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Dear Director

Revitalising National Competition Policy – submission by Virgin Australia

Virgin Australia Airlines Pty Ltd (**Virgin Australia**) welcomes the opportunity to provide a submission on revitalising the National Competition Policy (**NCP**), to ensure that it remains fit for the purpose of driving pro-competitive government policy and action towards the opportunities and challenges facing the modern Australian economy.

The points made in this submission reflect Virgin Australia's previous submissions to the Australian Government and the Productivity Commission regarding the deficiencies of the current 'light handed' approach to regulation of airports and the ongoing challenges for airlines in dealing with monopolistic behaviour by various airports.

While Virgin Australia welcomes the release of the Australian Government's comments in the White Paper regarding considerations of revising and mandating the Aeronautical Pricing Principles (**APPs**) and a negotiate-arbitrate model through the next Productivity Commission review, Virgin Australia considers it important that these points be reiterated in the National Competition Policy Review forum. This is particularly the case at a time when several major airports have announced an intention to invest in major infrastructure redevelopments, which has the potential to significantly impact airport charges for airlines and could ultimately result in higher airfares for consumers.

Importance of a fit for purpose NCP and its effective implementation in the aviation industry

Virgin Australia considers that strong competition in the aviation sector is essential to foster an efficient and sustainable industry for the benefit of consumers. A competitive aviation sector is also crucial for the health of the Australian economy. Many Australian businesses and communities depend on safe and accessible air travel. For this reason, a fit for purpose NCP and its effective implementation in the aviation industry are crucial for setting the right foundation for such competition to occur.

There is a need to be vigilant about unchecked anti-competitive behaviour by participants within the aviation industry. Virgin Australia has made submissions to the Productivity Commission's inquiry into the Economic Regulation of Airports in 2019¹ and more recently in 2023 to the Australian Government in

¹ Available at https://www.pc.gov.au/data/assets/pdf_file/0014/231440/sub054-airports.pdf

relation to the Aviation Green Paper², raising deficiencies in the existing regulatory framework in tackling such behaviour.

These concerns align with the need to revisit and refresh the NCP, particularly the principles relating to pricing oversight and access to services in the National Competition Principles and how these principles are being implemented. Virgin Australia agrees that certain aspects of these principles are outdated and need to be revitalised but more importantly, considers that the implementation of these principles in the aviation industry through the price monitoring regime³ and the access regime in Part IIIA of the *Competition and Consumer Act 2010* (Cth) (CCA) have been wholly ineffective in constraining the anti-competitive behaviour of airports, which are natural monopolies in the aviation industry.

Airports regularly exercise their monopoly power to the detriment of airlines and consumers

Australian airlines do not have any choice other than to use the facilities and services provided by airport operators. As a result, airports can, and do, exercise market power in negotiations with airlines. The exercise of monopoly power by airports imposes inefficient costs on the travelling public in two main ways:

- high airport charges ultimately lead to a higher cost of air travel for customers. Airport charges, levies and fees are currently Virgin Australia's third largest cost of operation after fuel and labour costs. This means that these costs and the associated competition impacts can be very significant, and ultimately can lead to increased airfares for passengers. The reality of this point is reflected in the comments of the CEO of Bonza who said (prior to the airline going into voluntary administration) that airport charges were the 'single largest cost' for Bonza⁴; and
- monopoly airports are able to discriminate between airlines, in both overt and non-transparent ways, including by charging some airlines substantially higher charges for access to the same services and facilities and/or by providing preferential treatment to some airlines in the delivery of services (e.g. exclusive or preferential access to different parts of an airport, management rights within airport terminals, signage and branding rights, etc). Where this occurs, it can ultimately be damaging to competition between airlines using the same airport infrastructure and may result in the inability of one or more airlines to compete on particular routes because those differentiated costs of access put them at such a severe competitive disadvantage.

The result is that airlines are forced to bear a disproportionate amount of increased airport costs because of the competitive environment in which they operate. This creates barriers to entry, expansion and viability for all airlines in Australia.

It is crucial that action be taken now to address these issues because major airports are poised to invest \$15 billion in significant capital development over the next five to seven years, which is triple the amount invested over the previous five to seven years. This is expected to lead to excessive price increases for airport users, noting that airports typically pass these costs through to airlines.

² Available at <https://www.infrastructure.gov.au/sites/default/files/documents/agp2023-submission-c223-virgin-australia.pdf>

³ Price monitoring of airports is undertaken by the ACCC pursuant to directions issued under section 95ZF of the *Competition and Consumer Act 2010* (Cth).

⁴ See <https://australianaviation.com.au/2022/02/exclusive-bonza-wont-deal-with-airports-that-dont-negotiate-fees/>

The growing concentration of ownership

The increasing concentration of ownership of major airports in Australian capital cities into the hands of a small number of private entities should also be a significant concern. The *Airports Act 1996* (Cth) includes a 15% limit on cross-ownership of certain pairs among Australia's four monitored airports, reflecting worries about the implications of ownership consolidation, such as substantial information asymmetry and unfair negotiating power. Virgin Australia points out that several institutional investors currently hold at least a 15% stake in two or more capital city airports. Industry Funds Management has significant stakes in Sydney, Melbourne, Brisbane, Adelaide and Darwin Airports.

Without meaningful regulatory changes, the trend toward greater airport ownership consolidation will likely continue to diminish the already limited negotiating power that airlines possess in commercial dealings.

Deficiencies with current price monitoring regime and access regime

As previously noted in its submissions to the Aviation Green Paper and the Productivity Commission inquiry into the economic regulation of airports, Virgin Australia considers that there are **five key deficiencies** in the current price monitoring regime and access regime as relevant to the regulation of airports:

1. the existing 'light-handed' regulation of airports through price monitoring is ineffective and needs to be replaced with genuine 'light-handed' regulation;
2. the current access regime in Part IIIA of the CCA is an ineffective constraint on airports' abuse of their power, as the declaration criteria are not designed to address abuse of market power by a non-vertically integrated monopoly service provider such as airports;
3. the negotiate-arbitrate model in Part IIIA of the CCA does not mitigate the significant information asymmetry that exists between airports and airlines by imposing obligations on service providers to provide information;
4. criteria to be applied by the ACCC in making arbitration determinations are too broad; and
5. there is potential for significant delays in resolving disputes under Part IIIA of the CCA.

Virgin Australia's submissions on each of these items is outlined below.

1. Ineffective price monitoring of airports needs to be replaced with genuine 'light-handed' regulation

The current price monitoring regime is often referred to as 'light-handed' regulation. However, Virgin Australia's consistent experience with various airports is that it is no regulation at all as prices and other terms of access to airports are not, in any sense, regulated. Instead, these are unilaterally determined by the monopoly airport operators.

Enabling airport behaviour is the fact that there is no regulatory oversight or determination of the terms of access, nor any recourse to a regulator to resolve disputes. The only role for the ACCC, the economic regulator under the current regime, is to periodically report on high level financial and service metrics for

airports. The ACCC's current monitoring role is similar to the role that it currently has for competitive industries, such as petrol, childcare, and retail banking, or indeed domestic airlines. It is not an appropriate form of oversight for monopoly activities, a fact which has been noted by the ACCC itself.⁵

Imbalance in bargaining power between airports and airlines

Under the existing regime for negotiating agreements with airports, Virgin Australia regularly faces significant challenges with information asymmetry. These negotiations often involve 'take it or leave it' pricing proposals, unnecessary or unreasonable investment that drives up the cost base, and lack of transparency. Airports hold all of the information relating to their costs, expenditure plans and allocation between aeronautical and non-aeronautical activities. Airlines rely on airports to provide information on a voluntary basis in support of their pricing proposals. The APPs relating to prices for aeronautical services and facilities provided by airports exist, but the application of these principles is not mandatory or enforceable. The resultant information asymmetry leads to unreasonably protracted and resource-intensive negotiations and is discussed later in this submission.

Evidence of airports taking advantage of this imbalance in bargaining power was provided in Virgin Australia's submission to the Commonwealth Government on the Aviation Green Paper in 2023.⁶ Further recent evidence includes a capital city airport denying Virgin Australia access to aerobridges during price negotiations, which meant passengers, including those with mobility restrictions and the elderly, were forced to use the stairs to disembark, including in inclement weather.

Without feeling any constraint from existing regulations, or the supposed 'threat' of more heavy-handed regulation, the monopolistic conduct of airports will continue to directly affect passengers.

Need for effective 'light-handed' regulation of airports where compliance with the APPs is required

For monopoly activities, there are broadly two forms of regulation that can potentially be effective if adopted:

- Heavier regulation - which typically involves ex ante determination or approval of prices and other terms of access by the regulator. This form of regulation currently applies to electricity distribution and transmission networks, certain gas pipeline infrastructure, the national broadband network and certain rail infrastructure (e.g. the Aurizon network in central Queensland); or
- Light-handed regulation – which typically provides for commercial negotiation of prices and other terms of access, but with access to a regulated arbitration process to resolve disputes. To support the negotiation and arbitration processes, service providers will often be required to disclose certain minimum levels of information relating to the costs of supply. This is the form of regulation that currently applies to most gas transmission pipelines and some seaport infrastructure in Australia. Virgin Australia has long-advocated for the introduction of a 'negotiate-arbitrate' model of light-handed regulation of airports, together with stronger APPs, reporting obligations and price

⁵ The former ACCC Chair Rod Sims observed: 'the mantra that light-handed regulation means price monitoring is ill-conceived in economic theory and not working in practice... Experience has shown that, in circumstances of natural or legislated monopoly, price monitoring will have little or no longer term impact on the conduct of the monopoly infrastructure owner. Why are we surprised? Price monitoring is not price regulation.'

⁶ Available at <https://www.infrastructure.gov.au/sites/default/files/documents/agp2023-submission-c223-virgin-australia.pdf> (see section 9.7 at pp 72 to 75).

monitoring. This position would bring airports into line with other monopoly infrastructures around Australia.

Under either form of regulation, there are clear principles or rules governing the determination of prices.

Critically, however, principles alone are not sufficient – especially if they are vague and open to interpretation and not subject to any mechanism for oversight by a regulator, as is the case with the APPs. For any principles to constrain the monopoly power of airports and ensure that only efficient costs are reflected in the prices paid by airport users, there needs to be some mechanism for ensuring that they will actually be applied. Under heavier forms of regulation, the regulator will apply the pricing principles or rules itself as part of its ex ante determination. Under genuine light-handed regulation, the threat of arbitration (and knowledge that the principles / rules will be applied in any arbitration) can ensure that the pricing principles or rules will be applied during negotiations.

Genuine ‘light-handed’ regulation would at least involve a role for a regulator (such as the ACCC) to resolve disputes in line with the APPs, and to support the consistent application of those principles in practice, by issuing appropriate guidance around the negotiation framework to be adopted, and information disclosure and transparency obligations.

2. Current access regime in Part IIIA of the CCA is an ineffective constraint on airports’ abuse of their power

Getting the regulatory settings right for access to airport services is essential to ensure that airlines of all sizes can efficiently operate and fairly compete, airlines’ costs are not unnecessarily increased, and passengers do not have inefficient costs passed on to them through higher airfares.

Virgin Australia considers that Part IIIA of the CCA⁷ is an inadequate constraint on airports’ abuse of market power. This is primarily because the current declaration criteria in Part IIIA are not directed at addressing potential abuses of market power by a non-vertically integrated monopoly service provider such as airports. Rather, they are directed at addressing circumstances where a vertically integrated monopoly service provider has the ability and incentive to act in a way that is damaging to competition in upstream or downstream markets.

This view was iterated by the ACCC in its submission to the Treasury’s consultation on improving the timeliness of the National Access Regime where it said:⁸

‘The National Access Regime was originally designed to deal with monopolists that are vertically integrated and that deny access to upstream or downstream competitors, following the Hilmer Committee’s report on *National Competition Policy*. At the time it was implemented, while monopoly pricing was a potential concern, denial of access was the predominant issue. That has now changed and some of the biggest concerns are arising in the conduct of non-vertically-integrated monopolies. In these cases, it is inefficient monopoly pricing, not denial of access, causing significant economic harm.’

⁷ CCA, s 44CA

⁸ Available at <https://www.accc.gov.au/system/files/Treasury%20consultation%20-%20Timeliness%20of%20National%20Access%20Regime.pdf> (see p 1).

In addition, changes introduced to the declaration criteria in November 2017 significantly increased the hurdle for users of non-vertically integrated infrastructure seeking declaration. Prior to those changes, an applicant was likely to satisfy the criterion in section 44CA(1)(a) of the CCA ('criterion (a)') if it could be demonstrated that **access to the relevant service was required** in order for users to be able to compete in dependent markets – a surmountable hurdle for users of critical infrastructure, such as a major airport. However, it now needs to be demonstrated that a **change in the terms of access as a result of declaration** would materially improve conditions for upstream or downstream competition.⁹

The design of criterion (a) is now such that it is unlikely to be satisfied in all cases where there is substantial market power, or even monopoly power. Rather, this criterion will only be satisfied where the exercise of monopoly power is leading to terms and conditions of access that are disrupting or inhibiting competition in another market.

As a result, Part IIIA is not equipped to address circumstances where non-vertically integrated monopoly service providers (such as airports) are acting in a way that is detrimental to economic welfare, but not materially impacting competition in any upstream or downstream market.

3. The negotiate-arbitrate model in Part IIIA of the CCA does not mitigate the significant information asymmetry that exists between airports and airlines by imposing obligations on service providers to provide information

A key deficiency in Part IIIA is that it does not impose any obligation on service providers, at the negotiation stage, to provide information to access seekers, which in the aviation context, often results in an imbalance of bargaining power between airports and airlines.

As noted above, information asymmetry is a material issue in the current 'light-handed' regulation of airports (noting that this is a well-recognised issue in economic regulation which extends to other industries involving natural monopolies). Such information asymmetry is usually in relation to cost and asset value information, which in turn is likely to be relevant to any assessment of the reasonableness of access terms and prices being proposed by airports.

Virgin Australia's experience in many cases is that it does not have sufficient information to meaningfully assess the merits of an airport's pricing proposal, including whether the APPs have been applied. Virgin Australia commonly encounters airports not providing information, delaying the provision of information, or providing it on a piecemeal basis after multiple requests.

To address information asymmetry, most access regimes (particularly 'light-handed' regimes) include obligations on service providers to either publish information and/or provide information during negotiations in a timely manner. For example, the gas pipelines access regime includes:

- obligations on service providers to periodically publish certain information in accordance with the rules and Australian Energy Regulator guidelines, including detailed cost and usage information; and

⁹ These issues are further explained the legal advice provided by Gilbert + Tobin which was provided as part of Virgin Australia's submission to the Productivity Commission's Issues Paper on Economic Regulation of Airports in 2018 (available at https://www.pc.gov.au/data/assets/pdf_file/0014/231440/sub054-airports.pdf). While Gilbert + Tobin's advice and Virgin's submission were prepared in 2018, they remain current, as the relevant criteria and dynamics discussed have not changed materially since that time.

- during negotiations, obligations to provide certain information regarding the basis for proposed pricing. This may include information about the method used to determine proposed prices and/or information regarding the costs of providing the pipeline service.

Virgin Australia submits that similar obligations to provide information regarding the methods and inputs used to determine pricing should apply to airports, including how those methods and inputs comply with the APPs and any relevant ACCC guidance.

Virgin Australia also supports the ACCC's recommendations for the amendment of the Airports Regulations to expand the reporting requirements of the currently monitored airports through the provision of disaggregated financial and operational data.¹⁰

4. Criteria to be applied by the ACCC in making arbitration determinations is too broad

Part IIIA of the CCA provides a relatively high level guidance to the ACCC on how it is to determine an access dispute. Again, this reflects the fact that Part IIIA is a general access regime, designed to cater for a wide range of different industries and types of disputes. Consequently, there may be some uncertainty as to the nature of the determination that would be made by the ACCC in any given case.

The degree of ACCC discretion in making an access determination, and the range of factors that it must take into account, means that outcomes could vary considerably from case to case. A further source of uncertainty is the fact that only two access determinations have ever been made by the ACCC under Part IIIA and both in unrelated industries – mining and water. A sector-specific regime could provide more guidance around how access determinations are to be made. Consequently, there could be greater certainty under these regimes as to the terms and conditions that would be determined if a dispute is referred to arbitration. This can in turn provide clearer parameters for commercial negotiations.

5. Potential for significant delays for resolution under Part IIIA

While there is a time limit of 180 days for the ACCC to determine an access dispute under Part IIIA, it may 'stop the clock' in a range of circumstances, including where the ACCC requests information or submissions from the parties. Further exemplifying the ineffectiveness of Part IIIA, such delays may come after:

- the parties conducted commercial negotiations for a period of 6 – 12 months or more;
- the airline prepared and filed a declaration application, including taking the time to prepare all of the information which the National Competition Council (NCC) seeks at the outset, such as expert reports on declaration criteria (a) and (b) in particular;
- the airline then participates in the NCC process which takes at least 180 days from the day the NCC receives the application;
- the airline is then required to wait 60 days for the designated Minister to make a decision;

¹⁰ See https://www.accc.gov.au/system/files/ACCC%20final%20advice%20on%20financial%20information%20May%202023_0.pdf.

- regardless of the Minister's decision, there is then the potential for the matter to be heard by the Australian Competition Tribunal, Full Federal Court and High Court. For Glencore, this process took nearly three years and would have taken even longer had Port of Newcastle's application for special leave to the High Court been successful; and
- if the service is ultimately declared and the airline wishes to seek arbitration, the airline then has to prepare its notification of an access dispute.

Altogether, there is real potential for this process to take 4 to 5 years if the process plays out in full, making the regime a wholly unsuitable method for resolving pricing disputes between airports and airlines. The process for Virgin Blue (as Virgin Australia was formerly known) to gain access to airside services at Sydney Airport took almost 5 years from the application for declaration in October 2002, to resolution of the terms of access to the airside services in May 2007.

As noted above, Treasury consulted on the timeliness of processes under Part IIIA in 2021¹¹ which resulted in exposure draft legislation being prepared, but the law has not been amended to address this issue.

Need for a fit for purpose NCP and its effective implementation in the aviation industry are greater than ever

Despite the clear inadequacies of the existing access principles and 'light-handed' regulation of airports through price monitoring, there have been no changes to the regulatory regime to level the playing field between the airports and the airlines. As a result, Virgin Australia considers that airport operators do not perceive any credible threat of heavy handed regulation and are increasingly emboldened to continue to exploit their monopoly power. With the aviation industry still seeking to fully recover post the pandemic era and with the current cost of living pressures, Virgin Australia considers that recalibrating the NCP and its implementation to ensure effective regulation of airports and strong competition in the aviation industry to be more important than ever.

This submission has focused on the need for change in the regulation of airports. Virgin Australia's position on other matters relating to competition in the aviation industry is set out in its Aviation Green Paper submission.¹² This includes issues in relation to the entrenched market dominance of Qantas and the need for strong enforcement of the CCA to address instances of anti-competitive conduct in the aviation industry.

Please do not hesitate to contact us if you would like to discuss these issues in further detail.

Yours sincerely



Susan Schneider
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¹¹ See <https://treasury.gov.au/consultation/c2021-225159>

¹² See <https://www.infrastructure.gov.au/sites/default/files/documents/agp2023-submission-c223-virgin-australia.pdf> (see section 7 at pp 43 to 51).