AUSTRALIAN COMPETITION & CONSUMER COMMISSION

Airline competition in Australia

Report 5: September 2021

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Australian Competition and Consumer Commission
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Glossary

ACL	Australian Consumer Law, at Schedule 2 of the Act
The Act	*Competition and Consumer Act 2010* (Cth)
ASK	Available seat kilometres
BITRE	Bureau of Infrastructure and Transport Research Economics
DANS	Domestic Aviation Network Support. An Australian Government program introduced in response to COVID-19 in order to fund a minimum number of flights on key domestic routes
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
Qantas Group	Qantas domestic passenger airlines, that relevantly includes Qantas, QantasLink and Jetstar airlines
RANS	Regional Airline Network Support. An Australian Government program introduced in response to COVID-19 in order to fund a minimum number of flights on key regional routes
RDAC	Retaining Domestic Airline Capability. An Australian Government program introduced in response to COVID-19 to assist airlines retain their frontline employees, and other domestic aviation capabilities
Regional	Domestic locations other than Sydney, Melbourne, Brisbane, Adelaide, Perth, Canberra and the Gold Coast
Slot	A permission which enables an airline to schedule a landing or departure at a particular airport during a specific time period
TANS	Tourism Aviation Network Support. An Australian Government program introduced in response to COVID-19 to reduce the costs for consumers flying to key tourism regions
VARA	Virgin Australia Regional Airlines. A regional airline operated by Virgin
Virgin	Virgin domestic passenger airlines that relevantly includes Virgin and VARA airlines. It previously operated Tigerair until March 2020.

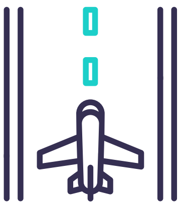
Key industry insights and developments

COVID-related movement restrictions shut down the majority of domestic flying

Movement restrictions related to outbreaks of the Delta strain of COVID-19 have significantly hurt domestic aviation across the country. Airlines were forced to cancel 1 in 3 flights in July 2021 as capacity dropped to 23% of pre-pandemic levels.

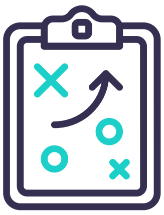
Sydney not in top 10 busiest routes while Queensland intrastate routes dominate

For the first time ever, routes in and out of Sydney were not among the top 10 busiest routes, in July 2021. Intrastate routes in Queensland were among the busiest, including Brisbane to Cairns, Townsville and Mackay.



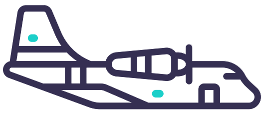
Proposed reforms to take-off and landing slots at Sydney Airport likely to help airline competition

The Australian Government published a report by Peter Harris following his review of the scheme for managing airline use of Sydney Airport. The ACCC supports recommendations that make it difficult for airlines to keep more take-off and landing slots than they need, which should free up slots for new and expanding airlines.



Virgin’s recent announcements reflect new competitive direction

Virgin has introduced a cheaper lead-in ticket without check-in baggage and seat selection inclusions, similar to Jetstar’s lead-in offering. Virgin also announced its top tier loyalty program will be rebooted early next year, with 3 of its 5 premium lounges to be reopened.



Many regional communities miss out on the benefits of airline competition

Air services provide important connectivity for regional communities, but most regional routes are not of sufficient size to support competing airlines. Qantas has extended its dominance on regional routes since COVID-19, in part due to Virgin reducing its regional network.

Overview

From mid-2021 most of the domestic airline industry once again came to a standstill as a result of COVID-19 and movement restrictions to stop its spread.

The disruption came shortly after the airlines were beginning to report activity approaching pre-pandemic levels. After passenger numbers peaked in April 2021 at 68% of pre-pandemic levels, this fell to just 23% in July 2021, the most recent data collected by the ACCC.[1] The number of passengers that flew in August and September is likely to be even lower. Airlines were forced to cancel 1 in 3 flights in July 2021, a rate only previously surpassed in April 2020.

The Qantas Group, Virgin and Rex have all announced temporary stand downs until flying can resume. These industry conditions could last for some time with key state borders expected to remain closed until late 2021. As a result, the government announced new federal assistance with the Retaining Domestic Airline Capability (RDAC) program, and extended a number of existing programs until 31 December 2021.

Both the Qantas Group and Rex recently released annual results containing substantial financial losses following a full 2020–21 financial year of COVID-19. However, airlines are optimistic demand will bounce back quickly once border restrictions can be eased. The Qantas Group has forecast that it will be flying at 110% of pre-pandemic levels in the first half of 2022. Also expecting a peak season of holiday travel, Virgin announced it has leased additional aircraft which are expected to be in the air by February 2022.

With COVID-related movement restrictions in NSW, for the first time ever Sydney was not among the top 10 busiest routes, in July 2021. Intrastate routes in Queensland and WA were among the busiest routes, including Brisbane to Cairns, Townsville and Mackay, and Perth to Karratha.

As movement restrictions lift, the ACCC will be watching for behaviours that may hinder the recovery of the domestic airline industry and of the overall economy. For example, the ACCC has heard concerns from airlines that airports may seek to increase their charges to airlines in order to recover their lost profits from the pandemic. This would be inconsistent with the Australian Government's Aeronautical Pricing Principles and provide a clear example of airports systematically taking advantage of their market power. Such increases in airport charges could damage the vulnerable airline sector's ability to recover, at the expense of both consumers and the economy.

Recent announcements from Virgin have provided further insight into its new competitive direction under owner Bain Capital. Virgin announced a cheaper lead-in fare without check-in baggage and seat selection. Virgin's re-defined lead-in service offering closely aligns with Jetstar's and is consistent with a strategy of expanding its reach to include price sensitive travellers. Virgin additionally announced it will reopen 3 of its 5 premium lounges, and its top tier loyalty scheme will be rebooted next year under new eligibility criteria.

While parts of the domestic airline industry have become more competitive in recent times, the Qantas Group has further extended its dominance in regional areas. The airline group has grown its already expansive regional network reach since COVID-19 struck, launching 13 new regional routes in the June 2021 quarter alone. In contrast, Virgin and Rex have both reduced their post-pandemic regional networks. In June 2021, the Qantas Group carried 70% of passengers flying between a larger city and a regional area, and 87% of passengers flying between two regional locations.

The ACCC continues to investigate Qantas' entry and expansion on certain routes and whether it raises competition concerns.

The Australian Government published a report by Peter Harris after his review of the demand management arrangements at Sydney Airport, which includes consideration of the effectiveness of allocating slots for take-off and landing. The ACCC supports recommendations that make it more difficult for airlines to keep more take-off and landing slots than they need. These recommendations, such as implementing a stronger enforcement and compliance regime, should make more slots available for new and expanding airlines. The ACCC is engaging closely with government on the recommendations, including participating in working groups alongside industry.

1 Throughout this report, pre-pandemic refers to the equivalent month in 2019 unless stated otherwise.

1. Introduction

This is the ACCC's fifth 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 Act to monitor prices, costs and profits relating to the supply of domestic air passenger transport services.

The direction requires 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.[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'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 prioritise investigations about alleged anti-competitive conduct in the domestic passenger airline industry,[3] and will consider 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 finds 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 (including Jetstar), Virgin and Rex. These 3 airline groups supply the vast majority of regular domestic air passenger services in Australia. We 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 our first public report published in September 2020.[4]

2 The Hon. Josh Frydenberg MP (the Treasurer), *ACCC directed to monitor domestic air passenger services* [media release], 19 June 2020, accessed 31 August 2021.

3 Competition issues in the context of the COVID-19 pandemic, including in the domestic air travel market, is an enforcement priority for the ACCC in 2021.

4 ACCC, *Airline competition in Australia – September 2020 report*, 17 September 2020.

2. Industry developments

2.1 COVID-related movement restrictions shut down the majority of domestic flying

COVID-related movement restrictions over the past few months have significantly disrupted the domestic airline industry. While sporadic border closures continued in the first half of 2021, the more pervasive outbreaks caused by the Delta strain arising around the middle of 2021 has brought the majority of flying activity to a stop. Ongoing cases continue to threaten the prospect for meaningful activity until late 2021.

By around May 2021, the industry was close to recovery with domestic airlines forecasting a return to pre-pandemic levels of flying early in the second half of 2021. The Qantas Group reported that Jetstar had reached 102% of its pre-pandemic capacity in May 2021, while Qantas and QantasLink combined reached 86%.[5] Government support provided under the Regional Airline Network Support (RANS) and the Domestic Aviation Network Support (DANS) programs had also dropped back as flying activity returned and routes became ineligible for the funding.

However, circumstances changed in late May with a COVID-19 outbreak in Melbourne. An outbreak of the more pervasive Delta strain led to growing cases in Sydney from mid-June, which later spread to other parts of NSW, and other states including Victoria, the ACT and Queensland.

Airlines were forced to cancel 1 in 3 flights in July 2021, one of the highest rates on record. With lockdowns impacting the majority of Australians, Qantas reported it was operating at less than 40% of its pre-COVID-19 capacity in July 2021.[6] Virgin reported it operated just a quarter of its planned schedule for August 2021.[7] Rex reported it shut down 80% of its business[8] and announced both intercity and regional routes in NSW, Victoria, South Australia, Queensland and Tasmania would be temporarily suspended or greatly reduced until restrictions eased.[9]

The outbreaks in several Australian states and territories, and an outbreak in New Zealand, also resulted in the trans-Tasman travel bubble being paused.

The Qantas Group announced 2,500 Qantas and Jetstar employees would be stood down until domestic borders reopen.[10] Rex announced 500 employees would be stood down until 10 October 2021.[11] Virgin notified its workforce that several staff would be temporarily stood down and/or have reduced hours.[12]

The Australian Government announced new support through the Retaining Domestic Airline Capability (RDAC) program. RDAC provides eligible airlines with $750 per week for frontline employees that are otherwise unable to access COVID-19 disaster payments. Additionally, the government extended a number of existing programs, including extending the Regional Airline Network Support (RANS) and Domestic Aviation Network Support (DANS) programs until 31 December 2021. The government also extended the date consumers can book and travel under the Tourism Aviation Network Support (TANS) half-price ticket program, until 30 November 2021.

5 Based on Available Seat Kilometres (ASKs); Qantas Airways Limited and its controlled entities, 'Preliminary final report for the financial year ended 30 June 2021', 26 August 2021, pp. 11–13; accessed 27 August 2021.

6 Baird, L, Australian Financial Review, 'Stand down spectre looms over airline workers', 22 July 2021, accessed 28 July 2021.

7 Baird, L. Australian Financial Review, 'Virgin and Rex stand down staff', 13 August 2021, accessed 16 August 2021.

8 Torn, A, Australian Aviation, 'Rex says lockdowns have shut down 80% of its business', 13 July 2021, accessed 28 July 2021.

9 Rex, *Rex implements capacity reductions due to COVID restrictions* [media release], 21 July 2021, accessed 28 July 2021.

10 Qantas, *Qantas Group posts significant loss from full year of COVID* [media release], 26 August 2021, accessed 30 August 2021.

11 Rex, *Extension to suspension of services and stand downs* [ASX release], 1 September 2021, accessed 1 September 2021.

12 Baird, L. Australian Financial Review, 'Virgin and Rex stand down staff', 13 August 2021, accessed 16 August 2021.

Movement restrictions may continue to hamper the majority of flying until late 2021 when the majority of the population is expected to be vaccinated. However, the Qantas Group remains optimistic, stating that 'demand from business, along with leisure travel, is expected to bounce back strongly once lockdowns end.'[13] The Group forecasts it will be flying 38% of pre-COVID-19 capacity by the end of September 2021 and 53% by the end of December 2021, before increasing to 110% by mid-2022.[14]

Anticipating an increase in demand as vaccination rates rise and borders reopen, Virgin announced it will lease an additional 9 Boeing 737-800s, bringing its total aircraft to 77.[15] Virgin intends to ramp up capacity over the summer holiday season, with all additional aircraft expected to be flying by mid-February 2022.

2.2 Airports should not significantly increase charges to recover lost profits

As movement restrictions lift, the ACCC will be watching for behaviours that may hinder the recovery of the domestic airline industry. Like other parts of the aviation sector, Australian airports have also experienced substantial falls in revenue due to the lack of domestic and international flying. However, unlike airlines, the large airports face minimal constraints on their pricing because they are effectively unregulated regional monopolies with significant market power.[16]

As part of its monitoring program, the ACCC has heard concerns from some airlines that, as contracts for aeronautical charges are renegotiated over the coming years, airports may seek to significantly increase aeronautical charges to recover their COVID-19 lost profits.

The ACCC considers that such actions would be inconsistent with the Aeronautical Pricing Principles.[17] The Principles outline the Australian Government's expectations for how airport operators should set access charges for aeronautical services. The Principles stipulate that prices should be set so as to allow the airport to recover the costs that it actually incurs, including a risk-commensurate return on investment in providing aeronautical services to its customers. This allowance does not include recovery of lost profits.

Should airports increase their aeronautical charges to recover their losses from COVID-19, this would be a clear example of airports systematically taking advantage of their market power. The ACCC is concerned that such increases in airport charges could damage both the vulnerable airline sector's ability to recover and, therefore, overall economic recovery. Consumers too may suffer, such as by paying higher airfares or missing out on additional competition should airlines decide to withdraw from, or not expand into, a route as a result of the higher charges.

The ACCC will continue to closely monitor airport pricing, including the extent to which the Aeronautical Pricing Principles are being used in negotiations between airports and airlines.

13 Qantas, *Qantas Group posts significant loss from full year of COVID* [media release], 26 August 2021, accessed 1 September 2021.

14 Qantas Airways Limited, 'FY21 results presentation', 26 August 2021, p. 30, accessed 27 August 2021.

15 Virgin Australia, *Virgin Australia finalises new agreements for Nine Boeing 737-800 NG aircraft* [media release], 27 August 2021, accessed 8 September 2021.

16 The ACCC monitors and reports annually on the prices, costs and profits of Sydney, Melbourne, Brisbane and Perth airports. In its submission to the 2019 review by the Productivity Commission of the economic regulation of airports, the ACCC stated that the monitoring regime was not effective in constraining the behaviour of the large airports.

17 The Aeronautical Pricing Principles can be found in: Productivity Commission, *Economic Regulation of Airports*, Report no. 92, 2019, p. 75

2.3 Airlines incur substantial financial losses

Airlines have recently reported substantial losses in their 2020–21 annual results following a full financial year of COVID-19, of which 330 days included domestic travel restrictions. The airlines stated that the industry had never been as 'badly ravaged' in aviation history,[18] and that the pandemic presented 'diabolical'[19] trading conditions.

Qantas Airways Limited reported a $2.35 billion statutory loss before tax for the 2020–21 financial year. This result captures performance across the whole business, including international and domestic flying, freight and the loyalty program. The company reported an $8.3 billion (58%) decrease in total revenue to $5.9 billion in 2020–21.[20]

Qantas Domestic (comprising Qantas and QantasLink) delivered $2.7 billion in revenue in 2020–21, down 41% from the previous year ($4.7 billion). Revenue from Jetstar, which flies both domestically and internationally, fell 62% to $1.1 billion, though the company noted Jetstar delivered a strong performance in the first half of 2021 when there was strong demand for leisure flying prior to the current outbreaks in NSW and Victoria.[21]

Rex reported a $7.2 million statutory loss before tax for the 2020–21 financial year. Revenue fell 20% from the previous year to $256 million. In contrast to Jetstar, Rex performed more strongly in the second half of 2020, noting it received the majority of government support in this period.[22]

While regular passenger air transport has been substantially impacted by COVID-related movement restrictions, a thriving freight and resources market has delivered strong results for some segments. Demand for charter services increased 35.4% in 2020–21 compared with pre-COVID levels.[23] As a result, charter operator Alliance Airlines reported a small increase in revenue for 2020–21 at $306.6 million,[24] while Rex also reported a small increase in charter revenue.[25] Qantas also reported record profits for its freight operations and deployed 11 A320s into WA to meet 'strong resource market demand'.[26]

2.4 Consumer entitlements when a flight is cancelled can differ by airline and ticket

Where COVID-19 disruptions affect airline travel, the particular remedy available to consumers depends on the terms and conditions of the ticket purchased.

All airlines have the same obligations under the Australian Consumer Law (ACL). In ordinary circumstances, consumers are entitled to obtain certain remedies for services not provided by a supplier through the consumer guarantees in the ACL. However, these guarantees are unlikely to apply when an airline cannot fly due to government restrictions. In these circumstances, whether a consumer is entitled to a refund or some other remedy will depend on the airline's terms and conditions of purchase. As a result, the airlines' specific policies and practices can be an important differentiator of service and consequently, an offering on which the airlines compete.

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18 Kim Hai, L, Rex, *Rex announces FY21 results* [media release], 31 August 2021, accessed 1 September 2021.

19 Joyce, A, Qantas, *Qantas Group posts significant loss from full year of COVID* [media release], 26 August 2021, accessed 1 September 2021.

20 Qantas Airways Limited and its controlled entities, 'Preliminary final report for the financial year ended 30 June 2021', 26 August 2021, p. 19, accessed 13 September 2021.

21 Revenue figures includes government support; Jetstar revenue figure includes revenue from Jetstar international operations, however most international operations were grounded in 2020–21; Qantas Airways Limited and its controlled entities, 'Preliminary final report for the financial year ended 30 June 2021', 26 August 2021, pp. 11, 13, 44, accessed 1 September 2021.

22 Revenue figure includes government support; Rex, Appendix 4E, 'Preliminary final report for the year ended 30 June 2021 (previous corresponding period: Year ended 30 June 2020)', 31 August 2021, pp. 1–2, accessed 1 September 2021.

23 Based on FY19 and FY21 passenger numbers, BITRE, 'Aviation: Domestic aviation activity 2020–21', 13 September 2021, p. 24; BITRE, 'Aviation: Domestic aviation activity 2019–20', 2021, p. 24, accessed 15 September 2021.

24 Alliance Aviation Services Limited, 'Annual report 30 June 2021', 11 August 2021, p. 3, accessed 30 August 2021.

25 Rex, Appendix 4E, 'Preliminary final report for the year ended 30 June 2021 (previous corresponding period: Year ended 30 June 2020)', 31 August 2021, p. 2, accessed 3 September 2021.

26 Qantas Airways Limited and its controlled entities, 'Preliminary final report for the financial year ended 30 June 2021', 26 August 2021, pp. 11–12, accessed 1 September 2021.

Each of Virgin, Jetstar, Rex and Qantas have terms and conditions that provide for refunds or credits depending on fare type and specific circumstances of cancellations.

Additionally, the airlines have introduced new policies in response to COVID-19 restrictions and border closures. Rex introduced a 'COVID Refund Guarantee' which expands the circumstances in which it will provide consumers with a refund where travel is affected by COVID-19 disruptions. Rex also added an online portal on its website to facilitate consumer refund requests.[27]

Virgin's 'Flexible Flying' policy allows consumers to make unlimited changes to a booking for travel up to 28 February 2022 without any change/cancellation fees.[28]

Qantas' 'Fly Flexible' policy allows consumers to make unlimited fee-free changes to their date of travel for domestic travel up to 28 February 2022.[29] Under Jetstar's 'Fly Flexible' policy, until 31 December 2021 consumers can make changes to their date of travel, for domestic travel up to 30 June 2023, without any change fees.[30]

Consumers should carefully review the airline's current policies and ticket terms and conditions before booking any travel. Consumers should also consider the costs and benefits of purchasing more flexible fares, which may be more expensive, versus purchasing discounted but more restricted fares. Further, eligibility for remedies may differ where the consumer cancels the booking as opposed to the airline, so consumers should carefully review the relevant terms and conditions before cancelling a booking. In some circumstances, it may be in a consumer's best interests to wait for updates from their airline before taking any steps to cancel their booking.

2.5 Virgin's recent announcements reflect new competitive direction

Virgin has made some recent announcements that shed further light on its new competitive strategy under owner Bain Capital.

In August 2021, Virgin announced that it would begin to offer a new cheaper lead-in ticket that does not include check-in baggage and seat selection.[31] This follows Virgin's previous announcement to remove complimentary meals for economy class. Virgin's re-defined lead-in service offering more closely aligns with Jetstar's lead-in offering, consistent with a strategy to expand its target market to include price sensitive travellers. For both Virgin and Jetstar, check-in baggage, seat selection and food is available for purchase on top of the cost of the respective lead-in fare.

Additionally, Virgin announced its top tier loyalty program 'the Club' will be rebooted and relaunched, with a new name, eligibility criteria and lounge offering that reflects Virgin's 'future direction'.[32] Virgin's premium lounges in Canberra and Perth will be permanently closed, while Melbourne, Sydney and Brisbane will reopen by the end of March 2022, when Virgin expects demand for business travel to have recovered. Membership to Virgin's premium lounges has previously been invitation-only, similar to Qantas' Chairman's Lounges, however this may change when these lounges reopen early next year.

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27 Rex, *Rex COVID Refund Guarantee*, Rex website, accessed 15 September 2021; Rex, *Rex implements capacity reductions due to COVID restrictions* [media release], 21 July 2021, accessed 15 September 2021.

28 Virgin Australia, *COVID-19 (Coronavirus) Customer Hub*, Virgin Australia website, accessed 15 September 2021.

29 Qantas, *Flying, now as flexible as you need to be*, Qantas website, accessed 21 September 2021.

30 Jetstar, *Flying with all the flex you need: Jetstar COVID-19 changes and cancellations*, Jetstar website, accessed 21 September 2021.

31 Virgin Australia, *Virgin Australia onboards new Economy airfares to offer more options and great value* [media release], 19 August 2021, accessed 23 August 2021.

32 Emerson, D, Virgin Australia, *Virgin Australia commits to premium loyalty program and lounges* [media release], 16 August 2021, accessed 31 August 2021.

2.6 Growing price gap between Qantas' and Virgin's corporate airfares

Further evidence of Virgin's new competitive strategy can be found in recent analysis by travel procurement consultant Butler Caroye. The study showed that Qantas' domestic average corporate airfares were higher than Virgin's, and this price gap had widened following the onset of the pandemic and Virgin relaunching as a mid-market carrier in late 2020.[33]

To compete for an increasing share of the business travel segment, Qantas and Virgin offer customised contracts for business and government customers. These corporate contracts provide a range of benefits in exchange for business. Thresholds and benefits differ depending on the size of the customer and nature of the agreement, but generally these arrangements work by rewarding customers with discounted airfares if they meet a particular threshold of volume share and/or expenditure. Corporate contracts are different to an airline offering business class tickets to individuals.

Butler Caroye's analysis found that Virgin's average corporate airfares have decreased by 13% from $222 in the first half of 2019 to $193 in the second quarter of 2021. In contrast, Qantas' average corporate airfares have increased by 9.4%, from $295 to $323 over this same time period. As a result, the price gap between Qantas and Virgin has doubled. This gap was 67.1% in the second quarter of 2021, compared with 32.8% in the first half of 2019.[34]

While this widening price gap may reflect an attempt by Virgin to attract a greater share of the corporate market, it may more likely reflect Virgin's strategic shift towards more value-conscious travellers. If this shift results in Qantas facing less competition at the premium end of the market, customers in this premium segment, including corporate customers, may continue to face increasing prices.

2.7 Proposed changes to take-off and landing slot arrangements at Sydney Airport may help airline competition

Recently proposed changes to the scheme for allocating slots to airlines for taking off and landing at Sydney Airport may promote further competition between airlines.

The framework for regulating airline use of Sydney Airport commenced in 1997. The measures include an overnight curfew, an hourly cap on aircraft movements (i.e. take-off and landing), protection for regional services, and the arrangements for allocating take-off and landing slots to airlines. The framework needs to balance a number of potentially conflicting objectives, including maximising the economic efficiency of the runways and managing the noise impact on the local community.

In June 2021, the Australian Government released a report[35] by former Chairman of the Productivity Commission Peter Harris, who was engaged in late 2020 to review most aspects of the demand management framework for Sydney Airport. The report recommends a number of reforms to help promote competition by assisting new or expanding airlines to obtain slots.

The most significant of these recommendations may be those designed to prevent incumbent airlines from obtaining and keeping more slots than they need. This should make more slots available for new and expanding airlines. The report recommends a stronger system for monitoring compliance by the airlines with the slot-use rules, in particular the requirement to use a slot at least 80% of the time. These recommendations include:

- additional resourcing for the scrutiny of flight cancellations data for services where cancellations materially exceed the average

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33 Butler Caroye, 'Blue paper, July 2021: Australian domestic airfares in 2021', July 2021.

34 Analysis includes the impact of airlines changing the availability of fare types. That is, shifting more seats into a more expensive fare type increases the average fare.

35 Harris, P, *Review of the Sydney Airport Demand Management Scheme*, February 2021.

- appointing an independent Chair with substantial legal experience in a compliance context to the Compliance Committee
- the Minister appointing a delegate to take responsibility for taking enforcement action in the Federal Court if serious or persistent misuse of slots is identified.

Another notable recommendation is for the Slot Manager (Airport Coordination Australia) to make more information about slot holdings publicly available. The report said that this could improve efficiency in the development of slot swaps and facilitate competitive entry. The ACCC agrees that the allocation of a public resource such as slots should be transparent and that consideration should be given to making this information available as soon as possible.

The report recommends removing the current priority given to incumbent airlines who are seeking to change the time of their slots over other types of slot allocation requests, including those by new entrants. However, the report did not adopt a suggestion from Rex that a regional airline expanding into intercity routes should benefit from being categorised as a 'new entrant'.

The Australian Government will respond to the report after consulting stakeholder working groups it established to consider the recommendations in more detail. The working groups, in which the ACCC has been participating, are due to conclude their work at the start of December 2021.

2.8 Minister sets out further temporary measures regarding airlines' use of slots at Sydney Airport

The Australian Government has temporarily reduced some obligations on airlines to use their allocated slots at Sydney Airport due to the continuing impact of COVID-19 movement restrictions on the industry. Airlines are normally required to use slots at least 80% of the time in order to retain access to those slots in future seasons (historical precedence).

The Minister for Infrastructure, Transport and Regional Development issued a Direction[36] providing international airlines with a waiver of the requirement to use their slots in the next scheduling season that runs from 31 October 2021 to 26 March 2022. Domestic airlines will be required to use their allocated slots at least 50% of the time, other than when relevant COVID-related travel restrictions apply.

The Direction also deals with slots still held by Tigerair, which ceased operations when its owner Virgin went into administration in 2020. The slots held by Tigerair will be returned to the broader pool and made available to other airlines. The ACCC understands that many of these slots fall within less appealing off-peak times. As a result, this may not provide much benefit to airlines seeking to secure historical precedence to peak time slots such as Rex.

36 Minister for Infrastructure, Transport and Regional Development, *Minister's Directions to the Slot Manager 2021 (No. 2)*, 27 August 2021.

3. Key industry metrics and analysis

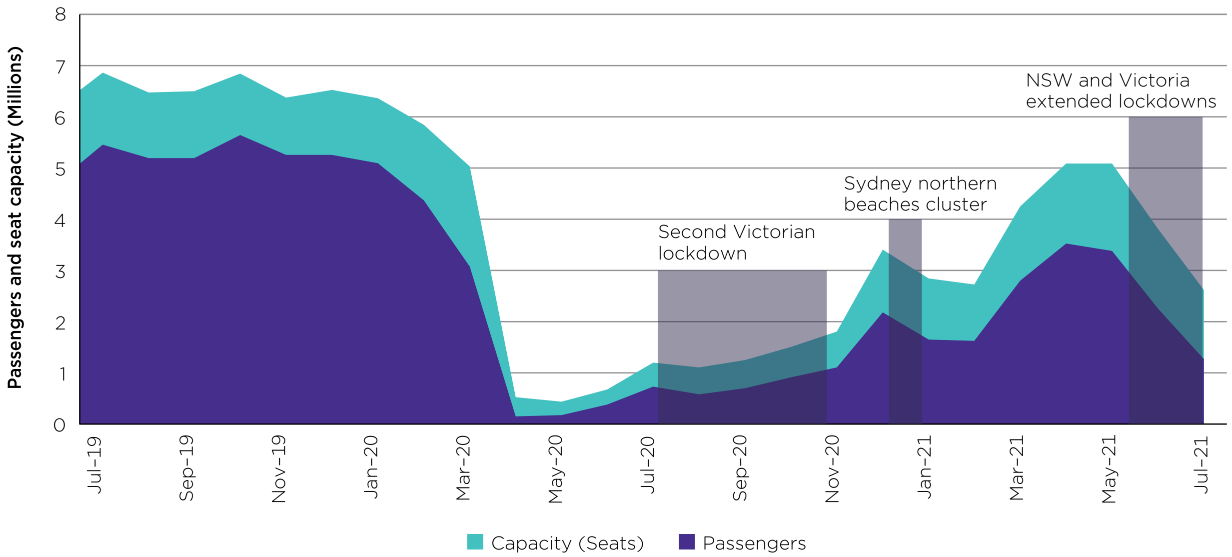
This chapter presents analysis of key industry metrics. Unless specified otherwise, the metrics are calculated using information collected from the Qantas Group (consisting of Qantas, Jetstar and QantasLink), Virgin (consisting of Virgin, VARA and discontinued Tigerair) and Rex on a monthly and quarterly basis. The chapter is broken into 3 parts:

- Section 3.1 covers the disruption to the airline industry due to the recent extended lockdowns in Victoria and New South Wales. This section includes data up to July 2021.
- Section 3.2 covers the state of the industry including network reach and market shares in June 2021, before industry disruption began to be felt nationwide.
- Section 3.3 covers the trends in airfares up to August 2021.

3.1 Monthly passenger numbers have fallen from pandemic highs in April 2021

By July 2021, the domestic airline industry was sharply contracting due to lockdowns in NSW and Victoria. Figure 1 shows that 1.3 million passengers travelled in July 2021, the lowest since November 2020, when state borders were opening up after Victoria's second lockdown. The July 2021 passenger numbers were 23% of pre-pandemic July 2019 levels, when 5.5 million passengers travelled domestically. Passenger numbers are expected to have fallen further during August and September 2021 as lockdowns continued in a number of states and territories.

Figure 1: Australian domestic air services – July 2019 to July 2021



Source: BITRE; Australian domestic airline activity.

Despite a high percentage of flight cancellations in July 2021 (discussed in section 3.1.2), flight capacity did not fall as rapidly as passenger numbers. Monthly seats fell to 2.6 million in July 2021 at 49% occupancy, the lowest average load factor since May 2020.

Since the beginning of the pandemic, April 2021 was the busiest month for the domestic airline industry with 3.5 million monthly passengers. Easter holidays and cheaper fares drove an increase in leisure demand, with cheaper fares a result of subsidised fares under the TANS program, and increased competition where the Qantas Group or Rex entered into new routes. At the April 2021 peak since COVID-19, passenger volumes had recovered to 68% of the monthly pre-COVID-19 number (5.2 million passengers in April 2019).

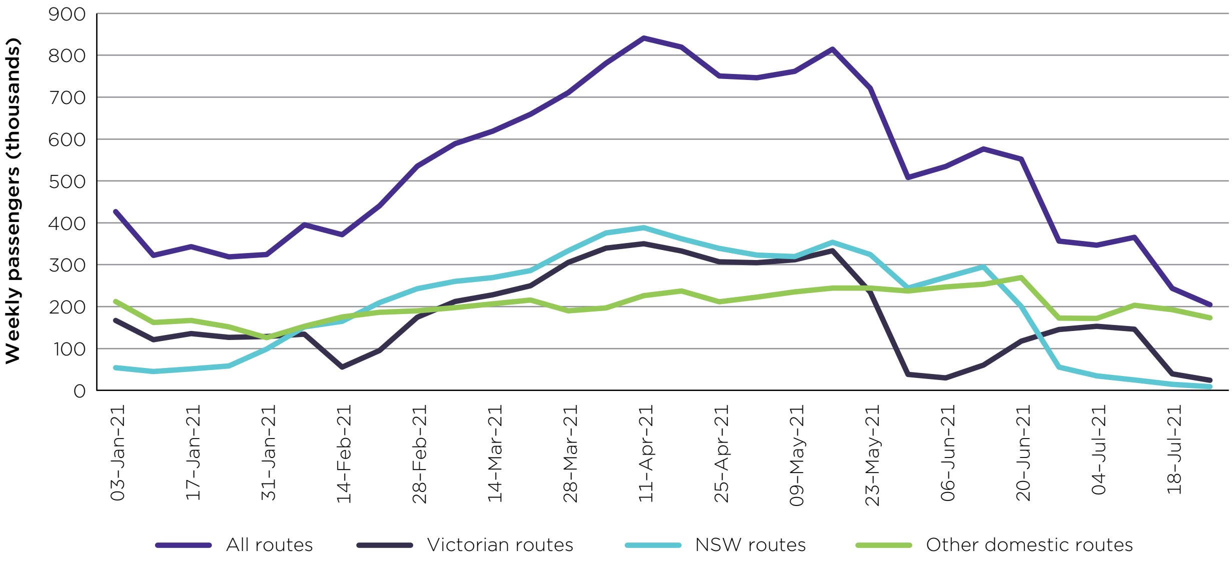
3.1.1 Victorian and NSW passenger numbers fell substantially through June and July 2021, driving down total domestic passenger numbers

Weekly passenger numbers on Victorian routes fell 91% due to the fourth Victorian lockdown, falling from 333,000 in mid-May 2021 to 30,000 in early June (see Figure 2). The fall in weekly NSW passengers was even greater in percentage terms, down 97% from 295,000 in mid-June to 9,000 by the end of July 2021.

Figure 2 also shows the impact that the drop in Victorian and NSW passengers had on total domestic weekly passengers. The Victorian lockdown drove the fall in total passenger numbers from late-May 2021. Total weekly passenger numbers fell from 815,000 to 535,000 over the same period, commensurate with the decline of 303,000 weekly passengers on Victorian routes.

The steep fall in weekly passengers from mid-June 2021 can be largely attributed to NSW. Total weekly passengers fell by 220,000 from 577,000 to 357,000, as weekly passengers on NSW routes fell by 239,000 over the same period. Although passenger numbers on routes outside of both Victoria and NSW also fell due to Queensland's snap lockdown, this was offset by passenger numbers recovering in Victoria from its early-June 2021 trough.

Figure 2: Weekly passengers on Victorian, NSW and all domestic routes – January 2021 – July 2021



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

Note: The 'Victorian routes' and 'NSW routes' series both include flights between the two states, for example, Melbourne – Sydney flights appear in both series. Therefore the sum of 'Victorian routes', 'NSW routes' and 'Other domestic routes' exceed the figures in 'All routes'.

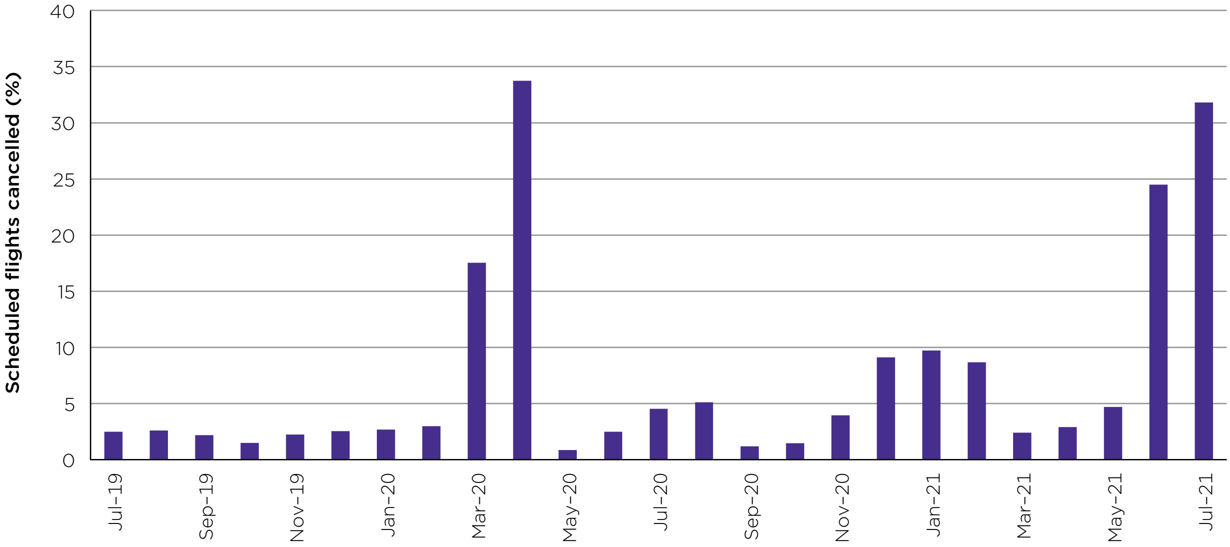
In the last week of July 2021, 173,000 or 85% of all domestic passengers flew on routes outside of Victoria and NSW.

3.1.2 Flights were cancelled at similar rates to the beginning of COVID-19

The airlines cancelled 25% and 32% of the approximately 38,400 and 29,400 scheduled flights in June and July 2021 respectively, due to the movement restrictions in response to COVID-19 outbreaks in Melbourne and Sydney. In total, the Qantas Group, Virgin and Rex cancelled approximately 9,400 flights in June 2021, the highest on record. Approximately 9,350 flights were cancelled in July 2021, slightly lower than June, with the higher July 2021 cancellation proportion reflecting a smaller number of scheduled monthly flights.

Figure 3 shows that the degree of industry disruption in June and July 2021 rivals that of March and April 2020, as states first began closing borders in response to COVID-19. Cancellation rates jumped to 18% in March 2020 and peaked at 34% in April 2020. Pre-COVID-19 the airlines typically cancelled approximately 2% of scheduled monthly flights, as observed across 2019.

Figure 3: Monthly domestic airline flight cancellation rates – July 2019 – July 2021



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

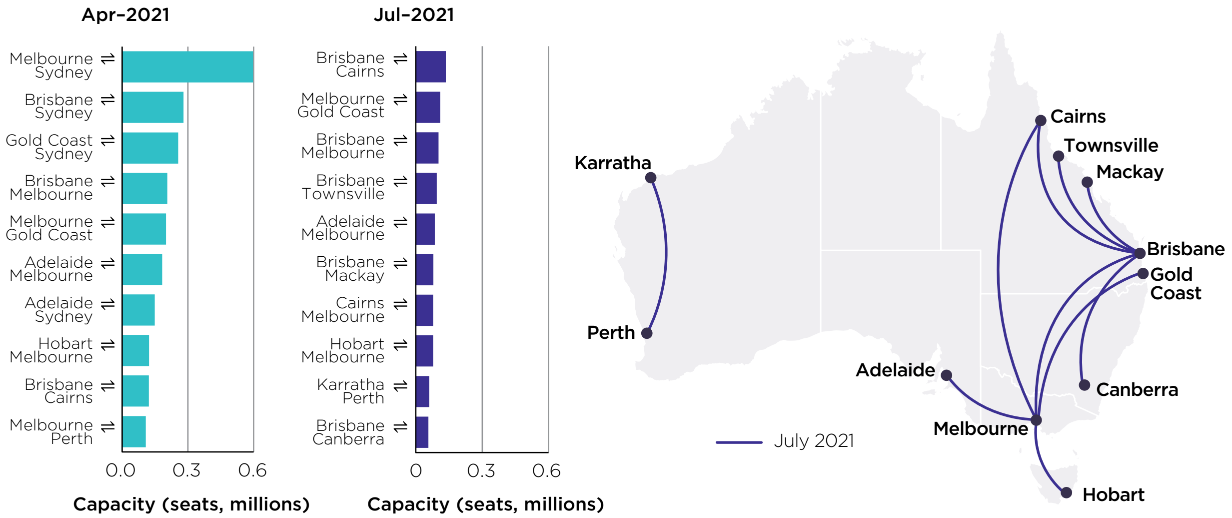
Cancellation rates were particularly acute on routes directly affected by outbreaks and border closures. Between 70% and 73% of flights were cancelled in June 2021 on major interstate routes to-and-from Melbourne, including Melbourne – Sydney, Melbourne – Adelaide and Melbourne – Perth. Cancellation rates on interstate routes to-and-from Sydney were greater in July 2021, with between 76% and 80% of flights cancelled on Sydney – Melbourne, Sydney – Brisbane and Sydney – Gold Coast.

3.1.3 For the first time, Sydney did not appear in the top 10 busiest domestic routes

Despite being Australia's busiest airport, routes to-and-from Sydney Airport were not among the top 10 busiest routes in July 2021. This is the first time a Sydney route has not been among the top 10 busiest routes.[37] Figure 4 shows the top 10 busiest routes by capacity in April 2021 and July 2021. April 2021 was the busiest month for domestic aviation since COVID-19, with the busiest routes in this month mostly consistent with the busiest routes pre-pandemic, featuring mostly interstate routes. Significantly reduced interstate flying due to border closures meant that 4 of the 10 busiest routes in July 2021 were intrastate routes in Queensland and WA, including Brisbane to Cairns, Townsville and Mackay, and Perth to Karratha.

37 Based on monthly passenger numbers from 1984–2021; BITRE, Australian Domestic Airline Activity — time series.

Figure 4: Busiest routes by monthly capacity – April 2021 and July 2021



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

Seven of the top 10 routes included at least one Queensland destination. In addition to three intrastate routes, flights from Brisbane, Cairns, and the Gold Coast to Melbourne appear in the top 10, as does Brisbane to Canberra. However, monthly capacity was down significantly compared to April 2021 across the interstate routes. Capacity in July 2021 on Brisbane – Melbourne fell 50% from 206,000 to 103,000 seats, and Gold Coast – Melbourne was down 45% from 200,000 to 111,000 seats. By contrast, capacity on the intrastate Queensland routes increased since April 2021. Capacity on Brisbane – Cairns and Brisbane – Townsville were both up 11% between April 2021 and July 2021 from 120,000 to 135,000 seats and 85,000 to 95,000 seats respectively.

Although several routes out of Melbourne also appeared in the top 10 (including the Queensland destinations), capacity on these routes fell toward the end of July 2021, consistent with passenger numbers on Victorian routes shown in Figure 2. Routes out of Melbourne are unlikely to feature among the busiest routes in subsequent months as Victoria's lockdown continues.

3.2 The airlines were continuing to expand their network reach before significant disruption in July 2021

The data presented here includes activity up to the end of June 2021, which provides a snapshot of the domestic airline industry before it endured significant disruption. June 2021 figures are compared to March 2021 figures reported in the previous Airline Competition in Australia Report,[38] and to June 2019 figures as a pre-COVID comparison.

3.2.1 The Qantas Group and Rex operated on more routes in June 2021 than pre-COVID-19

Competition across the domestic airline network increased between March 2021 and June 2021, as each of the 3 airline groups entered new routes including some seasonal holiday routes. Consequently, the combined domestic network reach increased from 146 routes to a post-COVID high of 156 routes.

The Qantas Group (comprising Qantas, Jetstar and QantasLink) has been servicing more routes than pre-COVID-19 since December 2020 and has continued to enter new routes this year. Figure 5 shows that the Qantas Group was regularly operating on 128 routes in June 2021, representing an increase of 13 routes since March 2021. The Qantas Group entered new routes including Darwin – Canberra and

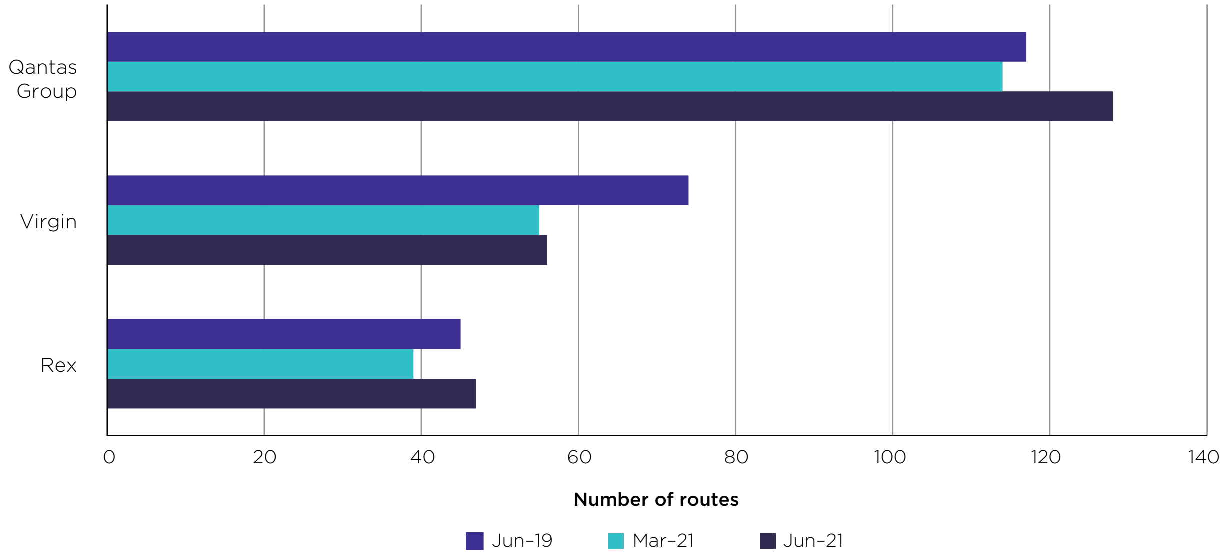
38 ACCC, *Airline competition in Australia – June 2021 report*, 4 June 2021.

Cairns – Newcastle, and had resumed regular services on routes including Melbourne – Broome and Canberra – Cairns.

Rex's network reach in June 2021 had expanded to 47 routes. Since late-March 2021 it had entered routes including Melbourne – Adelaide, Sydney – Gold Coast, Sydney and Melbourne to Canberra, and Sydney to Coffs Harbour and Port Macquarie. It serviced more routes in June 2021 than it did pre-COVID-19 (45 routes in June 2019) due to its entry onto these routes and other major domestic routes.

Virgin (comprising Virgin, VARA and discontinued Tigerair) serviced 56 routes in June 2021, having entered Melbourne – Ballina and Melbourne – Darwin since March 2021. However it has not resumed services on as many routes as it flew pre-COVID-19, having consolidated its airline fleet to Boeing 737s and exited some smaller routes (discussed in section 4.1).[39]

Figure 5: Number of routes operated by airline group, June 2019, March 2021 and June 2021



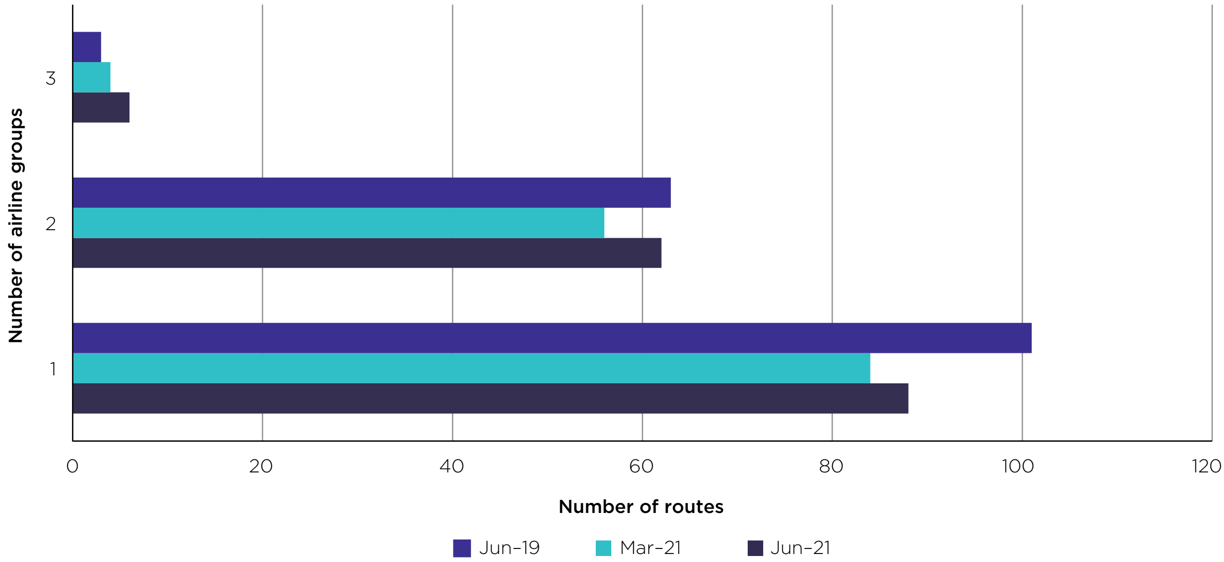
Source: Data collected by ACCC from the Qantas Group, Virgin and Rex.

Note: Select multi-hop routes are treated as a single route. Qantas/QantasLink/Jetstar and Virgin/VARA/Tigerair are each treated as individual airline groups.

Figure 6 shows the distribution of Australian domestic routes according to whether the route had one, 2 or 3 competing airline groups. Airline expansion since March 2021 primarily occurred on routes already serviced by one airline, with the count of routes serviced by 2 airlines increasing by 6 to 62 routes in June 2021. The number of routes with 3 competing airline groups grew from 4 to 6 over this same period following Rex's entry onto Melbourne – Adelaide and Sydney – Gold Coast routes.

39 Virgin Australia, *Virgin Australia Group announces plan to focus on core strengths, re-establishing itself as an iconic Australian airline* [media release], 5 August 2020, accessed 23 February 2021; Virgin Australia, Media Release, 9 September 2020, sourced from CAPA.

Figure 6: Number of routes serviced by one, 2 and 3 airline groups – June 2019, March 2021 and June 2021



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

Note: Select multi-hop routes are treated as a single route. Qantas/QantasLink/Jetstar and Virgin/VARA/Tigerair are each treated as individual airline groups.

Only 68 of the 156 (44%) domestic routes were serviced by more than one airline group in June 2021, which means a majority of routes do not benefit from direct competition. However, these routes are typically the least used services of the Australian network.

3.2.2 Qantas' market share on larger-city routes fell back to pre-COVID-19 levels in June 2021

Figure 7 shows the share of passengers carried by each of the 3 main airline groups in Australia, broken down by type of route. Virgin's and Rex's passenger market shares across all domestic routes increased since March 2021 to 30% and 4.1% respectively by June 2021. Although Qantas' market share fell to 66% in June 2021, it continued to hold a larger share of the overall passenger market than it did in June 2019 (61%).

Figure 7: Airline group market share by passengers flown – June 2019, March 2021 and June 2021

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

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

Virgin's passenger market share had recovered to 38% on routes between larger cities by June 2021, but remained below its March 2019 share of 40% when it still operated its low cost carrier Tigerair. Rex flew 2.7% of passengers flying between larger cities in June 2021, up from 1% in March 2021. However Rex's share was as high as 3.7% in May 2021 on these routes before the June disruptions. The Qantas Group's passenger share had returned to its 60% pre-COVID-19 level by June 2021 on routes between larger cities, given growth in Virgin's and Rex's market shares.

The Qantas Group continued to hold a greater share of the passenger market in June 2021 relative to its 2019 share on larger city-regional routes (70% in June 2021) and routes between regional destinations (87% in June 2021). This is due to factors including Jetstar picking up much of the price sensitive customer segment left behind by Tigerair's withdrawal from the industry, as well as Jetstar benefitting from the strong demand for leisure routes in the June 2021 quarter.

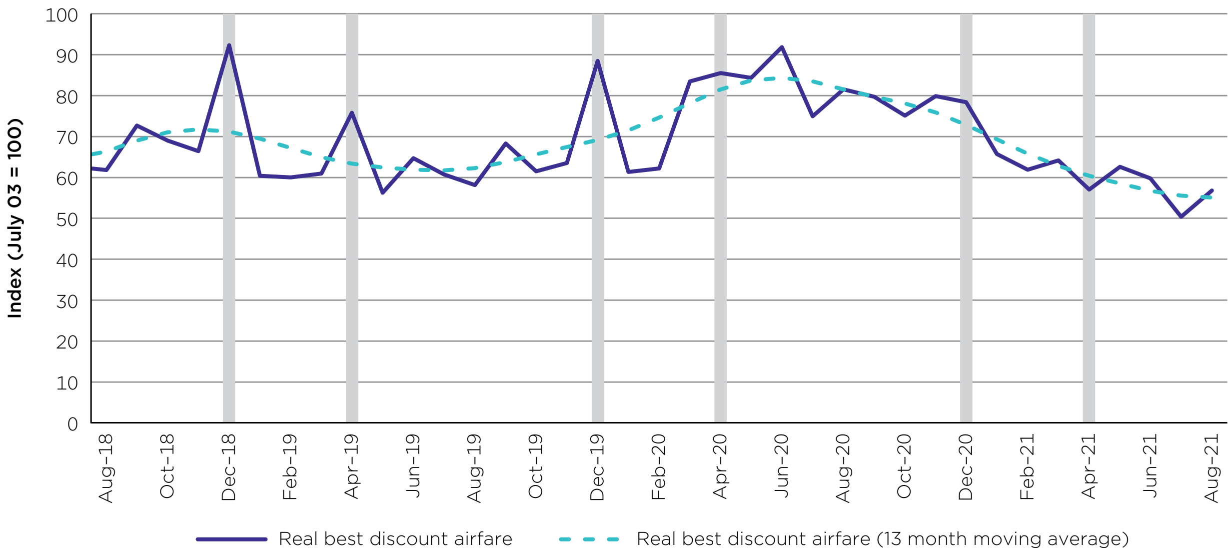
In August 2021, Qantas CEO Alan Joyce said that in 2022 it 'will have 70% domestic market share at least, a lot better than we had pre-COVID'.[40] At the same time, Virgin CEO Jayne Hrdlicka said that it was 'well positioned to reach our target share of 33% of the domestic market'.[41]

3.3 Airfares continued to fall through to August 2021

The airlines have been advertising lower-priced discount economy and business class airfares through July and August 2021, continuing the current trend toward cheaper fares.

Figure 8 shows the change in the price index representing the cheapest discount airfares, weighted across the 70 busiest domestic routes. The data shows that the price of discount airfares on high-volume routes has trended down in real terms since mid-2020, with the July 2021 index figure of 50.4 the lowest for several years. Airfares were particularly low on routes between larger cities serviced by all 3 airline groups, such as Melbourne – Sydney and Sydney – Gold Coast. Additionally, the price of discounted airfares on routes to northern destinations including Broome and Darwin have retreated from peaks between April 2021 and June 2021.

Figure 8: Price index of cheapest discount airfares weighted across 70 busiest domestic routes, August 2018 – August 2021



Source: ACCC analysis of BITRE data on domestic discount airfares (cheapest available fare).

Note: Grey bars indicate December and Easter holiday periods.

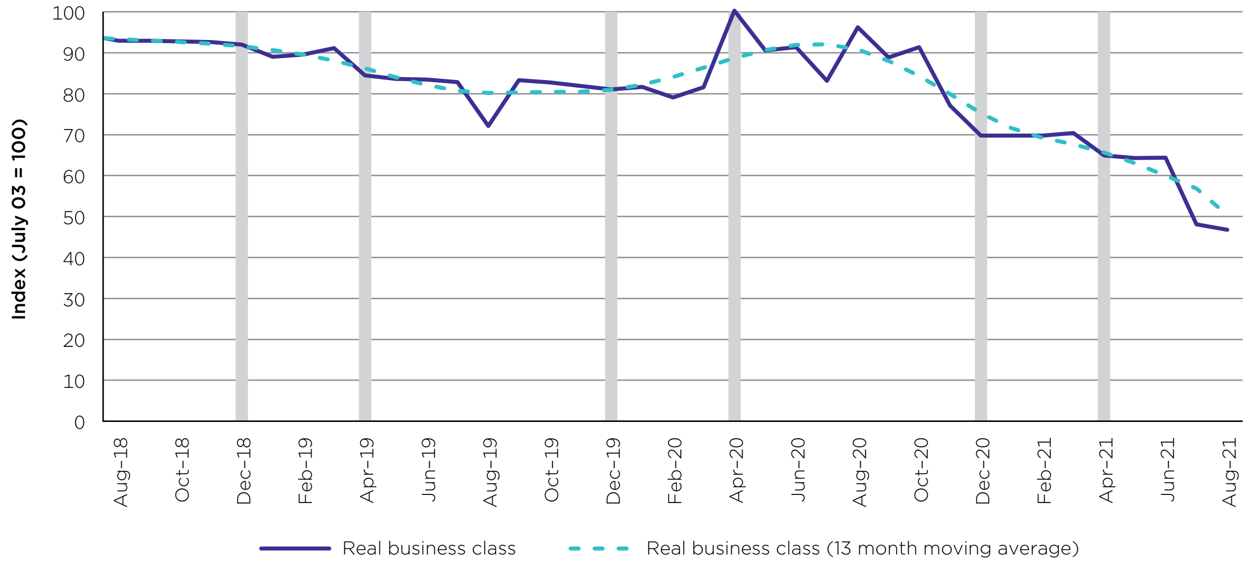
40 Quest, R, Qantas CEO: A380 'perfect' to meet massive pent-up demand for flying, CNN Business, August 30 2021, accessed 8 September 2021.

41 Virgin Australia, *Virgin Australia finalises new agreements for Nine Boeing 737-800 NG aircraft* [media release], 27 August 2021, accessed 8 September 2021.

The ACCC has observed that while the price of discount airfares has generally remained low for flights through August and September 2021, passengers are more likely to pay a premium to fly interstate with a specific airline if booking 1 or 2 weeks ahead of the flight. With limited flights, it is increasingly common that discount airfares are sold out, with only flexible fares available at a premium over the discount fare. However if passengers need to travel at short notice, discount airfares usually remain available from competing airlines for flights on the same day.

Figure 9 shows the price of the cheapest business class airfares have followed a similar trend to discount airfares since mid-2020. The price of business class airfares has been decreasing in real terms since the beginning of 2019 despite COVID-19 disruptions, and were at their cheapest recorded levels (in real terms) in August 2021.

Figure 9: Price index of cheapest business class airfares weighted across 70 busiest domestic routes, August 2018 – August 2021



Source: ACCC analysis of BITRE data on domestic business class discount airfares (cheapest available fare).

Note: Grey bars indicate December and Easter holiday periods.

The ACCC has observed that in June 2021 Virgin reduced the price of business class airfares by 20% or more for flights from 1 July 2021 on routes including Melbourne – Brisbane, Sydney – Brisbane, and Sydney – Hamilton Island. Virgin and Rex also reduced the price of business class airfares on Melbourne – Gold Coast. These reductions follow Virgin reducing the price of business fares in November 2020 by up to 20% from pre-COVID levels.[42]

42 Virgin Australia, *Virgin Australia at your service with new menus and even more affordable flights* [media release], 25 March 2021, accessed 31 August 2021.

4. Airline services in regional Australia

Air services fulfil an important role keeping regional communities connected with the rest of Australia. However, the low number of passengers on regional routes can mean many of these communities do not benefit from competition and face higher airfares and less discounting.

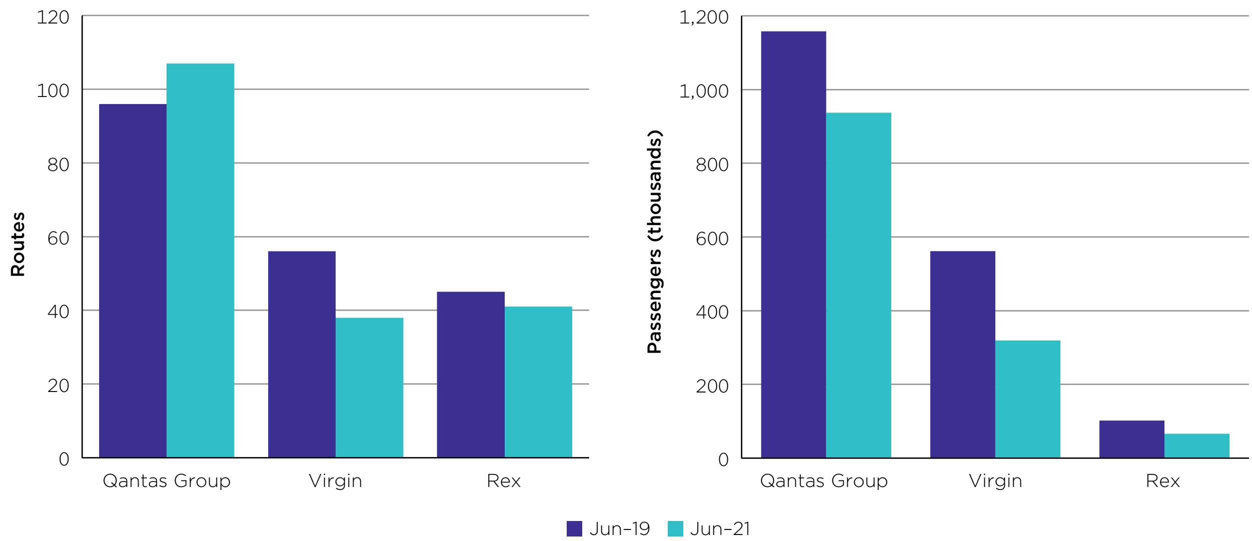
4.1 Airlines provide important connectivity for regional communities

Access to affordable air services is particularly important for regional and rural communities in a large country like Australia. For many places, air services provide essential connectivity to health, education, and other goods and services necessary to sustain local communities. These services can also support social connectivity with family and friends, and facilitate economic development through tourism and other important regional economic activities.

In June 2021, the Qantas Group, Rex and Virgin combined carried 1.3 million passengers across 134 different routes involving at least one regional airport.[43] This compares to 1.8 million passengers across 144 regional routes in June 2019, prior to the pandemic. Some of these routes contain stops at multiple airports.

Figure 10 shows that the Qantas Group is clearly the biggest operator in regional areas, whether measured by number of routes (107 in June 2021) or number of passengers (937,000 in June 2021). Jetstar carries most of these passengers on busy interstate routes linking capital cities with holiday destinations, while QantasLink is the primary carrier on a large number of smaller routes. The Qantas Group has expanded its network of regional routes significantly this year, with its total in June 2021 surpassing what it operated prior to the pandemic in June 2019. It launched 13 new regional routes between March 2021 and June 2021.

Figure 10: Number of routes served and passengers carried in regional areas – June 2019 and June 2021



Source: Data collected by ACCC from the Qantas Group, Virgin and Rex. Qantas/QantasLink/Jetstar and Virgin/VARA/Tigerair are each treated as individual airline groups.

In contrast, both Virgin and Rex have reduced their regional networks since COVID-19 struck. The most significant reduction is by Virgin, which has cut its regional operations by almost a third between June 2019 (56 routes) and June 2021 (38 routes). This reduction was the result of a decision to close down low cost carrier Tigerair and operate a smaller number of aircraft focused on Boeing 737s.

43 The ACCC categorises Sydney, Melbourne, Brisbane, Adelaide, Perth, Canberra and the Gold Coast as larger cities. All other locations are considered to be regional.

This aircraft is too large to be suitable for many regional routes due to airport runway limitations and demand characteristics of the routes.

With this in mind, Virgin sought and received authorisation from the ACCC in order to coordinate with Alliance Airlines on 41 regional routes until 31 March 2023.[44] Alliance Airlines is the country's largest supplier of contract charter services[45] for fly-in, fly-out (FIFO) workers, but also offers wet leasing services[46] to other airlines including Virgin. Its expanding fleet is expected to contain 32 newly acquired Embraer E190 jet aircraft and 43 Fokker aircraft by June 2022.[47] Under the authorisation, granted in November 2020, Virgin can access aircraft from Alliance Airlines that are better suited to some regional routes and enable it to re-establish its regional operations.

To date, there has been less coordination between Virgin and Alliance Airlines than initially expected. Virgin withdrew from a number of regional routes between June 2019 and June 2021, including some covered by the ACCC's authorisation. Virgin has subsequently only re-entered one of these routes, Brisbane – Emerald, using aircraft wet leased from Alliance Airlines. Virgin has also used aircraft wet leased from Alliance Airlines to supplement some of its routes serviced by Virgin's Boeing 737s. However, due to current lockdowns and border restrictions, use of Alliance Airlines aircraft on these routes has recently either been reduced or temporarily paused.

Alliance Airlines has also entered into a wet lease arrangement with the Qantas Group to provide certain regional services under the QantasLink brand. The arrangement covers the use of 18 Embraer E190s, which Qantas considers are the right size for routes such as Darwin–Adelaide. Qantas acquired a 19.9% ownership stake in Alliance Airlines in February 2019.

Other airlines operating in regional parts of Australia generally offer only a limited number of routes in localised areas, some of which may be provided as chartered services rather than regular passenger transport. These regional operators include Airnorth, Aviair, FlyPelican, Fly Tiwi, King Island Airlines, Sharp Airlines, Skippers Aviation and Skytrans.

A Senate Committee inquiry in 2019 found that the number of regional operators had declined significantly in recent decades.[48] A separate inquiry in 2003 found that regional airline failures appeared to be the result of escalating cost pressures on regional operators, together with declining patronage caused by regional population changes, and improved road conditions and vehicle efficiency.[49]

4.2 High regional airfares mainly due to low economies of scale

The degree to which air services can provide important social and economic connectivity to regional Australia depends in part on whether people can afford those services. Several parliamentary inquiries have been established over the last decade in response to concerns about high airfares for regional communities.

The 2019 Senate Committee inquiry found that low economies of scale on a route was one of the main factors, if not the primary factor, driving high regional airfares.[50] It recognised that there are a number of fixed costs associated with the operation of an aircraft. It said that on routes in regional and remote areas, there are generally lower passenger volumes on smaller aircraft, operating with less frequency, which results in higher per-passenger costs than in larger aircraft on busier, trunk routes.

44 ACCC, 'Virgin Australia and Alliance Airlines', ACCC website.

45 A chartered service is where a person or a company rents an entire aircraft for one or more flights, rather than buying individual tickets on a regularly scheduled flight.

46 A wet lease is a leasing arrangement whereby one airline provides an aircraft, crew and maintenance to another airline for the provision of a service. In contrast, only the aircraft is leased under a dry lease arrangement.

47 Alliance Airlines, *Alliance acquires an additional two E190 aircraft*, [ASX release], 28 June 2021, accessed 20 July 2021.

48 The Senate Rural and Regional Affairs and Transport References Committee, *Operation, regulation and funding of air route service delivery to rural, regional and remote communities*, June 2019, pp 9–10.

49 House of Representatives Standing Committee on Transport and Regional Services, *Regional Aviation and Island Transport Services: Making Ends Meet*, November 2003, p. xii.

50 The Senate Rural and Regional Affairs and Transport References Committee, *Operation, regulation and funding of air route service delivery to rural, regional and remote communities*, June 2019, p. 171.

These findings were informed by analysis by BITRE.[51] BITRE's analysis of the top 70 domestic routes found that the most significant factors in determining airfares were (in descending order): route length, market size (i.e. number of passengers), the number of competing airlines, the number of flights, load factors and oil prices. Figure 11 shows how some of these factors can result in higher airfares in regional and remote areas.

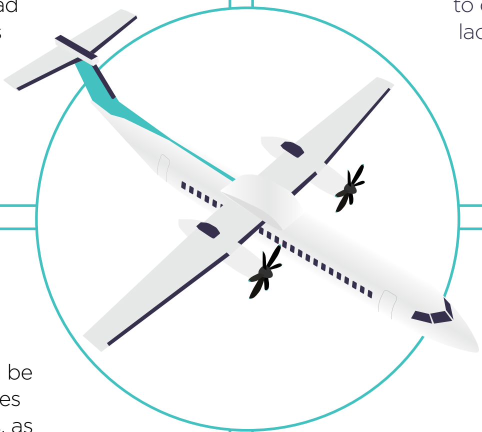
Figure 11: Reasons why airfares are often higher on regional routes

Smaller markets

Regional routes typically link smaller population centres than the busier intercity routes. The need to spread fixed costs over fewer passengers means that airlines need to charge higher prices.

Less competition

Fewer passengers on regional routes makes it difficult for multiple airlines to operate on an efficient basis. This lack of competition can mean there is less incentive for the airline to offer attractive airfares.



Higher cost of fuel, maintenance and airports

Certain operational costs such as fuel and maintenance can be higher in smaller population centres due to limited labour and facilities, as well as higher transport costs. Regional airports can also struggle with low economies of scale.

Lower load factors

The smaller number of passengers on regional routes means that aircraft are often flying with more empty seats than aircraft on busier intercity routes. Airlines need to charge more from those on the aircraft for the service to remain viable.

In recognition of the concerns about regional airfares, airlines have introduced programs which provide discounted airfares to either local residents or the general public. Rex's Community Fare scheme provides discounts on tickets booked at least 30 days prior to departure, or for any unsold seats one day prior to the flight, on selected routes. Qantas provides a discount of up to 30% off the Qantas-controlled component of all-inclusive airfares for local residents of certain routes. In December 2020, Virgin introduced special fares for residents in regional areas in WA, Queensland and the Northern Territory with essential travel needs (e.g. medical treatment).

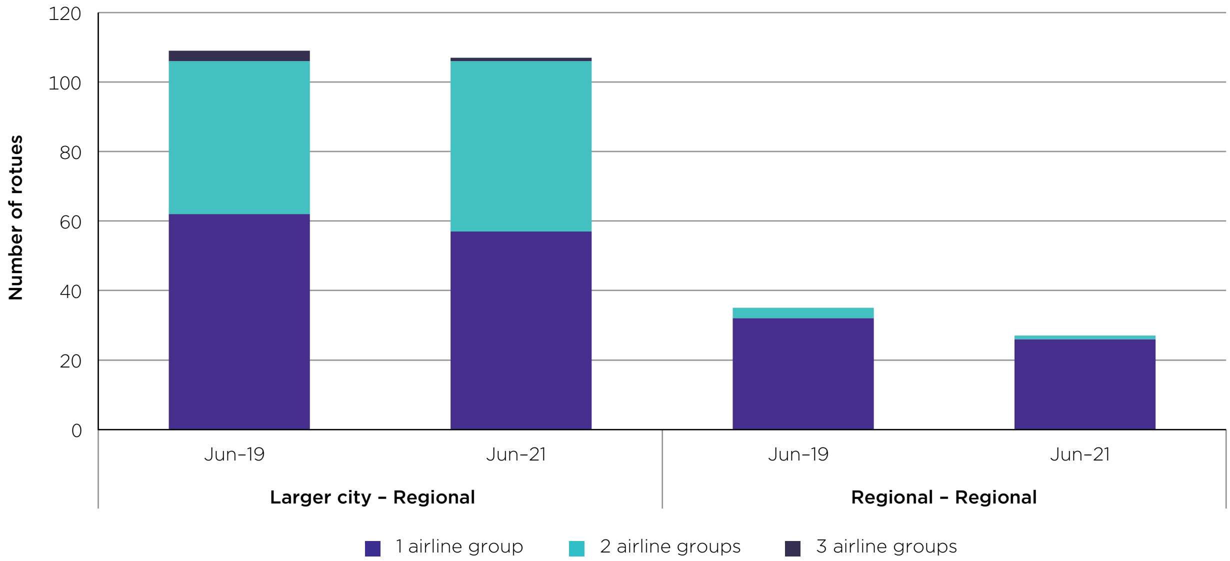
4.3 Competition in the provision of regional services

Unlike routes connecting two larger cities, there can often be insufficient passengers travelling on regional routes to support more than a single airline. This means that regional airlines can often face little or no active competition on many of their routes.

Figure 12 shows that travellers on most regional routes in Australia do not benefit from competing airline groups. In June 2021, only 46% of routes between a larger city and a regional airport were flown by more than one airline group. For smaller routes linking two regional airports, this figure was just 4%.

51 BITRE, *An empirical analysis of route-based differences in Australian scheduled domestic passenger air fares*, September 2018.

Figure 12: Number of airlines on regional routes – June 2019 and June 2021



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

Figure 12 suggests that there has not been much change in the level of competition over routes connecting larger cities with regional airports, despite Virgin withdrawing from many of these routes since the pandemic. A reason is that the Qantas Group has further expanded its network to enter routes that had previously been served by only a single airline. While this can potentially represent improved competition, the ACCC is investigating whether Qantas' entry and expansion on certain routes raises competition concerns.

There is also a general lack of competition when regional routes are considered in aggregate. As explored in section 3.2, the Qantas Group is even more dominant in regional areas than it is on routes connecting larger cities. The Qantas Group carried 87% of passengers flying between two regional locations in June 2021, with Rex accounting for most of the rest. This dominance of the Qantas Group on these intra-regional routes is largely unchanged from prior to the pandemic. However, the reduction in Virgin's domestic network since it emerged from voluntary administration has impacted competition on routes connecting larger cities with regional areas. On these routes, the Qantas Group has increased its market share from 63% in June 2019 to 70% in June 2021.

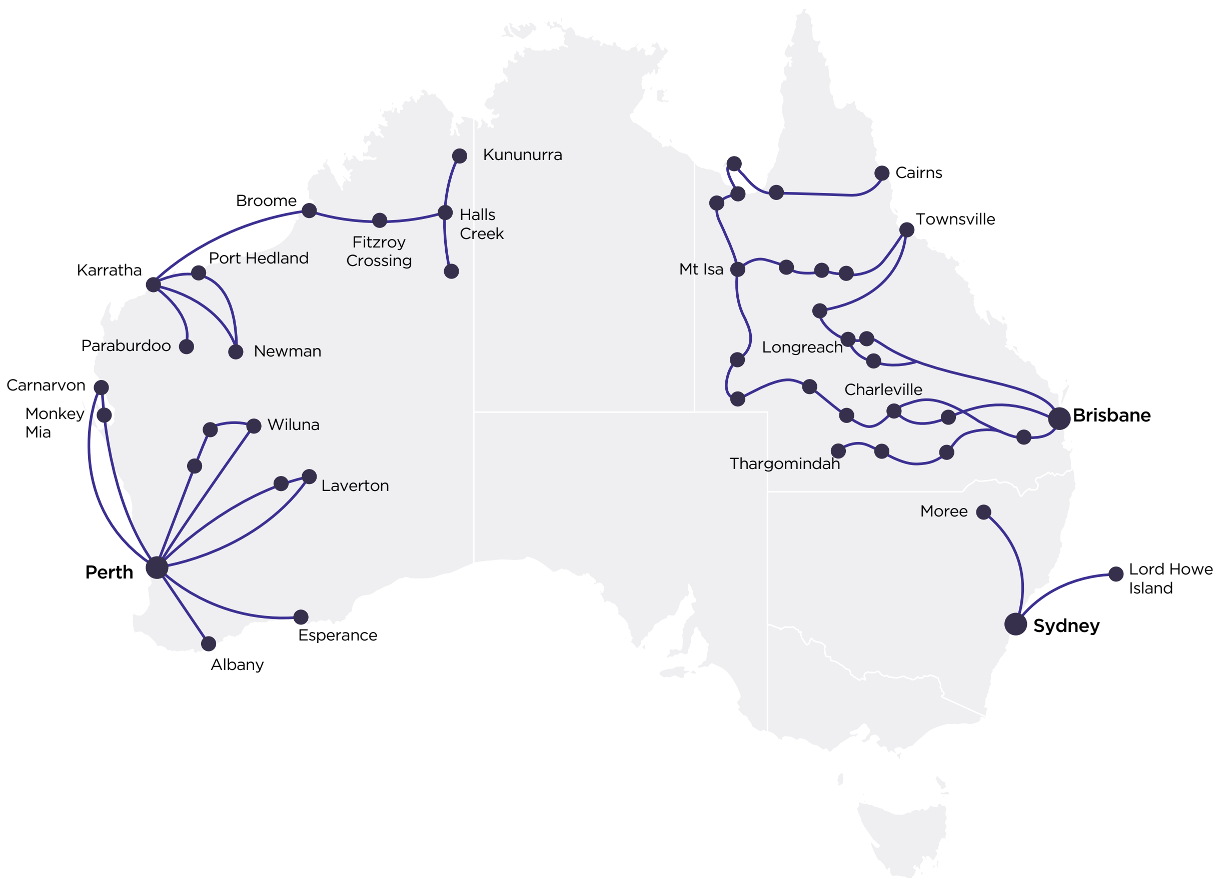
4.4 Consumers may be better off with only a single airline on some very low volume routes

While the presence of competing airlines on a route will generally lead to better outcomes for consumers, this may not be the case for some smaller routes. For some routes where there are relatively few annual passengers, it can be significantly more efficient for a single airline to provide the service because any splitting of the market will exacerbate the lack of economies of scale on these routes. As a result, a single airline may be able to offer consumers a more sustainable service and more attractive airfares than if there were multiple airlines.

Some state governments have introduced regulation of certain routes as a result, as well as to promote a more stable provision of services to the relevant regional communities. While the specific arrangements differ between states, they typically involve airlines competing to be granted a monopoly over the provision of services on a particular low volume route for a specified duration. In bidding for the route, airlines will typically be asked to set out a maximum airfare. The process may result in the provision of subsidies to make the route viable. The end result is that airlines compete for the route, rather than in the route.

There are currently 17 regulated routes across Australia (see Figure 13). Rex is the biggest operator with 8 routes spread across Queensland and WA. The other operators are QantasLink (4 routes), Skippers Aviation (3 routes) and Aviair (2 routes). The Queensland Government is currently in a tender process to determine which airlines will provide services over its 7 regulated routes for the next 5 years, with Rex and QantasLink sharing these routes at present.

Figure 13: Map of regulated routes in Australia



Source: Department of Transport (WA), Department of Transport and Main Roads (QLD), Transport for NSW.

The regulation of routes has proven to be beneficial for consumers in some circumstances. An inquiry by a Western Australia Legislative Assembly committee in 2017 found that airfares on regulated routes in that state were lower and less volatile than those on unregulated routes.[52] The inquiry also did not receive any submissions expressing discontent with prices on regulated routes.

However, regulation can result in poorer outcomes if it is applied to routes for which competition may be viable. The NSW Government has deregulated a number of routes because it 'removes the red tape associated with the licence application process, which may act as a disincentive for airlines seeking to establish new services'.[53] NSW applies a threshold so that a route can only be regulated if it operates at or below 50,000 passengers per annum. In contrast, the WA Department of Transport has suggested demand volume approaching 100,000 per annum as a threshold for when to consider opening a route to competition.[54]

52 Western Australia Legislative Assembly – Economic and Industry Standing Committee, *Perceptions and realities of regional airfare prices in Western Australia*, November 2017, pp. 19–20.

53 NSW Government, *NSW Government submission – Inquiry into the operation, regulation and funding of air route service delivery to rural, regional and remote communities*, March 2018, p. 8.

54 Department of Transport (WA), *Review of regulated regular public transport air routes in Western Australia*, 2015, p. 33.

4.5 Corporate passengers can impact communities' access to affordable services

A number of regional routes have a significant proportion of corporate travellers, especially in smaller regional centres in which there is a large mining operation. The presence of one or two large corporate entities can have a positive impact on the quality and price of air services available to local communities. The additional volume of travellers may be necessary for an airline to offer the route, or lead to more frequent flights than would otherwise be the case.[55] The extra passengers can also help airlines spread their fixed costs more broadly, resulting in relatively lower airfares.

However, a sizable corporate presence can also be a detriment to the local community in certain circumstances.[56] Depending on the size and the needs of the company, it may choose to charter its own flights, potentially reducing the demand for a public service to the point where it is no longer offered. The 2019 Senate inquiry also heard how large businesses could book a block of seats, leaving few available to local residents. Further, with corporate travellers often booking tickets quite late, airlines may be more reluctant to offer discounted tickets to fill seats than they normally would.

55 The Senate Rural and Regional Affairs and Transport References Committee, *Operation, regulation and funding of air route service delivery to rural, regional and remote communities*, June 2019, pp. 126–131.

56 Ibid.

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