AUSTRALIAN COMPETITION & CONSUMER COMMISSION

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18 December 2020

Committee Secretary
Senate Rural and Regional Affairs and Transport References Committee

By email: rrat.sen@aph.gov.au

ACCC submission - The future of Australia's aviation sector, in the context of COVID-19 and conditions post pandemic

The Australian Competition and Consumer Commission (ACCC) welcomes the opportunity to provide a submission to the Senate Rural and Regional Affairs and Transport References Committee (the Committee) in relation to its inquiry into the future of Australia's aviation sector, in the context of COVID-19 and conditions post pandemic.

Air travel is vital for the economy in a country as large and demographically dispersed as Australia. The jobs and spending generated by airlines and their supply chain play a major role in supporting the prosperity of the Australian economy. The long term health of the aviation sector is therefore of critical importance to the Australian public. Competition must be safeguarded through this period and beyond so our domestic airline industry can meet the needs of consumers, and the economy more broadly.

The ACCC is monitoring the domestic air passenger services industry

Since a direction from the Treasurer in June 2020[1], the ACCC has been monitoring the prices, costs and profits relating to the supply of domestic air passenger transport services and reporting to government, pursuant to Part VIIA of the *Competition and Consumer Act 2010* (Cth) (CCA).[2] The ACCC seeks to facilitate and protect competition in the domestic air passenger services industry as it recovers from the impacts of COVID-19.

In performing this role, the ACCC has been:

- collecting and analysing monthly flight capacity, passenger numbers, and revenue data from Qantas Group, Virgin Australia and Rex;[3]

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[1] *Competition and Consumer (Price Monitoring – Domestic Air Passenger Transport) Direction 2020.*

[2] The Hon Josh Frydenberg MP (the Treasurer), *ACCC directed to monitor domestic air passenger services*, media release, 19 June 2020. (Available at: https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/accc-directed-monitor-domestic-air-passenger-services)

[3] The ACCC can obtain information from airlines using its formal data gathering powers under the CCA.

- engaging regularly with key industry stakeholders including airlines, airports, industry bodies, Treasury, and the Department of Infrastructure, Transport, Regional Development and Communications;
- producing quarterly reports on the state of competition in the domestic airline industry;
- advocating for reform that could enhance competition within the industry; and
- assessing concerns of anti-competitive conduct.

In carrying out its functions, it may be that the ACCC identifies concerning behaviour and/or that the level of competition within the industry is diminishing, but short of thresholds for enforcement action. The ACCC will be ready to recommend potential policy options, including potential regulatory protection for airline users, should there be signs that competition is not effective.

The ACCC is reporting on the state of the industry and exploring issues that may impact competition

The ACCC has so far released two reports pursuant to the Treasurer's direction to monitor the airline industry. The first report (Attachment A), published on 17 September 2020, outlines the scope of the monitoring role and the ACCC's approach to protecting competition in the sector. Notably, the report identifies types of activities that could damage competition and for which the ACCC will be watching. The second report (Attachment B), published on 17 December 2020, discusses recent industry developments, analyses key industry metrics and explores potential changes to the Slot Management Scheme at Sydney Airport.

Access to slots at Sydney Airport is a key barrier to entry and expansion in Australian air passenger services market/s. In November 2020, the Australian government released the Sydney Airport Demand Management Discussion Paper[4] as the first step of conducting a comprehensive review of demand management at Sydney Airport. The ACCC has made a submission to the review (Attachment C) highlighting ways in which the Slot Management Scheme can impede competition. The ACCC's submission suggests that changes to the scheme should ensure the most efficient use of slots and foster an environment of robust competition.

COVID-19 has had a severe impact on the aviation sector but the domestic market is showing positive signs of recovery

COVID-19 has created some of the most difficult market conditions in Australian aviation history. However, with border restrictions easing, the airlines are cautiously optimistic about the future of domestic travel. While consumer demand for travel is recovering faster than expected, the path to recovery remains fragile.

The ACCC has so far observed volatility in the market shares of Australia's airlines and expects it to remain this way while the industry operates at reduced capacity. Market shares will continue to change as airlines add additional services to meet consumer demand and expand into new routes.

Robust competition benefits Australian consumers and is important to the future of the airline sector

Rivalry between airlines can encourage cheaper airfares, more favourable terms and

[4] Available at: https://www.infrastructure.gov.au/aviation/airport/review-sydney-airport-demand-management/files/sadm-discussion-paper.pdf.

conditions, better quality in-flight services, more frequent services and a broader network reach.

Prior to the pandemic, the Australian domestic airline sector was in many respects a duopoly between Qantas Group and Virgin Australia. To survive the impacts of the pandemic, both Qantas and Virgin downsized and consolidated their operations. However, for regional operator Rex the situation opened up opportunities for expansion into major domestic routes. On 1 December 2020, it began selling tickets for Sydney-Melbourne flights which are due to commence from 1 March 2021.

In November 2020, Virgin emerged from voluntary administration under the new ownership of Bain Capital. The airline has announced plans to position itself as a mid-market carrier with a business product and several aspects of its service offering currently under review.

At this stage, it's difficult to predict what the new market structure will mean for competition. The ACCC will continue to closely monitor the competitive dynamics of the industry as it emerges from this period.

Further consultation and engagement

The ACCC welcomes further engagement and consultation with the Committee on these issues and would be pleased to speak with you to discuss any questions or concerns.

Yours sincerely

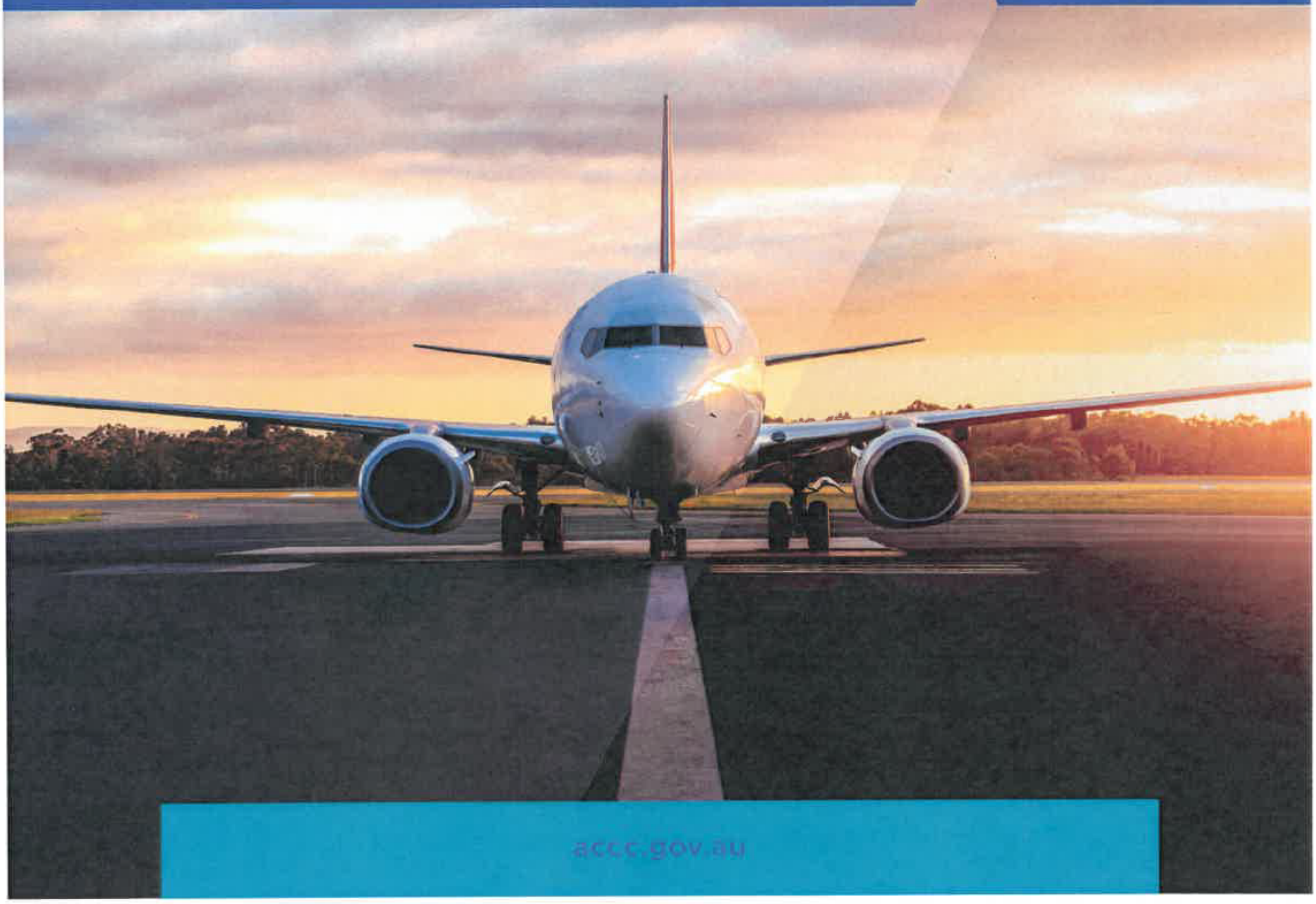
Rod Sims
Chair

Attachment A

AUSTRALIAN COMPETITION
& CONSUMER COMMISSION

Airline competition in Australia

September 2020



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Overview

The COVID-19 pandemic has had a severe impact on airlines globally, with international services all but ceasing and Australian domestic airline services being drastically reduced. Overall, domestic air passenger numbers and seating capacity during April 2020 were down around 95 per cent, relative to April 2019. Qantas reports that the extraordinary events of this year have made for the worst trading conditions in its 100 year history. Adding to this, Australia's second largest airline, Virgin Australia, entered voluntary administration in April.

In June 2020, the Australian Government issued a direction to the ACCC to monitor prices, costs and profits relating to the supply of domestic air passenger transport services for a period of three years. According to the government, the ACCC's role is to assist in protecting competition in the sector for the benefit of all Australian airline travellers. This is the first of a series of reports to be produced under the direction.

At the time of the government's direction to the ACCC it appeared that the domestic airline industry would shortly return to regular operations following the impacts of COVID-19. Subsequent infection spikes in some states and tightening of border restrictions have delayed such a return. Given that airline passenger numbers and seating capacity remain low, the ACCC's role will become more significant in the future as the airline industry moves toward more regular operations.

A competitive air passenger transport services industry is vital to meet the needs of consumers and the economy more broadly, especially for a large country as geographically dispersed as Australia. Rivalry between airlines can encourage cheaper airfares, more favourable terms and conditions, better quality in-flight services, more frequent services and a broader network reach. It may be that some airlines are more successful at meeting the needs of passengers than others.

However, it is also possible for airlines to engage in behaviour that unfairly reduces or prevents competition. Such conduct may result in rival airlines scaling back their services, withdrawing from the market or not entering the market to begin with. Passengers may then be faced with fewer services from which to choose, have to travel at less convenient times and pay higher airfares than otherwise. Some passengers may decide not to fly at all in these circumstances.

In undertaking this new role, the ACCC will seek to facilitate and protect competition in the domestic air passenger services industry. The ACCC intends to draw from a variety of tools including monitoring and reporting under the direction, advocacy, investigation and potentially taking enforcement action.

In carrying out its functions, it may be that the ACCC identifies concerning behaviour and/or that the level of competition within the industry is diminishing.

We will be ready to work with government about potential policy options in this regard, including potential regulatory protection for airline users should there be signs that competition is not effective.

1. Introduction

This is the first report on the ACCC's monitoring of the domestic air passenger industry.

The Treasurer issued a direction to the ACCC under subsection 95ZE(1) of the *Competition and Consumer Act 2020* (the Act) on 19 June 2020.[1] The purpose of the direction is for the ACCC to monitor prices, costs and profits relating to the supply of domestic air passenger transport services.

The direction includes a requirement for the ACCC to report on its monitoring at least once every quarter. The direction is for a period of three years.

In announcing the direction, the Treasurer stated that the ACCC's monitoring will assist in protecting competition in the sector for the benefit of all Australian airline travellers.[2] The Treasurer also said that the reporting role and focus by the ACCC would provide another avenue for those wishing to raise concerns about anti-competitive conduct in the sector.

The ACCC is in the process of establishing systems for the regular collection of data from the airline industry. As a result, this first report focuses on explaining the ACCC's role and the context for why it has been given this task. Future reports will benefit from analysis of the data using the systems and tools currently under development. The next report will be published at the end of 2020.

The structure of the report is as follows:

- relevant recent industry developments
- the ACCC's approach to protecting competition in the sector
- the types of behaviour that may harm competition, and
- ACCC matters related to the airline sector.

1 *Competition and Consumer (Price Monitoring—Domestic Air Passenger Transport) Direction 2020*

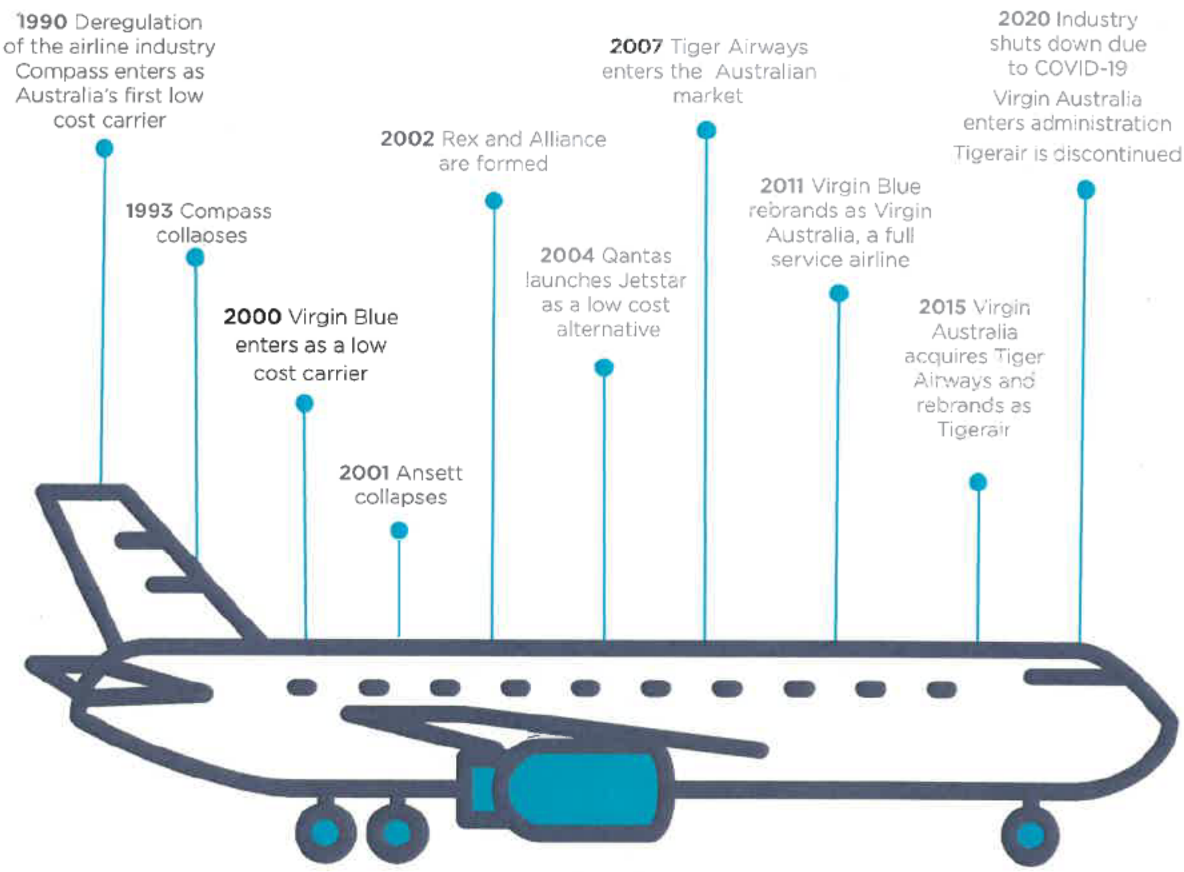
2 The Hon Josh Frydenberg MP (the Treasurer), *ACCC directed to monitor domestic air passenger services*, media release, 19 June 2020.

2. Industry developments

2.1 History of Australian domestic airline passenger services

From 1952 to 1990, Australia's airline sector was heavily regulated under the 'Two Airlines' policy, which was designed to support a stable environment for two major operators but did not allow for the threat of new entry. Since deregulation, a number of airlines have entered and exited the market (see Figure 1).

Figure 1 Timeline of major industry developments—1990 to 2020



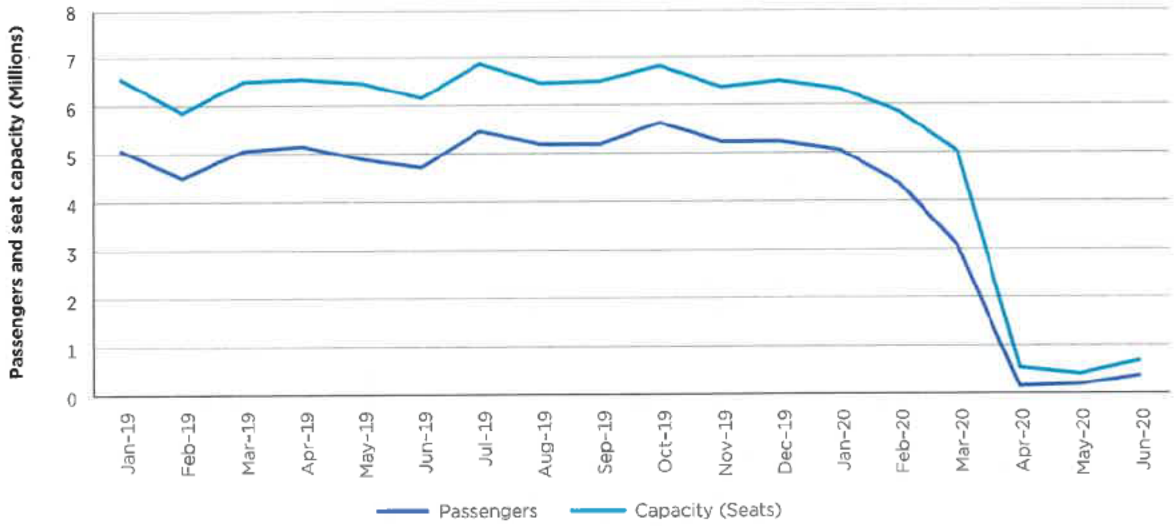
Prior to the COVID-19 pandemic, the Australian domestic passenger sector was in many respects a duopoly between Qantas Group and Virgin Australia. Qantas Group accounted for around 60 per cent of the sector across its Qantas and Jetstar brands, while Virgin Australia accounted for around a third of the sector with its Virgin and Tigerair brands. Much of the sector's activity was centred on the Brisbane-Sydney-Melbourne triangle, with the Sydney-Melbourne route the second busiest in the world.

The regional sector was more fragmented, with a number of airlines providing services but less direct competition over each route. Regional operators included Qantaslink, Regional Express (Rex), Virgin Australia Regional Airlines, Alliance Airlines, Airnorth and Sharp Airlines. For some low volume regional routes, state governments limit supply to a single airline in order to promote stability and ensure that the route continues to be serviced.

2.2 COVID-19 has severely disrupted air passenger travel

The COVID-19 pandemic has caused major disruptions to society and the economy, with social distancing measures, lockdowns, domestic border closures and international travel bans all contributing. Demand for airline passenger services has declined significantly as a result. Figure 2 shows that passenger numbers and seating capacity during April 2020 were down around 95 per cent, relative to April 2019.

Figure 2 Australian domestic air services—January 2019 to June 2020



Source: Bureau of Infrastructure, Transport and Regional Economics; Australian domestic airline activity.

Note: Data is for regular public transport (i.e. commercial flight operations on fixed schedules and specific routes available to the general public) and does not include charter operations.

The COVID-19 pandemic has had a significant impact on the operations of all airlines:

- Qantas announced in March 2020 a 90 per cent reduction to international capacity and 60 per cent to domestic capacity, with around 150 aircraft being grounded.[3] It also announced that 20,000 employees would be stood down until at least May 2020. Qantas reduced domestic operations further to 5 per cent of capacity during April, and had only recovered to 15 per cent of capacity through June.

  In August 2020, Qantas announced a $2.7 billion statutory loss for FY2020, following a 91 per cent drop in underlying profit before tax, $1.4 billion in write-downs and $642 million in restructuring and redundancy costs.[4] It explained that the stand down of 20 000 employees would continue, and that 4000 of at least 6000 redundancies were expected to be finalised by end-September 2020.

- Virgin announced in March 2020 a 90 per cent reduction to domestic capacity, with 125 aircraft grounded. It also announced that 80 per cent of its workforce would be temporarily stood down.[5] Virgin also entered voluntary administration as discussed in Section 2.4.

- Rex made announcements in March 2020 that it would reduce its capacity by 45 per cent, and subsequently to suspend services entirely.[6] After the federal and state governments provided assistance measures, Rex announced in April 2020 that it would run two to three return flights per week to all destinations on its network.[7]

3 Qantas, *Qantas group update on coronavirus response*, 17 March 2020.

4 Qantas, *Qantas Group FY20 financial results—navigating exceptional conditions*, 20 August 2020.

5 Virgin Australia, *Virgin Australia Group makes further capacity reductions in response to COVID-19*, 25 March 2020.

6 Regional Express, *Media release: Rex announces reductions to network*, 19 March 2020; Regional Express, Media release: *Rex to cease all passenger air services with the exception of Queensland*, 23 March 2020.

7 Regional Express, *Media release: Rex update on funding approval for regional services*, 29 April 2020

Anticipating a strong consumer desire to travel, the airlines are exploring solutions to meet that demand and increase their flight offerings. The easing of initial lockdowns led to offers of discount fares, with Qantas reporting strong demand from its June 2020 sale.[8]

However, the second Victorian lockdown and reimposed border closures have disrupted the airlines' recovery projections.[9] Qantas had planned to return to 40 per cent of its pre-crisis domestic capacity during July 2020, however as at August 2020, it had only scheduled 20 per cent of pre-crisis capacity.

In light of border restrictions, recent marketing initiatives have focused on intra-state travel. Virgin launched a sale in August 2020 focused on flights within Western Australia, Queensland, and New South Wales. Qantas has indicated that Brisbane to Cairns is its top route as at August 2020.

QANTAS GROUP

The Qantas Group[10] has identified the current environment as presenting the most challenging period in its long history. The first half of 2020 saw a near total collapse in travel demand and a $4 billion drop in revenue for the airline. Moreover the competitive landscape is being reshaped, requiring the Qantas Group to reinvent how it runs parts of its business into the future.

Border closures mean intra-state routes currently represent some of the Qantas Group's busiest services. The Group's international fleet is entirely grounded and inter-state domestic operations were operating at less than 10 per cent of pre-COVID levels from the end of March to June, recently rising to around 20 per cent, significantly below the 40 per cent the airline indicated in June that it anticipated it would be operating by this time. For example, prior to the pandemic, Qantas would operate about 40 flights a day between Sydney and Melbourne, and Jetstar would operate about 15 flights a day on that route. Those numbers are now down to 5 flights a week each.

In June 2020, in an effort to encourage latent travel demand in the light of then easing border restrictions, Jetstar ran a promotional sale. Reflecting latent consumer travel demand, Jetstar reported that this promotion was one of its fastest selling sales ever, with consumers buying nearly 150 000 tickets in 3 days.

2.3 The government has helped to maintain certain services

The government has implemented a range of measures to assist the aviation sector, including temporary programs to subsidise the cost of operating a minimum domestic aviation network. Under these programs the government covers the cost of, and receives all revenues from, operating the particular flights. By design, this program is cost neutral for the participating airlines, who are incentivised to provide services as the government specifies:

- $198 million is available under the Regional Airline Network Support (RANS) program to provide support for air services to connect regional Australia to freight, medical testing, supplies and essential personnel. Qantas, Virgin, Rex and a number of smaller airlines have received funding to provide services on select routes. Funding is currently available to provide services on regional routes until 31 December 2020.

8 Qantas, Australians snap up domestic sale fares, 19 June 2020.

9 Qantas, *CEO speech—Qantas group post-COVID recovery plan, 25 June 2020*; Qantas, *Qantas group FY20 financial results—navigating exceptional conditions*, 20 August 2020.

10 As reported to the ACCC in August 2020.

- The Domestic Aviation Network Support (DANS) program provides support for airlines to provide services on the 50 domestic routes with the most traffic. Qantas and Virgin have received $206 million and $112 million under the program respectively.[11] These airlines are currently receiving funding to maintain connectivity on the major domestic air routes.

The participating airlines remain free to provide non-subsidised services, and we expect they would do so wherever commercially viable.

The government has also provided $715 million under the Australian Airline Financial Relief Package, which provides relief from a range of taxes and government charges. A further $100m in cash flow assistance is available to regional airlines under the Regional Airlines Funding Assistance Package.[12]

2.4 Virgin entered administration and was acquired by Bain Capital

Carrying significant debt at the onset of the pandemic, Virgin entered voluntary administration in April 2020, with an aim to restructure and refinance the airline. Virgin announced in June 2020 that Bain Capital had entered into an agreement with the administrator, Deloitte, to become the new owner of the airline. An announcement of restructuring plans followed in August 2020, in which Virgin outlined its plans to:[13]

- reduce the cost base and simplify operations by streamlining its fleet and reset operations to meet reduced global and domestic demand,
- secure approximately 6000 jobs, with the potential number to increase to 8000 jobs in future, and to pay entitlements in full to employees who do depart from the company, and
- formally discontinue the Tigerair brand.

Bain's approach to running Virgin will have a significant impact on the domestic airline industry and the ACCC will monitor the situation closely.

Virgin australia group

The Virgin Australia Group [14] entered voluntary administration in April 2020 to recapitalise the business and ensure it emerged in a stronger financial position on the other side of the crisis.

Bain Capital entered into an agreement with the Group's Administrators in June 2020 to become the new owner of the airline, and subsequently announced a plan for a stronger, more profitable and competitive business, and securing approximately 6000 direct jobs.

The plan announced states that it aims to re-establish Virgin Australia and to bring strong competition for travellers. The airline will simplify its fleet to realise cost efficiencies and remove operational complexity. The Tigerair Australia brand has been discontinued, but its Air Operator Certificate (AOC) has been retained to provide an option for ultra-low-cost operations when the market recovers.

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11 In addition, Rex and Airnorth Regional Airlines have received $399 000 and $2.6 million respectively under the DANS program. Further information is available on the AusTender website: https://www.tenders.gov.au/.

12 Further information on Government assistance for the aviation sector can be found at https://www.infrastructure.gov.au/aviation/.

13 Virgin Australia, *Virgin Australia Group announces plan to focus on core strengths, re-establishing itself as an iconic Australian airline*, 5 August 2020.

14 As reported to the ACCC in August 2020.

2.5 Other airlines are planning expansions

Despite the uncertainty regarding the industry, Rex and Alliance Airlines are both enacting plans to expand their domestic operations. Rex has expanded its capacity in WA and commenced preparations to operate services on the Sydney-Melbourne-Brisbane triangle, with 1 March 2021 as the target start date.[15] Alliance Airlines is launching new regular public transport routes and has announced it is expanding its fleet with 14 additional aircraft.[16]

Rex [17] has historically been a regional and rural airline that does not operate between Australia's major cities. This has offered Rex a level of protection from the impacts of border closures between states and territories. Demand on Rex's intra-state regional routes has shown a good steady recovery in particular in Queensland and Western Australia, and South Australia too but to a lesser extent.

The impacts of the pandemic have created expansion opportunities for the airline in the domestic network. As a starting point, Rex intends to enter the Sydney-Melbourne-Brisbane 'Golden Triangle'. Rex is currently finalising its options for capital raising to fund its entry into the domestic operations in March 2021.

15 Regional Express, *Media Release: Rex Board has approved plans for domestic operations*, 29 June 2020.

16 Alliance Aviation Services, *ASX release—Alliance Aviation Services Limited ("Alliance"): Record revenue and profit*, 5 August 2020, p. 3.

17 As reported to the ACCC in August 2020.

2.6 The ACCC is engaging with airlines

The ACCC has been talking with the key Australian airlines about the state of the industry and how it may emerge from the current situation. Figure 3 sets out some of the key messages we have heard.

Figure 3 Key messages from the airlines about the current state of the industry

Based on the ACCC's engagement with airlines to-date, the following key themes have emerged.

Load factors: as is to be expected, the numbers of passengers on flights have dropped significantly from the end of March due to COVID-19.

Expansion: COVID-19 related market changes have created opportunities for some airlines to expand into the domestic network as the availability of infrastructure, aircraft, pilots and fuel has improved.

Downsizing: at the same time, major airlines Qantas and Virgin are down-sizing and re-structuring their fleets and workforces to reduce operating costs.

Barriers to entry: a key barrier to entry or expansion into the domestic network is access to slots at slot-constrained airports where demand exceeds capacity.

Inter-state travel: border closures continue to create uncertainty for the domestic network but are acknowledged to be an important part of the public health response.

Intra-state travel: while travel within Victoria and NSW has substantially decreased, intra-state travel elsewhere (particularly in Qld and WA) is relatively healthy.

Cheap flights: airlines are selling some airfares at very low prices in order to stimulate demand.

Government funding: a range of State and Federal Government financial support has been of great assistance to airlines and helps to sustain essential air travel services for remote communities.

3. The ACCC’s approach to protecting competition in the sector

The ACCC will use monitoring and reporting in order to meet its obligations under the direction, and advocacy, investigation and potentially enforcement action to protect competition in the domestic air passenger industry when it emerges from its COVID-19 related shutdown.

Central to this role will be the ACCC’s analysis of data from Qantas, Virgin and Rex who supply the vast majority of regularly scheduled passenger airline services in Australia. This monthly data is expected to build a time series of capacity (i.e. seats), utilisation (i.e. passengers) and revenues for each domestic route and will underpin both the ACCC’s analysis and public reporting.

The ACCC will also from time to time seek qualitative information from the airlines (e.g. Board papers) using information gathering powers under the Act. This type of information request will be used to explore certain behaviour in more detail and will reflect activity that the ACCC typically follows when conducting investigations. The extent of our investigation will depend on whether we are identifying potentially concerning behaviour, including whether we are receiving specific complaints from airlines.

We expect to produce and publish our reports to the Treasurer on a quarterly basis. However, collecting data on a monthly basis enables the ACCC to conduct more timely analysis. Should the ACCC identify any concerning behaviour that warrants the government’s attention, we may bring forward a report, or choose to publish reports on a more frequent basis.

The monitoring and reporting on the domestic airline industry is separate, but related, to the enforcement of competition law under Part IV of the Act. We will investigate and prioritise enforcement action where we form the view that conduct is likely to breach the Act.

In carrying out its functions, it may be that the ACCC identifies concerning behaviour and/or that the level of competition within the industry is diminishing, but short of thresholds for enforcement action. We will be ready to recommend potential policy options, including potential regulatory protection for airline users, should there be signs that competition is not effective.

4. The ACCC is watching for signs of behaviour that may harm competition

Markets function best when there is competition, or rivalry, among firms each trying to win customers from one another. The discipline of competition incentivises firms to innovate and to offer consumers lower prices and better quality products and services to win business at their competitors' expense. For domestic air passenger services, competition results in competitive airfares, more favourable terms and conditions, increased flight options and better quality in-flight services.

Sometimes, firms attempt to maximise profits through behaviour which harms the competitive process. Behaviour that damages the competitive process is characterised as anti-competitive behaviour. Anti-competitive behaviour in the domestic air passenger services market could lead to fewer airlines, more expensive airfares and a reduced number of flight options. As the industry moves toward more regular operations, the ACCC will be watching for signs of behaviour which may damage competition (see Figure 4), and will engage with government about any issues that raise concerns.

If conduct is identified that might contravene the competition law provisions contained within Part IV of the Act, the ACCC will consider taking enforcement action. It is always dependent on the specific circumstances as to whether conduct will amount to a contravention.

4.1 Types of behaviour that might raise competition concerns

Figure 4 sets out a non-exhaustive list of types of behaviour that may damage competition in the air passenger services market. Some of these behaviours are explained in greater detail below.

Capacity dumping

"Capacity dumping" may occur where capacity is increased beyond expected demand. Competition concerns may arise if it is done in a manner that harms rival airlines' ability to compete. However, there will be circumstances where increasing capacity is not intended to, or is unlikely to, damage the competitive process. In these circumstances, the conduct may be considered a normal part of the competitive process.

Predatory pricing

"Predatory pricing" may occur where airlines offer airfares below cost for the purpose, or with the effect, or likely effect, of substantially lessening competition.

Cheap airfares may be beneficial to consumers in the short-term. However, if an airline offering airfares below cost results in competitors exiting the market, consumers could be left with substantially more expensive airfares and less choice in the long-term.

In some circumstances, there may be rational, commercial reasons for offering airfares below cost. For example, in times of decreased demand, an airline may offer a select number of cheap airfares to entice consumers to purchase flights and stimulate demand.

Competition concerns may arise where an airline offers airfares for a flight at less than its "avoidable cost". That is, the airline makes less money by operating the flight at those airfares than the costs it incurs by operating the flight and could otherwise avoid.

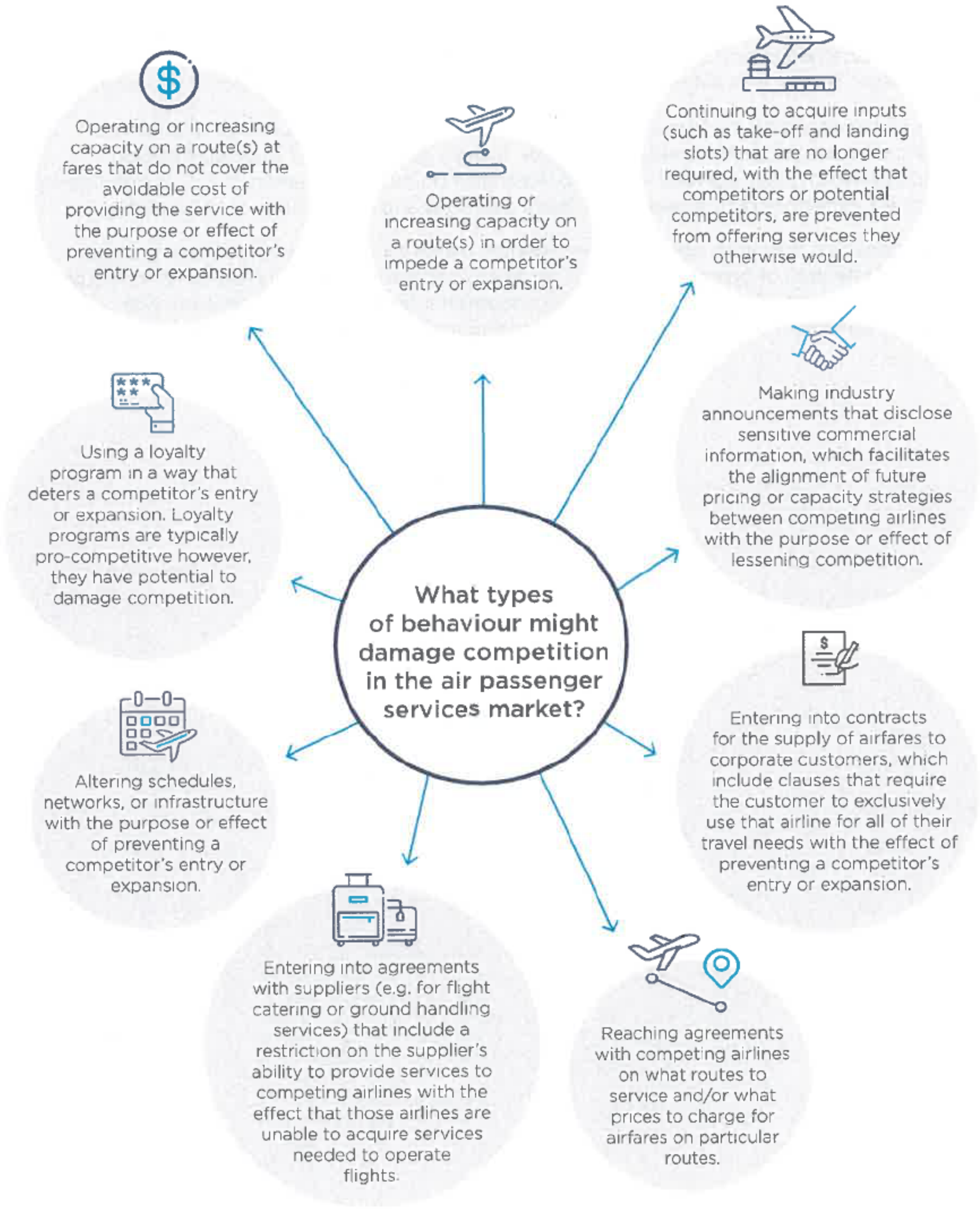
Hoarding of airport slots

A slot is a permission to take-off and land at a scheduled time on a specified date at an airport. At "level 3" slot-constrained airports, where demand exceeds capacity, slots are allocated on a historical precedence basis. That is, if an airline regularly utilises a slot they can retain that slot in the future.

For reasons including airport curfews and physical limitations on access to runways, a number of Australian airports are slot-constrained. In particular, Sydney Airport, one of Australia's busiest airports and one which plays a pivotal role in the Australian domestic air travel network, is significantly slot-constrained, especially during peak times (early mornings and late afternoons on weekdays).

Competition concerns may arise where airlines schedule flights for the purpose of retaining a slot but with no real intention of operating the flight, and likely cancelling the flight close to its scheduled departure time. Conduct of this nature may raise concerns if it has the purpose, effect or likely effect of substantially lessening competition (that is, by preventing a competitor from accessing those slots).

Figure 4 Behaviour that might damage competition



5. ACCC matters related to the airline industry

5.1 Qantas acquiring a stake in Alliance Airlines

The ACCC is considering whether Qantas's acquisition of a 19.9 per cent interest in Alliance Airlines is likely to substantially lessen competition. Qantas acquired the stake in Alliance in February 2019, making it Alliance's biggest single shareholder, without first seeking informal merger clearance from the ACCC.

Alliance supplies charter air services to corporate customers in Queensland, the Northern Territory and Western Australia. Its customers are mainly mining and resources companies requiring services for their fly-in-fly-out workforces. Alliance competes strongly with Qantas for this business, either in its own right or in cooperation with Virgin.

Alliance also operates the only alternative to Qantas on regular passenger transport routes between Brisbane and the important regional centres of Bundaberg and Gladstone. Alliance provides consumers and companies with a crucial alternative to Qantas in markets that are already highly concentrated.

The ACCC is monitoring the competitive dynamics between Qantas and Alliance, examining whether Qantas's stake affects Alliance's ability to raise funds, consider takeovers or participate in commercial ventures, and whether Qantas is attempting to exert influence on Alliance's decision-making or operations.

5.2 Industry complaints

Since January 2020 the ACCC has received a number of complaints made by market participants alleging anti-competitive conduct in the industry, including in relation to issues such as 'capacity dumping' and 'predatory pricing'. We note that COVID-19 has had a considerable impact on the aviation industry and that significant uncertainty remains. The ACCC will continue to observe as the industry stabilises, and will closely assess any behaviour that raises competition concerns.

In light of COVID-19 travel restrictions, the ACCC has engaged with airlines to ensure consumers are clearly informed about their rights and offered the remedies they are entitled to when their travel plans are disrupted by border closures. In June 2020, following ACCC engagement, Qantas contacted customers to inform them of their right to a refund on cancelled or suspended flights.[18] Qantas's previous communications may have encouraged its customers to cancel bookings themselves and receive credit when they would have been eligible for a refund.

5.3 Authorisation for short term industry coordination

On 26 March 2020 the ACCC granted conditional interim authorisation to enable Rex to coordinate flight schedules with Qantas and/or Virgin Australia and to enter into agreements to share revenue on 10 regional routes, as needed in response to the collapse in demand due to the COVID-19 pandemic.

The ACCC considers that the ability for the airlines to coordinate and share revenue is likely to result in public benefits by supporting the continuity of air services to certain regions during the COVID-19 pandemic and enabling better schedule spread, which provides greater choice for passengers flying to and from those regional destinations.

18 Australian Competition and Consumer Commission, Media release: *Qantas offers refunds for flight cancellations*, 19 June 2020.

Interim authorisation was granted on the condition that the airlines do not set a fare on the 10 routes that is higher than the equivalent fare specified in their respective fare schedules in place as at 1 February 2020.

On 11 September 2020, the ACCC granted authorisation subject to the condition on fares outlined above along with a reporting requirement. Authorisation is granted until 30 June 2021.

Attachment B

AUSTRALIAN COMPETITION & CONSUMER COMMISSION

Airline competition in Australia

Report 2: December 2020

accc.gov.au

Australian Competition and Consumer Commission
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Contents

Overview

This is the second of a series of reports to be produced under the direction from the Australian government to monitor competition in the supply of domestic air passenger transport services.

Data provided to the ACCC by Qantas, Virgin and Regional Express (Rex) for September 2020 reveals an industry operating at a fraction of its pre-COVID capacity. For example, total passenger numbers for the month of September 2020 were 87% below September 2019 and industry revenues were accordingly lower. The data also shows Qantas and Rex generally gaining market share at the expense of Virgin during the period, although market shares may be volatile given the depressed state of the industry.

We have also seen airlines take an opportunistic and agile approach to network management, seeking to tap into demand for particular routes and services to bring in much-needed cash in this environment, even if expected revenues are insufficient to cover fixed costs and therefore make a profit. At this stage, it is difficult to identify exactly how competition will evolve as the industry emerges from this period.

With signs that all states including Victoria have COVID-19 under some control, and key state borders opening up in November and early December, there is growing optimism that the industry can now begin its recovery. Airlines are increasing capacity to meet pent-up demand for travel as people come out of lockdowns and other travel restrictions wanting to see family and friends or just get away for a holiday. As this happens, the extent to which the industry relies on government support is diminishing. Some among the industry have suggested that with the holiday season, and continued growth into 2021, activity may approach pre-COVID levels on some leisure routes.

However, optimism is still cautious and the path to recovery is fragile. This was highlighted by the level of disruption caused by COVID-19 cases in South Australia in mid-November. Airlines observed a 'freeze' in sales and were forced to cancel flights as movement restrictions were reinstated.

There have been a number of significant developments in the industry since our first report in September 2020. Bain Capital officially became the owner of Virgin in November 2020 as the airline emerged from voluntary administration. Upon her commencement, new CEO Jayne Hrdlicka announced plans to position Virgin as a mid-market carrier. We note that various aspects of Virgin's product and service offering are under review and will become clearer as the airline implements its strategies. Bain Capital's direction for Virgin is likely to have significant implications for competition in the domestic airline industry.

During the course of the administration process, Virgin simplified its fleet and reduced its network coverage. The ACCC has also granted interim authorisation for Virgin to cooperate with Alliance Airlines on 41 domestic routes, which we expect will enhance its ability to compete with Qantas.

Regional operator Rex has further progressed its plans to expand into major domestic routes. On 1 December 2020 it began selling tickets for Sydney–Melbourne flights which are due to commence from 1 March 2021. It has also stated that it will further expand across the broader Sydney–Melbourne–Brisbane triangle.

One of the key inputs Rex will need to compete on these routes is access to airport slots. It has secured slots for its launch in March 2021, and is continuing to work on gaining access to slots for April 2021 onwards. The Australian government has initiated a comprehensive review of demand management at Sydney Airport. The ACCC's submission highlights ways in which slot management can impede competition through inefficient slot use and incentives to hoard slots, including by hindering opportunities for new and expanding airlines.

Key themes emerging in the airline industry

The ACCC continues to engage with key Australian airlines on the state of the industry and their recovery plans. Some of the key messages we have heard recently are set out below.

Domestic borders have re-opened

Major Australian border openings in November and December led to an influx of demand for interstate travel which resulted in Qantas and Virgin significantly increasing capacity. At the same time, the sudden South Australian border closure in November showed how fragile the situation remains.

International borders remain closed

International borders will remain closed for the foreseeable future. This is causing Australian airlines to turn to unique domestic flying opportunities to generate cash where possible.

Consumer demand for leisure flying is strong

Despite concerns that consumers would be reticent to fly, consumer demand is stronger than expected. Consumers appear to be comfortable with getting back in the air and experimenting with new domestic travel destinations, especially given the suspension of international travel.

The resources market in Queensland and Western Australia is similarly strong while government travel is subdued and corporate travel remains a fraction of what it was.

The airlines are optimistic about the future

Stronger than expected returning demand has given the airlines a positive outlook about the future of domestic travel. Qantas has added more flights and new routes to its domestic network. New Virgin CEO, Jayne Hrdlicka, has stated that Virgin is 'very focused on being successful' and 'will be fiercely competitive' to Qantas.

Rex's domestic network expansion plans are on-track with sales of Sydney-Melbourne flights for March 2021.

Access to take-off and landing slots

Access to airport slots continues to be a key issue for all airlines. A review of demand management at Sydney Airport is underway, which will include consideration of the Sydney Airport slot management scheme (the ACCC's submission to this review is outlined in section 4.1 of this report).

1. Introduction

This is the ACCC's second report on its findings from monitoring domestic air passenger transport services.

On 19 June 2020, the Treasurer issued a direction to the ACCC under subsection 95ZE(1) of the *Competition and Consumer Act 2020* (the Act) to monitor prices, costs and profits relating to the supply of domestic air passenger transport services.

The direction includes a requirement for the ACCC to report on its monitoring at least once every quarter. The direction is for a period of 3 years.

In announcing the direction, the Treasurer stated that the ACCC's monitoring will assist in protecting competition in the sector for the benefit of all Australian airline travellers.[1] The Treasurer also said that the reporting role and focus by the ACCC would provide another avenue for those wishing to raise concerns about anti-competitive conduct in the sector.

The ACCC's monitoring and reporting on the domestic airline industry is separate, but related, to its enforcement of competition law under Part IV of the Act. We will investigate and prioritise enforcement action where we form the view that conduct is likely to breach the Act. Consistent with normal practice, we will not be publicly commenting on active investigations.

In carrying out its functions, it may be that the ACCC identifies that the level of competition within the industry is diminishing and/or identifies anti-competitive behaviour, but short of thresholds for enforcement action. We will recommend potential policy options to government should there be signs that competition is not effective.

The monitoring direction provides the ACCC with the ability to compel information from relevant companies within the industry. We have established arrangements for collecting monthly and quarterly data from the Qantas Group, Virgin and Rex. These three airline groups supply the vast majority of regular domestic air passenger services in Australia. We will also seek qualitative information from airlines from time to time, such as Board papers relating to company strategy.

Further information about our approach to fulfilling our obligations under the monitoring direction and potential investigations can be found in the first public report published in September 2020.[2]

The structure of this second report is as follows:

- discussion of relevant industry developments, notably the finalisation of the sale of Virgin to Bain Capital and its authorised coordination with Alliance Airlines (Alliance)
- analysis of key industry metrics including passenger numbers, the number of routes in operation, the degree to which people have a choice of airline group, and each airline's share of total passengers
- an exploration of potential changes to the scheme for allocating take-off and landing slots at Sydney Airport in order to promote competition between airlines.

1 The Hon Josh Frydenberg MP (the Treasurer), 'ACCC directed to monitor domestic air passenger services', media release, 19 June 2020.

2 Available at: https://www.accc.gov.au/publications/report-airline-competition-in-australia.

2. Industry developments

2.1 Opening up of state borders drives domestic airline activity

2020 has been a year of upheaval for the aviation sector, which has likely suffered more as a result of COVID-19 than any other industry. However, there is cautious, but growing optimism within the industry that the opening of state borders will drive significant domestic travel over Christmas and into 2021.

Activity in recent months remains well down on pre-COVID levels. Some signs of life in July were largely snuffed out with the second wave of COVID-19 infections in Victoria, which resulted in state border closures being reinstated or retained throughout the country. Domestic traffic was also hurt by the absence of international travellers, business meetings continuing to be conducted via video, and the lack of major events that attract interstate visitors.

Over this period, airlines have significantly scaled back their network routes and frequencies with a significant reliance on Australian government funding to maintain a minimum level of connectivity across the country. The reduction in network coverage and capacity was particularly acute for Virgin, in the context of its fleet simplification and the administration and sale process.

However, we have also seen airlines take an opportunistic and agile approach to network management, seeking to tap into demand for particular routes and services to bring in much-needed cash in this environment, even if expected revenues are insufficient to cover fixed costs and therefore make a profit.

Although outside the scope of the ACCC's monitoring, chartered aviation services appear to have been resilient in response to the challenges posed by COVID-19. Alliance publicly reported that its total flight hours were stable in the 2020 financial year against 2019 levels, with its charter flights increased due to social distancing requirements and a lack of availability of services from other operators.[3] Alliance expects heightened revenue from charter services will continue through the 2021 financial year.[4] It has also recently expanded its regular passenger transport offering with flights between Canberra, the Sunshine Coast, and Cairns.[5]

With signs that all states including Victoria have COVID-19 under some control, and key state borders opening up in November and early December, there is growing optimism that the industry can now begin its recovery. Airlines are increasing capacity to meet pent-up demand for travel as people come out of lockdowns and other travel restrictions wanting to see family and friends or just get away for a holiday. As this happens, the extent to which the industry relies on government support is diminishing. Some among the industry have gone as far as suggesting that with the holiday season, and continued growth into 2021, activity may approach pre-COVID levels on some leisure routes.

However, optimism is still cautious and the recovery is fragile. This was highlighted by the level of disruption caused by COVID-19 cases in South Australia in mid-November. Airlines observed a 'freeze' in sales and were forced to cancel flights as movement restrictions were reinstated.

For much of 2020, airlines have been making decisions with a view to limiting the extent of losses and striving just to survive. However, a sustained recovery, supported by effective management of COVID-19 cases and minimal movement restrictions, may enable airlines to move towards profitable operations and compete against each other for market share. This kind of competition, if it eventuates, will result in the best outcomes for consumers.

3 Alliance Aviation Services, *Annual report: For the year ended 30 June 2020*, 6 August 2020, pp. 5–6; Alliance Aviation Services, *Investor presentation: Capital raising*, 11 June 2020, p. 20.

4 Alliance Aviation Services, *Investor presentation: Capital raising*, 11 June 2020, p. 20.

5 Canberra Airport, *Media release: Sunshine Coast flights take-off from Canberra Airport*, 23 October 2020.

2.2 New owner Bain Capital sets the future direction for Virgin Australia

Bain Capital officially became the new owner of Virgin in November 2020 as the airline emerged from a 7-month period of voluntary administration. The transfer of ownership followed the announcements that CEO Paul Scurrah and several members of Virgin's Board would step down, with Jayne Hrdlicka appointed as the new CEO.

The relaunched airline is now able to view the aviation market with greater certainty over its future and without the burden of significant debts. The potential for the airline to take a new approach to the sector led to some commentators to speculate that Bain Capital would operate Virgin as a low-cost carrier (LCC) focused on leisure markets. In particular, this speculation was due to the appointment of ex-Jetstar CEO Ms Hrdlicka as well as the airline's profitability prior to its transformation into a full service carrier. Virgin had also closed its LCC subsidiary Tigerair after entering administration.

Nonetheless, upon her commencement on 18 November, Ms Hrdlicka announced plans to position Virgin as a mid-market carrier.[6] Virgin said that it will serve 'all segments of the market', including price conscious corporate travellers, small to medium businesses, premium leisure travellers and holidaymakers.

Virgin outlined major elements of its plan including:

- an intention to retain a domestic market share of roughly one third (as was the case pre-COVID)
- rolling out a new-look lounge across its lounge network, beginning with Adelaide in early 2021
- aligning its business class offering with its core customers' expectations
- restructuring Virgin Australia Regional Airlines (VARA) to become a more sustainable and profitable business following a comprehensive business review.

As Australia's second largest airline, Bain Capital's direction for Virgin is likely to have significant implications for competition in the domestic airline industry. Were Bain Capital to change its view and transition Virgin to an LCC, it would likely provide direct competition for Jetstar in the leisure market, but leave Qantas facing limited competition for corporate customers. This could provide Qantas with an opportunity to modify its corporate offering, such as increasing fares and/or lowering service standards.

Furthermore, if Virgin was to withdraw from a significant number of routes it used to serve prior to COVID-19, it may lead to fewer passengers having an effective choice of airline and therefore reduced competition between airlines. Qantas expects that its share of the domestic market will grow from around 60% to up to 70% as the market recovers, owing to Virgin reducing its fleet and closing Tigerair.[7] In this regard, it is notable that Virgin has received interim authorisation from the ACCC to cooperate with Alliance. This may allow Virgin to provide services to a wider network in regional Australia than would otherwise be possible with its streamlined fleet of Boeing 737s.

Authorisation for Virgin and Alliance to coordinate services

On 19 November 2020 the ACCC granted interim authorisation to Virgin and Alliance allowing them to cooperate on 41 regional routes and two short-haul international routes. The cooperation will allow the airlines to share information, agree on service capacity and schedules, and potentially share revenues on the routes on which they operate, including for new routes not currently serviced by either airline.

The ACCC's preliminary view was that these arrangements are likely to result in a public benefit by assisting in the re-establishment of Virgin's national network of routes, thereby promoting competition in airline services. Cooperating to provide services on these regional routes will assist Virgin and Alliance to efficiently manage capacity and quickly respond to increases in demand as travel restrictions ease.

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6 Virgin Australia, *Media release: Ready for take-off: Virgin Australia Group sours out of administration, unveils future direction*, 18 November 2020.

7 Qantas, *Qantas Group FY20 financial results—navigating exceptional conditions*, 20 August 2020.

The cooperation will mean that Virgin and Alliance will not compete with each other on the routes covered by the agreement. The ACCC's preliminary view was that any public detriment resulting from reduced competition between Alliance and Virgin is likely to be limited, given Alliance's limited number of scheduled regular passenger services. The ACCC also considers that other airlines, including Qantas Airways and Qantas-owned Jetstar, are likely to compete strongly with Alliance and Virgin on many of the routes covered by the agreement.

The ACCC will consider this issue further in the course of its review of the substantive application for authorisation.

2.3 Continued government support for certain services

Since September 2020, the government announced it was extending two support programs for the airline industry in response to challenges presented by COVID-19. It extended its support under the Regional Airline Network Support (RANS) program from 31 December 2020 to 28 March 2021.[8] In December 2020, it further extended its Domestic Aviation Network Support (DANS) program from 31 January 2021 to 28 March 2021.[9]

The DANS program supports airlines to provide services on the 50 domestic routes with the most traffic. Qantas and Virgin have been awarded contracts worth $309 million and $243 million under the program respectively.[10]

The RANS program provides support for air services to connect regional Australia to freight, medical testing, supplies and essential personnel. Qantas, Virgin, Rex and a number of smaller airlines have received funding to provide services on select routes. Although the government extended the RANS program, the $198 million in available funding has not increased.

The extension of the RANS program reduces the need for airlines to coordinate their services. The ACCC granted Rex authorisation in September 2020 to coordinate flight schedules and share revenue with other airlines on 10 regional routes. Authorisation is granted until 30 June 2021. However, the airlines are unlikely to coordinate services on the regional routes when they can provide services with RANS support. The airlines may choose to coordinate services in April–June 2021, once RANS support expires.

2.4 Rex's planned entry to the domestic market

Regional operator Rex has further progressed its plans to expand into major domestic routes. On 1 December 2020 it began selling tickets for Sydney–Melbourne flights which are due to commence from 1 March 2021. It has also stated that it will further expand across the broader Sydney–Melbourne–Brisbane triangle.[11]

Rex took delivery of its first Boeing 737-800 aircraft in November 2020, which followed its announcement in September to lease six 737 aircraft.[12] The remaining five aircraft are to be phased in over the following four months. Rex announced it had signed an agreement for up to $150m funding for these domestic jet operations[13]; and hopes to expand its 737 aircraft fleet to ten by the end of 2021.[14] Its 737s will be configured with business class seats.

8 Minister for Infrastructure, Transport and Regional Development, *Media release: Budget support for aviation soars to new heights*, 28 September 2020.

9 Minister for Infrastructure, Transport and Regional Development, *Media release: Further Government support for aviation and appointment of expert advisory panel*, 14 December 2020.

10 In addition, Rex and Airnorth Regional Airlines have been awarded contracts worth $795,000 and $6.3 million respectively under the DANS program. Further information is available on the AusTender website: https://www.tenders.gov.au/.

11 Regional Express, *Media Release: Rex Launches Into Sydney–Melbourne–100,000 Tickets On Sale From $79*, 2 December 2020.

12 Regional Express, *Media Release: Rex locks in six Boeing 737-800 NG for domestic jet operations*, 30 September 2020.

13 Regional Express, *Media Release: Rex signs binding agreement with PAG on funding for domestic jet operations*, 19 November 2020.

14 Regional Express, *Media Release: Rex Launches Into Sydney–Melbourne–100,000 Tickets On Sale From $79*, 2 December 2020.

2.5 Refund policies of each airline are a point of competition

Given the possibility of further border closures if COVID-19 outbreaks occur, consumers will need to have confidence that they will receive a refund for a cancelled flight if they are to feel comfortable booking flights for early 2021. It may also be the case that an airline's terms and conditions providing for refunds will become a more important differentiator from a competition perspective than before. While all airlines have similar obligations under the Australian Consumer Law, the ability of a consumer to rebook or receive a refund also depends on the specific terms and conditions of the purchase.

Airlines have different policies on refunds for flights disrupted by COVID-19 which are outside the airline's control. We understand that Qantas, Virgin and Rex provide flight credits or refunds due to events beyond their control, including COVID-19 disruptions, however Jetstar only provides flight credits.[15]

Where the airlines' terms and conditions allow for refunds, the general conditions are:

- if a flight is significantly delayed[16] or cancelled, the airline may offer a direct refund, or offer an alternative flight arrangement. If the alternative arrangement is not suitable, the passenger is entitled to a refund
- if multiple flights were booked, the airline will refund the proportion of the ticket for flights not yet flown.

The ACCC has been working with the airlines to ensure they provide refunds consistent with their refund policies.

Virgin is unable to provide refunds for bookings made on or before 20 April 2020 due to its voluntary administration process. However, affected customers are eligible for credits under its Future Flight credits program.[17] Customers who had booked a Tigerair flight are eligible for a Future Flight credit for use on Virgin-operated services for the value of the Tigerair credit.

15 Qantas, *Conditions of Carriage*, section 9.2, viewed 20 November 2020; Jetstar, *Conditions of Carriage*, section 9.2, viewed 20 November 2020; Rex, *Conditions of Carriage*, section 11, viewed 24 November 2020; Virgin, Virgin Australia Guest Compensation Policy, section 4, viewed 10 December 2020.

16 Policies on what constitutes a 'significant delay' differs by airline, but is generally defined as either a set number of hours, or a delay that impacts upon the passenger's travel plans, for example a delay that would force the passenger to cancel their trip.

17 For further information see: https://travel.virginaustralia.com/au/coronavirus-update/future-flight-credits, viewed 19 November 2020.

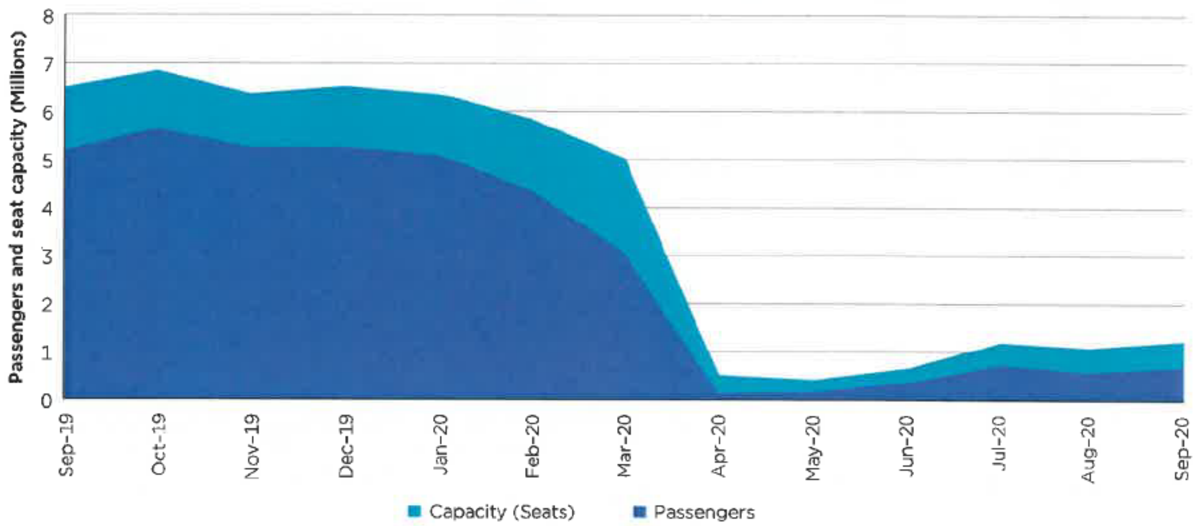
3. Key industry metrics and analysis

This section of the report presents analysis of key industry metrics. Unless specified otherwise, the metrics are calculated using information collected from Qantas Group, Virgin and Rex on a monthly and quarterly basis. The data presented here includes activity up to the end of September 2020.

3.1 Domestic aviation recovery stalled with border restrictions following Victorian outbreak

Despite airlines having cautious optimism about the future (as discussed in section 2.1), figure 1 shows that Australian domestic activity up to September 2020 was still well down on pre-COVID levels. Services started to recover in June 2020 as some state border restrictions were eased. However, the recovery was disrupted following a second outbreak of COVID-19 in Victoria, with movement restrictions resulting in lower passenger and capacity numbers in August relative to July.

Figure 1 Australian domestic air services—September 2019 to September 2020



Source: Bureau of Infrastructure, Transport and Regional Economics; Australian domestic airline activity.
Note: Data is for regular public transport (i.e. commercial flight operations on fixed schedules and specific routes available to the general public) and does not include charter operations.

Monthly capacity and passenger numbers in September 2020 were down 81 and 87% respectively compared to September 2019. The greater decrease in passenger numbers results in a lower average load factor. Through 2019, each flight was 79% occupied on average. This figure fell to 28% in April 2020 as governments' introduced movement restrictions and flights began to be driven more by government subsidies than passenger numbers. The average load factor remained around at 55–60% in the July–September 2020 period.

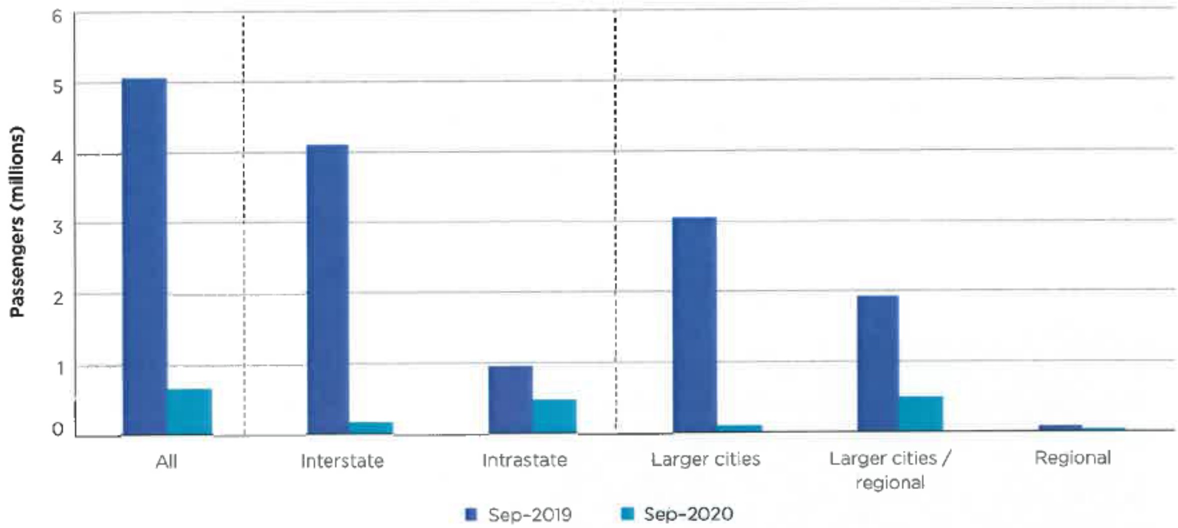
3.2 COVID-19 and associated border closures have changed where people are flying

This year has not only resulted in a significant reduction in the number of overall passengers, but also changed where they are flying. This change has been driven by a mix of border closures, government subsidy programs, airlines reviewing the ability for a route to bring in much-needed cash, and changing passenger demand in a pandemic.

Activity moved away from the 'golden triangle' to holiday destinations in northern Australia

The Australian domestic aviation sector is typically heavily dominated by interstate routes between the larger capital cities. Figure 2 shows that in September 2019, 81% of all passengers flew interstate. However, the chart also illustrates how the sector has moved towards intrastate flights in September 2020 in response to border closures. Intrastate flights accounted for 76% of all passengers in September 2020.

Figure 2 Monthly passenger numbers by route category—September 2019 and September 2020



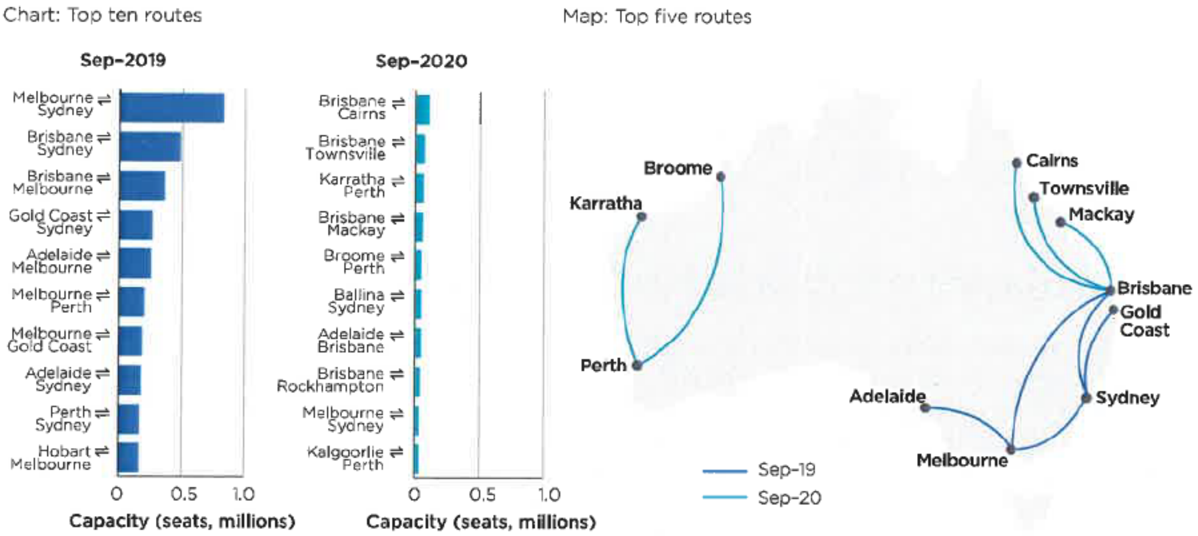
Source: Data collected by ACCC from Qantas, Virgin Australia and Rex.

Note: 'Larger cities' are Sydney, Melbourne, Brisbane, Adelaide, Perth, Canberra and the Gold Coast. Remaining locations are considered to be 'regional'.

Figure 2 also provides a breakdown of routes by classifying locations into larger cities and regional destinations. It shows that while fewer people travelled to regional destinations than larger cities pre-COVID (September 2019), routes containing a regional destination have been more resilient this year (September 2020) than travel between the larger cities.

Figure 3 shows the busiest routes (by capacity) in September 2019 and September 2020. It depicts a significant transition from the 'golden triangle' between Sydney, Melbourne and Brisbane to intrastate routes reflecting demand for leisure travel within Queensland and Western Australia.

Figure 3 Busiest routes by monthly capacity—September 2019 and September 2020



Source: Data collected by ACCC from Qantas, Virgin Australia and Rex.

With border restrictions easing, it is likely that the mix of busiest routes will shortly begin to reflect the pre-COVID situation with Sydney-Melbourne-Brisbane routes again at the top of the list. The airlines report a recent surge in demand for flights out of Melbourne, following the reopening of Victoria's borders.[18] Leisure routes are also expected to be the first to show signs of recovery as people seek out domestic holidays in lieu of overseas travel, as well as catching up with family and friends that had been behind closed borders earlier in the year.

Some airlines scaling back routes, others expanding

Each of the major airlines have been actively reviewing their domestic network in response to COVID-19 and subsequent border closures. Although each of the respective airlines have reduced their weekly flights, they have also increased services on select routes, or expanded into new routes. Some new services may be short-lived if the intent was to bypass an airport in a state subject to a border closure, though other new services may represent new strategies for the respective airline and therefore may be longer lasting.

Virgin has been particularly active in modifying its network. It has discontinued its Tigerair subsidiary, consolidated its domestic airline fleet to Boeing 737s and has exited some smaller routes, including flights to Uluru, Albury and Tamworth.[19] It has also received interim authorisation to coordinate services with Alliance in the short term in order to maintain services on regional routes.

Airlines including Rex and Alliance are expanding their services. These two airlines have taken advantage of a depressed industry in order to boost their fleet of aircraft at lower cost.[20] Rex announced its entry into the Sydney-Melbourne-Brisbane triangle, and has been in discussions to provide services on some routes that Virgin has exited.[21] Alliance has expanded into regular passenger transport routes between Canberra, the Sunshine Coast, and Cairns.[22]

18 Qantas, *Media Release: Qantas and Jetstar help loved ones reunite as NSW/VIC border opens*, 23 November 2020; Virgin Australia, *Media Release: Virgin Australia flights to Queensland take-off as travel opens to Victorians*, 25 November 2020.

19 Virgin Australia, *Media Release: Virgin Australia Group announces plan to focus on core strengths, re-establishing itself as an iconic Australian airline*, 5 August 2020; Virgin Australia, Media Release, 9 September 2020, sourced from CAPA.

20 Regional Express, *Media Release: Rex locks in six Boeing 737-800 NG for domestic jet operations*, 30 September 2020; Alliance Aviation Services, ASX release—Alliance Aviation expands fleet with acquisition of 14 Embraer E190 aircraft, 3 August 2020.

21 Regional Express, *Media Release: Rex update on regional routes abandoned by Virgin Australia*, 23 September 2020.

22 Canberra Airport, *Media Release: Sunshine Coast flights take-off from Canberra Airport*, 23 October 2020.

Qantas reduced the quantity of flights on most routes, however it continues to operate most of its pre-COVID network unless routes are subject to border closures. Additionally Qantas has expanded into several new routes including:

- Brisbane–Port Macquarie[23], which was previously serviced by Virgin
- Sydney–Orange and Sydney–Merimbula[24] in competition with Rex
- Canberra to Sunshine Coast, Cairns, and Hobart[25], which have also attracted entry by some smaller airlines.

3.3 Market concentration has increased

Market concentration can be a useful indicator of the level of competition in an industry, which in turn reflects the pressure that a supplier can feel with regards to pricing or improving their service offering. An industry with significant economies of scale such as air passenger transport is unlikely to have a large number of competitors. However, an airline may also feel competitive pressure from the threat of competitors entering a particular route in the future.

The majority of Australian domestic routes are serviced by a single airline group. This characteristic of the industry reflects both the size of the country and the number of routes connecting regional destinations, which do not necessarily have the patronage to support multiple carriers. This means that airline groups serving these routes would likely have little competitive pressure to drive performance. However, some of these routes are state government 'regulated' routes, where there may be competition between airline groups in the tender process to operate the route as the sole airline for a fixed period.

Figure 4 depicts data collected from Qantas, Virgin and Rex, which indicates that 92 routes were serviced by a single airline group in September 2019.[26] This compares to 66 routes on which there were two airline groups in operation, and three routes on which there were all three. Fewer routes were being serviced in September 2020 relative to September 2019. However the proportion of routes serviced by a given number of airline groups did not change significantly, about 60% of routes continue to be serviced by one airline group. In some cases, an airline group has exited a route, leaving its competitor as the sole operator. In other cases, the sole airline group serving the route has suspended services.

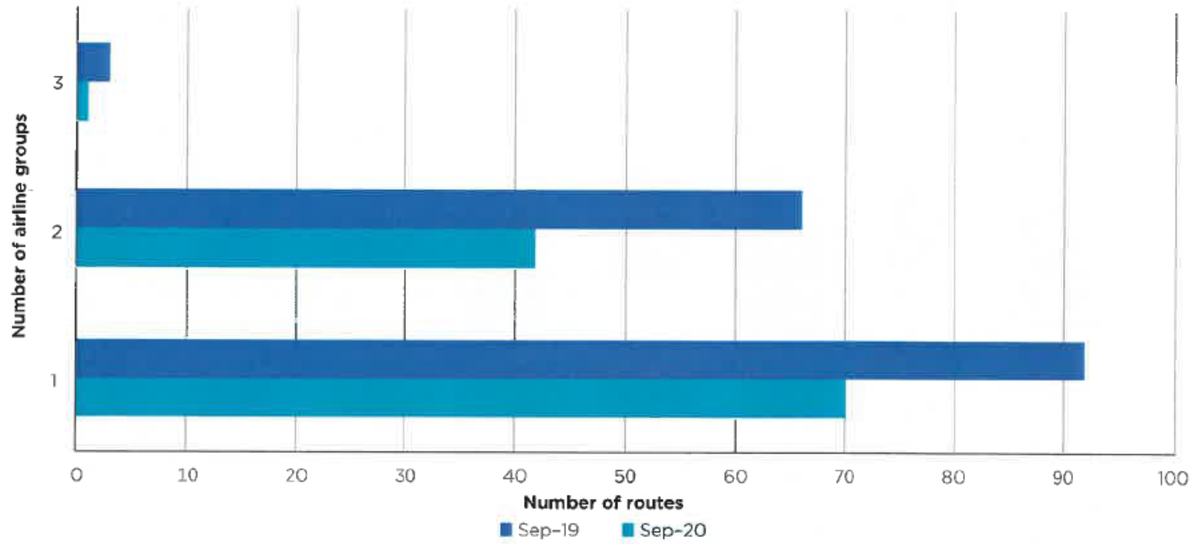
23 Qantas, *Media Release: Qantas to boost regional flights with new Brisbane-Port Macquarie service*, 10 September 2020.

24 Qantas, *Media Release: From the beach to the bush: Qantas launches two new NSW routes*, 1 July 2020; Qantas, *Media Release: Qantas to launch flights to Merimbula in time for summer*, 9 October 2020.

25 Qantas, *Media Release: Qantas adds three new routes from Canberra*, 6 November 2020.

26 Classifying multi-stop flights as a single route.

Figure 4 Number of airline groups by route—September 2019 and September 2020

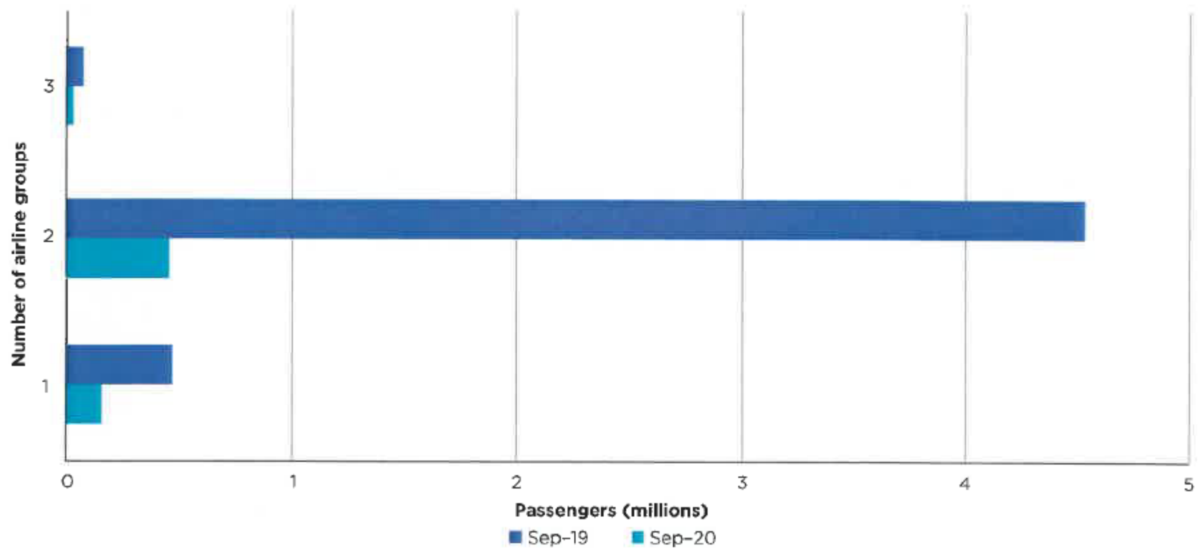


Source: Data collected by ACCC from Qantas, Virgin Australia and Rex.
Note: Multi-stop flights are treated as single routes.

The Qantas Group (including Jetstar) operated on 114 domestic routes in September 2019, the largest of any domestic airline. Virgin (including Tigerair), operated on 74 domestic routes in the same month, whilst Rex operated on 45 routes. By September 2020, Virgin had reduced its operating routes to 39, a reduction of almost half. Qantas and Rex had also reduced their operating routes by 20–30% by September 2020, to 82 and 36 routes respectively.

While the majority of *routes* are serviced by a single airline group, the majority of *passengers* have a choice of airline group they can travel with. This dynamic exists because more passengers fly on routes between major cities on which there are competing airlines. Figure 5 shows that in September 2020, 70% or about 450,000 customers flew on routes with a choice of two airline groups. In the same month, 24% of customers flew on a route operated by only one airline group.

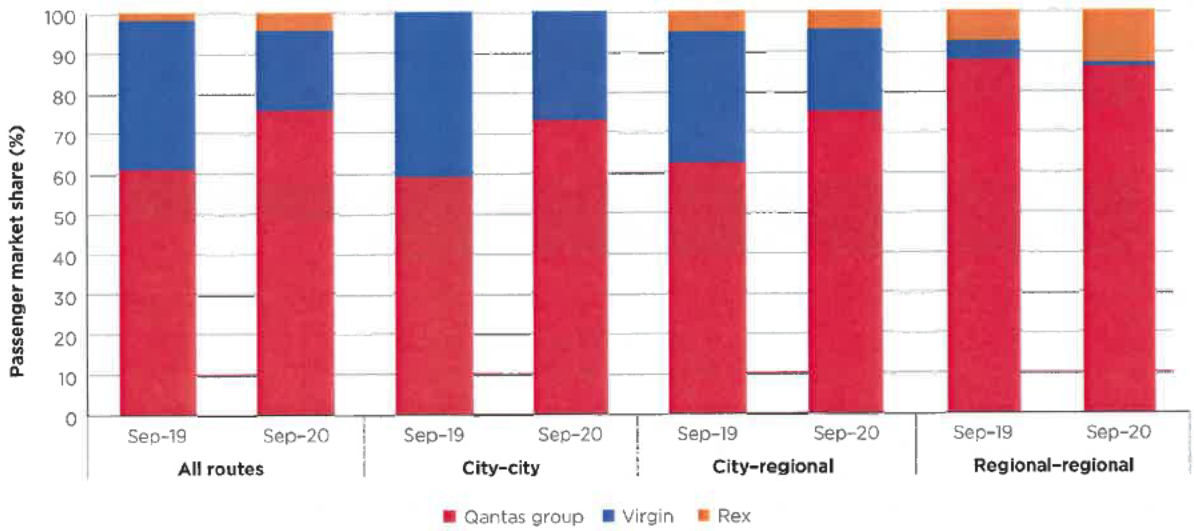
Figure 5 Passenger numbers on routes served by one or more airline groups—September 2019 and September 2020 (millions)



Source: Data collected by ACCC from Qantas, Virgin Australia and Rex.

In September 2019, Qantas carried 60% of all domestic passengers, as shown in figure 6. Its market share was highest on routes between regional airports, with 87% of passengers. On routes between larger cities and regional airports, where it faced the greatest degree of competition from both Virgin and Rex, it was still the dominant airline with 62% of passengers.

Figure 6 Airline group market share by passengers flown—September 2019 and September 2020



Source: Data collected by ACCC from Qantas, Virgin Australia and Rex.
Note: Larger cities (referred to as 'City' in figure 6) are Sydney, Melbourne, Brisbane, Adelaide, Perth, Canberra and the Gold Coast. Remaining locations are considered to be 'regional'.

By September 2020, Qantas' overall domestic passenger market share had increased to 75%. This increase may reflect Virgin's proportionally greater reduction in services as a result of both COVID-19 and its administration process. On intra-regional routes, it has been Rex (rather than Qantas) that has increased its share of passengers at the expense of Virgin.

We expect market shares to exhibit continued volatility in the short term as the industry operates at a fraction of pre-COVID capacity. Qantas expects that as the domestic market recovers, its share will grow from 60 to up to 70% as a result of Virgin reducing its fleet and closing Tigerair.[27] Meanwhile, Virgin has publicly stated that it intends to 'retain a domestic market share of roughly one third (as was pre-COVID)'.[28]

3.4 Airlines are generating significantly lower revenues

Airline industry revenues have declined significantly through 2020 due to commensurate declines in passenger numbers. Industry revenues are expected to recover significantly as interstate travel restrictions ease. However, the ongoing uncertainty with the likelihood of further COVID-19 outbreaks and resultant disruptions to the industry may affect the rate of recovery.

The average revenue per passenger—a proxy measure for the average airfare paid—increased between 2019 and 2020 across the three airline groups. However, this does not mean that airlines have been increasing airfares. The airlines have generated revenues in 2020 from a significantly lower number of passengers flying on a different mix of routes (as highlighted in section 3.2), which will affect average revenue calculations. For example, passenger volumes are down significantly on the Melbourne-Sydney route, which has a lower average fare than the network average. Monthly revenues per passenger are expected to fluctuate as the industry recovers and the mix of routes flown reverts to a greater emphasis on interstate travel. More detailed public information on the movement in domestic airfares can found on the Bureau of Infrastructure, Transport and Regional Economics (BITRE) website.

27 Qantas, *Qantas Group FY20 financial results—navigating exceptional conditions*, 20 August 2020.
28 Virgin Australia, *Media release: Ready for take-off: Virgin Australia Group soars out of administration, unveils future direction*, 18 November 2020.

4. Overcoming barriers to competition

4.1 Opportunity to stimulate competition through the way that slots at Sydney Airport are managed

Slots are an essential input for airlines looking to provide air passenger services. At slot-constrained airports, such as Sydney Airport, access to slots is a key barrier to entry and expansion.

As outlined in section 2.4 of this report, Rex is continuing to progress its plans to expand into major domestic routes. In expanding its services to include routes between Sydney and Melbourne, Rex is relying on access to peak period[29] slots at Sydney Airport. Rex has secured slots for its launch in March 2021, which falls at the end of the current slot season, and is continuing to negotiate access to peak period slots for the following slot season commencing in April 2021. Access to adequate peak period slots will be a key consideration for Rex as it continues to roll-out its expansion plans.

The government has initiated a review of demand management at Sydney Airport, which will include consideration of the slot management scheme

In November 2020, the Australian government released the Sydney Airport Demand Management: Discussion Paper[30] as the first step of conducting a comprehensive review of demand management at Sydney (Kingsford Smith) Airport.

A key purpose of the review is to consider whether the Sydney Airport slot management scheme remains appropriate, including in light of recent changes to the Worldwide Slot Guidelines and the Worldwide Airport Slot Guidelines, many of which were designed to address competition issues.

In the ACCC's September 2020 *Airline Competition in Australia report*[31], slot hoarding was identified as one of the behaviours that might damage competition in the air passenger services market/s. Sydney Airport is Australia's busiest airport, key hub and international gateway. Access to slots at the airport is crucial for airlines seeking to compete in the Australian air passenger services market/s, such as Rex.

The ACCC's submission highlights ways in which slot management can impede competition

The ACCC has made a submission to the review, focussing on two interrelated ways in which the existing slot management scheme can impede competition:

1. Rules that allow airlines to retain slots in perpetuity limit opportunities for new or expanding airlines to acquire slots needed to launch new services and compete.
2. Airlines are able to exploit the scheme by acquiring and hoarding slots for strategic reasons, resulting in inefficient slot use and further diminishing opportunities for increased competition.

Changes to the slot management scheme should ensure the most efficient use of slots and foster an environment of robust competition

The ACCC considers that a fundamental objective of any reform to the existing slot management scheme should be to ensure that the allocation of Sydney Airport slots results in the most efficient utilisation of slots and fosters an environment of robust competition between airlines.

The legislation governing Sydney Airport's slot management scheme is outdated and does not reflect contemporary worldwide slot management practices. We consider it is important that the scheme is

29 Peak period is defined as 6–11 am and 3–8 pm, Monday to Friday.

30 Available at: https://www.infrastructure.gov.au/aviation/airport/review-sydney-airport-demand-management/files/sadm-discussion-paper.pdf.

31 Available at: https://www.accc.gov.au/system/files/20-29RPT_Airline%20competition%20inquiry_FA.pdf, p. 11.

updated to reflect the objectives of the Worldwide Airport Slot Guidelines, particularly those which go to supporting and enhancing competition between airlines.

The scheme should also be refined to minimise opportunities for airlines to misuse slots and to strengthen compliance monitoring and enforcement of the scheme to deter airlines from engaging in slot misuse.

The ACCC will engage closely with the review of demand management at Sydney Airport and continue to advocate for changes that will enhance competition. As the sector recovers, we will continue to monitor the situation relating to Sydney Airport slots, to identify any signs that access to slots may be hindering competition in the airline industry.

Glossary

The Act	*Competition and Consumer Act 2010* (Cth)
ACA	Airport Coordination Australia. ACA allocates slots for aircraft runway movements at a number of airports including Sydney Airport.
BITRE	Bureau of Infrastructure, Transport and Regional Economics
Chartered flight	A flight that is chartered for a particular journey and is not part of an airline's published schedule.
DANS	Domestic Aviation Network Support. A Federal Government program introduced in response to the COVID crisis in order to fund a minimum number of flights on key domestic routes.
DITRDC	Department of Infrastructure, Transport, Regional Development and Communications
FIFO	Fly-in, fly-out. The commute of people employed in remote areas where they are flown temporarily to the work site instead of relocating permanently.
Full service carrier	An airline that typically offers passengers in-flight entertainment, checked baggage, meals, beverages and comforts such as blankets and pillows in the ticket price.
Golden triangle	Air routes connecting Sydney, Melbourne and Brisbane.
IATA	International Air Transport Association. IATA supports aviation with global standards for airline safety, security, efficiency and sustainability.
Larger city	Sydney, Melbourne, Brisbane, Adelaide, Perth, Canberra and the Gold Coast.
Load factor	The degree to which seats (i.e. capacity) are filled by passengers.
LCC	Low cost carrier. An airline that operators with an emphasis on minimising operating costs and therefore does not provide the full service and amenities in the fare.
RANS	Regional Airline Network Support. A Federal Government program introduced in response to the COVID crisis in order to fund a minimum number of flights on key regional routes.
Regional	Domestic locations other than Sydney, Melbourne, Brisbane, Adelaide, Perth, Canberra and the Gold Coast.
Regulated route	A low volume route for which government regulation limits provision of air services to a single licensed operator in order to provide stability and ensure that the route is serviced.
RPT	Regular passenger transport. Flight operations performed for remuneration and conducted to fixed schedules over specific routes, and on which seats and/or cargo space is available to the general public.
Slot	A permission which enables an airline to schedule a landing or departure at a particular airport during a specific time period.
VARA	Regional airline operated by Virgin Australia.

ACCC
AUSTRALIAN COMPETITION
& CONSUMER COMMISSION

Attachment C

Our ref: PRJ201270

7 December 2020

Director, Productivity Section
COVID Aviation Reforms
Department of Infrastructure, Transport, Regional Development and Communications

By email:

ACCC submission to the review of demand management at Sydney Airport

The Australian Competition and Consumer Commission (ACCC) welcomes the opportunity to provide a submission in response to the Department of Infrastructure, Transport, Regional Development and Communications' (the Department) Sydney Airport Demand Management Discussion Paper (the Discussion Paper).

In summary, our submission makes the following key points:

- demand management at Sydney (Kingsford Smith) Airport plays an important role in supporting and encouraging competition in the aviation industry;
- the existing slot management scheme can impede competition by reducing opportunities for new and expanding airlines to compete and enabling inefficient slot use;
- the fundamental objectives of the slot management scheme should be to encourage the efficient utilisation of slots, provide a level of certainty for airline planning while creating opportunities for new and expanding airlines to access slots, and facilitate competition and the competitive process;
- reform to the slot management scheme should centre around updating the legislation to reflect the objectives of the Worldwide Airport Slot Guidelines (WASG), particularly those relating to enhanced competition, and to strengthen compliance monitoring and enforcement to deter airlines from engaging in slot misuse;
- any interim measures implemented during the COVID-19 pandemic recovery period should ensure equitable access to slots for all airlines, where they can demonstrate that those slots will be used efficiently, and support long term competition in the airline industry; and
- while the price notification regime appears to be protecting regional services as intended, there is merit to the recommendation for commercially negotiated agreements to not be subject to ACCC assessment.

The ACCC monitors the airline and airport sectors

The ACCC is an independent Commonwealth statutory body whose role is to administer the *Competition and Consumer Act 2010* (the CCA) and a range of additional legislation promoting competition, fair trading and regulating national infrastructure for the benefit of all Australians. The ACCC promotes compliance with these laws and, where appropriate, takes action against businesses that contravene the law.

The ACCC also has a number of specific roles in relation to the airport and aviation industries:

- Since the Treasurer's direction in June 2020, the ACCC has been monitoring the prices, costs and profits relating to the supply of domestic air passenger transport services and reporting to Government, pursuant to Part VIIA of the CCA. Through this monitoring role, the ACCC seeks to facilitate and protect competition in the domestic air passenger services industry as it recovers from the impacts of COVID-19.
- The ACCC conducts annual price and service quality monitoring of the four major airports (Brisbane, Melbourne, Perth and Sydney) under Part VIIA of the CCA and Part 8 of the *Airports Act 1996*. This includes monitoring the provision of aeronautical and car parking services at those airports.
- The ACCC has a role in assessing proposed price increases by Sydney Airport (for regional air services) and Airservices Australia under the price notification regime contained within Part VIIA of the CCA.

Demand management at Sydney Airport plays an important role in supporting competition in the aviation industry

Sydney Airport is Australia's busiest airport and key international gateway. Managing access to its limited airside capacity therefore has significant implications for the price, quality and choice of flights available to passengers, as well as the broader economy that benefits from domestic and international travel.

A competitive air passenger transport industry is vital to meet the needs of consumers and the economy more broadly, especially for a large country as geographically dispersed as Australia. Access to Sydney Airport is crucial for airlines seeking to compete in the Australian air passenger services market/s, and the constraints on capacity at the airport at peak periods create difficulties for airlines looking to compete.

The ACCC considers that a fundamental objective of any reform to the demand management regime at Sydney Airport should be to ensure that the mechanisms of the regime support and encourage a competitive aviation industry.

The slot management scheme should provide all airlines with equitable access to slots

Slots are an essential input for airlines looking to provide air passenger services. At slot-constrained airports, such as Sydney Airport, access to slots is a key barrier to entry and expansion.

Sydney Airport is slot-constrained during peak hours, making it difficult for airlines to access the slots needed to provide competitive services. It is important that any reform to the slot management scheme ensures equitable access and efficient allocation of slots to airlines, and ultimately supports and encourages a competitive airline industry.

The slot management scheme should provide all airlines with equitable access to slots, regardless of their existing slot holdings, where they can demonstrate that those slots will be used efficiently. It is important that any measures implemented under the regime have the objective of supporting competition and the competitive process, not individual competitors.

Competition can be impeded through inefficient slot allocation and incentives to hoard slots

Competitive markets ensure better outcomes for consumers including through greater choice, lower prices and better quality products and services. As identified in the Productivity Commission's 2019 report into the economic regulation of airports[1], the existing legislated slot management scheme can restrict competition.

The ACCC considers that the existing slot management scheme can impede competition in two interrelated ways:

1. Rules allowing airlines to retain slots in perpetuity exacerbate capacity constraints by limiting the opportunities for new or expanding airlines to acquire slots needed to launch new services and compete.
2. Airlines are able to exploit the scheme by acquiring and hoarding slots for strategic reasons, such as to prevent competitors' access to slots, resulting in inefficient slot use and further diminishing opportunities for increased competition.

Under the existing slot management scheme, slots are allocated to airlines through an administrative process on the basis of historical precedence. Historical precedence gives the airline an indefinite right to retain a slot series in subsequent seasons so long as they satisfy the 'use it or lose it' and 'size of aircraft' tests in the previous equivalent scheduling season. While historical precedence provides airlines with certainty around their future slot holdings, which supports the airlines in their network planning, this system tends to reinforce the market power of incumbent airlines and hinders opportunities for future competition by new or expanding airlines.

In recent years, there have been growing concerns within industry that airlines have been able to exploit the slot management scheme to hoard slots and/or use slots inefficiently to maintain their market power and prevent entry or expansion by competitors. The concerns here are twofold: 1. that incumbent airlines lack the incentive to use slots efficiently, and 2. that incumbent airlines may have an interest in exploiting the slot allocation system so as to prevent competitors' access to slots for strategic reasons. As a result, competition between airlines can be reduced, resulting in higher airfares, lower quality service and less choice for consumers.

Under the current system, where slots are allocated to airlines based on historical precedence, airlines do not bear the scarcity value of their slot holdings. Where capacity constraints increase over time, the value of slot holdings also increase, giving the airlines an incentive to retain slots even if they are not being efficiently utilised. Airlines have a further incentive to hold onto slots given that, once relinquished to the slot pool, a competing airline will likely acquire the slot and gain historical precedence. This makes it very difficult for the original airline to re-acquire that slot again in future, reducing the original airline's ability to provide additional services in the long term.

Airlines can exploit the slot management scheme by applying for more slots than they need in order to prevent competitors or potential competitors from accessing those slots. By ensuring that they meet their obligations under the 'use it or lose it' and 'size of aircraft' tests, the airlines can retain historical precedence to those slots in subsequent scheduling seasons even though the slots could potentially be used more efficiently by another airline.

[1] Productivity Commission, *Economic Regulation of Airports,* Report no. 92, p. 255.

Holding onto slots for the purpose of gaining an anticipated value increase of slot holdings, to entrench market power and/or to restrict competitors' access to slots, can mean that slots are not used efficiently. This results in an overall loss in the productivity of the airport, decreases the value of slots for consumers and inhibits competition in the airline industry.

Changes to the slot management scheme should ensure the most efficient use of slots and foster an environment of robust competition

The ACCC considers that a fundamental objective of any reform to the existing slot management scheme should be to ensure that the allocation of Sydney Airport slots results in the most efficient utilisation of slots and fosters an environment of robust competition between airlines.

As outlined in the Discussion Paper, the legislation governing Sydney Airport's slot management scheme is outdated and does not reflect contemporary worldwide slot management practices. In particular, the scheme has not been updated following recent changes to the Worldwide Slot Guidelines (WSG) and the Worldwide Airport Slot Guidelines (WASG), including those designed to address competition issues.

From the ACCC's perspective, any changes to the slot management scheme should have a strong focus on supporting a competitive airline industry and, in particular, should seek to:

- reflect the objectives of the WASG, particularly those which go to supporting and enhancing competition
- minimise opportunities for airlines to engage in slot misuse, including those actions identified by the WASG as misuses of slots
- strengthen compliance monitoring and enforcement of the slot management scheme, including by increasing public transparency around such activities where appropriate, to deter airlines from engaging in slot misuse.

In addition, there may be benefits to implementing measures that create financial incentives for airlines to use slots efficiently. For example, airlines may be deterred from engaging in inefficient slot use if they face a significant financial penalty for each instance where a slot is not used. It would be necessary to set parameters around such a measure so that airlines would not be penalised for failing to use a slot for reasons outside of their control. Any financial measures that are implemented would also need to be actively monitored and enforced, so that they act as an effective deterrent against inefficient slot use. By imposing financial penalties for inefficient slot use, airlines might more readily return slots that they will not efficiently use. These returned slots would then be available for airlines who wish to enter the market or increase their services.

The ACCC is also supportive of a number of suggestions identified in the Productivity Commission's 2019 Inquiry Report into the Economic Regulation of Airports[2] and in the Discussion Paper which may assist in enhancing competition and encourage the efficient use of slots, including:

- **Strengthen the requirements of the 'use it or lose it' test** – increasing the percentage of slots that must be used by airlines would assist in ensuring slots are used efficiently. In addition to strengthening the test, it would be necessary to implement close monitoring of airlines' use of slots to identify any signs of slot misuse.
- **Revise the definition of a 'new entrant'** – revising the definition of 'new entrant' to have consideration for the landscape of Australia's air passenger services market/s

[2] Productivity Commission, *Economic Regulation of Airports*, Report no. 92, p. 257.

may increase opportunities for smaller airlines to access slots. For example, airlines that may have historically serviced predominantly regional markets may have a number of slots at a major city airport that are used to connect regional communities to the major city. Such airlines may already hold more than four (4) or seven (7) slots for the day at the major city airport and would therefore not fall within the definition of 'new entrant' under the current legislation nor under the WASG. However, such an airline may benefit from having the priority treatment of a 'new entrant' when seeking slots to provide new services outside of the regional network, which in turn could lead to increased competition.

- **Change the definition of a regulated hour** – applying the movement cap by each hour, rather than as a rolling 60-minute period commencing every 15 minutes, may make it more likely that the 80 movements per hour could be practically achieved. This change could also reduce the productivity loss that comes with recovering from flight disruptions and delays necessitated by the movement cap and could reduce the incentive for airlines to hoard slots. When the 80 movements per hour can be practically achieved, there may be increased opportunities for competition as airlines are able to utilise a greater number of slots.
- **Exclude certain flights from the movement cap** – excluding certain flights, such as regional flights and/or those operated by aircraft that fall below a noise threshold, from the movement cap would retain the noise-related policy objectives of the movement cap while increasing the permitted capacity of the airport. Increasing the permitted capacity of the airport would, in effect, increase the potential number of flights in and out of the airport each hour (where any flights beyond the 80 movements allowed under the cap meet the criteria of an *excluded flight*). In turn, this may create opportunities for new entrant or expanding airlines to launch new services (especially during peak periods) in competition with the existing airlines.

The ACCC considers that the suggestions outlined above may assist in increasing the efficiency of slot allocation and utilisation at Sydney airport, and thereby enhance competition in the airline industry. The ACCC acknowledges, however, that any changes to the existing slot management scheme will need to be carefully designed and implemented with appropriate consideration given to practical issues and real world complexities.

Interim measures to support airlines and encourage competition throughout the COVID-19 recovery period and beyond

The COVID-19 pandemic has had a severe impact on airlines, creating some of the most difficult market conditions in Australian aviation history. With demand for travel dramatically reduced, the current time provides a good opportunity to reform the slot management scheme to ensure that in the long term it enhances, supports and fosters an environment of robust competition while providing certainty for airlines.

However, it is also important to consider the short term impacts of any reform to the scheme, and, as outlined in the Discussion Paper, whether additional measures can be taken now to support the airline industry through the COVID-19 pandemic and protect competition in the long term.

Given the uncertainty facing the entire airline industry, it is equally important that existing airlines are provided with certainty around their slot holdings, while at the same time opportunities are provided to new and expanding airlines to introduce new services and compete.

The ACCC considers that it is critical that all airlines, regardless of their existing slot holdings, have equitable access to slots, where they can demonstrate that those slots will be used efficiently. It is important that measures implemented to support airlines through the

COVID-19 recovery period have regard to a key objective of protecting the competitive process.

As noted in the Discussion Paper it is unlikely that any reforms to the review of demand management will be implemented in time for the upcoming NS21 and NW21/22 seasons. In these circumstances, it is prudent to implement interim measures to support the aviation industry while the impacts of the COVID-19 pandemic continue to be felt.

The ACCC supports "Option 4: Reset"

The Discussion Paper puts forward a number of options in relation to slot allocations for the NS21 and NW21/22 seasons. The ACCC's view is that "Option 4: Reset" would create an environment most conducive to supporting and enhancing competition in the industry. The proposal to mandate the return of 20 per cent of slots by an airline that has five or more slots in an hour (with a particular focus on peak periods), would create opportunities for new and expanding airlines to access slots needed to launch new services.

In circumstances where incumbent airlines are not using all of the slots they had prior to the COVID-19 pandemic, and, in particular, where airlines may have had excess slots during peak periods prior to the pandemic, requiring airlines to relinquish inefficiently used slots back to the pool would provide an opportunity for those slots to be used more efficiently by a competing airline.

As a second choice to Option 4, the ACCC would also be supportive of "Option 3: Full or select waiver with conditions". This option may create greater certainty for incumbent airlines, although it is unlikely to result in the most efficient use of slots, particularly where there would be a delay in enabling new or expanding airlines from accessing slots until mid-season. However, in the current environment where airlines appear to be trialling new services as opportunities present themselves, this option would allow for greater flexibility for the incumbent airlines to trial new services.

In establishing any measures to address slot allocation during the COVID-19 pandemic recovery period, the ACCC agrees that it is important that specific consideration is given to slots previously used for international services to ensure these slots will continue to be available for international services once international travel returns.

A Pandemic Recovery Pool of slots could encourage efficient slot use

The ACCC would be supportive of creating a Pandemic Recovery Pool of slots if it results in the most efficient allocation and utilisation of slots while providing all airlines with equitable access to slots.

A Pandemic Recovery Pool may be beneficial if it creates opportunities for airlines to temporarily use slots differently to how they may have been used prior to the COVID-19 pandemic. For example, it may be beneficial to temporarily re-allocate international slots for domestic or regional services during the COVID-19 recovery period. Likewise, it may assist airlines to use smaller aircraft to service new regional routes out of slots historically used for domestic or international services operated by larger aircraft. It would be important to include conditions that require a re-evaluation of slots at the dissolution of any Pandemic Recovery Pool to ensure they are used as efficiently as possible once flying starts to recover to pre-COVID levels.

Allowing airlines to temporarily use slots to best suit the current situation will lead to more efficient use of slots and greater opportunities for competition in the short term, while conditions around those slots will assist in restoring maximum productivity in the long term. The transition from Pandemic Recovery Pool arrangements to normal arrangements would need to be managed carefully to avoid circumstances where airlines are able to use pool slots to expand services and slots airlines rely on for their expanded services are no longer available once the pool arrangements conclude.

The price notification regime

Sydney Airport's provision of aeronautical services to NSW regional airlines are declared services under the price notification provisions under Part VIIA of the CCA.[3] This means that the airport must notify the ACCC should it wish to increase the price of those services. The ACCC must then consult publicly on the proposal and determine whether it will object. While an objection does not prohibit a price increase, it is very rare for a business to go ahead with its proposal if the ACCC has objected.

The CCA sets out the matters to which the ACCC must have particular regard when conducting its assessment. For price notifications generally, the ACCC considers that these matters will normally be satisfied by economically efficient prices, which reflect an efficient cost base and a reasonable rate of return on capital.[4]

In its assessments, the ACCC is also required to have regard to any specific directions by the government. In relation to Sydney Airport, a government direction states that the total revenue-weighted increase in prices should not exceed the increase in the Consumer Price Index.[5]

The purpose of the price notification regime is to bring transparency to those markets where, in the view of the Minister, competitive pressures are not sufficient to achieve efficient prices and protect consumers. In the case of Sydney Airport, the combination of the price notification obligations and the protection of slots for regional services help to ensure that regional services will continue to operate in sufficient numbers out of the airport. This reflects a social objective for regional communities to maintain access to Sydney for purposes such as access to services and the promotion of social connectivity.

The regime appears to be working as intended

Sydney Airport has lodged three price notifications with the ACCC since 2002. The ACCC did not object to notifications lodged in 2002 and 2013 because they related to pricing restructures that were unlikely to result in price increases.

Of greater relevance is the ACCC's decision to object to a price notification in 2010. The airport proposed to increase charges by up to 2.9 per cent for the provision of various services including terminal access, check-in, runway access and apron parking. The ACCC objected to the proposal despite recognising that prices had not increased since 2001. It recognised that there had been strong growth in the number of passengers on regional services over this time, which had the effect of increasing the airport's revenues. The ACCC was not satisfied that the costs of providing services to regional airlines had increased to the extent that a price increase was required.

The outcome of the price notification regime has therefore been that charges for regional airlines have remained constant in nominal terms for almost two decades, representing a fall of 33.7 per cent in real terms. In contrast, average aeronautical revenue per passenger (a proxy for average charge) at the airport across all services has increased by 38.8 per cent in real terms since 2001-02.

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[3] See *Competition and Consumer (Price Notifications—Aeronautical Services to NSW Regional Airlines) Declaration 2019*.

[4] ACCC, *Statement of regulatory approach to assessing price notifications under Part VIIA of the* Competition and Consumer Act 2010, March 2017, p. 12.

[5] See *Competition and Consumer (Prices Surveillance—Aeronautical Services to NSW Regional Airlines) Direction 2019*.

It is reasonable to conclude that this outcome has contributed to the objective of maintaining regional services at the airport. While profitability of a route is impacted by a number of factors and costs, a reduction in airport charges of this extent is likely to have a material impact on whether some marginal routes continue to be offered. In this regard, Rex has stated that airport charges across its whole regular passenger transport network represented 16.7 per cent of its operating expenses in FY2018.[6]

The Discussion Paper noted the significant disparity in charges for regional and non-regional services, and suggested that it may be appropriate for the next determination to allow for the gap to close somewhat over time. In considering this proposal, it is relevant to acknowledge that it is unlikely that the current arrangements have resulted in artificially low prices for regional services. The ACCC objected to the proposed price increase in 2010 because it did not consider that the price increase was required for Sydney Airport to recover its efficient costs. Furthermore, if there had been a material change in these factors since then, Sydney Airport would have again sought a general price increase through a subsequent price notification.

Rather, the large disparity in charges between regional and non-regional services is due to significant increases in the latter. As recognised by the Productivity Commission in its recent review of airport regulation, Sydney Airport has significant market power in the provision of aeronautical services due to its geographic monopoly.[7] Despite this market power, the airport does not face an effective regulatory constraint over its ability to increase its prices. While the ACCC does not consider that the price notification regime should be extended to a broader range of Sydney Airport's services, it did submit to the Productivity Commission review that commercial arbitration may be able to help address the market power of the major airports.[8]

Potential changes to the regime

The price notification regime appears to be operating as intended and contributing to the government's objective to protect regional air services. As a result, there does not appear to be a need to make wholesale changes to the regime.

The ACCC's view is that implementing the Productivity Commission's recommendation that commercially negotiated agreements between Sydney Airport and regional airlines not be subject to price notifications would strengthen the price notification regime, and address stakeholder concerns about the disclosure of commercially sensitive information as part of the ACCC's assessment process.

This proposal is unlikely to weaken the protection of regional services because airlines that do not have a commercial agreement with the airport will continue to be charged notified prices. It is also envisaged that notified prices will also provide an anchor point for prices negotiated between airlines and the airport.

Further consultation and engagement

The ACCC welcomes further engagement and consultation on these issues and would be pleased to speak with you to discuss any questions or concerns.

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[6] Regional Express (Rex), *Response to the Productivity Commission Draft Report on the Economic Regulation of Airports*, March 2019, p. 10.

[7] Productivity Commission, *Economic Regulation of Airports,* Report no. 92, p. 11.

[8] ACCC, *Productivity Commission Inquiry into the Economic Regulation of Airports—ACCC Submission in Response to the Issues Paper*, September 2018, p. 4.

Yours sincerely

Rod Sims
Chair