Application for authorisation by Virgin Australia Airlines Pty Ltd on behalf of itself and Partner Carriers

Parties to the proposed conduct

1 **Provide details of the applicants for authorisation, including:**

1.1 **name, address (registered office), telephone number and ACN**

Virgin Australia Airlines Pty Ltd (ABN 63 125 580 823)
Level 11, 275 Grey Street
South Brisbane QLD 4101
Ph: +61 7 3295 3000
PO Box 1034, Spring Hill QLD 4004

Virgin Australia International Airlines Pty Ltd (ABN 63 125 580 823)
Level 11, 275 Grey Street
South Brisbane QLD 4101
Ph: +61 7 3295 3000
PO Box 1034, Spring Hill QLD 4004

(together, **Virgin Australia**)

1.2 **contact person's name, position, telephone number and email address**

Louise Klamka
Partner
Gilbert + Tobin
[redacted]

Kritika Rampal
Lawyer
Gilbert + Tobin
[redacted]

1.3 **a description of business activities**

Virgin Australia is an Australian airline founded in 2000. Virgin Australia's main hub is in Brisbane and it operates a network of domestic and international services. These services are operated by Virgin Australia Airlines Pty Ltd and Virgin Australia International Airlines Pty Ltd, and their respective bodies corporate.

1.4 **email address for service of documents in Australia.**

[redacted]

2 **If applicable, provide details of the other persons and/or classes of persons who also propose to engage, or become engaged, in the proposed conduct and on whose behalf authorisation is sought.**

The Application is made on behalf of Virgin Australia and its Partner Carriers. Partner Carriers is a class of international operating airlines, comprising any other international operating carrier with which Virgin Australia proposes to codeshare as marketing carrier so long as the proposed codeshare does not occur on an international route, or a flight segment of an international route, involving an origin airport and a destination airport (a city pair) which is subject to an existing codeshare agreement with Virgin Australia or which Virgin Australia services as operating carrier. United Airlines is the first airline to become a Partner Carrier.

	Name, address (registered office), telephone number and ACN	Contact person's name, telephone number and email address	Description of business activities
1	**United Airlines, Inc.** 233 South Wacker Drive, Chicago, Illinois 60606 Ph: (872) 825-4000 ARBN 148 003 392	Michael Corrigan Partner, Clayton Utz [redacted]	Airline – provision of domestic and international passenger and freight services

The proposed conduct

3 Provide details of the proposed conduct, including:

3.1 a description of the proposed conduct and any documents that detail the terms of the proposed conduct

The Applicant seeks authorisation on behalf of itself and Partner Carriers to make and give effect to codeshare agreements with Partner Carriers which contain pricing provisions that may trigger the prohibition against RPM conduct within the meaning of sections 48 and 96 of the CCA (the **Proposed Conduct**).

The Proposed Conduct will be limited to instances in which the Partner Carrier operating international services covered by the codeshare agreement will specify the fares at which the Applicant may market and resupply those services to consumers in Australia:

- under the Applicant's own, independently set fare families and fare conditions;
- under the Applicant's code (VA);
- via the Applicant's own channels; and
- whether these are sold as a standalone itinerary or part of an itinerary that includes segments operated by Virgin Australia.

For further information, please see section 2 of the Submission.

3.2 the relevant provisions of the *Competition and Consumer Act 2010* (Cth) (the Act) which might apply to the proposed conduct:

The below provisions of the Act may apply to the Proposed Conduct:

- resale price maintenance (s 48); and

- acts constituting engaging in resale price maintenance (s 96).

3.3 the rationale for the proposed conduct.

Please see sections 2.5-2.7 of the Submission.

3.4 the term of authorisation sought and reasons for seeking this period. By default, the ACCC will assume you are seeking authorisation for five years. If a different period is being sought, please specify and explain why.

The Applicants seek final authorisation for a period of five years. In addition, the Applicants seek interim authorisation by 13 May 2022.

4 Provide documents submitted to the applicant's board or prepared by or for the applicant's senior management for purposes of assessing or making a decision in relation to the proposed conduct and any minutes or record of the decision made.

The Applicant has not prepared or submitted any such document to its board or senior management.

5 Provide the names of persons, or classes of persons, who may be directly impacted by the proposed conduct (e.g. targets of a proposed collective bargaining arrangement; suppliers or acquirers of the relevant products or services) and detail how or why they might be impacted.

- **Airlines providing domestic and international passenger services:** As suppliers of services directly competing with the Applicant, this class of persons may be impacted by the introduction of increased competition in markets for city-pair routes in which the Applicant also operates;
- **Domestic and international tourists:** As acquirers of the services to be provided by virtue of the Proposed Conduct, this class of persons may be impacted through more competitive fare pricing and the introduction of additional city-pair routes.

Market information and concentration

6 Describe the products and/or services, and the geographic areas, supplied by the applicants. Identify all products and services in which two or more parties to the proposed conduct overlap (compete with each other) or have a vertical relationship (e.g. supplier-customer).

Virgin Australia provides domestic and international passenger transport services and operates services to 33 domestic Australian destinations and one international destination. Virgin Australia does not currently operate any long-haul international flights and so does not compete with Partner Carriers.

7 Describe the relevant industry or industries. Where relevant, describe the sales process, the supply chains of any products or services involved, and the manufacturing process.

The relevant industry is the Australian aviation industry, about which the ACCC has extensive experience. Please see section 4 of the Submission for details about how the COVID-19 pandemic has affected the Australian aviation industry.

8 In respect of the overlapping products and/or services identified, provide estimated market shares for each of the parties where readily available.

There are no relevant overlapping products or services supplied by the Applicants and the Applicants will cease to engage in the conduct to the extent that they commence operating overlapping routes.

9 In assessing an application for authorisation, the ACCC takes into account competition faced by the parties to the proposed conduct. Describe the factors that would limit or prevent any ability for the parties involved to raise prices, reduce quality or choice, reduce innovation, or coordinate rather than compete vigorously.

Please see section 5 of the submission.

Public benefit

10 **Describe the benefits to the public that are likely to result from the proposed conduct. Provide information, data, documents or other evidence relevant to the ACCC's assessment of the public benefits**.

Please see section 4 of the Submission.

Public detriment (including likely competitive effects)

11 Describe any detriments to the public likely to result from the proposed conduct, including those likely to result from any lessening of competition. Provide information, data, documents, or other evidence relevant to the ACCC's assessment of the detriments.

Please see section 5 of the Submission.

Contact details of relevant market participants

12 Identify and/or provide names and, where possible, contact details (phone number and email address) for likely interested parties such as actual or potential competitors, key customers and suppliers, trade or industry associations and regulators.

The ACCC is familiar with the participants in the relevant markets.

Additional information

13 Provide any other information or documents you consider relevant to the ACCC's assessment of the application.

Please see the Submission.

Declaration by Applicant(s)

Authorised persons of the applicant(s) must complete the following declaration. Where there are multiple applicants, a separate declaration should be completed by each applicant.

> 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).

Signature of authorised person

[redacted]

Partner, Gilbert + Tobin

Louise Klamka

Solicitor on behalf of the Applicant

This 13th day of April 2022

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.

Authorisation for proposed codeshare pricing between Virgin Australia Airlines Pty Ltd and participating international airlines

Confidential submission to ACCC in support of application for authorisation

Final

13 April 2022

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Executive summary

Application for authorisation

Virgin Australia seeks authorisation on behalf of itself and partner airlines within a specified class of international operating carriers (**Partner Carriers**) to make and give effect to codeshare agreements which contain pricing provisions that may trigger the prohibition against resale price maintenance (the **Proposed Conduct**).

The Proposed Conduct will enable Virgin Australia, together with its Partner Carriers, to market a comprehensive network of international flight itineraries to Australian consumers and create stronger incentives to price codeshare fares competitively, in circumstances where Virgin Australia's ability to offer long-haul international travel has been significantly impaired by the COVID-19 pandemic and the circumstances surrounding its administration.

Authorisation of the Proposed Conduct will incentivise Partner Carriers to make codeshare inventory available to Virgin Australia at competitive prorate levels, enabling Virgin Australia to pass competitive fares onto its customers. This will allow Virgin Australia to offer consumers tactical or sale fares in conjunction with its Partner Carriers, thereby providing the broadest range of available fares and reducing operational complexity for Virgin Australia and booking confusion for consumers. The Proposed Conduct will also enable Virgin Australia, at a minimum, to cover its costs when supplying these codeshare services and support its return to broader international services.

The proposed codeshare pricing conduct

Unlike in a traditional arm's length codeshare pricing model, it is proposed that the Partner Carrier operating international services covered by the codeshare agreement will specify the fares at which Virgin Australia may market and resupply those services under a VA code. This model will enable the Partner Carrier to respond to changes in market fares more efficiently and offer Australian travellers a competitive airfare, which is then replicated by Virgin Australia, regardless of whether they have booked on a VA code or the Partner Carrier code. At the same time, Virgin Australia can recover its costs and may make a return on marketing these services.

The Proposed Conduct, discussed in further detail in section 2.1 below, allows the operating carrier to better manage risk associated with operating the international flight services, including by controlling all pricing outcomes as the sole or substantial operator of an international itinerary, while also giving Virgin Australia as the marketing carrier the incentive to invest in distribution channels and ability to cover its own costs.

In the absence of the Proposed Conduct, the operating carrier may be incentivised to only supply inventory to Virgin Australia at an uncompetitive prorate level. This rate may be designed to protect the operating carrier from being undercut by a codeshare partner on market fares in circumstances where the operating carrier has taken on the risk and investment involved in operating those services. Alternatively, the operating carrier may be incentivised to remove permission for the code completely if it is undercut, depriving consumers of the substantial codeshare benefits, discussed below.

The result is that Virgin Australia is unable to match the fares offered by the operating carrier, or other carriers offering substitutable services, without making a significant loss. Further, without this alignment, the attractiveness of these codeshare services is diminished as consumers may be confused and frustrated about the inconsistent pricing in the market and suffer detriment if they prefer to travel on VA coded services (for example if they are Velocity members) and ultimately pay more to do so. Under a traditional arm's length codeshare agreement, lower tactical fares may not be available to consumers through VA channels.

The result of the traditional arm's length codeshare model (where each airline is free separately to set the codeshare fares as it may determine) is to create artificial price competition between the operating carrier and the marketing carrier (who cannot itself supply the services absent the codeshare agreement), while hindering their ability to compete with other carriers in the market – in other words, artificially preserving the theory of intra-brand price competition at the expense of meaningful inter-brand competition.

The incentives created by standard arm's length codeshare agreements have been managed in joint ventures, where each airline shares the risks and rewards associated with the operations and enter into broad cooperation agreements. The ACCC has previously authorised Virgin Australia (and other airlines) to jointly agree the price of codeshare services with a range of international airline partners in the context of these joint ventures. Here more narrow cooperation is sought to address these incentives across a number of relationships with partner airlines. As Virgin Australia expands its international services, it may again enter into joint venture relationships with specific international airlines and is likely to do so in markets where it commences operating its own services. However, at this early stage of rebuilding its international services it requires authorisation of this more limited Proposed Conduct, which will deliver the benefits associated with providing access to more codeshare services from and returning to Australia. Virgin Australia considers that the Proposed Conduct offers significant commercial and consumer benefits in contrast to standard arm's length codeshare arrangements.

The Proposed Conduct is restricted to circumstances where a Partner Carrier is an international airline that does not operate overlapping services with Virgin Australia (whether operated by Virgin Australia or marketed by Virgin Australia in circumstances where Virgin Australia has pricing control).

In the absence of the Proposed Conduct, it is commercially unsustainable for Virgin Australia to continue to sell fares via its existing arm's length codeshare agreements. In the short term, this will negatively impact Virgin Australia's international flight capability and the degree to which the Virgin Australia brand is 'front of mind' for consumers looking to fly internationally. In the long term, Virgin Australia may be unable to act as a viable challenger in the market for international flight services to and from Australia.

As the Applicant does not currently have the capability to offer consumers a substantive network of international flight services, there is no overlap between the Applicant and its Partner Carriers' operations. The complementarity of their services enhances the pro-competitive effect of the Proposed Conduct.

Significant public benefits

Absent the Proposed Conduct, Virgin Australia would be constrained in its ability to market international services in the short to medium term. While Virgin Australia is investigating the recommencement of international long-haul services, it does not currently have access to suitable aircraft to begin operating a substantive network of international long-haul services in its own right. Instead, it is beginning to rebuild its virtual international network of partner airlines enabling it to offer codeshare services to Australian travellers. Pre-administration and the COVID-19 pandemic, Virgin Australia's experience was that, as a result of unfavourable prorates, its arm's length codeshare services were often loss-making, complicated to administer, and did not enable it to ensure consumers have access to the broadest possible range of fares for their flight. The Proposed Conduct is designed to address these shortcomings and enable Virgin Australia to more quickly and efficiently build up its international network as global travel recommences.

The Proposed Conduct delivers the following significant public benefits to Australians:

- Enabling Virgin Australia to more efficiently and quickly **rebuild its market presence and international offering**.

- Promoting a **competitive response from third-party airlines including the Qantas Group** as a result of Virgin Australia's enhanced product and service offering, placing competitive pressure on fares and increasing consumer benefits through service competition and innovation.

- **Cost savings and efficiencies passed on to consumers through lower fares by removing any possible incentives for** Partner Carriers to provide unfavourable prorates for inventory, enabling Virgin Australia and its Partner Carriers to more effectively respond to market pricing of third-party carriers. The changed incentives under the proposed pricing model will enable Virgin Australia to pass on competitive fares to Australian consumers without incurring losses.

- **More fare products available to more consumers in more channels** as any fare level set by the Partner Carrier is also available to consumers via the Applicant's sale channels, at the same price, including tactical and sale fares that Virgin Australia would be unable to viably match in a traditional codeshare pricing model. Consumers are able to access the widest range of fares available and Virgin Australia is able to offer fares which are likely to be competitive with the market.

- **Enhancing the customer experience and reducing customer confusion** including by providing a single, streamlined booking process for itineraries through Virgin Australia, and eliminating the possibility of consumers being able to access an identical flight at different fare levels from the Applicant and the Partner Carrier.

- **Greater loyalty program benefits** for Virgin Australia's 10.3 million Velocity members by providing them with access to the opportunity to earn loyalty benefits while accessing competitive fares when they book on a VA code.

Pro-competitive Effects – No Competitive Detriment

The Proposed Conduct will not result in any material anti-competitive detriment.

- **Promotes effective inter-brand competition** by aligning incentives between the operating carrier and the marketing carrier, who is unable to supply services absent a codeshare agreement, enabling them to compete with third-party airlines more effectively and provide competitive and efficient services.

- **No competitive overlap between the Applicant and Partner Carriers** as the Applicant does not currently have the aircraft required to operate a substantive network of long-haul international flight services. The Proposed Conduct will cease to apply where Virgin Australia commences operating or pricing services in competition with a Partner Carrier on overlapping routes.

- The Applicant and Partner Carriers will be constrained by **vigorous and effective competitors on relevant routes**, including the Qantas Group and its international partner airlines.

Why Authorisation is sought	Virgin Australia is seeking authorisation for the Proposed Conduct, rather than relying on Notification under section 93 of the *Competition and Consumer Act 2010* (Cth) (the **CCA**), as a result of what appears to be an anomaly in the drafting of the anti-overlap provisions contained in section 45AQ of the CCA. The effect of this anomaly is that there is a theoretical risk of *notified* RPM conduct not receiving the benefit of the anti-overlap provisions in section 45AQ of the CCA, leaving the parties potentially exposed to a technical breach of the cartel provisions of the CCA, even while a valid Notification is on foot. Therefore, while the Proposed Conduct is not likely to result in a substantial lessening of competition in any market and will result in significant public benefits, Virgin Australia seeks Authorisation out of caution to minimise the risk of a technical breach of the CCA.
Authorisation sought for 5 years with request for interim authorisation before 13 May 2022	As there is no competitive detriment associated with the Proposed Conduct, and the Proposed Conduct will deliver clear public benefits, there is no regulatory risk to a five year authorisation period. From [**Confidential: restriction of publication claimed**], Virgin Australia intends to commence marketing United Airlines operated services under a codeshare agreement that includes pricing provisions that give rise to the Proposed Conduct. To enable this to occur, Virgin Australia requests that the ACCC grant interim authorisation by 13 May 2022. It is commercially important for these codeshare services to commence at this time so that Virgin Australia can attract customers and begin to rebuild its international network. At present, there is pent up demand for travel to and from Australia as international travel rules are relaxed and the Northern Summer travel season begins. If Virgin Australia delays the launch of these services, it will suffer detriment as it loses the opportunity to make the most of this increase in demand.

1 The Applicant

1.1 Application by Virgin Australia on behalf of itself and Partner Carriers

This application is made by Virgin Australia Airlines Pty Ltd ABN 36 090 670 965, on behalf of:

(a) itself and its related bodies corporate, and Virgin Australia International Airlines Pty Ltd ABN 63 125 580 823 and its related bodies corporate (together, **Virgin Australia**); and

(b) a class of international operating airlines, comprising any other international operating carrier with which Virgin Australia proposes to codeshare as marketing carrier, including but not limited to United Airlines, Inc. (**United Airlines**), so long as the Proposed Conduct does not occur on an international route, or a flight segment of an international route, involving an origin airport and a destination airport (a **city pair**) on which Virgin Australia operates or prices services (**Partner Carrier**).

1.2 Virgin Australia

Virgin Australia commenced operations in Australia in August 2000 as Virgin Blue and currently operates a network of domestic services and limited short-haul international services from its hub at Brisbane Airport in Queensland. Virgin Australia is headquartered at South Bank, Queensland.

Since 2000, Virgin Australia has evolved, setting its sights on becoming Australia's most loved airline, regarded for its great customer value, award-winning service, and supported by its loyalty program, Velocity Frequent Flyer. Together with its group companies including Virgin Australia Regional Airlines Pty Ltd, Virgin Australia Cargo Pty Ltd, and Virgin Australia Airlines (SE Asia) Pty Ltd, Virgin Australia services all key segments of the Australian market, including leisure, corporate and government, regional and charter travellers, and air freight customers.

Virgin Australia was placed into administration in April 2020 following significant impacts to its business related to the COVID-19 pandemic. On 17 November 2020 it was purchased and de-listed by Bain Capital, a private equity firm based in the United States, with the Virgin Group Ltd also acquiring a 5% economic interest. Virgin Australia continued domestic operations during Administration, subject to ongoing COVID-19 restrictions, by operating a minimal schedule with support from the Federal Government. These operations were initially only approximately 5% of Virgin Australia's domestic schedule prior to COVID-19. As part of the administration process, Virgin Australia divested its widebody aircraft including Boeing 777s and Airbus A330s.[1]

1.3 Overview of operations

Prior to March 2020, Virgin Australia operated approximately 2,850 domestic flights per week[2] covering 75 routes from 40 ports around Australia. However, in response to the COVID-19 pandemic, Virgin Australia was required to cease operations on a significant number of domestic services and drastically reduce the frequency of other services, operating just 17 domestic routes in the second quarter of CY2020.[3]

Virgin Australia currently operates a fleet of narrow-body aircraft:

Aircraft	Number in fleet	Passenger seats
Boeing 737 Next Generation aircraft (737-800s)	75	176
Boeing 737 Next Generation aircraft (737-700s)	2	128

In late-2021, Virgin Australia announced the addition of a further seven Boeing 737-700s to its fleet.[4] This will take the fleet to a total of 84 aircraft, with the first aircraft due to arrive in Q4 of CY2022.

Virgin Australia's fleet services its domestic regular passenger transport and charter operations and, at the date of this submission, operates services to 33 domestic Australian destinations and one international destination.

(a) International services

Virgin Australia operates limited short-haul international flight routes for Australian consumers. Currently, these include services to Nadi, Fiji (NAN), with flights to Bali, Indonesia set to recommence from 15 June 2022. Virgin Australia does not currently

[1] Deloitte., "Virgin Australia Holdings Limited and subsidiaries: insolvency case information" (link); Virgin Australia ASX release: "Virgin Australia Holdings Limited – VAH (Administrators Appointed): Outcome of second meeting of creditors" (4 September 2020) (link).

[2] Virgin Australia ASX release: "Virgin Australia enters Voluntary Administration" (21 April 2020) (link).

[3] Virgin Newsroom, "Virgin Australia Group revised domestic schedule" (19 March 2020) (link).

[4] Virgin Newsroom, "Virgin Australia soaring one year after re-launch" (18 November 2021) (link).

operate services to any long-haul international destinations as a result of two primary factors.

Firstly, previous and potential future lockdowns and customer hesitation caused by new variants of COVID-19 have continued to affect both consumer demand for Virgin Australia's international services, and Virgin Australia's capacity to provide such services for its customers.

Virgin Australia resumed short-haul international services in 2021, starting with services between Sydney and Melbourne and Fiji (NAN)[5] however these services were placed on hold as a result of the disruption caused by the COVID-19 Omicron wave in early 2022.[6] Virgin Australia resumed services from Sydney to Fiji (NAN) at reduced frequency on 10 March 2022, [**Confidential: restriction of publication claimed**].

The resumption of Virgin Australia's short-haul international flight services has been delayed as a result of travel uncertainty and variable consumer demand caused by border closures, travel restrictions and new COVID-19 variants. The impact of the COVID-19 pandemic on domestic and international airline travel is considered in further detail at section 4 below.

Secondly, lease contracts which provided Virgin Australia with a widebody aircraft fleet expired during the COVID-19 pandemic or were cancelled during administration, and while Virgin Australia [**Confidential: restriction of publication claimed**]. As widebody aircraft are generally required to service international long-haul destinations, Virgin Australia does not currently have the capacity to provide these international services to its customers until it is able to obtain leases for new widebody aircraft stock. Widebody aircraft are a significant investment and require lengthy lead times [**Confidential: restriction of publication claimed**].

1.4 Codeshare

(a) *Purpose of codeshare arrangements*

A codeshare agreement is an arrangement between two or more carriers, whereby an airline's (the **marketing carrier**) designator code is assigned to a flight operated by another airline (the **operating carrier**). Virgin Australia has historically typically entered into code sharing arrangements as a marketing carrier with other international carriers on an arm's length basis, including: Alitalia, Air Serbia, Air Canada, Virgin Atlantic, Hawaiian Airlines, South African Airways, and as part of authorised joint venture arrangements, including with: Delta Air Lines,[7] Singapore Airlines,[8] Etihad Airways, Air New Zealand, Hainan Airlines and Hong Kong Airlines.

Codeshare agreements allow carriers to expand their geographical area of service to routes on which they do not operate, extending the network of services they can sell to customers either on a standalone basis or as part of a connecting itinerary together with their own operated legs. Codeshare also creates efficiencies by providing operating carriers with more marketing channels to attract more customers (including in geographic areas beyond their home markets), ensuring that flights have optimal passenger loads.

[5] Virgin Newsroom, "Virgin Australia welcomes back international travellers" (21 February 2022) (link).

[6] Australian Aviation, Hannah Dowling, "Virgin renews push to hire hundreds of new staff" (28 February 2022) (link).

[7] This arrangement was granted substituted authorisation by the ACCC on 14 August 2015 until 7 September 2020. ACCC, Authorisation Determination in respect of Virgin Australia and others, 14 August 2015 (link).

[8] This arrangement was granted re-authorisation by the ACCC on 23 September 2016 for a term of five years. ACCC, Authorisation Determination in respect of Virgin Australia and Singapore Airlines, 23 September 2016 (link). See ACCC's register entry for the authorisation here.

Codeshare also creates a simpler experience for consumers using connecting flights, by allowing them to book an entire itinerary with one airline.

(b) *Operation of codeshare models*

There are several different models of codeshare, including:

- **Block space codeshare agreement**, where the marketing carrier accesses an allocation of inventory from the operating carrier; and
- **Free sale codeshare agreement**, where the marketing carrier only pays for the seats that it sells on the operating carrier's service.

The codeshare agreements contemplated here are free sale codeshare agreements.

(c) *Incentives created by traditional codeshare models*

In codeshare arrangements, the airline that issues the ticket collects payment from the customer. Where other airlines operate segments on the ticket, these operating airlines will need to bill the ticketing airline for the revenue they have earned by flying the passenger. This may be done by way of an agreed fixed rate, or through some pro-ration of a fare that has been collected that may cross over one or more segments on the ticket. Fixed rate is a set value that the ticketing airline pays to the operating airline. There is a value for every market segment, which will differ by inventory level. Inventory is controlled by the operating carrier. A prorate is a sharing of the value of the airfare that has been ticketed. This is calculated on a distance basis of each segment in the journey, with longer segments earning a greater portion of the airfare than shorter segments in the journey. In a traditional codeshare arrangement, the marketing carrier may hold responsibility for determining fares, ticketing and frequent flier entitlements, as they would on flights they operate, but they are constrained in their ability to do this by the agreed fixed rate or prorate.

Codeshare arrangements enable the marketing carrier to offer services that it is unable to operate, extending the network of services that it can sell to customers, and to broaden its network by offering connections behind or beyond its own operated networks. At the same time, the marketing carrier provides important benefits to the operating carrier in the form of channels for the distribution of the operating carrier's services, and makes investment in sales and marketing in order to do so. However, it is the operating carrier that bears the costs and risks associated with the provision of the services themselves. This level of operational risk affects the incentives of the operating carrier to provide inventory to the marketing carrier at a favourable prorate level. Without favourable prorates, the marketing carrier is limited in its ability to discount codeshare services or match sale fares that are being offered in the market by either the operating carrier or third-party airlines.

In a traditional arm's length codeshare arrangement, each operating carrier may seek to protect their revenue outcome by establishing fixed rates for their own operated segments. These arrangements work optimally when the risk is equally distributed between the parties to the arrangement and each is acting as both an operating and marketing carrier on similar flight segments (e.g. an agreement between Lufthansa and Singapore Airlines that covers their two networks, with services between Europe and Australia via Singapore).

In these balanced relationships, any potential "losses" from unfavourable fixed rate prorates on partner segments can be "absorbed" on the revenue that would accrue to operated segments when each party is selling tickets. Where the operating carrier operates all or a substantial majority of the itinerary, the operating carrier bears a disproportionate level of risk and is incentivised to ensure that the marketing carrier does not price in a way that would hinder its ability to make a return. Where Virgin Australia markets the long-haul services of its Partner Carriers to Australian consumers, while operating short-haul domestic services in Australia only, the risks and incentives are not balanced.

The Proposed Conduct, discussed in further detail in section 2.1 below, allows the operating carrier to better manage risk associated with operating the international flight service, including by controlling all pricing outcomes as the sole or substantial operator of an international itinerary, while also giving the marketing carrier the incentive to invest in distribution channels and cover its own costs.

1.5 Prospective international operations

Virgin Australia is committed to strengthening its position as Australia's second national airline, restoring customer confidence in the Virgin Australia brand, and taking advantage of important opportunities to earn revenue. It is therefore crucial for Virgin Australia to take steps to commence supplying a wider range of services to customers as soon as possible and by so doing, take advantage of easing movement restrictions and the recommencement of international travel.

On 15 December 2021 Virgin Australia announced a partnership with United Airlines commencing in 2022, which would replace Virgin Australia's codeshare and frequent flyer relationship with Delta Air Lines.[9] The partnership will allow Virgin Australia to triple its reach into the Americas as marketing carrier for United Airlines services to Mexico, the Caribbean and South America.[10] Since this announcement Virgin Australia and United Airlines have been in the process of negotiating the mechanics of the applicable pricing provisions, and are not yet operating as codeshare partners. [**Confidential: restriction of publication claimed**]. Virgin Australia anticipates entering into codeshare agreements with a range of international airlines, including former and new partners.

2 The Proposed Conduct

2.1 Proposed Conduct

The Applicant seeks authorisation on behalf of itself and Partner Carriers to make and give effect to codeshare agreements with Partner Carriers which contain pricing provisions that may trigger the prohibition against RPM conduct within the meaning of sections 48 and 96 of the CCA (the **Proposed Conduct**).

The Proposed Conduct will be limited to instances in which the Partner Carrier operating international services covered by the codeshare agreement will specify the fares at which the Applicant may market and resupply those services to consumers in Australia:

- under the Applicant's own, independently set fare families and fare conditions;
- under the Applicant's code (VA);
- via the Applicant's own channels; and
- whether these are sold as a standalone itinerary or part of an itinerary that includes segments operated by Virgin Australia.

[9] Virgin media releases, "Virgin Australia and United Airlines announce partnership" (15 December 2021) (link).

[10] Virgin media releases, "Virgin Australia and United Airlines announce partnership" (15 December 2021) (link).

If authorised by the ACCC, the effect of the Proposed Conduct will be that, for any relevant codeshare agreements with Partner Carriers, the Applicant would not independently price any flight segments operated by the relevant Partner Carrier. Instead, the Applicant would accept the fare level specified by the Partner Carrier. All other aspects of the relevant codeshare arrangements would be conducted on an arm's length basis.

Virgin Australia intends to enter agreements with Partner Carriers over time. Subject to authorisation, Virgin Australia proposes to enter into the Proposed Conduct as part of its codeshare agreement with United Airlines. [**Confidential: restriction of publication claimed**].

Provided at **Attachment A** is a copy of the template form of pricing provisions that Virgin Australia intends to propose to Partner Carriers to give effect to the Proposed Conduct. Each agreement with a Partner Carrier will be subject to commercial negotiation and agreement but Virgin Australia anticipates they will contain pricing provisions that are consistent with this template.

2.2 Why Authorisation is sought

The Applicant seeks authorisation for the Proposed Conduct, rather than notifying the RPM conduct under section 93 of the CCA, as a result of an apparent anomaly in the drafting of the anti-overlap provisions contained in section 45AQ. The effect of this anomaly is such that there is a theoretical risk of *notified* RPM conduct <u>not</u> receiving the benefit of the anti-overlap provisions in section 45AQ of the CCA and breaching the CCA even if the conduct has been validly notified.

Accordingly, while the Proposed Conduct is not likely to result in a substantial lessening of competition in any market and will result in significant public benefits, the Applicant seeks Authorisation out of caution to minimise the risk of a technical breach of the CCA.

Authorisation is sought in relation to the prohibition against RPM under sections 48 and 96 of the CCA.

2.3 Scope of the Proposed Conduct

The Proposed Conduct will not apply to international itineraries, or one or more flight segments of an international route, involving a city pair on which Virgin Australia operates services or markets the services of another international carrier under an arm's length arrangement.

The Proposed Conduct will cease to apply where Virgin Australia commences its own services in competition with a Partner Carrier.

The Proposed Conduct does not have the purpose of increasing the price of international flight services to Australian consumers and is not expected to result in an increase in the price Australian consumers pay for international flight services. Rather, the Proposed Conduct is likely to result in Australian consumers being able to access more competitive fares for international flight services as it will enable Virgin Australia to market sale and tactical fares on its code at competitive levels, without either Virgin Australia or the Partner Carrier incurring losses that could arise in the absence of the Proposed Conduct.

2.4 Timeframe for Proposed Conduct

If authorised, the Proposed Conduct will commence from the date of the ACCC's grant of interim authorisation [**Confidential: restriction of publication claimed**].

2.5 Commercial rationale: Codeshare agreements

Codeshare agreements with international carriers are a core component of Virgin Australia's strategy to build a strong domestic and international airline. Virgin Australia is not currently marketing any international long-haul services on its code.

Virgin Australia's partnerships with United Airlines, and prospective or revived partnerships with [**Confidential: restriction of publication claimed**], will provide Virgin Australia with the ability to recommence international services through a virtual network on its own code.

While Virgin Australia intends to recommence international long-haul services, it does not currently have access to suitable aircraft to begin operating a substantive network of services in its own right. Instead, it is beginning to rebuild and revive its virtual international network of partner airlines enabling it to offer codeshare services to Australian travellers. Pre-administration and COVID-19, Virgin Australia's experience was that, in the absence of authorised joint venture arrangements, its arm's length codeshare services were often unprofitable, complex to administer, and unfavourable prorates meant that it was not able to offer competitive fares to consumers. The Proposed Conduct is designed to address these shortcomings of arm's length codeshare and enable Virgin Australia to more quickly and efficiently build up its international network as demand for global travel resumes. At the same time, it will enable operating carriers, who take the risk of operating services themselves, to control pricing and better manage this risk, making codeshare services more competitive against other third-party services and removing the theoretical possibility of intra-brand price competition between operating and marketing carriers.

Outside authorised joint ventures, Virgin Australia has historically entered into codeshare agreements whereby the marketing carrier would independently price all itineraries, subject to a prorate agreement which allows the operating carrier to recover from the marketing carrier an amount of revenue for their operated service. This could be as a prorate of the overall fare, as a prorate subject to a minimum amount, or as a fixed rate. This is as a result of:

- the partner carrier and Virgin Australia theoretically competing with each other at a micro level to entice consumers to book directly with them on an **identical service** which weakens any incentive to offer competitive prorates; and

- the partner carrier competing with other operating carriers at a macro level to entice consumers to book with them on an **identical or substitutable route**.

The Proposed Conduct would mean that the latter form of competition would remain and be strengthened, but that the former which would not be sustainable would fall away.

Codeshare agreements are a critical stepping-stone in Virgin Australia's short to medium-term strategy to return to international services. Absent the Proposed Conduct, Virgin Australia will be constrained in its ability to market international services as Virgin Australia currently does not have the fleet capability to recommence long-haul international services. The Proposed Conduct will ensure that the Virgin Australia brand remains an option for both domestic and international flight services in consumers' minds until it is able to re-establish operational capability.

Virgin Australia's experience is that in the absence of an authorised joint venture permitting price coordination, traditional arm's length codeshare agreements are no longer commercially sustainable for Virgin Australia. In the absence of the Proposed Conduct, Virgin Australia will be unable to efficiently market international services as a virtual network or in conjunction with its own operations.

2.6 Commercial rationale: Absent the Proposed Conduct, traditional arm's length codeshare pricing models are commercially unsustainable for the Applicant

The Proposed Conduct will allow Virgin Australia to offer international services more efficiently to Australian consumers, at fare levels that are competitive with the market, while enabling operating carriers to control for their risks and Virgin Australia to cover the costs of its marketing services. In Virgin Australia's experience, traditional arm's length codeshare agreements are inefficient in circumstances where the operating and marketing carriers have unbalanced services, as is the case where Virgin Australia operates domestic services and select short-haul international services and its partner airlines operate long-haul international services that connect with these.

(a) Operating carriers must price itineraries competitively with other carriers on an identical route. However, in a traditional arm's length codeshare agreement, the operating carrier must also take into consideration the importance of setting a prorate for the marketing carrier (such as Virgin Australia) that is sufficiently high to ensure that the operating carrier can generate a return on any seats that it has allocated for the codeshare. In the absence of the Proposed Conduct, the operating carrier would be incentivised to only supply inventory to Virgin Australia at a prorate level designed to ensure Virgin Australia has no margin to undercut the operating carrier's fares. If the operating carrier were compelled to offer prorate fares at a lower rate and Virgin Australia did undercut the operating carrier's fares, the operating carrier would have an incentive to stop supplying inventory. This is a natural response as the operating carrier is bearing the risks associated with operating the relevant services.

(b) In Virgin Australia's experience, traditional arm's length codeshare agreements are inefficient for the marketing carrier, as the marketing carrier is tied to the fixed prorate or minimum amount for the codeshare seats, impeding its ability to price competitively with the market. In many cases, the result is that Virgin Australia is unable to match the fares offered by the operating carrier, or other carriers offering substitutable services, without making a significant loss. This means that the marketing carrier is disincentivised to invest in sales and marketing of those services and simply does not match the tactical fares offered by the operating carrier or other carriers offering substitutable services.

(c) Traditional arm's length codeshare agreements have the potential to cause customer confusion and frustration as they can see inconsistent pricing for identical flight services in the market and may suffer detriment if they prefer to travel on VA services, which may not be priced competitively.

(d) Traditional arm's length codeshare agreements require Virgin Australia to invest significant amounts of time and resources to respond to partner pricing, despite being constrained in its ability to do so in a meaningful way, resulting in lost efficiency.

There have been a number of instances in which Virgin Australia has had to decide whether to:

- offer a competitive codeshare fare to consumers in line with the market and generate a loss after taking into account the operating carrier's unfavourable prorate; or
- set a fare at a rate that is higher than the market rate, to be able to generate a return after taking into account the operating carrier's unfavourable prorate and risk losing customers.

These pricing difficulties have impeded Virgin Australia's ability to effectively offer codeshare services outside authorised joint ventures, while limiting access to distribution channels for international operating carriers.

Examples of the impact of these decisions on Virgin Australia's ability to compete with the market on fare levels are provided in section 2.7 below.

2.7 Pricing under existing codeshare revenue arrangements

In the absence of the Proposed Conduct, it is commercially unsustainable for the Applicant to continue to sell all fares of all partners via traditional arm's length codeshare pricing models, and it is likely that Virgin Australia would not restore codeshare sales with all partners.

If the Proposed Conduct receives authorisation, and agreements facilitating the Proposed Conduct are executed, Virgin Australia would have a contractual obligation not to undercut the Partner Carrier's fares. Under these circumstances, the Applicant will match the Partner Carrier's notified fare and the Partner Carrier will be in full control of pricing any flight segments pursuant to the Proposed Conduct. Virgin Australia will receive an amount representing the Interline Service Charge (**ISC**) for its marketing services (reflective of its cost of sale)[11] and, for itineraries which include a Virgin Australia operated segment, may also receive a fixed prorate in respect of its operated service. This means that Virgin Australia will be limited in its ability to profit on sales of fares under the Proposed Conduct. However, Virgin Australia will be protected from making a loss and the Proposed Conduct will:

(i) allow Virgin Australia to participate in the market for international flight services;

(ii) ensure that the Virgin Australia brand remains relevant in consumers' minds; and

(iii) generate additional traffic on Virgin Australia's operated services for itineraries which include a Virgin Australia operated segment.

The availability of this distribution channel will in turn create efficiencies for the operating carrier and provide end consumers with more choice.

The Applicant has sought to demonstrate this pricing through two common scenarios: tactical pricing and through-fares on multi-segment itineraries. These examples demonstrate that in the short term and in the absence of the Proposed Conduct, these pricing outcomes will mean that the Applicant is unable to offer long-haul international flight services for sale through its channels, resulting in a negative impact on consumers' perception of the Applicant's international flight capability. In the long term, the absence of the Proposed Conduct may mean that the Applicant is delayed in its ability to be a viable challenger in the market for international long-haul flight services to and from Australia.

As the Applicant has not been selling international flights through codeshare partners for almost two years, the Applicant has limited recent historical pricing information available, so these examples use a combination of actual data and illustrative examples based on Virgin Australia's experiences.

[11] The IATA Interline Service Charge sets the service charge at 9% (IATA, Passenger Services Conference Resolutions Manual, Resolution 780b, 780c and 780d), subject to any other agreement between the parties.

(a) Tactical pricing – Actual scenarios

[Confidential: restriction of publication claimed]

(b) Tactical pricing – Illustrative examples for Sydney to Honolulu pre- and post-Proposed Conduct

[**Confidential: restriction of publication claimed**]

(c) Through fares on multi-segment itineraries

Virgin Australia cannot sustainably offer codeshare services in circumstances where international carriers file discounted through fares for a multi-segment itinerary. This is because unfavourable prorates (including high fixed rates) under SPAs are provided for segments, regardless of the itinerary. Therefore, the same fixed rate will be billed for each sector regardless of the actual origin and destination. This presents challenges for Virgin Australia when partnering with an airline that is typically selling at least two of their own flights in combination. The Partner Carrier can file a discounted fare for the entire itinerary while billing Virgin Australia at the unfavourable prorates for each sector operated by the partner carrier, typically resulting in negative returns for Virgin Australia.

[**Confidential: restriction of publication claimed**]

3 Request for authorisation

3.1 Request for interim authorisation

The Applicant seeks authorisation to make, and give effect to, the Proposed Conduct as set out in 2 above, including by making and giving effect to pricing provisions in terms consistent with the template set out in Annexure A.

The Applicant submits that the ACCC should authorise the Proposed Conduct for a period of five years.

The Applicant seeks authorisation on the basis that:

- the Proposed Conduct will not result in competitive detriment; and
- the Proposed Conduct will result in significant public benefits which outweigh any potential detriment.

From [**Confidential: restriction of publication claimed**], the Applicant intends to market United Airlines operated services under a codeshare agreement which includes pricing provisions that give effect to the Proposed Conduct. To ensure that the Applicant can commence marketing to customers and begin the process of rebuilding its international network, the Applicant requests that the ACCC grant interim authorisation by 13 May 2022. It is commercially important for the Applicant to commence codeshare services with United Airlines by this time in circumstances where there is likely to be an increase in demand for travel to and from Australia as international travel rules are relaxed and the northern hemisphere's summer travel season begins.

The Applicant considers interim authorisation is appropriate because:

- interim authorisation will not permanently alter the competitive dynamics of the market or inhibit the market from returning to its pre-interim-authorisation state if final authorisation is later denied;

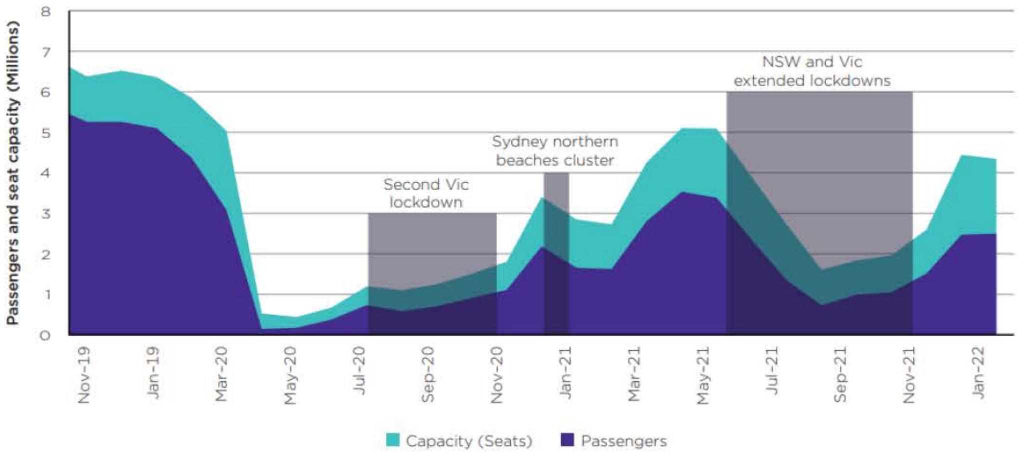
- there is some urgency to enable the Proposed Conduct to be offered to Australian consumers in the near term given the current market conditions and for the reasons explained in this submission;
- there is no possible harm to other parties (such as customers and competitors) if a request for interim authorisation is granted; and
- the public benefits relied on are such that the ACCC can assess these to a real extent at the time of considering the request for interim authorisation, particularly given the ACCC's substantial knowledge and experience of international airline markets.

3.2 International air travel is recovering, and Virgin Australia must move at pace to re-establish itself as a viable competitor

(a) Impact of the COVID-19 pandemic on the Australian international airline industry

It is difficult to overstate the devastating impact of the COVID-19 pandemic on the Australian aviation industry. In the first of its reports on airline competition in Australia, the ACCC reported an almost 95% reduction in passenger numbers and seating capacity in April 2020 when compared to April 2019.[12] Almost two years on from when the pandemic first impacted Australia in March 2020, the ACCC noted that the continuing effect of the pandemic was evident from airlines' financial results[13] and provided a picture of a disrupted path to recovery which was further impacted by the January 2022 Omicron outbreak:[14]

Figure 1: ACCC figure illustrating Australian domestic air services passenger and seat capacity from November 2019 to January 2022



Despite the overwhelming negative impact of the COVID-19 pandemic, it is apparent that domestic and international travel is beginning to recover. International scheduled passenger traffic in December 2021 increased 404% from the same month in 2020, and 73% more seats were available on international scheduled flights to and from Australia in December 2021 from the same month in 2020 (although seat utilisation decreased).[15] Figure 2 obtained from the Bureau of Infrastructure and Transport Research Economics

[12] ACCC, "Airline competition In Australia" (September 2020) (link), page 7.

[13] ACCC, "Airline competition In Australia" (September 2020) (link), page 13.

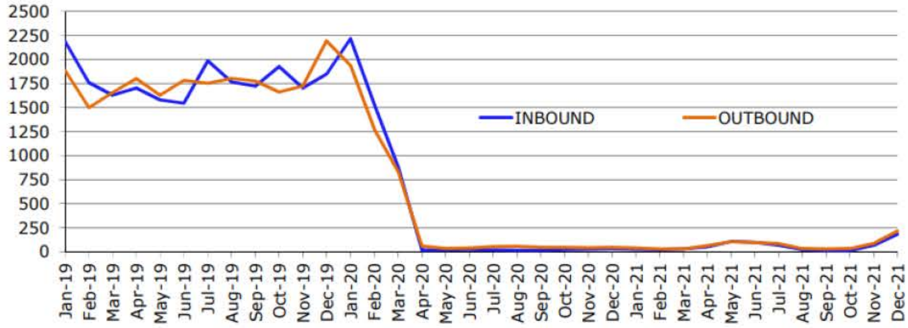
[14] ACCC, "Airline competition In Australia" (September 2020) (link), page 13.

[15] Department of Infrastructure, Transport, Regional Development and Communications, "Statistical Report – International airline activity" (December 2021) (link), page 4.

(**BITRE**) below provides a visualisation of the impact of the COVID-19 pandemic on international services, and demonstrates the modest recovery experienced by the industry in December 2021.[16]

2021 saw the limited introduction of travel bubbles and quarantine-free travel to selected countries, including quarantine-free travel between Australia and New Zealand from April to July 2021. After approximately 20 months of strict border control, Australia reopened its borders to Australian citizens and residents in November 2021, with all visa holders, including international tourists, following in February 2022. Following Australia's border opening, international travel continues to grow tentatively in 2022.

Figure 2: Passengers carried on international services (thousands) (BITRE 2021)



(b) Virgin Australia must establish itself as a viable competitor for international passenger transport services

While international air travel has been recovering tentatively as a result of intermittently easing movement and travel restrictions, it is apparent that the recovery is continuing to gather momentum. The International Air Transport Association (**IATA**) reported that total global demand for air travel in January 2022 was up 82.3% when compared with January 2021.[17] For carriers in the Asia-Pacific, international air traffic rose 124.4% in 2022 when compared to January 2021. While these figures fall short of the level of international traffic in 2019 prior to the COVID-19 pandemic, IATA has forecasted that international traveller numbers will improve to 83% of 2019-levels in 2022, 94% in 2023, 103% in 2024 and 111% in 2025.[18]

The forecasted increase in demand for international air travel means that it is crucial for Virgin Australia to establish itself as a strong domestic and international carrier in Australian consumers' minds, and to act as a strong competitor to Qantas Group and its partner airlines, which remains the dominant domestic and international carrier in Australia. In the year ending December 2019 Virgin Australia had the fifth-largest share of international passengers transported to or from an Australian port at 6.7%.[19] As a result of the factors discussed at section 1.3(a) above, Virgin Australia is a far less significant international carrier and was not a top 10 carrier in 2021 (see figure 4 below). A failure by Virgin to re-establish itself as one of several leading providers of international flight services risks Virgin Australia being left behind just as global movement and travel restrictions ease. Such a failure would be particularly disadvantageous in circumstances where the Qantas Group has projected an increase to 44% of its passenger levels prior to

[16] Department of Infrastructure, Transport, Regional Development and Communications, "Statistical Report – International airline activity" (December 2021) (link), page 20.

[17] IATA press release, "Air travel sees strong demand recovery in January but impacted by Omicron" (10 March 2022) (link).

[18] IATA press release, "Air travel sees strong demand recovery in January but impacted by Omicron" (10 March 2022) (link).

[19] Department of Infrastructure, Transport, Regional Development and Communications, "Statistical Report – International airline activity" (December 2019) (link), page 8.

the COVID-19 pandemic between April and June 2022[20] as it adds additional services to its roster to London, Los Angeles, Singapore and New Delhi. While Virgin Australia builds its aircraft fleet, interim authorisation will also allow Virgin Australia to utilise Partner Carriers' broad international networks to re-establish its presence in Australian and international markets as an international carrier.

3.3 The Proposed Conduct will allow the Applicant and Partner Carriers to manage pricing risk and to price fares competitively with the market

As outlined in in section 2 above, the Proposed Conduct would effectively remove the need for the Partner Carrier to recover a fixed rate or a minimum amount to the codeshare seats it allocates to Virgin Australia, resulting in efficiencies in pricing itineraries.

These efficiencies are realised as the Partner Carrier no longer artificially prices competitively with Virgin Australia to attract customers to its booking platform for an identical flight on which they are codeshare partners.

The traditional arm's length codeshare model may appear to preserve intra-brand price competition at the expense of inter-brand competition by inflating the price of fares through double marginalisation (or "double profit mark-up") by the operating carrier and the marketing carrier (who cannot itself supply the services without the codeshare agreement), while hindering both carriers' ability to compete with other carriers within the market. However, that model is not sustainable for the reasons explained above.

As a result of the Proposed Conduct, the commercial relationship between the marketing carrier and the operating carrier is reconfigured to remove artificial price competition between the operating and marketing carriers. Giving the operating carrier control over pricing enables it to manage the risks associated with operating the service, while the ability to cover costs or earn a return means that the marketing carrier is incentivised to invest in the distribution of the codeshare services, facilitating enhanced competition in the supply of international flight itineraries by promoting inter-brand competition.

3.4 The Proposed Conduct will allow Virgin Australia to offer Australian consumers competing options for international flights

In the absence of the Proposed Conduct, Virgin Australia will be unable to efficiently offer long-haul international flight services to Australian consumers in the short to medium term, including because it does not currently have access to widebody aircraft. The time that Virgin Australia may take to scale up its fleet of widebody aircraft may result in significant detriment to Virgin Australia as a challenger to Qantas as the only national carrier providing international long-haul flight services and result in reduced consumer choice.

4 Significant public benefits

Although the Proposed Conduct is limited in scope, it will result in clear public benefits that are commensurate with this scope and outweigh any detriment associated with the removal of artificial intra-brand price competition between the Partner Carrier operating international services, and Virgin Australia marketing those services to Australian consumers.

[20] Qantas Group, "Qantas Group HY22 Presentation" (24 February 2022) (link), page 29.

4.1 Enabling Virgin Australia to quickly rebuild its market presence, providing more international flight options for Australian consumers

The Proposed Conduct is a critical aspect of Virgin Australia's medium-term strategy to return to long-haul international travel. The proposed pricing model facilitates the efficient provision of competitive pricing of international long-haul fares to Australian consumers and allows Virgin Australia to cover its costs when marketing these services. This, in turn, makes the provision of codeshare services by Virgin Australia a far more efficient and sustainable enterprise, in circumstances where Virgin Australia's lack of widebody aircraft renders codeshare the only viable avenue for its provision of a substantive network of international long-haul services to Australian consumers. It is precisely the avoidance of significant losses, enabled by this pricing model, from which the material public benefits outlined here and below flow.

Under traditional arm's length codeshare agreements, international carriers are incentivised to avoid being undercut (i.e. maximise profits), to offer their codeshare services at a fixed-rate special prorate agreement (**SPA**) – that is, an agreement between two or more airlines on the apportionment of throughfares on itineraries with two or more segments operated by different airlines – regardless of pricing. When the international carrier offers tactical pricing on long-haul fares through its sales channels, Virgin Australia is unable to offer the same tactical pricing through its own channels without making substantial losses due to the fixed-rate SPA in place.

By diminishing the incentive of the Partner Carrier to protect its revenue through high fixed-rate SPAs, the Proposed Conduct enables Virgin Australia to match tactical pricing offered by its Partner Carrier and offer these to Australian customers. Virgin Australia will be able to better participate in the provision of discounted and tactical pricing to Australian consumers, in competition with international carriers, and more efficiently operate its codeshare services in the period prior to obtaining widebody aircraft.

This will enable Virgin Australia to more rapidly rebuild its market presence in circumstances where the COVID-19 pandemic and its administration have significantly impaired its offerings in this market. A stronger market offering from Virgin Australia will, in turn, play a significant role in the restoration of domestic competition and increased options for Australian consumers in the long-haul international flight market. In the absence of the Proposed Conduct, traditional arm's length codeshare arrangements are unsustainable for Virgin Australia. A stronger Virgin Australia benefits both consumers and competition by providing more choice and a long-term rival for the Qantas Group.

4.2 Promoting a competitive response from Qantas as a result of Virgin Australia's enhanced product and service offering

The Proposed Conduct would help facilitate a broader international network for Virgin Australia and lower fares, which in turn is likely to stimulate competition between Virgin Australia and third-party airlines including the Qantas Group.

In 2020 with the emergence of the COVID-19 pandemic, Virgin Australia suspended selling all itineraries involving partners and all codeshare where Virgin Australia was a marketing carrier, which included grounding international passenger operations for an extended period. Currently, Qantas and Qantas-owned Jetstar are the only Australian carriers offering flights into the US and parts of Asia, and Qantas is the only Australian carrier offering flights to Europe.

The unusually lopsided market for international flights that currently exists in Australia is consequence of the COVID-19 global pandemic and Australia's strategic public health response in closing Australia's border to international flights. This context is now changing. International borders are opening up, and Australians' appetite for international travel is recovering. It is therefore critical at this juncture of the COVID-19 pandemic and the state of the international flight market for Virgin Australia to be better placed to challenge Qantas' dominant position in relation to international long-haul travel to/from Australia.

Authorisation of the Proposed Conduct will allow Virgin Australia to partner with Partner Carriers, including United Airlines, [**Confidential: restriction of publication claimed**], and offer a comprehensive international network between Australia and the Americas, Europe, and Asia. In turn, this has the potential to trigger a competitive reaction from other airlines including Qantas by offering more services which, in addition to more competitive pricing, is likely to result in greater consumer benefits for Australians wishing to travel internationally in the form of, for example, greater loyalty program and lounge access benefits. Enhanced service offerings and cheaper flights will be key to encouraging Australians' appetite for and confidence to travel, which the ACCC has recently reported is what is currently driving recovery in the industry.[21]

This outcome is advantageous not only for consumers, but in facilitating a competitive international flight market with two full-service domestic carriers that also offer Australian consumers international connectivity. As former ACCC Chair Rod Sims has said on a number of occasions, the existence of two full-service airlines is essential to industry recovery through and beyond the COVID-19 pandemic.[22] To achieve this, it is critical for Virgin Australia to have an enhanced ability to compete in the long-haul international flight market.

Long-haul international flights play an important role in demand for domestic Australian flights and act as passenger feed for Virgin Australia's domestic services. In its latest report monitoring airline competition in Australia, the ACCC acknowledged this and stated that prior to the COVID-19 pandemic, international visitors contributed to 8% of the overall demand for domestic air services.[23] In rebuilding Virgin Australia as a full-service domestic carrier in competition with Qantas, the Proposed Conduct has the added benefit of re-invigorating domestic competition with Qantas, through making the operation of codeshare services for international long-haul travel more sustainable.

4.3 Lower fares and greater efficiencies in pricing services

As considered in further detail at 2.5 above, in Virgin Australia's experience the traditional arm's length codeshare pricing model works optimally where the marketing and operating carriers operate a relatively equal share of flying. This is due to the competing incentives operating on each airline to:

- protect their own operated segment revenues through fixed rates or minimum amounts, and
- to not price their own segments too highly, so as to attract favourable reciprocal rates for what is a sizeable proportion of the total flight.

Authorisation of the Proposed Conduct will allow Virgin Australia to take steps to implement a pricing model offering the Australian market prices that are competitive in the international flight market. The changed incentives under the proposed pricing model will

[21] ACCC, "Airline competition in Australia" (March 2022) (link), page 3.

[22] [In reference to the aftermath of the COVID-19 pandemic] "*[O]bviously we're going to need two airlines, two big airlines … we need the companies that were there before that were the key underpinning of our economy to still be there.*" Ben Butler and Josh Taylor, 'Rod Sims weighs in on Virgin Australia stoush with Qantas, calling for 'cooperative spirit'', *The Guardian* (online, 24 March 2020) (link); "*We desperately need two full-service airlines when this is over.*" *RN Breakfast* (ABC Radio National, 2 April 2020), as quoted by Adam Thorn, 'ACCC Chairman Publicly Backs Virgin', *Australian Aviation* (online, 2 April 2020) (link).

[23] ACCC, "Airline competition in Australia" (March 2022) (link), page 9, referencing Tourism Research Australia, "Moving forward: The role of domestic travel in Australia's tourism recovery" (August 2020), pages 7–8.

enable Virgin Australia to pass on competitive fares to Australian consumers without incurring losses, while enabling the Partner Carrier to concentrate on competing with international airlines rather than focusing on protecting its margin from erosion by the pricing of its codeshare distributor.

4.4 More fare products available to more consumers via more channels

Under the Proposed Conduct, any fare level set by the Partner Carrier will also be made available to consumers via the Applicant's sale channels, at the same price, including tactical and sale fares that Virgin Australia would be unable to match in a traditional codeshare pricing model. This will mean that consumers are able to access the widest range of fares available and that Virgin Australia is able to offer fares which are likely to be competitive with the market. For Australian consumers that prefer to book via Virgin Australia direct channels, or Velocity members that wish to travel on a VA* code, this will be a particular benefit. Absent the Proposed Conduct, consumers may miss out on the best available fares, if they are not also made available through the Virgin Australia channel.

4.5 Reduction in customer confusion through clearer and simpler pricing

Virgin Australia anticipates that customers may also benefit from the removal of inconsistent pricing for identical services operated by the Partner Carrier and marketed and ticketed by Virgin Australia. For travellers who prefer to travel on VA code, they will benefit by being able to access VA* coded services at a competitive price.

4.6 Greater loyalty program benefits for Virgin Australia's Velocity members

By authorising the Proposed Conduct, Virgin Australia's 10.3 million Velocity members will be able to earn frequent flyer points on a comprehensive network of international long-haul flights, providing significant added consumer benefits to Virgin Australia's extensive customer base. Due to certain differences in Points earn rates, Velocity members tend to earn more points when flying a Virgin Australia coded flight compared to a Partner Carrier coded flight. Further, Velocity Silver, Gold and Platinum members earn a tier bonus when flying on a Virgin Australia coded flight – for example, 75% extra points for Gold members – which is not typically honoured on a Partner Carrier coded flight.

5 No material competitive detriment

The Proposed Conduct will not result in any material competitive detriment for the reasons outlined below.

5.1 Resale price maintenance results in significant efficiencies and promotes inter-brand competition

The potential for vertical supply relationships to create efficiencies is well recognised. This is because vertical agreements allow the downstream producer to avoid "*monopolistic surcharges*" imposed by upstream suppliers who are marking up the price with a view to maximising profits, which would otherwise be required to be factored into the producer's retail price. Described by Chen and Hylton as the "successive monopoly problem" (or double marginalisation),[24] these monopolistic surcharges result in an over-inflated retail price which produces inefficiencies in the market and harms competition.

[24] Andy C M Chen and Keith N Hylton, "Procompetitive Theories of Vertical Control" (1999) *Hastings Law Journal* 50(3), page 597.

Vertical restraints can induce dealers to make *"optimal levels of investment in the provision of special services to promote new and existing products"* by sacrificing intra-brand competition in favour of inter-brand competition and creating incentives for dealers to *"provide services which drive demand for the manufacturers' product"*.[25] Richard Posner suggested that the imposition of resale price maintenance reflects a judgment on the part of the manufacturer that sales will increase if the dealers or distributors *"compete in areas other than price"*.[26] In its Final Report, the Harper Committee stated that in a competitive market, resale price maintenance conduct may be beneficial to competition and consumers as *"like other forms of vertical trading restriction, RPM will not have an effect on competition in a market if the product is subject to strong rivalry from competing products"*.[27]

By implementing a new pricing model, the Proposed Conduct will remove the potential for short term intra-brand competition (which for the codeshare parties is not commercially sustainable) and the inefficiencies it produces in relation to market fares. Instead, the Proposed Conduct will promote inter-brand competition and result in fares being determined by dynamics within the competitive market for the provision of international air travel services to and from Australia, providing consumers with more and better-priced fare options. Further, it will enable Virgin Australia and the Partner Carrier to better respond to dynamic market fares and avoid the scenarios outlined in section 2.7 above where Virgin Australia was unable to offer a competitive fare without incurring a loss.

5.2 No meaningful loss of competition by removing the largely theoretical possibility for the marketing carrier to compete on price with operating carrier

A traditional arm's length codeshare model creates the possibility of apparent price competition between operating carriers and marketing carriers (the latter of which cannot itself supply the services absent the codeshare agreement) for an identical service, incentivising operating carriers to set high prorates for marketing carriers like Virgin Australia. This in turn hinders the operating carrier's ability to compete with other carriers offering substitutable services in the market. Essentially, arm's length codeshare agreements may appear to preserve intra-brand price competition at the expense of meaningful inter-brand competition. The removal of this artificial intra-brand pricing competition will not result in any meaningful net loss of competition. As the examples in section 2 illustrate, under a traditional arm's length codeshare relationship, Virgin Australia does not have real freedom to price competitively as to do so will result in losses. Virgin Australia and the Partner Carriers will continue to compete on ancillary services (such as loyalty benefits) and their terms and conditions of carriage and will each seek to optimise sales through their own marketing channels. The removal of theoretical pricing competition (when only the operating carrier bears the risk of providing services and the marketing carrier cannot provide the services in the absence of the commercial distribution agreement) will not result in any detriment.

5.3 No competitive overlap between the Applicant and the Partner Carriers

There is no competitive overlap between the Applicant and the Partner Carriers as Virgin Australia does not currently have the aircraft required to operate long-haul international flight services [**Confidential: restriction of publication claimed**]. The scope of the Proposed Conduct is limited, and Virgin Australia will cease to engage in the Proposed Conduct if it commences operating or pricing overlapping services with the relevant

[25] Corones, "Competition Law in Australia" (December 2018, Thomson Reuters, 7th ed), pages 612-613.

[26] R Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality" (1981) 48 University of Chicago Law Review 6, page 9.

[27] The Australian Government Competition Policy Review, Final Report (31 March 2015) (link), page 377.

Partner Carrier. The Proposed Conduct therefore does not remove or hinder any future competition between Virgin Australia and the Partner Carriers.

5.4 The Applicant and the Partner Carriers will be constrained from anti-competitively increasing price

The market for international passenger air travel services to and from Australia is competitive and has historically been characterised by a large number of competitors, including the Qantas Group and its partners. In such a competitive market, the proposed vertical restraints on codeshare pricing cannot have any material anti-competitive effect.

(a) No incentive to raise fare prices

Under the Proposed Conduct, the Applicant will not have the incentive or ability to raise the price of international flights independently of the Partner Carrier.

The codeshare pricing model incentivises Partner Carriers to concentrate on competing with other operating carriers, rather than worrying about Virgin Australia's pricing of their codeshare services. The significant number of competitors means that Partner Carriers will have no ability to raise prices. As restrictions continue to ease and borders re-open, Partner Carriers will compete with other carriers to attract customers, maintain, and increase market share and continue to recover costs.

(b) Vigorous and effective competitors

Virgin Australia has not yet established its potential codeshare network so it is not possible to comprehensively discuss competition in all potential relevant markets. However, we note that across the markets for international air travel to and from Australia there is extensive competition from the Qantas Group, its partners, and other international carriers.

The competition in the markets between Australia and the United States and beyond, in which the codeshare between Virgin Australia and United Airlines will operate, is indicative of this level of competitive pressure. For example, the Sydney to Los Angeles route is serviced by United Airlines and five other international carriers offering closely substitutable services, including Qantas and its partner American Airlines, which will compete vigorously with Virgin Australia and Partner Carriers such as United Airlines. Currently, four carriers offer non-stop services between Sydney and Los Angeles, [28] with Air New Zealand providing a one stop service from Australia to Los Angeles via Auckland, and Hawaiian Airlines operating a one stop service from Sydney to Los Angeles via Honolulu.

In 2021, even with the effects of COVID-19, the Sydney-Los Angeles route was the fifth busiest international route to and from Australia.[29] The significance of this route to the Australian travel market means that any stimulatory effects of the Proposed Conduct will be material.

The Qantas Group is a significant competitor in the market for international passenger air travel to and from Australia. It operates a substantial network of international flight services and will continue to build on this offering as international travel restrictions continue to relax. By the end of 2022, Qantas will operate additional long-haul international services from more Australian points of origin to Los Angeles, Dallas Fort Worth, San Francisco, Rome and Tokyo. These services are in additional to services already offered to multiple long-haul international destinations including Vancouver,

[28] American Airlines, Delta Air Lines, Qantas and United Airlines (source: FlightConnections.com, accessed 6 April 2022) (link).

[29] BITRE, 2021.

Honolulu, Manila, Bangkok, Johannesburg, London and Delhi.[30] While Qantas has an extensive network as an operating carrier, the strength and reach of its network is enhanced by its partnerships with over 25 international carriers including Air New Zealand and Emirates. Of these, 14 are major carriers that are a part of the oneworld alliance, including American Airlines, British Airways, Cathay Pacific and Qatar.[31] Through the oneworld alliance alone, Qantas has access to over 1,000 global destinations.[32] In addition to operating services to five destinations in New Zealand, Jetstar offers flights to short-haul international destinations including Fiji, Phuket and Bali, as well as long-haul destinations including Singapore and Honolulu.

In its 2021 annual report, BITRE reported Qantas' share of international passengers as third highest at 12.9%.[33] Jetstar followed in eighth position with a share of 2.9%.[34] It should be noted that BITRE's analysis of international passengers by major airlines for FY2021 was severely impacted by travel restrictions and the existence of travel bubbles. For instance, Air New Zealand comprised 28.3% of the total number of international passengers in 2021, compared to figures of 7.1% and 8.3% in 2016 and 2011, respectively. This was as a result of Air New Zealand operating international services between Australia and New Zealand as part of a travel bubble while most other international travel was prohibited.[35]

It is evident from **Figure 4** below that there are a large number of carriers with significant market share operating international services to and from Australia, as well as a long tail of other international players. While the 2021 figures are unlikely to represent the long-term state of competition in a post-COVID-19 world, it is worth noting that Virgin Australia is not in the top 10 operators and United Airlines is the seventh largest, carrying 3.1% of passengers to and from Australia.

[30] Qantas, "International flight network" (undated) (link).

[31] Qantas, "oneworld alliance" (undated) (link).

[32] Qantas, "oneworld alliance" (undated) (link).

[33] Department of Infrastructure, Transport, Regional Development and Communications, "Statistical Report – International airline activity 2021 (calendar year)" (23 March 2022) (link), page 8.

[34] Department of Infrastructure, Transport, Regional Development and Communications, "Statistical Report – International airline activity 2021 (calendar year)" (23 March 2022) (link), page 8.

[35] This travel bubble commenced in April 2021 and was suspended in July 2021. It is set to resume in April 2022. Reuters, Jamie Freed and Renju Jose "Bubble burst: New Zealand suspends quarantine free travel with Australia" (23 July 2021) (link).

Figure 3: International passengers by major airlines - Years ended June (BITRE 2021)

As considered previously at section 1.3(a) above, Virgin Australia does not at present have the widebody aircraft required to operate substantive long-haul operations. Until it is able to do so, the Proposed Conduct will provide Virgin Australia with the opportunity to offer international services to its customers and maintain its brand presence as a full service international and domestic Australian airline.

6 Conclusion

For the reasons set out above, the Applicant requests that the ACCC:

- grant interim authorisation of the Proposed Conduct by 13 May 2022 to enable the Applicant and its Partner Carriers to enter into and give effect to pricing provisions consistent with that set out in Annexure A and ensure that the public benefits outlined in section 4 above are realised; and

- grant authorisation of the Proposed Conduct for a period of five years.

As outlined in this submission, the Proposed Conduct will create significant public benefits with no competitive detriments. Rather, the Proposed Conduct will provide Australians with more choice and better fares as international air travel continues to grow.

Annexure A – Template pricing provisions to give effect to the Proposed Conduct

[Confidential: restriction of publication claimed]