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Megan Trudgian
General Manager
Small Business, Competition and Consumer Policy Division
The Treasury
By email: competition@treasury.gov.au

Dear Ms Trudgian

Virgin Australia Airlines – submission on the Competition Policy Review Final Report

Thank you for the opportunity to provide a submission on the Competition Policy Review's final recommendations into Australia's competition laws, policies and institutions.

In summary, Virgin Australia:

- does not support the Panel's recommendation in relation to cabotage
- supports the introduction of a substantial lessening of competition test for third line forcing
- supports changes to the laws relating to vertical supply arrangements that do not substantially lessen competition, and
- does not support the Panel's recommendation to raise the threshold test for the effect of the access on competition.

This submission should be read in conjunction with Virgin Australia's Submission to the Competition Policy Review dated 17 November 2014 (**VA Draft Report Submission**) (**Attachment A** to this letter).

1. Cabotage

Virgin Australia does not support Recommendation 5 as it relates to cabotage and aviation. Allowing foreign airlines to serve domestic routes in Australia would not enhance the efficiency or competitiveness of air services. The potential benefits that would be realised by the community as a whole through the removal of cabotage restrictions contained in Australia's aviation policy would be significantly outweighed by the associated costs, and therefore cannot be justified. Broadly, such costs include reduced direct investment in Australia's aviation sector, a decrease in air services and connectivity for regional areas and fewer local jobs.

(a) Australian aviation policy

Australia's aviation regulatory regime is one of the most liberal globally in terms of the access it provides foreign airlines to the domestic market.

Foreign carriers are offered unrestricted access to all points in Australia other than Brisbane, Sydney, Melbourne and Perth on a unilateral basis in air services negotiations conducted by the Australian Government. In addition, most of Australia's bilateral air services arrangements extend own stopover rights to foreign carriers, enabling them to carry their international passengers to multiple points in Australia with the same aircraft. Singapore Airlines' subsidiary Silk Air recently commenced services from Singapore to Cairns and Darwin and transports its international passengers between the two ports. Opportunities for foreign airlines to code share on Australian carriers' extensive domestic networks are also commonplace in these arrangements.

Australia's aviation policy does not permit foreign airlines to serve the domestic market by means of consecutive cabotage, ie the ability to pick up domestic passengers or freight at an Australian airport for carriage to another Australian airport. New Zealand is an exception to this, as Australia has had Single Aviation Market arrangements in place since 1996, that permit the exercise of these rights on a reciprocal basis.

The grant of consecutive cabotage rights in air services agreements globally is almost non-existent.

Australia's aviation policy allows foreign entities, including airlines, to hold up to 100 per cent of the equity in an Australian domestic carrier, subject to national interest tests.

This 'investment cabotage' policy allows foreign entities access to the domestic market, but entails a necessary commitment to the establishment of a long-term presence, generating employment and supporting economic development. It also promotes competitive discipline among domestic airlines, through the ongoing threat of new entrants.

Both Virgin Blue and Tiger Airways were established under this policy, and have brought increased competition and innovation to the Australian market, providing consumers and exporters with greater choice and lower airfares.

The equity investments in Virgin Australia by Air New Zealand, Etihad Airways and Singapore Airlines are also testament to the effectiveness of this policy. These airlines have committed significant capital to underpin their participation in the domestic aviation market, strengthening its competitiveness, ability to expand its network footprint and grow Australian jobs.

Permitting consecutive cabotage would largely remove the incentive for foreign airlines to invest in the Australian aviation industry, as it would allow them to participate in the domestic market with a reduced commitment and to withdraw their participation more readily.

Virgin Australia notes that Recommendation 5 supports the removal of cabotage restrictions on coastal shipping and is aware that the Government intends to undertake reform of the policy framework with respect to this sector. Australia has a limited and shrinking coastal shipping fleet, which stands in stark contrast to the vibrancy and increasing competitiveness of its aviation industry. Against this background, Virgin Australia would caution against a 'one-size-fits-all' approach to this issue in the transport sector.

(b) Impact on Australia's aviation industry

The grant of cabotage rights, even on a limited basis, could be expected to have far-reaching consequences for the long-term sustainability of the Australian aviation industry.

On a practical level, these rights would enable foreign carriers to operate on routes alongside Australian airlines, using aircraft that would otherwise remain idle in the time period between international services. The foreign carrier would need only to recoup the marginal cost of the capacity operated on the route, in contrast to the local carrier, which has a requirement to recover the full cost of the sector. The resulting ability of foreign carriers to offer airfares that are lower than the average cost faced by domestic airlines in operating these services would lead to network rationalisation by local operators over the longer term. This would see Australian carriers redeploy aircraft onto higher-yielding trunk routes at the expense of marginally-profitable or loss-making regional routes, some of which deliver relatively little overall network benefit.

The likely practical impact of cabotage on the Australian aviation industry has been recognised, and accordingly ruled out, in successive aviation policy reviews on a bipartisan basis. While Virgin Australia recognises that policy settings evolve, we cannot identify a compelling reason for modification of the current framework.

It is widely acknowledged that the operation of international air services by Australian carriers is increasingly difficult, as a result of greater competition, labour rate differentials and Australia's geographic position as an end-of-line, rather than a hub, market. Eroding the viability of Australian airlines' domestic platform will undermine the industry's ability to expand internationally, which is a stated objective of the Government's aviation policy, as the markets are inextricably linked.

The Government's aviation policy seeks to foster a competitive and growing industry, and recognises the employment and flow-on effects for the wider economy that it supports. The grant of consecutive cabotage rights – even on a limited basis – would be wholly inconsistent with this objective. It would enable foreign airlines to take opportunistic advantage of the domestic market, at the expense of the viability and stability of the local industry, with little benefit for the broader economy. A superior outcome, in Virgin Australia's view, would be for government to undertake policy and regulatory reforms to enhance the competitiveness of the local industry.

(c) Aviation industry coverage

Australia is well served in terms of domestic air connectivity, including in the regions. In fact, the regional aviation footprint in Australia has grown strongly over the past decade and fares are highly competitive. Growth at regional airports over the five years to 2013 has been greater than at major cities.¹

Virgin Australia has played a significant role in the development of air services to the regions in recent years. We have invested in a fleet of ATR72 turboprop aircraft and acquired Western Australian based carrier Skywest to accelerate our growth. In 2010, Virgin Australia operated 700 weekly flights to 29 domestic destinations. Today, we operate over 3,000 services each week to 47 destinations, which in large part reflects our regional expansion.

Virgin Australia recently made a substantial investment in establishing daily services between Darwin and Alice Springs, including opening lounges at both airports. If the exercise of cabotage rights by foreign airlines had been in prospect, Virgin Australia would not have made this commitment.

It is worth noting that airport charges are a key determinant of the viability of regional routes, accounting for a large and increasing proportion of airfares. The introduction of a cabotage policy for any specific geographic region or specific routes could be expected to see relevant airports move to upgrade their infrastructure, with a view to attracting larger aircraft operated by international airlines. Given the relatively low passenger volumes, this would significantly increase overall charges, which are principally borne by domestic airlines and their passengers. This would render the sustainability of all services to these airports operated by Australian airlines – not just a particular route on which cabotage may be permitted – an even more challenging proposition.

2. Vertical supply arrangements and cartel laws

Virgin Australia supports the Panel's recommendations in relation to amendments to the *Competition and Consumer Act 2010 (CCA)* recognising that many vertical trading restrictions are unlikely to cause any significant competitive harm.

Virgin Australia primarily supports the Panel's **Recommendation 33** that anti-competitive vertical restrictions, including third line forcing, would be adequately addressed by amending sections 45 and 46, with section 47 being repealed in its entirety.

However in the alternative, Virgin Australia also supports the Panel's **Recommendation 32** that the third line provisions (section 47(6) and (7)) should be subject to the same substantial lessening of competition test as the rest of section 47.

¹ Bureau of Infrastructure, Transport and Regional Economics, Air transport services trends in regional Australia (2013 Update)

(a) Third line forcing applications

As noted in section 2.2 of the VA Draft Report Submission, in Virgin Australia's experience third line forcing commonly results in benefits that are valued by its guests, and also by members and partners of its loyalty program Velocity Frequent Flyer.

The need to continually notify such benign and ubiquitous consumer offers to the ACCC continues to create unnecessary legal and management costs and time inefficiencies and regulatory burdens for Virgin Australia, Velocity and their partners.

Virgin Australia would welcome an amendment to section 47 to subject third line forcing to the substantial lessening of competition test.

(b) Vertical trading restrictions and cartels

As noted in section 2.5 of the VA Draft Report Submission, Virgin Australia has concerns about the current state of the law in relation to vertical supply arrangements, price fixing and the anti-overlap provisions in the CCA.

Virgin Australia utilises multi-distribution systems for its products while also providing distribution services on behalf of other providers such as car hire companies and hotel booking services so this recent change in interpretation is of concern. The decisions handed down by the Federal Court in the recent Flight Centre and ANZ cases have created significant uncertainty in relation to the application of the CCA to dual-distribution models, where previously it was relatively uncontroversial that vertical restraints were permitted under the CCA provided they did not have the purpose or effect of substantially lessening competition.

To remove this uncertainty, Virgin Australia primarily supports the repeal of section 47 in its entirety, with associated amendments to section 45 and 46 and particularly the recommended inclusion of the broader exemption in new section 45J. From a commercial and operational perspective, Virgin Australia is able to evaluate relatively efficiently the effect on competition of its supply and distribution arrangements and the clarity of the broader exemption significantly reduces any uncertainty surrounding the structuring of distribution systems and engagement with agents.

However in the alternative, Virgin Australia supports the Panel's recommendation to amend section 47 and to include a broader exemption (as per the suggested drafting in section 45J)² to the cartel laws to ensure that genuine vertical supply restrictions are assessed under the substantial lessening of competition test and not interpreted as horizontal cartel conduct.

² Although it does appear that there may be a drafting error in section 45J(1)(a)(i) – the first reference to *acquirer* may actually mean *supplier*.

3. Improving access and pricing regulation in relation to airports

As set out in section 3 of the VA Draft Report Submission, it is Virgin Australia's experience that the current regulatory regime is not effective in guaranteeing the efficient operation of the Australian aviation industry or in providing incentives for airports to efficiently price services while addressing the imbalance in negotiating power between airports and airlines.

In that regard, Virgin Australia strongly disagrees with the Panel's view that "[t]he regulatory issue that arises in respect of airports is generally one of monopoly pricing rather than access"³ or that "[t]hose regimes [electricity wires, gas pipelines, telecommunication lines, freight rail networks, **airports** and ports] appear to be achieving the original policy goals identified by the Hilmer Review".⁴

For airlines, Part IIIA is not a 'back stop' to the current industry specific access regime – it is the **only** access regime.

Although the declaration provisions in Part IIIA of the CCA have their limitations, in the absence of an industry-specific regulatory regime Virgin Australia and its subsidiary TigerAir Australia have successfully used Part IIIA to secure access and negotiate commercial terms with Sydney Airport. Unless and until an appropriate industry specific regime is introduced, the declaration regime in Part IIIA will remain an important (and solitary) tool in Virgin Australia's arsenal for negotiating with airports.

Although as part of its light-handed regulation of the industry the Commonwealth Government does expect that airports will consider the Aeronautical Pricing Principles (**APPs**) when negotiating airport services and charges, in Virgin Australia's experience the airports do not always consider themselves to be bound by the APPs. In those circumstances Part IIIA is of significant importance.

In light of the above Virgin Australia does not support the Panel's recommended changes to the declaration Criterion (a) (that access to the service would promote a material increase in competition in at least one market other than the market for the service).

The Panel's concern that Criterion (a) sets too low a threshold for declarations is, in Virgin Australia's view, misguided. Although BHP's particular experience did not result in any actual access requests, this should not translate into a conclusion that section 44G sets the bar too low for all types of applications. For airlines that have no alternative, raising the threshold to 'substantial improvement' and 'nationally significant' raises the risk of placing Part IIIA out of reach.

It should also be noted that the volume (or lack thereof) of airport-related Part IIIA declarations and applications is a function of the lack of an aviation-specific regime and not necessarily a demonstration that access and pricing are issues of limited concern to airlines. To the contrary: the cost, time and uncertainty involved in utilising the regime are factors that weigh heavily in the cost-benefit process that Virgin Australia uses when deciding whether to proceed with an application or not.

³ Harper Review Final Report page 427-8

⁴ Harper Review Final Report page 431

In that regard, Virgin Australia agrees with the ACCC's views that bargaining power imbalances would be better addressed by improved competition, or by way of an industry-specific regime.⁵

For these reasons, Virgin Australia continues to advocate the adoption of a negotiate-arbitrate access model for airports. However, until and unless such a model is implemented, declaration under Part IIIA remains an important safeguard.

Yours sincerely



Adam Thatcher
General Counsel/Group Executive, Corporate Risk
Virgin Australia Airlines Pty Ltd

⁵ See for example ACCC media release 9 April 2015 – *Airport profits increase despite disappointing service levels*.
<http://www.accc.gov.au/media-release/airport-profits-increase-despite-disappointing-service-levels>



ATTACHMENT A