SUBMISSION TO THE COMMITTEE OF INQUIRY FOR THE REVIEW OF THE COMPETITION PROVISIONS OF THE TRADE PRACTICES ACT 1974 (THE REVIEW)

JULY 2002

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1. INTRODUCTION AND OVERVIEW

Virgin Blue welcomes the opportunity to contribute to the Inquiry for the Review of the Competition Provisions of the Trade Practices Act 1974 (**the TPA Review**).

Virgin Blue entered the Australian aviation market in August 2000. Virgin Blue operates as a low-far airline. Around the world, new entrant low fare carriers, such as Virgin Blue, have introduced widely available affordable air travel, resulting in huge increases in air travel, in both tourism and business, and jobs growth.

Worldwide the greatest threat to new entry in the aviation industry has been the ability of incumbent operators to engage in predatory and other exclusionary conduct. The dynamic nature of the airline industry and the ability of incumbent airlines to quickly and at low incremental cost switch capacity on to routes served by new entrants makes the aviation industry particularly prone to predatory conduct. The risk of predatory conduct coupled with the necessity for new entrant airlines to cover their start-up costs as quickly as possible in order to remain viable and the difficulties and significant costs associated with new entry, all act as substantial deterrents to new entry.

Virgin Blue considers that there is substantial scope for it to expand its operations and introduce competition on routes now dominated by Qantas. Whether or not Virgin Blue will be able to rapidly expand its operations and/or a new carrier is likely to enter (or existing smaller operators are likely to expand), is influenced in very large degree by the level of competition protection against predatory conduct.

Accordingly, to foster competition the aviation industry it is essential that there be strong regulatory protection against misuse of substantial market power.

Virgin Blue agrees with the assessment of the Australian Competition and Consumer Commission, at least in the aviation industry, that s 46 of the *Trade Practices Act 1974* does not currently provide adequate protection against predatory conduct. In particular:

- Section 46 does not prohibit a company taking advantage of a substantial degree of market power where that is likely to have an anti-competitive effect.

- There is still substantial uncertainty as to when conduct may be considered a taking advantage of market power, and in practice there is undue weight placed on narrow cost based rules.

- There is no framework for the development of clear ex ante guidelines and rules in relation to specific forms of anti-competitive conduct.

- The current enforcement framework does not permit a timely response to predatory conduct.

Each of these limitations is addressed through aviation specific regulation in the US and Canada.[1,2] Virgin Blue considers there is a clear case for aviation-specific competition regulation in Australia and has called on the Commonwealth Government to introduce similar competition regulation for the Australian airline industry.

Virgin Blue also recognises that similar issues may arise in other industries.[3] At the same time, these concerns may not be as significant for all industries.

Accordingly, Virgin Blue submits to the TPA Review that the TPA be amended:

- to provide for an effects test in s 46; and

- in relation to significant industries which are declared by the Minister, to permit the Commission to be able to develop specific ex ante guidelines and rules to give effect to s 46 in those industries and to have power to issue a notice requiring a person to cease from engaging in conduct in breach of those guidelines or rules.

These recommendations are broadly in line with the Commission's recommendations, but have the following advantages:

- the cease and desist power would only apply in industries that the Minister has determined to be appropriate for their application; and

- the Commission would be able to and would be required to provide clear guidance as to the particular forms of conduct which may constitute a misuse of market power giving rise to the prospect of a "cease and desist" notice.

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1 See Canadian *Competition Act* and Regulations relating specifically to anti-competitive conduct in the domestic airline industries; also 49 USC 41712 giving the US DoT specific powers in relation to unfair airline practices.

2 Virgin Blue also notes that in the telecommunications industry with a dominant Telstra there are specific anti-competitive conduct rules and a competition notice regime, facilitating timely and effective responses to predatory and other exclusionary conduct. (Part XIB of the TPA.)

3 There is currently specific anti-competitive conduct regulation in the telecommunications industry, Part XIB of the TPA.

2. DOMESTIC AVIATION IN AUSTRALIA

2.1 Overview of Australian Airline Industry

Australia's airline industry has historically been structured as a two-airline model, reflecting government policy. Australia's two-airline policy ensured that, since the 1950s, two airlines with parallel schedules, aircraft and prices served all major domestic routes.

Under the two-airline model, there was little price competition between Qantas and Ansett. Price increases were announced simultaneously and there was little or no price discounting. Each airline identified largely identical fare classes and restrictions, which reflected the orderly segmenting of customer groups to meet the airlines' yield maximisation strategies.

The two-airline policy was finally revoked in 1990 (with increasing regulatory flexibility having been introduced over time). However, with the notable exception of the failed Compass Airlines experiences (discussed below), until the launch of Virgin Blue and Impulse in 2000, Qantas and Ansett continued to operate on the basis of a de facto two-airline policy. They faced no domestic competition or any credible threat of competition, and operated almost identical services using parallel schedules, prices and fare conditions. Prices began to rise as soon as each generation of Compass went out of business, and continued to rise until 2000.

Compass Airlines entered the market in late 1990 with prices that were lower than prevailing fares, but the incumbents quickly matched these prices and Compass went out of business twelve months later. Many of Compass's assets were purchased by Southern Cross, which launched in 1992 and went bankrupt in 1993.

The Trade Practices Commission undertook a limited inquiry into the failure of Compass. The Commission did not make any finding that Qantas or Ansett had misused their market power in breach of section 46*,* however it did conclude that the response of the incumbent airlines was a substantial contributing factor in Compass's failure. This response included aggressive pricing, which Compass did not have the capital to withstand, and also included taking advantage of the incumbents' control of terminal infrastructure, ownership of computer reservations systems, links with travel agents and provision of business lounges and frequent flyer programs.

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

The Low Cost Airline Service Revolution

Since the deregulation of airline industries around the world, the greatest impact on competition and consumer welfare has come from the introduction of new entrant low-fare carriers. For example, in 1996 the United States Department of Transportation (**US DoT**) estimated that consumers saved $US6.3 billion in airfares in that year due to competition brought about by these airlines.[4]

The United States Department of Transport conducted an extensive study of the impact of new entry by airlines with low cost operating strategies in April 1996.[5] The US Department of Transport concluded that:

- The rapid expansion of low cost, low fare service in the United States by a growing cadre of carriers is a watershed development in domestic aviation that is having a profound effect on efficiency, competition, consumers and industry structure.

- A large and growing proportion of passengers in cities all across the country are now benefiting from the availability of low cost service.

- The consumer benefits of low fare service are enormous and are growing on a daily basis. We estimate that consumer savings are now $6.3 billion annually, up from $4.5 billion just 9 months earlier.

- The low cost service phenomenon is far from complete, and other carriers will face continuing pressures to become more efficient. The evidence suggests that network carriers and low cost carriers can co-exist, but the broad scope of low cost service means that additional fundamental change may be necessary for network airlines.

- The greater efficiency other carriers achieve in their efforts to compete with low cost carriers spills over into routes where low cost carriers do no compete. And new entrants inject the industry with new ideas which lead to service innovations and greater efficiency.

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4 US DoT, *The Low Cost Airline Service Revolution*, 23 April 1996.
5 *Ibid.*

- The spread of low cost service has global implications. Our international carriers' efficiency gains that result from their competition with low cost carriers enhances their efficiency relative to foreign flag competitors. And low cost service should spread to international markets—both within major foreign arenas, such as intra-Europe, and between major foreign arenas, such as U.S. – Europe.

- The principal and fundamentally important advantage low cost carriers have over larger, established network airlines is their lower unit operating costs.

- At network hub cities where low cost carriers do not compete, fare premiums are quite high and are increasing.

- Consumers at network carrier hub cities who have been subjected to higher prices do not have to be. Low cost carriers and network carriers can coexist and provide consumers the benefits of both types of operating systems.

- Low fare stimulated demand has very positive implications for the airline industry labour force, and promotes substantial economic growth to the benefit of consumers, local communities, travel related industries, and the aerospace industry.

- Today, one in every seven domestic passengers is flying because of the increased competitiveness resulting from low fare service.

- Virtually all domestic traffic growth in recent years is attributable to the spread of low cost service.

- The Department of Transportation, in cooperation with the Department of Justice, must ensure that market forces are allowed to play out freely, without the distorting effects of predatory or otherwise anticompetitive exclusionary activity by incumbent carriers against new entrants.

- The Department of Transportation must explore why low cost new entrant activity is successful at most cities but has not developed at others, to ensure that non-economic impediments are not obstacles.

The low-cost strategy has been very successful overseas for some airlines. These include Southwest Airlines in the USA, WestJet in Canada, and Easyjet and Ryanair in Europe. In Australia, this strategy has also been successful for Virgin Blue, with a huge growth in passenger travel, as low fares have attracted passengers who would not otherwise contemplate air travel. Given the lower cost/higher efficiency of low-fare airlines, they can profitably price at levels that are only rational for full-service airlines if they force the exit of competitive entrants.

Concerns in relation to the response of incumbent airlines to low fare carriers, leading to the failure of many low fare carriers, prompted the DoT to undertake an inquiry. The conclusions of that inquiry are set out below at 3.2(a).

In September 2001, Ansett was placed in voluntary administration and ceased flying in its current form. Since the collapse of Ansett, Qantas has quickly moved to expand its domestic capacity through redirecting international capacity,[6] short-term wet lease and other capacity arrangements[7] and substantial additional lease and purchase commitments.[8]

Qantas's capacity expansion has been so effective that it has been able to increase its market share from approximately 55% to in excess of 80% or more since the Ansett collapse.[9]

Virgin Blue considers that there is substantial scope for it to expand its operations and introduce competition on routes now dominated by Qantas. Virgin Blue also considers there is room for more than two operators in the Australian airline industry. Whether or not Virgin Blue will be able to rapidly expand its operations and/or a new carrier is likely to enter (or existing smaller operators are likely to expand), is influenced in very large degree by the level of competition protection against predatory conduct.

2.2 Dominant Firms in the Aviation Industry

Airline markets are prone to the development of a dominant airline. As an airline gains a dominant position in a particular market, there are substantial strategic and other entry barriers, which permit it to prevent or discipline new entry and to increase its dominance. As a result, a vigilant application of antitrust standards is required to sustain competition.

In its proposed Statement of Enforcement Policy, the US DoT recognised the susceptibility of the air travel industry to predatory conduct, noting that:[10]

> "*Although the Supreme Court has said that predation rarely occurs and is even more rarely successful, our informal investigations suggest that the nature of the air transportation industry can at a minimum allow unfair exclusionary practices to succeed. Compared to firms in other industries, a major air carrier can price-discriminate to a*

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

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

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

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

10 US DoT, proposed *Statement of the Department of Transportation's Enforcement Policy Regarding Unfair Exclusionary Conduct in the Air Transportation Industry,* 6 April 1998.

much greater extent, adjust prices much faster, and shift resources between markets much more readily. Through booking and other data generated by computer reservations systems and other sources, air carriers have access to comprehensive, 'real time' information on their competitors' activities and can thus respond to competitive initiatives more precisely and swiftly than firms in other industries."

The history since deregulation of domestic airline industries throughout the world demonstrates a persistent pattern of incumbent behaviour and a persistent failure of new entrant airlines. These patterns cannot be attributed to competition and are widely recognised as indicating a predatory strategy on the part of incumbents.[11] While consumers benefit from the short period of price discounting following new entry, they are worse off over the long term due to the lack of sustained competition.

(a) Strategic Entry Deterrence

There are a number of features of the airline industry that facilitate strategic entry deterrence, allowing incumbents to prevent the entry or force the exit of new entrant airlines. Apart from the structural characteristics of airline markets, information asymmetries allow signalling behaviour and reputation effects to discourage new entry and allow recoupment in a wider variety of circumstances than previously contemplated.[12]

The particular characteristics of airline markets that facilitate effective predatory conduct include the following:

- **Strategic Capacity Deployment**

Incumbent airlines can shift resources rapidly in order to add capacity to routes threatened by new entry. Mobility is the very essence of aircraft, and an incumbent with an extensive network and fleet can easily alter its flight schedules or simply switch aircraft to move capacity around the network. Even an entirely new destination can be served very quickly, as was seen in Australia after the Ansett collapse. However, in a near-monopoly climate it is most likely that the incumbent will already have some presence in any new destination served by a new entrant. As a result, the incumbent can respond to new entry immediately and without any additional investment, again denying the new entrant any first mover advantage. As noted by the US DoT:[13]

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11 Patrick Bolton, Joseph F Brodley & Michael H Riordan, "Predatory Pricing: Strategic Theory and Legal Policy", 88 Geo LJ 2239 (2000).

12 *Ibid* at 2248.

13 US DoT, *Findings and Conclusions on the Economic, Policy and Legal Issues,* 17 January 2001 at 35. See also Bolton, Brodley & Riordan, *supra* note 11 at 2262.

"Predatory-type behavior may be effective in the airline industry precisely because aircraft are so mobile and can be moved from one route to another. The mobility of aircraft was originally thought to be a guarantee that airline markets would be competitive. However, as shown, airlines incur significant sunk costs in entering a new airport, a factor which can discourage entry. On the other hand, when entry occurs, the incumbent hub airline can easily shift aircraft from other markets to increase capacity in the market served by the new competitor.

An airline that dominates a market thus can quickly expand its capacity on a route without making an irretrievable investment, since it can easily redeploy the aircraft to other markets when the entrant has been forced to exit or reduce service."

- **Yield Management: Incumbents can Effectively Price Discriminate**

In many other industries, predatory conduct has been said to be irrational for incumbents because they will have to reduce the price across their entire output and will therefore suffer much greater losses than a new entrant with the same price at a much lower level of output. However, airlines are expert price discriminators. An incumbent can direct discounting precisely at the new entrant's potential customers while maintaining high prices elsewhere. Although predatory pricing remains very expensive for incumbents, it may be less expensive in the airline industry than in other industries, giving the incumbent a greater likelihood of later recoupment and making the strategy viable.[14]

- **Flexible Price Adjustments**

The prices for airline tickets can be adjusted continuously and instantaneously in response to new entry and other demand characteristics, since they are sold directly by airlines or through travel agents with live access to the airlines' reservations systems. In addition, consumers are accustomed to rapidly fluctuating ticket prices, allowing airlines to change prices without customer resistance. Combined with the other factors discussed herein, this allows incumbent airlines to defend against new entry immediately and entirely reactively: that is, there is no need for them to price efficiently in order to discourage new entry because they can immediately discount in the event of actual entry and immediately raise prices following exit. It is also

[14] See the discussion in US DoT, *Findings and Conclusions, supra* note 13 from 23; and Clinton V Oster & John S Strong, "Predatory Practices in the US Airline Industry", 15 January 2001 at 21-23; and Douglas F Greer, *Industrial Organisation and Public Policy* 3d ed (New York: Macmillan, 1992) at 342.

impossible for a new entrant to gain any first-mover price advantage because there will be no delay in the incumbent matching the new entrant prices.[15]

- **Information on Competitor Activities.**

In order to operate each flight as profitably as possible, airlines must forward-book a high proportion of their seats and generally must advertise a new route and begin selling tickets at least a month in advance. This gives incumbent airlines direct pricing signals well in advance of any new entry and allows them to respond accordingly. Airlines can also readily determine the capacity of a competitor's flights from their flight schedules (which usually list aircraft type), can use ramp counts and other surveillance to determine competitor load factors, and can determine the price at which seats are available by attempting to purchase tickets (including over the Internet). This information allows incumbents to engage in predatory pricing with a high degree of accuracy and effectiveness.[16]

(b) Entry is Not Costless

Traditionally it has been thought that there are no substantial sunk costs for entry into airline operations. In fact, there are substantial costs that must be incurred in establishing a new entrant airline that can not be recouped if the airline fails. These include:[17]

- head office and associated costs;
- brand establishment, advertising and promotion costs;
- aircraft leasing costs;
- airport facility costs; and
- training and operator certification costs.

The costs of entry are not symmetrical. Capital is more expensive and more difficult to obtain for new entrants since capital lenders will factor in the risk of successful predation (given that there is likely to be only very weak and imperfect enforcement of rules against predation).

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15 See Michael E Levine, "Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy", 4 *Yale J on Reg* (Spring, 1987) 383 at 444-446, 451-452, cited with approval in the US DoT, *Findings and Conclusions, supra* note 13 at 22.

16 US DoT, *Findings and Conclusions, supra* note 13 at 36; Bolton, Brodley & Riordan, *supra* note 11 at 2262.

17 US DoT, *Findings and Conclusions, supra* note 13 at 22; Levine, *supra* note 15 at 473.

As the US DoT has noted:[18]

> *"Contestability has proven inapplicable. (Levine, "Airline Competition in Deregulated Markets", at 405.) First, an airline entering a market incurs certain sunk costs that cannot be recovered if it exits, for example, advertising costs and the cost of setting up facilities at the new airport. Travellers will be reluctant to book an airline that exits and reenters a market, moreover, given the significant possibility that the airline may again leave the market before the date of their planned trips. As a result, airlines cannot freely enter routes."*

(c) Other Barriers to Entry

The response of incumbent airlines clearly represents a substantial barrier to effective entry. Even without incumbents' strategic response, the airline industry would be subject to high barriers to entry, including the incumbents':

- extremely strong brand positions and the need for new entrants to invest in substantial advertising;
- customer lock-in strategies such as frequent flyer and reward point schemes;[19]
- established relationships with travel agents and extensive long-term arrangements with corporate customers;[20] and
- very large economies of scale and strategic advantages accruing from in place route networks.[21]

In addition, there is limited access to scarce resources dominated by incumbents. For example, the need to obtain access to terminals and facilities and to take-off and landing slots presents a significant barrier to new entry.

2.3 Qantas Dominates the Australian Airline Market

Qantas has a unique position in the Australian market (and an almost unique in the world aviation market, though its position is similar to that of Air Canada since the consolidation of the

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18 US DoT, *Findings and Conclusions, supra* note 13 at 22.

19 See for example Greer, *supra* note 14 at 342.

20 See for example US General Accounting Office, "Airline Deregulation: Barriers to Entry Continue to Limit Competition in Several Key Domestic Markets", GAO/RCED-97-4 (October 1996), at 15, 17-18, cited by US DoT, *Findings and Conclusions*, *supra* note 13 at 22.

21 See for example, US DoT, *Findings and Conclusions*, supra note 13 at 24-28.

Canadian airline industry). Its market dominance is indicated and reinforced by the following factors:

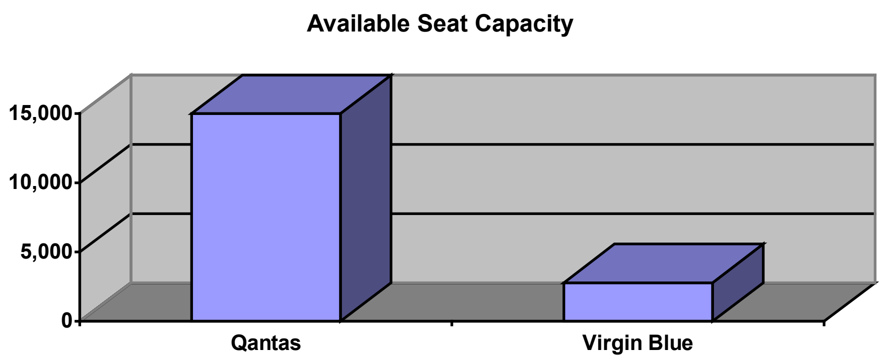
(a) Market Share

Qantas accounts for in excess of 80% of domestic jet travel,[22] with a similar or higher proportion of regional travel. Together with major shareholder British Airways, it also has the largest share of international travel to and from Australia.[23]

(b) Capacity

Qantas operates 145 aircraft, serving an average of 450 domestic flights per day and 540 international flights per week.[24] Its aircraft include 37 Boeing 747s, 36 Boeing 767s, 38 Boeing 737s, eight Boeing 717s and a number of smaller regional aircraft. In November 2001, it announced a strategy to purchase 31 new aircraft, all long-range and high-capacity Boeing and Airbus aircraft. By contrast, Ansett has abandoned its old Boeing fleet with plans to operate up to 30 Airbus A320 aircraft during 2002/2003 (which have now been abandoned), and Virgin Blue operates 17 Boeing 737 aircraft, which it intends to increase to 30 by the end of 2002.

Virgin Blue estimates available seat capacity in Australia as follows:[25]



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

23 See ACCC authorisation decision, "Joint Services Agreement between Qantas Airways Limited and British Airways plc", 10 May 2000.

24 Source: www.qantas.com.au.

25 Based on the assessment contained in *Australian Aviation*, "Room for Three Airlines", March 2002 at 24-25, prior to the demise of Ansett II.

(c) Network

Qantas operates a ubiquitous network of routes across Australia, unparalleled by Virgin Blue. The Qantas network fully integrates regional, major domestic and overseas destinations.

This network is integrated through Qantas's:

- code-share and other cooperative international arrangements, including domestic on-carriage arrangements with various international airlines (Qantas is a member of the Oneworld global alliance with Aer Lingus, American Airlines, British Airways, Cathay Pacific, Finnair, Iberia and LanChile, and has code-sharing agreements with British Airways, American Airlines, Air Pacific, Alaska Airlines, Asiana, Japan Airlines, Vietnam Airlines, Swissair, Eva Air, Polynesian Airlines, Air Tahiti Nui and South African Airways);

- existing international operations, which are to be further expanded and integrated into its domestic network with the start of Australian Airlines;

- a full schedule of flights to all major domestic destinations. Further, Qantas'ss flight schedule is dominated by frequency, with key routes such as Sydney-Melbourne and now Sydney-Brisbane served with departing flights every half hour from the morning to late in the evening. Even smaller routes such as Sydney-Canberra have flight schedules with departures every hour or less at key times of the day. This gives Qantas a significant advantage over other airlines even where prices are comparable, particularly in the case of business travellers and travellers making connections; and

- a network of interconnecting regional routes operated by regional subsidiaries and affiliates Airlink, Eastern Australia Airways, Southern Australian Airlines, Sunstate Airlines and Airconnex, now organised together under the brand QantasLink.

In Australia, Qantas is the only incumbent full-service carrier serving the entire network. Qantas faces one low-fare new entrant operating to major centres and now faces no prospect of Ansett emerging as a full-service carrier.

As a result, Qantas can engage in a strategy of containment on each new route that a new entrant enters, by eroding yield and profitability, thereby slowing down the new entrant's rate of expansion. The cost to Qantas of discounting on a particular route is effectively recouped through higher returns across the rest of its network, in addition to the recoupment possible after the new entrant withdraws from a route.

(d) Brand and Product Differentiation

Qantas has operated in Australia since the 1920s and is well established as one of the leading brands in Australia. It also retains the "Australian Airlines" brand (which it is relaunching as a separate low-fare international and possibly domestic carrier), itself one of the major domestic airline brands prior to its acquisition by Qantas. Qantas is one of the biggest advertisers in Australia, for example spending $28 million in 2000.[26]

Qantas also operates an extensive Frequent Flyer program, which provides an incentive for members to be loyal to Qantas by awarding points to customers who fly with Qantas or its extensive network of airline partners. It estimates that its program has over two million members.[27] Qantas also offers other products, such as a Qantas Visa card, that provide further incentives for customers to fly with Qantas.

In addition, the "Qantas Club" brand provides business lounges in airports served by Qantas and its partners throughout the world, providing strong incentives for business travellers.

(e) Vertical Industry Relationships

Qantas has a network of wholly-owned Qantas travel centres in Australia, as well as strong agency distribution channels through its established relationships with a number of the largest travel agency chains in Australia, including American Express, Community Travel, Flight Centre, Harvey World Travel, Jetset, National World Travel, STA Travel and UTAG. It also has extensive long-term arrangements with major corporate customers and corporate travel agents, effectively removing these customers from the market accessible by new entrants. Importantly, its historical position as a government-owned airline has left it with extensive travel arrangements with the Commonwealth government.

(f) Terminals and Facilities

Qantas owns terminals and associated facilities in all major airports, using long-term leases of airport land from airport operators.

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26 *Sydney Morning Herald,* "Absolutely Horrible Year", 13 December 2001, citing ACNielsen Adex figures.

27 Source: www.qantas.com.au.

3. ANTI-COMPETITIVE CONDUCT IN THE AIRLINE INDUSTRY

3.1 Overview

As discussed above, the airline industry is particularly susceptible to the misuse of market power by incumbent airlines to deter or eliminate new entrants due to high barriers to entry, access to competitor information and the ease with which incumbents can reallocate their capacity and price-discriminate.[28] This sensitivity has been recognised by governments and regulators overseas including in the United States and Canada, and is equally applicable in Australia.

The particular forms of anti-competitive conduct consistently identified in the airline industry are:

(a) Predatory Pricing and Capacity Behaviour

Predatory pricing and capacity behaviour is the most widely recognised and the most damaging form of anti-competitive conduct in the airline industry. The following aspects are relevant:

- **Capacity Increases and Deep Discounting**

Incumbent airlines frequently respond to new entry on a route by substantially reducing fares on that route while substantially increasing both overall capacity and the number of discount fares available. The effect of this conduct is to ensure that the new entrant does not sell sufficient fares for it to operate viably, and is forced to exit the route substantially or completely. After this exit, the incumbent is able to raise fares to their previous level. Often the incumbent's pricing and capacity conduct will only be rational if it has the effect of forcing the new entrant from the route, based on the incumbent's costs and revenues associated with the conduct, and a predatory purpose may thereby be inferred. [29]

- **The Commencement of a Low-fare Carrier Brand by an Incumbent Full-service Airline**

The commencement of a low-fare "fighting brand" carrier by an incumbent full-service airline can have exactly the same effect as the conduct described above engaged in by the incumbent itself. Although the new brand may have a different cost structure from the incumbent's existing

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28 Greer, *supra* note 14 at 338.

29 See John Haring & Jeffrey H Rohlfs, "Public Policy to Deter Exclusionary Practices in the Airline Industry", Submission to US DoT Inquiry, 25 September 1998 at 13; also Levine, *supra* note 15 at 417, US DoT, *Findings and Conclusions, supra* note 13 at 7.

operations, measures of cost are not necessary for a finding of predatory conduct and in any case the incumbent's entire cost, not only that associated with the new brand, is relevant.[30]

- **Signalling**

A successful course of predatory conduct has the additional advantage that other potential new entrants are likely to consider the incumbent's reputation for that conduct when deciding whether or not to enter a route. Predatory pricing and capacity behaviour signals to new entrants that the incumbent's market share will be vigorously defended, and allows incumbents to deter new entry while maintaining high prices. Incumbents can also signal this intention in other ways, for example through the media.[31]

(b) Travel Agent Commission Overrides used to Encourage Travel Agents to Discriminate against Other Carriers

Travel agent commission overrides (**TACOs**) are a method by which airlines structure their travel agent commissions in order to exclude competitors. Ordinarily, a travel agent is paid a commission that varies in a straight linear relationship with the number or value of fares booked. TACOs generally modify this arrangement by *increasing* the percentage commission payable if the agent reaches certain targets, which may be based on:

- the number or value of the incumbent's fares booked; or
- the proportion of total fares booked by the agent that are the incumbent's fares,

both of which significantly advantage the largest operator in the market (that is, the incumbent) and discourage travel agents from booking fares for new entrant airlines.

The Canadian Competition Bureau notes the potential for the anti-competitive use of TACOs:[32]

> *"Travel agent commissions can be used as an instrument to foreclose a potential or existing rival. In response to entry on a route, the dominant airline could increase the commission bonus earned by travel agents that book a large percentage of their passengers with the dominant carrier. Where the increase in bonus commissions is sufficient to induce agents to book flights of the offering carrier with the consequent effect of eliminating or disciplining a competitor, the Bureau will consider the increased offering to be an anti-competitive act."*

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30 See Canadian Competition Bureau, draft *Enforcement Guidelines on the Abuse of Dominance in the Airline Industry,* February 2001, para 44-45.

31 See Oster & Strong, *supra* note 14 at 36, US DoT, *Findings and Conclusions*, *supra* note 13 at 39.

32 Canadian Competition Bureau, *supra* note 30 at para 75.

The Regulations to the Canadian *Competition Act* specifically list as an anti-competitive act any action of a domestic airline operator:

> *"using commissions, incentives or other inducements to sell or purchase its flights for the purpose of disciplining or eliminating a competitor or impeding or preventing a competitor's entry into, or expansion in, a market."*[33]

Further, the undertakings required from Air Canada in connection with its acquisition of Canadian Airlines include an undertaking that Air Canada will not base its travel agent commissions on Air Canada's revenue performance or market share for domestic services and will not penalise travel agents for booking domestic flights of new entrants.

(c) Vertical Integration and Other Manipulation of the Supply Chain

The vertical integration of an incumbent into other parts of the supply chain can be used to prevent or deter new entry. For example, at airports where there is no common user terminal an incumbent airline can use its market power to exclude or substantially restrict new entry, though legislated access provisions can help to mitigate this power.

More critically, incumbent airlines and Qantas in particular who own travel agencies can exercise significant market power to the detriment of new entrants.

Even where they are not vertically integrated, incumbents can exert considerable pressure on other parts of the supply chain to their benefit and to the detriment of new entrant airlines. For example, incumbents can effectively force exclusive dealing arrangements by threatening not to deal with independent travel agents or hotels that deal with new entrants. Incumbents can also influence airport pricing in ways that may look neutral but operate to the incumbents' advantage, for example by shifting from weight-based to per-passenger charges that discriminate against more efficient operators.

3.2 Overseas Experience

Overseas experience demonstrates a broad pattern of incumbent airlines responding to new entry using all the forms of conduct described above. For example:

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[33] Canadian *Regulations Respecting Anti-Competitive Acts of Persons Operating a Domestic Service,* cl 1(f).

(a) United States

Since deregulation in 1978, a wide variety of low-fare new entrant airlines have attempted to challenge the incumbent airlines and almost all of them have failed (the significant exception is Southwest Airlines, a low-fare airline operating prior to deregulation and now a successful operator). The US DoT notes that:[34]

> *"We have found cases where the incumbent airline responded by cutting fares, making the low fares widely available without the restrictions usually imposed on such fares, and even adding flights. As a result, the entrant often exited the market, and the incumbent airline then charged average fares at least as high as those charged before the entry occurred. The public thus benefited from the incumbent's low fares only during the period when the incumbent faced competition."*

Oster and Strong reviewed new entry on a range of routes in the US, by reference to whether the new entrant was a major network airline, Southwest (a long term and highly successful low fare carrier) or another new entrant low fare carrier. In relation to new entry by a major network airline or Southwest they concluded:

> *"In sum, when the major network airlines were subject to entry either by Southwest or by another major network airline, the response was typically either a very slight fare reduction with no significant increase in capacity or a fare increase."*[35]

In relation to the 12 other cases of new entry by a low fare carrier, other than Southwest, they found that the incumbent tended to significantly drop prices and add capacity, characterising this response as more aggressive than any response to entry by Southwest. In particular, Oster and Strong noted that:[36]

- in nine of the twelve cases, the incumbent's average fare fell by one-third or more in the two quarters following new entry, and in four cases the incumbent's total traffic rose by more than one-third following new entry;

- in six of the twelve cases, the new entrant had exited the market within two years, and in a further two cases the new entrants were operating with such low load factors that survival was uncertain;

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34 US DoT, *Findings and Conclusions, supra* note 13 at 7.

35 Oster & Strong, *supra* note 14 at 15.

36 *Ibid* at 13-15. The routes in question were DTW-BOS, ATL-MOB, DTW-PHL, PIT-BOS, MSP-MCI, DFW-ICT, DFW-MCI, ATL-CLT, ATL-MCI, ATL-PIT, ATL-DTW and ATL-DFW.

- in all cases, fares rose once the new entrant had exited, and in three of these six cases rose above pre-entry levels; and

- in five of the six cases in which the new entrant exited, within two years following exit the incumbent's revenues had increased sufficiently to offset revenue losses from additional low-fare traffic during the time of competition.

The US DoT has also noted the presence of signalling in the US market. In one case the Department of Justice filed an antitrust suit against the major airlines because they were unlawfully using their electronic systems for exchanging fare information as a means of negotiating fare changes.[37] The US DoT also notes that in other cases, a network airline has entered a competitor's hub market to retaliate against the latter's increased competition in one of the first airline's major markets and to encourage the second airline to end that competition.[38]

The most recent antitrust action in the US was the Department of Justice proceedings in the *American Airlines* case. Although the Court summarily dismissed the case on the basis that the plaintiff had not shown pricing below avoidable cost, the Court did not refute that American Airlines had engaged in a pattern of:

- at some time prior to new entry, completely or substantially withdrawing from a route on the basis that it was unprofitable;

- immediately following new entry, substantially increasing capacity on the route and reducing fares to levels that approached or matched new entrant fares, forcing the new entrant out of the route; and

- following the forced exit of the new entrant, raising fares to levels that approached or exceeded fare levels prior to new entry.

(b) Canada

The Canadian government introduced aviation-specific legislation following the acquisition of Canadian Airlines by Air Canada, which became the country's dominant domestic carrier. The legislation was introduced in part to prevent Air Canada from abusing its dominant position by excluding new entrants through pricing and capacity behaviour and through other means such as travel agent commission override structures.

37 US DoT, *Findings and Conclusions*, *supra* note 13 at 39.
38 *Ibid.*

Following the consolidation of the domestic airline industry in 2000, the Canadian Competition Bureau released its draft *Enforcement Guidelines on the Abuse of Dominance in the Airline Industry* relating to its new powers under the competition legislation. It notes that:[39]

> "*The pricing and capacity decisions of a dominant carrier will have an anti-competitive effect if they result in higher prices and reduced output due to the elimination or disciplining of a rival, or the exclusion of a potential rival.*"

In September 2000, the Commissioner of Competition commenced an inquiry into low-fare entrant airline CanJet's complaint that Air Canada had anti-competitively reduced its fares on routes served by CanJet. The Commissioner subsequently issued a temporary order requiring Air Canada to cease and desist offering these reduced fares. In February 2001, Air Canada introduced new discount fares, but withdrew them in response to the Commissioner's concerns.

In March 2001, the Competition Bureau filed an application to the Competition Tribunal seeking an order prohibiting Air Canada from operating and increasing capacity at fares that do not cover avoidable costs on certain routes, and from matching low-cost carrier fares without regard to their effect on Air Canada's profitability or its higher standard of service and with the foreseeable effect of making low-cost carriers such as CanJet and WestJet unprofitable. The hearing is due to be held in October 2002.

In early 2001, CanJet was acquired by Canada 3000, which itself ceased operations and filed for bankruptcy in November 2001.

(c) United Kingdom

The Virgin group has direct experience of the response to incumbents in the United Kingdom through its operation of Virgin Atlantic. Virgin Atlantic was launched in 1984 and steadily built up transatlantic services from London to US destinations as well as Tokyo. In 1990 and 1991, British Airways embarked on a campaign of "dirty tricks" initially designed to discredit and undermine public confidence in Virgin Atlantic, and later progressing to "switch selling": that is, examining customer databases to contact existing customers of Virgin Atlantic and offering them inducements to switch to British Airways. British Airways also refused to enter into reasonable commercial arrangements for parts and maintenance, withheld slots and access to airport check-in facilities.

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[39] Canadian Competition Bureau, *supra* note 30 at para 30.

(d) Germany

In January 2002, the German Cartel Bureau issued a warning to Lufthansa over its pricing strategy on the Frankfurt-Berlin route, which it considered was unfairly hindering its competitor Germania and squeezing it out of the market. Lufthansa offered a discount of more than 60% from its previous fully-flexible fares to match the price offered by Germania on its entry onto the route. The Bureau stated that:[40]

> "*The reaction of Lufthansa, which used to be the monopolist on the Frankfurt-Berlin route, to Germania's tariff gives grounds for suspicion that Lufthansa, through this low-price policy, is considerably impeding Germania's opportunities to compete without any objective justification and that it is exploiting its superior market power over Germania to unfairly hinder this competitor. In this connection it should be noted that Lufthansa has not cut prices for business travellers on its remaining domestic routes where Germania has so far not been active as a competitor.*"

3.3 Experience in Australia

In an interview in May 2001, Qantas CEO Geoff Dixon stated:[41]

> "*What Qantas has done, it has not put any low fares in the market except to follow both Virgin and Impulse and indeed perhaps Ansett. We have not done that, we've followed. Our capacity position has been well within the norms and well within what is the growth in the market at the moment. We have played it hard, we have played it fair.*"

However, Qantas has in fact engaged in each of the typical responses of incumbent dominant airlines to new entry. In particular, the response of Qantas to the entry of Virgin Blue (and Impulse) has been:

- to substantially increase capacity on routes operated by the new entrant, even as the profitability of that route falls;
- to offer seats at a price which matches or betters the price that the new entrant is offering;

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40 Bundeskartellamt press release, "Bundeskartellamt warns Deutsche Lufthansa AG over its pricing strategy on the Frankfurt-Berlin route", 22 January 2002.

41 *Business Sunday,* Interview with Helen McCombie, 6 May 2001. Transcript available at http://finance.ninemsn.com.au/businesssunday/Interviews/stories/story_1387.asp.

- to radically alter existing ticketing conditions to match the new entrant's; and
- to continually signal the market that Qantas will stand firm to protect its market share at any cost.

In reviewing this conduct at the time of the Impulse collapse, Gordon Mills, Honorary Professor of Economics at Sydney University observed that:[42]

> *"When the new airlines started, Qantas and Ansett responded with lower discount fares, but did not offer so many seats at the new prices. So this had relatively little effect on the newcomers, who soon claimed small operating profits. But weeks ago, Qantas announced it would add extra capacity to its flight schedules, presumably to offer more discounted seats.*
>
> *On routes that have not been served by Impulse and Virgin, the lowest fares of Qantas and Ansett have been around 50 per cent of their full fares. But on routes served by the newcomers, the major airlines have been charging about 20 per cent of those traditional fares. These discounts up to 80 per cent off surely mean that Qantas and Ansett have sold at prices that are below their costs. And on some of the Impulse routes, Qantas last week announced flexible fares at half the previous level.*
>
> *Of course, we have seen such moves before. While Compass I and II were flying in the early 1990s, the big boys discounted some tickets. But prices soon went up again once Compass had exited the market.*
>
> *The present lower fares have led to reduced profits for Qantas and increased losses for Ansett. These airlines complain about their financial woes. But customers should be sceptical about the significance of these stories.*
>
> *It's not surprising that competitive entry removes some cream. But part of the pain at Qantas, and even at Ansett, seems to be voluntary. They have adopted short-term strategies that seem to lose more money, especially when they increase the number of seats flown.*
>
> *It can make financial sense for a company to pursue such a strategy. After all, an established company that drives out a newcomer can hope to return to high profits that outweigh short-term voluntary losses."*

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42 *The Australian Financial Review*, "Air Fares Don't have to Take Flight", 3 May 2001.

(a) Capacity Increases

In response to the new entry of airlines on major routes in Australia, Qantas has selectively increased the number of available seats (and particularly discounted seats) on flights on routes where new entry has occurred. The increase has been very large.

The substantial increase in capacity by Qantas was signalled shortly after Virgin announced its intention to start a new airline in Australia. Virgin made this announcement in late November 1999. On 23 February 2000, Qantas issued a media release that it had entered into an agreement to lease an additional 7 Boeing 767-300 jet aircraft from its shareholder and alliance partner, British Airways. These aircraft are wide body jet aircraft that seat 228 passengers and are suited for long-haul routes including some domestic routes. The Qantas press release notes:[43]

> "*Mr Dixon said the aircraft would also enable Qantas to maintain its current capacity share on domestic routes and provide for market growth.*"

In June 2000, Qantas announced capacity increases on certain major domestic routes, to be achieved by replacing smaller 737 aircraft with 767 aircraft. These routes included Cairns-Brisbane, Brisbane-Sydney and Sydney-Perth.[44] Boeing 767 aircraft are designed for long-haul routes and, while suitable for the Sydney-Perth route, are less suitable for the other routes. Virgin Blue had announced in February 2000 that it intended to make Brisbane its base for the commencement of Australian domestic operations.

On 22 February 2001, Qantas released its interim results indicating a reduction in domestic EBIT of 26.1% compared to the prior year. As the overall capacity and passenger numbers being carried on competitive routes increased, the prices for travel on these routes fell very sharply. As a result of this, yields (and therefore profits) on these routes dropped.

In February 2001, Qantas announced its half-yearly profit results. Commenting on these results, *The Sydney Morning Herald* reported that:[45]

> *"Qantas Airways has signalled it will escalate competition in the domestic aviation market after yesterday reporting a sharp drop in interim earnings and warning that there is little to suggest trading conditions will improve in the second half ...*

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43 Qantas press release, "New Qantas/British Airways Aircraft Lease and Kangaroo Route Schedule Arrangements", 23 February 2000.

44 Qantas press release, "Qantas Boosts Capacity With New Schedule", 30 June 2000.

45 *Sydney Morning Herald,* "Qantas steps up fare war as profit dives 22pc", 23 February 2001, p. 21.

Chief executive-designate Geoff Dixon said Qantas would 'stand our ground' on domestic routes and continue its aggressive response to the new market entrants.

The fall in profit was concentrated in Qantas'ss eastern seaboard services, the routes targeted by discount operators Impulse Airlines and Sir Richard Branson's Virgin Blue.

In the six months to December, net profit fell 22.2 per cent to $262.9 million, reflecting a sharp deterioration in yields as revenue rose 13.1 per cent to $5.1 billion."

At the same time as Qantas announced it was experiencing a sharp drop in profits concentrated on those routes where there had been new entry, it also announced that it would suspend certain international routes in order to bring these large aircraft back to fly on domestic routes. In a press release this decision was stated to be as a result of a "comprehensive business review".[46] This same press release recorded this decision as:

"the redeployment of aircraft from suspended international services to meet new competition on key domestic routes."

Therefore, Qantas'ss response to declining profits on certain major routes as a result of matching the low fare airline's pricing was to further bolster capacity on these unprofitable routes. The aircraft to be brought back to add capacity to domestic routes were four Boeing 767-300 aircraft, which are wide bodied jets which seat 228 passengers. These aircraft are almost double the capacity of the 117 seat Boeing 717s operated by Impulse and larger than the 162 seat 737-400s operated by Virgin Blue. They are also designed for long-haul operations rather than the domestic trunk routes for which they are now being used.

The Sydney Morning Herald noted that:[47]

"Concerns immediately turned to the prospect of another fare war after Qantas announced the job cuts and a decision to swing four Boeing 767-300 aircraft on to domestic routes, after suspending all services to China and Canada.

The redeployment will boost Qantas'ss domestic capacity by 11 per cent, compared with the market's 7.5 per cent rate of growth."

This conduct is of course the hallmark of a predatory response to new entry. For example, as noted by Haring and Rohlfs:[48]

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46 Qantas press release, "Qantas Results for the Half Year Ended 31 December 2000", 22 February 2001.

47 *Sydney Morning Herald, supra* note 14.

48 Haring & Rohlfs, supra note 29.

> *"The usual response of major carriers to competitive entry by a small carrier on a particular route is to reduce prices substantially on that route, while substantially increasing capacity. Price reductions in the face of competitive entry are certainly understandable (though one may quarrel with the magnitudes of the reductions). However, substantial expansion of capacity is more difficult to explain, apart from anti-competitive intent. Competitive entry reduces the demand facing the firm and makes a market* less *profitable. Why then should competitive entry be the occasion to* increase *capacity?*
>
> *The major carriers argue that when they match (or nearly match) the entrant's prices, their demand greatly increases. They therefore need to increase capacity, or else they would have to ration seats. This argument is hardly compelling, since the carriers routinely ration seats through their yield management programs."*

Qantas then continued this pattern of capacity expansion. On 28 June 2001, Qantas rerouted several of its international services to include domestic sectors, which substantially increased effective domestic capacity. New or rerouted flights include Townsville to Singapore via Brisbane, Cairns to Singapore via Brisbane, Sydney to Osaka via Cairns, and Adelaide to Singapore via Darwin, increasing capacity on the Townsville-Brisbane, Cairns-Brisbane, Sydney-Cairns and Adelaide-Darwin sectors.

Qantas later announced that the Townsville services would be discontinued from March 2002, and in relation to this announcement Qantas regional general manager Terry Simpson admitted that the service had been introduced to boost domestic capacity between Townsville and Brisbane.[49]

On 2 July 2001, Qantas announced that it would replace three weekly Boeing 767s direct from Perth to Tokyo with larger Boeing 747s flying from Perth to Tokyo via Sydney, increasing capacity on the Perth-Sydney sector. This rerouting was later abandoned for political reasons.

On 16 August 2001, Qantas released its full-year results indicating a further reduction in domestic EBIT of 53.2% compared to the prior year. While overall capacity was increased by 7.6%, domestic yield fell by 8.2% excluding any foreign exchange impact.[50] The results also revealed that Qantas'ss international EBIT increased by 22.4% for the same period.

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49 *Townsville Bulletin,* "Qantas Dumping International Flight", 15 December 2001.

50 Qantas press release, "Qantas Results for the Year Ended 30 June 2001", 16 August 2001.

Since the demise of Ansett, Qantas has announced further massive expansions in capacity, including purchasing fifteen Boeing 737-800s to be added in 2002,[51] and moving three 737, six 767 and three 747 existing aircraft from international to domestic operations.[52]

In the airline industry, the capacity on a particular route is measured by the available seat kilometres (**ASKs**) for that route. This figure is the number of seats (whether empty or full) on each plane which flies on that route multiplied by the distance travelled (in kilometres) by each plane on that route. Revenue passenger kilometres (**RPKs**) are calculated in the same way as ASKs except only seats occupied by paying passengers are counted. The load factor for a particular route is simply the RPKs divided by the ASKs.

As can be seen clearly from the table below, the capacity on the key routes which have seen new entry over the last year has increased dramatically, more than doubling on the Brisbane-Adelaide route and substantially increasing over other routes.

On the top 5 busiest routes in Australia, the overall capacity (measured by ASKs) increased by over 30% in the period from 31 January 2000 to 31 June 2001 on the figures published by the Department of Transport. The Department stated:[53]

> *"Domestic airline activity continued to sustain the strong growth trend of recent months during January 2001. Yet another substantial increase was recorded in the combined passenger activity on Australia's three busiest domestic air routes, Brisbane – Melbourne, Brisbane – Sydney and Sydney – Melbourne, increasing 41.6 per cent in comparison to January 2000. In all, the growth in passenger activity across the five routes with 3 or more competing airlines was 40.9 per cent over January 2000. These routes comprise the top three plus Canberra – Sydney and Adelaide – Brisbane."*

As can also be seen from the table below, this increase in capacity goes far beyond the introduction of new aircraft by the new entrants. The major airlines also increased their capacity on routes where new entry had occurred. The following table compares domestic capacity at June 2001 (after the takeover of Impulse but before the collapse of Ansett, and the last official data available from the Department of Transport) with capacity at June 1999 (before the launch of Impulse and Virgin Blue, and in order to provide a month-on-month comparison), using the top ten routes by revenue passenger numbers and the routes served or announced by Virgin Blue as at 30 June 2001 (in bold).

51 Qantas press release, "Qantas Buys Boeing 737-800s", 28 October 2001.

52 Qantas press release, "Qantas Moves International Jets to Domestic Operations", 26 September 2001.

53 Department of Transport, *Domestic Airline Activity Monthly Status Report for period ended 31 January 2001*, 26 March 2001.

Route	Jun-99 ASKs	Jun-01 ASKs	Increase	QF/AN Increase	QF/AN Inc %
Melbourne-Sydney	**395,280,634**	**439,866,328**	**44,585,694**	**44,585,694**	**11.28%**
Brisbane-Sydney	**258,450,201**	**364,200,609**	**105,750,408**	**42,162,953**	**16.31%**
Brisbane-Melbourne	**238,300,584**	**375,082,958**	**136,782,374**	**58,085,331**	**24.37%**
Coolangatta-Sydney	**83,358,858**	**86,413,735**	**3,054,878**	**-28,739**	**-0.03%**
Adelaide-Melbourne	**94,259,627**	**112,367,737**	**18,108,110**	**-646,480**	**-0.69%**
Adelaide-Sydney	**144,931,451**	**197,232,120**	**52,300,668**	**12,465,572**	**8.60%**
Brisbane-Cairns	140,826,275	145,212,871	4,386,596	4,386,596	3.78%
Perth-Sydney	322,513,366	344,632,540	22,119,174	22,119,174	9.86%
Brisbane-Townsville	63,200,854	74,363,605	11,162,751	348,425	0.55%
Melbourne-Perth	240,658,811	286,579,408	45,920,597	45,920,597	26.46%
Canberra-Sydney	25,820,216	26,612,426	792,209	792,209	4.64%
Adelaide-Brisbane	**32,388,059**	**78,428,313**	**46,040,254**	**16,952,840**	**52.34%**
Brisbane-Townsville	**63,200,854**	**74,363,605**	**11,162,751**	**348,425**	**0.55%**

The selective nature of this increase in capacity can be demonstrated over time as in general there was no or little increase in Qantas capacity on routes where new entrants were not flying or had not announced intended operations.

(b) Pricing

On almost every route serviced by Virgin Blue, Qantas has immediately matched or undercut both Virgin Blue's promotional and regular fares, and has greatly expanded the number of tickets available at its lowest fare category (reducing its yield and Virgin Blue's yield and load factor) and the number of seats available overall (reducing both airlines' yield and load factor). Virgin Blue discounts have typically been matched or exceeded by further discounting by Qantas. In many cases, Qantas has priced at Virgin Blue's promotional fare beyond the period of Virgin Blue's promotion, in effect establishing promotional fares as a lead in fare.

Since its acquisition of Impulse, Qantas has raised many of its fares and rounded their fares up to whole dollars instead of the undercutting by between 10 and 60 cents. However, in August 2001 prior to the demise of Ansett, the two airlines had headline fares for the following city-pairs:

Route	Virgin Blue	Qantas
Adelaide-Brisbane	$109.00	$108.90
Adelaide-Melbourne	$66.00	$66.00
Adelaide-Sydney	$99.00	$99.00
Brisbane-Canberra	$119.00	$121.00

Brisbane-Melbourne	$97.00	$96.80
Brisbane-Sydney	$66.00	$66.00
Brisbane-Townsville	$118.00	$117.70
Sydney-Gold Coast	$66.00	$66.00
Sydney-Melbourne	$66.00	$66.00

In contrast to Qantas public statements to the effect that it has not led prices down, on 25 August 2001, Qantas again lowered its fares on certain routes by between $11.00 and $55.00. Virgin Blue and Ansett were forced to lower their fares to attract passengers.

(c) Revised Fare Conditions

Following the entry of Virgin Blue, Qantas removed fare restrictions (such as 7-day, 14-day and 21-day advance purchase requirements and Saturday overnight stay requirements) from a great number of its available fares.

On 6 April 2001, Qantas launched its "QBiz" product designed for the small-to-medium enterprises that form the target market for Virgin Blue's fully flexible fares. The QBiz product offers fully flexible fares to registered small companies on part of the Qantas website separate from the main fares. These fares closely match Virgin Blue's fully flexible fares.

(d) Signalling

Qantas has engaged in a consistent practice of signalling its "tough intentions" to the market place. There is general recognition that such conduct can have an anti-competitive effect by raising financing costs and undermining consumer and creditor confidence. This signalling includes:

- announcements of massive increases in capacity, following announced new entry (referred to above);
- statements that Qantas will match prices and compete "hard"; and
- publicising the view that only two airlines will or can survive, in circumstances where the size of the routes that Virgin Blue operate on is sufficient to sustain three, four and five operators in other parts of the world.

This conduct has the effect of undermining confidence in the new entrants and warning the new entrant in relation to its expansion plans.

(e) Qantas Travel Agent Commission Arrangements

Qantas has extensive arrangements with the major travel agents in Australia as well as operating its own travel agencies, Qantas Holidays and Qantas Business Travels. Virgin Blue is not aware of the commission structures offered by Qantas to travel agents, but understands that they may use TACOs or similar structures that discriminate against new entrant airlines. The Commission should investigate these arrangements for any possible exclusive dealing or misuse of market power.

(f) Vertical Integration and Other Controls of the Supply Chain

Qantas provides a range of travel agency services through its Qantas Holidays and Qantas Business Travel (**QBT**) divisions, offering flights and packages including flights, accommodation and other services. QBT is the largest corporate travel agency in Australia and is significantly larger than the other competitors in that sector, which include American Express, BTI and TQ3. QBT has extensive arrangements with many major corporate clients and, importantly, handles the majority of Commonwealth government travel contracts. QBT invariably books Qantas fares and books an insignificant number of Virgin Blue fares. Even though QBT's arrangements with its clients may include requirements to book the "best fare on the day", these clauses generally exclude Virgin Blue since they only apply to fares available on the public computer reservation systems.

4. LEGAL FRAMEWORK FOR THE PROTECTION OF COMPETITION

4.1 Overview of Section 46

Section 46 of the TPA prohibits a corporation with a substantial degree of market power from taking advantage of that market power for one of the following proscribed purposes:

- eliminating or substantially damaging a competitor;
- preventing the entry of a person into a market; or
- deterring or preventing a person from engaging in competitive conduct in a market.

This part of the TPA is designed to address the specific concerns that arise where a corporation has substantial market power. In these conditions, behaviour that in other market participants may be considered legitimate competition may in fact be anti-competitive:[54]

> "*Where a defendant maintains substantial market power, his activities are examined through a special lens: Behaviour that might otherwise not be of concern to the anti-trust laws – or that might even be viewed as pro-competitive – can take on exclusionary connotations when practised by a monopolist.*"

(a) Substantial Degree of Market Power

The Trade Practices Tribunal in the *QCMA* case stated that:[55]

> *"as is often said in United States antitrust cases, the antithesis of competition is undue market power, in the sense of the power to raise price and exclude entry. That power may or may not be exercised. Rather, where there is significant market power the firm (or group of firms acting in concert) is sufficiently free from market pressures to 'administer' its own production and selling policies at its discretion."*

Subsequently, in the *Queensland Wire* case, Dawson J cited with approval the following characterisation of market power:[56]

> *"A firm possesses market power when it can behave persistently in a manner different from the behaviour that a competitive market would enforce on a firm facing otherwise similar cost and demand conditions."*

The Explanatory Memorandum to the relevant amendments to the TPA indicate that in the context of section 46, "substantial" is intended to mean "large or weighty" or "considerable, solid or big".[57] However, the term has also been interpreted to mean "real or of substance and not insubstantial or nominal".[58]

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54 *Eastman Kodak Co v Image Technical Services Inc* 504 US 451 at 488 per Scalia J, quoted with approval by the majority in *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] HCA 13 at para 29.

55 *Re Queensland Co-op Milling Association and Defiance Holdings Ltd* (1976) ATPR ¶40-012 at 17,246.

56 *Queensland Wire Industries v BHP* (1989) CLR 177 at 200.

57 *Ibid* at para 41.

58 per Deane J in *Tillmans Butcheries Limited v Australasian Meat Industry Employees' Union* (1979) ATPR 40-138 in relation to section 45D, applied to section 46 in *Mark Lyons Pty Limited v Bursill Sportsgear Pty Limited* (1987) ATPR ¶40-809; *Pont Data Australia Pty Limited v ASX Operations Pty Limited* (1990) ATPR ¶41-007; and *Eastern Express Pty Limited v General Newspapers Pty Limited* (1991) ATPR ¶41-128.

In any case, it is clear that a "substantial degree of market power" requires considerably less than the monopoly power required in the United States or the ability to control a market required by the previous formulation of section 46.

(b) Proscribed Purposes

Under section 46 of the TPA, it is clear that the prohibited purpose can be inferred from the corporation's conduct. Section 46(7) states:

> *"Without in any way limiting the manner in which the purpose of a person may be established for the purposes of any other provision of this Act, a corporation may be taken to have taken advantage of its power, for a purpose referred to in sub-section (1) notwithstanding that, after all the evidence has been considered, the existence of that purpose is ascertainable only by inference from the conduct of the corporation or of any other person or from the relevant circumstances."*

Further, under section 4F of the TPA, the prohibited purpose need not be the sole purpose for which the corporation engaged in the relevant conduct, it need only be a substantial purpose.

(c) Taking Advantage of Market Power

It is clear that the words "take advantage" in section 46 require a connection between the corporation's substantial market power and the conduct which is alleged to be engaged in for a purpose prohibited by the section.

The Explanatory Memorandum which accompanied the 1986 amendments to section 46 of the TPA explain the necessary connection as follows:[59]

> "*the corporation is able, by reason of its market power, to engage more readily or effectively in conduct directed to one or other of the objectives in paragraph (a), (b) and (c). ... Its market power gives it leverage which it is able to exploit and this power is deployed so as to 'take advantage' of the relative weakness of other participants or potential participants in the market.*"

In its most recent consideration of this aspect of section 46, the High Court in its majority judgment stated that:[60]

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59 Explanatory Memorandum to the *Trade Practices Revision Act 1986* (Cth), para 49.

60 *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] HCA 13 at para 51.

> *"it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power. To that extent, one may accept the submission made on behalf of the ACCC, intervening in the present case, that s 46 would be contravened if the market power which a corporation had made it easier for the corporation to act for the proscribed purpose than otherwise would be the case."*

However, there is little clear specific guidance as to what conduct may constitute a taking advantage of market power. In the context of predatory conduct, there have been various measures proposed.

The principal basis for determining whether conduct is predatory (ie a use of market power) is cost based. However, there is substantial uncertainty as to what is the appropriate cost measure and further how in a particular case the particular measure may be determined.

The prevailing cost based approach to predatory pricing in the US is based on Areeda and Turner's 1975 article arguing that predatory pricing could be inferred from pricing below average variable cost as a proxy for marginal or avoidable cost.[61] The Areeda-Turner test was embraced and extended by the Supreme Court in *Brooke Group v Brown & Williamson Tobacco Corp.*[62] In *Brooke Group,* the Supreme Court held that it must also be shown that the profits lost through below-cost pricing may be recouped by charging monopoly prices once the new entrant has exited the market.

The emphasis on pricing below average variable cost and on the dangerous likelihood of recoupment has contributed to the failure of plaintiffs to make out predatory pricing claims in all United States federal cases since *Brooke Group.* Indeed, it has been suggested that the Court in *Brooke Group* consciously set an extremely difficult test for predatory pricing, in part to avoid the possibility that low prices would be discouraged.[63] It was therefore unsurprising that the Kansas District Court refused to find predatory pricing in *US v AMR Corporation, American Airlines Inc and AMR Eagle Holding Corporation* (***American Airlines***).

The *American Airlines* case represents the conservative Chicago School view of predatory pricing and is not consistent with Australian jurisprudence in relation to s 46. More generally, there is

61 Phillip Areeda & Donald F. Turner, "Predatory Pricing and Related Practices under Section 2 of the Sherman Act", (1975) 88 Harv. L Rev. 697 at 702.

62 509 US 209 (1993)

63 See for example Norman W Hawker, "Predatory Pricing in the United States and Canada", 7 U Miami Bus L Rev 201, Spring 1999.

growing recognition that the Supreme Court's analsyis in *Brooke Group* is unduly conservative and ignores strategic and other significant anti-competitive dimensions of predatory pricing. [64],[65]

More recent analysis of predatory pricing has focused on other cost measures including average avoidable cost, which can include fixed and common costs associated with providing combinations of services.[66] In the airline industry, for example, while costs that cannot be attributed to individual passengers are not strictly variable since they do not increase with quantity of output, they are avoidable insofar as capacity can be redirected elsewhere.[67]

In the aviation industry, the Canadian Competition Bureau has adopted a modified form of avoidable cost measure.[68]

In Australia, evidence of pricing below some measure of cost has been accepted as *sufficient but not necessary* for the inference of a proscribed purpose in cases such as *Eastern Express*[69] and *Boral.*[70] While in practice Australian cases do place substantial reliance on cost based measures to determine whether predatory conduct constitutes a taking advantage of market power and whether a proscribed purpose may be inferred, under section 46 of the TPA (as opposed to s 2 of the *Sherman Act*), a predatory purpose can be inferred without below-cost pricing.[71]

This recognition of the limitations of cost based measures in Australian law coincides with significant international developments in identifying predatory conduct other than through evidence of pricing below any particular measure of cost.

In industries such as the aviation industry which are characterised by high fixed costs, it is recognised that tests on avoidable or incremental costs are inappropriate and unduly conservative. As Oster and Strong have noted:[72]

> *"Trying to apply an Areeda-Turner type of test to the airline industry, even with its other critical limitations, could present difficult measurement problems with both price and cost. Perhaps the biggest problems are with measuring costs. Marginal cost can be an elusive concept in the airline industry."*

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64 See also Bolton, Brodley & Riordan, *supra* note 11 at 2271.

65 Oliver E Williamson, "Predatory Pricing: A Strategic and Welfare Analysis", 87 Yale LJ 384 (1977), cited in *ibid.*

66 William J Baumol, "Predation and the Logic of the Average Variable Cost Test", (1996) 39(1) Journal of Law and Economics 49 at 58.

67 See also Bolton, Brodley & Riordan, *supra* note 11 at 2271.

68 Canadian Competition Bureau, *supra* note at para 38.

69 *Eastern Express Pty Ltd and General Newspapers Pty Ltd* (1992) 106 ALR 297; (1992) 35 FCR 43.

70 *ACCC v Boral Limited* [2001] FCA 30.

71 Explanatory Memorandum to the 1986 amendments to the TPA at paragraph 54; Federal Court in *Eastern Express Ibid* at para 11; *Boral, supra* note 73 at para 266.

72 Oster & Strong, *supra* note 14 at 20.

One of the most significant alternative treatments of predatory pricing is that of the US DoT. Following its consideration of unfair competition in the aviation industry, the US DoT has moved away from cost based rules. In its *Findings and Conclusions on the Economic, Policy and Legal Issues,* the DoT concluded that:

> *"airlines engage at times in unfair competitive practices designed to eliminate or reduce competition and that the Department should take action to prevent such practices…. The Department should consider taking action when an incumbent airline responds to entry with fare cuts,* ***capacity increases, or other tactics*** *that appear to be economically rational only if they force the new entrant to exit the market."*

The *Findings and Conclusions* reject the claims of incumbent airlines that additional capacity and large numbers of seats at matching prices are necessary to meet the competitive challenge of new entry. The *Findings and Conclusions* are founded on the notion of a "reasonable alternative response" based on maximising profits in both the short and long term rather than sacrificing short-term profits in order to exclude a new entrant. Importantly, the *Findings and Conclusions* specifically reject the necessity of any requirement to prove that prices are below any specific measure of costs.[73]

The US DoT notes that the "reasonable alternative response" put forward in its proposed policy is simply an acknowledgment of *opportunity costs*, which are not ordinarily included in a cost-based analysis of predatory pricing. The US DoT considers that opportunity costs, which are economic costs as real as any other, should be included in any such analysis.[74]

Various other proposals have been developed to avoid the need to explicitly consider costs. Most famously, Baumol has proposed a rule that required a firm that has reduced prices in response to new entry to maintain those prices after exit.[75] A price increase on exit would be evidence of predatory pricing. This approach avoids the need to consider costs at all. However, it provides no *ex ante* enforcement rule, which is essential for effective competition regulation of the airline industry. Edlin further develops the Baumol analysis and proposes that any substantial price reduction in response to new entry before the new entrant has had a reasonable time to recover its costs and become viable can be predatory.[76]

The expansion of capacity on a route in the face of new entry may also be prima facie anti-competitive conduct. This is because the ordinary effect of new entry is to some degree to

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73 US DoT, *Findings and Conclusions, supra* note 13 at 73.

74 *Ibid* at 75.

75 William J Baumol, "Quasi-Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing", 89 Yale Law Journal (1979).

76 Aaron S Edlin, "Stopping Above-Cost Predatory Pricing", UC Berkeley Public Law and Legal Theory Working Paper No. 57, 2000, at 22.

reduce demand for the incumbent's services customers as customers switch. The loss of customers in the airline industry results in decreasing yield, reducing the profitability of each affected flight. However, expanding capacity (to win back customers) does not address this problem, it makes it worse, as the only way to win back those customers is to reduce fares and make available more low priced fares. Increasing capacity therefore only further reduces yield and profitability.

Even if sufficient demand is stimulated by the reduced prices to mitigate the reduction in load factors, this demand can only be stimulated at increasingly low fares often resulting in substantial losses. Additional capacity further drives down prices and reduces yield. However, it is more common for both yield and load factors to decline (as expected) as capacity is increased. Increasing capacity in the face of the falling demand does not maximise profits (or minimise losses) unless the increase is designed to retain sufficient traffic to starve the new entrant and forced it to exit the route/market.

The predatory nature of capacity addition has been widely recognised in theory[77] and was widely recognised in the United States DoT aviation inquiry.[78] The DoT rejected incumbent airlines' claims that they should be entitled to increase the availability of low fares in order to retain traffic that might otherwise be diverted to the new entrant.[79] Arguments that capacity expansion is based on the need to meet additional demand due to lower fares are also widely rejected.[80]

5. LIMITATIONS OF SECTION 46

There are three principal limitations to s 46:

- It focuses on the purpose of conduct, not its effect or likely effect.
- There is no capacity for specific guidance to be provided in relation to particular forms of conduct other than through the judicial process.
- There is no timely and effective means of addressing anti-competitive conduct as it is occurring.

These are discussed below.

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77 Oliver E Williamson, "Predatory Pricing: A Strategic and Welfare Analysis", Yale Law Journal, December 1997, cited in WK Viscusi, JM Vernon & JE Harrington Jr, *Economics of Regulation and Antitrust,* 2d ed (MIT Press: Cambridge, MA, 1995).

78 Alfred E Kahn, "Comments on Exclusionary Airline Pricing", Submission to US DoT Inquiry, September 1998.

79 US DoT, *Findings and Conclusions*, *supra* note 13 at 48.

80 Haring & Rohlfs, *supra* note 29.

5.1 No Effects Test

Virgin Blue agrees with the Commission's submission that an effects based test should be included in s 46. Such a test is consistent with the overall framework of Part IV of the TPA and is directed to the outcome of conduct (the principal concern of competition regulation), not its motivation.

Virgin Blue is concerned that a focus on the motivation for conduct leads to substantial unnecessary delay in investigating and enforcing breaches of s 46.

Further, in the aviation industry, certain conduct can more readily be identified as having an anti-competitive effect, while determining its motivation may be very difficult (and ultimately from a policy perspective irrelevant).

For example, notwithstanding that capacity expansion often provides a superior indicator of anti-competitive conduct to cost based measures in the aviation industry, a case under s 46 based on capacity expansion alone would have a high degree of risk because of the potential for an incumbent airline to suggest that it had other non-anti-competitive purposes. The result is to create an environment in which incumbent airlines are largely unconstrained in their response to new entrants. This has the effect of chilling even the prospect of new entry as investors recognised that there is little protection available against such conduct.

However, Virgin Blue does not consider an effects based test of itself sufficient to address the threat of anti-competitive conduct in the aviation industry. It is likely that even an effects based test will require substantial investigatory activity and will be subject to substantial enforcement delays. Furthermore, there is still substantial uncertainty as to when certain conduct may constitute a taking advantage of market power. For these reasons, Virgin Blue considers that s 46 should be revised to permit the Commission to develop conduct guidelines and for the Commission to be able to require a company to stop engaging in conduct in breach of those guidelines.

5.2 Lack of Guidance

Notwithstanding the Australian jurisprudence, in practice Australian cases do place substantial reliance on cost based measures to determine whether predatory conduct constitutes a taking advantage of market power (and whether a proscribed purpose may be inferred).

This practical reliance on cost based measures, coupled with the prospect that a company may subsequently develop an innocent alternative explanation of its conduct, leads inevitably to extremely detailed and time consuming investigations of s 46 complaints by the Commission. Further, the situation for a private litigant is made worse by its limited recourse to investigatory tools and the usual requirement to provide an undertaking as to damages in interlocutory proceedings.

There are substantial limitations of the current cost based focus of s 46 predatory conduct allegations, for example:

- the clearest cost based measures that have developed are overly conservative (avoidable costs);

- above incremental costs there remains little guidance as to when pricing and other conduct may constitute a taking advantage of market power;

- there is substantial debate as to what constitutes an appropriate measure of avoidable costs, eg incremental costs, average variable costs, or a broader concept of opportunity costs; and

- cost based measures are not well suited to addressing non-price based conduct (eg capacity expansion).

Consequently, there is currently little guidance to both incumbents and new entrants as to when a response to new entry will constitute a taking advantage of market power and when it will not.

Reliance on judicial decisions to develop this guidance is slow and ad hoc. While a body of case law develops, there is the prospect that much anti-competitive conduct goes unaddressed and new entry is stifled. Firms with substantial market power may consider a lack of guidance a constraint on competitive conduct.

There is a proper role for an agency such as the Commission to develop guidelines as to when conduct may or may not be in breach of s 46. Such guidelines do not bind the Court, but give guidance to industry participants as to when the Commission may or may not take action. Further, such guidelines can underpin the basis for issuing cease and desist notices as proposed by the Commission. There are analogues for such guidelines, including the Commission's Merger Guidelines and the Commission's Price Exploitation Guidelines.

Such guidelines can be more or less prescriptive as is appropriate. For example, they may operate at the level of general principles or may specifically identify particular conduct.

In the airline industry, the US DoT and the Canadian Competition Bureau have both issued guidelines and/or discussion papers identifying particular forms of anti-competitive conduct in the airline industry and which provide a greater degree of guidance as to when the relevant agencies will be likely to use their cease and desist powers.

The US DoT *Findings and Conclusions* state that:

> *"airlines engage at times in unfair competitive practices designed to eliminate or reduce competition and that the Department should take action to prevent such practices…. The Department should consider taking action when an incumbent airline responds to entry with fare cuts, capacity increases, or other tactics that appear to be economically rational only if they force the new entrant to exit the market."*

(The US DoT has decided not to issue prescriptive conduct guidelines, however its discussion paper sets out clear principles as to when it considers a response to new entry to be unfair competitive practice.)

The Canadian Competition Bureau gives the following reasons for publishing its draft Guidelines:[81]

> *"By publishing these Guidelines, the Bureau seeks to inform all industry stakeholders about the type of conduct which the Bureau is likely to challenge. The Bureau's objective in doing so is to facilitate as high a degree as possible of compliance with the airline amendments to the Competition Act and the related regulations, thereby minimizing the need for enforcement action under the Act."*

5.3 Lack of Timely Enforcement

Virgin Blue recognises that there are practical limitations on the speed with which the Commission can act in relation to complaints under s 46. Virgin Blue notes and agrees with the Commission's observations in this regard.

While interim injunctive relief may effectively end predatory conduct, in most circumstances the time involved in preparing and hearing a case is likely to be substantial. Furthermore, unlike a cease and desist notice, which does not necessarily rest on a conclusion that conduct does in fact breach s 46, the Commission is unlikely to seek an interim injunctive remedy (and it may be inappropriate to do so), unless it is prepared to proceed to a final hearing, which of course requires it to be satisfied that there is a proper basis for the proceeding.

While Virgin Blue submits that the existing provisions of the TPA are breached where an incumbent airline with a substantial degree of market power increases capacity or reduces prices to an extent that is only rational if it results in the exit of a new entrant airline, it recognises that proving this is a very difficult and time consuming forensic activity.

[81] Canadian Competition Bureau, *supra* note 30 at para 2.

Virgin Blue notes that the Commission's investigation into its complaint in relation to dramatic expansion of capacity by Qantas on the Adelaide/Brisbane route in response to its commencement on that route took over 17 months before it led to court proceedings. Given appeals, it is likely that such proceedings will not be concluded for at least several more years.

This can be contrasted with the average time in which a new entrant fails in response to predatory conduct. In the United States, Oster and Strong studied twelve routes on which a low fare carrier had entered found that in six of these cases the new entrant had exited within two years, and in a further two cases the new entrants were operating with such low load factors that survival was uncertain. Both generations of Compass airlines failed within one year, and Impulse was acquired by Qantas less than one year after commencement as a low-fare carrier.

Virgin Blue notes the Productivity Commission's support of the Commission's telecommunications industry-specific powers under Part XIB. It also notes the Canadian Competition Bureau's use of its cease-and-desist powers to prevent predatory pricing by Air Canada. The Competition Bureau used its power to make temporary orders in late 2000 while investigating allegations of predatory conduct against WestJet and CanJet, and subsequently commenced proceedings in the Competition Tribunal. In February 2001, the Competition Bureau expressed concerns about new fares offered by Air Canada, and the incumbent voluntarily withdrew these fares. The availability of the temporary orders has made the Bureau a much more effective regulator and has significantly increased its ability to ensure effective competition in domestic air services.

6. REFORM SUGGESTIONS

Virgin Blue agrees with the assessment of the Australian Competition and Consumer Commission, at least in the aviation industry, that s 46 of the Trade Practices Act 1974 does not currently provide adequate protection against predatory conduct. In particular:

- Section 46 does not prohibit a company taking advantage of a substantial degree of market power where that is likely to have an anti-competitive effect.
- There is still substantial uncertainty as to when conduct may be considered a taking advantage or market power, and there is undue weight placed on limited cost based rules.
- There is no framework for the development of clear ex ante guidelines and rules in relation to specific forms of anti-competitive conduct.
- The current enforcement framework does not permit a timely response to predatory conduct.

Each of these limitations is addressed through aviation specific regulation in the US and Canada.[82,83] Virgin Blue considers there is a clear case for aviation-specific competition regulation in Australia and has called on the Commonwealth Government to introduce similar competition regulation for the Australian airline industry.

Virgin Blue also recognises that similar issues may arise in other industries.[84] However, Virgin Blue recognises there may be a concern that such a regime may not be warranted for all Australian industries.

Accordingly, Virgin Blue proposes that the TPA be amended:

- to provide for an effects test in s 46 as proposed by the Commission; and

- in relation to significant industries which are declared by the Minister, to permit the Commission to be able to develop specific ex ante guidelines and rules to give effect to s 46 in those industries and to have power to issue a notice requiring a person to cease from engaging in conduct in breach of those guidelines or rules.

These recommendations are broadly in line with the Commission's recommendations, but have the following advantages:

- the cease and desist power would only apply in industries which the Minister has determined to be appropriate for their application; and

- the Commission would be able to and would be required to provide clear guidance as to the particular forms of conduct which may constitute a misuse of market power giving rise to the prospect of a "cease and desist" notice.

These proposals would greatly increase the effectiveness of competition in the domestic airline industry (and other declared industries).

82 See Canadian *Competition Act* and Regulations relating specifically to anti-competitive conduct in the domestic airline industries; also 49 USC 41712 giving the US DoT specific powers in relation to unfair airline practices.

83 Virgin Blue also notes that in the telecommunications industry with a dominant Telstra there are specific anti-competitive conduct rules and a competition notice regime, facilitating timely and effective responses to predatory and other exclusionary conduct. Part XIB of the TPA.)

84 There is currently specific anti-competitive conduct regulation in the telecommunications industry, Part XIB of the Trade Practices Act 1974.