AUSTRALIAN COMPETITION TRIBUNAL

Virgin Blue Airlines Pty Limited [2005] ACompT 5

SUMMARY

File No 1 of 2004

RE: APPLICATION FOR REVIEW OF THE DECISION BY THE PARLIAMENTARY SECRETARY TO THE TREASURER DATED 29 JANUARY 2004 IN RELATION TO THE APPLICATION FOR DECLARATION OF THE AIRSIDE SERVICE PROVIDED AT SYDNEY AIRPORT

BY: VIRGIN BLUE AIRLINES PTY LIMITED

Applicant

GOLDBERG J (President), MR G F LATTA and DR J S MARSDEN
9 DECEMBER 2005

MELBOURNE (VIA VIDEO LINK TO SYDNEY)

SUMMARY

1. In accordance with the practice of the Australian Competition Tribunal for matters of significant public interest, the following summary has been prepared to accompany the Determination made today, and the Reasons for Determination which will be published on Monday, 12 December 2005 after any outstanding issues of confidentiality have been resolved. The summary is intended to assist in understanding the outcome of this proceeding and is necessarily not a complete statement of the reasoning, or the conclusions, of the Tribunal. The only authoritative statement of the Tribunal's reasons is that contained in the published Reasons for Determination which will be published on 12 December 2005 and will be available on the internet at www.fedcourt.gov.au, together with this summary.

2. The matter before the Tribunal, constituted by Goldberg J (President), Mr G F Latta and Dr J S Marsden, was an application for review sought by Virgin Blue Airlines Pty Limited ("Virgin Blue") of the decision of the Parliamentary Secretary to the Commonwealth Treasurer not to declare a service, described as the "Airside Service", provided by Sydney Airports Corporation Limited ("SACL") at Sydney (Kingsford-Smith) International Airport ("Sydney Airport").

3. On 1 October 2002, Virgin Blue applied to the National Competition Council ("NCC") for a recommendation that the Airside Service be declared pursuant to s 44G of the *Trade Practices Act* 1974 (Cth) ("TPA").

4. The Airside Service was defined as:

> *"(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".*

5. The NCC recommended to the Parliamentary Secretary that the Airside Service should not be declared on the basis that it did not meet the requisite criteria in ss 44G(2)(a) and (f) of the TPA. Those criteria require that the NCC be satisfied:

- That access or increased access to the Airside Service would promote competition in at least one market other than the market for the Service;

- That access or increased access to the Airside Service would not be contrary to the public interest.

6. On 29 January 2004, the Parliamentary Secretary to the Commonwealth Treasurer published his decision not to declare the Airside Service on the basis that it did not meet the requisite criteria in ss 44H(4)(a) and (f) of the TPA (which are in identical terms to criteria (a) and (f) of s 44G(2)).

7. On 18 February 2004, Virgin Blue applied to the Tribunal for a review of the Parliamentary Secretary's decision. The parties involved in the review were Virgin Blue, the NCC, Qantas Airways Limited ("Qantas"), SACL and the Parliamentary Secretary. The review by the Tribunal was a re-consideration of the matter which was before the Parliamentary Secretary.

8. We have formed the view that the Airside Service in respect of which declaration was sought by Virgin Blue encompasses those activities which commence, in relation to the departure of an aircraft, with the loading of aircraft parked at a departure gate or point of embarkation with baggage, freight and all products required on the flight, and the entrance of passengers into the aircraft. It terminates when the aircraft is airborne. It also encompasses those activities which commence, in relation to an arriving aircraft, at a point when the aircraft lands, taxis to an arrival gate or point of disembarkation, and the passengers leave the aircraft, their baggage and freight are unloaded, and supplies, waste and other items used during the flight are removed from the aircraft. In short, the "Airside Service" covers all movement in relation to aircraft between runways and passenger arrival and departure gates and the servicing, maintenance, equipping and re-equipping of aircraft at the start and end of a flight.

9. Pursuant to s 44H(4) of the TPA, the Tribunal cannot declare a service unless it is satisfied of all of the following criteria:

(a) that access or increased access to the service would promote competition in at least one market other than the market for the service;

(b) that it would be uneconomical for anyone to develop another facility to provide the service;

(c) that the facility is of national significance having regard to its size, its importance to constitutional trade or commerce, or the importance of the facility to the national economy;

(d) that access to the service can be provided without undue risk to human health or safety;

(e) that access to the service is not already the subject of an effective access regime;

(f) that access or increased access to the service would not be contrary to the public interest.

10. Criteria (b) to (e) were not in issue in the proceeding, and we are satisfied that each of those criteria has been satisfied. The criteria which were contested in the proceeding were criteria (a) and (f).

11. Criteria (a) required market definition. We found that the "market for the service" is the market for aeronautical services in Sydney. The "market other than the market for the service" (referred to as the "dependent market"), is the market for the carriage of domestic air passengers into and out of Sydney.

12. The critical issue in assessing whether increased access would promote competition in the dependent market was whether there would be an enhancement of the competitive environment, and a greater opportunity for the implementation of competitive conduct in the dependent market. This assessment involved comparing the future with declaration against the future without declaration, that is, a comparison of the factual and counterfactual.

13. One of the principal issues canvassed in the proceeding was whether SACL had misused its monopoly power in such a manner as warranted the conclusion that there had been, and would continue to be in the absence of declaration of the Airside Service, an effect on competition in the dependent market. When we refer to a misuse of monopoly power, we are referring to an exercise of power in a manner which would not occur in a competitive environment.

14. We are satisfied that SACL has misused its monopoly power in the past, and that, unless the Airside Service is declared, competition in the dependent market will continue to be affected. In particular, we are satisfied that SACL has misused its monopoly power by the manner in which, and the reasons for which, it changed the basis for its charge for providing the Airside Service in July 2003 from an aircraft's maximum take-off weight ("MTOW") basis to a charge on a per-passenger basis ("known as the Domestic PSC"). This change adversely affected low cost carriers such as Virgin Blue as against full service airlines such as Qantas. Further, the evidence disclosed that SACL chose a passenger-based charge "because Qantas preferred it". At the time the basis for this charge was altered, SACL knew that it would impact more adversely on Virgin Blue than on Qantas.

15. SACL submitted that the Domestic PSC encouraged a more efficient use of the services and facilities provided at Sydney Airport than did the former MTOW-based charge, and that efficient pricing principles warranted the use of a Domestic PSC. We have rejected this submission. We are satisfied that efficient pricing of the Airside Service required consideration of the underlying cost drivers of that Service by reference to the nature of the aircraft using the Service, rather than by reference to the number of passengers travelling in such aircraft.

16. A number of issues were raised in relation to the level of revenue SACL would be able to derive in the future. We are satisfied that, in the light of the history of the development of the Domestic PSC and the manner in which SACL is contemplating imposing further charges, these revenue issues are likely to be resolved by SACL exercising monopoly power to impose upon the airlines a level of revenue growth which would not be open to it in a competitive environment. While these issues are outstanding, and where the airlines have no recourse to independent arbitration and determination, there remains the opportunity for SACL to impose

higher and additional charges upon the airlines which would be unlikely to be accepted in a more competitive environment.

17. We are satisfied that any commercial negotiations in the future between SACL and airlines using Sydney Airport as to the non-price terms and conditions on which the airlines utilise the facilities and related services at Sydney Airport are likely, as in the past, to continue to be protracted, inefficient, and ultimately resolved by SACL using its monopoly power to produce outcomes that would be unlikely to arise in a more competitive environment. This situation is exacerbated by the lack of an appropriate dispute resolution procedure providing independent arbitration in any of the commercial agreements entered into or proposed between SACL and the airlines.

18. We are satisfied that the ability of SACL to exercise monopoly power in relation to the airlines' use of the Airside Service is not subject to any effective constraints. We do not consider that the airlines have any significant countervailing power, or that the threat of re-regulation by the Commonwealth Government is an effective constraint upon SACL, or that SACL's ability to derive non-aeronautical revenues operates as a sufficient constraint on SACL's monopoly power.

19. We are satisfied that the environment for competition in the market for the carriage of domestic air passengers into and out of Sydney would be enhanced if the Airside Service was declared, in particular, because of the opportunity that declaration would create for airlines to have any access dispute with SACL resolved by the independent arbitration of the Australian Competition and Consumer Commission ("ACCC"), there being no other effective dispute resolution procedure available to domestic airlines using Sydney Airport.

20. We are therefore satisfied that increased access to the Airside Service would promote competition in the dependent market and consequently that criterion (a) is met.

21. We are also satisfied that increased access to the Airside Service would not be contrary to the public interest. We are satisfied that increased access to the Airside Service will promote competition in the dependent market, and that any costs of regulation arising from declaration are not of such weight that, notwithstanding this finding, increased access to the Airside

Service would be contrary to the public interest. Nor are we persuaded that any other reason exists which would make increased access to the Airside Service contrary to the public interest.

22. We are therefore satisfied that criterion (f) is met.

23. We note that the access regime provided for in Pt IIIA involves two stages. Declaration of a service, governed by Div 2 of Pt IIIA, is the first stage. Upon declaration, the commercial relationship between the provider of the service and the access seeker continues, and they have the opportunity to pursue commercial dialogue and negotiations with a view to reaching agreement on terms and conditions of access to the service. Where the parties are unable to reach agreement in relation to an aspect of access to the service, the second stage of the access regime is enlivened. The second stage of the access regime, governed by Div 3 of Pt IIIA, enables an access seeker or a provider, in default of agreement, to have issues as to access determined by arbitration conducted by the ACCC.

24. Declaration of the Airside Service does not therefore inexorably lead to arbitration; there is still scope for commercial resolution of access issues between the parties. Rather, declaration enables commercial negotiations to continue, but provides an opportunity for independent arbitration of the terms and conditions of access to the Airside Service should those commercial negotiations prove unsuccessful.

25. We therefore make the following determination, pursuant to s 44K(8)(b) of the TPA:

1. The decision of the Parliamentary Secretary to the Commonwealth Treasurer of 29 January 2004 not to declare the services required 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.

   be set aside.

2. The 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,

(defined as the "Airside Service"), be declared.

3. The declaration in paragraph 2 be effective on and from 9 December 2005 and shall expire on 8 December 2010.

AUSTRALIAN COMPETITION TRIBUNAL

Virgin Blue Airlines Pty Limited [2005] ACompT 5

DETERMINATION

File No 1 of 2004

RE: APPLICATION FOR REVIEW OF THE DECISION BY THE PARLIAMENTARY SECRETARY TO THE TREASURER DATED 29 JANUARY 2004 IN RELATION TO THE APPLICATION FOR DECLARATION OF THE AIRSIDE SERVICE PROVIDED AT SYDNEY AIRPORT

BY: VIRGIN BLUE AIRLINES PTY LIMITED

JUSTICE A H GOLDBERG (President), MR G F LATTA & DR J S MARSDEN
9 DECEMBER 2005
MELBOURNE (VIA VIDEO LINK TO SYDNEY)

IN THE AUSTRALIAN COMPETITION TRIBUNAL **File No 1 of 2004**

RE: APPLICATION FOR REVIEW OF THE DECISION BY THE PARLIAMENTARY SECRETARY TO THE TREASURER DATED 29 JANUARY 2004 IN RELATION TO THE APPLICATION FOR DECLARATION OF THE AIRSIDE SERVICE PROVIDED AT SYDNEY AIRPORT

BY: VIRGIN BLUE AIRLINES PTY LIMITED

THE TRIBUNAL:	**JUSTICE A H GOLDBERG (President)** **MR G F LATTA** **DR J S MARSDEN**
DATE OF DETERMINATION:	**9 DECEMBER 2005**
WHERE MADE:	**MELBOURNE (VIA VIDEO LINK TO SYDNEY)**

THE TRIBUNAL, PURSUANT TO s 44K(8)(b) OF THE *TRADE PRACTICES ACT* 1974 (CTH):

1. Sets aside the decision of the Parliamentary Secretary to the Commonwealth Treasurer of 29 January 2004 not to declare the services required 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.

2. Declares the 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).

3. Determines that the declaration in paragraph 2 be effective on and from 9 December 2005 and shall expire on 8 December 2010.

AUSTRALIAN COMPETITION TRIBUNAL

Virgin Blue Airlines Pty Limited [2005] ACompT 5

TRADE PRACTICES – application pursuant to s 44K(2) of the *Trade Practices Act* 1974 (Cth) – application for review of a decision made by the Parliamentary Secretary to the Commonwealth Treasurer not to declare a service described as the "Airside Service" – Airside Service provided at Sydney (Kingsford-Smith) International Airport – whether criteria in s 44H(4) of the *Trade Practices Act* 1974 (Cth) satisfied – meaning of "increased access" – whether increased access to the Airside Service would promote competition in the market for the carriage of domestic air passengers into and out of Sydney for the purposes of s 44H(4)(a) of the *Trade Practices Act* 1974 (Cth) – whether increased access to the Airside Service would not be contrary to the public interest for the purposes of s 44H(4)(f) of the *Trade Practices Act* 1974 (Cth).

Airports Act 1996 (Cth): ss 71, 192
Civil Aviation Legislation Amendment Act 2003 (Cth)
Competition Policy Reform Act 1995 (Cth)
Federal Airports Corporation Act 1986 (Cth)
National Third Party Access Code for Natural Gas Pipeline Systems: s 1.9(a)
Prices Surveillance Act 1983 (Cth): ss 21, 22(2)(a), 27A
Trade Practices Act 1974 (Cth): Pt IIIA, Div 2, Div 3, ss 44B, 44F, 44G, 44H, 44I, 44K, 44S, 44U, 44V, 44X, 44Y, 44ZF

Productivity Commission Inquiry Report, *Price Regulation of Airport Services*, January 2002

Freight Victoria Limited (2002) ATPR ¶41-884, considered
Rail Access Corporation v New South Wales Minerals Council Ltd (1998) 87 FCR 517, considered
Re Duke Eastern Gas Pipeline Pty Ltd (2001) 162 FLR 1, followed
Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd (1976) 8 ALR 481, considered
Re Review of Declaration of Freight Handling Services at Sydney International Airport (2000) ATPR ¶41-754, considered

File No 1 of 2004

RE: APPLICATION FOR REVIEW OF THE DECISION BY THE PARLIAMENTARY SECRETARY TO THE TREASURER DATED 29 JANUARY 2004 IN RELATION TO THE APPLICATION FOR DECLARATION OF THE AIRSIDE SERVICE PROVIDED AT SYDNEY AIRPORT

BY: VIRGIN BLUE AIRLINES PTY LIMITED

JUSTICE A H GOLDBERG (President), MR G F LATTA & DR J S MARSDEN
12 DECEMBER 2005
SYDNEY

CONTENTS

IN THE AUSTRALIAN COMPETITION TRIBUNAL **File No 1 of 2004**

RE: APPLICATION FOR REVIEW OF THE DECISION BY THE PARLIAMENTARY SECRETARY TO THE TREASURER DATED 29 JANUARY 2004 IN RELATION TO THE APPLICATION FOR DECLARATION OF THE AIRSIDE SERVICE PROVIDED AT SYDNEY AIRPORT

BY: VIRGIN BLUE AIRLINES PTY LIMITED

THE TRIBUNAL:	**JUSTICE A H GOLDBERG (President)** **MR G F LATTA** **DR J S MARSDEN**
DATE OF REASONS FOR DETERMINATION:	**12 DECEMBER 2005**
PLACE:	**SYDNEY**

REASONS FOR DETERMINATION

INTRODUCTION

1 This is an application by Virgin Blue Airlines Pty Limited ("Virgin Blue") for review of a decision made by the Hon Ross Cameron MP, Parliamentary Secretary to the Commonwealth Treasurer. The Parliamentary Secretary's decision was not to declare certain services provided by Sydney Airports Corporation Limited ("SACL") at Sydney (Kingsford-Smith) International Airport ("Sydney Airport").

2 Part IIIA of the *Trade Practices Act* 1974 (Cth) ("TPA") provides the statutory context for Virgin Blue's application for review. Part IIIA was inserted into the TPA by the *Competition Policy Reform Act* 1995 (Cth). Part IIIA establishes a regime to facilitate third parties obtaining access or increased access to services provided by means of significant infrastructure facilities of national significance. The rationale underlying the regime is that access to certain facilities with natural monopoly characteristics is required to encourage competition in related markets. Accordingly, the regime enables third party access seekers to apply for declaration of such services.

3 Declaration does not provide an automatic right of access to the service for access seekers. Rather, it provides a basis for access seekers to negotiate terms of access with the service

provider and, where parties are unable to agree on any aspect of access, there is provision for compulsory arbitration of the dispute by the Australian Competition and Consumer Commission ("ACCC").

4 In order for a service to be declared, an application must first be made to the National Competition Council ("NCC") for a recommendation that the service be declared. The NCC makes a recommendation to the relevant Minister (as designated under the TPA), whether the service ought to be declared, having regard to the criteria set out in s 44G of the TPA. The designated Minister (in this case the Parliamentary Secretary to the Commonwealth Treasurer) then decides whether to declare the service or not, having regard to the criteria set out in s 44H of the TPA. By virtue of s 44K, decisions of the designated Minister are subject to review by the Australian Competition Tribunal.

5 On 1 October 2002 Virgin Blue applied to the NCC for a recommendation pursuant to s 44G of the TPA in respect of the following:

> *"(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**)"*

("the combined application").

6 In December 2002 the application in respect of the "Domestic Terminal Service" was withdrawn, following an agreement reached between Virgin Blue and SACL in relation to the provision of that service.

7 On 30 June 2003 the NCC issued a draft recommendation that the service, described by Virgin Blue as the "Airside Service", be declared. However, in its final recommendation, dated November 2003, the NCC recommended that the so-called Airside Service should not be declared on the basis that it did not meet the requisite criteria in ss 44G(2)(a) and (f) of the TPA.

8 On 29 January 2004 the Parliamentary Secretary to the Commonwealth Treasurer published his decision under s 44H(1). He decided not to declare the Airside Service ("the designated Minister's decision").

9 On 18 February 2004 Virgin Blue applied to the Tribunal pursuant to s 44K(2) of the TPA for review of the designated Minister's decision.

10 Qantas Airways Limited ("Qantas") and SACL were each granted leave to intervene in Virgin Blue's application for review. The Parliamentary Secretary was also granted leave to intervene for the limited purpose of making submissions and filing evidence in relation to the Commonwealth Government's policy on price regulation of airport services in Australia.

11 At the hearing, the NCC appeared in order to assist the Tribunal with any questions regarding the interpretation and application of the criteria set out in s 44H(4) of the TPA and any additional matters in respect of which the Tribunal sought assistance.

12 We note at the outset that, pursuant to s 42 of the TPA, where a question of law is determined in these reasons, or a view is expressed or a conclusion is reached on a question of law, such question has been determined, such view is expressed and such conclusion has been reached, in accordance with the opinion of the presidential member presiding, Goldberg J.

13 As s 44K(4) of the TPA makes clear, a review of a designated Minister's decision by the Tribunal is a "re-consideration" of the matter, that is, a re-hearing. Where the designated Minister has decided not to declare a service, as in the present case, s 44K(8) provides that the Tribunal may either affirm that decision or set it aside and declare the service. For the purposes of a review, s 44K(5) provides that the Tribunal has the same powers as the designated Minister. The Tribunal must reach its decision as to declaration by reference to the criteria set out in s 44H(4).

BACKGROUND

14 Sydney Airport is the largest and busiest airport in Australia and is of critical significance for domestic airlines. Approximately 50% of all international passengers arriving in Australia, and 30% of all Australian domestic passengers, pass through Sydney Airport. It is one of the terminals on the Melbourne-Sydney route, the busiest route in Australia, which in 2000

represented more than 20% of all passenger movements in Australia. The Melbourne-Sydney route was said to be consistently one of the ten busiest air routes in the world.

15 SACL provides services at Sydney Airport through use of its facilities, including three runways, taxiways, and aprons for parking aircraft at around 40 gates designated for domestic operations.

16 Facilities at airports, including Sydney Airport, are generally characterised as either "airside" or "landside" facilities. Whilst the definition and scope of the "Airside Service" that is the subject of the present application was controversial and involved some debate as to what facilities fall within the airside characterisation, in general terms, airside facilities traditionally include runways, taxiways and aprons, airfield lighting, aircraft parking bays, visual navigation aids, hangars, freight terminals, and facilities for aircraft maintenance, refuelling and in-flight catering. Landside facilities generally comprise terminals and the infrastructure within them, including flight information display systems, check-in counters, public amenities and lounges for passengers and space for commercial operations such as retail shops. Landside facilities also generally include facilities outside terminals such as perimeter roads, car parks and walkway links to public transport.

17 Certain services provided by means of the use of areas for ramp handling and freight services at Sydney Airport were previously the subject of an application for declaration under Pt IIIA of the TPA at a time when Sydney Airport operated under a different regime to that presently before the Tribunal: see *Re Review of Declaration of Freight Handling Services at Sydney International Airport* (2000) ATPR ¶41-754 ("*Sydney International Airport*"). These services were declared by the Tribunal for a period of five years.

PRIVATISATION OF AUSTRALIAN AIRPORTS

18 A significant issue in this proceeding is the manner in which, and the terms and conditions upon which, SACL provides services at Sydney Airport. Accordingly, a brief background to the regulatory and pricing history of Australian airports in general, and of Sydney Airport in particular, follows.

19 Prior to 1997, most of the principal airports in Australia were owned and operated by the Federal Airports Corporation ("FAC"), which was established under the *Federal Airports Corporation Act* 1986 (Cth).

20 In 1997 and 1998 the Commonwealth Government effectively privatised most of Australia's large airports, with the exception of Sydney Airport, by entering into leases with private operators for 50 year terms.

21 On 1 July 1998 the Commonwealth Government leased Sydney Airport to SACL for a period of 50 years with an additional 49 year option. At that time, SACL was a public company wholly owned by the Commonwealth Government.

22 On 28 June 2002 Sydney Airport was sold to the Southern Cross Airports Consortium. On the same day, the shares in SACL were acquired by Southern Cross Airports Corporation Pty Ltd, a member of the Southern Cross Airports Consortium.

REGULATION OF AIRPORTS

23 One of the consequences of privatisation of airports was the introduction of a regulatory framework for managing airport pricing. In the Productivity Commission Inquiry Report, *Price Regulation of Airport Services*, published in January 2002, ("Productivity Commission Inquiry Report"), the Productivity Commission said that regulation of privatised airports was necessary in order to temper the strong market power of airports (in particular, the ability of airports to price well above cost), as any misuse of that market power could potentially increase airfares. It was hoped that regulation would be able to assist in producing more efficient outcomes than the outcomes produced in the market at that time.

24 Privatised airports were subject to special regulation under the *Airports Act* 1996 (Cth) ("Airports Act"), in addition to the general access regime under Pt IIIA of the TPA. Section 192 of the Airports Act set out a specific access regime for all privatised airports designated to be "core regulated airports" under that Act. Section 192 of the Airports Act provided that, within twelve months of the lessee of a "core regulated airport" becoming a privately-owned corporation, each airport service would be a declared service for the purpose of the access regime under Pt IIIA (unless an access undertaking had been given in relation to that service within twelve months of privatisation).

25 Although Sydney Airport was designated as a "core regulated airport", when the lease for Sydney Airport was transferred in July 1998 from the Commonwealth Government to SACL (then a government-owned public company), it fell outside s 192 of the Airports Act as it was not leased by a privately-owned corporation. As noted above, SACL was later privatised in June 2002.

26 Prior to privatisation of the Australian airports, FAC had established its landing and terminal charges on a network-wide "single-till" basis. The expression "single-till" has been defined by the Productivity Commission as:

> *"An arrangement for setting airport charges whereby all airport revenues and costs are taken into account in setting aeronautical prices. Allowable aeronautical prices are set on a 'residual basis', after subtracting from total airport costs the revenue derived from non-aeronautical activities."*

27 A "single-till" arrangement is to be contrasted with a "dual-till" arrangement, which has been described by the Productivity Commission as:

> *"An arrangement for setting airport charges whereby only the costs and revenues of providing* ***aeronautical services*** [defined by the Productivity Commission as 'services provided by infrastructure that facilitates aircraft movements (eg runways), and passenger processing facilities'] *are included in the assessment of allowable aeronautical prices. In other words, aeronautical services are priced on a 'stand-alone' basis, without regard to any net revenues from* ***non-aeronautical services*** [defined by the Productivity Commission as 'services provided by or at airports that are not aeronautical services (eg freight facilities, car parking and retail shops and food outlets)']." (emphasis added)

28 At the time of privatisation, the Commonwealth Government did not require the privatised airports to use the single-till pricing arrangement. It imposed transitional price regulation on the airports. Airports at Melbourne, Brisbane, Perth, Adelaide, Alice Springs, Canberra, Coolangatta, Darwin, Hobart, Launceston and Townsville were subjected to a five-year, CPI — X per cent annual cap on prices for aeronautical services. These price caps were subsequently removed from eight of the eleven airports on 5 October 2001. The price caps remained on Melbourne, Brisbane and Perth airports, although these airports were allowed to implement one-off average price increases for price-capped services.

29 Sydney Airport was never made subject to a price-cap or any other requirement to reduce annually charges for aeronautical services. Instead, by declaration made on 30 June 2000, Sydney Airport was made subject to a price notification regime under the *Prices Surveillance Act* 1983 (Cth) ("Prices Surveillance Act"). Under the price notification regime, SACL was required to notify the ACCC of any proposed increase in the price, or substantial variation of the terms and condition of supply, of aeronautical services.

30 Pursuant to the price notification regime, SACL submitted a 'Revised Draft Aeronautical Pricing Proposal' to the ACCC in October 2000 seeking to increase certain aeronautical charges at Sydney Airport. In May 2001 the ACCC handed down its decision in relation to SACL's application, objecting to SACL's proposed increase which was, on average, an increase of approximately 130%, but approving a lower increase of approximately 97%. In that decision, the ACCC expressed support for a "building block methodology" to be used for assessing SACL's maximum allowable revenue, a methodology to which we will return.

31 The Productivity Commission Inquiry Report noted that Sydney Airport was one of four airports with substantial market power. The Productivity Commission proposed two options for regulation of Sydney Airport; Option A, involving dual-till price caps, and Option B, involving price monitoring.

32 Option B, which the Productivity Commission ultimately recommended and which was subsequently adopted in large part by the Commonwealth Government, provided, *inter alia*:

> *"**Option B: price monitoring***
>
> *This option would extend price monitoring to Phase 1 airports and Sydney airport for a* probationary period, *and maintain (modified) price monitoring of Adelaide, Canberra and Darwin airports. As in Option A, there would be no airport-specific price regulation of any other airports.*
>
> For Sydney, Melbourne, Brisbane, Perth, Adelaide, Canberra and Darwin airports, *there would be mandatory price monitoring by the ACCC. The monitoring regime would continue for five years:*
>
> - *During this probationary period the regulator would not have the power to alter unilaterally the monitoring regime or impose stricter price regulation.*
>
> ...
>
> - *Voluntary commercial agreements between airports and users (including non-airline users) would be encouraged by providing guidelines regarding coverage, consultation and dispute-settlement mechanisms. (The*

Commission sees no need to exempt from access regulation airports that enter into such agreements.)

- *An independent public review would be conducted towards the end of the five-year monitoring period to ascertain whether there should be any future price regulation of those airports. Other airports could be included in the review only where there is* prima facie *evidence of persistent misuse of market power.*

…

All airports *should be subject to the generic provisions of the Part IIIA National Access Regime."*

33 The Productivity Commission preferred price monitoring on the basis that it would encourage the airlines and airports to negotiate commercial agreements, whilst constraining inefficient outcomes. The Productivity Commission encouraged commercial agreements over regulation, but clearly designated the commercial environment in which such agreements would be successful.

34 Notably, the Productivity Commission considered that such commercial agreements should include dispute-settlement mechanisms, such as provision for independent arbitration.

35 The Productivity Commission recommended that price notification be replaced with mandatory price monitoring for a probationary period of five years, following which an independent public review should be conducted to ascertain the necessity or extent of any further regulation.

36 It further recommended that airports be subject to the generic provisions of Pt IIIA of the TPA. The Productivity Commission clearly stated that the general access and anti-competitive conduct provisions of the TPA would apply to all airports, noting that: "Under both options [dual-till price caps and price monitoring], the general access and anti-competitive conduct provisions of the Trade Practices Act would apply to all airports." It considered that Pt IIIA of the TPA operated as a constraint on inefficiency.

37 The Commonwealth Government supported these recommendations of the Productivity Commission in a joint press release issued by the Commonwealth Minister for Transport and Regional Services and the Treasurer on 13 May 2002. In particular, the Commonwealth Government supported in principle the recommendation that commercial agreements should be encouraged and assisted, but was not prepared to play a role in preparing guidelines for the

conduct of the negotiations or the content of particular agreements. The press release noted that:

> *"In the event that commercial agreement cannot be concluded in relation to access terms and conditions, the access provisions in Part IIIA of the TP Act provide recourse to arbitration for determining those conditions for 'declared' services. The Government is, however, prepared to assist airports and airport users* [to] *develop industry guidelines for commercial agreements should that be required."*

38 From 1 July 2002 the Commonwealth Government's policy moved towards what the joint press release referred to as "lighter-handed regulation", which saw a change from price notification to price monitoring, as recommended by the Productivity Commission. Under the new regime, aeronautical prices are monitored by the ACCC over a period of five years, towards the end of which time an independent review is to be conducted to ascertain the need for any future airport price regulation. The Commonwealth Government considered that this threat of possible re-regulation would "encourage negotiated pricing outcomes based on efficient costs and an adequate return on capital".

39 The Commonwealth Government has reserved its right to bring forward the review or conduct its own review in the event that airports impose unjustifiable price increases. The Commonwealth Government set out a number of principles which would form the basis of the independent five-year review, and any earlier or separate review conducted by it ("the Review Principles"). The Commonwealth Government stated in the joint press release that it "would only consider re-introducing price controls on an airport if it formed the view that the airport had operated in a manner inconsistent with the [review] principles." The Review Principles were then set out as follows:

> *"At airports without significant capacity constraints, efficient prices broadly should generate expected revenue that is not significantly above the long-run costs of efficiently providing aeronautical services (on a 'dual-till' basis). Prices should allow a return on (appropriately defined and valued) assets (including land) commensurate with the regulatory and commercial risks involved.*
>
> *Price discrimination and multi-part pricing that promotes efficient use of the airport is permitted. This may mean that some users pay a price above the long-run average costs of providing aeronautical services, whereas more price-sensitive users pay a price closer to marginal cost.*

> *At airports with significant capacity constraints, efficient peak/off-peak prices may generate revenues that exceed the production costs incurred by the airport. Such demand management pricing practices should be directed toward efficient use of airport infrastructure and, when not broadly revenue neutral, any additional funding that is generated should be applied to the creation of additional capacity or undertaking necessary infrastructure improvements.*
>
> *Quality of service outcomes should be consistent with user's* [sic] *reasonable expectations, and consultation mechanisms should be established with stakeholders to facilitate the two way provision of information on airport operations and requirements.*
>
> *It is expected that airlines and airports will primarily operate under commercial arrangements and in a commercial manner, and that airport operators and users will negotiate arrangements for access to airport services."*

40 Following the Commonwealth Government's acceptance of the recommendations contained in the Productivity Commission Inquiry Report, the declaration under s 21 of the Prices Surveillance Act which subjected SACL to a price notification regime was revoked.

41 As part of the change in policy, on 26 June 2002 the Parliamentary Secretary to the Treasurer directed the ACCC to undertake monitoring of prices, costs and profits related to the supply of aeronautical services and aeronautical-related services at a number of airports, including Sydney Airport, from 1 July 2002, and to report annually to the Parliamentary Secretary on such monitoring.

42 As noted above, the Productivity Commission recommended that all airports should be subject to the generic provisions of Pt IIIA of the TPA rather than an airport-specific access regime. This was supported by the Commonwealth Government, which considered that there was no need for the airport-specific access regime in s 192 of the Airports Act to continue. Accordingly, s 192 of the Airports Act was repealed by the *Civil Aviation Legislation Amendment Act* 2003 (Cth).

AIRLINES: NATURE AND HISTORY

43 The present proceeding involves a number of airlines which have adopted different business models. Of most significance is the distinction between the low-cost carrier ("LCC") business model and the full-service airline ("FSA") business model. The distinction between

these business models becomes relevant when we come to consider the impact of SACL's pricing policies upon the various airlines.

44 The FSA model has been the traditional business model of airlines. However, the LCC business model emerged in the 1980s and is now a well-established and highly competitive business model. As Qantas and Virgin Blue were the two principal domestic airlines using Sydney Airport at the time of the hearing, we have analysed their structure and activities as exemplary of the FSA and LCC business models.

45 For many years the domestic Australian market was primarily dominated by two FSAs, Qantas and Ansett Australia Limited ("Ansett"), operating significant networks on domestic routes in Australia, with Ansett and its subsidiaries servicing regional and major routes. However, in September 2001 Ansett went into voluntary administration. At the time of the hearing, the Australian domestic passenger market was being serviced predominantly by Virgin Blue, Qantas, Jetstar Airways Pty Ltd ("Jetstar") and Regional Express ("REX").

Virgin Blue and the LCC business model

46 Virgin Blue began operating in Australia on 31 August 2000 and now operates scheduled flights between a large number of Australian destinations. By 30 April 2004 Virgin Blue had 42 aircraft operating 40 domestic routes, with over 3,000 employees. Virgin Blue's main competitors in the Australian domestic passenger market are Qantas and Jetstar (although REX also operates aircraft on some of the same routes as Virgin Blue). As at February 2004, Virgin Blue's share of the domestic passenger market was approximately 32%.

47 Virgin Blue's business model is said to be based on offering affordable, convenient and service-minded travel, and reflects the LCC business model that has enjoyed success in Europe and the United States of America. Virgin Blue said that LCCs keep their costs low by adopting efficient business practices and cutting out what they perceive to be unnecessary extras, such as free airline meals. The savings are passed on to the consumer as a lower fare, which in turn stimulates demand and increases the number of people flying on the routes on which it operates.

48 Virgin Blue seeks to make low fares widely available to stimulate demand and, where demand is subsequently strong, to increase the frequency of services, rather than to increase

fare levels. This is seen as a key difference between the LCC and the FSA business models. Virgin Blue said that it has increased its capacity on many routes in response to high load factors (that is, the percentage of seats flown which are occupied), whereas traditionally an FSA may simply increase fares in response to high demand.

49 LCCs tend to target more price-sensitive passengers, such as leisure travellers, people visiting friends and relatives, and certain types of business travellers who are generally from small to medium-sized businesses. It was said that less service comes with lower cost. LCCs seek to attract those customers who are willing to forego certain features that might be enjoyed on a service run by an FSA in exchange for lower fares. Although LCCs do attract some of the traditional customers of an FSA, the LCC model is also intended to stimulate additional demand, that is, to attract customers who would otherwise not have flown if the low fare were not available.

50 Virgin Blue contended, and we accept, that a significant majority of its customers are particularly cost conscious and would prefer lower fares, with a less luxurious service, than to pay even a couple of dollars more for such services.

51 As a general rule, LCCs keep their costs low by:

- operating a single type of aircraft, thereby reducing training and fleet support costs;
- configuring the aircraft to maximise the number of seats;
- minimising in-flight amenities;
- not providing complimentary meals or lounges;
- adopting procedures that enhance the efficient turn-around of aircraft;
- operating on routes and flight schedules which maximise operating efficiency;
- operating out of simple, low-cost terminals;
- implementing flexible labour arrangements;
- adopting more efficient financial systems and keeping management small.

52 Virgin Blue has adopted many of these typical LCC features, although it has customised its product to the Australian market.

53 Virgin Blue has in place a complex yield management system which aims to maximise revenue per flight by maximising sales of airfares at the best achievable price. The basic objective is to sell each seat on a flight at the highest fare level possible, based on anticipated demand and competitors' pricing. Each airline seat is allocated a particular fare category or "bucket", and the yield management computer systems are employed to determine the number of seats which should be offered in each bucket and the price point which should be set for each bucket, based on historic demand.

54 Virgin Blue assesses the profitability of its services on a route-by-route basis. Each route is assessed for its commercial viability and, where a route is unprofitable, Virgin Blue indicated that it would consider reducing the frequency of flights or withdrawing from the route altogether. This was said to be in contrast to FSAs, which tend to operate as a network, and therefore tolerate less profitable routes where they feed into more profitable areas of the network.

55 Around the world, the major effects of entry by LCCs into markets previously serviced by one or more FSAs have been said to be: the reduction of average fares on routes serviced by the LCC; increased demand as more price-sensitive passengers consider air travel; growth in the LCCs' market share; and a decline in FSAs' market share which in turn may lead to FSAs instigating cost-reduction programs, and, occasionally, withdrawing from a route.

Qantas and the FSA business model

56 Qantas, by contrast, has traditionally employed the FSA model. Qantas is the largest user of Sydney Airport, and its main operations base is located there. Qantas is the eleventh largest airline worldwide on the basis of RPKs (that is, annual revenue passenger kilometres). Along with its subsidiaries, it operates a domestic and international fleet of approximately 190 aircraft. At the time of the hearing, Qantas provided 732 international services every week to 80 destinations in 37 countries. Qantas and its subsidiaries operated more than 4,581 domestic flights each week to 58 urban and regional destinations across Australia.

57 Qantas and its subsidiaries also provide related services to the Qantas fleet such as catering, engineering, maintenance, inventory, training and support services for aircraft and engines, and ground handling and passenger handling services.

58 FSAs generally have large-scale operations with wide networks and extensive fleets and facilities offering a variety of amenities to customers. They tend to offer a range of services, notwithstanding the extra cost, in order to attract certain consumer segments, particularly business customers. In contrast to LCCs, FSAs typically offer:

- a greater range of routes;
- a greater number of flights per route;
- a large fleet capacity;
- business and first class travel;
- in-flight catering at no additional charge;
- complimentary business lounges;
- larger space between seats;
- complimentary newspapers and in-flight entertainment;
- frequent flyer programs;
- vertical integration into travel agencies;
- alliance agreements with other airlines, and associated benefits such as baggage check-through;
- arrangements with other travel and accommodation organisations.

59 Qantas is a network carrier. As such, it tends to view its profits on a network-wide basis rather than on an individual sector basis. Even if some sectors are not profitable, Qantas may continue to operate them where it is profitable overall in its network. As a network carrier and an FSA, Qantas sees its strength as the provision of network breadth (that is, geographic reach) and depth (that is, frequency and capacity of service), providing interconnecting flights and amenities such as in-flight catering, in-flight entertainment, lounges, business class seats on most domestic flights, and a frequent flyer program. We were told that Qantas' business model is designed to be as attractive as possible to a wide cross-section of passengers.

60 FSAs tend to have higher average fares than LCCs, but they are able to compete with LCCs at certain price points. It was said that, traditionally, FSAs are likely to increase overall fare levels in response to strong demand.

61 Like Virgin Blue, Qantas now has in place a complex yield management system that aims to set fare buckets to attract different types of passengers.

Jetstar

62 Towards the end of 2003, Qantas established its own separately managed and independently operated domestic LCC, Jetstar. Jetstar is a point-to-point carrier. It commenced flights from Sydney Airport on 25 May 2004.

REX

63 REX is a regional airline which was launched on 1 August 2002. REX links regional centres with Sydney, Melbourne and Adelaide, and, at the time of the hearing, operated flights on the Sydney-Canberra route. REX emerged out of the collapse of Ansett when two of Ansett's subsidiaries, Kendell Airlines and Hazelton Airlines, were placed into administration and their assets bought to form REX. REX is Australia's largest independent regional airline. It flies to 29 destinations and operates in excess of 1,000 flights per week on 32 different routes in south-eastern Australia.

64 Sydney Airport is the core airport for REX's operations, as more than half of REX's passengers are processed through Sydney Airport, 15 of the routes operated by REX connect a regional centre (or Canberra) to Sydney, and approximately 60% of all travel on REX involves flights to or from Sydney Airport.

LEGISLATIVE FRAMEWORK: PT IIIA OF THE TPA

65 The background to the introduction of Pt IIIA into the TPA has previously been set out by the Full Federal Court in *Rail Access Corporation v New South Wales Minerals Council Ltd* (1998) 87 FCR 517 at 518-519 as follows:

> *"On 11 April 1995, the Commonwealth of Australia, the States of New South Wales, Victoria, Queensland, Western Australia, South Australia and Tasmania, the Australian Capital Territory and the Northern Territory entered into the 'Competition Principles Agreement' (the Agreement). By the Agreement, the Commonwealth, State and Territory Governments agreed to adopt certain principles of competition policy and to apply competition laws across the public sector. The Agreement stated the 'objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities'. This was to be achieved by the structural reform of public monopolies, so as to remove from the public monopoly any responsibility for industry regulation and to introduce competition to markets traditionally supplied by a public monopoly.*

> *Clause 6(1) of the Agreement provided that, subject to subcl (2), the Commonwealth would put forward legislation to establish a regime for third-party access to services provided by means of significant infrastructure facilities where:*
>
> *'(a) it would not be economically feasible to duplicate the facility;*
>
> *(b) access to the service is necessary in order to permit effective competition in a downstream or upstream market;*
>
> *(c) the facility is of national significance having regard to the size of the facility, its importance to constitutional trade or commerce or its importance to the national economy; and*
>
> *(d) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.'*
>
> *As a result of the Agreement, the Commonwealth enacted the* Competition Policy Reform Act…*"*

66 The access regime provided for in Pt IIIA involves two stages. The first stage is governed by Div 2 of Pt IIIA and requires declaration of a service. Upon declaration, the commercial relationship between the provider of the service and the access seeker continues and they have the opportunity to pursue commercial dialogue and negotiations with a view to reaching agreement on the terms and conditions of access. Where the parties are unable to reach agreement in relation to an aspect of access to the service, the second stage of the access regime is enlivened. The second stage is governed by Div 3 of Pt IIIA and enables an access seeker or a provider, in default of agreement, to have issues as to access determined by arbitration conducted by the ACCC.

67 Declaration of a service under Pt IIIA may therefore be characterised as "default regulation", in the sense that regulation, in the form of arbitration by the ACCC, is only engaged upon default of commercial agreement between the parties as to an aspect of access to the service.

68 Once the service is declared, it is declared in respect of the provider and all, or any, access seekers, and not merely between the parties to the application for declaration. Although one access seeker can initiate the procedure which may lead to the declaration of a service, if declaration is made it enures for the benefit of anyone who wishes to obtain access to the relevant service. Section 44I provides that the duration and effect of any declaration made is to be specified in the declaration, and continues in operation unless it is earlier revoked.

69 Division 3 of Pt IIIA of the TPA sets out the regime for arbitration of access disputes by the ACCC in relation to declared services. Arbitration is not an inevitable consequence of declaration of a service, but arbitration under Div 3 is only available upon the service being declared under Div 2. Declaration of a service opens it up to the possibility of regulation by arbitration. However, it does not follow inexorably that arbitration, and therefore regulation, will occur. The parties are still free to negotiate a commercial resolution of their outstanding access issues.

70 This proceeding concerns the first stage of the access regime, namely declaration of a service pursuant to Div 2 of Pt IIIA of the TPA.

THE ISSUES FOR DETERMINATION BY THE TRIBUNAL

71 The Tribunal's role on review is to reconsider the matter that was before the designated Minister, and for this purpose the Tribunal stands in the shoes of the designated Minister.

72 Section 44H(4) of the TPA provides that the designated Minister cannot declare a service unless the Minister is satisfied of the criteria set out in s 44H(4)(a) to (f). In order to declare the relevant service, the Tribunal must similarly be satisfied of each of the criteria listed in s 44H(4).

73 The parties' submissions to the Tribunal centred on the criteria set out in s 44H(4)(a) (hereafter referred to as "criterion (a)"), and s 44H(4)(f) (hereafter referred to as "criterion (f)"). Our focus is largely directed towards the issues arising out of criterion (a) and, to a lesser extent, criterion (f). However, it is also necessary to make findings in respect of the criteria set out in ss 44H(4)(b) to (e).

CRITERIA (b) TO (e)

74 In its final recommendation, the NCC was satisfied that the criteria set out in ss 44G(2)(b) to (e) were met. Virgin Blue submitted that the Tribunal could also be satisfied of these criteria, and SACL did not dispute that proposition.

75 Section 44H(4)(b) provides that the designated Minister (or the Tribunal on review) cannot declare a service unless the Minister (or Tribunal) is satisfied that "it would be uneconomical for anyone to develop another facility to provide the service."

76 In the earlier decision of *Sydney International Airport*, the Tribunal rejected the contention that the relevant facility, for the purposes of s 44H(4)(b), was less than, what was in effect, the total airport. We see no reason to revisit this issue. The fact that a different service is provided by the facility does not alter the basic proposition that it would be uneconomical for anyone to develop another facility, being the total airport, to provide that service. There has been no evidence put before us in relation to events and circumstances which occurred after the hearing of *Sydney International Airport* which causes us to change this view. Accordingly, we are satisfied that it would be uneconomical for anyone to develop another facility to provide the service that is the subject of this application and we are therefore satisfied of the matter set out in s 44H(4)(b).

77 Section 44H(4)(c) provides that the designated Minister (or the Tribunal on review) cannot declare a service unless the Minister (or Tribunal) is satisfied that "the facility is of national significance, having regard to:

(i) the size of the facility; or

(ii) the importance of the facility to constitutional trade or commerce; or

(iii) the importance of the facility to the national economy."

78 We are satisfied that the facility at Sydney Airport is of national significance having regard to its size, its importance to constitutional trade and commerce, and its importance to the national economy. As noted earlier, approximately 50% of all international passengers arriving in Australia pass through Sydney Airport, as do approximately 30% of all domestic passengers in Australia. It is thus a major international gateway for Australia's tourism industry, and also makes a substantial and significant contribution to trade in Australia. Accordingly, we are satisfied of the matter set out in s 44H(4)(c).

79 Section 44H(4)(d) provides that the designated Minister (or the Tribunal on review) cannot declare a service unless the Minister (or Tribunal) is satisfied that "access to the service can be provided without undue risk to human health or safety."

80 It was not in issue that access to the service that is the subject of this application can be provided without undue risk to human health or safety. In its final recommendation the NCC noted the submission of the representative body of the airlines, the Board of Airline Representatives Inc ("BARA"), that the conditions of use which apply at Sydney Airport

require airlines to comply with all legislation, SACL's Airport Operations Manual, SACL's airport security program, and other relevant directions and legislative provisions. The NCC concluded that access to the Airside Service could be provided without undue risk to human health or safety. We are satisfied, having regard to the evidence that was placed before us as to the manner in which air operations are carried out at Sydney Airport, that access to the service that is the subject of the present application can be provided without undue risk to human health or safety. Accordingly, we are satisfied of the matter set out in s 44H(4)(d).

81 Section 44H(4)(e) provides that the designated Minister (or the Tribunal on review) cannot declare a service unless the Minister (or Tribunal) is satisfied that "access to the service is not already the subject of an effective access regime."

82 As the Tribunal noted in *Sydney International Airport* at [217], 40,795:

> *"The expression 'effective access regime' … is a reference to a regime for access to a service or a proposed service established by a State or Territory that is a party to the Competition Principles Agreement which the Commonwealth Minister has decided is an effective access regime for the service or proposed services: ss 44M and 44N."*

It was not submitted that any such regime had been established and we know of no such regime. We are satisfied that access to the service is not already the subject of an effective access regime. Accordingly, we are satisfied of the matter set out in s 44H(4)(e).

83 As a result, the issues in the review are in substance confined to whether the Tribunal, standing in the shoes of the Minister, can be satisfied as to criterion (a) and criterion (f).

CRITERION (a)

84 Criterion (a) requires that the Tribunal be satisfied:

> *"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".*

85 It is therefore necessary to consider a number of preliminary issues of definition relating to the service the subject of the proposed declaration, the relevant markets, the meaning and scope of "access" and "increased access", and the substance of the term "promotion of competition", in the context of criterion (a).

WHAT IS THE "SERVICE" WHICH IS THE SUBJECT OF THE PROPOSED DECLARATION?

86 As noted earlier, when Virgin Blue applied to the NCC for a recommendation of declaration in the combined application, it did so in respect of the following:

> *"(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**)."*

87 Virgin Blue subsequently informed the NCC on 26 November 2002 that it had reached agreement with SACL on terminal access, and, in December 2002 Virgin Blue formally withdrew its application for declaration of the "Domestic Terminal Service".

88 Accordingly, it is only the first limb of Virgin Blue's definition of the service in respect of which declaration is sought which is relevant — the part of the service described as the "Airside Service".

89 Virgin Blue argued that its intention was to define the "Airside Service" broadly so as to encompass all the services that were required to turn aircraft around between flights. Virgin Blue submitted that the definition of "Airside Service" should be viewed in the context of the combined application, which was clearly intended to cover all services at Sydney Airport.

90 Virgin Blue submitted that, in that context, the "Airside Service" should be construed comprehensively to encompass the domestic operations that airlines were entitled to undertake under the standard form of the conditions of use which SACL employs to govern the use of its services and facilities by airlines at Sydney Airport, the 'Sydney Airport Conditions of Use', version 2.6, dated 1 October 2003 ("SACL's Standard COU").

91 Schedule 5 of SACL's Standard COU provides that the use of facilities and services referred to as the "Domestic operations at Terminal 2" attracts a number of charges, including a runway charge, an aircraft parking charge, a Terminal 2 passenger use charge and a Terminal 2 passenger screening charge. The facilities and services covered by SACL's Standard COU are set out in sch 9, subject to the proviso that a separate agreement between SACL and the relevant airline may provide otherwise.

92 Schedule 9 of SACL's Standard COU lists a range of facilities including airside grounds, runways, taxiways and aprons. It is in the following terms:

> *"**Facilities and Services***
>
> ***Aircraft movement facilities and services***
> - *Airside grounds, runways, taxiways and aprons*
> - *Airfield lighting, airside roads, airside lighting*
> - *Airside safety*
> - *Nose-in guidance*
> - *Aircraft parking*
> - *Visual navigation aids*
>
> ***Passenger processing facilities and services***
> - *Forward airline support areas services*
> - *Aerobridges, airside buses*
> - *Departure lounges and holding lounges (but excluding commercially important persons lounges)*
> - *Immigration and customs service areas*
> - *Public address systems, closed circuit surveillance systems and security systems*
> - *Baggage make-up, baggage handling and baggage reclaim*
> - *Public areas in terminals, public amenities, public lifts, escalators and moving walkways*
> - *Flight information display systems*
> - *Landside roads, landside lighting and covered walkways"*.

93 Virgin Blue submitted that SACL's Standard COU was in similar terms to the definition used in Direction No. 27, issued by the then Parliamentary Secretary to the Commonwealth Treasurer, Senator the Hon Ian Campbell, on 26 June 2002 pursuant to s 27A of the Prices Surveillance Act, which is the current price monitoring direction ("Price Monitoring Direction"). The Price Monitoring Direction directs the ACCC to undertake formal monitoring of the prices, costs and profits relating to the supply of aeronautical services and aeronautical-related services by a number of airports, including SACL.

94 "Aeronautical services" are defined in the Price Monitoring Direction as "aircraft movement facilities and activities" and "passenger processing facilities and activities". "Aircraft movement facilities and activities" are defined as:

> *"(i) airside grounds, runways, taxiways and aprons;*
> *(ii) airfield lighting, airside roads and airside lighting;*
> *(iii) airside safety;*
> *(iv) nose-in guidance;*
> *(v) aircraft parking;*
> *(vi) visual navigation aids;*
> *(vii) aircraft refuelling services."*

"Passenger processing facilities and activities" are defined as:

> *"(i) forward airline support area services;*
> *(ii) aerobridges and airside buses;*
> *(iii) departure lounges and holding lounges (but excluding commercially important persons lounges);*
> *(iv) immigration and customs service areas;*
> *(v) security systems and services (including closed circuit surveillance systems);*
> *(vi) baggage make-up, handling and reclaim;*
> *(vii) public areas in terminals, public amenities, public lifts, escalators and moving walkways;*
> *(viii) flight information display and public address systems."*

95 At the hearing, Virgin Blue sought to clarify its definition of the "Airside Service" by setting out the facilities and operations which it said were intended to fall within the term. Virgin Blue submitted that, although it was not open to the Tribunal to amend the application (as the Tribunal is bound to consider the matter that was before the designated Minister), it was permissible and appropriate that the Tribunal clarify any ambiguity in the definition of the service.

96 Virgin Blue's proposed clarification was set out as follows:

> *"The service the subject of the application is the use of airside facilities at Sydney Airport for the purpose of domestic air transport operations.*
>
> ***Airside facilities** means:*
>
> *(a) airside grounds, runways, taxiways and aprons;*
>
> *(b) airfield lighting, airside roadways and airside lighting;*
>
> *(c) visual navigation aids and nose-in docking guidance systems;*
>
> *(d) airside access gates and perimeter fencing;*

(e) airside water, air and power infrastructure;

(f) airside waste disposal facilities; and

(g) other facilities integral to the use of (a) to (f).

***Domestic air transport operations** means:*

(a) take off and landing of passenger aircraft travelling to and from other airports in Australia;

(b) movement of such aircraft;

(c) parking of such aircraft;

(d) loading and unloading passengers, baggage and goods on and from such aircraft;

(e) servicing of such aircraft including by way of maintenance, refuelling, catering, toilet and water services and cleaning;

(f) other operations necessary to enable (a) to (e).”

97 Virgin Blue submitted that its clarification was consistent with the definitions of “airside” and “landside” contained in s 71 of the Airports Act, in which “airside” is defined to mean “the part of the airport grounds, and the part of the airport buildings, to which the non-travelling public does not have free access.” It also submitted that its clarification was consistent with the definition of “aircraft movement facilities and activities” contained in the Price Monitoring Direction (see [94] above) and the background discussion contained in the Productivity Commission Inquiry Report.

98 Qantas supported Virgin Blue’s clarification and its submissions on the ambit of the “Airside Service”. In particular, with regard to the matters listed in (a) to (c) of the definition of “Airside Facilities” in the Virgin Blue clarification, Qantas submitted that those matters were considered part of “aircraft movement facilities and activities” under the Price Monitoring Direction and were consistent with SACL’s Standard COU. In support of paragraphs (d) to (g) of “Airside Facilities” in the Virgin Blue clarification, Qantas submitted that those matters are associated with the taking off and landing of aircraft and were not inconsistent with the definition of the “Airside Service” adopted by the NCC in its final recommendation. In support of the matters listed in (c) to (e) under “Domestic air transport operations” in the Virgin Blue clarification, Qantas submitted that such operations were implicitly part of the operations that are necessary to turn aircraft around upon completion of a flight and in order to prepare the aircraft for the next flight.

99 The NCC submitted that the Tribunal's power to amend is limited by the service considered by the relevant designated Minister. Where the purposes for the use of the facility are changed, the dependent markets may also change, and the Tribunal may not be considering declaration of the same subject matter.

100 The NCC submitted that some elements listed under "Airside Facilities" and "Domestic air transport operations" in Virgin Blue's clarification would fall outside the scope of the "Airside Service" as considered by the NCC and the designated Minister. In particular, Virgin Blue's clarification extended the purposes for which access was sought from the movement of aircraft to encompass loading and unloading passengers, baggage and goods from passenger aircraft, and servicing aircraft including maintenance, refuelling, catering, toilet and water services, and cleaning. The NCC submitted that Virgin Blue's clarification specified additional facilities to those contained in Virgin Blue's application to it, including airside access gates and perimeter fencing, airside water, air and power infrastructure, and airside water disposal facilities.

101 Before the NCC, Virgin Blue had submitted that the facilities included in the term "Airside Service" did not need to be specifically listed, but that if they did, they would at least include the following:

- The runways at Sydney Airport;
- The taxiways at Sydney Airport;
- The parking aprons at Sydney Airport;
- Airfield lighting;
- Airside roadways;
- Airside lighting; and
- Visual navigation aids.

The NCC did not expressly consider the additional purposes and facilities in its final recommendation.

102 SACL submitted that the way in which the "Airside Service" was defined by Virgin Blue meant that it was limited to those services provided by SACL to facilitate aircraft movement. SACL submitted that a narrow approach to the definition of "Airside Service" was required on the basis that the Tribunal is bound by the scope of the application before the designated

Minister and the NCC and by the terms of the application made to the Tribunal. As the Tribunal does not have power to amend the application, SACL contended that the only question for the Tribunal to determine was the meaning of "other associated facilities" found in the phrase "runways, taxiways, parking aprons and other associated facilities" used in Virgin Blue's application. SACL submitted that the "other associated facilities" must be those facilities relevant to the activities listed in the definition, namely takeoff and landing using the runway, and movement between runways and passenger terminals. Therefore, the other associated facilities would be airfield lighting, airside lighting, visual navigation aids and nose-in docking guidance systems only.

103 SACL submitted that "Airside Service" should not be interpreted to include the servicing of aircraft, loading or unloading aircraft, or anything that happens after arrival at the terminal or before departure from the terminal.

104 Qantas submitted that the inclusion of aprons in the definition of "Airside Service" demonstrated that the term is not strictly limited to movement of aircraft. As Qantas pointed out, aircraft do not take off and land on the aprons, rather, aprons support the servicing of aircraft between flights, including baggage handling, refuelling, catering access, and the loading and unloading of freight.

105 Qantas noted that the term "apron" is defined by SACL in a document recently proffered by SACL for consideration by Qantas to govern ground handling services at Sydney Airport, the 'Sydney Airport Conditions of Use for Ground Handling', version 2, August 2004 ("draft Ground Handling COU"). In the draft Ground Handling COU "apron" is defined to mean "any part of [Sydney] Airport which is used for the purpose of servicing an aircraft."

106 Qantas also relied upon SACL's Airport Operations Manual, which forms part of the conditions of use agreement currently governing Qantas and SACL's relationship. SACL's Operations Manual describes "aprons" as:

> *"A defined area on a land aerodrome intended to accommodate aircraft for the purposes of loading and unloading passengers, mail or cargo, fuelling, parking or maintenance.*
>
> *That part of an aerodrome to be used:*
>
> *(a) for the purpose of enabling passengers to board, or disembark from, aircraft;*

(b) for loading cargo on to, or unloading cargo from, aircraft; and/or

(c) for refuelling, parking or carrying out maintenance on aircraft."

107 Finally, Qantas relied upon the submission to the NCC put by BARA, that "Airside Service" included the servicing (that is, refuelling, catering and cleaning) of an aircraft within the airside precinct. Qantas noted that the NCC's final recommendation failed to make any express exclusion of servicing of aircraft as part of the definition it adopted of "Airside Service", even though the servicing of aircraft was clearly placed within that definition by BARA's submission.

108 The determination of the scope of the service the subject of the present application is of critical significance because the resolution of this issue dictates the extent to which SACL will be able to impose charges and terms and conditions in respect of services not included within the subject matter of this proceeding. This is of particular relevance as SACL has intimated that it intends to introduce new fees or charges for certain services, such as ground handling and fuel throughput, and to impose separate terms and conditions on the provision of such services in the future. Virgin Blue maintains that these services properly come within the bundle of services encompassed in the Airside Service for which it already pays a charge. If the Airside Service is declared, it is only the charges for, or the terms and conditions in relation to access to, the Airside Service which can be the subject of arbitration by the ACCC.

109 It is important to bear in mind that declaration pursuant to Pt IIIA is in respect of access to a service provided by a facility, as distinct from access to a facility. "Service" is defined in s 44B as follows:

"service *means a service provided by means of a facility and includes:*

(a) the use of an infrastructure facility such as a road or railway line;

(b) handling or transporting things such as goods or people;

(c) a communications service or similar service;

but does not include:

(d) the supply of goods; or

(e) the use of intellectual property; or

(f) the use of a production process;

except to the extent that it is an integral but subsidiary part of the service."

110 This distinction between a service and a facility was explained in *Rail Access Corporation v New South Wales Minerals Council Ltd* (supra), where the Full Federal Court observed at 524:

> *"The definition of 'service' in s 44B of the Act makes clear that a service is something separate and distinct from a facility. It may, however, consist merely of the* use *of a facility. The definition of 'service' distinguishes between the* use *of an infrastructure facility, such as a road or railway line, and the* handling *or transporting of things, such as goods or people, by the use of a road or railway line. The fact that one service provider, such as Freight Rail Corporation, is using the railway line infrastructure facility made available to it by Rail Access Corporation for the purposes of carrying coal by rail does not mean Rail Access Corporation is carrying on, or is the provider of, a service of carrying coal by rail."*

111 As the NCC correctly observed, the Tribunal's role is to determine whether the additional purposes and facilities that Virgin Blue identified as properly being included in the definition of "Airside Service" fall within the scope of the term, in light of the fact that the Tribunal is limited to a consideration of the service that was the subject of consideration by the designated Minister, which decision was in turn based upon the NCC's final recommendation.

112 The service that is the subject of the present application is the "particular service" which is the subject of the written application to the NCC in accordance with s 44F(1) of the TPA. It is not for the NCC in its recommendation pursuant to s 44G, nor the designated Minister or Tribunal pursuant to the obligations imposed by s 44H, to redefine, expand, contract or otherwise interfere with the description of the "particular service" which is the subject of the written application to the NCC. However, it is for the NCC, the designated Minister, and the Tribunal on review, to interpret the definition or scope of the "particular service" which is the subject of the written application to the NCC.

113 The Tribunal's general discretion to regulate and control proceedings before it pursuant to s 103 of the TPA was discussed in *Freight Victoria Limited* (2002) ATPR ¶41-884. However, the general discretion found in s 103 would only permit amendments that do not amount to a material alteration, or a change in substance, of the subject matter before the Tribunal. The question for the Tribunal is whether Virgin Blue's clarification changes the breadth or the scope of the description of the service so as to alter it materially from the service considered by the designated Minister.

114 In our view, the clarification proffered by Virgin Blue comes dangerously close to amending substantially the subject matter of the service sought to be declared. Some of the items in the clarification clearly fall within the scope of the subject matter of the service sought to be declared in Virgin Blue's application to the NCC. Others are more problematic, such as the insertion of the phrase "for the purpose of domestic air transport operations" which is used to open a number of gateways. Accordingly, we do not adopt Virgin Blue's clarification in the terms propounded. Instead, we have focused only on the definition provided in Virgin Blue's application.

115 The expressions "Airside Service" and "Airside Facilities" are terms used by Virgin Blue in its application as a composite definition of the expressions and terms which precede them. These are expressions which are commonly used in the aviation industry and accordingly their use in the application must be construed having regard to that common usage. Usage may change the content of definitions over time. Our task is to examine the usage of the expressions at the time of Virgin Blue's application.

116 In its final recommendation, the NCC referred to the following submissions made to it by BARA:

> *"BARA submitted that the term 'airside service' is an ambiguously defined term in the airline industry but that the term 'airside' has a generally accepted and understood meaning … The International Civil Aviation Organisation (ICAO) defines 'airside' as: 'the movement area of an aerodrome, adjacent terrain and buildings or portions thereof, access to which is controlled.' Given the ICAO definition,* ***BARA considers it reasonable to conclude that Airside Service refers to the activities associated with the access, movement and servicing (refuelling, catering and cleaning) of an aircraft within the airside precinct."*** (emphasis added)

117 The NCC also referred to the definition which the ACCC had given to "airside facilities" in its "Draft Guide to Section 192 of the Airports Act - Declaration of Airport Services" (October, 1998), which included:

> *"aircraft movement areas such as runways, taxiways and aprons, aircraft parking areas, safety devices and guidance systems, airfield and airside lighting, airside grounds associated with the use of these facilities and vehicular access to these facilities."*

118 Also of relevance is the definition of "airside facilities" adopted in the Productivity Commission Inquiry Report which included "runways, taxiways and aprons, as well as airfield lighting, aircraft parking bays, visual navigation aids, hangars, freight terminals and facilities for aircraft maintenance and refuelling, and in-flight catering".

119 In its final recommendation, the NCC accepted Virgin Blue's definition of "Airside Service", which it said was broadly consistent with definitions given by the ACCC and the Productivity Commission and with submissions received from interested parties.

120 It is clear from Virgin Blue's combined application (set out above at [86]), that there was an intention to cover the entire field of aeronautical services, comprising both airside services and landside services. The excision of the "Domestic Terminal Service" was not intended to exclude anything more than activities occurring inside the terminal.

121 We have formed the view that the use of the service the subject of Virgin Blue's application encompasses those activities which commence, in relation to the departure of an aircraft, with the loading of aircraft parked at a departure gate or point of embarkation with baggage, freight and all products required on the flight, and the entrance of passengers into the aircraft. It terminates when the aircraft is airborne. That use of the service also encompasses those activities which commence, in relation to an arriving aircraft, at a point when the aircraft lands, taxis to an arrival gate or point of disembarkation, and the passengers leave the aircraft, their baggage and freight is unloaded, and supplies, waste and other items used during the flight are removed from the aircraft. In short, the "Airside Service" covers all movement in relation to aircraft between runways and passenger arrival and departure gates and the servicing, maintenance, equipping and re-equipping of aircraft at the start and end of a flight. We define the term "Airside Service" accordingly.

122 We have formed this view for a number of reasons. The wording of Virgin Blue's application suggests that the Airside Service covers those aspects of access to SACL's facility that relate to the preparation and loading of aircraft for departure, the takeoff and landing of aircraft, and the process of the turning around of aircraft in between flights. This indicates that access to the aprons for the purposes of refuelling, catering, loading and unloading of passengers and baggage forms part of the Airside Service. So much was put to the NCC by BARA and was therefore considered by the NCC when making its final

recommendation, in which it adopted Virgin Blue's definition of "Airside Service". Further, the definition of "Airside Service" given by Virgin Blue in its application specifically refers to "aprons" and the purpose for which aprons are used clearly goes well beyond movement of aircraft. We therefore consider that everything that happens on aprons forms part of the Airside Service for the purpose of defining the scope of Virgin Blue's application.

123 This interpretation is supported by the broad meaning that "airside" is given in the aviation industry and, from a practical perspective, is preferable to a narrow definition which would limit the nature of the service which Virgin Blue intended to put before the NCC (and in turn the designated Minister), and which the NCC and the designated Minister in fact appeared to consider. In addition, a narrow interpretation would frustrate the intention of the applicant for review, would lead to commercial uncertainty, and would be likely to encourage further costly and time-consuming proceedings. In these circumstances, such a broad definition of Airside Service, which accords with Virgin Blue's intention, is supported by the common industry understanding, and which reflects the scope of the service considered by the NCC and the designated Minister, is to be preferred.

WHAT IS THE "MARKET FOR THE SERVICE" AND THE "MARKET OTHER THAN THE MARKET FOR THE SERVICE"?

124 Market definition was not a major issue in the proceeding. It was agreed by the parties that the "market for the service" in criterion (a) is the market for aeronautical services in Sydney. The parties differed somewhat as to the definition of the "market other than the market for the service" (more commonly described as the "dependent" market.)

125 Virgin Blue submitted that the dependent market is the market for domestic air passenger and freight services to and from Sydney, or alternatively, the market in which domestic air passenger services are supplied to and from Sydney. Qantas contended that the dependent market is the market for domestic air passenger services to and from Sydney. SACL contended that the dependent market is the market for domestic air passenger services only, but extending throughout Australia. SACL relied upon the expert opinion of Mr Gregory Houston, director of the United States of America firm National Economic Research Associates Inc, and Managing Director of its Australian operating entity. Mr Houston contended that the dependent market should be defined as the Australia-wide market for domestic (both interstate and intrastate) air passenger services. He submitted that the

network nature of the aviation industry, and the fact that airlines can flexibly redeploy aircraft from one route to another within the Australian domestic market, supported such a definition.

126 The differences in the definitions put forward by the parties are therefore to be found in the product dimension and geographic dimension of the market.

127 If all the relevant domestic airlines using Sydney Airport operated a national network with Sydney Airport as their hub, we would be inclined to the view that the relevant dependent market for the purposes of our analysis is the Australian national market for domestic air passenger travel. However, since the demise of Ansett and the commencement of operations by Virgin Blue, the LCC model has intruded into the equation. In particular, Virgin Blue and, more recently, Jetstar, do not use Sydney Airport as a hub for their domestic operations. These airlines, being LCCs, tend to focus upon individual sectors rather than operating on a network basis. This supports a market definition involving routes to and from Sydney. Similarly, new entrants may have fewer opportunities to redeploy aircraft than incumbent airlines, undermining the premise of the market definition put forward by Mr Houston.

128 It therefore seems to us that, properly understood, the relevant dependent market should relate to the carriage of domestic air passengers into and out of Sydney.

129 Although most passenger aircraft also carry varying quantities of freight, we note that there are also in operation throughout Australia dedicated freight carriers about which we heard little evidence. We are therefore inclined to exclude the use of freight from the definition of the relevant dependent market. Whether the market be the market for the carriage of passengers and freight into and out of Sydney, or the carriage of passengers alone into and out of Sydney, the conclusion reached by us would not change.

WHAT IS THE MEANING AND SCOPE OF THE EXPRESSIONS "ACCESS" AND "INCREASED ACCESS"?

130 The expressions "access" and "increased access" are not defined in Pt IIIA of the TPA. Virgin Blue's primary submission was that criterion (a) required determination of whether a right or ability (or an increased, or greater, or enhanced right or ability) to use the service, as opposed to no right or ability (or only a limited or restricted right or ability) to use the service, would promote competition in the dependent market. In the alternative, Virgin Blue

submitted that access (or increased access) was to be equated with declaration, which required asking whether competition in the dependent market would be promoted by declaration, as opposed to the position where there was no declaration. This latter submission was the principal submission of the NCC and Qantas.

131 The NCC and Qantas sought to equate the terms "access" and "increased access" in criterion (a) with regulated access in the form of declaration under Pt IIIA of the TPA. Such an approach was said to reflect earlier Tribunal decisions interpreting the terms, in particular, the Tribunal decision in *Sydney International Airport* at [106], 40,775. The NCC submitted that increased access included accommodation of terms and conditions of access, including access on more favourable terms.

132 SACL rejected this approach, submitting that the actual consequences of declaration would need to be identified and assessed to see whether access or increased access in terms of more competitive use of the facility would in fact be achieved. In its view, the fact of declaration itself was not enough to constitute access or increased access. SACL agreed that an aspect of "access" would include the terms and conditions or the price upon which access was granted, but only where it could first be shown that such terms would have an effect upon the level of access, that is upon the right or opportunity to use the service.

133 SACL contended that, in any event, Virgin Blue's application did not pertain to a question of access at all, as it was clear that Virgin Blue had access to Sydney Airport, and the substance of Virgin Blue's contentions was not that it did not have access to Sydney Airport, nor that it had insufficient access. SACL submitted that criterion (a) was thus not engaged. In SACL's view, Virgin Blue's application was in reality merely a pre-emptive attempt to stop SACL from imposing increases in its charges for the Airside Service, and an attempt to change the mode of pricing imposed by SACL to a model that benefited Virgin Blue over Qantas. SACL submitted that pricing disputes were not properly brought within the access regime under Pt IIIA unless either existing pricing was affecting access, or future pricing was likely to increase and so would affect access to the service. It submitted that neither of these circumstances arose in the present case.

134 There was an element of ambiguity in SACL's submissions as to the meaning and content of "increased access". SACL accepted that if "access" to a service meant the "right or

opportunity to use the facility", then "increased access" to such a service would mean "either or both a change in, or extension of, such rights or opportunities that may exist in relation to the level of use of the facility which would increase the level of use of that facility". It followed, submitted SACL, that "increased access" required a "consideration of the means by which different sets of rights or opportunities can lead to different levels of use of the facility". SACL further accepted that the notion of a "right" refers to "terms and conditions on which an access seeker can use a facility owned by another", which terms and conditions can influence the extent to which a facility may be used in a direct and indirect way.

135 SACL then submitted that "the type and extent of access or increased access that the Tribunal must hypothesise is the access or increased access that is likely to exist if the relevant service were to be declared". This involved some assessment about the likely nature and extent of access that would be provided under Div 3 of Pt IIIA. Although SACL accepted that the Tribunal was not required to "second guess" the precise terms of access that the ACCC might determine upon an arbitration commenced under s 44S of the TPA, it submitted that in some circumstances it would be appropriate for the Tribunal "to anticipate how the ACCC might determine an arbitration over access". It contended that where the issue is whether "increased access" to a service would promote competition, it was "inevitable" that the Tribunal would have to "make a more detailed assessment of the nature and extent of the access" that would exist if the service was declared. Without such an assessment, SACL said it would be impossible for the Tribunal to assess rationally whether declaration would result in increased access.

136 We part company with SACL at the point at which it contends that it may be appropriate for the Tribunal to anticipate how the ACCC might determine an arbitration over access. It forms no part of our inquiry to assess whether increased access would result in any particular outcome in an ACCC-arbitrated dispute over terms and conditions of use of Sydney Airport. We should not opine as to, speculate, or second-guess the methodology that the ACCC might adopt in relation to the setting of the price or other terms and conditions of infrastructure services.

137 As noted above, the TPA does not define access or increased access. Looking to the common meaning of the term "access", the *Concise Oxford Dictionary* (8th ed., 1990) defines access as, *inter alia,* "the right or opportunity to reach or use or visit". The *New Oxford Dictionary*

of English (2001) defines access, *inter alia*, as "the means or opportunity to approach or enter a place". The *Macquarie Dictionary* (3rd ed., 1998) defines access as meaning, *inter alia*, "way, means or opportunity of approach". It was generally agreed between the parties that the ordinary meaning of the terms meant that where "access" is used in criterion (a), it is a noun meaning a right or ability or opportunity to make use of the service, and that "increased access" is therefore an enhanced right, ability or opportunity to make use of the service.

138 In the present circumstances, Virgin Blue already has use of the facility of Sydney Airport. However, access is a concept that is broader than physical access, and includes the terms and conditions on which such physical access is available.

139 In our view, the notions of access and increased access include the terms and conditions upon which such access or increased access is made available at the facility. This is consistent with the view taken by the Tribunal in *Re Duke Eastern Gas Pipeline Pty Ltd* (2001) 162 FLR 1 where the Tribunal considered the meaning of "access (or increased access) to Services" for the purposes of s 1.9(a) of the *National Third Party Access Code for Natural Gas Pipeline Systems.* There, the Tribunal rejected the applicants' argument that the statutory criterion regarding access or increased access was not enlivened unless access to the service was either unavailable or limited in some way. The Tribunal stated at 16:

> *"criterion (a) does not have as its focus a factual question as to whether access to the pipeline services is available or restricted. Put in that way, the question would not take sufficient account of the terms on which access is offered. Rather, the question posed by criterion (a) is whether the creation of the right of access for which the Code provides would promote competition in another market."*

140 Such an interpretation is also supported by the legislation. Div 3 of Pt IIIA of the TPA explicitly recognises that access disputes in that Division cover aspects of access to a declared service: s 44S. Further, s 44V(2)(c) allows the ACCC in its determination of an arbitration of an access dispute to specify the terms and conditions of a third party's access to a service. Although Divs 2 and 3 of the TPA operate independently, their operation should be complementary as they relate to the same subject matter and it is therefore desirable that the construction of terms that are common to both Divisions be consistent.

141 The definition in s 44B of the TPA of a "third party", in relation to a service, as being "a person who wants access to the service or wants *a change to some aspect of the person's existing access to the service*" (emphasis added) also supports this interpretation.

142 This interpretation is further supported by the fact that it gives a meaning to criterion (a) that reflects its origin, namely cl 6(1)(b) of the Competition Principles Agreement, dated 11 April 1995, which provides:

> *"Subject to subclause (2), the Commonwealth will put forward legislation to establish a regime for third party access to services provided by means of significant infrastructure facilities where:*
> …
> *(b) access to the service is necessary in order to permit effective competition in a downstream or upstream market."*

143 In this proceeding, Virgin Blue is essentially seeking different terms and conditions for the use of the Airside Service; those terms and conditions being the opportunity for arbitration in default of commercial agreement between access seekers and the provider of the service in relation to matters and issues which affect Virgin Blue's ability to engage in competitive conduct in the dependent market. Accordingly, this is a case of increased access, where Virgin Blue is seeking an enhanced right, ability or opportunity to make use of the Airside Service at Sydney Airport in the sense that it is seeking different terms and conditions upon which the use of that Service is made available to it which involve the opportunity for arbitration in default of agreement.

144 Increased access will occur if declaration is made because the terms and conditions of access will change and the right of access will be enhanced. In the present circumstances this will occur because, whereas prior to declaration a decision to impose a charge by SACL or impose a term and condition as a prerequisite to gaining or continuing use of the Airside Service could not be challenged or appealed in any way, subsequent to declaration such charge or term or condition could be challenged, made the subject of negotiation and, if it could not be negotiated to a mutually acceptable resolution, could be referred to arbitration by the ACCC.

"PROMOTION OF COMPETITION" IN A DEPENDENT MARKET

145 Competition, in the context of the TPA, is generally defined as a process, rather than a state of affairs, and is now understood to refer to the nature and extent of rivalry in a given market. In *Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd* (1976) 8 ALR 481, the Trade Practices Tribunal held at 515:

> *"Competition expresses itself as rivalrous market behaviour… In our view effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers."*

146 In *Sydney International Airport* the Tribunal considered the meaning of "promoting competition" at [106]-[107], 40,775, as follows:

> *"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.*
>
> *We have reached this conclusion having had regard, in particular, to the two stage process of the Pt IIIA access regime. The purpose of an access declaration is to unlock a bottleneck so that competition can be promoted in a market other than the market for the service. The emphasis is on 'access', which leads us to the view that s 44H(4)(a) is concerned with the fostering of competition, that is to say it 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 Tribunal considers that the 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.*

147 In *Re Duke Eastern Gas Pipeline Pty Ltd* (supra) at 17, the Tribunal endorsed the approach taken in *Sydney International Airport* as set out above, stating:

> *"The Tribunal* [in *Sydney International Airport*] *concluded that the* Trade Practices Act *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."

148 In order to determine whether access or increased access "would promote competition" in a dependent market, it is necessary to undertake an analysis of the future with declaration (which is referred to as the "factual") as against the future without declaration (which is referred to as the "counterfactual"). As the Tribunal in *Sydney International Airport* observed at [108], 40,775, a comparison of the factual and the counterfactual requires a forward-looking analysis which involves a comparison of the competitive conditions and environment likely to arise in the future with and without declaration.

149 The characterisation of the factual and counterfactual scenarios put forward by Virgin Blue in its primary submission was that the Tribunal is required to compare 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 to use the service. We do not agree. In our view, the counterfactual should be understood by reference to the current conditions of access projected into the future. Virgin Blue currently has use of Sydney Airport, and to undertake a counterfactual analysis which discounts this fact would be wholly unrealistic.

150 SACL's submissions tended to infer that an assessment of the factual required the Tribunal to surmise the possible outcomes of any arbitration under Div 3 of Pt IIIA. We reject the proposition that predictions of the outcomes of arbitration by the ACCC are any part of the Tribunal's task in assessing whether criterion (a) is made out. This much was made clear by the Tribunal in *Sydney International Airport* at [187], 40,790-40,791. We note that, in any event, it would be exceedingly difficult for the Tribunal to engage in such a practice, requiring as it does a hypothesis not only as to what determination the ACCC would reach, but also as to the identity of the parties to any potential arbitration. As s 44U makes clear, the parties to the arbitration of an access dispute are the provider, the third party access seeker and "any other person … having a sufficient interest".

151 SACL also submitted that, in looking to the future with or without declaration, the relevant question is whether SACL will engage in anti-competitive conduct. This formulation puts the test too highly. Rather, one should ask whether past or present conduct of the service

provider informs us as to the likely future conduct of the service provider and the effect on competition in the dependent market of such conduct. If such conduct has, or is likely to have, an adverse effect on competition, then one looks at declaration and asks whether that will enhance competition in the dependent market by creating opportunities and an environment in which the impact of such conduct and its effect on competition may be lessened or diminished.

152 When one considers the counterfactual, the current scenario may be used as a benchmark, taking into account past and current events and circumstances and extrapolating them into the future. A consideration of the factual involves an assessment of whether increased access on different terms and conditions would enhance the environment for competition in the dependent market and create or open up more opportunities for competitive conduct in the dependent market.

153 Put another way, the task of the Tribunal is to compare:

- the opportunities and environment for competition in the dependent market if the Airside Service is declared; with
- the opportunities and environment for competition in the dependent market if the Airside Service is not declared.

154 This comparison is assisted by any evidence of monopolistic behaviour, or of a capacity and willingness on the part of the monopolist to engage in conduct which significantly disrupts or affects competition in the dependent market.

155 The promotion of competition in the dependent market does not require a demonstration that there will be more efficient outcomes in the dependent market. Greater efficiency may follow declaration, but the critical issue is whether there will be an enhancement of the competitive environment and greater competitive opportunities in the dependent market.

156 Whether competition will be promoted depends upon the extent to which a service provider has the ability, in the absence of declaration, to use market power to affect adversely competition in the dependent market. If a service provider has market power and the ability to use it in a way that adversely affects competition in a dependent market, and if the service

provider has a history of so acting, declaration involving increased access to the service (in the sense of access on different terms and conditions with the ability to negotiate and, if necessary, have independent arbitration of those terms and conditions), would be likely to improve the environment for competition in the dependent market.

157 Thus, the relevant comparison is the future with declaration (involving an assessment of what impact the opportunity for arbitration will have, such that future commercial negotiations would be conducted in the context whereby arbitration would be available to the parties as a circuit-breaker in the absence of reaching an agreement), and the future without declaration (this being understood by reference to the current conditions of access and the current and past behaviour of the service provider projected into the future).

158 It was common ground between the parties that the promotion of competition involves promoting the conditions or opportunity or environment for rivalry to occur, to a non-trivial or tangible extent. So much is clear from the authorities in *Sydney International Airport* and *Re Duke Eastern Gas Pipeline Pty Ltd* (supra). However, the parties differed in the degree of probability or certainty which those terms connote.

159 According to Virgin Blue, "non-trivial" connotes the same degree of change as the word "substantial", which appears elsewhere in the TPA. Virgin Blue submitted that the effect need not be large or weighty, but should be meaningful to the competitive process.

160 Virgin Blue also submitted that the requirement that access or increased access "would" promote competition meant "realistically could" and was not to be interpreted as "will" promote competition. Virgin Blue contended that the degree of certainty required by the phrase "would promote competition" is that there is a significant finite probability, rather than that such a consequence be "more probable than not".

161 SACL, on the other hand, submitted that when considering the future opportunities and environment for competition, the Tribunal should not engage in hypothesising what "might realistically" or "could or might be expected" to occur. It submitted that the use of the word "would", rather than "may" or "would be likely", was significant.

162 In our view, we need to be satisfied that if the Airside Service is declared there would be a significant, finite probability that an enhanced environment for competition and greater opportunities for competitive behaviour – in a non-trivial sense – would arise in the dependent market.

APPLICATION OF CRITERION (a) TO THE PRESENT PROCEEDING

163 In order to analyse the future with and without declaration of the Airside Service, we must consider the extent to which SACL has the ability, in the absence of declaration, to use its market power to affect adversely competition in the market for the carriage of domestic air passengers into and out of Sydney. If SACL has market power and the ability to use it in a way that adversely affects competition in this market, and if SACL has a history of so exercising its market power, we then have to consider whether declaration of the service would be likely to improve the opportunities and environment for competition in the relevant dependent market.

164 The existence of SACL's monopoly power was not controversial and, indeed, was accepted by all the economic experts called by the parties. This leads to a consideration of whether SACL has misused its monopoly power. In these reasons, when we refer to a misuse of monopoly power, we are referring to an exercise of power in a manner which would not occur in a competitive environment. Secondly, it must be considered whether there are any effective constraints on the manner in which SACL can exercise its monopoly power. This inquiry raises for consideration the countervailing power of the airlines, the threat of re-regulation by the Commonwealth Government, and the importance of non-aeronautical revenue to SACL. Finally, we must consider what impact SACL's use of its monopoly power has on the competitive conditions existing in the dependent market.

165 At all times in this analysis we are seeking to determine what the environment for competition in the dependent market would be if the Airside Service was not declared, compared with the likely situation if the Airside Service was declared. When considering the situation without declaration, it is necessary to take into account what has happened in the past and what is happening in the present with a view to determining what is likely to happen in the future without declaration. In this sense we are informed by SACL's conduct in the past and the present. If SACL has misused its monopoly power and has engaged in monopoly

pricing in the past or is continuing to do so in the present, that is a harbinger of what is likely to happen in the future.

SACL'S USE OF ITS MONOPOLY POWER

166 Virgin Blue and Qantas submitted, in general terms, that three areas demonstrated a misuse of monopoly power by SACL, these being:

(1) SACL's revenue, pricing policies and charges for the Airside Service;
(2) SACL's non-price terms and conditions of access to Sydney Airport;
(3) A number of specific incidents involving SACL and various airlines which use the facilities provided at Sydney Airport.

SACL'S REVENUE AND PRICING POLICIES

167 A number of charges presently relate to the Airside Service. These charges include:

- the Domestic Passenger Services Charge ("Domestic PSC") payable by domestic airlines in respect of each arriving and departing passenger;
- a portion of the Terminal 2 Passenger Facilitation Charge ("PFC");
- the regional aircraft runway charge payable by regional airlines;
- the freight and general aviation runway charge payable by operators of freight and general aviation aircraft;
- an apron charge for general aviation aircraft;
- security charges.

168 Of relevance to the present proceeding is the Domestic PSC, and, to a lesser extent, the PFC.

169 In December 1999 SACL began detailed discussions with its aviation customers regarding the development of a proposal to increase substantially its aeronautical charges. At the time, aeronautical charges were based on the maximum take-off weight of the aircraft ("MTOW").

170 In February 2000 a group of 27 airlines, including Qantas, commenced proceedings against SACL in the Federal Court of Australia alleging, *inter alia,* that SACL was not entitled to increase its aeronautical charges in order to recover amounts that SACL had spent on airport upgrades in preparation for the Olympic Games in Sydney, and that SACL was liable to pay

compensation for various disruptions to airline services caused by the upgrades. According to Mr Steven Fitzgerald, General Manager, Airport Operations at SACL, Qantas appeared to be the primary driver of these proceedings. In February 2001 SACL filed a cross-claim in the Federal Court proceedings, seeking orders, *inter alia*, that Qantas was bound by certain conditions of use at Sydney Airport.

171 As we have noted earlier (see [30] above), in October 2000 SACL submitted a 'Revised Draft Aeronautical Pricing Proposal' to the ACCC seeking to increase certain aeronautical charges at Sydney Airport by an average of around 130%. In May 2001 the ACCC published its decision in relation to SACL's proposal. The ACCC rejected SACL's proposed increase of approximately 130%, but approved an average increase in aeronautical charges of approximately 97%.

172 In its decision, the ACCC set out a basis for SACL's allowable aeronautical revenue up until May 2006. The charges were "smoothed" to establish constant nominal prices over the period which were expected to generate revenue of $183.5 million in 2000/2001 which was to increase to $215 million in 2004/2005. The ACCC also expressed support for a "building block methodology" to be used in assessing SACL's maximum allowable revenue.

173 From April to July 2001, there were intensive negotiations between SACL and the various airlines in relation to settlement of the Federal Court proceedings, during which time SACL and Qantas discussed replacing various airport charges with a single passenger-based charge. On 1 August 2001 SACL and Qantas executed a Deed of Settlement and Mutual Release in settlement of the Federal Court proceedings ("the Deed of Settlement"). As part of the settlement, SACL agreed to prepare a Passenger Services Charge Notification to the ACCC to replace the various airport charges with a single passenger-based charge. In the Deed of Settlement, SACL and Qantas agreed, *inter alia,* to the following:

> *"**1. Passenger Services Charge***
>
> *(a) SACL agrees to submit its Passenger Services Charge Notification to the ACCC on the Lodgement Date.*
>
> *(b) If the ACCC notifies SACL in writing that it needs more time to make its decision in relation to the Passenger Services Charge Notification, the parties may agree to extend the ACCC Decision Date to another date.*

(c) *SACL will not revoke or amend its Passenger Services Charge Notification without the prior written consent of Qantas.*

(d) *SACL agrees to give due and proper consideration to any proposed amendments to the Passenger Services Charge Notification proposed by the ACCC and, with the agreement of Qantas, may (but is not obliged to) amend the Passenger Services Charge Notification.*

(e) *SACL acknowledges that the ACCC should be encouraged and assisted to reach a decision that it does not object to the Passenger Services Charge Notification. SACL and Qantas will each use its best endeavours to cooperate with each other and the ACCC in responding to any questions or requests from the ACCC and/or any consultants appointed by the ACCC concerning the Passenger Services Charge Notification.*

(f) *In order for SACL to discharge its 'best endeavours' obligation in clause 1(e), SACL agrees to:*

i. *ensure all statements (whether oral or in writing and whether public or privately to the ACCC and/or its consultants) about the Passenger Services Charge Notification and passenger service charges generally contain expressions of support for and/or descriptions of the benefits of the Passenger Services Charge Notification and passenger service charges generally;*

ii. *ensure correspondence to and discussions with the ACCC and the Government and/or any consultants appointed by the ACCC which relate to the merits of the Passenger Services Charge Notification and passenger service charges generally contain expressions of support for and/or descriptions of the benefits of the Passenger Services Charge Notification* [and] *passenger service charges generally;*

iii. *provide to the ACCC all documentation, records and information necessary for the ACCC to reach a decision in relation to the Passenger Services Charge Notification in a timely manner;*

iv. *ensure that the Government is provided with information necessary for it to understand the rationale for the passenger service charge;*

v. *arrange to meet jointly with Qantas and the ACCC and/or any consultants appointed by the ACCC when required;*

vi. *provide Qantas with a copy of any correspondence received by SACL from the ACCC and/or consultants appointed by the ACCC in relation to the Passenger Services Charge Notification within one business day of the receipt of such correspondence unless prohibited by and then only to the extent of any express confidentiality obligation to the ACCC or a third party;*

> *vii. consult with Qantas prior to responding (whether verbally or in writing) to any correspondence provided under clause 1(f)(vi) other than responses seeking clarification of any request; and*
>
> *viii. consult with Qantas in relation to any submissions made by SACL to any public forum or inquiry arising from the Passenger Services Charge Notification.*
>
> *(g) The provisions of clauses 1(e) and (f) will have no force or effect after the ACCC decision process in relation to the Passenger Services Charge Notification is completed.*
>
> *(h) Subject to this clause, SACL will maintain a passenger services charge ('PSC') as the primary basis for charging for aeronautical charges such as landing…"*

174 On 3 August 2001 SACL sought the ACCC's approval under s 22(2)(a) of the Prices Surveillance Act to replace the existing MTOW-based charges that applied to the use of runways, taxiways and airside facilities by international and domestic airlines with a charge based on the number of arriving and departing passengers. SACL proposed an International Passenger Service Charge ("International PSC") of $19.31 (including GST) per passenger movement through the international terminal and a Domestic PSC of $4.00 (including GST) per domestic passenger movement.

175 Qantas and Ansett supported SACL's proposed change to the tariff structure, but it was opposed by Virgin Blue on the basis that a passenger-based charge did not reflect cost drivers, would promote inefficiency and was anti-competitive. Virgin Blue's business model relies upon achieving high load factors and, upon its calculations as at 13 August 2001, if it achieved a 70% load factor and 20 rotations per day, SACL's proposed change to the tariff structure would result in an additional cost per year of between $[x] and $[x].

176 On 28 August 2001 the ACCC determined that, although it did not object to the imposition of a passenger service charge for international passengers, it objected to a passenger service charge for domestic passengers. The ACCC concluded that:

> *"…Virgin Blue's submission raises important concerns about the impact the domestic passenger charge may have on competition in the domestic aviation market. It appears that the proposed restructure may disadvantage new entrants who carry more passengers per aircraft. However, these complex*

issues requires greater analysis than what has been possible in the PS Act's 21 day statutory period.

The Commission considers that it has not had sufficient time under the PS Act's 21 day statutory period to fully consider and analyse the effects of the proposed domestic charge restructure. As such, the Commission objects to the proposed passenger service charge for domestic passengers."

177 It should be borne in mind that the International PSC was a composite airside and passenger facilitation (or terminal) charge, which created a logical connection between the number of passengers and the basis of the charge. The proposed Domestic PSC, on the other hand, was limited to the Airside Service, that is, the use by domestic aircraft of runways, taxiways, aprons and associated facilities. We also note that neither Virgin Blue nor any other LCC was operating international flights out of Sydney Airport at the time SACL sought approval of the change in tariff structure from the ACCC.

178 Following the ACCC's decision, SACL proceeded to implement an International PSC commencing November 2001. However, SACL deferred any further steps to implement a Domestic PSC and continued to employ an MTOW-based charge.

179 As noted earlier (see [38] above), following the movement in the Commonwealth Government's policy towards "lighter-handed regulation", as of July 2002 SACL was no longer required to notify the ACCC of any proposed increases in the price of aeronautical services. Instead, from 1 July 2002, SACL was simply required to report to the ACCC in relation to its prices and financial performance, and the ACCC in turn reported to the Parliamentary Secretary to the Treasurer.

180 In August 2002, SACL reconsidered its position in relation to the manner in which it levied aeronautical charges. SACL's reconsideration of the Domestic PSC was documented in a number of papers.

181 First, Mr Dominic Schuster, who was at the time the Manager of Economics at SACL, prepared an internal memorandum dated 27 August 2002 for Mr Gregory Timar, then SACL's General Manager of Corporate Planning and Strategy. Mr Schuster's responsibilities included making recommendations to SACL's Board Strategy Committee in respect of the appropriate level of charges for aeronautical services. Mr Timar's position required him to

address the maximisation of SACL's revenue. In particular, Mr Timar was responsible for recommending to SACL's Board that it change its pricing for domestic aeronautical charges from an MTOW-based charge to a passenger-based charge. This involved consideration of the ways in which aeronautical charges could be raised. The issue of the introduction of a Domestic PSC "for runway use" was raised in this memorandum as follows:

> *"Introducing the charge at the level proposed last year would generate revenues of some $4.5m annually against the existing MTOW regime, because of the higher load factors being achieved since Ansett's collapse. Qantas continues to support a move to the domestic PSC, explicitly recognising that there would be upside for SACL. Virgin Blue is now subject to passenger-based runway charges at Melbourne and Perth Airport, but there is no suggestion that it has relaxed its philosophical stance against this form of charge. Moreover, SACL's current relationship with the carrier may make introduction more difficult. Qantas has advised that it would not support the passenger-based charge unless it also applied to Virgin Blue."*

182 Secondly, in SACL's 'Traffic & Aeronautical Revenue Task Force Report', dated 16 October 2002, it was noted:

> *"The domestic PSC for runway use which was rejected by the ACCC in August 2001 can now be re-instated provided all stakeholders are in agreement. The move to passenger-based landing charges domestically could yield up to $5m a year over the weight-based regime, because of the assumptions adopted for passengers excluded from the charge, and high aircraft load factors.*
> …
> *Qantas actively supports moving to a domestic PSC. While theoretically, different carriers could be charged on a different basis, Qantas would only support the PSC on the basis that it is charged to all domestic carriers.*
>
> *Virgin Blue opposes the introduction of the passenger-based charge as its single class 737 aircraft carry more passengers per landed tonne than Qantas. Virgin Blue also has a much lower rate of transfer and transit passengers, which are to be exempt from the domestic PSC, than Qantas."*

183 Thirdly, Mr Schuster co-sponsored the SACL 'Board Strategy Committee (Information) Paper 7/6' that was prepared for a meeting of that Committee on 16 December 2002 ("Strategy Committee Paper of December 2002"). This Paper was co-sponsored with Mr Timar and Mr Greg Russell, Director of Aviation at SACL. Appendix 3 of the Paper stated:

> *"Qantas continues to be extremely keen that a domestic PSC be introduced. It has recognised informally that the potential exists for SACL to derive more revenue from a PSC than the weight-based equivalent, but has no difficulties*

> *with this. The main reasons for Qantas' enthusiasm for the PSC are that it can be passed directly to passengers, becoming a variable cost while Qantas would be unlikely to adjust airfares, and because it could strengthen their commercial position relative to Virgin Blue.*
> …
> *A further consideration is SACL's relationship with Virgin Blue which remains somewhat difficult, and whether we can successfully implement a domestic PSC at the previously struck rate with that airline. While Qantas has indicated a willingness to adopt charge struck in August 2001, one would assume that Virgin Blue management will see the potential for passenger loads to drop and argue that a charge struck prior to Ansett's collapse is no longer appropriate. They may also query the transfer and transit rate as very much higher than its experience. This may lead to as* [sic] *charge being calculated that comes much closer to SACL's publicly stated goal of a revenue-neutral restructuring of charges. A successful declaration of airside facilities under the Trade Practices Act access regime, as sought by Virgin Blue, would also hamper any attempt to restructure domestic charges."*

A table annexed to the Strategy Committee Paper of December 2002 showed the clear economic advantage to SACL in charging a Domestic PSC.

184 There followed a number of discussions with Virgin Blue regarding the introduction of a Domestic PSC. On 10 February 2003 the newly appointed Executive Chairman and Chief Executive Officer of SACL, Mr Max Moore-Wilton, attended Virgin Blue's offices in Brisbane for a "meet and greet" and informed Virgin Blue that SACL was considering a move to a passenger-based charge.

185 In a facsimile dated 13 February 2003 Mr Brett Godfrey, Chief Executive Officer of Virgin Blue, wrote to Mr Moore-Wilton stating that Virgin Blue would not like to see an increase in landing fees given that the aeronautical charge was doubled less than two years prior.

186 In a presentation given at the Price Deregulation and Airline Commercial Agreement Workshop held by the Strategy Committee on 26 February 2003 ("Strategy Committee Presentation of February 2003"), SACL considered the optimal approach to pricing. The Presentation acknowledged a "material disadvantage" to Virgin Blue upon the imposition of a Domestic PSC. This disadvantage was based on Virgin Blue's higher load factors and use of Boeing 737 aircraft. It was noted that Virgin Blue carried around 2 passengers per tonne, whereas Qantas carried approximately 1.1 passengers per tonne. The Presentation showed

that "[r]ebalancing to reflect pax [passengers]: MTOW, QF would pay around $4.00, Virgin $2.00 per pax." The Strategy Committee Presentation of February 2003 also noted "Qantas strongly supports the PSC, as it can be fully passed on to customers and aids its competitive advantage."

187 On 4 March 2003 Virgin Blue wrote to SACL stating its opposition to the change in the airside charges and seeking that SACL consult with the airlines and enter into a long-term agreement in relation to airport use. Mr Godfrey wrote to Mr Moore-Wilton:

> *"If SACL is changing methodologies to push through a pricing regime that will discriminate against Virgin Blue, relative to its major competitor Qantas, and against the findings of the ACCC, we would consider this bordering on bad faith. … I must reiterate an uncapped per pax charge levied compared with the existing MTOW would most likely directly benefit Qantas at our expense."*

188 On 10 March 2003 SACL informed the airlines of its intention to implement a Domestic PSC at Sydney Airport from 1 July 2003. In a letter to Virgin Blue on that date, Mr Moore-Wilton stated SACL's opinion that the ACCC's reasons given in August 2001 did not signal a complete opposition to the Domestic PSC, but rather that the ACCC had not had enough time to consider fully and analyse the effects of the proposed passenger charge. Mr Moore-Wilton's letter also stated, *inter alia*:

> *"You have expressed concern about your competitive position relative to Qantas under the domestic PSC. Sydney Airport is open to public scrutiny and must be able to demonstrate a transparent approach to charging that ensures airlines pay the same for equivalent levels of service. As such, we do not see any case for a differential charging regime. This is consistent with the approach to runway charges that I understand Virgin Blue has accepted at other airports.*
>
> *Passenger based charges provide a better measure of airport utilisation than traditional weight based charges, and also provide for a sharing of risk between airports and airlines, as landing charges are based on passenger loads rather than simply the scheduled weight of the aircraft which will vary over time."*

189 Virgin Blue continued to oppose the introduction of a Domestic PSC on the basis that it would dramatically increase Virgin Blue's costs of operating from Sydney Airport and would place it at a significant competitive disadvantage with respect to Qantas. In a letter dated

14 March 2003 from Mr Diederik Pen, Head of Ground Services for Virgin Blue, to Mr Russell, Mr Pen stated:

> *"We are very disappointed by your proposal to introduce a passenger service charge for domestic runway use. The effect of this charge, if introduced, will be to dramatically increase Virgin Blue's costs of operating from Sydney Airport as well as to place Virgin Blue at a significant competitive disadvantage with respect to Qantas.*
>
> *This proposal retards the constructive relationship we had hoped we were building following our difficulties last year.*
>
> *The introduction of passenger-based charges for the use of the runway at Sydney Airport will have significant anti-competitive effects on competition in domestic aviation and will penalise Virgin Blue as the more efficient operator. Virgin Blue disagrees with your statement that passenger-based charges are a better measure of airport utilisation. Weight-based charges are a better measure of the impact of use on the relevant physical assets – the run-way and associated facilities. It is impossible to believe that a 737 with only 1 passenger has only 1/150th of the impact of a 737 with 150 passengers on board. Passenger-based charges are not efficient and do not reflect the cost of the service provided.*
>
> *The ACCC accepted the potential for passenger-based charges to have substantial impacts on competition in the domestic aviation market. The ACCC noted that SACL's then-proposed restructure may disadvantage new entrants who carry more passengers per aircraft. On the basis of these concerns, the ACCC objected to the charge in 2001. SACL had the opportunity to come back to the ACCC and address this issue, however SACL instead chose not to proceed with the passenger-based charge for domestic users. I think that it is telling that SACL didn't think that it could respond to the concerns raised by the ACCC in 2001.*
>
> *In the context of the current regulatory regime for airports, Virgin Blue has reluctantly accepted passenger-based charges at other airports, but these charges were part of wider deals with these airports that on balance allowed Virgin Blue to maintain its competitive position. As part of that process Virgin Blue also obtained long term commitments from them as to price and service levels. Neither of these seems to be the case with SACL.*
>
> *Virgin Blue has always had a position where it will enter into long term commitments on pricing and service levels for landing charges. We have always been willing to enter such discussions with SACL on the proviso that SACL does not erode Virgin Blue's competitive position.*
> *…"*

190 A meeting of representatives from SACL and Virgin Blue took place on 21 March 2003 to discuss the move to a Domestic PSC. At the meeting Mr Russell of SACL accepted that SACL's proposal meant an increase in landing charges to Virgin Blue of 50-53% and an

increase to Qantas of only 4% or even less. However, he observed that it was SACL's policy to introduce a Domestic PSC because "we feel it is more efficient to charge that way". The reason why it was efficient was not stated. We return to this issue later in these reasons.

191 A sequence of correspondence followed the meeting and on 8 April 2003 Mr Moore-Wilton wrote to Mr Godfrey in the following terms:

> *"…the following outlines the situation from SACL's perspective.*
>
> *Virgin Blue has been aware since mid-2001 of SACL management's intention to move to passenger-based charges for domestic services. While SACL chose not to proceed with this initiative during what was a time of upheaval in the domestic aviation sector, the time has now come to bring domestic charges in line with the framework that applies to the majority of other major Australian airports and to the rest of Sydney Airport's customers.*
>
> *In our view, this hiatus provided Virgin Blue with a relative advantage during its start-up phase. As a matter of principle, however, SACL considers that passengers using the same Sydney Airport facilities should pay the same in airport charges regardless of which airline they fly with or the type of aeroplane on which they fly. Consistent with our aim of treating passengers consistently across carriers and recognising that all passengers use the airport's runway facilities, we have decided to levy the charge on all arriving and departing passengers, including transferring and transit passengers.*
>
> *The proposed passenger charge, of $2.86 per arriving and departing passenger for runway use, excluding security and GST, compares favourably with the PSC levied at other major Australian airports. Moreover, I understand that a number of airports that have not adopted passenger-based charges would have done so, but for the opposition of Virgin Blue.*
>
> *…*
>
> *You observe in your letter that Virgin Blue would like long-term certainty on aeronautical costs. SACL is currently in the process of developing its Master Plan, in consultation with airlines, and it would be illogical for SACL to make long-term pricing commitments in advance of this. However I stand by my earlier proposal to negotiate long-term commercial agreements with airlines once the Master Plan has been accepted by Government, expected early next year.*
>
> *In the short term, however, I am prepared to commit to Virgin Blue that, once implemented, the runway component of the domestic PSC will not change for two years. This will provide Virgin Blue with a high degree of certainty as to its costs of operating from Sydney Airport. This commitment is conditional on Virgin Blue withdrawing its application to the National Competition Council for a declaration of airport facilities for an equivalent period of two years."*

192 Virgin Blue responded in a letter dated 7 May 2003. Virgin Blue told SACL that, amongst other things, the proposed Domestic PSC would increase Virgin Blue's costs by 53% whilst increasing Qantas' costs by only 4%, and constituting an overall price increase of 20% to SACL. Of particular note is Mr Godfrey's observation:

> *"Without trying to be flippant, let me state something that all of us can agree on,* passengers don't land on runways … aircraft do. *The asset is depreciated by the rubber hitting the runway, whether the aircraft is full or empty. We expect to and are happy to pay for that privilege regardless of whether we succeed or fail in getting passengers on board – that is a business risk we assume and we are not about to pass on the cost of that risk to your shareholders.*
>
> *The general principal* [sic] *of virtually all transport is the opposite – that is it should reward efficiency and optimum utilisation that we strive for…*
> *…*
> *While we are well aware of the excellent and valued relationship you have with Qantas, tilting the playing field in its favour is upsetting a long established egalitarian principle of airport facility use. We sweat the asset and SACL gets the benefit in your retail/terminal activities without incurring any additional costs.*
>
> *We also consider that your proposed charges represent unjustifiable price increases in contravention of the pricing principles articulated by the Commonwealth Government in its response to the Productivity Commission report. Far from encouraging the efficient use of airport facilities, your proposed charges would achieve the exact opposite.*
> *…*
> *Your $2.86 per arriving and departing passenger increases our cost by 53%, Qantas's by an estimated 4% and therefore at our detriment, grants SYD airport an overall further price increase of 20%. This follows less than 2 years after raising them by 97%. SACL has ignored the fact that we squeeze more passengers into the aircraft by way of a trade off in lowering our yields – SACL seems to prefer to incentivise us to fail (just think of the money we could save if our planes flew empty!). This is why, as you correctly stated, we oppose these charges.*
>
> *Not only has SACL chosen to change the methodology to the detriment of Virgin Blue, you are also using stealth to cover an additional $5-6 million per annum price increase on the travelling public so soon after privatisation.*
> *…"*

193 In response to SACL's comments in Mr Moore-Wilton's letter in relation to the application for declaration of Sydney Airport, Virgin Blue went on to say:

> *"In light of SACL's track record on price increases, including the more recent change in methodology, further compounded by an unwillingness to commit long term due to your incomplete master plan, we are left with no choice but*

> *to assume that the airport is likely to seek further price rises in relation to this aeronautical charge. Therefore Virgin Blue believes that it is in its best interests to reject your proposal, and pursue our National Competition Council application to have the Airside Service declared, even though Virgin Blue understands that declaration under Part IIIA of the Trade Practices Act can be a lengthy process. We however certainly believe we have little to lose in light of your consultation process and consequent 'proposal.'"*

194 On 26 May 2003 Mr Moore-Wilton wrote to Mr Godfrey, attaching a notification of variation of aeronautical charges that informed all customers that from 1 July 2003 SACL would start charging aeronautical fees on a per-passenger basis. In the letter Mr Moore-Wilton said:

> *"I have heard the concerns of Virgin Blue, however, Sydney Airport remains of the view that passengers at the airport should pay the same price for use of the same facilities. It is particularly disappointing that Virgin Blue spokesmen have reverted to inflammatory media comments in seeking to force your view."*

195 In a letter dated 28 May 2003 one of Virgin Blue's major shareholders, Sir Richard Branson, sought to intervene in the situation, expressing concerns that the proposed change in pricing would "penalise Virgin Blue, subsidise Qantas and secure a significant price rise and consequent revenue raising for SACL."

196 On 30 May 2003 SACL's Board approved the variation in aeronautical charges to a per-passenger basis, effective from 1 July 2003.

197 Mr Moore-Wilton responded to Sir Richard Branson in a letter dated 6 June 2003, expressing the view that Virgin Blue's objections were to a rise in price and not based on any "point of principle". He said that SACL would consider any further proposal from Virgin Blue. Although Mr Moore-Wilton said that Virgin Blue's objections were not based on any point of principle he did not respond, and had not previously responded, to Mr Godfrey's observation in his letter dated 7 May 2003 (see [192] above) that:

> *"passengers don't land on runways … aircraft do. The asset is depreciated by the rubber hitting the runway, whether the aircraft is full or empty…*
> *The general principal* [sic] *of virtually of all transport is the opposite – that is it should reward efficiency and optimum utilisation that we strive for ..."*

198 Mr Moore-Wilton's principle, as stated in his earlier letter of 8 April 2003 (see [191] above), had been that:

> *"passengers using the same Sydney Airport facilities should pay the same in airport charges regardless of which airline they fly with or the type of aeroplane on which they fly. Consistent with our aim of treating passengers consistently across carriers and recognising that all passengers use the airport's runway facilities, we have decided to levy the charge on all arriving and departing passengers, including transferring and transit passengers."*

199 From 1 July 2003 SACL commenced imposing a Domestic PSC on aircraft using Sydney Airport rather than the previously applied MTOW-based charge.

THE CHANGE IN DOMESTIC AIRSIDE SERVICE CHARGES FROM MTOW TO PSC

200 It should be noted at the outset that SACL submitted that an analysis of its change from an MTOW-based charge to the Domestic PSC would only be relevant if the Tribunal formed the view that, in the event of declaration of the Airside Service, the charge for that service would be structured on an MTOW basis, and, if it were so structured, there would be an increase in access to the Airside Service which would promote competition. We reject this submission. It misunderstands the significance and relevance of the change and ignores the manner in which the change may be characterised. The relevance of the change to a Domestic PSC is the consideration whether it is an example of an exercise of monopoly power by SACL which could not be sustained in a competitive market and which has an adverse effect on competition. This consideration feeds into the analysis of whether the environment for competition would be promoted in a future with declaration as against a future without declaration.

201 Virgin Blue submitted that SACL's change from an MTOW-based charge for domestic flights to the Domestic PSC was discriminatory. As we outlined above, Virgin Blue employs an LCC business model which is typically premised upon the airline attracting and maintaining higher load factors, relative to the FSA model, and keeping costs low. Virgin Blue's basic concern was that, as LCCs tended to have smaller aircraft and more passengers per aircraft than FSAs such as Qantas, when SACL began to charge for aeronautical services on a per-passenger basis for each aircraft movement rather than on the weight of the aircraft, Virgin Blue, as an LCC, had to pay higher charges for aeronautical services than Qantas. This was said to be discriminatory because the change in the tariff structure was made in

circumstances where SACL knew that it would have a greater impact on Virgin Blue than it would on Qantas, and was aware that Qantas supported the change because, among other things, of this disadvantageous effect on Virgin Blue. Furthermore, the change could not be said to constitute a more efficient manner of pricing or to represent the only or most effective method for SACL achieving any legitimate ends that it could properly pursue in a competitive environment.

202 Virgin Blue estimated that the change from an MTOW-based charge to the Domestic PSC resulted in an increase in the charge paid by Virgin Blue of approximately 52% (based on the assumption of an 80% load factor, 125 passengers per aircraft and an average MTOW of 69 tonnes). This was to be compared to the increase for Qantas estimated to be approximately 4%. This result was acknowledged by Mr Russell of SACL at the meeting held between representatives of SACL and Virgin Blue on 21 March 2003 (see [190] above). We accept that the change in tariff structure from an MTOW-based charge to a Domestic PSC had such a differential impact on the airlines.

203 Virgin Blue's contention that, as an LCC, it was more affected by the Domestic PSC than Qantas, it being an FSA, was supported by Professor Tae Hoon Oum, UPS Foundation Professor of Transport and Logistics at the University of British Columbia. Professor Oum opined:

> *"All of the empirical findings via the duopoly competition models indicate clearly that a 100% increase in SACL's Airside Service charges (from A$3 to A$6 per passenger) has a significantly larger negative percentage impact on Virgin Blue's traffic volumes than those of Qantas in all of the duopoly routes to/from Sydney Airport. This result is supported by a clear intuition: because a low cost carrier, such as Virgin Blue, carries a large share of fare sensitive passengers and has a lower cost per passenger, an identical cost increase per passenger will surely have a larger impact on it than a full service airline, such as Qantas."*

204 In our view, it is clear that the differences between the LCC and FSA business models of Virgin Blue and Qantas mean that a tariff structure based on charging per passenger versus charging per unit of MTOW will systematically affect these airlines differently.

205 Compared to FSAs such as Qantas, Virgin Blue, and indeed other potential LCC entrants, tend to operate with higher load factors and lighter aircraft. LCCs are more likely to operate

aircraft in a single class configuration, which also tends to increase the passenger-to-MTOW ratio. The combination of larger aircraft, a greater variety of service levels and a higher absolute level of service typical of FSAs means that Qantas tends to have a lower load factor than Virgin Blue. This, combined with the fact that the weight of an aircraft goes up more than proportionally with the passenger load, leads to a result that Qantas, as an FSA, would tend to have a much lower passenger-to-MTOW ratio than an LCC like Virgin Blue.

206 SACL's change from an MTOW-based charge to a Domestic PSC thus puts LCCs such as Virgin Blue at a disadvantage vis-à-vis FSAs such as Qantas due to the higher load factors and lighter, single class configuration aircraft used by LCCs.

207 However, as SACL pointed out, any tariff structure it employed could be said to discriminate against the business model of any given airline. Had it retained the MTOW-based charge for its Airside Service, it submitted that Qantas could have complained that the tariff structure discriminated against it because the FSA model which it adopts tends to use heavier aircraft and have lower load factors than the LCC model used by Virgin Blue. SACL submitted that it was not possible for any airline to protect, indefinitely, an advantageous manner of charging. It submitted that it was equally impossible for airports to determine levies in an attempt to charge in such a way that would affect all airlines similarly. Accordingly, SACL submitted that a misuse of its monopoly power could not be demonstrated by the fact that the Domestic PSC resulted in higher charges to LCCs.

208 Furthermore, SACL submitted that Virgin Blue's ability to compete was not damaged by the change in tariff structure, as Virgin Blue remained a strong competitor for Qantas and Jetstar. SACL contended that the impact the change in tariff structure has had on airlines' costs is to be distinguished from an impact on competition, which is the relevant focus of the present inquiry. That may be so, but the extent of competition in the dependent market can still be inhibited by the imposition of a discriminatory charge.

209 Accordingly, the context in which SACL made the decision to change its tariff structure and whether such a tariff structure is supported by a legitimate rationale such that it would survive in a competitive market must therefore be examined.

210 The history of SACL's change from an MTOW-based charge for aeronautical services to a Domestic PSC shows that the issue of a passenger-based charge was discussed by SACL and Qantas in mid to late 2001 in the context of settlement of court proceedings which Qantas and a number of other airlines had brought against SACL. Qantas had shown a particular interest in ensuring that SACL did everything within its power to see the Domestic PSC approved by the ACCC so that SACL could introduce it. So much is clear from cl 1 of the Deed of Settlement between SACL and Qantas on 1 August 2001 (referred to above at [173]).

211 The Deed of Settlement contained what might be thought to be unusual provisions in relation to the implementation of a "best endeavours" obligation on SACL to shepherd through the ACCC a change to the Domestic PSC. We draw particular attention to cl 1(f) of the Deed of Settlement, which contains a detailed description of how SACL was to discharge its "best endeavours" obligation. In particular, we draw attention to subcl (iv) whereby SACL agreed to:

> *"ensure that the Government is provided with information necessary for it to understand the rationale for the passenger service charge"*.

How that "rationale" was communicated to the Government was not made clear in the proceeding before us.

212 The history of SACL's change to a Domestic PSC also makes it quite clear that when the SACL Board was considering the imposition of a Domestic PSC in early 2003, SACL was well aware that Virgin Blue opposed the change and that its principal complaint related to the inefficient and anti-competitive nature of the Domestic PSC as a pricing policy. SACL was well aware of Virgin Blue's contention that the Domestic PSC would penalise Virgin Blue as a more efficient operator than Qantas and would have significant anti-competitive effects on domestic aviation. This had been made clear in Mr Pen's letter of 14 March 2003 (referred to above at [189]). What is more, as SACL knew from the Strategy Committee Paper of December 2002 (see [183] above), the main reason for Qantas being "extremely keen" that the Domestic PSC be introduced was that Qantas could pass it on directly to passengers and it could strengthen Qantas' commercial position relative to Virgin Blue.

213 We are satisfied, particularly having regard to the content of the Strategy Committee Paper of December 2002, that Qantas had either told SACL, or it was clearly apparent from the discussions that SACL had had with Qantas, that Qantas saw the Domestic PSC as putting

Virgin Blue at a competitive disadvantage to Qantas in relation to its use of Sydney Airport. It is a reasonable inference from the contents of that Paper, which we draw, that Qantas had told SACL representatives of this fact.

214 Mr Timar, now the General Manager, Aviation Business Development at SACL, acknowledged as much in his answer to this question from counsel for Virgin Blue:

> *"What I want to suggest to you is that you well understood that Qantas was happy to pay on a per passenger basis even if it involved Qantas paying more because Qantas knew that the per passenger charge would hurt Virgin Blue much more than it would hurt Qantas?'*

Mr Timar answered:

> *"That's one way to phrase it but I think that's broadly right, yes."*

215 We draw particular attention to Mr Schuster's replies under cross-examination to counsel for Virgin Blue which confirmed that Qantas' preference for a passenger-based charge was one of the reasons why SACL introduced the change in tariff structure. Counsel for Virgin Blue questioned Mr Schuster, now SACL's Manager of Aviation Pricing and Economics, about the revenue SACL would raise in the current financial year if it priced its charges for aeronautical services so as to achieve allowable revenue according to the ACCC's methodology. Mr Schuster said SACL was working on an expected revenue of $46.9 million and that if it had retained an MTOW basis for the charge, SACL would only have received $36.9 million. The following exchange then occurred:

> "[COUNSEL FOR VIRGIN BLUE]*: So the delta between an MTOW charge and a per passenger charge has reached has it not for this financial year $10 million?*
>
> *MR SCHUSTER: Yes.*
>
> [COUNSEL FOR VIRGIN BLUE]: *And that was a fairly strong reason, wasn't it for SACL to move from MTOW to per passenger, wasn't it?*
>
> *MR SCHUSTER: Yes, it was.*
>
> [COUNSEL FOR VIRGIN BLUE]: *And I want to suggest to you that that was the reason why SACL moved from MTOW to per passenger, not because of any decision or concern about efficiency otherwise. It simply came down to revenue, didn't it, for SACL?*
>
> *MR SCHUSTER: Our primary goal was to move closer to allowable revenue. We could have chosen to increase our tonnage base charge to get*

> *there but because of other considerations that we've discussed, we chose a passenger base charge.*
>
> [COUNSEL FOR VIRGIN BLUE]: *And that other consideration we discussed I take it was Qantas' view that it would prefer a domestic per passenger charge rather than MTOW?*
>
> *MR SCHUSTER: We did do it because Qantas preferred it."*

216 It will be recalled that, in the Strategy Committee Paper of December 2002, Mr Schuster wrote that Qantas was "extremely keen" and enthusiastic for the Domestic PSC to be introduced. In cross-examination Mr Schuster elaborated on this issue. He said that he had regular discussions with the head of Qantas' airport charges and billing area about the subject matter of the Domestic PSC. He said that the reference in the Strategy Committee Paper of December 2002 to the main reasons for Qantas' enthusiasm for the Domestic PSC were his view of Qantas' rationale for the Domestic PSC. He put a gloss on the observation in the Paper when he said that the sentence that started "the main reasons" could perhaps have better been worded to say "my view of the main reasons". He appeared to be resiling from the inference which flows from the Paper that Qantas or officers of Qantas had told him directly about these reasons. He said that the observation that the Domestic PSC could strengthen Qantas' commercial position relative to Virgin Blue was not what someone told him directly but rather, was what he had surmised. In an attempt to explain why he had surmised Qantas' position in this way, Mr Schuster said "[b]ecause I had offered to Qantas the prospect of them moving to a domestic PSC in advance of reaching agreement with Virgin Blue on it", and Qantas was not attracted to that option.

217 Mr Schuster's explanation does not really shed any light on the reason as to why he had stated in the Strategy Committee Paper of December 2002 that the Domestic PSC "could strengthen [Qantas'] commercial position relative to Virgin Blue". What Mr Schuster did make clear however was that he formed the conclusion that moving to the Domestic PSC could strengthen Qantas' commercial position relative to Virgin Blue.

218 We are satisfied that, as the result of discussions with Qantas, SACL was aware (through Mr Schuster, who passed the information on to more senior members of SACL on the Board Strategy Committee) that Qantas particularly wanted the Domestic PSC introduced to give it a competitive advantage over Virgin Blue, that is, to put Virgin Blue at a competitive disadvantage to Qantas. In such a situation it was incumbent upon SACL to be even more

cautious about its reasons for changing the nature and methodology of its airside charges. To change from an MTOW-based charge to a Domestic PSC because Qantas preferred it was a misuse of monopoly power, especially when SACL could have chosen, as Mr Schuster acknowledged, to "increase our tonnage base charge" to achieve the goal of moving "closer to allowable revenue".

219 At the hearing, during the course of discussing the context in which SACL changed its tariff structure, the following exchange took place:

> *"GOLDBERG J:…Is it open to the Tribunal to make a finding from the material that over a period starting at least at the deed of release or perhaps before it and going through up until – the deed of release was August 2001 – going through to at least December 2002 there was a deliberate proposal – I'm trying to find a neutral word – by SACL either in conjunction or with a tacit understanding of Qantas to bring in a charge which would be – I'm choosing the words generally for the moment – anti competitive or anti Virgin. At the top of* [the Strategy Committee Paper of December 2002] *it starts…:* 'Qantas continues to be extremely keen that a domestic PSC be introduced.' *Now if that finding or inference is open…on one view it's a stronger example if you like of an exercise of monopoly power…*
>
> [COUNSEL FOR VIRGIN BLUE]*: Your Honour, the answer is yes and that inference is more easily drawn in the light of Mr Schuster's affidavit t..."*

This reference to Mr Schuster's affidavit was a reference to [42] which stated:

> *"SACL's proposal to move from weight-based charges to passenger-based charges was also supported by its then two major domestic customers, Qantas and Ansett, and formed part of SACL's obligations under the Deed of Settlement and Mutual Release in relation to legal action taken by the airlines against SACL."*

220 Counsel for SACL then made the following submission:

> "[COUNSEL FOR SACL]*: Your Honour, if I could just at that stage interpose and say* [that] *proposition has never been put in evidence or in cross-examination and indeed when one looks at paragraph 10.24 of my learned friend's written submissions in the second sentence it is said:* 'It is clear from the analysis that SACL's conduct in relation to its decision to change from an MTOW based Airside Service charge to a domestic PSC that its principal motivation was to protect its revenue base and discourage airlines from using smaller more efficient aircraft.'
>
> *There's nothing there about our conduct being aimed at Virgin Blue. We were conscious obviously from the material - - -*

GOLDBERG J: Conscious?

[COUNSEL FOR SACL]*: Conscious of the effect which it could have; not merely as major as my learned friend would seek to say whereas the evidence would establish but the idea that we engaged in a conspiracy with Qantas to disadvantage Virgin Blue is something which has never been raised in this inquiry and in our respectful submission ought not to be permitted to be raised."*

221 Indeed, counsel for Qantas noted that counsel for Virgin Blue "has very carefully put the matter in a way which wouldn't require your Honour to make the sort of finding that your Honour has generally alluded to…"

222 We form no view as to whether there was a "conspiracy" between SACL and Qantas with a view to disadvantaging Virgin Blue. That was not an issue which was put before us. Rather, we find that the evidence outlined in the above history of SACL's pricing policy demonstrates that SACL changed the basis of its airside charges to a methodology which it had been told by Virgin Blue was inefficient and anti-competitive when it also knew that Qantas believed it would give it a competitive advantage over Virgin Blue and wanted it changed for that reason. That was a reason which motivated SACL to change its pricing methodology for airside charges from an MTOW-based charge to a Domestic PSC. As Mr Schuster said; "We did do it because Qantas preferred it."

223 SACL advanced a number of submissions which it contended justified the change in the methodology of the pricing for its airside charges. They can be conveniently categorised as follows:

- the Domestic PSC encouraged a more efficient use of Sydney Airport than the MTOW-based charge;
- the Domestic PSC encouraged airlines to use large rather than small aircraft thereby encouraging the efficient use of airport facilities;
- the Domestic PSC reduced barriers to entry in the domestic aviation market;
- the Domestic PSC provided a more sustainable basis of charging in terms of revenue to SACL;

- the Domestic PSC provided for greater equity in the application of airport charges, enabled transparency and facilitated risk sharing between SACL and the airlines;
- passenger-based charges were supported by aviation authorities and had been adopted by a number of other airports and accepted by Virgin Blue in a number of other airports;
- the Domestic PSC produced a revenue which fell within the ceiling of allowable revenue provided for in the ACCC's building block methodology.

Efficient use of Sydney Airport

224 A principal proposition in SACL's submissions was that the Domestic PSC encouraged a more efficient use of Sydney Airport than did the former MTOW-based charge, and that efficient pricing principles warranted the use of the Domestic PSC.

225 Mr Schuster of SACL said that the Domestic PSC better reflects the "underlying drivers for demand for runway facilities than aircraft MTOW". He made this assertion on the basis that most of the aircraft movements at Sydney Airport were passenger aircraft, and that airlines carrying those passengers would therefore respond to passenger demand for their services.

226 Virgin Blue rejected this argument, submitting that the Domestic PSC was levied for the use by aircraft — not passengers — of runways, taxiways and aprons. Virgin Blue submitted that in order for the charges to be efficient, they should reflect cost drivers, these being the use by aircraft of runways, aprons and taxiways, rather than the number of passengers on the aircraft. Virgin Blue submitted that it was common ground that for aeronautical charges to be efficient, total revenue must cover the long-run cost of providing the aeronautical services, including a commercial rate of return on the value of assets employed.

227 Mr Schuster put the basis for efficient pricing of airside charges in the following way:

> *"In my view, efficiency in aeronautical charges requires that the total revenues cover the long-run cost of providing the aeronautical services, including a commercial rate of return on the value of the assets employed. This provides for efficient resource allocation, attracting an appropriate level of investment and ensuring that demand for airport services is not distorted by prices that are not representative of the cost of providing the facilities."*

228 Whilst SACL claimed that passenger-based charging encouraged efficiency, the evidence did not disclose that efficiency considerations were taken into account in adopting the Domestic PSC.

229 In cross-examination, Mr Schuster of SACL conceded that for all the facilities and services listed in sch 9 of SACL's Standard COU (set out at [92] above), the costs were driven by the size and weight of the aircraft, rather than by the number of passengers. As noted earlier, sch 9 of SACL's Standard COU defined the "Facilities and Services" at Sydney Airport (subject to the proviso that a separate agreement between SACL and the relevant airline may provide otherwise). The facilities and services were listed under "Aircraft movement facilities and services" and "Passenger processing facilities and services" (as noted earlier at [92]). It will be recalled that the "Aircraft movement facilities and services" comprised:

- Airside grounds, runways, taxiways and aprons;
- Airfield lighting, airside roads, airside lighting;
- Airside safety;
- Nose-in guidance;
- Aircraft parking;
- Visual navigation aids.

230 Mr Schuster agreed, as is the fact, that if one wanted to identify the cost drivers for SACL's Domestic PSC, one would go to each of the bullet points under the heading "Aircraft movement facilities and services" and determine what drives the costs incurred by SACL in providing those facilities and services. Mr Schuster said that passengers did not drive any of the matters listed under "Aircraft movement facilities and services". Although he said that weight scarcely dictated any of these facilities and services, he agreed that each of the aircraft movement facilities and services was referable to aircraft rather than the passengers carried within the aircraft. Whilst Mr Schuster said that he could not see any relevant difference between aircraft weight and passenger numbers as a potential cost driver for the aircraft movement facilities and services set out in sch 9 to SACL's Standard COU, he accepted that the aircraft movement facilities and services were referable to aircraft rather than the passengers carried within the aircraft. In short, Mr Schuster agreed that numbers and size of aircraft were the cost drivers for each of the "Aircraft movement facilities and services" referred to in SACL's Standard COU.

231 In his second supplementary affidavit, Mr Schuster produced a chart entitled "Airside cost categories and their drivers" with reference to SACL's 2000/2001 cost base. Mr Schuster agreed that his reference in the chart to "Runways, Taxiways and Aprons" accommodated the "Aircraft movement facilities and services" described in sch 9 of SACL's Standard COU. In that chart, Mr Schuster identified the cost driver for those facilities and services as "Movements/MTOW", in contrast to "Passenger".

232 It follows that the Domestic PSC basis of charging had not been established by reference to the cost drivers driving the use of the assets to provide the airside services made available by SACL.

233 Furthermore, in its submission to the ACCC in August 2001 requesting approval to change from MTOW-based charging to passenger charging, SACL stated "[t]he number of passengers will generally be a reasonable proxy for aircraft size (reflecting the capital and maintenance costs of runway provision)."

234 This statement acknowledges that runway provision costs are most closely driven by aircraft size. We do not understand why a proxy would be needed when actual measurements of aircraft size are available. We would also question the reliability of passenger numbers as a proxy for aircraft size due to significant variations in load factors and aircraft configuration.

235 We make the general observation that, in a perfectly competitive market, a firm sets its prices according to its marginal costs. This promotes efficiency because it compels all firms to price at the most efficient level of the provision of their product. Firms in a competitive market will set their prices so as to reflect the underlying cost drivers. In a competitive market, if a firm sets its prices according to inappropriate cost drivers, its competitors would be able to gain a competitive advantage by setting their prices by reference to more appropriate cost drivers. Thus, competitive markets tend to set prices that reflect the underlying cost drivers, including the short-run marginal costs.

236 The evidence before us indicates that the costs of the Airside Service are driven by factors relating to aircraft such as aircraft numbers and aircraft weight. These factors are a more appropriate base than passengers for any per-unit charge in the tariff structure.

237 Efficient pricing principles dictate that the supplier price its services by reference to its efficient costs and charge according to its cost drivers, that is to say, by reference to the factors, events or circumstances which generate the costs.

238 Therefore, a monopolist like SACL should price its airside charges and other charges accordingly if it wishes to contend that it has adopted efficient pricing principles. Further, an efficient use of Sydney Airport will come about if the charges levied for SACL's services, whether airside or otherwise, result in an efficient use of those services by customers such as airlines for a cost which adequately reflects the use of those services.

239 In general terms, it may be said that a supplier of goods or services will have an incentive to price those goods or services to the highest possible level. In a competitive environment this level is continually constrained by the threat of entry. Competitors will enter whenever they expect to recover the return of capital via depreciation, operating costs, and an adequate and competitive return on the capital and funds invested. To price above this level would, in a competitive environment, create an opportunity for competitors to enter and to price their goods or services so as to attract customers.

240 Put another way, efficient pricing principles for the use of airside services at an infrastructure facility such as Sydney Airport require that the price reflect the cost of the use of the assets employed in the provision of the airside services. The airside services are used by aircraft, not by passengers. Passengers do not drive the costs of the provision of airside services, rather they are driven by aircraft, albeit the demand by aircraft is a derived demand. So much was demonstrated by Mr Schuster's explanation of the cost drivers for the facilities and services governed by SACL's Standard COU.

241 We are satisfied that efficient pricing of the provision of SACL's Airside Service requires consideration of the cost drivers underlying the provision of the Service by reference to the nature of the aircraft using those facilities, rather than by reference to the number of passengers travelling in such aircraft.

242 There was some suggestion by SACL that a passenger-based charge was more appropriate in the event of an airport being constrained in terms of capacity or slots. Reference was made to the policies of the International Civil Aviation Organisation ("ICAO"), including *ICAO's*

Policies on Charges for Airports and Air Navigation Services (7th edition, 2004) ("ICAO Policies"), and the Airports Council International, *Policy Handbook* (4th edition, 2003) ("ACI Policy Handbook").

243 We note that all the parties acknowledged that Sydney Airport did not presently face capacity or slot constraints, and it was estimated that there would not be any significant capacity constraints for at least five to ten years. However, in our view, even if Sydney Airport was constrained by the number of slots or movements at certain hours, efficient pricing principles as espoused by the Productivity Commission would favour time-based charges, or perhaps a movement-based charge. Similarly, a fixed charge per aircraft or a combination of a fixed charge with a weight-related element would be more efficient and in line with the ICAO Policies to which SACL referred and which are included in the ACI Policy Handbook.

244 The efficiency of peak and non-peak pricing also appeared to be accepted by Mr Schuster, who stated:

> *"Based on discussions that I have had with various members of SACL management and members of its Board Strategy Committee, I am aware that further measures are likely to be required over time to manage peak demand and provide for better utilisation of the airport in off-peak periods. I understand that, in economic efficiency terms, peak period charging is used to ensure that where slots are scarce they are used by those airlines or services that value them most highly."*

245 In short, we reject SACL's submissions that the Domestic PSC encourages a more efficient use of Sydney Airport than does an MTOW-based charge. Efficient pricing of the charges for the Airside Service would require consideration of the cost drivers underlying the provision of those services by reference to the aircraft using those facilities, rather than by reference to the number of passengers travelling in such aircraft. Considerations of capacity or slot constraints at Sydney Airport are not a relevant consideration in the short to medium term and do not, in any event, alter our conclusion that a passenger-based charge in the form presently adopted by SACL does not present a more efficient form of pricing than an MTOW-based charge, nor encourage more efficient use of the Airside Service provided at Sydney Airport.

The use of larger aircraft

246 SACL submitted that it preferred airlines to use larger aircraft because larger aircraft carry more passengers per movement which makes more efficient use of airport facilities. It submitted that the Domestic PSC removed an incentive that had existed under the MTOW-based charge for airlines to fly smaller aircraft. Mr Schuster contended on behalf of SACL that "weight-based charges implicitly disadvantage users of large aircraft and, given the limit on the number of aircraft movements at Sydney Airport each hour, it was (and remains) important for SACL to send the correct signals to airlines about the use of larger aircraft …"

247 Mr Schuster justified his proposition that passenger-based charges encouraged the efficient use of airport facilities in the following way. Mr Schuster said that the wear and tear of an aircraft using runway and apron facilities was relatively insignificant, and that runways had extremely long useful lives with periodic maintenance. Mr Schuster also contended that it was the opportunity cost of an aircraft using runway capacity that was important in pricing. He contended that weight-based runway charges had the unintended distortionary impact of discouraging the use of larger aircraft as the weight of aircraft tended to increase at a faster rate than the number of passengers carried as aircraft became larger. He contended, in particular, that Virgin Blue's Boeing 737 aircraft were not efficient, stating:

> *"Although Virgin Blue is entitled to operate the aircraft fleet of its choice, its Boeing 737 aircraft are not 'efficient' as Virgin Blue claims, from an airport perspective because they carry fewer passengers per movement than a larger aircraft."*

248 The greater efficiency of larger aircraft was said to be of particular importance where airports are slot or capacity constrained. Mr Schuster said that, although Sydney Airport was not slot constrained, "legislative caps and forecast passenger demand mean that consideration must be given in setting charges to the impact they might have on peak and average utilisation of the airport." Mr Schuster took the view that, as Sydney Airport had a limit on the number of aircraft movements that could be handled in any hour, it was important to encourage greater numbers of passengers per aircraft movement. However, he acknowledged that Sydney Airport was not subject to immediate significant constraints on capacity. Although he said that, in the medium to long term, SACL anticipated that slot constraints would impose a significant restriction on Sydney Airport's ability to cater for forecast passenger demand, that

forecast was projected out to 2023/2024. It was not suggested that there would be any significant capacity constraints for at least the next five to ten years. According to Mr Schuster, the airport is under-utilised during off-peak periods and has approximately ten slots available in the busiest period.

249 In response, Virgin Blue emphasised the fact that, as Mr Schuster acknowledged, Sydney Airport was not capacity constrained and so rejected any justification for the introduction of the Domestic PSC on the basis that it was a response to capacity constraints. Virgin Blue submitted that, in any event, if Sydney Airport were to face a constraint at peak periods, the evidence of Mr Schuster showed that the most appropriate response to such a constraint in terms of economic efficiency would be to introduce peak and off-peak pricing rather than to introduce a passenger-based charge.

250 More generally, Virgin Blue pointed to the fact that SACL's 2003 Annual Report showed that, since Virgin Blue entered the market, the trend at Sydney Airport has been that significantly fewer aircraft have carried significantly more domestic passengers.

251 Virgin Blue also contended that efficient Airside Service charges would mean that the total revenue would cover the long-run cost of providing the aeronautical services, including a commercial rate of return on the value of the assets employed. Thus, efficient charges would reflect the cost drivers of the service which, as Mr Schuster had acknowledged, were the size and weight of aircraft, not the passenger numbers. As we discussed above, there is substance in this submission.

252 Virgin Blue submitted with some force that the Domestic PSC in fact penalises those airlines that have higher load factors, contrary to SACL's contentions. As was shown by two charts attached to Mr Schuster's second supplementary affidavit, under the Domestic PSC an airline with an 80% load factor would be better off flying aircraft larger than a Boeing 737. Airlines operating Boeing 737-800 aircraft in two classes, such as Qantas, would be unaffected at an 80% load factor, whereas Virgin Blue, which operates Boeing 737-800 in one class, would suffer a disadvantage of around $0.50 per passenger. However, where an airline has a 60% load factor, all carriers receive a net benefit in a change to a per-passenger charge, regardless of aircraft type. This is a demonstration of how the Domestic PSC is a tax on efficiency.

253 We have formed the view that the contention that a passenger-based charge encourages airlines to use large rather than small aircraft, thereby encouraging the efficient use of airport facilities by encouraging more passengers per aircraft, does not survive critical analysis. Mr Schuster expressed the view that weight-based runway charges discouraged the use of larger aircraft as the weight of aircraft tended to increase at a faster rate than the number of passengers carried as aircraft became larger. However, there was no evidence put before us to support this view. Although Mr Schuster presented a table which he said demonstrated that under a tonnage-based charging system an airline had a disincentive to use larger aircraft, there was no evidence that this had occurred.

254 Rather, the evidence was to the contrary, namely that the smaller aircraft operated by LCCs brought about a more efficient use of airport facilities, and that the change from a weight-based charge to a passenger-based charged actually removed the incentive for airlines to maximise their passenger/MTOW ratio, rather than removing any disincentive previously existing under the MTOW-based charge to use larger aircraft. On 13 February 2004 Ms Kerrie Mather, the Chief Executive Officer of Macquarie Airports and the Deputy Chairman and a Director of SACL, made a presentation in Singapore entitled 'The impact of low-fare airlines on private sector airports'. This presentation highlighted the benefits to airports from LCCs, including enhanced traffic, enhanced income and increased utilisation of existing capacity. Ms Mather described the benefits of LCCs on the airside and terminal side of the airport, as including:

> *"Faster turnaround times reduce aircraft stand demand (25 minutes compared to 45-60 minutes)*
>
> *Simplified passenger processing reduces processing space requirements (eg 90 seconds compared to three minutes)*
>
> *Reduced differential between peak and off-peak periods."*

255 In her presentation, Ms Mather expressed the view that "low-fare airlines" created additional demand when entering existing, stable or declining routes. She noted in particular that airports benefited from low-fare airlines because, *inter alia*, low-fare airlines increased utilisation of existing capacity. She noted, for example, that the faster turn-around times of low-fare airlines reduced aircraft stand demand, being 25 minutes compared to 45 to 60 minutes. Ms Mather also presented a table which demonstrated that low-fare airlines made more efficient utilisation of airport facilities. She referred, in particular, to:

- simpler procedures with shorter turn-around times, no connections, hubbing or complex ticketing and baggage transfer facilities;
- more passengers and movements per gate/stand;
- less peaky schedules.

256 Ms Mather also noted, for example, that FSAs used 4.8 times as much apron capacity as LCCs and 2.4 times as much runway/taxiway capacity. Whilst the exact provenance of the figures was not discussed, it appears to be based on the European experience of LCCs and it would be reasonable to assume that some of these benefits would be transferable to the context of Virgin Blue and other LCCs entering the Australian domestic passenger market.

257 As a result, we do not see the change to a Domestic PSC as being justified as an appropriate method for encouraging airlines to employ larger aircraft so as to make more efficient use of airport facilities.

Barriers to entry

258 SACL submitted that passenger-based charging promoted competition as it benefited new entrants during their start-up phase when they tend to have lower passenger loads. Mr Schuster contended that passenger-based charges gave a clear advantage to airlines as they converted airport charges to a variable (rather than a fixed) cost, thereby sharing the risk of fluctuating passenger loads with airport operators. He contended that this would reduce barriers to entry for new airlines which traditionally have lower passenger loads during their start-up phase and during the introduction of new routes and expansion and upsizing of fleets.

259 Virgin Blue contested SACL's proposition, relying on the evidence of Dr Philip Williams, Chairman of Frontier Economics in Australia. Dr Williams' evidence supported Virgin Blue's argument that a passenger-based charge could at best be described as a subsidisation of entry, and could not constitute a structural characteristic of the market in the form of a lower barrier to entry. Dr Williams stated that SACL's argument wrongly confused barriers to entry with cash flow, contending:

> *"An essential element of any economic definition of barrier to entry is an asymmetry between incumbents and potential entrants because of their incumbency. The argument of SACL is not contingent upon incumbency: it has to do with turnover."*

260 Virgin Blue gave the example of a prospective new LCC entrant that, similar to Virgin Blue, intended to operate medium-sized aircraft such as the Boeing 737 in a single class configuration. Once this airline reached load factors approximately equal to those currently enjoyed by Virgin Blue and Qantas, it would be faced with paying approximately 50% more under the Domestic PSC than it would under the MTOW-based charge. Virgin Blue submitted that this was a large, ongoing, additional cost to be borne in return for paying lower charges during a short start-up phase. Further, Virgin Blue contended that potential new entrants would make decisions as to whether to enter a market or a particular route based on their potential to operate profitably over the medium to long term, rather than on the basis of reduced losses in the initial few months. Thus, Virgin Blue saw the Domestic PSC as acting as a disincentive to new entry by LCCs by reducing their likely profitability over the medium to long term.

261 Mr Schuster's proposition that the Domestic PSC reduced barriers to entry in the domestic aviation market does not appear to us to be warranted. Mr Schuster justified his proposition on the basis that new airlines traditionally have lower passenger loads during their start-up phase, during the introduction of new routes, and during any expansion or upsizing of fleets. However, we are of the view that this characterisation of new entrants needs to be qualified somewhat. With regard to LCCs at least, their business model is predicated on high load factors, and analysing profitability on a route by route basis. As a result, a new LCC entrant into the market would be more likely to start with fewer routes with reasonably high load factors, rather than low load factors on several routes, and would consider withdrawing from a market or route if it was not achieving high load factors fairly quickly. Thus, if there is any benefit to LCCs of passenger-based charging, it is only for a short period, and is unlikely to be sufficient to outweigh the concerns of an aspiring entrant as to the long-term cost.

262 In any event, in general terms, the benefits obtained by airlines – both LCCs and FSAs – during any start-up phase would be short lived, and although any new entrant would only be required to pay for the passengers it carries, in considering whether it faced any barriers to entry, it would be looking at a longer timeframe than the initial start-up phase or introductory phase of a new route.

263 We also observe that if the Domestic PSC can in fact be characterised in terms of structural market factors, on one view it could be seen as raising barriers to entry rather than lowering

them for new LCC entrants in the medium to long term, as their business models dictate that smaller aircraft and higher load factors be used.

Sustainability of basis for charging in terms of revenue

264 Mr Schuster said that, following the collapse of Ansett, the number of domestic aircraft movements and tonnes landed at Sydney Airport declined more significantly than passenger movements. According to Mr Schuster, both Virgin Blue and Qantas experienced much higher aircraft load factors and passenger numbers remained at relatively high levels. Mr Schuster gave evidence that the reduction in aircraft movements had a significant adverse effect on SACL's revenues. Thus, after the collapse of Ansett in March 2002, SACL was under-recovering against its costs of providing the domestic airside services. Mr Schuster said that, accordingly, "the introduction of passenger-based charges … [was] a step towards reducing SACL's significant under-recovery against allowable revenues following the collapse of Ansett."

265 SACL acknowledged that it had the option of increasing the amount of its MTOW-based charges as a response to its under-recovery of revenue, but said that it decided that passenger numbers were a more appropriate measure for reflecting airport usage. Mr Schuster said that passenger numbers were expected to grow at a faster rate than aircraft movements or total landed tonnes. He said that retention of an MTOW-based charge would have seen SACL consistently under-recover against its required return on domestic airside facilities or it would have required an increase in the MTOW-based charge. Thus, he thought that conversion to a Domestic PSC would allow SACL to generate revenues in line with passenger growth through the airport, although he said that SACL has still under-recovered against allowable revenues, that is, the maximum ceiling which the ACCC allowed for SACL to recover in its decision of 2001.

266 Mr Schuster said that the collapse of Ansett was a risk which could not have reasonably been foreseen when the ACCC's building block methodology for the fixing of SACL's charges was devised. Mr Schuster explained that SACL had initially proposed a rate to the ACCC of $3.35 (excluding GST and security) per passenger, this being based on the charge being levied on arriving and departing passengers excluding transfer and transit passengers, infants and positioning crew. SACL subsequently endorsed a rate of $2.86 per passenger which Mr Schuster said was equivalent to the $3.35 charge but levied on arriving and departing

passengers without an exception for transfer and transit passengers. The amount of 2 cents was added to this amount bringing it to $2.88 for the domestic users' share of recovery of new capital investments.

267 Mr Schuster's proposition that the Domestic PSC provides a more sustainable basis for charging in terms of revenue to SACL fails to explain why a passenger-based charge was more sustainable when, as Mr Schuster himself acknowledged, an increase in the level of the MTOW-based charge could have brought about a similar increase in SACL's revenue.

268 The ACCC described its building block methodology as:

> *"essentially a 'bottom up' approach to pricing based on forecasts of the cost of the service over the regulatory period. Total maximum allowable revenue is calculated as the sum of the return on capital, return of capital (i.e. depreciation allowance) and operating and maintenance expenditure.*
>
> *Prices are then set so that revenue projections based on projected traffic units (MTOW, passengers etc.) are less than or equal to the maximum allowable revenue."*

269 The evidence before us established that, to achieve an increase in airside revenue up to a level consistent with the ACCC's building block methodology, SACL had several options, including:

(a) to increase the then existing MTOW-based charges by around 20%; or

(b) to switch to a passenger-based charge at a rate which would also give an average overall price increase of 20% and result in an increase in charges to Virgin Blue of approximately 52% and an increase to Qantas of 4% or even less; or

(c) some other means, for example a switch to a charge per aircraft movement.

270 The legitimate desire to increase revenue up to the allowable ceiling set by the ACCC does not inevitably lead to the introduction of a passenger-based charge for the Airside Service.

271 It is true that, following the Ansett collapse, the number of flights operating at Sydney Airport decreased and the load factors of the airlines increased, and thus SACL would have been recovering less revenue on the MTOW-based charge it had been imposing. However, the revenue level could have been increased by SACL increasing the MTOW-based charge.

The proposition that SACL needed to change to a Domestic PSC in order to increase its revenue is not warranted, unless SACL believed that other airlines were going to cease operating, or there was some other explanation as to why passenger numbers would be more constant than airline numbers. SACL failed to address this point adequately or provide any supporting evidence for its contentions. Again, we pause to note that SACL has acknowledged that it chose a passenger-based charge "because Qantas preferred it" to an MTOW-based charge, and because it moved close to its allowable revenue. The charge on a per passenger basis was not satisfactorily justified upon recovery of cost principles.

Equity, commercial risk sharing and transparency of charges

272 What was more curious was SACL's proposition that the Domestic PSC provided for greater equity in the application of airport charges. Mr Schuster noted that in making the decision to change from an MTOW-based charge to the Domestic PSC, SACL considered that:

> *"passenger-based charging provided a transparent approach which ensured that airlines pay the same for equivalent levels of service and that passengers using Sydney Airport facilities pay the same in airport charges, regardless of which airline they fly with or the type of aeroplane on which they fly…"*

and

> *"passenger-based charging provided a better measure of airport utilisation than weight-based charges, and also provided for a sharing of risk between airports and airlines, as landing charges are based on fluctuating passenger loads rather than simply the scheduled weight of the aircraft…"*

273 Mr Schuster said that SACL wished to introduce a uniform passenger-based charge that ensured that all domestic passengers paid the same for the use of the same airport facilities, regardless of the airline or type of aircraft on which they travelled. He said that this allowed for commercial risk-sharing between SACL and the airlines and ensured that no airlines received an unintended commercial advantage which could occur under the MTOW-based charges. He said that it also had the advantage of transparency, as it could be separately displayed on passenger tickets or itineraries and made clear to passengers the cost of using the airport facilities.

274 Mr Schuster contended that this approach was more equitable on the basis that all passengers make use of airside facilities and because Virgin Blue and Qantas would be expected to have

significantly different proportions of transferring and transiting passengers based on the greater degree of hub activities undertaken by Qantas at Sydney Airport.

275 Virgin Blue rejected SACL's argument that the charge was more equitable. It noted that an aircraft with no passengers on board, or filled to half its capacity, consumed the same amount of runway, taxiway and apron space as a fully loaded aircraft, and submitted that there was no clear explanation as to why it would be more "equitable" to permit an empty aircraft to pay nothing, or a half full aircraft to pay half the amount levied against a fully loaded plane, when each uses the same amount of the same facilities.

276 In relation to SACL's contention that a Domestic PSC enabled greater commercial "risk sharing," Virgin Blue submitted that this was valid, at best, for the short term only. It noted that if passenger numbers were to decline, there would be a proportionate decrease in aircraft numbers and thus, even without a passenger-based charge, the airport and airlines would share risks in relation to increases and decreases in demand for air travel in the medium to long term. Virgin Blue also submitted that airlines' typical response to external shocks resulting in reductions in passenger numbers was to reduce airfares and increase traffic volumes, and as a result, airports were less exposed to such external shocks than airlines.

277 In our view, SACL's concern should be with the efficient use of the Airside Service rather than with equity as between passengers. The Airside Service costs are not primarily driven by passenger numbers; these costs occur independently of the number of passengers on the aircraft. A full aircraft taking off or landing makes the same use of the Airside Service as an empty aircraft, and any difference in costs to the airport is marginal.

278 By purporting to address equity between airline passengers rather than the efficiency of the use of its services by airlines, SACL is, in effect, discouraging efficiency and innovation by airlines. The Domestic PSC is, in effect, a tax on efficiency. As the Strategy Committee Presentation of February 2003 shows (referred to above at [186]), Qantas carries approximately 1.1 passengers per tonne whereas Virgin Blue carries around 2 passengers per tonne because of its higher aircraft capacity and use of Boeing 737 aircraft. SACL should be addressing the issue of the proper utilisation of its assets and obtaining a proper return and calculating its charge by the costs it incurs, rather than referring to notions of "equity" between passengers.

279 In regard to risk sharing between the airports and airlines, we do not perceive that there was any "unintended commercial advantage" resulting from a charge based on MTOW. Under MTOW-based charges, each airline pays for its use of the service. In this sense, MTOW-based charges address Mr Schuster's concern that airlines should "pay the same for equivalent levels of services". If an airline chooses to use a heavy aircraft, then that has a consequence for the services provided by the airport and the airline pays accordingly. As was noted in Ms Mather's presentation, the aircraft used by larger airlines have longer turn-around times leading to longer stand times, they also use more apron capacity and runway/taxiway capacity. To say that LCCs are gaining an unintended advantage under MTOW-based charges and so should be penalised discourages innovation and efficiency. Rather, based on Ms Mather's analysis, LCCs should be rewarded, rather than discouraged, for their more efficient use of the airside infrastructure.

280 Further, we see no merit in SACL's transparency submission. We do not accept that there would be any merit in displaying the passenger-based charge separately on passenger tickets or itineraries. Passengers are concerned with overall price levels.

Industry standards

281 Mr Schuster said that in formulating the Domestic PSC he had regard to the ACI Policy Handbook. He said that publications of the ICAO were also used by SACL "to some extent". It was submitted that these aviation bodies supported the use of a passenger-based charge such as the Domestic PSC.

282 Mr Schuster characterised the ICAO Policies as tending to lag behind international practice and preferred the ACI Policy Handbook, which included guidelines for airport charges. The ACI Policy Handbook states that aircraft weight is the usual basis for charging for landing and parking. However, it acknowledges that other economic principles are relevant and that the manner in which charges are levied will vary between airports. In particular, it states:

> *"Airport charges must take account of national and local public policy, the rights of airports to determine their own economic and commercial policies, and their financial independence.*
> …
> *The choice of charging systems is affected by many factors which vary from airport to airport. Whilst aircraft weight is the basis for landing and parking charges in many airports, other economic principles may be applied in setting*

> *charges in accordance with the ICAO Airport Economics Manual taking into account the 'cost to access' scarce airport capacity.*
> …
> *Airport charges play a role in the efficient allocation of resources at airports. It is therefore appropriate for airport charges to recover from users the economic costs resulting from air traffic congestion, airport access, aircraft noise and other environmental problems, as well as all other expense items. Differential pricing may be one means of achieving the efficient and equitable allocation of resources and of recovering these economic costs."*

283 Although Mr Schuster contended that no one choice of charge for airside services was necessarily clearly superior to another, he could not point to any policy, guideline, document or presentation which supported the proposition that a passenger-based charge for runways, aprons and taxiways was a more efficient basis of charging than MTOW. Although he had regard to the ACI Policy Handbook, Mr Schuster agreed that there was no statement in it that suggested that a passenger-based charge for runway services was more preferable or more efficient for an aircraft than an MTOW-based charge.

284 Looking at the ICAO Policies and the ACI Policy Handbook, we note that the ICAO Policies are more prescriptive than the ACI Policy Handbook, and explicitly state:

> *"26. The Council recommends that the following principles be taken into account when landing charges are established:*
> *i) Landing charges should be based on the weight formula, using the maximum certificated take-off weight as indicated in the certificate of airworthiness (or other prescribed document) as the basis for assessment. However, allowance should be made for the use of a fixed charge per aircraft or a combination of a fixed charge with a weight-related element, in certain circumstances, such as at congested airports and during peak periods.*
> …"

285 The ACI Policy Handbook is less explicit, but does indicate that weight is an appropriate basis for setting landing charges. Relevantly, neither document makes a specific reference or endorsement to a passenger-based landing charge. In our view, stating that these documents support a passenger-based landing charge is putting the matter too highly.

286 Mr Schuster also submitted that it was "desirable to bring [SACL's] domestic charges into line with the framework that applies to the rest of SACL's airline customers and at the majority of the major airports in Australia". Mr Schuster noted that a number of other Australian airports, including Melbourne, Perth, Canberra, Gold Coast, Hobart, Launceston,

Darwin and Alice Springs, had introduced passenger-based charges since the Commonwealth Government's move to "lighter-handed regulation" in July 2002. He also noted that Virgin Blue had included these airports in its route networks. Mr Schuster contended that this conflicted with Virgin Blue's proposition that the introduction of the Domestic PSC at Sydney Airport was likely to affect its opportunity to compete in the dependent market.

287 Virgin Blue had a ready explanation, which we accept, for the reason why it was prepared to accept passenger-based charges at other airports but not at Sydney Airport. Mr Pen said that Virgin Blue had accepted these charges at other airports as part of wider commercial arrangements with those airports. In particular, in relation to Perth and Melbourne airports, Virgin Blue was able, in exchange for a passenger-based charge, to obtain certainty of price over a long term, commitment to maintain the quality of the airports' services at an acceptable level, and a reduced rate for domestic terminals.

288 The question of why it would be desirable for SACL's domestic charges to be brought into line with the charging methods applied to its international customers, or with charging methods applied at other Australian airports, was not adequately addressed by Mr Schuster. He provided no explanation of what underlying objectives were being achieved. Standardisation is not a benefit in its own right, particularly where there are no economies of scale or scope. In our view, the choice of tariff structure should focus upon the objective of promoting efficient use of the relevant service. Standardisation of charges, even if it supported SACL's position (which in our view it does not), would not be determinative without further explanation of the benefits it would bring.

Pricing in accordance with the ACCC's allowable revenue ceiling

289 SACL submitted that the terms upon which it would price and provide the Airside Service in the future without declaration would be consistent with the terms on which it was likely to price and provide the Airside Service if it were declared. SACL summarised the reasons underlying this submission in the following way:

(a) SACL had set charges and would continue to set charges for the Airside Service consistently with the ACCC building block methodology and the Commonwealth Government's Review Principles, rather than as a monopolist seeking to maximise profit;

(b) the threat of the reimposition of direct price controls, and the ability of Virgin Blue and Qantas to apply pressure on SACL to price consistently with the ACCC's building block methodology and the Review Principles, would ensure that SACL would not set charges in the future inconsistently with the building block methodology or otherwise act in a way that might lead to a diminution of access to the Airside Service;

(c) previous disputes did not disclose any anti-competitive conduct on the part of SACL which would bring about an outcome different to what would occur in a competitive market.

290 In our view, the legitimate desire to increase revenue up to the ceiling set by the ACCC should not be seen as leading inevitably to the introduction of a passenger-based charge for the Airside Service. As previously noted (at [269] above), an increase in airside revenue up to a level consistent with the ACCC's building block approach could have been achieved in a number of ways.

291 As we have already noted, Mr Pen of Virgin Blue said that the change from an MTOW-based charge to a passenger-based charge at Sydney Airport (assuming an 80% load factor, 125 passengers per aircraft and an average MTOW of 69 tonnes) resulted in a 52% increase in charges for the Airside Service paid by Virgin Blue. It will also be recalled that Mr Godfrey had told SACL on 7 May 2003 that he saw Virgin Blue's charges being increased by 53% compared with only a 4% increase for Qantas and an overall price increase to SACL of 20%. These were the consequences (of which SACL was well aware) of SACL electing to increase its revenue by changing the tariff structure in the manner it did.

292 SACL's submission that the increased amount raised by the change to a Domestic PSC fell below the ceiling fixed by the ACCC for allowable revenue, and that therefore the change from an MTOW-based charge to a Domestic PSC was justified and not objectionable, confuses the issue of total allowable revenue with the structuring of charges which allow that level of revenue to be obtained. The revenue ceiling fixed by the ACCC does not bear upon the appropriate manner in which the tariff for charges for the Airside Service is to be set. The fact that overall revenue raised may be within the ceiling of revenue allowed by the ACCC provides no justification for a monopolist determining a tariff charge structure which is

discriminatory or which is not determined by reference to principles which would apply to the fixing of prices in a competitive environment. If revenue raising was the reason for changing the tariff structure, this could just as easily have been achieved by increasing the MTOW-based charge. Indeed, it could have been achieved by any number of tariff structures, including structures more conducive to more efficient uses of the asset, such as an MTOW-based charge with an adjustment for peak and off-peak times.

293 Setting a level of charges for the Airside Service within the ceiling of allowable revenue set by the ACCC tells us nothing about whether SACL has imposed a discriminatory tariff or otherwise set a tariff in a manner which is not consistent with efficient pricing principles which would occur in a competitive environment. Further, the Review Principles provide that in airports without significant capacity constraints, "efficient prices broadly should generate expected revenue that is not significantly above the long-run costs of efficiently providing aeronautical services (on a 'dual-till basis')". This is not the manner in which SACL determined the change from an MTOW-based charge to the Domestic PSC. It did not take into account the cost drivers involved in the provision of aeronautical services. There was no suggestion that Sydney Airport had any significant capacity constraints.

294 A further part of the Review Principles was that "it is expected that airlines and airports will primarily operate under commercial agreements and in a commercial manner". In our view, SACL did not operate in a commercial manner in changing from an MTOW-based charge to a Domestic PSC "because Qantas preferred it" in circumstances where SACL knew that this preference was based upon the competitive advantage Qantas would achieve over Virgin Blue.

295 Further, for reasons which we shall discuss, we do not consider that the threat of reimposition of direct price controls operates as a significant constraint on SACL's exercise of its monopoly power. It has not done so to date. Virgin Blue and Qantas may have had the ability to apply pressure on SACL to ensure that its total revenue did not exceed the allowable revenue set by the ACCC, but the manner in which the change from MTOW-based charge to a Domestic PSC came about shows that Virgin Blue had no ability to apply pressure on SACL to price in a way that was non-discriminatory.

DID SACL HAVE AN INCENTIVE TO RESTRICT COMPETITION IN THE DEPENDENT MARKET?

296 Our task is to determine whether increased access will promote competition in the dependent market. This involves forming a judgement as to the likely conduct of SACL without declaration as against its likely conduct with declaration, that is, to make a comparison of the counterfactual as against the factual. That prediction is influenced by SACL's past conduct. If, in the past, SACL has exercised its monopoly power in a manner which it could not have done in a competitive environment and which adversely affects competition in the dependent market, it is likely that SACL will continue so to act in the future without declaration. It is the objective fact of SACL's past conduct which provides a basis for judgement as to its future conduct. We do not consider that it is necessary to find an incentive on SACL's part to exercise monopoly power in a manner which adversely affects competition in the dependent market before we can form a judgement as to its future conduct. However, if SACL has demonstrated an incentive so to act in the past, this reinforces a judgement based on past conduct that such behaviour will continue in the future.

297 In its final recommendation, the NCC stated:

> *"The Council does not consider whether the service provider intended to harm competition through the exercise of market power. Rather, the focus is on whether a service provider has the incentive to exercise its market power such that its use will have the effect of adversely affecting competition in a dependent market."*

We agree with the NCC's final proposition, but do not consider that the focus should be on incentive to exercise market power. Rather, the focus should be on ability to exercise market power, and whether that ability has been translated into conduct in the past and is likely to be translated into conduct in the future.

298 If we are wrong in our analysis that we do not have to make a specific finding that SACL has an incentive to exercise monopoly power, we are satisfied nevertheless that such an incentive does exist.

299 Whilst the NCC distinguished between a relevant incentive being to exercise market power in such as way that its use will have the effect of adversely affecting competition in a dependent market, and an irrelevant incentive being to use monopoly power to harm competition in the dependent market as such, SACL's submissions before us were focused upon the proposition

that it had no incentive to restrict competition in the dependent market. SACL submitted that its interests were best served by promoting, rather than limiting, competition in the dependent market. This was because SACL did not itself compete in the dependent market and because of SACL's desire and need to derive non-aeronautical revenue from the use of Sydney Airport. Mr Timar of SACL stated:

> *"The reality is that SACL has no incentive to deter Virgin Blue or Qantas from competing or being able to compete with each other, because SACL is not in competition with them and because SACL's success depends upon airlines and passengers using Sydney Airport."*

300 In making good its submission, SACL relied upon the evidence of Professor William Baumol, Professor of Economics at New York University and Professor Emeritus and Senior Research Economist at Princeton University. Professor Baumol observed:

> *"… economic analysis provides substantial insights into the difference between the incentives of two profit-seeking firms, one in an upstream market and the other in a downstream market, in terms of their aims relative to promotion of downstream competition. Normally, and as is true here, the interests of the upstream firm will be served by an* increase *in downstream competitiveness, while the interests of any downstream enterprise will evidently be promoted by a* diminution *of the competitive pressures it faces. This observation about the implicit objectives of the parties to these proceedings may be helpful to the Tribunal in interpreting their contentions, and putting into perspective their positions on the issue of landing and takeoff fees based on number of passengers."*

However, this observation must be considered in light of the limited number of participants in the downstream market.

301 Dr Williams, the economic expert called on behalf of Virgin Blue, accepted that SACL's claim to have strong commercial incentives to increase the level of usage and competition in the dependent market was reasonable in a scenario where a non-vertically integrated monopolist supplied a number of players in a competitive market. However, he observed:

> *"…if you change the model to one of a monopoly seller selling to a few large buyers in order to increase your bargaining power it may well be in your interest to leave some frustrated buyers out there so as to keep the few remaining buyers in line.*
>
> *So my second proposition is that if you consider a situation that, in a loose way, corresponds to the fact before the Tribunal in this case, and you have a single* [supplier] *negotiating prices with a few large buyers, then the theory*

based on stated prices with a monopolist facing competition downstream is no longer applicable and it may well be then in the interests to deny supply to the people downstream."

302 Dr Williams also observed:

> *"A well-known reason why an upstream monopolist (like SACL) may try to restrict the number of firms in a downstream market is so as to make credible its commitment to limit the quantity of services that it provides. This is an important element in maximising its bargaining power with respect to the purchasers of the essential service that it provides.*
>
> *If a monopoly controller of access to a facility with high fixed costs and low marginal costs starts offering cheap deals for access to marginal users, it may become impossible for it to maintain high prices for those users with a high willingness to pay. The problem for the monopolist is how to make its representation to high-paying users that it is not willing to offer cheap deals to marginal customers. One way is simply to refuse to offer any service to them at all. That is, to deny access to more than a few downstream businesses.*
> …
> *Economics does suggest reasons why an upstream monopolist may wish to limit the number of downstream businesses that it provides. The arguments that SACL has proposed with respect to its incentives not to deny access could be used by every controller if an essential facility with high fixed costs and low variable costs associated with use of the facility."*

We accept Dr Williams' analysis.

303 The point to be made is that a non-vertically integrated monopolist selling to a perfectly competitive market with a number of large players will not necessarily want to decrease competition in the downstream market. However, when the downstream market has a small enough number of large players, a monopolist can sometimes increase its own profits by restricting supply and lessening competition in the downstream market.

304 Mr Houston, called on behalf of SACL, said that these exceptions to the general approach of a monopolist should not be the focus of attention, and merely highlighted the complexity of the task facing a regulator. However, Professor Baumol, who was also called on behalf of SACL, accepted that the situation identified by Dr Williams might arise, and accepted that the interests of the monopolist may be ambiguous with respect to competition in the buyer market in that scenario. Mr Henry Ergas, the Managing Director of Network Economics Consulting Group Ltd, who was called as an economic expert on behalf of Qantas, was of the

view that SACL would accept a decrease in demand for the Airside Service if it received an increase in its share of profit.

305 We accept the proposition that, while a monopolist would ordinarily have no incentive to deny access to its facilities to downstream customers where there is strong competition between its customers, this situation does not hold where the market is characterised by relatively few large customers and strategic behaviour is possible. The relevant issue was cogently summarised by Professor Oum, who opined:

> *"… each of the airlines might want to cut a special deal with SACL, and SACL may be able to use a divide-and-conquer strategy. This is particularly the case when a generic airside service charge increase has a different degree of impact on Qantas and Virgin Blue."*

306 In this context, we refer again to the Strategy Committee Paper of December 2002 (see [183] above). It will be recalled that in the course of that Paper it was asserted:

> *"Qantas continues to be extremely keen that a domestic PSC be introduced. It is recognised informally that the potential exists for SACL to derive more revenue from a PSC than the weight-based equivalent, but has no difficulties with this. The main reasons for Qantas' enthusiasm for the PSC are that it can be passed directly to passengers, becoming a variable cost while Qantas would be unlikely to adjust airfares, and because it could strengthen their commercial position relative to Virgin Blue."*

307 We are also mindful in this regard of Mr Schuster's response to counsel for Virgin Blue's questioning about SACL's motivation for changing the tariff structure from an MTOW-based scheme to a passenger-based scheme – that "We did do it because Qantas preferred it" (see [215] above). This response and the observation in the Strategy Committee Paper of December 2002 demonstrates the validity of Professor Oum's proposition.

308 We also note that SACL's change in tariff structure had no basis in efficient pricing, and was not based on the relevant cost drivers of the service.

309 SACL had several potential incentives for initiating the change in tariff structure, including its value as a bargaining chip for inclusion in the Deed of Settlement, its effect in raising revenue nearer allowable levels in the short term, and an expectation of it exceeding allowable revenues in the longer term.

310 A significant factor in SACL's decision to implement the passenger-based charge was that it would not be opposed by Qantas so long as it applied to all airlines. SACL was aware that the change would provide a relative advantage to Qantas over Virgin Blue and would therefore provide a relative disadvantage to Virgin Blue, or other LCCs. This is against a backdrop where Virgin Blue's entry and expansion was increasing the intensity of rivalry in the market for the carriage of domestic air passengers into and out of Sydney.

311 We do not accept SACL's proposition that, because it does not itself compete in the dependent market and because airlines and the passenger traffic through Sydney Airport which airlines generate provides revenue to SACL, its only incentive must be to promote competition in the dependent market. In our view, in line with the evidence of a number of the economic experts, situations can arise where a monopolist supplying a small number of large buyers in the downstream market may have an incentive to restrict or affect competition in the downstream market.

312 The evidence before us suggests that the present scenario in which SACL supplies a small number of airlines at Sydney Airport, including one airline with considerable market power – Qantas, undermines the assumption that SACL's only incentive will be to act in a manner which promotes competition in the dependent market. We are not satisfied that SACL lacks the incentive to exercise its market power such that its use will have the effect of adversely affecting competition in the dependent market.

LEVEL OF REVENUE ISSUES

313 As at the date of the hearing, there was no suggestion that SACL was deriving revenue from the use of Sydney Airport which was in excess of the ceiling of revenue set by the ACCC in 2001. Nevertheless, two revenue issues have arisen for consideration. The first is that the period during which SACL's ceiling of revenue has been determined by the ACCC will expire in May 2006. Thereafter, in the absence of further regulation, SACL will be able to pursue increases in revenue beyond the present ceiling established by the ACCC. It is probable that SACL will seek to achieve this result having regard to its past performance and current issues under consideration. We point to:

- the manner in which SACL changed the basis of its airside charges in July 2003;
- outstanding issues in relation to the components of the building block methodology such as the value of land and the asset beta. (The asset beta is a reflection of the risk of the business relative to the market value of the asset. It is a ratio of the expected relative movement of the value of the asset, versus the relative movement in value of the overall asset market);
- a model prepared by SACL showing that the Domestic PSC could rise in the future;
- SACL's proposal to carve out areas otherwise covered by the Airside Service and to impose further charges in respect of their use, which will not be the subject of price regulation.

314 The second issue is that SACL has indicated that it is considering a number of proposals which involve raising new and separate charges from its Airside Service charge, namely the potential imposition of fees for ground handling services and a fuel throughput levy.

Revenue level

315 Although SACL's level of revenue has not exceeded the level of allowable revenue established by the ACCC to date, there was an issue as to what level of revenue SACL would seek to derive from the use of Sydney Airport once the period for which the ACCC has established a level of allowable revenue expired.

316 The airlines referred to SACL's 'Airline Commercial Agreement Aeronautical Charging Proposal' which SACL presented to the airlines and their representative body, BARA, on 7 July 2004 ("7 July 2004 Charging Proposal"). That Proposal was to form the basis for negotiation of future terms of airport pricing, service levels and conditions of use of Sydney Airport. The 7 July 2004 Charging Proposal adopted the structure of the ACCC building block methodology (referred to above at [268]).

317 There were, however, three respects in which SACL took a different view to the ACCC, which differences had resulted in the ACCC not approving the total increase originally sought by SACL in its application of May 2001.

318 SACL's 7 July 2004 Charging Proposal included the following figures:

- a weighted average cost of capital ("WACC") of 7.9%;
- a risk free rate of 5.9%;
- an asset beta of 0.75;
- a forecast of an increase in domestic passenger traffic from 17,470,000 in 2005 to 22,933,000 in 2011.

319 The differences between SACL's 7 July 2004 Charging Proposal and the ACCC building block methodology were:

(a) the ACCC had used an indexed historic cost of land, whilst SACL used opportunity cost to determine land value;

(b) the ACCC had determined an asset beta of 0.6, used as a component of the formula to determine the WACC, whereas SACL used an asset beta of 0.75;

(c) the ACCC had considered that SACL's operating costs may not be efficient and so had proceeded on the basis that SACL should achieve annual efficiencies which translated into real reductions in operating costs of 4% per annum, whereas SACL contended that its actual operating costs should be used.

320 The 7 July 2004 Charging Proposal resulted in a domestic pricing model which increased the Domestic PSC from its then current amount of $2.88 to $3.08 in 2005, and to $4.63 in 2011. That increase represents a real per annum increase of 4.44% over seven years.

321 Following the 7 July 2004 Charging Proposal, SACL then distributed a proposed Long Term Aeronautical Services Agreement, dated 28 September 2004, to the airlines ("draft Aeronautical Services Agreement"). We note that Recital D of this Agreement states: "this agreement replaces the former agreement known as Sydney Airport's Conditions of Use".

322 A model was tendered at the hearing which revised SACL's 7 July 2004 pricing model as at 28 September 2004 ("the 28 September 2004 model"). The 28 September 2004 model forecast charges out to 2010/2011. In the 28 September 2004 model, as with the 7 July 2004 model, SACL started with the ACCC building block methodology which, as noted above, had

used an indexed historic cost of land (rather than opportunity cost) to determine land value, and an asset beta of 0.6 rather than 0.75. The 28 September 2004 model:

- changed the planned capital works over seven years of $426 million to planned capital works over five years of $317 million;
- continued to ascribe a value to aero land and assets on the basis of opportunity cost at $1.931 million;
- continued to use an asset beta of 0.75;
- continued to use a WACC of 7.9%;
- used a risk free rate of 5.9%;
- did not change the forecasted increase in domestic passenger traffic used in the 7 July pricing model.

323 This 28 September 2004 model produced a projected airside passenger service charge (at that time $2.88) of $3.02 in 2004/2005 and $3.98 in 2010/2011 and a seven-year constant passenger charge of $3.44. This, according to SACL, constituted a real per annum increase of 2.15%.

324 Virgin Blue produced a similar model calculated with the same structure as SACL's 28 September 2004 model but in relation to the following key parameters:

- it used the ACCC's indexed historical cost method to value the aero land and assets (at $70 per square metre), which it valued at $1,408 million. (We note that Mr Timar contended that $70 per square metre, the value used by the ACCC was not the correct figure to use. He asserted that $77 per square metre, the indexed figure as at the date of the hearing, was the appropriate figure);
- it used an asset beta of 0.6 which resulted in a real cost of capital of 7.03%.

325 Virgin Blue's model produced a projected airside passenger service charge of $2.81 in 2004/2005 and $2.40 in 2010/2011 and a seven-year constant passenger charge of $2.61. This constituted a real per annum decrease of 5.17% smoothed. We note that, if Mr Timar's figure of $77 per square metre is adopted for land value instead of $70, the seven-year

constant passenger charge would increase by 6 cents to $2.67. This constitutes a real per annum decrease of 4.57% smoothed.

326 In addition to the issue between SACL and Virgin Blue as to the correct figures to be inserted into the building block methodology in relation to the land value and asset beta, there is also an issue of how to determine the forecasted passenger numbers to be taken into account in assessing SACL's total costs to determine the appropriate passenger service charge after the expiry of the ACCC assessed revenue levels in May 2006.

327 We observe that, in its draft Aeronautical Services Agreement, SACL has included a force majeure clause which insulates SACL from much of the risk of a sudden downturn in revenue from its Airside Service, which clause will be discussed in more detail below. All other things held constant, this clause would be expected to reduce the volatility of the underlying cashflows and reduce movements in the value of the asset as the market moves. The force majeure clause in the draft Aeronautical Services Agreement therefore suggests the use of a lower beta. However, in its pricing models for the future, SACL has in fact increased its assumed asset beta to 0.75, beyond the original ACCC asset beta of 0.6.

328 We also observe that the growth of LCCs and forecasted passenger growth in domestic air traffic demonstrates that domestic passenger numbers will increase at Sydney Airport over the next five years or so. The incremental cost of additional passengers on the cost of maintaining the assets the subject of the Domestic PSC is nominal. The marginal cost of the Airside Service per passenger is probably close to zero. As passenger numbers increase, it would be expected that the Airside Service charge would decline in real terms over the period of the pricing proposal, rather than increase as SACL currently proposes.

329 It is no part of our task to determine what value should be attributed to aero land and assets, what asset beta should be used, and what projected passenger increases should be allowed for, in determining the appropriate charge on a per-passenger basis for the supply of the Airside Service after May 2006. However, we consider it appropriate to observe that SACL's proposed pricing should be based on a rigorous appraisal of the cost drivers of providing the Airside Service, including the determination of the appropriate land valuation, the beta to apply to the WACC, the force majeure clause and its impact on the beta, and the efficiencies realised from increases in passenger numbers at Sydney Airport over the length of the pricing

proposal. The result of applying SACL's methodology instead of Virgin Blue's methodology is to impose substantial cost increases on the airlines in the future, and to enable SACL to derive revenue substantially in excess of what it is deriving whilst under the ACCC-regulated ceiling.

330 We were informed that BARA and SACL had agreed upon Ernst and Young as a proposed party who could resolve the beta issue, or if not resolve it, give advice in respect of it. That advice would not be binding on the parties and, as at 8 October 2004, Qantas and SACL were not in agreement as to the terms of Ernst and Young's engagement letter.

331 Suffice it to say that, whilst these issues are outstanding, with no opportunity for arbitrated or independent resolution, there is still the opportunity for SACL to impose higher charges upon the airlines without the airlines having recourse to independent arbitration and determination.

332 What this analysis demonstrates is that there are likely to be substantial revenue issues during the period in respect of which declaration is sought, this being five years, and beyond. In the light of the history of the development of the Domestic PSC and the manner in which SACL is contemplating imposing further charges, these revenue issues are likely to be resolved by SACL exercising monopoly power to impose upon the airlines a level of revenue growth which would not be open to it in a competitive environment.

SACL's intention to impose new charges in the future

333 A significant issue arose in the proceeding in relation to the claim by Virgin Blue and Qantas that SACL was proposing to levy new charges which would be in addition to the charges relating to the Airside Service. The airlines contended that SACL was proposing to excise specific services from the services covered by the existing Airside Service charges without a commensurate reduction in the level of the Airside Service charge. Ground handling services and a fuel throughput levy were given as examples of what the airlines called "carve-outs" from existing services and charges.

334 This issue illustrates the significance of the scope of the Airside Service. One of SACL's key submissions was that the Domestic PSC related to only some airside activities, relying upon SACL's Standard COU and the draft Aeronautical Services Agreement that specifically exclude certain services and facilities from the services and facilities to which those

agreements relate. On this construction of the Airside Service, SACL had contended that it could impose licence fees for ground handling and any fuel throughput levy on the basis that they were not services that SACL provides to the airlines and so were not covered by the Domestic PSC. SACL argued that it had a right to impose new charges upon parties seeking to use its facilities to provide services to the airlines, whether or not the parties seeking such access were the airlines themselves or third party service providers.

335 There is currently no agreement or licence in existence between Qantas and SACL in respect of ground handling services, although discussions are on foot in order to commit an agreement to writing in the form of the draft Ground Handling COU. Qantas has historically conducted its own ground handling activities and it established a new subsidiary called Express Ground Handling Pty Limited to conduct ground handling activities for Jetstar aircraft.

336 Clause 9.1 of the draft Aeronautical Services Agreement sets out the facilities and services which are not subject to the charges payable by airlines under the Agreement. These facilities and services relevantly include "(g) *ground handling services* other than allocating aircraft parking bays".

337 "Ground handling services" are defined in the draft Aeronautical Services Agreement by reference to the draft Ground Handling COU. In the draft Aeronautical Services Agreement, "ground handling services" is defined to mean "those services that are governed by [the draft Ground Handling COU]" and which generally include any of the following:

> *"(a) load control and communications;*
>
> *(b) unit load device (ULD) control (assumed to be responsibility of freight handler or, if no freight handler exists, the baggage handler unless otherwise advised to SACL);*
>
> *(c) passengers and baggage processing;*
>
> *(d) cargo and mail handling;*
>
> *(e) ramp services;*
>
> *(f) aircraft servicing;*
>
> *(g) fuel and oil servicing;*
>
> *(h) aircraft maintenance;*
>
> *(i) flight operations;*

(j) catering services;

(k) supervision and administration;

(l) crew administration;

(m) security services;

(n) airside escort services;

(o) freight bypass services;

(p) livestock bypass facilities;

(q) airside driving authority (ADA);

(r) category 2 ADA Theory and Practical Training Course; and

(s) authority for use airside (AUA)".

338 "Ground handling services" are defined in the draft Ground Handling COU by reference to a list of different services, including "any other direct support function required to facilitate aircraft operation and which requires access to the *airside*".

339 The draft Ground Handling COU does not include the imposition of a fee by SACL on Qantas for ground handling and other services. However, the agreement is expressed to expire on the later of 1 July 2006 or three months after a notice of review is issued. If, after the date of termination of the draft Ground Handling COU, new conditions are not agreed between Qantas and SACL, which conditions may include the imposition of a charge for conducting ground handling activities, then SACL would have the right to stop Qantas from using SACL's facilities and services at Sydney Airport to conduct its ground handling activities. This result is brought about by the operation of cl 19 of the draft Ground Handling COU which provides:

> *"**19. Termination and holding over provisions***
>
> *This agreement shall remain in force until the later of 1 July 2006 or either you or SACL requesting a review of this agreement in which event will trigger a three month notice of termination of this agreement. In the event that new conditions are not agreed you will be in breach of these conditions and SACL may stop you from using SACL's* services and facilities *under clause 11.3 of these conditions*."

340 Clause 11 of the draft Ground Handling COU relevantly provides:

> *"**11. If you do not comply with these conditions***
>
> *11.1 Subject to SACL's obligations under* legislation*, SACL may give you 14 days notice in writing not to use the* facilities and services *at the* airport *if you do not comply with these conditions in a material way after giving you a reasonable time to rectify the breach.*
>
> *…*
>
> *11.3 SACL may stop you from using the* facilities and services *at the Airport if you do not comply with SACL's notice if it has given you a reasonable time to rectify the breach. However, SACL agrees to meet with you and negotiate in good faith prior to the taking* [of] *such action in relation to the terms and conditions on which access to and use of the Airport may be provided following such an event if acceptable to SACL."*

341 In its draft Aeronautical Services Agreement, SACL states that it will not impose any new fees or charges for the provision of facilities or services outlined in the Agreement, but then specifically reserves its right to levy other certain new fees. The following provisions are relevant:

> *"21.1 During the* Term*, SACL will not impose any new fee, charge or levy for the provision of* facilities and services*, other than as permitted under this agreement.*
>
> *21.2 For the avoidance of any doubt:*
>
> *(a) during the* Term*, SACL is not prevented from passing onto the* Operator *any new costs which are imposed on SACL, such as those imposed by* legislation *or mandatory direction given to SACL by an* authority*; and*
>
> *(b) SACL is not restricted from negotiating a fee, charge or levy with any person relating to use of:*
>
> *(i) any facilities and/or services that fall outside the scope of this agreement including in relation to:*
> - ***fuel throughput levy****;*
> - *landside ground transport user fees for commercial hire vehicles;*
> - **ground handling services***; and*
> - *airside advertising; or*
>
> *(ii) the* facilities or services *for a use other than the* permitted use*."* (emphasis added)

342 Thus, although there is currently no charge associated with the draft Ground Handling COU, by operation of cl 11 of the draft Ground Handling COU and its definition of ground handling as outlined above, and the operation of the draft Aeronautical Services Agreement, it appears

that SACL has reserved to itself the right to charge in the future in respect of any other direct support function required to facilitate aircraft operation which requires access to the airside.

343 The existence of these clauses has led the airlines to believe that they are soon to be subjected to new charges, rather than be subjected to increases in the charges currently levied for the Airside Service. Virgin Blue submitted that the intention is for new charges to fall outside the definition of "aeronautical revenue" so that they are not reportable to the ACCC and do not form any part of the basis for charges currently levied pursuant to the commercial agreements in place between SACL and the airlines. The categories listed under "ground handling services" are numerous and none are presently subject to the imposition of fees.

344 SACL denied it was proposing to carve out services from existing services and maintained that the proposed charges which were being considered were for different services than those presently within the Airside Service.

345 SACL submitted that, although it does not presently impose fees for ground handling services, if it were to impose a fee on these services, it would not amount to a carve out. SACL argued that ground handling arrangements clearly fall outside the purview of the existing conditions of use agreements. SACL noted that it does not provide ground handling services to airlines itself, rather these services are provided by either the airlines themselves or third party providers.

346 It is apparent that SACL's intention is to use the draft Aeronautical Services Agreement so as to enable it to create and impose new charges, some of which cover services already included within the Airside Service. In this way, SACL will be able to increase its revenue without the new charges being subject to price monitoring.

347 SACL's intention is found, for example, in SACL's 'Board Strategy Committee Decision Paper 8/16', dated 17 December 2003 ("Strategy Committee Paper of December 2003") which states:

> "Integration of Commercial Agreement with other SACL Initiatives
>
> *51. In developing the proposed commercial agreement, management will liaise closely to ensure that the strategy and approach fits with and complements other initiatives, in particular a* ***fuel throughput levy****,* ***ground handling fees, ground access fees*** *and improved efficiency in*

> *the GA and corporate areas.* ***Generally, areas excised from the airline commercial agreement, and charges set lower than could be justified using fundamentals, will support the case for implementation of other specific user charges.****"* (emphasis added)

348 This intention was confirmed by Mr Timar of SACL, whose position description included maximising aeronautical revenues, including determining appropriate long-term charges strategy and periodic implementation of revised charges. Mr Timar was a sponsor of the Strategy Committee Paper of December 2003.

349 Mr Timar accepted that SACL intended to reserve the right to impose a levy, fee or charge in the future on anyone undertaking any of the activities within the definition of "ground handling services". His approach was that, if there were a more modest increase in the future in the charges for the Airside Service, it would render the newly introduced charges more acceptable. It was clear to us that what SACL was proposing was to create an opportunity to increase its aeronautical revenue substantially without being subjected to any control or supervision over the newly introduced fees and charges.

350 Although the views expressed in the Strategy Committee Paper of December 2003 were the views of Mr Timar and Mr Schuster, it was not suggested that those views were not adopted by the SACL Board. Indeed, the structure of the draft Aeronautical Services Agreement is consistent with those views having been adopted.

351 Mr Timar acknowledged that the difference between "ground access fees" and "ground handling fees" (the expressions referred to at [51] of the Strategy Committee Paper of December 2003 cited above), was a "reasonably fine one". He said that the ground handling fees related to services predominantly on the airside at the airport, and that ground access fees related to matters where people were seeking to run their businesses through gaining access to the airside of the airport. Mr Timar gave the example of a ground handler loading and unloading baggage as a service that would be covered by a ground handling fee, and the example of the movement of catering on and off the airport as a service that would be covered by a ground access fee. Mr Timar said that, in principle, SACL would be interested in imposing a fee in respect of the use of the apron for the provision of catering services, as well as possibly charging an access fee for a caterer to enter the airport generally.

352 Mr Timar described the Domestic PSC as payment for access to the "airfield assets of the airport" for domestic movement. He defined "airfield assets" as the runways, the taxiway and, depending on the exact arrangements, possibly the aprons as well. SACL's Mr Schuster described the Domestic PSC as a charge for:

> *"domestic airlines' use of the runway, taxiway and airside facilities at Sydney Airport and is currently charged to the airlines at the rate of $2.88 per passenger for each landing and departure. The services to which the Domestic PSC relates are often referred to as 'domestic airside services'…"*

353 Qantas submitted that the Domestic PSC is a charge, at least in part, for access to the facilities described in sch 9 of SACL's Standard COU (set out above at [92]), which is in similar terms to the equivalent schedule in the conditions of use agreement governing SACL's relationship with Qantas. Qantas submitted that access to aprons for the purposes of parking was paid for under the PFC, however access to the aprons for other purposes – such as ground handling – was paid for under the Domestic PSC.

354 The difficulty with SACL's submissions is that the definition of ground handling services in the draft Aeronautical Services Agreement is so wide as to include services which are already covered, in whole or in part, by services included in services for which the Domestic PSC is charged. We refer in particular to services that are conducted on, or in relation to, aprons such as "ramp services", "aircraft servicing", "fuel and oil servicing", "aircraft maintenance" and "catering services".

355 Mr Schuster sought to explain some of the charges which would be included in ground handling charges as resulting in "commercial" revenue rather than "airside" revenue. He explained some of the charges as a concession fee in the following way:

> *"So, where does the ground handling charge fit?---I think it's best considered in terms of a concession fee, so the basic assets required to provide ground handling services around aircraft are covered by the airside charge, to the extent that a ground handling company undertakes ground handling business on the airport and stores its equipment in exclusive licensed areas around the airport then we have as* [sic] *view to a form of concession rental for the rights then to operate off the airport.*
>
> *And we've had concession charges like that before, have we which are therefore grandfathers* [sic]*?---Not for ground handling to my knowledge.*

> *So that would be notifiable to the ACCC?---It would essentially be commercial revenue because we would be seeking to put in place a commercial arrangement with businesses operating on the airport providing support services. I'd view it as commercial revenue."*

356 Whichever characterisation is correct, be it commercial or airside revenue, the consequence is that SACL is reserving the opportunity to increase charges under the draft Aeronautical Services Agreement in respect of the use of assets already the subject of a Domestic PSC, such as aprons, which will impact either directly or indirectly on airlines. It is doing so in a way which has the effect, presumably intended, of excluding such charges from price monitoring.

357 The fuel throughput levy is another charge that is expressly excluded from the scope of the draft Aeronautical Services Agreement by operation of cl 21.2, set out above. Refuelling services at Sydney Airport are provided by the "JuHi Consortium." A lease agreement dated 8 January 1990 between SACL and the JuHi Consortium provides for a fuel throughput charge to be imposed. However, at the time of the hearing SACL had not imposed any charge for fuel throughput.

358 SACL submitted that if it were disposed to impose a fuel throughput levy, it would be introduced in accordance with the terms of its lease agreement with the JuHi Consortium and would not be a charge for the Airside Service or for the use of "airside facilities that are used in connection with the Airside Service". SACL therefore submitted that the imposition of a fuel throughput levy would be done by activating an existing right under the commercial lease of non-airside land and in respect of the business conducted on that land.

359 SACL referred to the fact that other airports, namely the Brisbane and the Perth airports, had imposed a fuel throughput levy. It also contended that there was support for the imposition of such a levy, without any setting off against charges for the Airside Service, in the Productivity Commission Inquiry Report.

360 SACL emphasised the fact that the fuel throughput levy would be a charge on a third party, the JuHi Consortium, and so would not represent a direct charge on the airlines, although it acknowledged that it may indirectly increase the cost of airlines.

361 Virgin Blue submitted that SACL is proposing to seek to avoid having to report to the ACCC on the proposed fuel throughput levy so that it can earn revenue from that levy in addition to aeronautical revenue.

362 SACL's 'Board Strategy Committee Paper 8/17', presented to the SACL Board Strategy Committee on 17 February 2004 ("Strategy Committee Paper of February 2004") and sponsored by Mr Timar and Mr Schuster, noted:

> *"The modelling does not take into account revenues expected from a fuel throughput levy. ACCC regulatory reporting requirements include fuel-related revenues as aeronautical, however, also include an exemption for revenues from pre-existing arrangements entered into under FAC common seal. If implementation of the proposed fuel throughput fee is done in the context of the existing JUHI lease, then SACL would have grounds to exclude these from reported aeronautical revenues and by implication, not take fuel throughput revenues in account in setting aeronautical charges. This is the approach adopted to date by Brisbane and Melbourne airports."*

363 There is support for the airlines' submission that an inference should be drawn that SACL will seek to introduce these new charges in such a way as to avoid the ACCC's price monitoring. In cross-examination Mr Schuster was taken to the Strategy Committee Paper of February 2004 which he sponsored. Although Mr Schuster said that the manner in which the fuel throughput levy was proposed was not to avoid reporting, he accepted that if it was done under the existing arrangements then it would not be reportable. He accepted that he thought the SACL Board Strategy Committee would be interested in knowing that if they implemented the proposed fuel throughput levy in a particular way SACL would not need to report it to the ACCC. He denied that SACL's purpose in not reporting the proposed levy would be to minimise the effectiveness of the ACCC's price monitoring process. Rather, he said that the purpose in not reporting the levy would be to earn revenue from it in addition to SACL's aeronautical revenue.

364 Whatever the purpose of structuring the levy so as to avoid ACCC price monitoring – the end result is the same. SACL is seeking to maximise revenue as a monopolist without being subjected to the constraints in a competitive situation which would otherwise limit the opportunity to extract a monopoly rent.

365 In our view, there is a clear distinction between, on the one hand, refining the structure of charges which together generate the allowable level of revenue for airside services, and, on the other hand, continuing to set existing charges at the same level and introducing new charges which generate additional revenue.

366 We are satisfied that, without declaration, SACL will seek to increase its revenues by reference to charges imposed either directly or indirectly on airlines by creating specific new charges calculated to increase revenue in a manner which will not be the subject of supervision or control and will be implemented in a manner which would not otherwise occur in a competitive environment.

NON-PRICE TERMS AND CONDITIONS

367 Virgin Blue and Qantas complained about a number of non-price terms and conditions that govern their relationship with SACL. Virgin Blue contended that SACL has the ability to exercise its monopoly power in ways unrelated to price to affect competition in the dependent market, and that in a number of ways SACL had imposed non-price terms and conditions on the airlines which have the potential to impact significantly on the operations of the airlines and on their ability to compete effectively in the dependent market. Qantas similarly submitted that the non-price terms and conditions of which the airlines complain are examples of SACL restricting access to the Airside Service in ways which have substantially impaired Qantas' operations and the quality of service it has been able to provide to its domestic passengers. Qantas contended that SACL's conduct in this regard harmed competition in the dependent market.

368 The non-price terms and conditions of which the airlines complain are found in a number of commercial agreements, either implemented or proposed, between SACL and the domestic airlines using Sydney Airport. These include:

- conditions of use agreements which cover a number of facilities and associated services at Sydney Airport, of which there is a Virgin Blue-specific version and a Qantas-specific version;
- the draft Aeronautical Services Agreement which was proffered by SACL on 28 September 2004. We note that Recital D of this Agreement indicates that this document will replace the existing conditions of use agreements";

- a long-term agreement between Virgin Blue and SACL which covers Virgin Blue's use of Terminal 2;

- a number of documents constituting a "Heads of Agreement" which governs Qantas' use of Terminal 2. The Heads of Agreement includes the "Outline of Key Principles for the Occupation and Use by Qantas and QantasLink of the former Ansett Terminal for Domestic Services to be incorporated in formal documentation", dated 23 August 2002; a "Record of Meeting with Qantas Airways Limited and Sydney Airports Corporation Limited dated 16 September 2002"; and supporting letters dated 17 September 2002 and 24 September 2002;

- a long-term exclusive lease between Qantas and SACL which governs Qantas' use of Terminal 3.

369 At the time of the hearing, there was no agreement or licence in place between Qantas and SACL in respect of ground handling services, although there were discussions in relation to a written agreement. To this end, SACL has prepared the draft Ground Handling COU to which we referred earlier.

370 The airlines complained generally about the lack of negotiation in the implementation of the conditions of use agreements.

371 The airlines also submitted that a number of particular non-price terms and conditions imposed upon the airlines evidenced SACL's ability to use its monopoly power to the detriment of the airlines' ability to compete in the dependent market and therefore to the detriment of competition in the dependent market generally.

372 Of particular relevance are the following non-price terms and conditions which appear in the existing conditions of use agreements or in the draft Aeronautical Services Agreement which SACL has indicated may replace those agreements:

- SACL's unilateral right to increase prices charged for the use of facilities and services, combined with SACL's ability to detain planes on default of payment of charges by Virgin Blue;

- the limited nature of the dispute resolution procedure provided for and the lack of adequate opportunities for arbitration in the draft Aeronautical Services Agreement;
- the force majeure clause in the draft Aeronautical Services Agreement;
- the lack of minimum service standards in the conditions of use agreements;
- SACL's exclusion of liability clause in the conditions of use agreements and the draft Aeronautical Services Agreement.

373 The airlines also referred to a number of specific incidents which they said illustrated the way non-price terms and conditions imposed by SACL could have a significant impact on airlines' operations and their ability to compete effectively in the dependent market. The incidents to which the airlines referred were:

- SACL's response to Qantas disembarking arriving passengers from an aircraft at one terminal and then having departing passengers for the same aircraft embark through another terminal, described as the "split aircraft turn-around issue";
- SACL's discussions with REX regarding REX's access to Gate 39 in Terminal 2.

Negotiation of the conditions of use agreements

374 SACL provides airlines with access to the aeronautical facilities at Sydney Airport under conditions of use agreements which set out the contractual and administrative framework for the use of various facilities at the airport, as well as the charges which apply for the use of those facilities and related services. The conditions of use agreements are not identical for all airlines. SACL's Standard COU has been modified in relation to both Virgin Blue and Qantas. Although there are differences between the conditions of use agreements, there are some key common clauses.

375 The airlines' concerns regarding the conditions of use agreements related to the manner in which SACL negotiated or settled the terms and conditions contained in such agreements. The airlines submitted that the process involved little negotiation. Given the lack of viable alternatives to Sydney Airport, the airlines had little choice but to accept terms and conditions, some of which they claimed could not otherwise have been imposed in a competitive market.

376 In 1998, SACL developed a draft conditions of use agreement and entered into a period of consultation with its main aviation customers at the time, Ansett and Qantas, BARA and the International Air Transport Association. Amendments based on some of BARA's responses to the draft were made and a further draft was distributed in April 1999.

377 When SACL distributed its proposed draft conditions of use agreement in April 1999, Qantas objected on the basis that they were generic conditions, and did not reflect the size of Qantas' operations at Sydney Airport, the fact that Sydney Airport is Qantas' main operations base, or the specific requirements and nature of the relationship that Qantas had with Sydney Airport.

378 In late November 1999, SACL wrote to Ansett and Qantas informing them that the conditions of use agreement enclosed with its letter would come into force on 1 January 2000.

379 Qantas continued to assert that it was only bound by any written or unwritten terms and conditions of use that applied in 1999 and that it was not bound by the agreement proposed by SACL.

380 As noted earlier, in February 2000, Qantas and a number of other airlines commenced proceedings against SACL in the Federal Court of Australia. In March 2001 SACL and Qantas commenced discussions in relation to an out-of-court settlement of those proceedings, resulting in the Deed of Settlement signed on 1 August 2001. One of the terms of the Deed of Settlement required that Qantas and SACL execute the Conditions of Use and Deed of Variation to the Conditions of Use attached to the Deed of Settlement ("Qantas COU").

381 There is some dispute as to when the Qantas COU came into operation. SACL submitted that it was on 1 January 2000, as stated in its letter of November 1999, whereas Qantas submitted that it was on the date of the signed version following the settlement on 28 August 2001. Regardless of which date is correct, it is clear that the Qantas COU resulted only after a lengthy period of negotiation.

382 Qantas submitted that, although some variations to SACL's Standard COU were made in the Qantas COU, such variations were "superficial", and the terms that were ultimately agreed upon were not reflective of terms that would be obtained through negotiation with a service provider such as SACL in a competitive market.

383 SACL responded that it had negotiated with Qantas and had agreed to a number of changes to its proposed conditions of use agreement. SACL submitted that for three years Qantas refused to engage, in any meaningful manner, in negotiations on the draft conditions of use agreement, and had refused to be bound by SACL's proposed conditions of use agreement even whilst it continued to use the aeronautical services provided by SACL.

384 As previously noted, a modified version of SACL's Standard COU also applies to Virgin Blue, the "Virgin Blue COU". Virgin Blue similarly contended that its attempts to negotiate amendments to the Virgin Blue COU were largely unsuccessful and that the changes made to the Virgin Blue COU were not commercially significant. Mr Pen of Virgin Blue said that the only amendments to SACL's Standard COU which Virgin Blue had been able to negotiate with SACL were "procedural as opposed to substantive" and mainly clarified the operation of the agreement, rather than providing commercially significant rights or obligations.

385 Mr Pen said that other major airports, such as the main airports at Brisbane and Melbourne, had been more willing to negotiate conditions of use with Virgin Blue.

386 The conduct of SACL in relation to the conditions of use to be applied to Jetstar was also relied on as an example of SACL's use of monopoly power to impose non-price terms and conditions that would impact upon an airline's ability to compete in the dependent market.

387 On 16 October 2003, Qantas announced the launch of Jetstar, and shortly thereafter negotiations with SACL on operational issues were instituted. The issue of terms and conditions of use was first raised by SACL on 5 May 2004, when Ms Michelle Turcotte, Manager, Freight and Aviation Agreements at SACL, sought Jetstar's agreement to be bound by the Qantas COU. Mr Terry Bowen, Chief Financial Officer of Jetstar, responded on the same day indicating that Jetstar would either agree to be bound by the Qantas COU or sign a new conditions of use agreement to be agreed with SACL by Friday 7 May 2004. Jetstar then sought confirmation that it could continue to set up Terminal 2 during the negotiation of the conditions of use agreement.

388 Jetstar was concerned that the Qantas COU contained three clauses that were not in Jetstar's interests: first, that Jetstar would be bound by any increase in charges unilaterally imposed by

SACL; secondly, that an indemnity clause excluded SACL from liability for Jetstar's loss and damage even where SACL was negligent or reckless; and thirdly, that the Qantas COU did not contain minimum service levels. Jetstar therefore sought to negotiate changes to those clauses.

389 On 17 May 2004 at a meeting between representatives from SACL and Jetstar convened to discuss the issues relating to the conditions of use agreement for Jetstar, SACL refused to negotiate any amendments to its proposed terms until agreement was reached with all airlines using Sydney Airport. SACL's attitude to the negotiations can be summed up in the following exchange between Mr Bowen of Jetstar and Mr Timar of SACL:

> *"Bowen: 'As I understand it, you are saying that there are two different versions of the Conditions of Use and if Jestar does not sign one of them it cannot fly. And, under both versions of the Conditions of Use, charges are ultimately determined by SACL and there is no recourse to a third party to resolve any disputes over charges.'*
>
> *Timar: 'That is correct.'"*

390 On 20 May 2004, five days before Jetstar was due to commence flying, SACL ejected contractors from Terminal 2 who were setting up operations for Jetstar. Mr Bowen contacted Mr Timar to attempt to persuade SACL to allow the contractors to re-enter Terminal 2 and resume work, but SACL refused to permit re-entry unless and until Jetstar signed written conditions of use. On the same day, Mr Bowen wrote to Mr Timar acknowledging that Jetstar would operate under the Qantas COU. If Jetstar had not signed the Qantas COU it would not have been able to commence flights to and from Sydney Airport on its first day of business.

391 Jetstar's experience at Sydney Airport was in stark contrast to its experience of negotiating terms at Melbourne airports. Jetstar initially sought to operate from Melbourne Airport, and began to negotiate terms in November 2003, but by mid-March 2004 it had not been able to agree on the terms. At the end of March, Jetstar sought and obtained from Qantas some accommodation at Melbourne Airport in the Qantas domestic terminal. At the end of March 2004 Jetstar entered into agreements for terminal and airside use at Avalon Airport and an agreement was reached following spirited negotiation over a lengthy period. Mr William Jauncey, Head of Airports at Jetstar, said that following Jetstar's announcement that it was operating from Avalon, Melbourne Airport had been "more willing to offer significantly

better terms to Jetstar for use of either the DET [Domestic Express Terminal] or the South Terminal at Melbourne Airport." He said that Melbourne Airport's attitude had been more flexible.

392 This experience of Jetstar showed that where an airport, such as Melbourne airport, is operating in a competitive market, the environment for negotiating terms is enhanced. SACL's refusal to enter into negotiations with Jetstar on the problematic clauses contained in the Qantas COU demonstrated how monopolistic power is used in a diminished competitive environment.

393 Jetstar had been forced to agree to the conditions of use put forward by SACL in conditions that it would not otherwise have to accept if it was not dealing with a monopoly service provider. The Jetstar experience shows that competition in the dependent market is assisted by airlines being able to negotiate varied terms and conditions of use.

394 SACL's version of events in relation to the launch of Jetstar is somewhat different to that of the airlines. Mr Timar of SACL said that on 19 February 2004 Mr Paul Tranter, then Acting Chief Financial Officer of Jetstar, had confirmed that Jetstar would proceed with the Qantas COU. However, SACL was still in negotiations with Qantas to formalise an agreement for Qantas' use of Terminal 2, and as part of the Terminal 2 discussions Qantas said that it would not allow Jetstar to be bound by the Qantas COU. On that basis, SACL continued to seek Jetstar's separate agreement to the Qantas COU.

395 Mr Timar said that the Qantas COU had not been not open to amendment because SACL's draft Aeronautical Services Agreement was on the negotiating table and SACL had wanted to avoid disrupting the course of those negotiations.

396 SACL submitted that any claim that Jetstar believed it could have commenced operations at Sydney Airport without signing any terms and conditions relating to its use of aeronautical facilities lacked credibility and that it was common and prudent commercial practice for a business to require written documentation before permitting others to use its facilities.

397 SACL's version of events shows that there was a breakdown in process which could not be resolved by a circuit-breaker such as an arbitrated outcome. Nevertheless SACL's

intransigent attitude is demonstrated by the exchange between Mr Bowen and Mr Timar set out above at [389]. This attitude provides a forecast as to what might occur in the future if commercial negotiations are entered into without the opportunity or end result of an arbitrated outcome.

398 We take the view that the sequence of negotiations between SACL and the airlines over conditions of use demonstrates the intransigent attitude of a monopolist – SACL – exercising its monopoly power without the constraints of a competitive environment, which would otherwise have generated a more compromising negotiating position in order to keep the airlines' business and not lose it to a competitor.

399 The sequence of events commencing in April 1999, and which continued for some years thereafter, relating to the conditions of use of Sydney Airport demonstrates a breakdown in process which occurred due to the absence of a circuit-breaker. This meant that there was no timely resolution, of disputes, resulting in an inefficient use of resources, a lack of commercial certainty, and an accumulation of ill-will between organisations which had a long commercial relationship ahead of them.

400 In the absence of declaration, we are satisfied that any commercial negotiations in the future, and certainly over the next five years or so, between SACL and the airlines would be likely to be contentious, protracted and inefficient.

SACL's unilateral right to increase charges and the consequences of failure to pay a charge

401 The airlines contended that the non-price terms and conditions imposed to date are illustrative of the type of terms and conditions that would be imposed by SACL in the future. They submitted that such terms and conditions were not such as they would accept in a competitive environment, and that they were likely to have a detrimental impact on competition in the dependent market.

402 In particular, the right which SACL has arrogated for itself under the conditions of use agreements and draft Aeronautical Services Agreement to increase unilaterally prices charged for the use of its facilities and services was controversial.

403 Clause 8.1 of the Virgin Blue COU provides that SACL can "vary any of the charges or the application of them at any time by giving you [Virgin Blue] 30 days notice in writing…" Clause 8.2 provides that SACL consult with Virgin Blue at least 90 days before varying charges.

404 Clause 8.5 of the Qantas COU is in similar terms, although there is an additional requirement in cl 8.4 of the Qantas COU requiring the parties to negotiate in good faith for any new conditions which might apply in the event that legislative requirements relating to increasing charges for the relevant facilities and services should vary or cease.

405 Clause 16 of both the Virgin Blue COU and the Qantas COU provides a mediation procedure in the event of a disputed charge but there is no provision for arbitration or independent determination.

406 We note that there is some provision for SACL to vary charges under the draft Aeronautical Services Agreement. In particular, cl 6.4 relevantly provides:

> *"… SACL may vary any of the* usage charges [these being the charges which relate to the airline's use of the facilities and services governed by the Agreement] *or the application of them in the circumstances listed in* ***clauses*** **[22(b) to (f)]** *by giving 30 days written notice to the* Operator *of a proposed variation in the* usage charges *at any time following consultation with the* Representative Users*."*

We also note cl 22 provides for a series of circumstances in which SACL may vary its charges or the application of them, this clause is discussed further below in relation to SACL's proposed force majeure clause.

407 In our view, the threat of unilateral increases to charges in circumstances where there are no alternative service providers, is significant for current airlines and potential new entrants who wish to fly into and out of Sydney Airport. Once they have committed to Sydney routes they have few options — pay the unilaterally increased charge, or withdraw from routes to and from Sydney.

408 SACL's contractual right to increase charges for aeronautical services unilaterally, including the Airside Service, is a right that would, if it existed in a competitive environment, be difficult to exercise because in a competitive market the user of the service would have the

opportunity, if dissatisfied with the increased price, to switch to an alternative supplier of the service. The obstacles to SACL including and using this clause appear much less in the present circumstances than they would be in a competitive market.

409 This unilateral right is not subject to any effective safeguards to protect the airlines. Indeed, the consequences of not paying any unilaterally imposed charge or increased charge may be quite draconian.

410 If Virgin Blue does not pay an amount owing within 21 days of the due date, cl 9.5 of the Virgin Blue COU provides that SACL may:

> *"(a) refuse to allow any or all of your aircraft to use our* facilities and services *at the Airport; and/or*
>
> *(b) use reasonable means to detain any of your aircraft until you have paid all due charges and interest provided that:*
>
> *(i) we have first sought to negotiate in good faith any dispute about charges in accordance with 9.3 above;*
>
> *(ii) we have first sought to recover any outstanding charges and interest by exercising our right under any bank guarantee provided in accordance with clause 2.2 above; and*
>
> *(iii) we have given you 14 days notice in writing either during or after the 21 day period that we intend to do this."*

411 If Qantas does not pay an amount owing within 21 days of its due date, cl 9.5 of the Qantas COU provides that SACL may refuse to let Qantas aircraft use the relevant facilities and services governed by the Qantas COU, but importantly, there is no provision for SACL to detain Qantas' aircraft.

412 However, cl 25 of draft Aeronautical Services Agreement, which SACL intends to implement in place of the current conditions of use agreements, does provide for the detention of aircraft in certain circumstances. Clause 25 is in the following terms:

> *"25.1 If the* Operator [the airline] *does not pay the amount it owes on time, the* Operator *will be liable to pay interest on the amount payable from and including the day the amount becomes payable to and including the day the* Operator *pays the amount and all interested accrued on it.*
> …
> *25.3 If the* Operator *notifies SACL in writing that it disputes any charge shown in an invoice within five* business days *of receiving that invoice and in*

SACL's reasonable opinion the Operator *has grounds to dispute it, then the provisions of* ***clause 31*** [the dispute resolution procedure] *will apply.*

…

25.5 Subject to ***clause 25.3****, if the* Operator *does not pay SACL an amount it owes SACL within 21 days after it is due for payment, SACL may:*

(a) prevent any or all of the Operator's *aircraft to use the* facilities and services*; and/or*

(b) use reasonable means to detain any of the Operator's *aircraft until it has paid all due charges and interest provided that SACL has:*

(i) first sought to negotiate in good faith any dispute about charges in accordance with ***clause 25.3*** *above;*

(ii) first sought to recover any outstanding charges and interest by exercising its right under any bank guarantee provided in accordance with ***clause 15****; and*

(iii) given the Operator *14 days notice in writing either during or after the 21 day period that SACL intends to do this."*

413 SACL claimed that ports commonly retained this type of clause for ships. In our view, the scenario of ports imposing similar clauses to cl 25 for refusing services or detaining goods, is quite different from the position of an airline and an airport. Port operators have a reasonable concern that a ship or a ship's owner may never return to the port and so may need to use such a clause to recover a disputed charge. In this context, commercial interactions between a port and a ship, or a port and the ship's owner, are frequently one-off or limited events. This scenario appears much less likely in the case of an airport and an airline where the airport is likely to have multiple, ongoing interactions with the airlines in the form of multiple aircraft using the facility and a continuous desire by the airline to use the airport, particularly in the case of domestic airlines. This provides an ongoing opportunity for the airport to recover a disputed charge which may be lacking in the shipping industry.

414 Clause 25 of the draft Aeronautical Services Agreement refers to the availability of a dispute resolution procedure in the event that a dispute regarding amounts owed arises. We turn now to consider the efficacy of the dispute resolution procedure provided for.

Dispute resolution procedures and arbitration opportunities

415 Qantas in particular complained of the absence of any provision for a binding dispute resolution procedure under SACL's proposed draft Aeronautical Services Agreement.

416 A dispute resolution procedure is provided for in cl 31 of the draft Aeronautical Services Agreement. It provides that, in the event that a dispute between the parties as to rights and obligations under the Agreement is not resolved within 21 days, either party can refer the dispute for non-binding mediation or to an independent person agreed between the parties who is experienced in dealing with the subject matter of the dispute. Clause 31.9 expressly states that the parties agree that nothing in cl 31 constitutes an arbitration agreement within the meaning of the *Commercial Arbitration Act* 1984 (NSW).

417 Notably, cl 31(1) of the draft Aeronautical Services Agreement excludes a number of disputes from the ambit of the dispute resolution procedure, including:

> *(a)* *the re-negotiation of terms of this agreement (**clause 5**);*
>
> *(b)* *SACL's decision whether or not to carry out capital expenditure works (**clause 11.3**);*
>
> *(c)* *SACL's decision whether or not to expand capacity at the* Airport *(**clause 11.4**);*
>
> *(d)* *SACL's obligations in relation to managing the provision of the* facilities and services *(**clause 18**);*
>
> *(e)* *the provision or otherwise of the* government mandated services *in accordance with **clause 20**;*
>
> *(f)* *SACL's decision in relation to any incentive or discount applicable in accordance with **clause 23**;*
>
> *(f)* [sic] *the* Operator's *failure to pay* usage charges *that have not been disputed within the time allocated in accordance with **clause 25.3**;*
>
> *(g)* *the* Operator's *compliance with a notice given by SACL to comply with any safety or security requirements in accordance with **clause 26.2**;*
>
> *(h)* *the* Operator's *compliance with an notice given by SACL to move or remove an aircraft in accordance with **clause 27.2**; and*
>
> *(i)* *SACL's requirements under* legislation *or under the* Head Lease *in accordance with **clause 35**.*

418 We note that the application of the dispute resolution procedure in cl 31 is expressly confined to disputes about whether either party has complied with an obligation or has a right under the Agreement. Although, there is provision for referral of disputes to mediation or to an independent expert for opinion, there is no provision for referral to arbitration or independent

determination prior to the parties opting for litigation. Clause 31 is also unsatisfactory because it excludes so many significant commercial matters from the purview of its process.

419 We are concerned that the conditions of use agreements for Sydney Airport contain no arbitration process by which to resolve disputes. The draft Aeronautical Services Agreement relates to an extremely important service, provided by way, in substance, of an essential facility, and should have appropriate dispute resolution mechanisms, including an appropriate arbitration clause. In a competitive environment it would do so; and if it did not, an alternative service provider would be available with whom to negotiate a usage charge or a condition of use which was the subject of disagreement.

420 We are satisfied that there is an absence of an effective dispute resolution process in the draft Aeronautical Services Agreement, an effective dispute resolution process being a procedure that ends in independent arbitration or determination and is not overly exclusive of the matters that fall within its purview. Were the draft Aeronautical Services Agreement to be implemented, such a deficiency is likely to allow SACL, in the absence of declaration under Pt IIIA of the TPA, to act in a monopolistic manner to the disadvantage of airlines using Sydney Airport which would not occur in a competitive environment.

The force majeure clause

421 Qantas contended that the force majeure clause contained in the draft Aeronautical Services Agreement was an example of a term which one would not expect to find in a commercial agreement in a competitive environment.

422 Clause 22 of the draft Aeronautical Services Agreement provides that SACL may vary any of the usage charges in certain circumstances, which circumstances include the occurrence of a "force majeure" event. Clause 22 is relevantly in the following terms:

> *"**22. Varying** **usage charges***
>
> *SACL may vary any of the* usage charges *or the application of them in certain circumstances in order to properly manage and maintain the quality of the* facilities and services. *The circumstances in which the* usage charges *may be varied are as follows:*
>
> …

(e) a force majeure event occurs which:

(i) triggers at least a 20% decline in either domestic or international passenger numbers (as measured by the respective total of embarking passengers *and* disembarking passengers*) in any 30 day period compared to the previous year's corresponding period; and*

(ii) where, in SACL's reasonable opinion, having regard to the nature of the force majeure event*, such a decline will continue for a further 60 days,*

SACL reserves the right to increase applicable usage charges *so as to achieve allowable revenues consistent with the prior year's traffic levels.*

Once passenger numbers return to levels anticipated prior to the force majeure event*, then the* usage charges *will revert to those levels that would have applied but for the* force majeure event *for that period as set out in accordance with the* Financial model*…"*

"Force majeure" is defined in cl 2.1 to mean:

"an act of God, war, sabotage, riot, terrorism, insurrection, civil commotion, national emergency (whether in fact or law), martial law, labour or union strike, lightning, cyclone, earthquake, landslide, epidemic, quarantine, radiation or radioactive contamination, fire, flood or other natural disaster."

423 Force majeure style clauses are not uncommon in commercial agreements, but they would usually operate so as to exclude a party from liability arising from events beyond its control, as opposed to requiring a party to guarantee the other party's revenue where events occur which are beyond either party's control.

424 The force majeure clause was said to be unfair because any force majeure event contemplated in the draft Aeronautical Services Agreement would be likely to have an equal impact on demand for an airline's services as it would on demand for the airport's services. This impost, if triggered by natural disaster for example, could arrive at the same time that the airlines themselves would be suffering most — during a drop in passenger numbers.

425 Further, Qantas noted that the drafting of the clause, which refers to SACL's risk and loss, meant it was possible that an airline which had maintained its usual number of passengers could effectively be part of an equalisation process among other airlines to insure SACL's risk. For example, if the sudden drop in passenger numbers was due to a decrease in passenger numbers from just one airline, as was the case with the Ansett collapse, then the remaining airlines would be forced to cover SACL's resultant decrease in revenue. The

clause could also potentially operate on a domestic airline where a triggering event caused a 20% decline in international passenger numbers, or vice versa.

426 SACL justified a number of its proposed terms and conditions, including the force majeure clause, on the grounds of "symmetrical" risk sharing. Currently SACL receives the benefit of increased revenue flowing from increased demand for its services, and bears the risk of any decrease in revenue from any decreased demand.

427 SACL is compensated for the portion of risk that it bears in regard to decreased demand by the rate of return it receives under the ACCC building block methodology. By introducing the proposed force majeure clause, SACL is seeking to have the airlines also bear the risk of any substantial decrease in SACL's revenue brought about by a drop in passenger numbers. As Qantas put it:

> *"Risk shifting, rather than risk sharing, is a more accurate description of what SACL has done and seeks to do in the future."*

428 Qantas submitted that the force majeure clause was intended to satisfy the interests of those of SACL's shareholders who had also made substantial loans to SACL in excess of half a billion dollars. It was submitted that what was driving the force majeure clause was a concern on SACL's part to protect the interests of these parties.

429 There is support for this submission in the 7 July 2004 Charging Proposal, discussed earlier. In this proposal, under the heading "other Risk Sharing Provisions" it states:

> "Force majeure *provision for traffic shocks: charges permitted to increase to the extent required to protect SACL's debt coverage until traffic returns."*

The force majeure clause was subsequently included in the draft Aeronautical Services Agreement propounded by SACL in September 2004.

430 SACL submitted that the draft Aeronautical Services Agreement, being a long-term agreement which SACL is offering the airlines, provides the airlines with stability, and that the proposed force majeure clause was part of the "quid pro quo" which SACL expected in return for such stability. Counsel for SACL noted that a drop in revenue extending over what would in effect be a 90 day period with 20% less custom as envisaged by the force majeure clause would be catastrophic for SACL. He argued that it was usual for commercial

arrangements to contain provisions which seek to preserve the interests of both parties against catastrophic events in a long-term pricing arrangement.

431 This may be a laudable commercial explanation but it is also another example of the monopolistic imposition of an unusual and unreasonable condition of use which would be unlikely to be insisted upon in a competitive environment in which there were the constraints of alternative service providers who would be limited in the terms and conditions of use they could impose by the opportunities available to their competitors.

432 In our view, SACL has included an unusual and onerous force majeure clause in its draft Aeronautical Services Agreement, subjecting the airlines to open-ended, downside risk. The proposed force majeure clause effectively requires the airlines to maintain SACL's revenue levels in the case of a sudden downturn in passenger numbers. The only real concession which SACL appeared to have offered in exchange for this onerous provision is a proposal for long-term pricing.

433 The open-ended nature of these potential costs is likely to require incrementally higher insurance cover for the airlines, or for the airlines to simply carry the risk. Either of these results is likely to impact on the incentive for existing airlines to enter new routes and for potential new airlines to enter the dependent market, relative to the case where non-price terms and conditions of access are consistent with a competitive market benchmark.

434 As the force majeure clause is prospective at this stage, we cannot be certain whether or not it will remain in this or another form in any final agreement. However, we view it as a strong signal of SACL's intended future conduct which can and should be taken into account in our assessment of the factual as against the counterfactual in order to determine whether declaration of the Airside Service would promote competition in the dependent market.

No minimum service standards

435 Qantas gave detailed evidence regarding its repeated attempts to have minimum service standards included in the Qantas COU over a period of more than five years. These attempts were largely ineffective until shortly before the hearing commenced, when SACL proffered its draft Aeronautical Services Agreement, which included service standards.

436 When Qantas received a further draft of a conditions of use agreement from SACL in April 1999, the draft included a message from the Chief Financial Officer that "the next major step" was for SACL to develop a service charter for inclusion in future versions of the conditions of use. No such charter emerged over the ensuing five years.

437 During Qantas' negotiations of a conditions of use agreement with SACL, Qantas pushed for a Memorandum of Understanding to be entered into as a precursor to preparation of a comprehensive services agreement. On 15 October 1999 Qantas provided SACL with a draft Memorandum of Understanding. SACL did not enter into substantive negotiations with Qantas in relation to the draft Memorandum of Understanding. SACL continued to urge Qantas to sign up to the conditions of use it had proffered. In SACL's 'Revised Draft Aeronautical Pricing Proposal' submitted to the ACCC in October 2000 (referred to at [30] above), SACL stated that the revised draft proposal would assist the development of service level agreements with the airlines and that it had initiated a discussion with airline customers on the issue of service level agreements. SACL wrote to Qantas on 4 October 2000 stating that it was preparing service level agreements. However, prior to the commencement of the hearing, SACL had not entered into a service level agreement with Qantas.

438 As noted above, as part of the settlement of the Federal Court proceeding between SACL and a number of airlines including Qantas, a conditions of use agreement was agreed upon to govern the relationship between SACL and Qantas – the Qantas COU. Qantas sought to have minimum standards inserted into the Qantas COU that would apply to all of SACL's facilities and services, but such minimum standards were not inserted.

439 The first time SACL proffered any sort of arrangement involving service standards was in the draft Aeronautical Services Agreement dated 28 September 2004, two weeks prior to the commencement of this hearing. It is not unreasonable to infer that this proceeding operated as an incentive for SACL to seek to achieve what it would have been obliged to achieve in a competitive environment in which airlines would have competitive service providers willing to offer minimum service standards in order to attract competitive business.

440 SACL submitted that the lack of any service level agreement needed to be assessed in the light of the long-term negotiation process to produce the Qantas COU during which time Qantas continued to use the aeronautical services provided by SACL at Sydney Airport.

SACL said that the Memorandum of Understanding proffered by Qantas in 1999 contained unrealistic commercial terms which would have created uncertainty in the commercial relationship between SACL and Qantas and would have limited SACL's ability to run Sydney Airport efficiently for the benefit of all its users. We doubt that this is so, but we do not form a view as to whether the terms proffered by Qantas were commercially unrealistic or not. It is sufficient to note that, over a period of five years, an airport and an airline were unable to agree on terms as to service levels to be provided at the airport. We would not expect such a situation to occur in a competitive environment in which multiple independent service providers would compete for airline business.

441 SACL also submitted that the lack of a service level agreement of the kind described by Qantas should be considered in the light of SACL's quality of service reporting requirements to the ACCC pursuant to the *ACCC Airports Reporting Guideline: Information Required under Part 7 of the Airports Act 1966 and section 95ZF of the Trade Practices Act 1974* (revised March 2004). This guideline indicates that the Commonwealth Government actively monitors SACL's aeronautical charges and quality of service. However, we note that this guideline tends to focus on financial, accounting and charging data. In any event, such a monitoring regime by a regulator is no substitute for an explicit statement of service levels in a commercially negotiated agreement between the parties.

442 Whilst we are of the opinion that minimum service standards would be desirable in a market where a user of a service has no choice or ability to switch to a different service provider in the event that the user is dissatisfied with the standard of service provided, the absence of minimum service standards in the conditions of use agreements is not of itself conclusive of a misuse of monopoly power by the service provider. However, the absence of minimum service standards agreed to by SACL, combined with the lack of alternative service providers, and the absence of an opportunity for independent arbitration of disputes, is a relevant consideration in assessing the future competitive environment with and without declaration.

The exclusion of liability clause

443 Finally, we note that the airlines complained about the limited scope of SACL's liability by virtue of the "Release and indemnity" provisions of the conditions of use agreements which are taken up in the draft Aeronautical Services Agreement. These clauses limit SACL's

liability to the airlines in a number of cases such as where losses arise from the unavailability of Sydney Airport or from delays in the movement or scheduling of aircraft and any consequential losses due to negligence or recklessness by SACL or its officers, employees or agents.

444 Clauses 14 of the Virgin Blue COU and the Qantas COU are in different terms. However, by virtue of cl 14.2 in each conditions of use agreement, SACL is not liable, *inter alia*, for any loss suffered by the airlines as a result of Sydney Airport being closed or any service or facility at Sydney Airport being unavailable. SACL is also not liable for any loss suffered by the airlines, or any person claiming through the airlines, because of delays in the movement or scheduling of aircraft at Sydney Airport. Nor is SACL liable for any consequential injury, loss or damage in connection with the use or closure of Sydney Airport. Clause 14.2 of the Qantas COU further explicitly provides that this exclusion of liability includes "any loss arising from our [SACL's] negligence or recklessness, or the negligence or recklessness of our [SACL's] officers, employees or agents."

445 This exclusion of liability is repeated in the draft Aeronautical Services Agreement which relevantly provides:

> *"29.2 SACL and its* personnel *are also not liable for:*
>
> *(a) any loss the* Operator [airline] *suffers for any reason because the* Airport *or any part of it is closed or any service or facility at the* Airport is unavailable*;*
>
> *(b) any loss the* Operator *suffers, or any person claiming through the* Operator *suffers, for any reason because of delays in the movement or scheduling of the* Operator's *aircraft; or*
>
> *(c) any consequential injury, loss or damage in connection with the use of or closure of the* Airport *(including anything referred to in (a) or (b) of this clause)."*

446 ACL's broad exclusion of its own liability does, as the airlines complained, have the result that a certain amount of risk is passed on to the airlines. However, we are not satisfied that this clause goes beyond what could be expected in a competitive environment and do not consider it to be a relevant or useful indicator of SACL's future conduct against which we can assess whether declaration would promote competition in the dependent market.

The split aircraft turn-around issue

447 The airlines submitted that Qantas' experience with SACL regarding split aircraft turn-around demonstrated SACL's ability to impose conditions of use on airlines which had the capacity to affect adversely competition in the dependent market.

448 Sydney Airport has two domestic terminals: Terminal 2, which was formerly used by Ansett, and Terminal 3, which is leased by AAL Aviation Limited, a wholly-owned subsidiary of Qantas. Prior to the collapse of Ansett, Qantas used Terminal 3 only. However, since 24 September 2002 Qantas has used Terminal 2 for flights between Sydney Airport and regional centres in order to process the volume of domestic passenger services it provides.

449 Qantas generally uses Dash 8-type aircraft for regional flights which operate out of Terminal 2, although Dash 8 aircraft are also used for Qantas' flights between Sydney and Canberra, which operate out of Terminal 3. For the purposes of optimal aircraft utilisation, Qantas' Dash 8 fleet is used for a mixture of both regional flights and flights between Sydney and Canberra, and we were told by Qantas that it is not possible for it to dedicate particular aircraft solely to one or other of these routes.

450 Qantas indicated that its Sydney–Canberra flights must leave from Terminal 3 as that route is part of the CityFlyer service that is geared towards business travel. It is important to Qantas that the CityFlyer flights leave from the same terminal because this enables CityFlyer customers conveniently to make their connecting CityFlyer flights, and because the Sydney-Canberra route is used by many Chairman's Lounge passengers and the Chairman's Lounge is located in Terminal 3.

451 As a result of the one fleet of Dash 8 aircraft being operated from two terminals, a "split aircraft turn-around" situation periodically arises whereby arriving passengers on a Dash 8 aircraft are disembarked through one terminal, but the departing passengers on the same aircraft must embark through another terminal. Where a Dash 8 aircraft lands at Sydney Airport from a regional centre, its passengers will disembark through Terminal 2 and if that same aircraft is then being used for a flight to Canberra, the Canberra-bound passengers will be processed through Terminal 3 and taken by bus to the aircraft parked at Terminal 2.

452 Split aircraft turn-arounds are not expressly dealt with in the Heads of Agreement which currently sets out the basis on which Qantas uses Terminal 2, but at a meeting between Qantas and SACL on 16 September 2002, the following action item for the final version of the agreement was noted:

> *"Wording to reflect that passengers on aircraft departing from T2 will check-in at T2 except for transits and transfers who will check in at another port. For specific operational events (on an exceptional basis), such as unserviceable aircraft and weather delays, passengers checking in at T3 may depart from aircraft operating from T2. Only people who have been through passenger screening can use the link ..."*

453 On 18 March 2003 Mr Moore-Wilton of SACL informed Qantas that its practice of remote parking aircraft on Terminal 2 aprons without including the passengers in PFC calculations for Terminal 2 was of concern. Qantas wrote back on 25 March 2003 stating that use of Terminal 2 aprons in the manner outlined by Mr Moore-Wilton was needed infrequently to deal with operational issues.

454 On 31 October 2003 SACL wrote to Qantas informing it that from 1 December 2003 it would not allocate Terminal 2 parking bays for Qantas flights unless both their arriving and departing passengers were facilitated through Terminal 2. SACL agreed to consider the allocation of bays for flights which did not meet this criteria "on a case by case basis to support day of operation exigencies of Qantas". From 1 December 2003 SACL's new policy was implemented.

455 The current terms of the Heads of Agreement governing Qantas' use of Terminal 2 clearly require Qantas to pay SACL, in return for its use of Terminal 2, $[x] per annum for its use of priority gates, rental of $[x] per annum, and a PFC for each passenger whose arrival or departure is facilitated through Terminal 2.

456 It is likely that the fact that a PFC is payable for each passenger whose arrival or departure is facilitated through Terminal 2 influenced both Qantas' actions and SACL's decision to require both arriving and departing Qantas passengers to be facilitated through Terminal 2 before it would agree to allocate parking bays at Terminal 2.

457 Following SACL's December 2003 policy regarding parking at Terminal 2, Qantas began towing its Dash 8 aircraft between Terminals 2 and 3 for split aircraft operations. Qantas said

that moving its Canberra operations to Terminal 2 would not have resolved the split aircraft turn-around problem as, during peak periods, Qantas flies jet aircraft to Canberra that also fly on routes from other major cities and arrive and depart from Terminal 3. It therefore saw towing the Dash 8 aircraft between the terminals to be the most appropriate option available to it.

458 Qantas said that the towing of aircraft between Terminals 2 and 3, the busiest area at Sydney Airport, gave rise to a number of practical problems, including airport congestion, occupational health and safety issues, delay in turn-around times, and delays in Qantas flights.

459 Qantas had agreed to pay parking charges to SACL effective from 1 December 2003 for aircraft parked on Terminal 2 whose passengers were facilitated through Terminal 3. This was in addition to the payment of the PFC for passengers facilitated through Terminal 2 from the same aircraft. However, SACL maintained its restrictions on allocation of parking aprons at Terminal 2 up until 23 September 2004.

460 In September 2004 Qantas and SACL executed a deed of settlement and release in relation to the split aircraft turn-around issue and Terminal 2. Mr Grant Fenn, Qantas' Executive General Manager, Airports and Catering, said that Qantas' signing of that deed was a position into which Qantas was forced because of the disruption that split aircraft turn-arounds were causing to its operations.

461 Qantas submitted that SACL's real concern in restricting access to Terminal 2 was to maximise its revenue from the use of Terminal 2 by ensuring that all passengers on Dash 8 aircraft were processed through Terminal 2 and thus required to pay a PFC. It said that in pursuing this approach, SACL had foregone revenue in the form of parking charges which Qantas had agreed to pay from 1 December 2003 onwards.

462 Qantas submitted that SACL's handling of the split aircraft turn-around issue exemplified the manner in which SACL could use its monopoly power to supply a bundled service where only one service was required by the airline. Where split aircraft turn-arounds were concerned, Qantas only needed access to parking aprons but it was required to utilise the full

range of services paid for by the PFC, of which apron parking was only one of several components.

463 SACL responded by noting that at the September 2002 meeting between itself and Qantas to discuss the conditions of use for Terminal 2, it was contemplated that, apart from transiting or transferring passengers, all passengers on aircraft departing from Terminal 2 would check in at Terminal 2, save for the case of specific operational events.

464 SACL also noted the lack of protest in Qantas' response to Mr Moore-Wilton's letter of 18 March 2003 in which SACL expressed concern over Qantas' practice of remote parking aircraft on Terminal 2 aprons without those passengers being included in the PFC calculations for Terminal 2. SACL submitted that the first time Qantas had indicated that split aircraft turn-around was a continuing requirement of Qantas, as opposed to an infrequent occurrence based on operational events, was when Qantas wrote to SACL on 12 December 2003 in response to SACL's letter informing Qantas of its decision to restrict the conditions on which parking at Terminal 2 would be allocated. SACL therefore submitted that the split aircraft turn-around issue ought not be characterised as a "lengthy dispute" between the parties.

465 SACL's position was that it has never limited Qantas' access to apron parking at Sydney Airport. Rather, its motivation in changing its policy regarding parking at Terminal 2 was said to have been done to advance its own business interests by seeking payment for use of the aprons by Qantas, which is in fact the manner in which the issue was resolved. SACL said that this outcome indicated that SACL's motivations were legitimate.

466 Finally, SACL submitted that Qantas did not contend that SACL's decision regarding parking at Terminal 2 would have resulted in a reduction in Qantas' use of, or access to, the Airside Service if not withdrawn. Accordingly, SACL submitted that this issue was irrelevant to the present proceeding and no evidence had been adduced to show that SACL would not make the same decision if the Airside Service were declared, nor that such a decision impacted upon competition in the dependent market.

467 In our view, SACL was not misusing its monopoly power by requiring that arriving and departing passengers on the one aircraft be processed through the one terminal. It is not unreasonable for SACL to package the passenger facilitation services, including an apron

parking component, as a whole rather than enabling Qantas to take the unusual step of parking on the apron at a terminal (which parking space might otherwise be allocated to an aircraft which wished to take the ordinary course of disembarking and embarking passengers at that terminal), but not utilising the other passenger facilitation services of SACL provided at that terminal. We therefore do not view the split aircraft turn-around issue as supporting the case put by the airlines that SACL's behaviour has had an adverse effect on competition.

REX's access to Gate 39 in Terminal 2

468 REX traditionally operated at Sydney Airport under an agreement that gave it exclusive use of Gate 39. At the time of the hearing, REX's agreement for exclusive use of Gate 39 was due to expire in November 2004.

469 Mr Hans van Pelt, former Executive General Manager of Commercial at REX said that he had met with Mr Moore-Wilton and Mr Timar of SACL in February 2004 to discuss the possible extension of its contract. He said that Mr Moore-Wilton had told him that negotiations on the contract would not commence until July or August 2004. As at August 2004, REX had not been given an indication as to whether its contract would be extended or where its new gate would be located were the contract not to be extended.

470 Gate 39 was attractive to REX because passengers could embark and disembark quickly and REX could turn aircraft around within 30 minutes. Any requirement to park aircraft a distance from the gate would create the need to bus passengers to the terminal, which in turn would create delays in turning around aircraft, potential passenger dissatisfaction, and difficulty for airlines meeting their performance levels. A short turn-around time enabled REX to gain extra utilisation from its aircraft and this had an effect on route profitability and the ability of REX to offer lower fares.

471 We were told that gate allocation and parking positions at Sydney Airport are important to airlines as they can have a large impact on the quality of service provided by airlines to their customers, and to the efficiency of the fleet utilisation. The shorter the turn-around time for an aircraft, the more flights an aircraft can operate in a day and thus the greater the return an airline can receive per aircraft.

472 Virgin Blue said that REX's situation illustrated how non-price terms and conditions imposed by SACL on airlines can have a significant impact upon airline operations and an airline's ability to compete effectively in the dependent market.

473 SACL rejected any suggestion that its negotiations with REX constituted a denial of access by SACL or an example of SACL imposing terms that would detrimentally affect REX's business or ability to compete. SACL contended that it has not denied REX access to the airport and maintains a commitment to facilitating REX's services through Terminal 2.

474 The evidence in relation to REX's access to Gate 39 in Terminal 2 is quite inconclusive and, indeed, incomplete. At the time of the hearing, Mr van Pelt was no longer employed by REX and we were not informed by REX as to what had occurred between it and SACL after Mr van Pelt left its employment in August 2004.

475 In our view, it is not at all clear how SACL's position of not immediately acceding to REX's request for continued exclusive access at Gate 39 is relevant to any issue in this proceeding. It was not made clear whether Gate 39 is particularly desirable for REX alone, or whether it is desirable for the entire class of regional operators. It was also not made clear how the availability of an aerobridge at Gate 39 that was not used by REX affects the efficient distribution of access rights to various gates at Terminal 2.

476 We are of the view that the issue of REX's use of Gate 39 does little to inform us on any of the relevant issues in this proceeding. In particular, it provides little assistance in predicting SACL's relevant conduct in the future in the absence of declaration.

Conclusion as to non-price terms and conditions

477 In the absence of declaration, we are satisfied that any commercial negotiations in the future as to the non-price terms and conditions on which the airlines utilise the facilities and related services at Sydney Airport are 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 arise in a competitive environment. The proposed force majeure clause and the retention of aircraft clause in the draft Aeronautical Services Agreement are examples of such outcomes. This situation is exacerbated by the lack of an appropriate dispute resolution

procedure providing independent arbitration in any of the commercial agreements entered into or proposed between SACL and the airlines.

ARE THERE ANY EFFECTIVE CONSTRAINTS ON THE MANNER IN WHICH SACL MAY EXERCISE ITS MONOPOLY POWER?

478 Whilst the existence of SACL's monopoly power was accepted by all the economic experts, they were divided on the issue of whether the exercise of SACL's monopoly power was subject to any constraints. The economic experts made the following observation in a joint report to the Tribunal:

> *"Sydney Airport Corporation Limited (SACL) has monopoly power. However, the countervailing power of airlines and the threat of reregulation may constrain the exercise of monopoly power to a greater or lesser degree. The extent of countervailing power and the effect of the threat of reregulation are not agreed. It should be noted that the existence of non-aeronautical services affects the monopoly price for the Airside Service and gives an incentive for SACL to charge less than the stand alone monopoly price for the Airside Service."*

479 The inquiry as to the constraints operating upon SACL's monopoly power raises for consideration the following matters: the countervailing power of the airlines, the threat of re-regulation by the Commonwealth Government and the importance of non-aeronautical revenue to SACL.

THE COUNTERVAILING POWER OF THE AIRLINES

480 SACL submitted that its ability to exercise market power was limited by the countervailing power of Virgin Blue and Qantas, and that these airlines had the capacity and incentive to put pressure on SACL to ensure that it set its prices consistently with the ACCC's building block methodology and the Commonwealth Government's Review Principles, to which we referred earlier. SACL contended that the airlines had substantial countervailing or bargaining power because of the economic value of their business in relation to aeronautical and non-aeronautical revenue. In 2003/2004 Qantas and Virgin Blue and their subsidiaries accounted for 76.1% of passengers flying into and out of Sydney Airport. SACL submitted that the relevant question in assessing the airlines' countervailing power was how Qantas and Virgin Blue would react to any attempt by SACL to increase its charges for the Airside Service, and how SACL would respond to those reactions.

481 One of the expert economists called by SACL, Mr Houston, contended that it was not necessary for an airline to have absolute bargaining supremacy over SACL in order to have countervailing power which constrained SACL in its pricing policies. Mr Houston contended that airlines needed only to have sufficient bargaining power to prevent SACL from determining its Airside Service charges on a purely unilateral basis. Mr Houston said the focus should be upon whether the airlines have some influence in the negotiation of terms and conditions and charges.

482 The economic experts called by Qantas and Virgin Blue did not see the matter of countervailing power in this way. Dr Williams considered that the real issue was what negotiating power the airlines had, which depended upon the external opportunities available to them and to SACL. Professor Oum phrased the appropriate query in terms of who would have the final say if there was disagreement in negotiations. In his view the airlines did not have any final say. Mr Ergas supported these views.

483 By contrast, Professor Baumol, called by SACL, said that the airlines had countervailing power, but not in the "usual way". He said that the airlines had countervailing power through their ability to threaten litigation.

484 We consider that the views expressed by Dr Williams, Professor Oum and Mr Ergas on the nature of countervailing power offer the most realistic definition of countervailing power in the area in which we are concerned. This definition asks whether a party can create a credible threat to withdraw from negotiations or whether the party must accept a take-it-or-leave-it offer.

485 SACL submitted that any unjustifiable increase in its charges would cause Qantas and Virgin Blue to bring the matter to the attention of the ACCC and the Government and to lobby for the re-introduction of "heavy-handed regulation". However, it is one thing to knock on the door of the ACCC and Government; it is another thing to have an effective and timely response. We consider that Qantas and Virgin Blue's bargaining power in relation to resisting any increase in charges, whether justifiable or otherwise, is extremely limited because they have no alternative avenues open to them other than to use Sydney Airport.

486 Sydney is critical to Qantas' network and to Virgin Blue's activities. Neither of them, nor any other airline operating aircraft of comparable size, has any alternative location for its airline activities. The evidence was that Sydney Airport is the only airport available for commercial airline services flying to Sydney as, of the other New South Wales airports, Bankstown Airport is unable to handle major jet services, and Richmond Airport is prohibited from handling commercial aircraft. Further, Southern Cross Airports Corporation Holdings Ltd, the parent company of SACL, has the first right of refusal to build and operate any second major airport within 100 kilometres of the Sydney central business district.

487 Thus, the airlines can complain to SACL during the negotiating process about the terms and conditions SACL wishes to impose, but, lacking a credible threat to withdraw from Sydney Airport due to the absence of viable alternatives in and around Sydney, they are really in a position where they must accept take-it-or-leave-it offers made to them by SACL. So much was evident in SACL's response to Virgin Blue during 2003 regarding the imposition of the Domestic PSC. At that time, as we have discussed, Virgin Blue's complaints to SACL regarding the proposed change in tariff structure fell on deaf ears and Virgin Blue had no other avenue of redress other than seeking declaration under Pt IIIA of the TPA.

488 It was said by SACL that Qantas, Sydney Airport's largest customer, possessed considerable countervailing power. In this regard, Mr Houston referred to the fact that Qantas had used Sydney Airport for a period of time without signing up to any written conditions of use. Mr Houston argued that Qantas' policy of not signing a formal conditions of use agreement when it did not obtain the terms it wanted, but continuing to use the airport, was an example of countervailing power. He contended that "[a]irports appear powerless to prevent an airline continuing to use their facilities even though the terms are not agreed."

489 Qantas argued that it was in a similar position to Virgin Blue in the sense that it was not able credibly to threaten to withdraw its business from Sydney Airport because of the lack of viable alternative sites. Qantas relied upon the evidence of Mr Michael Smart, an Executive Director and Principal of Network Economics Consulting Group Pty Ltd. Mr Smart provided quantitative modelling that indicated that Qantas would be more heavily affected than SACL by a decision to withdraw flights to and from Sydney Airport – a circumstance which he acknowledged would be extremely unlikely to occur. Mr Houston noted that the estimated

losses to SACL of such an occurrence would be significant, albeit not as large as those of Qantas.

490 We do not place a great deal of weight on Mr Smart's quantitative modelling, as it involved a number of over-estimates of loss which are difficult to quantify and accordingly the figures provided are unreliable. For example, Mr Smart's work was based on the premise of Qantas withdrawing from both domestic and international routes and being unable to recapture any lost profits by redeploying its fleet to other routes not involving Sydney. Mr Smart suggested that in the long term, Qantas may be able to reduce some of its costs. However, this prediction is not included in the quantitative analysis. Such assumptions are likely to lead to an overstatement of the reduction in Qantas' profits. Mr Smart's analysis of SACL's losses following any withdrawal by Qantas assumed that Qantas' international passenger market share would be quickly captured by other existing operators, while its domestic market share would not. This appears inconsistent with the fairly rapid replacement of capacity which followed Ansett's withdrawal from the domestic market in September 2001. In that respect, Mr Smart's model is likely to overstate Qantas' losses.

491 Although we do not rely on the figures provided by Mr Smart, we are satisfied that the costs to Qantas of foregoing Sydney Airport would be higher than the costs to SACL of foregoing Qantas' business, because Qantas has no alternative source of supply whilst SACL has alternative sources of demand. The response of competing airlines to fill the gap left after Ansett's collapse is evidence of SACL's alternative sources of demand.

492 Qantas also referred to the evidence of Mr Ergas who said that airlines' countervailing power is reduced by the significant sunk investment it has in maintenance facilities at airports which reduces the credibility of any threat by an airline to relocate to another airport. We agree with this assessment.

493 In general, Qantas, as with Virgin Blue, faces a lack of alternative suppliers. Orthodox economic principles indicate, as Mr Ergas opined, that even a large buyer needs a credible threat to withdraw demand to have significant countervailing power. Qantas clearly does not have this power because of the lack of alternative sites in and around Sydney.

494 It is important to note that Qantas and Virgin Blue's ability to exercise countervailing power is not enhanced by them joining together as they have different interests in relation to the charges and terms and conditions imposed by SACL. Professor Oum put the matter quite succinctly when he stated:

> *"Furthermore, since Qantas and Virgin Blue are competitors and have different competitive interests each have difficulty in posing a common front against the airport management every time airport pricing issues are on the agenda. This is because each of the airlines may want to cut a special deal with SACL, and SACL may be able to use a divide-and-conquer strategy. This is particularly the case when a generic airside service charge increase has a different degree of impact on Qantas and Virgin Blue. Therefore, each airline individually has no countervailing power over what airport management wants to do."*

495 These different interests were exemplified by the sequence of events in relation to SACL's proposal in 2003 to abandon MTOW-based charges in favour of a Domestic PSC. Qantas was extremely keen to have the Domestic PSC introduced, whereas Virgin Blue saw such a tariff structure as disadvantageous to it.

496 In our view, both Qantas and Virgin Blue have little ability to bypass or withdraw their services from Sydney Airport, given its monopoly position and importance nationally. We observe that the smaller regional airlines operating intrastate services would also have little ability to bypass or withdraw their services from Sydney Airport. This contrasts with SACL having at least the option of withdrawing its services from one airline and offering them to another existing airline or potential new entrant into the market.

497 We should also note that, contrary to the proposition put by Professor Baumol, we do not consider there to be elements of countervailing power in the opportunity to threaten litigation as this does not operate as an immediate constraint upon SACL. The threat of litigation contemplated by Professor Baumol and the opportunity to seek declaration under Pt IIIA of the TPA do not demonstrate effective countervailing power on the part of the airlines because the outcome of any such litigation or process cannot be predicted with any degree of certainty. If anything, the need to rely solely upon the threat of litigation is evidence of an absence of countervailing power.

498 The final result is that any countervailing power the airlines have is limited to legal proceedings, media campaigns and lobbying for regulation. We see these as relatively weak bases of countervailing power which are generally related to, and dependent upon, the regulatory environment.

THE THREAT OF RE-REGULATION

499 A further basis put forward as a constraint upon the exercise of monopoly power by SACL was the threat of re-regulation that was said to loom over Sydney Airport. Underlying SACL's submissions in this regard was the proposition that there is considerable uncertainty as to the trigger points for further regulation by the Commonwealth Government and such uncertainty provides more of a restraint on SACL's behaviour than if specific trigger points had been identified which SACL could seek to avoid.

500 The threat of re-regulation is said to arise as a result of the Commonwealth Government's acceptance on 13 May 2002 of the Productivity Commission's recommendations that the then existing price notification arrangements for Sydney Airport should be replaced by a price monitoring regime for a period of five years. This "lighter-handed regulation" of airports, in the form of price monitoring, was subject to an independent review at the end of the five-year period. As we noted earlier, the Government reserved the right to conduct a review if there were unjustifiable price increases. The Government noted that the "threat of possible re-regulation will encourage negotiated pricing outcomes based on efficient costs and an adequate return on capital".

501 SACL submitted that it wished to avoid the re-introduction of what it called "heavy-handed regulation" of the prices for aeronautical services and that in order to minimise the risk of that occurring it sets its prices consistently with the Review Principles outlined by the Commonwealth Government. SACL contended that it had not set its prices at levels above the competitive level and that there was no evidence that it was likely to do so.

502 Mr Timar, whose responsibilities included formulating proposals in relation to charging for aeronautical services, said that in making recommendations to the SACL Board and the Strategy Committee he was aware that if SACL set prices in a manner inconsistent with the Government's expectations, including those set out in its Review Principles, it would be likely to result in the re-introduction of price controls, a result he and the Board wanted to

avoid. Mr Schuster, whose responsibilities included making recommendations to SACL's Board Strategy Committee in respect of the appropriate level of charges for aeronautical services, gave evidence to similar effect. He acknowledged that there was uncertainty as to the level of charges which the Government and the ACCC regarded as appropriate. He believed therefore that any increase in charges for SACL's aeronautical services carried an inherent risk of misjudging the point at which the Government would seek to re-regulate prices for those services.

503 The Parliamentary Secretary submitted that SACL was likely to modify its behaviour by reference to the existence of the Commonwealth Government's policy and submitted that the Tribunal did not have to embark on the task of assessing the likelihood or otherwise of a decision to implement re-regulation, other than to assess the evidence as to SACL's perception of that likelihood. In this respect, the Parliamentary Secretary relied upon the evidence of Mr Timar and Mr Schuster.

504 In our view, whilst Mr Timar and Mr Schuster may have had the concerns which they expressed, this did not inhibit them in making recommendations for the introduction of a Domestic PSC in place of the MTOW-based charge. This change, as we have found, was discriminatory against Virgin Blue to SACL's knowledge and was not based upon "efficient costs" which the Commonwealth Government wanted to encourage, as set out in the joint press release of the Minister for Transport and Regional Services and the Treasurer on 13 May 2002.

505 Notwithstanding the submission of the Parliamentary Secretary that the Commonwealth Government's policy provides a pervasive environment designed to foster responsible conduct on the part of airport operators, we are satisfied that any threat of re-regulation is, in reality, quite limited. Although the Government announced that an earlier review would be conducted if there was evidence of unjustifiable price increases or if it were found that airport operators were abusing their market power by unjustifiably raising prices and the Government reserved the right to re-impose price controls, there has been no evidence that the conduct of SACL to date has stimulated any further Government action or interest.

506 We are not satisfied that the threat of re-regulation has acted as a constraint or will act as a constraint upon SACL's pricing policies. In any event, there is no firm basis upon which

there can be any conclusion as to what the Commonwealth Government's policy would be at any particular time in the future, and regulation would be unlikely to come into operation before the end of 2007, at the earliest. Further, we observe that, even if Sydney Airport were to become regulated again, such re-regulation could not operate retrospectively and would therefore enable SACL to retain, and not have to disgorge, any excessive or inappropriate pricing proceeds which it had derived prior to the introduction of any future re-regulation. Re-regulation would not enable the airlines to redress the consequences of SACL's monopolistic conduct which had occurred prior to that date.

507 Finally, we should note that there was evidence from the expert economists that the threat of re-regulation would not act as a sufficient constraint on SACL's power to price substantially above the competitive level. However, that economic evidence was of little assistance to us. We agree with the submission of the Parliamentary Secretary that the economics of law enforcement, which was initially put forward by some of the expert economists as a means of analysing the threat of re-regulation, provides little assistance in the present case. As the Parliamentary Secretary pointed out, discussions of law enforcement in the context of economic incentives depends on the level of detection and enforcement of the law across a large number of potential lawbreakers. That context is of little relevance in the present circumstances.

508 It should also be noted that the Commonwealth Government expressly supported the continuing application of Pt IIIA of the TPA to airports and it specifically stated that Sydney Airport would be sold into a regime which included Pt IIIA of the TPA.

NON-AERONAUTICAL REVENUES

509 SACL submitted that the derivation of non-aeronautical revenues from the use of Sydney Airport constrained it from setting charges at a profit-maximising level. Non-aeronautical revenues are a large and increasing part of airport revenues. They include revenues from duty-free shopping and other retailing, car parking and property developments.

510 All the economic experts accepted that the existence of non-aeronautical revenues would cause SACL to set charges for its airside services lower than would be the case if SACL did not receive non-aeronautical revenues. However, that is not the relevant issue in the present proceeding. The relevant question here is to what extent the existence of the

non-aeronautical revenues constrains SACL from increasing the charges for the Airside Service, and the Domestic PSC in particular, above current levels.

511 There was general agreement among the economic experts that the answer to this question was that the constraining effect of non-aeronautical revenues was not significant. For example, Mr Houston, who was called by SACL, accepted that the existence of non-aeronautical revenues alone was not sufficient to eliminate SACL's incentive to increase the charges for the Airside Service above their current level. It appeared that the existence of non-aeronautical revenues might be relevant if SACL sought to set its Airside Service charges at the profit-maximising price. However, it was apparent from the modelling carried out by the economic experts that this profit-maximising price was significantly above the current level of Airside Service charges.

512 We are therefore mindful that the evidence of the economic experts did not disclose that the existence of non-aeronautical revenues alone was sufficient to constrain SACL in the sense that the existence of those revenues eliminated its incentive to increase Airside Service charges above their current levels. If there was to be any constraint as a result of non-aeronautical revenues, that would only occur if the Airside Service charges were raised to levels substantially higher than they are presently set at.

CONSTRAINTS IN COMBINATION

513 We should finally note the opinion of Mr Houston, called by SACL, that there was potential for the three constraints – the airlines' countervailing power, the threat of re-regulation, and the effect of non-aeronautical revenue – to be combined in some manner. Mr Houston argued:

> *"While the existence of related revenues and of countervailing bargaining power on the part of airlines are not individually sufficient to constrain its behaviour, SACL's pricing conduct and its achieved returns suggests that, when taken together and particularly in combination with the current regulatory framework, these factors are effective."*

We do not agree with this reasoning. In particular, it assumes the current regulatory framework includes a credible regulatory threat which we have found has not been effective. Further, we cannot see any factor which makes the combination effective when its components individually do not have such an effect.

514 Mr Ergas, the economic expert called by Qantas, highlighted several problems with this combination concept. In particular, he noted that each constraint operates in a different manner with no obvious means for interacting in such a way as to increase the efficacy of the constraints. He observed:

> *"•* *The countervailing power constraint (if it exists in any meaningful sense) would simply prevent SACL increasing its prices unless SACL made some concession to the airlines as part of that bargain. So SACL's ability to increase prices in May 2001 up to the maximum permitted by the ACCC without offsetting concessions to the airlines suggests that the countervailing power constraint is not effective.*
>
> • *In contrast, the non-aeronautical revenue constraint imposes a profit penalty that increases continuously as the aeronautical price increases. As noted in Mr Smart's report of 10 September 2004, the profit penalty is smaller than the profit 'reward' from higher aeronautical prices at current Sydney Airport charges, and continues to be so even at much higher price levels.*
>
> • *The third type of constraint which Mr Houston claims is able to be combined is the threat of reregulation. That constraint operates as a threshold effect. The emphasis given to the concept of 'unjustifiable price increases' indicates a threshold of justifiability which, once crossed, might be likely to trigger reregulation. The intention to encourage robust commercial negotiations without undue regulatory interference leads to a low risk of reregulation when prices are below the threshold of justifiability.*
>
> *Even assuming they each operate to some degree, given the differing character of these three constraints, it is my opinion that they would not be likely to combine in any meaningful way. For example, airport prices within the 'justifiable' zone would fail to invoke the threat of reregulation. At these price levels, as Mr Smart has shown, the non-aeronautical revenue constraint would fail to prevent further price increases, and the countervailing power constraint would continue to be inoperative in any practical sense. Similarly, airport prices that are clearly above the 'justifiable' zone would, according to the Government's Review Principles invoke reregulation quite independently of any impact on non-aeronautical revenues. Again, the countervailing power constraint would be inoperative."*

515 The mechanisms by which these three possible constraints on the exercise of monopoly power by SACL would operate with any synergy in combination are, at best, unclear. In any event, we have found that 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-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. We agree with Mr Ergas' analysis.

WILL INCREASED ACCESS TO THE AIRSIDE SERVICE PROMOTE COMPETITION IN THE DEPENDENT MARKET?

516 In order for the Tribunal to declare the Airside Service on the basis of a finding that increased access to the Airside Service would promote competition in the dependent market, it is necessary to establish that, in the counterfactual, SACL's use of monopoly power in relation to use of the Airside Service would have an adverse impact on competition in the dependent market which would not exist in the factual with declaration. We are guided by SACL's past conduct in assessing how it will act in the future. Where SACL has misused its monopoly power in the past in such a way that has adversely impacted on competition in the dependent market, we can assume that in the future without declaration SACL will continue to misuse its monopoly power in a way which will have an adverse impact on competition in the dependent market. In the factual SACL will be constrained from misusing its monopoly power in the future because commercial negotiations will be conducted with the knowledge that, in default of agreement, independent arbitration is available.

517 Whether increased access to the Airside Service will promote competition in the dependent market, in the sense of enhancing the environment for competition, can be ascertained by comparing the situation in the dependent market with declaration with the situation in the dependent market without declaration. That is, a comparison of the factual with the counterfactual.

518 With regard to the likely future with declaration, Dr Williams, whose evidence we accept on this issue, said:

> *"Competition has many dimensions and there are many ways in which those dimensions of competition can be affected. The principal ways in which declaration of the Airside Service would promote competition in the dependent air services market are:*
>
> *a) it would be less likely to deny access to potential entrants into the air services market;*

b) it would be less likely to raise the level of the price of the Airside Service in such a way as: (i) to reduce the range of price/service options offered by airlines, and (ii) to reduce the incentive for (new or established) airlines to commit capacity to fly to and from Sydney; and

c) it would be less likely to structure the price of the Airside Service in such a way as to soften competition and favour full-service over low-cost carriers."

519 We are satisfied that the likely future without declaration will include the following circumstances:

- the Domestic PSC for the Airside Service will continue to be imposed and will increase over time in accordance with SACL's 28 September 2004 model;
- negotiations for new or varied contractual arrangements will continue to be long, drawn-out and inconclusive;
- minimum service standards for SACL may not be established for some considerable time or at all;
- new charges for services may be imposed by SACL upon airlines either directly or indirectly. We refer in particular to charges for ground handling services and the fuel throughput levy. SACL's carve out proposal would take some parts of SACL's revenue out of the asset base for revenue calculation purposes which has historically been regulated by the ACCC. This gives rise to a potential for SACL to double-charge for the use of assets in respect of which charges for the Airside Service are levied, presuming the asset base for revenue calculation purposes was not appropriately adjusted (a matter which SACL has not foreshadowed);
- post-May 2006 SACL unilaterally may increase substantially the revenue it obtains from airlines from the imposition of its Airside Service charge. This involves calculations using SACL's valuation of land, asset beta, risk-free rate and the number of passengers passing through Sydney Airport, figures which are the subject of some controversy;
- the proposed force majeure clause, if implemented, is likely to reduce SACL's risk and increase the potential risk and cost liability of the airlines using the Airside Service at Sydney Airport.

520 These are issues which will have an effect on competition in the dependent market. Each of these matters will affect the ability of airlines using SACL's Airside Service at Sydney Airport to compete effectively in the dependent market.

521 It is likely that, without declaration, these issues will either remain the source of protracted dispute or be resolved by SACL in a manner which is brought about by the exercise of monopoly power and not brought about by an opportunity for an arbitrated solution. If declaration is made, the environment for the promotion of competition is enhanced in the dependent market because there will be an opportunity for all the matters to which we have referred to be resolved by means of independent arbitration, more in line with what would be expected in a competitive environment. In any such arbitration the ACCC would take into account the following matters specified in s 44X(1) of the TPA:

> *"(a) the legitimate business interests of the provider, and the provider's investment in the facility;*
>
> *(b) the public interest, including the public interest in having competition in markets (whether or not in Australia);*
>
> *(c) the interests of all persons who have rights to use the service;*
>
> *(d) the direct costs of providing access to the service;*
>
> *(e) the value to the provider of extensions whose cost is borne by someone else;*
>
> *(f) the operational and technical requirements necessary for the safe and reliable operation of the facility;*
>
> *(g) the economically efficient operation of the facility."*

522 In reaching this conclusion, we have not lost sight of the fact that we are concerned to consider the promotion of "competition" in the dependent market rather than the promotion of "competitors". The limited number of participants in the dependent market, and, in particular, the existence of a virtual duopoly, makes it inevitable that we focus on effects on the participants, particularly the major participants.

THE IMPACT OF THE CHANGE IN DOMESTIC AIRSIDE SERVICE CHARGES FROM MTOW TO PSC

523 Dr Williams explained, and we accept, that the change from an MTOW-based charge to the Domestic PSC has the effect of changing the ratio of fixed costs to variable costs for the airlines. When SACL changed the tariff structure, the cost that was formerly fixed (with

respect to the number of passengers on the aircraft) was converted to a cost that varied according to the number of passengers on the aircraft. The ratio of fixed to variable costs is one of the basic conditions that affects competition in the dependent market.

524 This conversion of a fixed cost to a variable cost has two significant consequences for competition in the dependent market. First, FSAs are favoured over LCCs as the tariff structure has a differential impact on LCCs as compared to FSAs. LCCs will have to increase their prices by a larger proportionate amount than FSAs to accommodate the change to the passenger-based charge. To the extent that LCCs are constrained in the price they can set for airfares, this would be expected to lead to a larger proportional impact on the profits of LCCs.

525 The second consequence of the change in the fixed to variable cost ratio identified by Dr Williams is that airlines are less likely to chase incremental or marginal customers and less likely to be concerned about losing marginal customers to their rivals. If a competitor were successfully to attract passengers away from another airline, the higher the costs that the airline will save by losing those marginal passengers to its competitor, the less its incentive to respond to the competitor's activities. Dr Williams explained this as a "softening" of competition. We accept that this is a likely consequence.

526 By way of example, FSAs typically offer passengers a probability that seats will be available on alternative flights if they wish to change their time of travel. It is costly for an airline to provide this service. The cost of providing this service equates to the net revenue that has to be foregone if some seats on planes are left unsold in order to provide flexibility to passengers. Put another way, the revenue foregone is the lost revenue less the marginal cost to fill the seat. Dr Williams said that the lower the marginal cost of filling a seat, the greater the net revenue that is foregone by leaving a seat vacant. When SACL imposed an Airside Service charge that varied with the weight of the plane – the MTOW-based charge – the airlines incurred costs as the weight of aircraft increased, whilst the cost of carrying additional passengers on any given aircraft was very low. Under the Domestic PSC, it has become less costly for FSAs to leave a seat empty and therefore less costly to provide the service to their passengers of ticket flexibility. For an LCC, the same mechanism applies. The net cost of failing to fill a seat is reduced by any increase in the marginal cost per passenger. However, the reduction in the net cost of failing to fill a seat is proportionately

larger for an LCC so that the blunting of the incentive to chase the incremental passenger is proportionately greater for an LCC.

527 This consequence probably contributed to Qantas' enthusiasm for the change to a Domestic PSC, as recommended by Mr Schuster. Virgin Blue submitted that the change to a Domestic PSC was specifically aimed at Virgin Blue, upon Qantas urging SACL to do so. There is substance to this submission. We have already noted Mr Schuster's evidence that SACL chose a passenger-based charge "because Qantas preferred it". Virgin Blue acknowledged that the Tribunal's inquiry is to be directed towards the impact of the Domestic PSC on competition, as opposed to its impact on individual competitors. Nevertheless, in a market such as that presented to us which is substantially a duopoly, the distinction between an effect on competition and an effect on competitors becomes blurred. More particularly is this so when the trend in the airline industry is towards a growth in LCCs rather than FSAs. We accept the evidence of Dr Williams that the effect of increasing the marginal costs of Qantas and Virgin Blue is to decrease the intensity of rivalry between them and to impact more significantly on Virgin Blue.

528 The intensity of competition in the domestic air passenger market is heavily reliant on the existence and emergence of multiple carriers in the market or on particular routes. For example, where Virgin Blue has entered routes previously the domain of Qantas alone, competition on those routes has increased in terms of flights and price.

529 More generally, in the last 20 years, and in the last five or six years in Australia, the emergence of LCCs has contributed greatly to the levels of competition in the air passenger market. This is true in several regions of the world and has also been the case in Australia with the initial entry and subsequent expansion of Virgin Blue. The entry of Virgin Blue has both increased the rivalry in the air passenger market and helped to expand the total market, in particular by expanding the price sensitive segment of the air passenger market.

530 This trend, both worldwide and in Australia, for successful significant entry to come from LCCs, can reasonably be expected to continue for at least the short to medium term. It is also reasonable to expect the expansion of competition in the particular segment of price sensitive domestic passengers to be spurred primarily by airlines operating an LCC model.

531 As Mr Fenn of Qantas said:

> *"The emergence of strong LCCs has radically altered competitive patterns in the airline industry worldwide. Australia is a very good example…An LCC imposes a discipline on competing airlines. It requires airlines competing in the same market to focus primarily on the price standard set by the LCC. In my view, because of the pricing discipline imposed by an LCC, FSAs must ensure as far as practicable, that its networks are provided on the most efficient, cost effective and manageable basis."*

532 The change in tariff structure had an adverse effect on competition. The issue was not that it increased SACL's revenue closer to its "allowable revenue". The issue was that it did so via a change in tariff structure that penalised the likely primary source of increased rivalry in the domestic passenger market – Virgin Blue and any other LCC that was considering starting up.

533 Competitors generally do not have identical cost structures, nor do they serve identical customers. Thus any particular tariff will have differential effects on different competitors compared with other tariff structures. This is particularly so in the airline industry where the two general airline models, the FSA and the LCC, have distinct cost structures and their passengers have distinct pricing and service preferences.

534 The evidence of Dr Williams, which we accept, was that that the change in the cost structure of airlines that results from the change to a Domestic PSC from an MTOW-based charge is likely to cause LCCs to increase their prices by a larger proportion than FSAs, and is likely to have a proportionally larger effect on the profits of LCCs.

535 The evidence before us established that the marginal costs of LCCs are lower than the marginal costs of FSAs. This is so because FSAs offer extra benefits and services to passengers, such as the opportunity to change the time of a flight or obtain a refund where a ticket is not used. As the marginal costs of LCCs are lower than those of FSAs, and as an increase in the marginal cost of servicing a passenger results in a reduction in the opportunity cost of leaving a seat vacant, the uniform dollar increase in landing charges that the Domestic PSC imposes results in a higher proportional increase in the marginal costs of LCCs as compared to FSAs.

536 A standard proposition in economics is that, unless demand is perfectly elastic, an increase in marginal costs will lead producers to consider an increase in prices. Where demand is

relatively inelastic, the additional revenue gained by an increase in prices will off-set any reduction in demand caused by the increased prices.

537 The extent to which an airline can pass on increased costs to passengers in the form of increased fares is limited particularly by the yield management practice of the airline. As noted earlier, Virgin Blue and Qantas engage in sophisticated yield management and price discrimination. The aim of a yield management system is to ensure that total passenger revenue received for each flight is maximised. The yield management system seeks to ensure that expected revenue from each fare bucket is maximised and that seats are allocated between buckets and priced to the point of elasticity so as to maximise the total level of revenue.

538 The evidence before us indicates that, for airlines such as Virgin Blue and Qantas who are practising yield management, there is a restricted ability to pass on profitably costs to passengers in the form of higher airfares, with the likely result being that any cost increases will be predominantly absorbed by the airline with a consequent reduction in profitability. This is a general effect for all airlines facing elastic demand in their fare buckets. However, such general effects do not preclude that their impacts may be different reflecting the different markets served and different cost structures employed. Further, LCCs are likely to suffer a greater relative loss of profitability as they have a greater proportion of highly price-sensitive passengers.

539 We are also satisfied that consumer choices are influenced by relative prices. Where an airline is faced with a greater percentage increase in its marginal costs of servicing passengers than its competitor and accordingly has to consider a greater percentage increase in the price of its service, it will be at a competitive disadvantage to its competitor as compared to the situation it was in prior to the increase in costs. The effect of the increase in the marginal costs of an LCC such as Virgin Blue is to reduce the benefits passengers have come to expect and obtain from the introduction of LCC services, namely, lower fares, the existence of which is explained by lower cost structures.

540 SACL submitted that neither increased access nor declaration of the Airside Service would promote competition in the dependent market because:

- if there were no such declaration, the terms on which the Airside Service would be provided in the future would be consistent with the terms on which the Airside Service would be provided if there was declaration;
- any marginal increase in its Airside Service charges would not have any impact on the extent of rivalry between airlines in the dependent market;
- any small increases in charges would be unlikely to affect purchasing decisions of passengers or the business decisions of airlines;
- there was insufficient material to enable the Tribunal to be satisfied that declaration would promote competition in the dependent market;
- Virgin Blue and Qantas did not adduce clear evidence of any adverse impact on competition. Any likely increase in the level of the Airside Service charge was not shown to cause any significant loss of passengers due to the ability of the airlines either to absorb the increase or pass it on through their yield management systems in a manner which would minimise its impact. Any reduction in passenger numbers would not be likely to reduce the number of flights, and therefore would not be likely to lessen the level of access to the Airside Service or the level of competition.

541 We do not accept these submissions, in particular, because of the manner in which the Domestic PSC came into existence and the manner and extent to which that charge already discriminates against LCCs such as Virgin Blue. Further, it is apparent that SACL's 28 September 2004 model foreshadows significant increases in the level of the Domestic PSC which will impact adversely in particular on LCCs such as Virgin Blue.

542 SACL's submissions fail to take account of the need to analyse and understand the nature, extent and terms of the access presently given to the airlines. It is not to the point that, without declaration, the terms on which the Airside Service would be provided in the future would be consistent with the terms on which the Airside Service would be provided if there was declaration, if the terms on which the Airside Service is currently being provided are antithetical to competition in the dependent market.

543 This was recognised by Professor Baumol, SACL's expert economist, who said, quite correctly, that mere possession of market power is not by itself a valid basis for regulation. Professor Baumol continued:

> *"Rather, to determine whether there are legitimate grounds for the declaration desired by Virgin Blue and Qantas, it is necessary to investigate further what are the appropriate criteria, the behavioural incentives facing SACL and the evidence on the behaviour that can be expected in the circumstances and its consequences in the light of available analysis and evidence obtainable from the experience of analogous situations elsewhere."*

544 The response to SACL's submissions is that the present and past conduct of SACL informs us as to the likely conduct of SACL in the future and the consequences and effect of that conduct.

545 The structure, consequence and effect of the Domestic PSC was discriminatory in its creation and implementation against LCCs such as Virgin Blue. It continues to be so and is likely to continue to be so in the future. For the reasons we have discussed, it has a deleterious effect on competition in the dependent market and is likely to continue to have that effect in the future given SACL's 28 September 2004 model and SACL's proposal to carve out services for which further charges will be imposed which will affect airlines either directly or indirectly, and to impose new ground handling service charges.

546 If the Airside Service is declared, it does not follow automatically that the Airside Service charge will be changed or varied; nor does it follow automatically that any further charges for services by SACL will be withdrawn or eliminated. What will follow from declaration of the Airside Service is that the situation as at the date of the hearing and as forecast into the future in relation to SACL's charges and conduct will be able to be challenged by the airlines, rather than imposed on them without any recourse. To that extent there is the opportunity for the airlines, by independent arbitration and determination by the ACCC, to seek to remove and eliminate the detrimental effects on competition in the dependent market brought about by the current level and structure of the Airside Service charge and any further charges which are likely to be imposed.

547 Any arbitration conducted by the ACCC, and any determination made by it, will take into account the matters specified in s 44X(1) of the TPA, set out above at [521]. A number of these matters bear upon issues which we have considered in relation to SACL's conduct and the promotion of competition. For example, "the legitimate business interests of the provider, and the provider's investment in the facility" and "the direct costs of providing access to the service" are relevant to the manner in which, and basis upon which, a charge for the Airside

Service should be constructed. The matter of "the economically efficient operation of the facility" has a bearing upon the negotiation of, and agreement on, the conditions of use applying to airlines at Sydney Airport.

548 SACL emphasised that none of the material put before the Tribunal was sufficient to satisfy us that competition would be promoted if the Airside Service were declared. It submitted that, although voluminous material had been put before the Tribunal to show the competitive impact that a potential increase in the Airside Service charges and other conduct by SACL would have in the dependent market, none of the material was sufficient to establish that competition would be promoted if the Airside Service were declared. As we have observed, that submission fails to take account of the fact that the present Airside Service charge, based on a per-passenger charge, has a discriminatory effect on LCCs such as Virgin Blue. This effect consequentially impacts upon competition in the dependent market. It has an effect on LCCs' marginal costs, different from those of FSAs, which affects the profitability of LCCs on the routes they fly. Further, LCCs have a lesser ability than FSAs to pass these costs on to their passengers due to the distinct preferences of their passengers and their current yield management practices.

549 SACL supported its submissions by relying on Professor Baumol's observation that regulation should not "force firms to adopt measures that they would not have to adopt in a fully competitive market". Declaration of the Airside Service will not have that consequence in the circumstances under consideration. In a fully competitive market SACL would not have acted as it has done to date, for example, introducing a discriminatory Airside Service charge because of Qantas' preference for it in circumstances where Qantas had acknowledged to SACL the differential impact of that charge on Virgin Blue.

550 In the absence of declaration, that position will be maintained with a likelihood of it being exacerbated in the future for the reasons to which we have referred. Competition is affected in the dependent market at the present time as a result of the imposition of the Domestic PSC. Declaration of the Airside Service will result in a competitive environment which will include the opportunity for the airlines to seek to negotiate the method of charging for the Airside Service and, absent a negotiated resolution, they will have the opportunity for the nature, content and level of charges to be set by independent arbitration.

551 To adapt the words of Professor Baumol, declaration of the Airside Service will require SACL to behave as it would if its activities were carried out in a competitive marketplace.

552 SACL submitted that the airlines had ignored SACL's long-term pricing proposal in assessing the impact of increases in the Airside Service charges and that their witnesses had simply made general statements about the impact of increased charges. The evidence of the expert economists was controversial in this respect.

553 In the modelling performed by Professor Oum and Mr Smart, much was made of significant increases which would occur in the Airside Service charges. Some of these increases were not realistic. Mr Smart demonstrated that certain increases, and also reductions, in the Airside Service charge would have an effect on the profitability of a number of routes for Qantas. However, Mr Smart did not consider that significantly higher Airside Service charges would cause Qantas to exit any routes, although he considered that relatively modest changes to the level of the Airside Service charges could result in some routes to and from Sydney becoming unprofitable. He reached a similar conclusion in relation to Virgin Blue's route profitability, albeit based on limited information.

554 Route profitability is, however, particularly significant for an LCC such as Virgin Blue which considers route profitability on a stand-alone basis, rather than on a network basis. Virgin Blue generally requires all routes to be profitable on a stand-alone basis in the long term, although unprofitable routes may be continued in the short term if they meet certain specific criteria. Mr Tim Jordan, Virgin Blue's Head of Commercial, said that Virgin Blue will generally not accept an unprofitable route unless there are strategic reasons for maintaining the route in the short term, such as the strategic importance of Virgin Blue servicing a particular route or city, expected improvement in profitability in the medium term, or scheduling issues.

555 Mr Smart's analysis was the subject of significant criticism by Mr Houston, called by SACL, who concluded that the data produced by Qantas was inadequate for the purpose of determining whether a change in the level of the Airside Service charge was likely to result in an airline suspending, maintaining or expanding capacity on a route.

556 Mr Houston's criticism of Mr Smart's analysis and also his criticism of Professor Oum's modelling was cogent, but it fails to take account of the differential impact the change from an MTOW-based charge to a passenger-based charge has on the costs of Virgin Blue as an LCC. As noted earlier, the change in tariff structure converted a fixed cost to a variable cost which adversely affected Virgin Blue and reduced the incentive for airlines to chase the marginal customer.

557 In Professor Oum's assessment, an increase in the Airside Service charge (using a 100% increase from $3.00 to $6.00 per passenger) would have a significantly larger negative percentage impact on reducing Virgin Blue's traffic volumes as compared to Qantas in all of the duopoly routes to and from Sydney Airport. Accordingly, Virgin Blue would lose proportionally more passengers if both airlines faced an identical increase in the Airside Service charge.

558 There can be some criticism of the figures Professor Oum ultimately reached. However, it is sufficient for present purposes to observe that (with all airlines using yield management systems which price all buckets to the point of elasticity) a greater percentage reduction in passenger volumes as a result of an identical dollar increase in a passenger-based charge for the Airside Service would be expected for airlines with a lower price structure, as compared with an airline whose market and strategy is based on a higher pricing structure.

559 LCCs such as Virgin Blue service a particular type of passenger, which is price sensitive, and operate under a particular cost structure which is different to that of FSAs such as Qantas. These factors support the contention that an increase in the Airside Service charge and the particular tariff structure employed by SACL will impact more heavily on LCCs such as Virgin Blue.

560 We have formed the view that airlines have a somewhat limited scope to pass through profitably any increases in the Airside Service charges to the majority of their passengers, which result will impact on demand and route profitability. We have also formed the view that LCCs in particular will be disadvantaged vis-à-vis FSAs by such an increase and by the use of a Domestic PSC in particular. This has consequences for the level of rivalry in the dependent market in general, and on demand and route profitability in particular.

561 SACL relied on the introduction of fuel surcharges and a credit card surcharge by Qantas and Virgin Blue to demonstrate that the imposition of identical charges by the airlines would not have any adverse affect on competition in the dependent market. SACL contended that if both airlines similarly passed on to passengers any increase in the Airside Service charge, then neither airline would be worse off and there would be no subsequent reduction in competition.

562 On 11 May 2004 Qantas introduced a fuel surcharge of $6.00 on all domestic tickets issued after 18 May 2004. Two days later, on 13 May 2004, Virgin Blue increased the price of each of its fare buckets by $6.00 as a fuel surcharge, to take effect from tickets issued on or after 18 May 2004. According to Mr Jordan, whose evidence we accept, notwithstanding the introduction of the $6.00 fuel surcharge in May 2004, Virgin Blue's average fares did not increase by $6.00. Rather, the average fares derived by Virgin Blue between April 2004 and June 2004 decreased on all routes other than the Sydney-Canberra route on which a small increase in the average fare occurred.

563 Mr Jordan attributed this decrease in average fares to a decreased demand for tickets which brought about a change in the number of tickets purchased in each fare bucket. What occurred was that, in order to sustain demand and maintain acceptable load factors, Virgin Blue was obliged to offer more tickets in cheaper fare buckets. No doubt it can be said that the reduction in demand for tickets was attributable to a number of factors and not solely the fuel surcharge. Relevant factors impacting on demand arise from seasonal factors, changes in capacity on particular routes and increases in competition on routes, particularly from Jetstar. Nevertheless, the fact is that immediately after the first fuel surcharge was implemented, demand for Virgin Blue tickets was reduced and average fares were reduced. We are satisfied that the first fuel surcharge had an impact on that reduced demand.

564 A second fuel surcharge of $4.00 (bringing the total fuel surcharge to $10.00) was introduced by Qantas and Virgin Blue, effective from 26 August 2004. At the time of the hearing there was no evidence available as to the effect of the increase on demand for tickets.

565 The credit card surcharge gives rise to different considerations. In one sense, it is voluntary and avoidable. A passenger can pay in cash or by cheque, although such payments limit the manner in which tickets can be purchased. Tickets can only be purchased over the internet

by credit card payment. Further, a credit card surcharge does not appear as part of the headline ticket price. It does not have to be included in an advertised ticket price.

566 In February 2003 Qantas introduced a 1% surcharge on credit card transactions effective from the beginning of April 2003. Virgin Blue refrained from following suit. It undertook an advertising campaign in April 2003 to draw a distinction between Qantas' and Virgin Blue's approach to a credit card surcharge. Subsequent market research showed that passengers had not chosen to fly with Virgin Blue because Qantas imposed a credit card surcharge and Virgin Blue did not do so.

567 Virgin Blue brought in a credit card surcharge in June 2004 of $2 per sector per passenger because there was no competitive advantage in not doing so. It was not part of the headline ticket price and so had less impact on passengers' views about total ticket cost, and because it gave Qantas and Jetstar a competitive advantage as they recovered their merchant service costs whilst Virgin Blue did not do so.

568 In summary, the credit card surcharge is not an analogue for an increase in ticket prices to recover an Airside Service charge, and has little relevance to the issue whether the Airside Service charge and any increase in it has an adverse impact on competition in the dependent market.

THE IMPACT OF AN INCREASE IN REVENUE

569 Any further increase in the charge for the Airside Service will further exacerbate the adverse effect of that charge on competition in the dependent market. As it has a differential impact on LCCs such as Virgin Blue as compared with FSAs such as Qantas, any further increase will reduce the differential of variable operating costs between airlines such as Virgin Blue and Qantas. Any additional charges levied for services currently provided as part of the Airside Service so as to increase SACL's level of revenue will have an impact on the costs of the airlines and their ability to compete in the dependent market.

570 As we have noted earlier, Virgin Blue estimated and SACL accepted (see [202] and [190] above, respectively), that the change from an MTOW-based charge to the Domestic PSC would result in an increase of approximately 52% to the Airside Service charge paid by Virgin Blue whereas Qantas' charges would only increase by approximately 4%. This

disproportionate effect will intensify as the Domestic PSC increases, as proposed by SACL in its draft Aeronautical Services Agreement, propounded on 28 September 2004. The consequent reduction in the difference in operating costs between Virgin Blue and Qantas, brought about by the disproportionate increase in the costs of LCCs such as Virgin Blue, will have a flow-on effect in relation to the prices offered for air travel and a consequent narrowing of the difference in prices offered.

571 As Dr Williams pointed out, this will have the effect of limiting the range of price options available for passengers in the dependent market. This will have an effect on competition because it will reduce the extent to which the LCC model airline will be competitive with the FSA model airline. The significance the LCC model has for competition in the air passenger market generally is that its low cost structure has enabled it to provide vigorous competition to the FSA model airline.

572 Although the increases in the Domestic PSC proposed by SACL in its draft Aeronautical Services Agreement are on one view relatively small compared to Virgin Blue's overall variable costs and the average domestic fares, Virgin Blue's yield management practices operate so that fare buckets are priced to the point of elasticity and leave little room for passing on costs to passengers without there being a corresponding effect on demand. Mr Jordan of Virgin Blue noted that overall Virgin Blue made a pre-tax profit on each passenger processed through Sydney Airport for the eleven month period ended February 2004 of approximately $[x] averaged across all Sydney routes. Thus, even a small increase in a per-passenger charge will have a significant effect on Virgin Blue's profitability. This effect will be exacerbated by the fact that Virgin Blue assesses its route profitability on a stand-alone basis (and some of these routes are only marginally profitable). The significance of route profitability is demonstrated by the fact that in September 2004 Virgin Blue suspended its Sydney-Canberra service (Virgin Blue had not operated profitably on the route for a considerable time). Virgin Blue also ceased flying the Sydney-Alice Springs route after October 2004 because it was unprofitable. In its place, it commenced flying the Adelaide-Alice Springs route. The key factor in Virgin Blue's decision to switch from the Sydney-Alice Springs route to the Adelaide-Alice Springs route was that the direct operating costs were significantly lower on the Adelaide-Alice Springs route. Thus an increase in charges by SACL may also lead to a reduction in the frequency or capacity of routes currently offered by Virgin Blue.

573 We accept the proposition put by SACL that consumers will be influenced in their choice by the relative airfares offered by the airlines. This does not mean that a uniform increase in the charges for the Airside Service will not have any impact on competition because the differential between the prices of each airline's airfares would remain constant. As we have previously discussed, the different cost structures and different passenger preferences of Virgin Blue and Qantas mean that a uniform increase in costs to the airlines impacts differently upon each airline. A uniform increase in costs will therefore not necessarily translate to a uniform increase in the airfares offered by each airline. Furthermore, LCCs seek to target, among others, a large proportion of passengers who only choose to fly because a low fare is offered. The LCC model is premised upon generating such additional demand, rather than merely attracting existing passengers away from other airlines. Even a small increase in airfares may deter such passengers from choosing to fly.

THE IMPACT OF NON-PRICE TERMS AND CONDITIONS

574 We have already found that, without declaration of the Airside Service, the counterfactual scenario will involve:

- protracted negotiations for new or varied contractual arrangements in relation to the conditions of use of Sydney Airport;
- minimum service standards by SACL may not be established;
- new charges are likely to be imposed by SACL on airlines either directly or indirectly;
- SACL may unilaterally increase substantially the revenue it obtains from the imposition of the Airside Service charge;
- the proposed force majeure clause is likely to generate a significant increased risk for the airlines and therefore involve them in an increased cost;
- services will be carved out of existing services and the airlines will be subject to extra charges and imposts.

575 Each of these factors has an impact on airlines because they either affect the efficiency of airlines in the manner in which they operate in a competitive environment or add to their cost structure in a manner which affects their ability to pass on further costs to passengers and their profitability.

576 We are satisfied that the operating efficiency of an airline and its ability to be competitive in a relevant market can be affected by the conditions of use to which it is subject when it uses an airport. Much depends upon the nature of the conditions of use laid down by the airport operator. Protracted negotiations lead to uncertainty and an inability to engage efficiently in forward planning. Where one of the negotiating parties is a monopolist with the ability and the inclination (as SACL has demonstrated in the past) to exercise its monopoly power, the negotiations tend to end up with the other negotiating party being compelled to accept terms which can impact on its ability to be competitive. An example of such a situation is found in Jetstar's experience at the time it was about to commence operations at Sydney Airport.

577 Although SACL has propounded a long-term pricing proposal, it is apparent, as we have found earlier, that it is proposing to introduce further charges which will be imposed in respect of the use of components of the Airside Service.

578 These charges will increase the costs of the airlines using Sydney Airport which will have an effect on their ability to be, and remain, competitive in the dependent market. More particularly is this so where the airlines in the dependent market have different cost structures based on the LCC and FSA models.

579 A similar effect will occur if the force majeure clause is implemented. It will involve the airlines assuming a significant risk and either having to make some provision for the contingency involved or obtain adequate insurance cover as protection against a substantial open-ended contingent liability. In either case, there will be a cost effect which will impact on their ability to be, and remain, competitive in the dependent market.

580 If the Airside Service is declared, and these factors continue to exist (as we consider they will if the Airside Service is not declared), the airlines will have the opportunity to negotiate these matters in a manner more reflective of what would occur in a competitive environment because, in the absence of a negotiated resolution of any such matter, the disputed issue can be referred to the ACCC for an arbitrated determination. For example, if the negotiations in relation to the conditions of use of Sydney Airport remain protracted and without resolution, the airlines can have the terms of their conditions of use determined by independent arbitration.

CONCLUSION AS TO CRITERION (A)

581 The issue whether increased access to the Airside Service will promote competition in the dependent market is complex because the answer is derivative. In this context, increased access equates to access on different terms and conditions; in particular, on a term that if any airline which uses Sydney Airport is unable to agree with SACL on any aspect of access to the Airside Service then an access dispute will arise which, in the absence of a negotiated resolution, will be arbitrated and determined by the ACCC.

582 Increased access does not mean that an airline will inevitably be able to alter, vary or modify the terms upon which it is given access to the Airside Service. Rather, it means that the commercial environment will change and the airline will have the opportunity to seek to achieve such alteration, variation or modification by independent arbitrated determination in default of a negotiated resolution.

583 An example exposes the distinction: if the Airside Service is declared, Virgin Blue will not be able to require SACL to change the Domestic PSC to an MTOW-based charge or any other charge. However, Virgin Blue will have the opportunity, if it wishes, to seek to negotiate that charge with SACL on mutually acceptable terms. If it cannot do so, it will have the opportunity, indeed the right, to notify the ACCC that an access dispute exists and to have the ACCC, by arbitration, determine whether the nature, structure and level of the Airside Service charge should be changed and, if so, in what manner. A similar situation can also arise, for example, if Qantas asks SACL to lay down certain minimum standards of service delivery in relation to the provision of the Airside Service. If SACL is unwilling to do so, Qantas would have the option of referring the matter to the ACCC for an arbitrated determination.

584 It can be seen from our analysis of the factual and the counterfactual that a comparison of the circumstances and state of competition between the factual and the counterfactual discloses that declaration of the Airside Service would bring about increased access (that is, access on different terms and conditions) to the Airside Service at Sydney Airport which would promote competition in the dependent market. The environment for competition in the dependent market will be enhanced if declaration of the Airside Service is made compared to the state of competition in the dependent market if the Airside Service is not declared.

585 We are therefore satisfied, in terms of criterion (a), that increased access to the Airside Service would promote competition in at least one market other than the market for the Airside Service, that is, the dependent market.

CRITERION (f)

586 The second disputed criterion in s 44H(4) concerned criterion (f), which requires that the Tribunal be satisfied:

> *"(f) that access (or increased access) to the service would not be contrary to the public interest."*

587 In *Re Duke Eastern Gas Pipeline Pty Ltd* (supra) the Tribunal considered the construction of a provision in similar terms to s 44H(4), s 1.9 of the *National Third Party Access Code for Natural Gas Pipeline Systems.* The Tribunal considered at 33, that s 1.9(d) (which is substantially similar to criterion (f)), "does not constitute an additional positive requirement which can be used to call into question the result obtained by the application of [the earlier criteria in s 1.9]". Rather, s 1.9(d) accepted the results derived from the application of the earlier criteria but "inquires whether there are any other matters which lead to the conclusion that coverage would be contrary to the public interest".

588 We consider that this construction applies equally to criterion (f). It is an independent and self-contained criterion of which we must be satisfied. It requires consideration whether there are circumstances other than those raised for consideration by ss 44H(4)(a) to (e) which demonstrate that increased access (the issue in this proceeding) would be contrary to the public interest.

589 Virgin Blue submitted that the question the Tribunal must ask itself in respect of criterion (f) is whether conferring on airlines a right or ability to use the Airside Service is contrary to the public interest.

590 According to the NCC, as criterion (f) is phrased in the negative, in a case where ss 44H(a) to (e) are satisfied, in order to make a decision not to declare a service, the costs of regulated access must outweigh the benefits of regulating natural monopoly services. It was said that the task for the Tribunal is to assess whether the costs of regulation outweigh the benefits of declaration and, in doing so, the costs should be recognised as including both direct costs of

regulation, for example, the costs of arbitration, and indirect costs of regulation, for example, the cost of distorting efficient investment or production decisions.

591 SACL submitted that the direct and indirect costs of regulation would outweigh any benefits that might be obtained in the dependent market under declaration of the Airside Service. SACL relied upon the evidence of Professor Baumol who sought to show that declaration would lead to costly regulation which would be open to strategic misuse. Professor Baumol's evidence regarding the excessive cost and perniciousness of regulation was, as he acknowledged, largely based on his experience of regulation in the United States of America and to that extent his evidence in this respect was of limited assistance.

592 The direct, immediate and up-front nature of much regulation in the United States of America contrasts with the default nature of the arbitration available under a declared service pursuant to Div 3 of Pt IIIA of the TPA. The use of arbitration under Div 3 of Pt IIIA is only activated where the parties are unable to reach agreement on one or more aspects of access to a service. Arbitration is not immediate and indeed may never occur. We note in this regard Qantas' reference to Australia's past experience under s 192 of the Airports Act where no arbitrations arose in the four years during which airport services at Brisbane, Melbourne and Perth were deemed to be declared under Pt IIIA of the TPA. Further, following the declaration of ramp handling services at Sydney Airport as a result of the Tribunal's decision in *Sydney International Airport*, there has not been resort to arbitration under Div 3 of Pt IIIA of the TPA.

593 If arbitration were to occur, the arbitration process has the potential to be swift and relatively inexpensive. The powers of the ACCC are sufficient to ensure that any arbitration that does occur is conducted efficiently and expeditiously: see, for example, ss 44Y and 44ZF. The ACCC is not bound by the rules of procedure and may give directions as necessary for expedient hearings of matters, including for matters to be heard via telephone or video link: s 44ZF. The ACCC is also empowered to terminate an arbitration where it is vexatious, where the subject matter is trivial, misconceived or lacking in substance, or where the party notifying the dispute has not engaged in good faith negotiations: s 44Y.

594 We note that SACL's other economic expert, Mr Houston, also sought to highlight the costs and disadvantages of regulation. A key assumption of Mr Houston's analysis was that

declaration would involve arbitration by the ACCC and he estimated the timing and cost to the parties involved of such an arbitration. As indicated, declaration need not result in arbitration. The parties are free to reach commercial agreements and will have a clear commercial and financial incentive to do so. The commercial negotiations would presumably be no more or less expensive with declaration. Declaration therefore does not incur costs at the stage before a Div 3 arbitration is requested.

595 We consider Mr Houston's analysis to be of little probative value. It is speculative and based on a number of assumptions that will not necessarily be valid at any given point of time. Much would depend upon the nature of the dispute and the extent to which there had been negotiations to resolve the dispute. Any estimate of such costs, particularly where arbitration is not inevitable, is speculative in the extreme. It should also be remembered that the legislation anticipates a speedy and cost efficient arbitration: s 44ZF.

596 We also observe that previous independent work by Mr Houston emphasised elements of the desirability of regulation, particularly in situations of private investment in infrastructure. In a paper entitled 'Private Participation in Infrastructure in China. A Regulatory Perspective' delivered on 15 November 2001, Mr Houston said:

> *"*[A] *critical requirement for successful private participation in infrastructure industries everywhere is the establishment of an 'independent' regulatory framework with*
>
> - *clarity of jurisdiction*
> - *independence from vested interests*
> - *dispute resolution processes and principles."*

597 It was put to Mr Houston that the lighter-handed policy devised by the Commonwealth Government, involving as it did only the threat of re-regulation, did not meet this critical requirement. Mr Houston did not agree with the proposition put to him, but was unable to identify a dispute resolution process and principle in the Commonwealth Government's policy. We do not consider that the Commonwealth Government's lighter-handed policy does include an independent regulatory framework other than in Pt IIIA of the TPA.

598 We are not satisfied that there is any substantive or effective dispute resolution process directly tied to the threat of re-regulation. The Review Principles do not give any indication that disputes in general would lead to re-regulation. The Review Principles state that "[i]t is

expected that airlines and airports will primarily operate under commercial agreements and in a commercial manner, and that airport operators and users will negotiate arrangements for access to airport services", without commenting on any mechanism for the resolution of disputes. The need for dispute resolution processes that had been identified by the Productivity Commission was not effectively responded to by the Commonwealth Government.

599 The Review Principles focused on the conditions that, if violated, could trigger a review regarding the need for a resumption of price controls. Accordingly, violation of the Review Principles would not necessarily trigger the introduction of more general dispute resolution processes. It is not clear that re-regulation would bring dispute resolution processes to bear on non-price terms and conditions of access, for example. It is therefore difficult to see how moves to re-regulation, if limited to price controls as foreshadowed by the Review Principles, would amount to the imposition of dispute resolution processes beyond those associated with price levels.

600 Virgin Blue submitted that a bargaining power asymmetry exists between SACL and the airlines and that the economic expert evidence had demonstrated that declaration would assist in redressing that asymmetry, leading to a net public benefit.

601 Virgin Blue argued that where a disparity of bargaining power exists between negotiating parties, the prospect of arbitration if negotiation fails increases the likelihood of the parties reaching a commercial agreement that truly reflects a fair negotiated position. Such an outcome is in the public interest. Virgin Blue also argued that where the bargaining power is equal there is no reason to conclude that declaration, introducing the possibility of arbitration, would reduce the opportunities for commercial negotiation.

602 We agree with these submissions and consider that declaration will redress the bargaining power asymmetry presently existing due to SACL's position as a monopoly provider of the Airside Service in Sydney in circumstances where the scope of dispute resolution procedures in relation to access to the Airside Service are severely limited. As Mr Houston himself put it in his presentation (referred to above at [596]), "[t]he overall objective of economic regulation is to mimic the outcome of a 'competitive market'".

603 The NCC accepted that declaration did not mean that the opportunity for commercial negotiations was foregone but contended that declaration would limit or alter the nature and outcomes of commercial negotiations between access seekers and service providers such that the potential benefits of commercial negotiation without any recourse to a binding dispute resolution process would be foregone. We do not agree. Nor do we agree that early recourse to arbitration may result in an imposed outcome that is not as efficient as one that may have been developed by the parties themselves.

604 We consider that the availability of a binding dispute resolution process provides an incentive for parties to negotiate in a realistic, practical and positive manner in an attempt to resolve differences which affect, and have a real impact on, their daily commercial activities. Indeed, we consider that the availability of a binding dispute resolution process will bring about a more efficient outcome than a situation where no such process is available. More particularly is this so where the arbitrator has to take into account the matters specified in s 44X(1) of the TPA.

605 We do not regard the outcome of the negotiations between SACL and the airlines in relation to the issues which arose between them, and which we have discussed, as an efficient disposition of their differences. The history of the conduct of SACL to which we have referred demonstrates the desirability, indeed the necessity, of having in place a binding dispute resolution process.

606 We are satisfied that where there is significant bargaining asymmetry, as we have found exists between SACL and the airlines using Sydney Airport, a binding dispute resolution process will address such bargaining asymmetry and provide a better framework for commercial negotiation.

607 The interaction of the provisions of Pt IIIA of the TPA and the Commonwealth Government's policy of lighter-handed regulation were contentious. SACL submitted that the Government's acceptance of the lighter-handed approach should preclude declaration under Pt IIIA of the TPA. SACL contended that, just because Pt IIIA continues to operate, it does not mean that the Airside Service should automatically be declared. SACL also emphasised the importance and predominance of the Government's stated policy of "lighter-handed" regulation. In particular, SACL submitted two matters that it considered to

be of great weight in the determination of criterion (f), both of which arose from that policy, as outlined in the Commonwealth Government's joint press release issued in May 2002 following the release of the Productivity Commission Inquiry Report (referred to at [37] above). These matters were:

- that the prices notification regime be replaced with a prices monitoring regime for a probationary five-year period;
- that the Government supported the lighter-handed regulation in the form of prices monitoring arrangements and that an independent review be conducted after five years "to determine whether there have been unjustifiable price increases that warrant the imposition of price controls."

However, it should be remembered that the Commonwealth Government's joint press release also stated that all airports should be subject to the generic provisions of the National Access Regime in Pt IIIA of the TPA.

608 We acknowledge, and have given considerable weight to, the Commonwealth Government's policy of lighter-handed regulation. We do not challenge that policy, but nevertheless place it in context with all the other factors and criteria to be taken into account in determining whether the Airside Service should be declared. In particular it must be again remembered that the Commonwealth Government's policy includes the applicability of Pt IIIA of the TPA to Sydney Airport.

609 We have already found that we are satisfied that our finding as to promotion of competition in the dependent market is sufficient to outweigh any perceived effect or consequence of declaration on Government policy. Indeed, we consider that, in the light of such finding, declaration is consistent with the underlying objectives of Government policy. We are therefore satisfied for the purposes of criterion (f) that increased access to the Airside Service will not be contrary to the public interest.

RESIDUAL DISCRETION

610 SACL submitted that even if we were satisfied that criteria (a) and (f) were satisfied, we should nevertheless decline to declare the Airside Service because of the Government's policy of lighter-handed regulation, the absence of market failure, the current negotiations between the parties to reach a long-term agreement, and the unlikelihood that any benefit will

be derived from declaring the Airside Service. It was submitted that, to the extent, if any, these considerations were not relevant to the question of public interest, they were relevant on any issue of residual discretion.

611 We accept that we have a residual discretion to decline to make a declaration, but it is extremely limited. In *Sydney International Airport* the Tribunal said at [223], 40,796:

> *"The Tribunal is prepared to accept that the statutory scheme is such that it does have a residual discretion. However, when one has regard to the nature and content of the specific matters in respect of which the Tribunal must be satisfied pursuant to s 44H(4) of the Act, that discretion is extremely limited. The matters therein specified cover such a range of considerations that the Tribunal considers there is little room left for an exercise of discretion if it be satisfied of all the matters set out in s 44H(4)."*

612 We agree with these observations. The comprehensive issues set out in s 44H(4) leave little room for the consideration of other issues. Particularly is this so when s 44H(4)(f) requires consideration of the broad subject of "the public interest."

613 Each of the matters raised by SACL in respect of the exercise of a residual discretion has been considered in our analysis of criteria (a) and (f). We see no reason which warrants us reconsidering those matters in the context of the exercise of our residual discretion.

614 We are satisfied, in the exercise of our residual discretion, having regard to our satisfaction of the matters raised in s 44H(4), that the Airside Service should be declared.

PERIOD OF DECLARATION

615 It remains to consider the period during which the Airside Service should be declared. The issues which have given rise to the application for declaration show that the period of declaration should be sufficiently long to enable SACL and any airline using Sydney Airport to make and implement strategic business decisions. However, the period of declaration should not be so long as to deny SACL the opportunity to demonstrate that its conduct is such that continuous or renewed declaration is no longer necessary. We note that it is desirable that any decisions as to pricing proposals and the implementation of terms and conditions of access to the services offered at Sydney Airport are able to be made in such a way during the period of declaration that there is sufficient time for any access disputes to be negotiated and,

if incapable of commercial resolution, to be determined by arbitration by the ACCC. It is also desirable that any period of declaration allow for the implementation of any such decisions and arbitrated issues so that during the period of declaration the consequences of such decisions and arbitrated outcomes can be observed and understood.

616 In its draft recommendation when it considered that the Airside Service should be declared, the NCC formed the view that declaration for a period of five years was most appropriate. This is the period of declaration which Virgin Blue in fact sought before us. SACL contended that a period of two years was more appropriate in order to enable SACL's proposed long term commercial agreements to be bedded down, or otherwise a period of three years was sufficient for the result of any review undertaken by the Commonwealth Government to be known.

617 We consider that five years is an appropriate period for declaration. In the circumstances outlined above, we initially considered that a period of seven years might be an appropriate period for declaration. However, whilst SACL and the airlines negotiated terms and conditions of access over a number of years, between 1998 and 2004, we consider that declaration will truncate any future commercial negotiations of this nature as any party will be able to insist upon arbitration if genuine and good faith negotiations do not achieve a commercial resolution. Accordingly, a period of five years is a sufficient period for declaration.

THE DETERMINATION

618 The Tribunal therefore makes the following determination pursuant to s 44K(8)(b) of the TPA:

1. It sets aside the decision of the Parliamentary Secretary to the Commonwealth Treasurer of 29 January 2004 not to declare the services required 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.

2. It declares the 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).

3. It determines that the declaration in paragraph 2 of the determination shall be effective on and from 9 December 2005 and shall expire on 8 December 2010.

I certify that the preceding six hundred and eighteen (618) numbered paragraphs are a true copy of the Reasons for Determination herein of the Tribunal

Associate:

Dated: 12 December 2005

Counsel for Virgin Blue:	S J Gageler S.C. and J A Halley
Solicitors for Virgin Blue:	Gilbert & Tobin
Counsel for Qantas:	J E Griffiths S.C. and M J Darke
Solicitors for Qantas:	Minter Ellison
Counsel for Sydney Airport Corporation Limited:	F M Douglas QC and N Manousaridis
Solicitor for Sydney Airport Corporation Limited:	Mallesons Stephen Jaques
Counsel for the National Competition Council:	P R Whitford S.C.
Solicitor for the National Competition Council:	Phillips Fox
Counsel for the Parliamentary Secretary to the Treasurer:	A I Tonking
Solicitor for the Parliamentary Secretary to the Treasurer:	Australian Government Solicitor
Dates of Hearing:	11, 12, 13, 14, 15, 18, 19, 20, 25, 26 and 27 October 2004
Date of Final Submissions:	16 December 2004
Date of Reasons for Determination:	12 December 2005