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9 April 2020

Daniel McCracken-Hewson
General Manager, Adjudication
Australian Competition and Consumer Commission

Re: Application for Authorisation – COVID19 airline industry impact

Dear Mr McCracken-Hewson

As discussed with Dayna Field, in her call with Gavin Jones on Thursday 2 April 2020, the Australian domestic airline industry is facing unprecedented challenges. While most air travel has ceased, we still need to be able to move Australians around the country and our region for essential travel purposes, including work, access to healthcare, repatriation, and compassionate reasons. Balancing the provision of these essential services, against the cessation of most revenue-generating services, necessitates a careful and efficient allocation of resources. This is important in the interests of passengers today, and ensuring that our airlines survive to compete tomorrow.

In view of this, enclosed is an application requesting urgent interim and final authorisation from the ACCC under section 88 of the *Competition and Consumer Act 2010* (Cth) to enable Virgin Australia to cooperate with other operators of domestic and international short haul trans-Tasman and Pacific Island RPT and cargo flights to ensure the continuation and efficient provision of essential air travel services during the Covid-19 crisis.

Thank you for your consideration and support for the Australian aviation industry during this crisis.

Yours sincerely



Paul Scurrah
Chief Executive Officer and Managing Director

Application to the ACCC for authorisation and interim authorisation to enable coordination with Australian domestic airlines for the efficient continuity of services during the Covid-19 crisis

1. Executive Summary

As the ACCC is aware, since the outbreak of the Covid-19 pandemic, there has been a sharp drop in demand for domestic and international air travel which has been intensifying over recent months. The Australian Government has restricted Australian citizens and permanent residents from travelling overseas except in very limited circumstances and has directed that Australians must avoid all “non-essential” domestic travel. Several states and territories have applied their own entry restrictions. Despite these restrictions, there will continue to be a small number of Australians who must travel for essential work, medical, or compassionate grounds, and it is important that Australians are also able to be repatriated from countries in our region.

All major carriers in Australia have significantly cut capacity in response to the crisis and subsequent government restrictions. It has unfortunately been necessary for airlines to stand down staff accordingly. However, the need to cut capacity in response to far lower than sustainable load factors must be balanced with the need to make available these essential domestic and short-haul international services.

As a short-term response to the Covid-19 pandemic and domestic and international travel restrictions, in order to facilitate the sustainable operation of these essential services, Virgin Australia proposes to coordinate with one or more of any of the Australian-based airlines that usually operate domestic or short-haul trans-Tasman and Pacific Island international services in relation to:

- agreeing the routes, scheduling and/or capacity of RPT services, in order to remove inefficient overlapping services and supply efficient levels of inventory/capacity to meet the continuing travel needs of Australians both during the crisis and as the crisis eases;
- jointly determining which carrier is best placed to operate a particular route or service;
- agreeing split or share of revenue generated by services in relation to which airlines have cooperated (including discussing and sharing financial support provided by Commonwealth and State governments), but not extending to agreements relating to the price of fares offered to the market;
- discussing and agreeing the allocation of cargo space with air freight providers and operators; and
- joint negotiations (including collective bargaining) with airports in relation to (but not limited to) infrastructure use and fee relief.

This cooperation is essential to enable the most efficient provision of these travel services in an environment in which airlines are unable to generate commercial revenue and need to lower variable costs and preserve cash as far as possible. Likewise, this cooperation is essential as the crisis passes, to ensure that services are appropriately matched to demand during the rebuild period to limit cost inefficiencies for an industry that has been so heavily impacted by the crisis.

The public benefits resulting from the proposed cooperation are significant and far outweigh any detriment associated with short-term coordination, including:

- the ability to meet Australian demand for essential travel in a context where there is insufficient demand to support competing services, including by avoiding duplication, matching aircraft to routes with demand, and ensuring maximum geographic and temporal coverage, unable to be provided by one airline alone;
- by enabling joint negotiation with airports on fees, reducing costs incurred by airlines during a time in which they will not be generating material revenue;
- maximising the ability for airlines to retain remaining staff;
- the promotion of efficient operations; and
- in the longer term, improving the prospects that all Australian airlines are able to quickly return to normal services and remain competitive once the Covid-19 crisis passes.

2. Parties

Virgin Australia Airlines Pty Ltd (on behalf of the Virgin Australia Group)
56 Edmondstone Road
Bowen Hills QLD 4006

Contact:

Dayna Field
Chief Legal and Risk Officer



The Virgin Australia Group of Airlines operates domestic Australian and international regular passenger transport flights. This application is made on behalf of Virgin Australia Airlines Pty Ltd, Virgin Australia International Airlines Pty Ltd, Tiger Airways Australia Pty Limited, Virgin Australia Regional Airlines Pty Ltd and Virgin Australia Cargo Pty Ltd (together, **Virgin Australia**).



3. Counterparties

This submission is made by Virgin Australia and relates to the regular passenger transport (RPT) and cargo services operated by VA, the Qantas Group (including Jetstar), Regional Express (Rex), Alliance Airlines, Cobham, Air North and all other airlines operating RPT and cargo services in Australia.

VA supports the application for authorisation made by Rex dated 23 March 2020, in relation to which the ACCC granted conditional interim authorisation on 26 March 2020.

4. Proposed conduct

As a short-term response to the Covid-19 pandemic and associated domestic and international travel restrictions, VA proposes to cooperate with one or more of any of the Australian-based airlines usually operating domestic or short haul trans-Tasman and Pacific Island international services, along with suppliers of air freight capacity, in relation to:

- agreeing the routes, scheduling and/or capacity of RPT services, in order to remove inefficient overlapping services and supply efficient levels of inventory/capacity to meet the continuing travel and supply of goods and service needs of Australians;
- jointly determining which carrier is best placed to operate a particular route or service;
- discussing and agreeing the split or share of revenue generated by services in relation to which airlines have cooperated (including discussing and sharing financial support provided by Commonwealth and State governments), but not extending to agreements relating to the price of fares offered to the market;
- discussing and agreeing the allocation of cargo space with air freight providers and operators; and
- joint negotiations (including collective bargaining) with airports in relation to (but not limited to) infrastructure use and fee relief.

Without authorisation, the proposed cooperation would give rise to conduct that may contravene the *Competition and Consumer Act (Cth) 2010* as:

- cartel conduct, in contravention of the provisions of section 45AD;
- collective bargaining conduct, in contravention of section 45AD;
- contracts, arrangements or understandings that restrict dealings or affect competition, in contravention of sections 45(1)(a) and (b); and/or
- concerted practices, in contravention of section 45(1)(c).

5. Context for Application: the Covid-19 crisis

The Covid-19 pandemic has given rise to catastrophic public health risks and, with it, unprecedented disruption to businesses globally and to the commercial aviation industry in particular.

The decisions of Australian and international governments to rightly protect their citizens from the threat posed by Covid-19, by restricting the movement of individuals across state and national borders, has had an immediate, intensifying and deleterious effect on Virgin Australia's load factors, network operations and capacity.

Key events in this context include:

- On 13 March 2020, following significant drops in demand, VA announced a revised schedule, reducing domestic capacity by at least 50 per cent and suspending all international flights until 14 June 2020, including the temporary suspension of some routes, as a direct result of the effects of Covid-19 on demand for passenger travel.¹
- On 25 March 2020, following intensifying drops in demand for services, VA announced a further revised domestic schedule, with an additional reduction of capacity to 90 per cent (effective midnight 27 March to 14 June 2020), including the suspension of all Tigerair services, effective immediately.²
- Since 25 March 2020, the Government has restricted Australian citizens and Australian permanent residents from travelling overseas. There are limited exceptions to the ban, including:
 - people ordinarily resident in a country other than Australia;
 - airline and maritime crew and associated safety workers;
 - people engaged in the day-to-day conduct of outbound and inbound freight;
 - people whose travel is associated with essential work at offshore facilities; and
 - people travelling on official government business, including members of the Australian Defence Force.³

People falling within these exceptions continue to require air travel services.

The Government has also stipulated that from 25 March 2020, Australians must avoid all non-essential domestic travel. Several states and territories have applied their own restrictions, including closing their state borders.⁴ For example, travellers who enter the Northern Territory, Queensland, Tasmania, South Australia or Western Australia from another state or territory

¹ <https://newsroom.virginaustralia.com/release/virgin-australia-group-update-covid-19-response>

² <https://newsroom.virginaustralia.com/release/virgin-australia-group-revised-domestic-schedule-0>

³ <https://covid19.homeaffairs.gov.au/travel-restrictions>

⁴ <https://www.health.gov.au/news/health-alerts/novel-coronavirus-2019-ncov-health-alert/coronavirus-covid-19-advice-for-travellers>

must self-isolate for 14 days, effectively precluding travel for non-residents. Certain exemptions apply, including for mining industry workforces in WA,⁵ who continue to require air travel services. Undoubtedly the restrictions will continue to evolve and change over the coming months.

Additionally, as a consequence of the reduction in passenger flights, the capacity and connectivity available for the transportation of air freight has also been significantly negatively impacted. As Virgin Australia's cargo is carried primarily in the belly space of passenger flights (with a small number of cargo-only flights operated by third party providers) the 90% reduction in domestic flights and 100% reduction in scheduled international flights has limited Virgin Australia's cargo capacity, along with the usual connectivity available to air freight customers.

Virgin Australia remains committed to its future as a vigorous competitor domestically and internationally and was well advanced in its transformation program to deliver sustainably profitable operations in the future.

However, the Covid-19 pandemic is an unprecedented situation that has immediately and fundamentally changed the shape of the airline industry globally. It is an industry that, if unsupported, will be profoundly disadvantaged throughout the crisis and beyond, and which will cause acute flow-on disadvantages to the travelling public and the community more broadly. The International Air Transport Association (IATA) has predicted the recovery process for the airline industry as a whole will be more than six to seven months after the crisis, though this is based on modelling assuming a three month "lockdown" of the global air travel market, and it must be noted that the crisis could last for longer than this, delaying the recovery.⁶

While acknowledging the financial relief package for the airline industry announced by the Australian government,⁷ IATA has warned of the severe cash burn that airlines will be faced with, given their high fixed costs and inability to generate material revenue, stating that airlines need working capital to sustain their businesses through this period of extreme volatility.⁸

Mechanisms to protect the cash position of airlines and enable them to efficiently supply the limited services required by the travelling public, will assist them to remain as competitors once the crisis has passed.

⁵ <https://www.wa.gov.au/organisation/department-of-the-premier-and-cabinet/covid-19-coronavirus-travel-and-transport-advice>

⁶ IATA, *IATA Economics' Chart of the Week* (27 March 2020), available at <https://www.iata.org/en/iata-repository/publications/economic-reports/covid-19-delivers-unprecedented-shock/>.

⁷ IATA, *Asia-Pacific Governments Urged to Provide Urgent Emergency Support for Airlines* (26 March 2020), available at: <https://www.iata.org/en/pressroom/pr/2020-03-26-01/>.

⁸ IATA, *Airlines Facing Rapid Cash Burn* (31 March 2020), available at <https://www.iata.org/en/pressroom/pr/2020-03-31-01/>.

6. Rationale for cooperation

Virgin Australia requires the ability to cooperate with other Australian airlines in order to support its dual requirements of:

1. efficiently serving the essential travel needs of Australians during and in the rebuild after this crisis; and
2. minimising its costs and maintaining its cash position to enable to retain staff and more quickly rebuild after the crisis, so that it can remain as an important competitor in the Australian air travel market.

These concerns are being experienced by all Australian airlines at this time.

Coordination on the supply of services

The ability to coordinate with airlines in relation to the provision of air services is essential to ensure that services are made available on routes and at times that meet travellers' essential demand, while avoiding duplication, matching aircraft to demand levels, and maximising load factors on these services. This will promote the efficient operation of services while ensuring that essential travel is catered for. In the absence of cooperation, airlines may all decide to make capacity available on more popular services, while others with lower but essential demand remain unserved. Or they may operate services on "peak" travel days, leaving other days without available services.

Given the cost of air travel supplying services and the limited demand, it is in no one's interest to have competing near-empty services in operation. While demand has fallen drastically, the remaining demand is for essential travel required to ensure that Australia continues to function and its citizens stay safe. It makes sense, from the perspective of both travellers and airlines, to coordinate the delivery of these services.



In respect of potential revenue sharing on coordinated routes, Virgin Australia foresees that this will most likely occur on a case-by-case negotiated basis and the coordination of services could be assisted by an independent party such as the government.

Enabling cooperation to promote equitable access to scarce cargo capacity to Australian exporters, in line with Australian Government priorities, will also support the ongoing operations of Australian industry. The Australian Government has appointed an International Freight Coordinator General to work with various departments, exporters, airlines and freight forwarders to focus on export of seafood, red meat, horticulture and dairy and import of medical and other supplies.

The application does not include coordination in respect of any international passenger services operated by Virgin Australia at the request of the Australian or other Governments.

Collective bargaining with airports

The ability to coordinate with airlines in relation to negotiations with airports, in particular collective bargaining in relation to lowering or waiving airport charges, is an essential step required in minimising costs and maintaining the cash position of airlines. It is in the long-term interests of the aviation industry and of the Australian public to ensure that airlines can retain staff and rebuild their services as viable competitors post-crisis. Crucial to this is preserving cash. As IATA has noted, fixed and semi-fixed costs, including airport charges, can amount to a material portion of an airline's costs. If these costs continue at the same level, it impacts an airline's ability to reduce cost commensurate with the reduction in revenue

While airports also face challenges at this time, many of the costs incurred by airlines are fixed and not dependent on passenger numbers. The ability to collectively negotiate with airports in relation to security services, check-in counters, rent for back-of-house premises would be of particular utility during the crisis.

[REDACTED] Virgin Australia has no knowledge of the fees payable by other airlines and historically has found negotiation with airports challenging, as noted in the submission to the Productivity Commission's Inquiry into the Economic Regulation of Airports.⁹

7. Term sought

In light of the daily deterioration in the situation for the aviation industry during the Covid-19 crisis, VA requests that the ACCC grants interim and full authorisation for the proposed conduct as a matter of urgency.

⁹ https://www.pc.gov.au/data/assets/pdf_file/0014/231440/sub054-airports.pdf

Consistent with the ACCC's decision to grant interim authorisation in response to the Application made by Rex, Virgin Australia requests authorisation of the proposed conduct until 30 June 2021.

Virgin Australia views this as a temporary measure necessary to enable airlines to get through this crisis and its immediate aftermath of rebuilding services.

8. Market information and concentration

The ACCC has a deep knowledge of the participants and dynamics in Australian passenger air travel markets, including as a result of previous authorisation applications made by Virgin Australia in relation to its international alliances, regional alliance, and its acquisition of Tiger Airways.

Australian markets for domestic air passenger travel have in recent years has been competitive and well-served including by the Virgin Australia group of airlines, Qantas (including Jetstar), and a number of smaller operators including Rex, Cobham, Alliance Airlines, and Air North. The many markets for international travel to and from Australia, including the trans-Pacific and Pacific Islands, are contested by a number of international airlines, as well as the Virgin Australia group of airlines, Qantas, and their respective alliance partners.

Virgin Australia is well-positioned to weather the fluctuations of the industry. However, the effects of the Covid-19 pandemic are far beyond a fluctuation. In order to remain as an effective competitor in the long-term, Virgin Australia requires the flexibility to provide essential services while controlling costs that would be provided by this authorisation.

9. The proposed conduct will result in significant immediate and longer-term public benefits

The proposed conduct will result in significant immediate public benefits associated with the continuation of essential airline services and their efficient delivery, maximising airlines' ability to retain staff and preserve cash during the Covid-19 crisis. In the longer term, the proposed conduct will have the essential public benefit of preserving airlines' ability to survive the Covid-19 crisis in the interests of sustainable long-term competition within the Australian passenger travel market.

Enable airlines to meet the demand for essential travel during the crisis

While the Covid-19 crisis, together with government restrictions on travel, has resulted in a reduction in most air travel demand, connectivity is required and passenger air travel services are required to meet the essential travel needs of Australians. These travel needs include for work, including to support essential services such as energy generation and distribution, mining and food production; for logistics and supply chain support; for government operations, and to enable Australians to access healthcare or travel for compassionate and family reasons. For

Australians who are located overseas in our region, or people who travel for offshore work, the ability to maintain services in the Pacific and facilitate repatriation of citizens and residents is essential.

However, the cost of supplying these services with reduced (albeit essential) demand and therefore revenue makes it unsustainable for airlines to continue to compete to provide these services. Cooperation enables airlines to provide these services in a way that will:

- maximise the number of communities served and ensure the most efficient aircraft are deployed on routes;
- avoid duplication of services, with multiple carriers operating competing unsustainable services;
- ensure schedule spread to reach the maximum number of passengers and provide better services to travellers and shippers; and
- ensure that all routes for which there is essential demand for passenger travel and cargo are serviced, even if they are financially unviable.

The ability for airlines to coordinate the supply of these services, and then reach agreement on the share of revenue from these services, will maximise their ability to service the Australian travelling public efficiently while accessing some revenue in the face of little demand.

Australians who must travel at this time will directly benefit from this cooperation and the continuation of services, as will airlines which will be able to realise efficiencies and maintain some revenue.

Reduction in fixed costs incurred by airlines while revenue has plummeted, alleviating cash burn

Collective bargaining with airports to negotiate reductions in airport charges at this time will be essential to airlines' ability to control some of their fixed costs during a period where revenue has dropped substantially. Fixed costs make up a significant portion of an airline's costs and will continue even if they are not flying. These include many airport charges. Any mechanism that allows airlines to conserve cash at this time has the significant public benefit of supporting the continuation of their operations to emerge post crisis as viable businesses.

As each airline is suffering the same significant challenges, it will promote efficiency and equity to enable airlines to collectively negotiate with airports, regardless of their relative size or negotiating power as an individual business.

Increased opportunity to retain staff

The ability to reduce costs and achieve some revenue security and cost reduction at this time, alleviating cash burn, will improve airlines' ability to retain remaining staff for the duration of

the crisis. This results in material benefits to airline staff, the airline businesses themselves, and the broader Australian community.

Promotion of efficiency

All of the benefits described above will, in turn, result in the promotion of efficiency which, in itself, is a significant public and economic benefit. In this case, the beneficiaries of these efficiencies include the Australian public as a whole.

Increased prospect of continued competition in the Australian air travel market post-crisis

A vibrant and competitive airline industry is now part of Australia's DNA. It is clear that the traveling public values the benefit of choice: of services, routes, and fares; all elements of a market that supports a number of competitive airlines across domestic mainline and regional services, as well as international routes.

The trade minister, Simon Birmingham, has cited airlines' role in future economic recovery and maintaining regional connectivity, saying "a strong airline sector in Australia is not negotiable". The importance of a competitive and strong airline to the Australian economy is demonstrated by the announcement by the Australian government of a \$715 million relief package for the aviation industry. However, given there is currently insufficient demand to support competing services, the way to ensure competition in the future is to maximise efficiency by allowing cooperation between domestic airlines on scheduling. This will make it more likely that each airline will continue to vigorously contest routes in the future to the benefit of the Australian travelling public.

Granting Australian domestic carriers, the ability to cooperate in the short term on the issues listed above, and only as a response to this crisis and post-crisis, will assist in sustaining the viability of the industry as a whole in the long term and the fair and equitable access by guests to a variety of sustainable flights. Virgin Australia will be able to consider how a level of essential connectivity can be efficiently retained. This is particularly relevant in light of the Government's announcement on 28 March 2020 that funding would be provided to support continued air services into regional centres: efficient coordination of regional capacity will assist to ensure the efficient utilisation of public funds.

As the crisis passes, Virgin Australia expects there will be a gradual rebuild of demand (rather than an immediate reinstatement of pre-crisis demand). The ability to ensure that services are appropriately matched to demand during this rebuild period will limit cost inefficiencies for an industry that has been severely impacted by the crisis.

Without coordination, the ability of airlines to continue operations through the crisis, and being able to rebuild post-crisis, is materially reduced. It is not in the interests of Australian travellers or businesses to allow a return to a monopoly in Australian air travel.



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10. The proposed conduct will not result in any material public detriment

There is limited, if any, public detriment in enabling competitors to engage in the proposed conduct during this unprecedented market contraction. The cooperation sought is measured and appropriate and does not go beyond what is required.

Virgin Australia is not seeking authorisation to enable coordination on the pricing of services.

In relation to cooperation in airport negotiations, the cooperation proposed by Virgin Australia would not extend to conduct that amounts to collective boycotts.

Further, the proposed cooperation is intended only as a short-term measure, with a view to preserving Australia's airlines while ensuring that RPT services and cargo space are available to those who need them during this crisis. Any potential public detriment posed by the cooperation will be vastly offset by the longer-term benefits of supporting ongoing competition in the Australian aviation industry.



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11. Declaration

The undersigned declare that, to the best of their knowledge and belief, the information given in response to questions in this form is true, correct and complete, that complete copies of documents required by this form have been supplied, that all estimates are identified as such and are their best estimates of the underlying facts, and that all the opinions expressed are sincere.

The undersigned undertake(s) to advise the ACCC immediately of any material change in circumstances relating to the application.

The undersigned are aware that giving false or misleading information is a serious offence and are aware of the provisions of sections 137.1 and 149.1 of the *Criminal Code* (Cth).

A large grey rectangular box redacting the signature of the authorised person.

Signature of authorised person
Chief Legal and Risk Officer

Dayna Field
Name of authorised person

This 9th day of April 2020

Note: If the Applicant is a corporation, state the position occupied in the corporation by the person signing. If signed by a solicitor on behalf of the Applicant, this fact must be stated.



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