airport is likely to be very low due to:
 - (i) Bankstown Airport being located significantly farther from the Sydney central business district than Sydney Airport; and
 - (ii) a lack of facilities at Bankstown Airport, including a lack of interconnection with other airlines.

Low consumer demand will mean that providers of domestic air passenger transport services who operate from Bankstown Airport will not be able to compete effectively against those providers who operate from Sydney Airport.

Given that the Airside Service is a necessary input for the provision of domestic air passenger transport services in the Sydney Domestic Market, and therefore that no provider of domestic air passenger transport services could compete in the Sydney Domestic Market without access to this Service, Virgin Blue considers that access (or increased access) to the Airside Service would promote competition in at least the Sydney Domestic Market.

4.1.2 Paragraph 44G(2)(b) – that it would be uneconomical for anyone to develop another facility to provide the service

Following the approach adopted by the Tribunal in *Re Sydney International Airport*, the relevant facility which must be uneconomical to duplicate is "another facility to provide the service".

Virgin Blue considers that the relevant facility that should be considered is not just those specific facilities referred to in the description of the Airside Service, but rather the whole of Sydney Airport. This is due to the highly interconnected or bundled nature of domestic air passenger transport operations at Sydney Airport.

In Re Sydney International Airport, the Tribunal considered the declaration of:

(a) the service provided through the use of freight aprons and hard stands to load and unload international aircraft at Sydney Airport; and

(b) the service provided by the use of an area at Sydney Airport to store equipment used to load/unload international aircraft and to transfer freight from the loading/unloading equipment to/from trucks at Sydney Airport.

In that matter, the Tribunal found that the relevant facility was the whole of Sydney Airport, stating at paragraph 197:

Accordingly, we reject the contention that the relevant facility, for the purposes of s 44H(4)(b), is less than, what is in effect the total airport. We do not accept that provision of another facility to provide the service would be satisfied by, for example, a simple extension of the freight aprons. It is evident that the function of ramp handling requires movement to and from several parts of the airport and the movement of aircraft carrying freight into and out of the airport. It follows that the use of the general airport structure is essential to carry on the function of ramp handling.

In the same way, Virgin Blue considers that the use of the general airport structure at Sydney Airport is essential to the provision of domestic air passenger transport services at Sydney Airport.

As the Airside Service is intrinsically linked to, and depends upon, other services provided at Sydney Airport, it is not possible to duplicate the Airside Service without duplicating all (or a vast majority of) the other facilities at Sydney Airport.

This approach to the consideration of which facility it is uneconomic to duplicate is consistent with the approach previously adopted by the Tribunal⁶ and the Council⁷ in relation to Part IIIA of the Act.

The meaning of uneconomical has been considered by the Tribunal. It found:

The Tribunal considers...that the uneconomical to develop test should be construed in terms of the associated costs and development for society as a whole. Such an interpretation is consistent with the underlying intention of the legislation... this language does not suggest that the intention is only to consider a narrow accounting view of 'uneconomic' or simply issues of profitability.⁸

The test therefore relates to the total costs and benefits of developing another facility, including social costs and benefits, to ensure the most efficient allocation of society's resources.

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Re Sydney International Airport, paragraph 197

Application for Declaration of Certain Airport Services at Sydney and Melbourne International Airports – Council's Reasons for Decision dated 8 May 1997 at page 31

⁸ Re Sydney International Airport, paragraph 204

Virgin Blue submits that Sydney Airport is uneconomic to duplicate. In support of this submission, Virgin Blue notes:

- (a) both the Council⁹ and the Tribunal¹⁰ have found that it is uneconomic for Sydney Airport to be duplicated;
- (b) the Commission's Draft Guide to Section 192 concludes that most larger airports, and possibly all core regulated airports, could not be economically duplicated; and
- (c) Sydney Airport is the busiest airport in Australia, processing over 14.8 million domestic (including regional) passengers annually and 208,086 domestic (including regional) aircraft movements each year. It operates 3 runways and covers a total of 2,369 hectares. It clearly exhibits significant economies of scale and very substantial entry and exit costs.

4.1.3 Paragraph 44G(2)(c) - the facility is of national significance

There is little question that Sydney Airport is of national significance.

In support of this submission, Virgin Blue notes:

- (a) the comments of the Tribunal in *Re Sydney International Airport* when considering the same question with regard to Sydney Airport, namely that it is "*beyond doubt that the facility is of national significance*" (although the Tribunal in that matter was more concerned with the freight operations carried out through Sydney Airport);
- (b) the data on passenger traffic and aircraft movements through Sydney Airport set out above in section 4.1.2; and
- (c) the comments of SACL that 12 :
 - (i) Sydney Airport is one of the major employers in Sydney, directly providing 33,500 jobs and a further 33,000 jobs through flow-on effects; and
 - (ii) Sydney Airport generates approximately \$3.5 billion in economic benefits to the Sydney region and a further \$3.8 billion in flow-on effects in New South Wales.

Application for Declaration of Certain Airport Services at Sydney and Melbourne International Airports – Council's Reasons for Decision dated 8 May 1997 at page 32

Re Sydney International Airport, paragraph 206

¹¹ Re Sydney International Airport, paragraph 207

SACL publication titled "Facts at a glance" dated September 2001

4.1.4 Paragraph 44G(2)(d) - access to the services can be provided without undue risk to human health or safety

Virgin Blue is unaware of any reason why access to the Airside Service cannot be provided without undue risk to human health or safety.

4.1.5 Paragraph 44G(2)(e) - access to the service is not already the subject of an effective access regime

The expression "effective access regime" is not defined in the Act. However, some guidance as to its meaning can be found from the following:

- (a) sub-section 44G(3) of the Act provides that when considering whether an access regime amounts to an effective access regime the Council must apply the relevant principles in the Competition Principles Agreement. Clause 6.4 of the Competition Principles Agreement describes the principles that an effective access regime should incorporate; and
- (b) the Tribunal has found¹³ that "an effective access regime" means an access regime that the Commonwealth Minister has decided is an effective access regime pursuant to section 44N of the Act.

There is no access regime that relates to the Airside Service which satisfies either of these criteria, therefore there is no effective access regime within the meaning of Paragraph 44G(2)(e) relating to the Airside Services.

It is the case that landing rights at Sydney Airport are governed by the Sydney Airport slot management scheme.¹⁴ However, this scheme does not govern all terms and conditions of access to the Airside Service, including landing and apron parking fees, and does not satisfy either of the criteria described above.

Re Sydney International Airport, paragraph 217

See the:

[•] Sydney Airport Demand Management Act 1997 (http://scaleplus.law.gov.au/html/pasteact/2/3185/top.htm);

[•] Sydney Airport Demand Management Regulations 1998 (Consolidation) (http://scaleplus.law.gov.au/html/pastereg/2/1457/top.htm);

[•] Sydney Airport Slot Management Scheme 1998 (Consolidation) (http://scaleplus.law.gov.au/html/instruments/0/11/rtf/2001062001.rtf); and

[•] Sydney Airport Compliance Scheme 1998 (http://scaleplus.law.gov.au/html/instruments/0/11/rtf/SydAirport98)

It is also the case that pursuant to the lease of Sydney Airport from the Commonwealth to SACL, that SACL is required to operate the site as an airport and provide for access to the airport by intrastate, interstate and international air transport.¹⁵ However, this obligation does not provide any access rights to third parties, such as a right to have an access dispute determined by an independent arbitrator and as such would not amount to an effective access regime within the meaning of Part IIIA the Act.

4.1.6 Paragraph 44G(2)(f) - access (or increased access) to the service would not be contrary to the public interest

Due to the competition that would be promoted through declaration (including in the Sydney Domestic Market), Virgin Blue submits that declaration of the service is in the public interest, and knows of no reason why it would be contrary to the public interest.

4.2 DOMESTIC TERMINAL SERVICE

4.2.1 Paragraph 44G(2)(a) - access (or increased access) to the service would promote competition in at least one market other than the market for the service

In order to provide domestic air passenger transport services, the provider must be able to process its customers, check the customers onto the flight, take receipt of the customers' baggage and return the baggage at the destination, transport the customers' baggage to and from the aircraft, and allow customers to board and disembark the aircraft (**Customer Processing Services**).

Virgin Blue submits that access (or increased access) to the Domestic Terminal Service will promote competition in the Sydney Domestic Market because it is not possible to provide domestic air passenger transport services in the Sydney Domestic Market without providing Customer Processing Services using the Domestic Terminal Services.

In terms of potential substitutes to the Domestic Terminal Services for the provision of Customer Processing Services, Virgin Blue believes that the full range of Customer Processing Services cannot be provided through the use of facilities located elsewhere than at Sydney Airport. In its Melbourne Airport Determination, when considering the services provided through the use of domestic terminals at Melbourne Airport, the Commission stated that:

The ACCC considers that current or potential off-airport facilities do not compete with terminal facilities at Melbourne Airport. It is difficult to conceive of how a number of

see clause 3 of the Airport Lease for Sydney (Kingsford-Smith) Airport

Domestic Terminal Services (such as the loading or unloading of passengers) could be provided anywhere other than the airport.¹⁶

Since there is no substitute for the Domestic Terminal Service if a person wants to offer domestic air passenger transport services in the Sydney Domestic Market, Virgin Blue considers that access (or increased access) to the Domestic Terminal Service would promote competition in the Sydney Domestic Market.

4.2.2 Paragraph 44G(2)(b) – that it would be uneconomical for anyone to develop another facility to provide the service

As noted above, following the approach adopted by the Tribunal in *Re Sydney International Airport*, the relevant facility which must be uneconomical to duplicate is "another facility to provide the service".

In relation to the Domestic Terminal Service, Virgin Blue believes that the relevant facility is the whole of Sydney Airport, as is the case with the Airside Service due to the highly interconnected or bundled nature of domestic air passenger transport operations at Sydney Airport.

For the reasons set out in section 4.1.2, Virgin Blue considers that it would be uneconomical to duplicate Sydney Airport.

It may be argued that the type of facility that should be properly considered when analysing whether it would be uneconomical to develop another facility to provide the Domestic Terminal Service is another domestic terminal facility. Virgin Blue does not support this interpretation, however, in the event that it is adopted by the Council, Virgin Blue submits that:

- (a) for the reasons outlined in section 4.2.1 above, it would be necessary to locate the terminal at Sydney Airport; and
- (b) it is uneconomical to develop another domestic terminal facility at Sydney Airport. This is because:
 - (i) of the existing unused excess capacity at Terminal 2. In considering a similar test under the Gas Code, the Tribunal in *Re Duke Eastern Gas Pipelines* accepted:¹⁷

"...that if a single pipeline can meet market demand at less cost (after taking into account productive, allocative and dynamic affects) than two pipelines, it would

Melbourne Airport Determination, page 15

paragraph 64

be "uneconomic" in terms of criterion (b), to develop another pipeline to provide the same services."

For the same reasons, Virgin Blues submits that it would be uneconomic to invest in further infrastructure where sufficient capacity already exists in Terminal 2 and remains unused;

- (ii) the absence of suitable land for the construction of an additional domestic terminal facility;
- (iii) even if suitable land were available, SACL controls all of the land at Sydney Airport and there is no incentive for SACL to allow a third party to build suitable facilities; and
- (iv) the fact that there are currently three domestic terminals does not make a domestic terminal capable of duplication as a matter of fact. The relevant question to consider is whether it would be uneconomic for someone other than the facility owner to duplicate the facility¹⁸. Virgin Blue submits, for the reasons, outlined above that is not.

4.2.3 Paragraph 44G(2)(c) - the facility is of national significance

For the reasons set out in section 4.1.3 above, there is little question that Sydney Airport is of national significance.

4.2.4 Paragraph 44G(2)(d) - access to the services can be provided without undue risk to human health or safety

Virgin Blue is unaware of any reason why access to the Domestic Terminal Service cannot be provided without undue risk to human health or safety.

4.2.5 Paragraph 44G(2)(e) - access to the service is not already the subject of an effective access regime

As noted above, the expression "effective access regime" is not defined in the Act.

Virgin Blue submits that, since there is no access regime that relates to the Domestic Terminal Service which satisfies either of the criteria set out in paragraphs (a) and (b) in section 4.1.5 above, there is no effective access regime within the meaning of Paragraph 44G(2)(e).

Melbourne Airport Determination, page 22

4.2.6 Paragraph 44G(2)(f) - access (or increased access) to the service would not be contrary to the public interest

Due to the competition that would be promoted through declaration (including in the Sydney Domestic Market), Virgin Blue believes that declaration of the service is in the public interest and knows of no reason why it would be contrary to the public interest.

ATTACHMENT 1

GLOSSARY

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

Applications means these applications made by Virgin Blue under section 44F(1) of the Act;

Commission means the Australian Competition and Consumer Commission;

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

Council means the National Competition Council;

Draft Guide to Section 192 means the Draft Guide to Section 192 of the Airports Act – Declaration of Airport Services published by the Commission and dated October 1998;

Gas Code means the National Third Party Access Code for Natural Gas Pipeline Systems;

Melbourne Airport Determination means the Final Determination of the Commission pursuant to section 192 of the Airports Act 1996 in Relation to the Application by Virgin Blue in Respect of Certain Domestic Terminal Services at Melbourne Airport;

PSA means the *Prices Surveillance Act* 1983.

Re Duke Eastern Gas Pipelines means re Re Duke Eastern Gas Pipelines [2001] AcompT 2;

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

SACL means Sydney Airports Corporation Limited;

Tribunal means the Australian Competition and Consumer Tribunal;

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