



# Determination

Application for authorisation AA1000533

lodged by

Virgin Australia and Alliance Airlines

in respect of

cooperation on 41 regional routes and two short-haul international routes

Authorisation number: AA1000533

8 April 2021

Commissioners:

Keogh

Rickard

Brakey

Court

Ridgeway

## Summary

The ACCC has decided to grant authorisation to enable Virgin Australia and Alliance Airlines to coordinate their operations in relation to the provision of services on 41 regional routes and two short-haul international routes.

Virgin Australia and Alliance are proposing to coordinate their operations to enable them to better manage capacity and respond to changes in demand over the next two years as the aviation industry recovers from the COVID-19 pandemic.

The ACCC considers that these arrangements are likely to result in a public benefit by promoting competition on certain regional and short haul international routes.

Specifically, the ACCC considers that the proposed conduct is likely to:

- result in a more efficient and sustainable operation of services by Virgin Australia and Alliance, including maximising aircraft utilisation, accessing a broader range of aircraft and fleet types, and appropriately managing capacity on regional routes to meet the nature and volume of demand
- support regional air services and regional communities, and
- facilitate increased competition through Virgin Australia being a more effective and vigorous competitor in operating certain regional and short haul international routes.

The ACCC considers that the proposed conduct may result in some public detriment by removing competition between Virgin Australia and Alliance in providing services on the relevant routes. However, the ACCC considers the public detriment resulting from a lessening of competition is likely to be limited because:

- Alliance's regular passenger transport network is limited, Virgin Australia and Alliance have not historically both operated flights on the same routes and if the proposed coordination does not proceed, they are unlikely to compete with each other to any significant extent on most of these routes over the two year period for which authorisation is sought, and
- other airlines, primarily Qantas/Jetstar, are likely to provide a strong competitive constraint on Virgin Australia and Alliance on many of these routes.

The ACCC has granted authorisation until 31 March 2023.

## 1. The application for authorisation

- 1.1. On 23 October 2020, Virgin Australia and Alliance Airlines (the **Applicants**) lodged application for authorisation AA1000533 with the Australian Competition and Consumer Commission (the **ACCC**). The Applicants are seeking authorisation to cooperate in relation to the provision of services on 41 regional and two short haul international routes (the **Relevant Routes**) for two years. This application for authorisation AA1000533 was made under subsection 88(1) of the *Competition and Consumer Act 2010* (Cth) (the **Act**).

- 1.2. The ACCC may grant authorisation which provides businesses with legal protection for arrangements that may otherwise risk breaching the competition laws but are not harmful to competition and/or are likely to result in overall public benefits.
- 1.3. The Applicants also requested interim authorisation to enable them to coordinate in providing services on the Relevant Routes while the ACCC considered the substantive application. On 19 November 2020 the ACCC granted interim authorisation, under subsection 91(2) of the Act.

## The Applicants

- 1.4. Virgin Australia is an airline that operates a network of domestic and international services from its main hub at Brisbane Airport in Queensland. These services are operated by a range of entities in the Virgin Australia group of companies including Virgin Australia Airlines Pty Ltd, Virgin Australia Regional Airlines Pty Ltd (VARA), Virgin Australia International Airlines Pty Ltd, and Virgin Australia Airlines (SE Asia) Pty Ltd (collectively, **Virgin Australia**).
- 1.5. In April 2020 Virgin Australia's parent company, Virgin Australia Holdings entered voluntary administration. In November 2020 the sale of Virgin Australia Holdings to Bain Capital was completed.
- 1.6. Alliance Airlines (**Alliance**) is an Australian airline that provides contract, charter and Regular Public Transport (**RPT**) services. Its customer base includes companies in the mining, energy, tourism and government sectors, and it has regional charter bases in Brisbane, Townsville, Cairns, Adelaide, Perth, Melbourne, Darwin and Rockhampton. Alliance also conducts commercial flights between Gladstone, Bundaberg and Port Macquarie, as well as RPT services from Brisbane and Western Australia to regional airports within each respective state.
- 1.7. Qantas currently owns approximately 19.9 per cent of Alliance. The ACCC has previously raised competition concerns in relation to the acquisition by Qantas of this minority stake in Alliance. This investigation is continuing.

## The Proposed Conduct

- 1.8. The Applicants are seeking authorisation to cooperate in relation to the provision of services on 41 regional routes and two short-haul international routes as listed at **Attachment A**, by:
  - (a) sharing information (including in relation to costs, willingness to operate a route, capacity, utilisation, anticipated demand and pricing) about Relevant Routes
  - (b) agreeing capacity, flight schedules and aircraft type, including whether an Applicant will suspend operation on a Relevant Route
  - (c) agreeing which Applicant will operate the Relevant Route and under what arrangements (e.g. wet lease, codeshare, revenue-share arrangements) and putting in place commercial agreements for the route considering the nature and levels of demand and risk profile of a route
  - (d) discussing and agreeing ways of providing services on the Relevant Routes in a post COVID-19 environment, including new forms of commercial arrangements other than wet leases and codeshare agreements, and
  - (e) potentially, risk and revenue sharing mechanisms and agreements as to price(the **Proposed Conduct**).

- 1.9. At the time of lodging the application the Applicants overlapped in the provision of RPT services on one regional route in Australia (Brisbane-Proserpine). Prior to COVID-19 they did not overlap with RTP services on any routes.

## 2. Background

### Previous relationships between Virgin Australia and Alliance

- 2.1. Virgin Australia and Alliance have, or have had, a number of commercial arrangements: a Wet Lease Agreement, Charter Alliance Agreement and Marketing & Distribution Agreement.
- 2.2. **Wet Lease Agreement** - A wet lease is an arrangement whereby one airline provides an aircraft, complete crew, maintenance, and insurance (ACMI) to another airline, which markets and sells tickets for the flight and pays the operating airline by hours operated. This means the operating airline receives a fixed payment for operating the flight and the marketing airline's revenue is dependent on tickets sold.
- 2.3. Virgin Australia has acquired wet lease services from Alliance for various RPT services, such as Brisbane to Alice Springs, Cloncurry, Emerald, Mount Isa, Port Moresby and Rockhampton. Alliance operated the services by providing the aircraft, crew, maintenance, and insurance for the aircraft, with Virgin Australia retaining responsibility for all other inputs. The aircraft remained in Alliance's fleet with aircraft and crew in Alliance's livery; however, flights were sold as Virgin Australia services on the Virgin Australia code through Virgin Australia's distribution channels, and Virgin Australia made scheduling and ticket pricing decisions.
- 2.4. On 24 March 2020, the Wet Lease Agreement was temporarily suspended.
- 2.5. **Charter Alliance Agreement** – On 18 May 2017 the ACCC issued a determination granting authorisation to Virgin Australia and Alliance to jointly tender for and supply charter air services to corporate customers (predominantly FIFO services) until June 2022. The agreement and associated authorisation explicitly exclude cooperation in relation to RPT services and is therefore unrelated to the current application.
- 2.6. **Marketing and Distribution Agreement** (codeshare agreement) - Pursuant to this agreement, Alliance currently operates flights between Brisbane-Bundaberg, Gladstone-Bundaberg, Brisbane-Gladstone and Brisbane-Port Macquarie in its own right and at its own risk. Virgin Australia places its code on these services and markets them through its own distribution channels. The Applicants submit that these routes were formerly operated by Virgin Australia however, when it withdrew from those services as they were uneconomic for it to operate, Alliance decided to operate services on those routes.

### COVID-19 impact on the aviation industry and recovery

- 2.7. The Applicants submit that the COVID-19 pandemic has had a devastating effect on the Australian aviation industry, including regional RPT services. The Australian aviation industry has been one of the sectors most significantly affected by the COVID-19 pandemic given its exposure to travel bans and a reduction in consumer demand.
- 2.8. The Applicants submit that with the outbreak of COVID-19 in or around January 2020, all RPT services in Australia (including regional RPT services) suffered a very sharp decline in passenger traffic and airlines have suffered a very sharp decline in cash flow, a weakening of liquidity and significantly higher leverage.

- 2.9. Virgin Australia submits it reduced its domestic capacity by 90% (including RPT services) in response to government travel restrictions announced as a result of the COVID-19 pandemic and stood down 8,000 employees. In April 2020, Virgin Australia Holdings entered voluntary administration.
- 2.10. Alliance submits its services have also been disrupted by COVID-19, including the suspension of its Wet Lease Agreement with Virgin Australia in March 2020, and reducing and suspending certain RPT routes.
- 2.11. However, Alliance submits revenue from its charter business has increased during the COVID-19 pandemic, due to the scarcity of RPT options and social distancing requirements increasing the number of flights required by customers including mining companies. In June and July 2020, Alliance successfully undertook a capital raising.

### **Applicants' rationale for seeking authorisation**

- 2.12. The Applicants submit that as Australia begins to slowly and inconsistently move towards a resumption of normal air travel following the disruption caused by COVID-19, airlines will need to assess how they can efficiently and effectively supply airline services and respond quickly to changes in regulations, including border closures and openings, while demand remains low and volatile.
- 2.13. Virgin Australia submits that the impact of COVID-19 on its operations has been exacerbated by the challenges associated with its administration. Virgin Australia submits it is imperative it builds its business again, regains customer confidence and demonstrates its commitment and ability to service the Australian domestic air travel market. Virgin Australia submits that regional services are an important part of its network and it remains committed to serving regional destinations. However Virgin Australia submits it cannot efficiently operate regional services alone – this was always the case but COVID-19 has accelerated the need for the aviation sector, and Virgin Australia, to cut costs and simplify its fleet. The Applicants submit that by cooperating on the Relevant Routes, they can efficiently offer a more compelling product, provide choice and convenience for consumers, and competition to Qantas.
- 2.14. The Applicants further submit that their existing commercial arrangements do not provide the flexibility to deal with the unique market circumstances that result from the COVID-19 pandemic, and the Proposed Conduct provides an opportunity to more flexibly respond to these challenges.
- 2.15. The Applicants submit the Proposed Conduct will:
  - (a) enable the Applicants to efficiently provide airline services to regional communities and businesses as demand fluctuates
  - (b) minimise costs and risk exposure in supplying those services
  - (c) assist in ensuring the long-term survival of Virgin Australia as an efficient and vigorous competitor to Qantas
  - (d) enable the Applicants to develop new, innovative ways to respond to a non-linear recovery path, post COVID-19, and
  - (e) maximise aircraft utilisation, access a broader range of aircraft and fleet types, and appropriately manage capacity on regional routes to meet the nature and volume of demand.

### 3. Consultation

- 3.1. A public consultation process informs the ACCC's assessment of the likely public benefits and detriments from the Proposed Conduct.
- 3.2. The ACCC invited submissions from a range of potentially interested parties including competitors, industry associations and regulatory bodies. Prior to the draft determination, the ACCC received 9 public submissions and a number of submissions that were excluded from the public register at the request of the party making the submission.
- 3.3. Queensland Airports Limited supports the application, submitting the arrangements are an example of the innovative solutions needed to deal with the altered operating environment arising from COVID-19, and will assist to foster competition on routes supported by Queensland Airports, generating public benefit through increased capacity and price competition.
- 3.4. The Northern Territory Government Department of Industry, Tourism and Trade (**NTDITT**) supports the application, submitting that with the authorised cooperation Virgin Australia and Alliance will be better able to serve the NT. NTDITT submits Virgin Australia's post administration fleet (comprised of a single large capacity aircraft type) will be unsuitable for most NT regional routes without cooperation with Alliance, due to the Boeing 737's size and capacity. NTDITT also considers Alliance by itself lacks the marketing and distribution capabilities needed for the success of more mainstream regional routes. NTDITT further submits authorisation may lead to more affordable prices for customers if the Applicants enter regional routes and compete with Qantas. Other benefits may include increased international and interstate connectivity, contributing to economic development and tourism in areas that rely on aviation access, and employment opportunities at Alliance's Darwin operational base.
- 3.5. Northern Territory Airports (**NTA**) supports the application, submitting the proposed cooperation will allow Virgin Australia to continue to connect regional routes, which it could not do by itself due to its single plane type large capacity fleet, and will benefit from Alliance's smaller capacity planes. NTA submits that it is unlikely that any of the relevant routes which are not currently operated by Virgin Australia or Alliance will commence without the proposed cooperation (e.g. Alice Springs-Darwin, Alice Springs-Ayers Rock, Darwin-Cairns).
- 3.6. Bundaberg Regional Council (**BRC**) submits that Qantas dominates the local market for scheduled air travel at Bundaberg Airport with its network of destinations and frequency of services. BRC also submits that previously, even with Virgin Australia and Alliance's cooperation in Bundaberg via their Marketing and Distribution Agreement, they did not threaten Qantas' dominance. BRC further submits that Virgin Australia would face greater difficulty profitably operating some regional routes due to its high capacity Boeing 737s, compared to Qantas and Alliance's smaller capacity plane options. BRC submits that Alliance would be unlikely to be able to offer competitive frequency of services on the Brisbane – Bundaberg route without access to Virgin Australia's connecting passenger network. BRC consider that when Virgin Australia and Alliance jointly operated Bundaberg services, prices were lower compared to prices with Qantas as the sole airline currently servicing the region.
- 3.7. Confidential submissions indicate that without the proposed cooperation, the Applicants may not be able to service regional areas for some time, reducing consumer choice and hampering the region's connectivity and ability to recover from the effects of COVID-19.

- 3.8. Rex submits that the proposed cooperation is very broad, as it includes sharing cost information, strategic entry plans and information about future pricing, and agreeing matters such as which airline will operate on certain routes. Rex submits that once such information is shared, it cannot be unshared, and any resultant competitive harm cannot be undone. Rex further submits the Proposed Conduct and the effects on competition will be difficult to monitor. Rex considers the Proposed Conduct will lead to higher prices and less services, as the Applicants will agree not to compete with each other on the Relevant Routes.
- 3.9. Solomon Airlines describes the Brisbane – Honiara route, on which it operates, as a marginal route in the current circumstances and submits that allowing Virgin Australia and Alliance to cooperate on this route is unlikely to be of any real benefit to the public until the route returns to some level of normality.
- 3.10. Other confidential submissions also indicate that the proposed cooperation could make it more challenging for other smaller airlines seeking to establish or re-establish services on some routes, and may lead to their exit, and subsequent price rises by the remaining airlines.
- 3.11. Sydney Airport submits that insofar as the proposed cooperation relates to Virgin Australia's peak slots at Sydney Airport it appears from the application that Virgin Australia intends to retain the slots by allowing Alliance to use them temporarily. Sydney Airport submits that this is inconsistent with its slot regime. Sydney Airport submits that slots that an airline is not able to efficiently use should be returned to the slot pool to allow other airlines, including new entrants, the opportunity to enter or expand their presence at Sydney Airport.
- 3.12. On 5 March 2021 the ACCC issued a draft determination, proposing to grant authorisation. The ACCC received one submission, from the Applicants, after the draft determination was issued. This submission was in response to submissions made by market participants during the pre-draft determination consultation process. A pre-decision conference was not requested.
- 3.13. Public submissions are available on the [public register](#) for this matter.

## 4. ACCC assessment

- 4.1. The ACCC's assessment of the Proposed Conduct is carried out in accordance with the relevant authorisation test contained in the Act.
- 4.2. The Applicants have sought authorisation for Proposed Conduct that would or might constitute a cartel provision within the meaning of Division 1 of Part IV of the Act and may substantially lessen competition within the meaning of section 45 of the Act. Consistent with subsections 90(7) and 90(8) of the Act, the ACCC must not grant authorisation unless it is satisfied, in all the circumstances, that the conduct would result or be likely to result in a benefit to the public, and the benefit would outweigh the detriment to the public that would be likely to result (authorisation test).

### Relevant areas of Competition

- 4.3. To assess the likely effect of the Proposed Conduct, the ACCC identifies the relevant areas of competition likely to be impacted.
- 4.4. The Applicants submit that the area of competition likely to be affected by the authorisation is the supply of air passenger transport services on the Relevant Routes.

- 4.5. The Applicants further submit that the Proposed Conduct should also be considered in a broader domestic aviation market in which airline competition is critical for consumers and the economy, especially for a large country as geographically dispersed as Australia. The Applicants submit any measures which enhance Virgin Australia's ability to offer services on the Relevant Routes will also have an impact on the competitiveness of its broader network and customer offer, increasing the viability of its services in the immediate term and its role as a sustainable competitor for Qantas in the long term.
- 4.6. The ACCC considers that the relevant areas of competition are likely to be:
- regional air passenger transport services within Australia, and
  - international air passenger transport services between Australia and Papua New Guinea, and Australia and Solomon Islands.
- 4.7. Within these areas of competition, the ACCC considers that it is also appropriate to examine the likely effects of the authorisation on competition and rivalry on particular routes where necessary. The Relevant Routes are listed at Attachment A of this determination.

## Future with and without the Proposed Conduct

- 4.8. In applying the authorisation test, the ACCC compares the likely future with the Proposed Conduct that is the subject of the authorisation to the likely future in which the Proposed Conduct does not occur.
- 4.9. The ACCC considers that in the future without the Proposed Conduct, the Applicants would either not coordinate on the Relevant Routes or coordinate on some of the Relevant Routes through arm's length commercial arrangements, as the Applicants have previously done and as summarised at paragraphs 2.1 to 2.6.

## Impact of COVID-19

- 4.10. The ACCC recognises that due to travel restrictions, the market conditions in which the Proposed Conduct will be implemented, at least over the two years for which authorisation is sought, will be substantially different. In particular, demand for services is likely to be significantly lower than historical levels, at least initially. Although regional air travel is experiencing some recovery in passenger numbers, the timing, pace and extent of the recovery in demand is uncertain and likely to be non-linear. This impacts the assessment of both the public benefits and public detriments likely to result from the Proposed Conduct over the period for which authorisation is sought.

## Public benefits

- 4.11. The Act does not define what constitutes a public benefit. The ACCC adopts a broad approach. This is consistent with the Australian Competition Tribunal (the **Tribunal**) which has stated that the term should be given its widest possible meaning, and includes:

*...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements ... the achievement of the economic goals of efficiency and progress.*<sup>1</sup>

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<sup>1</sup> Queensland Co-operative Milling Association Ltd (1976) ATPR 40-012 at 17,242; cited with approval in Re 7-Eleven Stores (1994) ATPR 41-357 at 42,677.



4.12. The ACCC has considered the following public benefits:

- more efficient and sustainable operation of services by the Applicants
- supporting regional air services and regional communities
- better connectivity for passengers, and
- increased competition on some regional routes and across Virgin Australia's network in the longer term.

### **More efficient and sustainable operation of services**

4.13. The Applicants submit that regional routes are not always profitable on an individual route basis and uncertainty around when normal travel will resume has further impacted the commercial viability of regional services.

4.14. The Applicants also submit that the Proposed Conduct will maximise aircraft utilisation in circumstances where Virgin Australia has rationalised its fleet to a single plane type, the large capacity Boeing 737. The Applicants submit the Proposed Conduct will allow them to use a broader range of aircraft and fleet types, and appropriately manage capacity on regional routes to meet the nature and volume of demand. The Applicants consider this will allow customers greater access to services on regional routes which require a broader range of aircraft and fleet types to service, and this will lead to improved choice of fares.

4.15. As noted, while there has been some recovery in demand for regional air travel, in the short term there is likely to be significant uncertainty about market conditions and passenger demand. The ACCC considers that this may make airlines more reluctant to commit to reinstating and growing capacity than would otherwise be the case.

4.16. The ACCC considers that the Proposed Conduct will give the Applicants a broader range of options in considering re-establishing and/or expanding services on the Relevant Routes, and/or servicing new routes, by combining their complementary fleets and operations and sharing risk and cost exposure.

4.17. The ACCC also considers that the Proposed Conduct is likely to allow the Applicants to draw from a broader range of aircraft, reducing the limitations of each of Virgin Australia's and Alliance's fleet mix and allowing the Applicants to better match capacity on the Relevant Routes to the nature and volume of demand and thereby better service these routes.

4.18. In particular, coming out of administration Virgin Australia has a smaller fleet of aircraft, and only one type of aircraft (Boeing 737s), in an attempt to achieve operational simplification and cost savings. This aircraft cannot service some regional routes due to airport runway limitations and may not be suitable for others due to distances and demand characteristics of the route. These routes are able to be more efficiently serviced, and in some cases only serviced at all, by different aircraft types such as smaller aircraft that Virgin Australia will have access to through the proposed cooperation with Alliance.

4.19. The ACCC therefore considers that a likely public benefit from the Proposed Conduct is the more efficient and sustainable operation of services on the Relevant Routes.

4.20. The ACCC considers that a more efficient and sustainable operation of services on these routes will also support the realisation of some of the other public benefits that the Applicants have submitted are likely to result from the Proposed Conduct as discussed below.

## **Supporting regional air services and regional communities**

- 4.21. The Applicants submit that the Proposed Conduct is likely to support regional air services and regional communities. Virgin Australia submits there are a number of routes it will not be able to offer in the future without the Proposed Conduct and the Proposed Conduct will increase the likelihood that these routes are able to be serviced.
- 4.22. As discussed, the ACCC considers that the Proposed Conduct will allow the Applicants to operate more efficient and sustainable services on the Relevant Routes by combining their complementary fleets and operations and sharing risk and cost exposure.
- 4.23. This is likely to improve the viability of operating services on these routes, assist Virgin Australia to re-establish its network, and allow the Applicants to provide services to a wider network in regional Australia than they would be able to operating independently of each other on the Relevant Routes.

## **Better connectivity for passengers**

- 4.24. The Applicants submit that the Proposed Conduct will enable them to better match the most efficient aircraft to demand, for example by transferring charter customers onto existing RPT services to better utilise aircraft, providing a different number of services with more suitable aircraft or converting charter services into additional RPT services, all of which could result in increased frequency of service that would provide a better schedule spread and range of customer options.
- 4.25. The Applicants submit that under the Proposed Conduct, instead of the Applicants flying wingtip to wingtip on the same days of the week, they will be able to better coordinate schedules and align frequencies to the times of day or days of the week more suited to their respective aircraft sizes.
- 4.26. The ACCC considers that there is likely to be some improvement in connectivity of regional services under the proposed conduct both because services on the Relevant Routes are likely to be more sustainable and because coordination between the Applicants is likely to facilitate better scheduling spread.
- 4.27. However, this improved connectivity is primarily likely to be limited to coordination in relation to the mix of RPT and charter services contemplated by the Applicants as discussed at paragraph 4.24.

## **Increased competition on some regional routes and across Virgin Australia's network**

- 4.28. The Applicants submit that by cooperating, they can efficiently offer a more compelling product to customers, providing increased competition to Qantas.
- 4.29. Bundaberg Regional Council submits that if the ACCC authorises Virgin Australia and Alliance to cooperate on the Bundaberg-Brisbane sector, they will be able to serve both point-to-point and connecting passengers to and from Bundaberg; however, even with this cooperation the Applicants remain at a competitive disadvantage with Qantas due to the lower efficiency of their current fleet.
- 4.30. Northern Territory Airports submits that a temporary approval for cooperation with Alliance, who operates a fleet of lower capacity aircraft, will allow Virgin Australia to remain a competitive carrier in regional Australia.

- 4.31. Queensland Airports submits that the arrangements will assist to foster competition on routes supported by Queensland Airports.
- 4.32. The ACCC notes that Virgin Australia has exited voluntary administration with a smaller, single aircraft type fleet, and fewer staff. Each of these factors will impact Virgin Australia's ability to operate a comprehensive set of routes on a standalone basis, particularly on the specific regional and short haul international routes that are the subject of this application for authorisation. The challenges in doing so are increased by the uncertainty of the recovery in demand for airline services post COVID-19.
- 4.33. The ACCC considers that the Proposed Conduct is likely to mean that certain regional and short haul international routes will experience more competition than they would otherwise and that this is likely to be a significant public benefit.

## Public detriments

- 4.34. The Act does not define what constitutes a public detriment. The ACCC adopts a broad approach. This is consistent with the Tribunal which has defined it as:

*...any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.<sup>2</sup>*

- 4.35. The ACCC has considered the following public detriments:

- reduced competition to supply RPT services, and
- restricting access to scarce airport landing slots.

## Reduced competition to supply RPT services

- 4.36. Cooperation could limit competition between the Applicants on the Relevant Routes in the short term and/or facilitate long term understandings regarding scheduling services and other aspects of their operations.
- 4.37. The Applicants submit that the Proposed Conduct will have no material adverse effect on competition because:
- there is limited overlap between the services offered by Virgin Australia and Alliance, with current overlap limited to one route Brisbane – Proserpine, and
  - the Applicants' ability to increase prices will be constrained by low demand and competing services.
- 4.38. Rex submits that it is not clear why the Applicants assert that regional services could not be provided via other means of cooperation that do not limit competition by removing the independence of decision-making by each party (for example, arm's length commercial wet-leases or code share arrangements as previously used).
- 4.39. Rex submits that the nature of the conduct proposed involves immediate sharing of highly sensitive information to make decisions about cooperation. Once shared, the parties cannot un-learn what they know. Rex submits that granting authorisation (and interim authorisation), allows competitors to share highly sensitive information, with no monitoring or safeguards, allowing them to use the cover of a temporary authorisation to jointly shape what they will do 'independently' post-authorisation.

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<sup>2</sup> Re 7-Eleven Stores (1994) ATPR 41-357 at 42,683.

4.40. The ACCC considers that the Proposed Conduct is likely to reduce competition between Virgin Australia and Alliance to provide services on the Relevant Routes. However, the ACCC considers that the lessening of competition on the Relevant Routes, and any associated public detriment, is likely to be limited because:

- competition between Virgin Australia and Alliance on the Relevant Routes is likely to be limited without the Proposed Conduct, and
- other airlines are likely to impose a degree of competitive constraint on the Applicants on many of these routes.

#### *Competition between Virgin Australia and Alliance on the Relevant Routes*

4.41. The ACCC has considered the extent to which the Applicants are likely to compete against each other on the Relevant Routes if authorisation is not granted, and accordingly whether the Proposed Conduct may result in reduced services on routes where both Virgin Australia and Alliance would otherwise have entered or remained competitors.

4.42. At the date of the current application, the Applicants both operated services on one route only, Brisbane-Proserpine. Prior to the COVID-19 pandemic, the Applicants did not both operate services on any of the Relevant Routes. Further, on eight routes, neither airline operated services prior to the COVID-19 pandemic.

4.43. Prior to the COVID-19 pandemic, Virgin Australia offered RPT services on 28 of the Relevant Routes. While its services were suspended on many of these routes through much of 2020, it would be expected that many of these services will resume as demand picks up and Virgin Australia emerges from voluntary administration. However, the extent to which Virgin Australia would offer services on all these routes, and the level of capacity it would operate on each route, is uncertain, particularly given Virgin Australia's recent restructure and rationalisation of its fleet to a single aircraft type, the Boeing-737, which cannot operate on some of these routes and is unsuitable for others. Although Virgin Australia could choose to enter into a wet lease arrangement with Alliance or another airline to serve these routes, this does not align with Virgin Australia's business plan to streamline its fleet.

4.44. Prior to the COVID-19 pandemic Alliance had a significantly more limited network of RPT flights than Virgin Australia. Alliance was offering RPT services on only four of the routes covered by the Proposed Conduct: Brisbane-Port Macquarie/Gladstone/Bundaberg and Adelaide-Olympic Dam.<sup>3</sup>

4.45. However, Alliance has introduced new regional routes in its own right in the last year, having introduced RPT services between Brisbane-Proserpine, Brisbane-Moranbah (supported by Peabody, a coal producer), Cairns-Maroochydore (Sunshine Coast) and Canberra-Maroochydore.

4.46. As summarised at paragraphs 2.1-2.6, Alliance also previously operated Virgin Australia-ticketed services on a number of other routes covered by the Proposed Conduct under a wet lease agreement. Although, if Alliance were to operate these services in its own right, Alliance would assume the financial risk.

4.47. Further, current market conditions – increasing demand as travel restrictions ease in circumstances where incumbent operators may not have as strong a presence as they

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<sup>3</sup> Alliance's number one customer on the Adelaide - Olympic Dam route is BHP which uses Alliance's RPT services on that route to supplement the approximately 40 charter flights per week (as of March 2020) provided to it on that route by Alliance.

have traditionally – may provide a greater opportunity for new entry, allowing smaller airlines to compete with airlines that historically had a stronger presence on some routes.

- 4.48. This suggests that Alliance may be able to offer services in its own right on some of the Relevant Routes absent the Proposed Conduct. The ACCC considers that the Proposed Conduct removes any possibility of Alliance competing to offer services on these routes independently of Virgin Australia.
- 4.49. However, having regard to their historical operations, the uncertain short term environment as the industry recovers from the COVID-19 pandemic, Alliance's limited network of RPT services and Virgin Australia's restructure post administration, the ACCC considers that on most Relevant Routes Virgin Australia and Alliance would be unlikely to compete significantly with each other absent the Proposed Conduct. In particular, while one or the other airline, most likely Virgin Australia, may operate on a range of the Relevant Routes absent the Proposed Conduct, it is less likely that the Applicants would both operate on the same routes, with limited exceptions such as the Brisbane – Proserpine route, over the two year period for which authorisation is sought.
- 4.50. In relation to the Brisbane – Proserpine route, since interim authorisation was granted for the Applicants to coordinate their operations, Alliance has ceased operating services separately to Virgin Australia on this route. The impact of Alliance's withdrawal from this route on competition to provide RPT services is difficult to gauge at this time given the short time that Alliance operated services on the route previously and the continued offer of competing services on the route by Virgin Australia and Jetstar. However, the ACCC considers that Alliance's withdrawal from the route is likely to have resulted in at least some reduction in competition on the route which is likely to result in a public detriment in the form of potentially higher airfares and/or a reduction in the quality and frequency of services.
- 4.51. The ACCC considers that while the extent to which Virgin Australia and Alliance would be likely to compete significantly with each other on the relevant Routes in the longer term is uncertain, there is a greater prospect of significant competition between them on some of the Relevant Routes in the longer term. In this respect, while the Proposed Conduct is intended as a short term measure, the sharing of information and coordination of operations that will occur does have the potential to impact competition between Virgin Australia and Alliance in the longer term.
- 4.52. In particular, commercially sensitive information may be shared, and insights to each other's operations, including future plans, gained which may facilitate alignment of Virgin Australia and Alliance's competitive behaviour and soften competition between them in the longer term. This may lead to a public detriment in the form of a reduction in competition between the Applicants in the longer term on some of the Relevant Routes.

*Competitive constraint imposed by other airlines*

- 4.53. The Applicants submit they will continue to face significant competitive constraint from the Qantas Group (including Jetstar and QantasLink).
- 4.54. As summarised at Attachment A, prior to the COVID-19 pandemic Qantas/Jetstar operated on 33 of the Relevant Routes covered by the Proposed Conduct.
- 4.55. The ACCC considers that Qantas/Jetstar are likely to provide a strong competitive constraint on the Applicants on many of these routes. While most routes only had two,

or three, airlines operating on them pre-COVID-19, as airlines seek to re-establish themselves on these routes as demand increases, Qantas/Jetstar are likely to compete vigorously with Virgin/Alliance in the short term on routes on which Qantas/Jetstar operate services.

- 4.56. The ACCC considers that Virgin Australia and Alliance will be a more vigorous and effective competitor to Qantas/Jetstar on these routes with, rather than without, the Proposed Conduct.
- 4.57. In relation to routes where Qantas/Jetstar were not operating pre COVID-19, either Virgin Australia or Alliance was operating services on 7 of the Relevant Routes pre COVID-19, on 3 routes where no airline was operating services. On two of the Relevant Routes Virgin Australia and one other airline other than Qantas/Jetstar were operating services: Solomon Air on Brisbane-Honiara and Airnorth on Perth-Kununurra.
- 4.58. There are three routes where, pre-COVID-19, Virgin Australia was the only airline offering services (Brisbane-Cloncurry, Cloncurry-Mount Isa and Perth-Onslow)<sup>4</sup> and two where only Alliance was offering services (Brisbane-Port Macquarie and Adelaide-Olympic Dam).
- 4.59. As noted, some interested parties consider the Proposed Conduct would provide the Applicants with a competitive advantage over smaller airlines on some of the Relevant Routes, some of which it was submitted are only marginally profitable and/or may only be able to sustain one airline.
- 4.60. The ACCC considers that to the extent the Proposed Conduct could provide the Applicants with a competitive advantage over smaller airlines that have historically operated, or could seek to operate on these routes, this is likely to reflect the greater efficiency that cooperation between Virgin Australia and Alliance could offer

### **Access to airport slots**

- 4.61. The Applicants submit that if Virgin Australia is not able to resume flying certain regional routes from 28 March 2021, it will be required to hand back valuable slots, particularly at Sydney Airport. The Applicants submit that if Virgin Australia is required to return these slots to the slot pool, the slots would be likely to be acquired by Qantas, further entrenching its dominant market position and foreclosing Virgin Australia's ability to offer particular services in the future.
- 4.62. Sydney Airport submits that it appears that Virgin Australia intends to retain its slots by allowing Alliance to use them temporarily. Sydney Airport submits that this would be inconsistent with the Sydney Airport slot regime, managed by the *Sydney Airport Demand Management Act 1997* (Cth) and the *Sydney Airport Slot Management Scheme 2013* (Cth) which specifically state that slots are not transferable.
- 4.63. Sydney Airport submits that peak Sydney Airport slots are a scarce resource and a public good that should not be retained by any airline if it is not able to efficiently use them, but rather should be returned to the slot pool to allow other airlines, including new entrants, the opportunity to enter or expand their presence at Sydney Airport. The economically efficient use of Sydney Airport's capacity and infrastructure would increase competition and consumer choice and welfare. It would also facilitate the recovery of the aviation industry and its long-term growth after the COVID-19 crisis.

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<sup>4</sup> Brisbane-Cloncurry and Cloncurry-Mount Isa were operated for Virgin Australia by Alliance under the Wet Lease Agreement.

- 4.64. Rex submits that any returned slots would not necessarily be acquired by Qantas as Rex has the capacity and intent to enter NSW regional routes that have been ceased by Virgin Australia. Rex submits that allowing Virgin Australia special advantages with regards to airport slots will disadvantage other competitors and effectively return Australia to a duopoly.
- 4.65. The ACCC notes that the Australian government is currently conducting a comprehensive review of demand management at Sydney Airport. A key purpose of the review is to consider whether the Sydney Airport slot management scheme remains appropriate. The ACCC has made a submission to the review, focussing on two interrelated ways in which the existing slot management scheme can impede competition:
- Rules that allow airlines to retain slots in perpetuity limit opportunities for new or expanding airlines to acquire slots needed to launch new services and compete.
  - Airlines are able to exploit the scheme by acquiring and hoarding slots for strategic reasons, resulting in inefficient slot use and further diminishing opportunities for increased competition.
- 4.66. As addressed in the ACCC's decision to grant interim authorisation for the Proposed Conduct, authorisation does not remove or alter any of the Applicants' obligations under applicable legislation in relation to Sydney Airport slots, including the *Sydney Airport Demand Management Act 1997* requirements and any Ministerial Directions relating to Sydney Airport and Sydney Airport slots.
- 4.67. If any interested party considers that any conduct engaged in by the Applicants in coordinating their operations under the interim authorisation raises concerns about the hoarding of slots the ACCC invites submissions on this issue.

### Balance of public benefit and detriment

- 4.68. The ACCC considers that the Proposed Conduct is likely to result in public benefits in the form of:
- a more efficient and sustainable operation of services by the Applicants, including maximising aircraft utilisation, accessing a broader range of aircraft and fleet types, and appropriately managing capacity on regional routes to meet the nature and volume of demand
  - supporting regional air services and regional communities
  - allowing customers better connectivity on some of the Relevant Routes covered by the Proposed Conduct, and
  - facilitating increased competition on certain regional and short-haul international routes through Virgin Australia being a more effective and vigorous competitor in operating certain regional and short haul international routes.
- 4.69. The ACCC considers that the proposed cooperation may result in some public detriment by removing competition between Virgin Australia and Alliance in providing services on the Relevant Routes. However, the ACCC considers that any public detriment resulting from a lessening of competition is likely to be limited because:
- Alliance's RPT network is limited, the Applicants have not historically both operated flights on the same Relevant Routes and if the proposed cooperation does not proceed, they are unlikely to compete with each other to any significant extent on most of the Relevant Routes over the two year period for which authorisation is sought, and

- other airlines, primarily Qantas/Jetstar, are likely to provide a strong competitive constraint on the Applicants on many of the Relevant Routes.
- 4.70. The ACCC considers that the information sharing and coordination of operations by Virgin Australia and Alliance in the short term may, by providing each with insights into the other's operations, have some impact on competition between them beyond the two year period for which authorisation is sought.
- 4.71. The ACCC also considers that the Proposed Conduct could make it more challenging for other, smaller, airlines seeking to establish or re-establish services on some routes because of Virgin Australia's more comprehensive service offering. However, the ACCC considers that any potential impact of the Proposed Conduct on existing operators on the limited number of routes is likely to be outweighed by the broader pro-competitive effects likely to result from the Proposed Conduct.
- 4.72. Therefore, for the reasons outlined in this determination, the ACCC is satisfied that the Proposed Conduct is likely to result in a public benefit and that this public benefit would outweigh any likely detriment to the public from the Proposed Conduct.

## Length of authorisation

- 4.73. The Act allows the ACCC to grant authorisation for a limited period of time.<sup>5</sup> This enables the ACCC to be in a position to be satisfied that the likely public benefits will outweigh the detriment for the period of authorisation. It also enables the ACCC to review the authorisation, and the public benefits and detriments that have resulted, after an appropriate period.
- 4.74. In this instance, the Applicants seek authorisation for two years from the date of the ACCC's determination. The Applicants submit that a minimum authorisation period of two years is appropriate given the Proposed Conduct is a temporary measure to allow the Applicants to continue providing essential airline services to regional communities and minimise costs and risk exposure in the face of the COVID-19 pandemic and its severe effect on the Australian aviation industry.
- 4.75. The ACCC considers that there is significant uncertainty in the aviation industry at this time including about the timing and pace of a recovery in domestic and short haul international travel. Having regard to this uncertainty the ACCC has decided to grant authorisation until 31 March 2023.

## 5. Determination

### The application

- 5.1. On 23 October 2020, the Applicants lodged application AA1000533 with the ACCC, seeking authorisation under subsection 88(1) of the Act.

### The authorisation test

- 5.2. Under subsections 90(7) and 90(8) of the Act, the ACCC must not grant authorisation unless it is satisfied in all the circumstances that the Proposed Conduct is likely to result in a benefit to the public and the benefit would outweigh the detriment to the public that would be likely to result from the Proposed Conduct.

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<sup>5</sup> Subsection 91(1)



5.3. For the reasons outlined in this determination, the ACCC is satisfied, in all the circumstances, that the Proposed Conduct would be likely to result in a benefit to the public and the benefit to the public would outweigh the detriment to the public that would result or be likely to result from the Proposed Conduct, including any lessening of competition.

5.4. Accordingly, the ACCC has decided to grant authorisation.

### Conduct which the ACCC has authorised

5.5. The ACCC grants authorisation AA1000533 to enable the Applicants to cooperate in relation to the provision of services on the Relevant Routes, as described in paragraph 1.8 and defined as the Proposed Conduct.

5.6. The Proposed Conduct may involve a cartel provision within the meaning of Division 1 of Part IV of the Act or may have the purpose or effect of substantially lessening competition within the meaning of section 45 of the Act.

5.7. The ACCC has decided to grant authorisation AA1000533 until 31 March 2023.

## 6. Date authorisation comes into effect

6.1. This determination is made on 8 April 2021. If no application for review of the determination is made to the Australian Competition Tribunal, the authorisation will come into effect on 30 April 2021.

## Attachment A: Relevant Routes<sup>6</sup>

| International routes |                | Airlines operating services pre COVID-19 | Airline operating services when the application was lodged (October 2020) |
|----------------------|----------------|--|---|
| Brisbane             | Honiara        | Virgin Australia, Solomon Air            | None  |
| Brisbane             | Port Moresby   | Air Niugini, Qantas, Virgin Australia    | None  |
| Domestic routes      |                |  |   |
| Brisbane             | Proserpine     | Jetstar, Virgin Australia                | Jetstar, Virgin Australia, Alliance Airlines, Qantas                      |
| Brisbane             | Mackay         | Qantas, Jetstar, Virgin Australia        | Qantas, Jetstar, Virgin Australia   |
| Brisbane             | Emerald        | Qantas, Virgin Australia                 | Qantas  |
| Brisbane             | Mount Isa      | Qantas, Virgin Australia                 | Qantas, Virgin Australia  |
| Brisbane             | Newcastle      | Qantas, Virgin Australia, Jetstar        | Virgin Australia, Qantas, Jetstar   |
| Brisbane             | Cloncurry      | Virgin Australia                         | None  |
| Brisbane             | Alice Springs  | Qantas, Virgin Australia                 | Qantas  |
| Brisbane             | Rockhampton    | Qantas, Virgin Australia                 | Qantas, Virgin Australia  |
| Brisbane             | Moranbah       | Qantas                                   | Qantas, Alliance Airlines   |
| Brisbane             | Gladstone      | Qantas, Alliance Airlines                | Qantas, Alliance Airlines   |
| Brisbane             | Port Macquarie | Alliance Airlines                        | None  |
| Brisbane             | Bundaberg      | Qantas, Alliance Airlines                | Qantas  |
| Brisbane             | Weipa          | Qantas                                   | Qantas  |
| Brisbane             | Ayers Rock     | Jetstar                                  | Jetstar   |
| Brisbane             | Tamworth       | Qantas, Fly Corporate (now Link Airways) | Link Airways  |
| Cairns               | Ayers Rock     | Qantas                                   | Jetstar, Qantas   |
| Cairns               | Darwin         | Jetstar, Airnorth                        | Airnorth  |
| Cairns               | Maroochydore   | None                                     | Alliance Airlines   |
| Canberra             | Maroochydore   | None                                     | None  |
| Alice Springs        | Darwin         | Qantas                                   | Qantas, Airnorth  |
| Alice Springs        | Ayers Rock     | Qantas                                   | None  |
| Melbourne            | Kununurra      | None                                     | None  |
| Melbourne            | Newcastle      | Jetstar, Virgin Australia                | None  |
| Melbourne            | Canberra       | Qantas, Virgin Australia, Tigerair       | Qantas, Virgin Australia  |
| Melbourne            | Mildura        | Qantas, Virgin Australia, REX            | Qantas, Rex   |
| Adelaide             | Olympic Dam    | Alliance Airlines                        | Alliance Airlines   |
| Adelaide             | Canberra       | Qantas, Virgin Australia                 | Qantas, Virgin Australia <sup>96</sup>                                    |
| Adelaide             | Alice Springs  | Qantas, Virgin Australia                 | Qantas, Virgin Australia  |
| Sydney               | Canberra       | Qantas, Virgin Australia                 | Qantas  |
| Sydney               | Coffs Harbour  | Qantas, Virgin Australia, Tigerair       | Qantas, Virgin Australia  |

<sup>6</sup> Information provided by the Applicants in their application dated 23 October 2020.

|           |                      |                                  |                            |
|-----------|----------------------|----------------------------------|----------------------------|
| Sydney    | Port Macquarie       | Qantas, Virgin Australia         | Qantas                     |
| Sydney    | Tamworth             | Qantas, Virgin Australia         | Qantas                     |
| Sydney    | Albury               | Qantas, Virgin Australia,<br>REX | Qantas, REX                |
| Sydney    | Ayers Rock           | Jetstar, Virgin Australia        | None                       |
| Cloncurry | Mount Isa            | Virgin Australia                 | Qantas                     |
| Perth     | Kalgoorlie – Boulder | Qantas, Virgin Australia         | Qantas, Virgin Australia   |
| Perth     | Kununurra            | Virgin Australia, Airnorth       | Virgin Australia, Airnorth |
| Perth     | Port Hedland         | Qantas, Virgin Australia         | Qantas, Virgin Australia   |
| Perth     | Newman               | Qantas, Virgin Australia         | Qantas, Virgin Australia   |
| Perth     | Karratha             | Qantas, Virgin Australia         | Qantas, Virgin Australia   |
| Perth     | Onslow               | Virgin Australia                 | Virgin Australia           |