AUSTRALIAN COMPETITION & CONSUMER COMMISSION

Airline competition in Australia

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Australian Competition and Consumer Commission
23 Marcus Clarke Street, Canberra, Australian Capital Territory, 2601

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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 2010* (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*

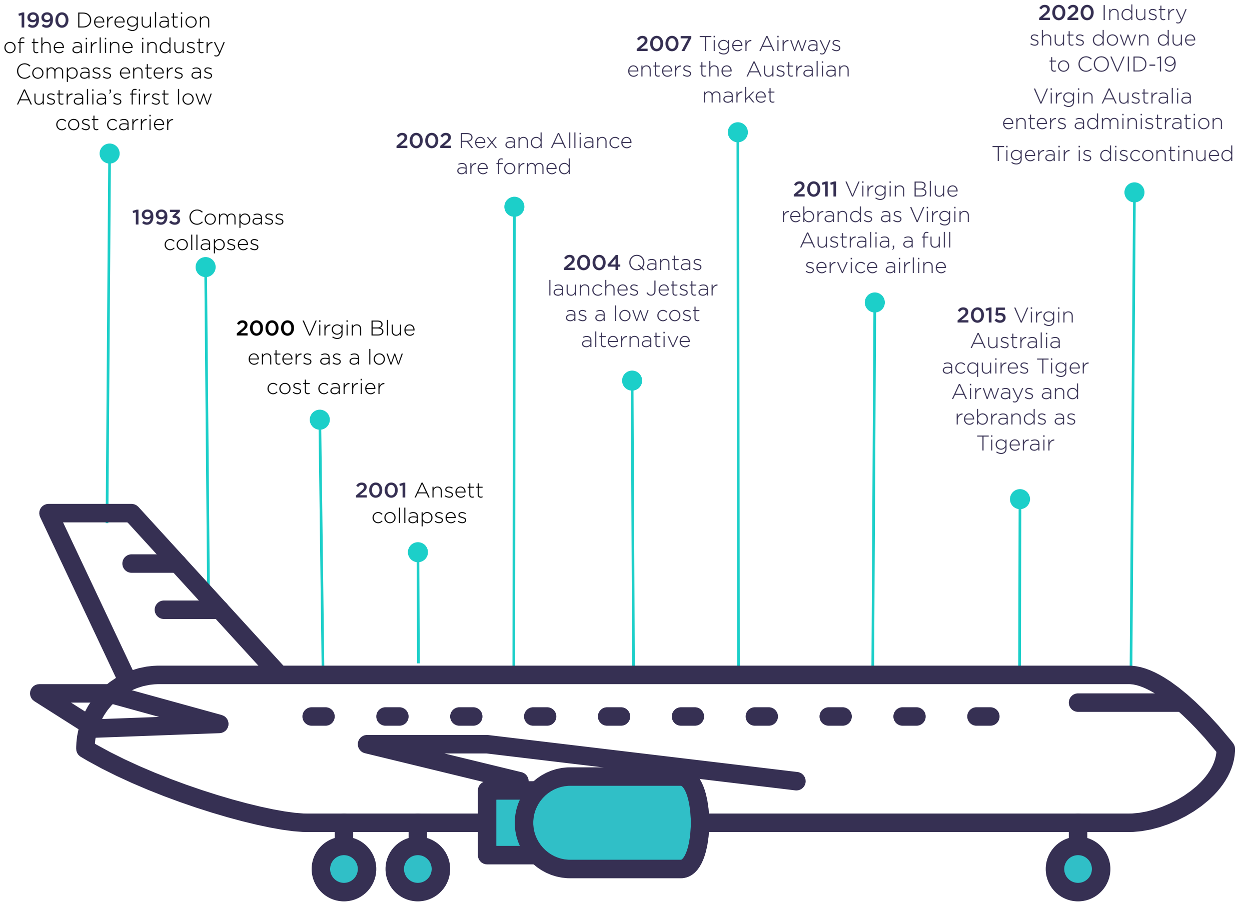
2 The Hon Josh Frydenberg MP (the Treasurer), *ACCC directed to monitor domestic air passenger services*, media release, 19 June 2020.

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



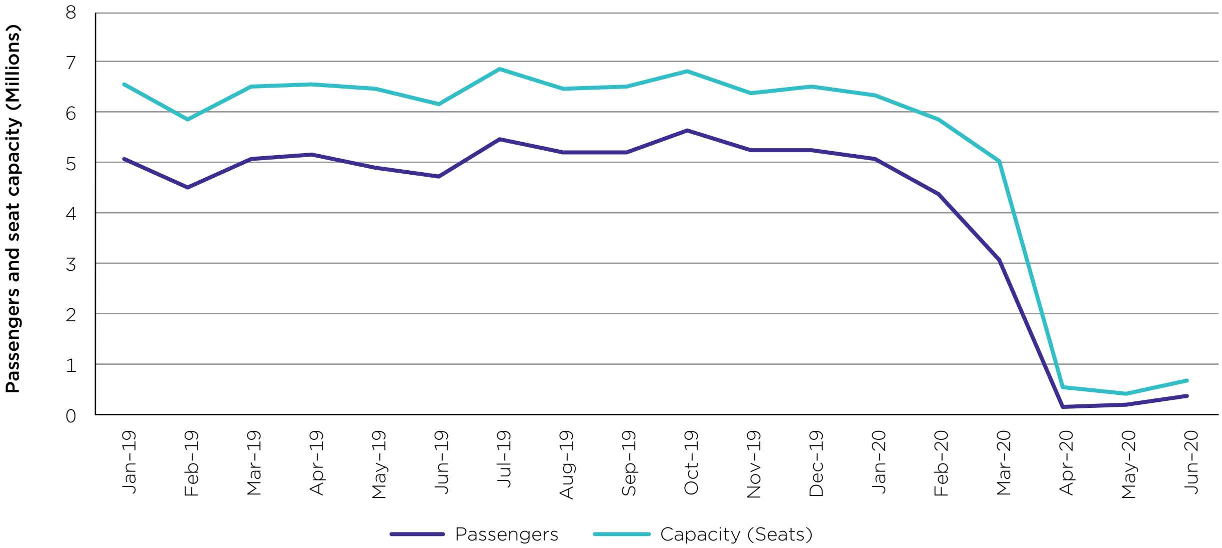
Prior to the COVID-19 pandemic, the Australian domestic passenger sector was in many respects a duopoly between Qantas Group and Virgin Australia. Qantas Group accounted for around 60 per cent of the sector across its Qantas and Jetstar brands, while Virgin Australia accounted for around a third of the 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.

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.

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.

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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.

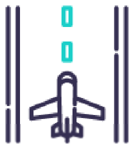
Figure 3 Key messages from the airlines about the current state of the industry

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.

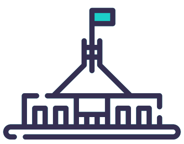


Barriers to entry: a key barrier to entry or expansion into the domestic network is access to slots at slot-constrained airports where demand exceeds capacity.

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.

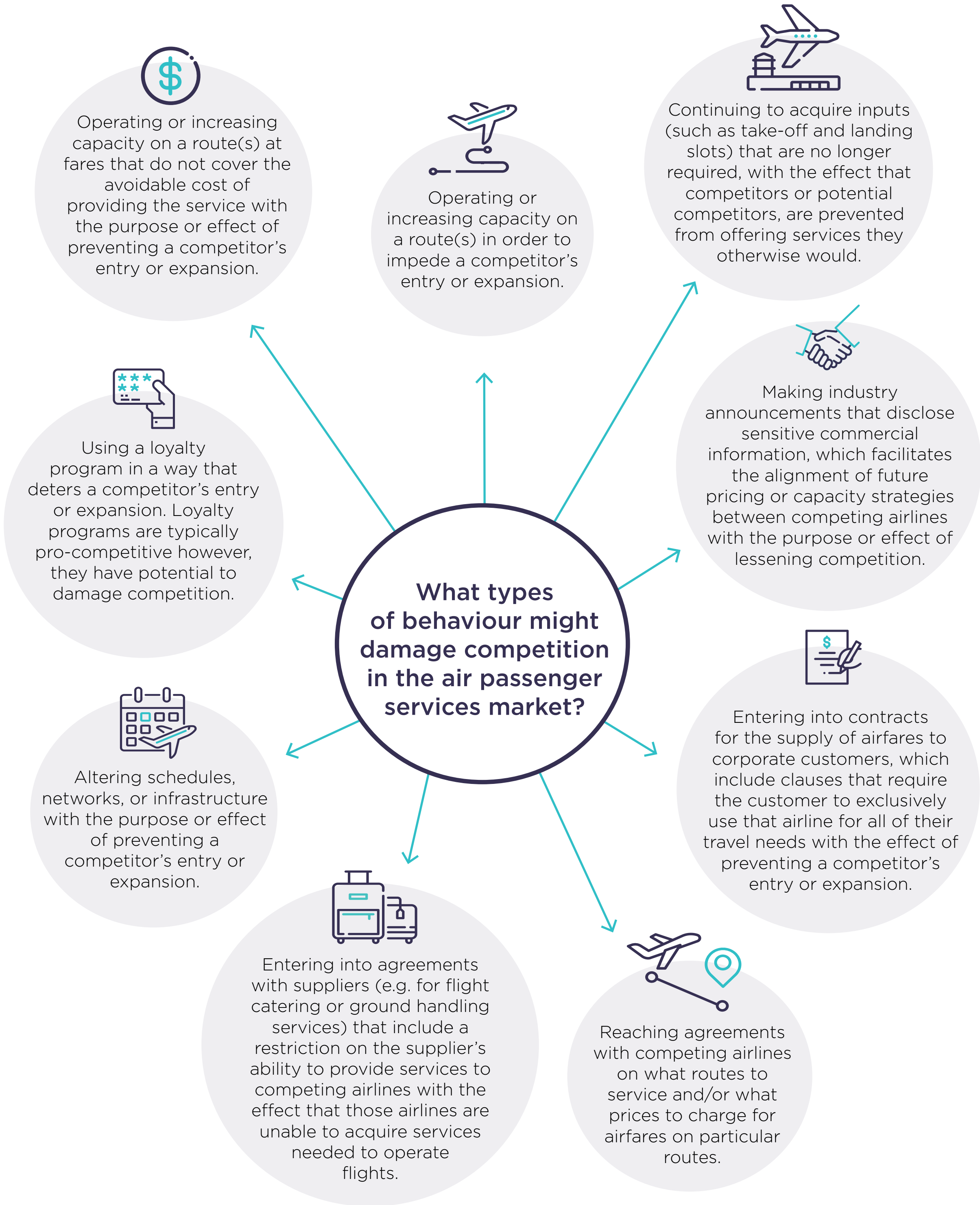
Hoarding of airport slots

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.