



27 October 2006

Ms Jill Irvine
Productivity Commission
PO Box 80
Belconnen ACT 2616

Dear Ms Irvine

Price Regulation of Airport Services – Commission Inquiry

As the Commission will be aware, on 19 October 2006, the Full Federal Court handed down its decision in *Sydney Airport Corporation Ltd v Australian Competition Tribunal* [2006] FCAFC 146 (hereafter **SACL v ACT**). *SACL v ACT* related to an application by Sydney Airport Corporation Limited (**SACL**) for judicial review of the decision of the Australian Competition Tribunal (**Tribunal**) to declare the domestic airside service (**Airside Service**) at Sydney Airport under Part IIIA of the *Trade Practices Act 1974* (**TPA**).

Summary of the impact of SACL v ACT

Virgin Blue Airlines Pty Limited (**Virgin Blue**) considers that the decision of the Full Federal Court:

- (a) confirmed that the test originally proposed to the Tribunal by Virgin Blue is the correct test to apply when considering declaration criterion (a); and
- (b) approved of the reasoning of the Tribunal in the Tribunal's finding that:
 - (i) SACL had monopoly power;
 - (ii) without declaration (being the right to seek arbitration if negotiations are not successful), SACL would impose terms and condition for access to the Airside Service that would not otherwise occur in a competitive market;
 - (iii) neither airlines' countervailing power, the threat of re-regulation nor non-aeronautical revenue provided any effective constraint on SACL's market power; and
 - (iv) therefore, the availability of the right to arbitration over the terms and conditions on which SACL provided the Airside Service would promote competition in the dependent airline market.

The decision of the Full Federal Court has confirmed that the test under criterion (a) is a straightforward test: the relevant inquiry is whether access to the relevant service is necessary in order to permit effective competition in a dependent market.

This decision is entirely in keeping with the intention of Parliament in introducing Part IIIA of the TPA, and the Government's stated policy that airports should be subject to the general access provisions under Part IIIA.

However, as a mechanism for constraining airports' market power, Part IIIA still suffers from a number of drawbacks, including that it is costly and there are significant delays involved in obtaining declaration.

Therefore Virgin Blue remains of the view that Commission should recommend the introduction of a negotiate-arbitrate model in relation to the provision of aeronautical services at major airports. Such a model would most effectively constrain the market power of airports while also providing for negotiation to be the primary mechanism for airports to agree on terms and conditions with their users. Further, such a model would provide all parties with certainty and avoid the costs of the declaration process under Part IIIA of the TPA.

The correct test under declaration criterion (a)

SACL's application related to the proper construction of declaration criterion (a). At the relevant time criterion (a) stated that the relevant Minister could not declare a service unless he or she was satisfied:

- (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...*"

Before the Tribunal, Virgin Blue submitted that the test under criterion (a) simply asks whether access (in the ordinary sense of the word) to the service is necessary in order to permit effective competition in the dependent market. In other words, the relevant comparison is between the state of competition in the dependent market with a right or ability to use the service, and the state of competition in the dependent market without any right or ability or with a restricted right or ability to use the service.

Virgin Blue submitted that this test was the construction that best reflected the wording of the statute and the underlying intention of parliament in introducing Part IIIA of the TPA.

However, the Tribunal found that the test required under criterion (a) was a comparison of the future state of competition with and without *declaration*. As the Commission would be aware, the Tribunal found that the Airside Service met even this higher test.

SACL sought judicial review of the Tribunal's decision on the basis that it should have applied an even higher test under criterion (a) than it did.

The Full Federal Court rejected the test proposed by SACL and the test applied by the Tribunal in favour of the test proposed by Virgin Blue. The Court found that the relevant inquiry for the purposes of criterion (a) is the comparison between access and no access and limited access and increased access.¹ Further, the Court found that all that that provision requires:²

"...is a comparison of the future state of competition in the dependent market with a right or ability to use service [sic] and the future state of competition in the dependent market without any right or ability or with a restricted right or ability to use the service."

The Full Federal Court came to this conclusion after an exhaustive review of the background materials to the introduction of Part IIIA. The Court concluded that its simpler test best reflected the intention of Parliament in introducing Part IIIA:³

"This construction of s 44H(4)(a) conforms to the purpose of Part IIIA revealed by the background and context: see in particular the Hilmer Report, the COAG explanatory material referred to above and clause 6 of the Competition Principles Agreement referred to above. None of this material reveals any necessity to examine the current state of access or to engage in an enquiry based on assessing the future with and without declaration. The

¹ at [81]

² at [83]

³ at [86]

essential precondition discussed was that access (that is in its ordinary meaning) was necessary to permit effective competition in a downstream or upstream market.”

Given the statements in these background materials, Virgin Blue does not consider that the Full Federal Court’s interpretation of criterion (a) is surprising. Nor could it be argued that the interpretation is contrary to Parliament’s intentions.

The decision of the Full Federal Court has lowered the threshold for declaration under Part IIIA of the TPA.

Criterion (a) has recently been amended to read:

“(a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service...” (added words underlined)

However, Virgin Blue notes that this amendment does not affect the basic comparison required by criterion (a). Therefore the test remains as discussed in *SACL v ACT*, being a comparison between:

- the future state of competition in the dependent market with a right or ability to use the service; and
- the future state of competition in the dependent market without any right or ability or with a restricted right or ability to use the service.

The effect of the recent amendments is that declaration would not be warranted where this comparison indicated only an immaterial or trivial difference in competition in the dependent market.

The Full Federal Court’s consideration of the Tribunal’s findings

In its judgment, the Court considered in detail the Tribunal’s reasoning in relation to the impact on competition in the downstream market that would result from declaration.

The Full Federal Court found that Sydney Airport was a natural monopoly and exerted monopoly power.⁴ The Court referred to the Tribunal’s finding that absent declaration:

- SACL would continue to impose charges for the Airside Service in a manner that would not occur in a competitive market;⁵ and
- negotiations with SACL in relation to non-price terms and conditions were likely to continue to be protracted, inefficient and may ultimately be resolved by the use of monopoly power producing outcomes that would be unlikely to occur in a competitive market.⁶

Further, the Court referred to the Tribunal’s finding that there were no effective constraints on SACL’s monopoly, quoting from the Tribunal’s reasons:⁷

“... the airlines do not have any effective countervailing power, that the threat of re-regulation has had, and will continue to have, little effect on SACL’s conduct, and that non-

⁴ at [91]

⁵ at [62]

⁶ at [63]

⁷ at [64]

aeronautical revenue is an insufficient constraint in relation to the current and likely future levels of Airside Service charges in the medium term. In such circumstances, the combination of these matters does not bring together any effective constraints on SACL's exercise of monopoly power as they do not interact to enhance the significance of each other on the whole."

Finally, the Court referred to the Tribunal's conclusion that there would be a promotion of competition if declaration were made.⁸

While the Full Federal Court disagreed with the approach the Tribunal adopted to criterion (a), the Court specifically found that the Tribunal's reasoning referred to above was still relevant to the declaration decision.⁹

Implications for the Commission's current review

While the decision in *SACL v ACT* has resulted in a lower threshold for declaration under criterion (a) than the Tribunal had previously considered to be the case, this does not mean that Part IIIA should now be considered to be an effective constraint on the market power of major airports.

While the recent decision of the Full Federal Court will have reduced any uncertainty as to the wider application of Part IIIA to airports, Part IIIA suffers from other drawbacks as a constraint on market power, including the time taken and the cost involved in seeking declaration (as recognised by the Commission in its Draft Report).

In relation to the delay involved in seeking declaration, it is instructive to remember that Virgin Blue originally applied to the National Competition Council for a recommendation that the Airside Service be declared in October 2002. The decision of the Full Federal Court dismissing SACL's application for judicial review came more than 4 years after Virgin Blue's original application. While recent amendments to Part IIIA should reduce the time taken from application to declaration, the process will still take a significant time, and access seekers have no effective avenue for redress if they are significantly overcharged or otherwise denied fair access to airport facilities in the period before declaration.

In relation to the cost of declaration, Virgin Blue's application for declaration of the Airside Service has to date involved a large number of parties, two separate hearings and thousands of pages of submissions and evidence which have been provided to the National Competition Council, the Tribunal and the Federal Court. The parties have incurred hundreds of thousands of dollars of costs.

For these reasons, Virgin Blue considers that the Full Federal Court's decision does not change its view that the Commission should recommend the introduction of a negotiate-arbitrate model for aeronautical services provided at major airports.

As discussed at length in Virgin Blue's submissions to the Commission,¹⁰ a negotiate-arbitrate model would best constrain the market power of major airports while also establishing negotiation as the primary method by which airports would agree with their customers on the terms and conditions for use of their facilities. This is the case regardless of any decision in relation to the declaration criteria under Part IIIA of the TPA.

If anything, Virgin Blue considers that the decision of the Full Federal Court creates an even greater incentive for the Commission to recommend the introduction of Virgin Blue's preferred

⁸ at [67]

⁹ at [94]

¹⁰ See in particular section 9 of Virgin Blue's submission to the Commission dated 17 October 2006 and section 11 of Virgin Blue's submission to the Commission dated 21 July 2006.

model. Without Virgin Blue's preferred model, there is a significant risk of a plethora of applications for declaration of different services at different airports.¹¹ Such an outcome would be very costly to all concerned, and is likely to result in a patchwork of declared airport services emerging after a number of years.

By contrast, Virgin Blue's preferred model would provide all parties (both airports and airport users) with certainty, and would also avoid the unnecessary cost of the declaration process.¹²

In closing, Virgin Blue notes that other parties have submitted that the Commission recommend the introduction of various other models to assist airlines and airports to resolve disputes. To the extent that these other models amounted to effective access regimes for the purposes of Part IIIA, then, like Virgin Blue's preferred model, they would preclude declaration of the covered services. However, to the extent that they did not amount to effective access regimes then declaration under Part IIIA would remain an option.

This is entirely in keeping with the Government's policy on access to airports. The Government's response to Recommendation 7 from the Commission's last inquiry into the price regulation of airport services stated:

"The Government supports the application of the generic provisions of Part IIIA to airports."

Virgin Blue would strongly object to the introduction of any dispute resolution mechanism that did not amount to an effective access regime yet also sought to exclude airports from possible declaration by amending Part IIIA to remove airports from its scope. Such a proposal would clearly provide less constraint on airports than the Government intended.

Yours sincerely



Scott Swift
General Manager Corporate Affairs

¹¹ See for example the letter from Qantas Airways Limited to the Commission dated 19 October 2006

¹² Under declaration criterion (e) in Part IIIA of the TPA, services that are already the subject of an effective access regime cannot be declared. It is intended that Virgin Blue's preferred model would be implemented as an effective access regime.