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**Rex submission to ACCC**

Virgin Australia and Alliance Airlines  
application for authorisation

*Ref: AA1000533*

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## 1. Summary of what the parties seek to have authorised.

The applicants (Virgin and Alliance) are seeking authorisation to cooperate in relation to 43 specified routes (2 international routes and 41 domestic routes). Of the 41 domestic routes:

- Only one is an overlapping route currently serviced by both parties (Brisbane – Proserpine). This was not an overlapping route pre-COVID, Alliance having entered this route in June 2020;
- Three are routes where one of the parties is currently the sole operator on the route;
- 14 are routes currently serviced by one of the parties and another operator (in all but one case, the other operator is the Qantas group); and
- 23 are routes that are currently serviced by neither of the parties, 10 of these being routes that neither operated pre-COVID.

The nature of the cooperation the parties want authorised is extremely broad, and covers the sharing of cost information and strategic entry plans (allowing the parties to act as if they were part of the same corporate group). The application describes the proposed cooperation as including:

- *sharing information (including in relation to costs, willingness to operate, capacity, anticipated demand and pricing) about Relevant Routes;*
- *agreeing capacity, flight schedules and aircraft type, including whether a carrier will suspend or continue operations, which carrier will operate Relevant Routes and under what arrangements (eg, wet lease or codeshare etc.); and*
- *putting in place temporary commercial agreements that are most suitable for the Relevant Route considering demand and risk profile in the exceptional current market conditions; and*
- *potentially, risk and revenue sharing mechanisms and agreements as to price*

## 2. This is not about responding to COVID.

The application is presented as being about responding to COVID but examination of the routes and nature of the cooperation reveal that this is not really about the pandemic.

The submission refers to the COVID-related authorisation obtained by Rex as recognition by the ACCC of the challenges airlines are facing due to the COVID pandemic (page 24).

However, the two authorisations are very different, as explained below.

Rex's application made at the start of the pandemic (and before funding arrangements were in place) was about allowing temporary cooperation by all pre-COVID operators on particular routes during the

pandemic, to maintain essential services while keeping total load factors viable during a period of severely depressed demand.

The scope of co-operation was limited to things airlines can do with no, or minimal, sharing of confidential information (co-ordinating schedules and sharing revenue) and specifically without any need to share highly sensitive information about costs, future pricing or strategic plans that might have lasting impacts beyond the authorisation.

These factors meant that any cooperation during the authorisation could be easily and transparently monitored by the ACCC and the market, against a clear baseline position of what each operator was doing independently before authorisation, including their independent pricing.

As summarised in the ACCC's final determination on Rex's application:

*4.20. Where airlines act independently during periods of unusually low demand, the effect that each airline has on the demand of the other airline's services is not taken into account by either party in planning schedules. Airlines are likely to prefer to schedule their flights at the most popular departure time, which can result in duplication of services.*

*4.21. The Proposed Conduct has the potential to address this issue by giving the Participating Airlines the ability and incentive to coordinate their schedules. Allowing the Participating Airlines to share revenue is likely to result in them being indifferent to individual load factors and route profitability and create the incentive for them to offer a better schedule spread.*

*4.22. As such, the ACCC considers that once the Funding Arrangements are removed, the Proposed Conduct is likely to result in a public benefit by enabling greater schedule flexibility and choice for passengers flying to and from certain regional destinations during periods of unusually low demand.*

In contrast, the Virgin application is focused on allowing two specific competitors (and only these two) to jointly shape their network strategy as demand increases coming out the pandemic.

The cooperation is not linked to dealing with route load factors, and because it does not cover all operators on the route, cannot deal with route load factors. Indeed, Virgin is explicit in the application that it is not interested in this, despite the ACCC recognising in the Rex authorisation that there is public benefit in doing so on regional routes during the period of unusually low demand caused by COVID.

The submission notes (at page 17) that two of the routes for which Virgin and Alliance seek authorisation are routes covered by the Rex authorisation (Sydney- Albury and Melbourne – Mildura). However, Virgin explicitly states that it does not plan to participate in coordination under the Rex authorisation:

*In addition, two Relevant Routes (Sydney – Albury and Melbourne – Mildura) are the subject of the ACCC’s determination to grant REX authorisation to co-ordinate operations with Qantas and Virgin Australia on specified routes. Virgin Australia expressed support for REX’s application, recognising the need to realise efficiencies to provide services during the COVID-19 crisis. However, Virgin Australia does not plan to coordinate flights with REX on these Relevant Routes. It has a long-standing commercial relationship with Alliance Airlines and their businesses are largely complementary, making a partnership between Virgin Australia and Alliance Airlines a clear choice.*

This makes it clear that this application is not about dealing with a temporary COVID crisis, it is about Virgin seeking a leg up from the ACCC to build a new strategic footprint as it re-builds following financial collapse.

### **3. This is really about what Virgin wants to rebuild after financial collapse.**

The rationale stated on page 1 of the submission is that:

*“It is imperative that Virgin Australia begins to build its business again, regain customer confidence and demonstrate its commitment and ability to service the Australian domestic air travel market.”*

Page 13 of the submission is more explicit, stating that Virgin wants a partner to service routes it has exited:

*On 9 September 2020, It was announced that Virgin Australia had decided to cancel a range of services, including regional services such as Sydney-Port Macquarie, Brisbane-Cloncurry, Cloncurry-Mount Isa, Sydney-Tamworth, Sydney- Albury, Melbourne-Mildura and Sydney-Hervey Bay. Virgin Australia has cancelled these services due to depressed demand, historically unsustainable revenue per flight which have been exacerbated by the COVID-19 pandemic, and the unsuitability of a number of these routes for services using Virgin Australia’s Boeing 737 fleet. Post administration, Virgin Australia is very likely to cancel loss-making routes. Virgin Australia remains committed to servicing these routes in the future, even though it may be unable to operate them itself. The Proposed Conduct is designed to address this issue.*

Page 25 of the submission is even more explicit that Virgin does not want Rex entering those routes:

***Delays in granting authorisation would cede market advantage to Qantas and REX.** When demand for air travel increases, Virgin Australia's limited network and schedule will become obvious to consumers. If Virgin Australia is not able to quickly launch services in response to new demand, it will cede competitive advantages to Qantas and REX. The longer Virgin Australia stays out of markets, the harder it will be to re-enter. For example, in response to the South Australian Government's announcement on 24 September 2020 that it will reopen its borders to New South Wales residents and the Queensland Government's announcement on 23 September 2020 that it will reopen its borders to residents of parts of regional New South Wales, Qantas and Jetstar immediately boosted capacity and offered sale fares to stimulate demand, announcing it would triple the number of flights on some routes. Virgin Australia requires the Proposed Conduct to enable it to also respond quickly to these opportunities.*

Virgin is saying it does not want to operate loss-making routes but it wants to preserve the market share / strategic footprint that it developed to mirror Qantas through loss-making routes. In a similar vein, on pages 20 and 21 of the submission, Virgin makes it clear that it also wants to hold on to slots it used on those loss making routes:

***Retention of valuable airport slots.** If Virgin Australia is not able to resume certain flying regional routes from 28 March 2021, it will be required to hand back valuable slots at airports. Many of these slots, especially at Sydney Airport are in high demand, such as the Sydney-Port Macquarie peak regional slots. If Virgin Australia were required to return these slots to the slot pool, they would likely be acquired by the Qantas Group, further entrenching its dominant market position and foreclosing Virgin Australia's ability to offer these services in the future.*

With reference to the NSW regional slots at Sydney Airport, it is important to acknowledge that these slots are ring-fenced to NSW intrastate flights. It is not correct to assume any unused NSW regional slots would likely be acquired by the Qantas Group, because Rex has already stated on the public record that it has the capacity and intent to enter NSW regional routes that have been abandoned by Virgin.

Virgin is attempting to make the ACCC believe that Virgin's inability to use NSW regional slots will increase the market dominance of Qantas. However, Qantas is not the only carrier in the NSW regional space that can fill the void to service regional NSW.

Furthermore, the Commonwealth Government has already granted dispensation for the historic slot precedence rules in both the Northern Summer 2020 and Northern Winter 2020 scheduling seasons. To make further rulings outside of this structured process would cause significant complications and uncertainty given the critical importance of Sydney airport access as part of the post-COVID recovery.

This authorisation is essentially about Virgin wanting to have its cake and eat it too, on the justification that it is trying to compete with a dominant carrier (Qantas). However, this is something no other competitor to Qantas gets to do (e.g. if Rex exits a route or loses slots, it has to live with the consequences). Allowing Virgin special advantages in this regard will disadvantage other competitors and effectively return Australia to a duopoly.

#### **4. It is incorrect to state that the proposal will have no material adverse effect on competition.**

The assertion is repeated in the submission that the proposal “will have no material adverse effect on competition”. However, this is not correct.

The assertion is essentially based on the premise that there is limited overlap between the services currently offered by the parties (indeed only one overlapping route) and there is significant competition on the relevant routes, so competing services will constrain the parties’ ability and incentive to raise prices on these routes, compared to what would have been the case if they were acting independently.

However, it is important to consider that the application does not just seek to allow broad coordination on the one overlapping route (which Alliance entered during COVID) where there is a baseline as to their pre-authorisation independent pricing decisions on the route, but on another 40 domestic routes, of which:

- 23 are routes that neither of the parties operate;
- three are routes where one of the parties is currently sole operator; and
- three are listed as having no operators pre-COVID. Another four are listed as having no current operators.

Further the conduct which the parties want authorised includes “sharing information, including in relation to costs, willingness to operate ...and pricing” and agreeing “which carrier will operate the Relevant Routes”.

So authorisation would allow the parties to agree that one of them will exit the overlapping route, to agree not to enter each other's sole operator routes and to agree only one will enter routes neither currently operates. This, with no baseline to measure whether this results in higher prices or less service compared to what would have been the case if the parties had continued to act independently.

On a broader level, giving Virgin special advantages to rebuild after its financial collapse, on the basis that this will make Virgin stronger competition to Qantas, carries the danger that the flip-side of that coin is to weaken all other competition to both Qantas and Virgin. That is a particularly dangerous path to go down.

The worst thing the ACCC could do right now would be to give special treatment to Virgin in the wishful hope that the airline will become an "equal but different" competitor to Qantas. See the comments below from the ACCC Chairman to the House Economics Committee scrutinising the ACCC's annual report on 23 October 2020:

*Mr Sims : We were asked by the government to monitor the airline industry, and so they've given us funds and powers to do that. We're going to do that very, very closely. We're going to look at things like revenues and capacity by sector to try and analyse what's happening in a competition sense. Rex and Alliance Airlines have said they're going to actually do more flying rather than less, which is interesting. We'll see how that plays out. Virgin—the good news is they're still around. They're going to be there for some time, I think. I did speak to the new CEO recently, and I certainly understand that not only the back end but also the front end of the aircraft is going to be competing with Qantas as well as Jetstar. They'll be offering a service that can bring competition to Qantas. They might do it in a different way. But often, in our world, competitors doing things in a different way benefits competition rather than harms it. If you go back to the old days, when Qantas and Ansett, if you can go back that far—*

*Mr Sims : They even left at the same time. You could almost get the same meal! That was pretty cosy competition. If Virgin can come at it a different way, provided they're competing at the front and back end, then it could work. But we're going to be watching it very carefully. Given all the border closures—hopefully when the borders open up we'll be able to get a better handle on what's going on.*



The reality is that Qantas is too entrenched for a domestic competitor to become its equal in size, scale and resources. It is possible to have an environment where Qantas faces genuine competitive pressure from the combined effect of a number of smaller nimble competitors who are not equal but importantly different. However, to achieve that environment:

- the ACCC must preserve Alliance as an independent operator with a different business model to Qantas and Virgin, which means not allowing this authorisation and making Qantas divest its 19.9% stake in Alliance acquired last year without ACCC clearance; and
- the ACCC must address the issues Rex has consistently raised regarding what it must do to become an effective protector of competition. In particular, in its monitoring reports the ACCC must identify the specific factors that it will use to assess when adding capacity or price discounting on an uneconomic route will be investigated. It must identify all such routes under investigation and it must provide transparency on the outcome of these investigations.

## **5. It is impossible to properly assess and monitor the conduct.**

This authorisation is impossible to properly assess and monitor due to:

- the nature of the conduct which the parties want authorised; and
- the fact that Qantas has a 19.9% stake in Alliance.

The nature of the conduct makes it impossible to assess because there is no baseline and the cooperation is so extensive. This effectively allows Virgin and Alliance to act like one corporate group (for example, sharing cost, pricing and strategic planning information to make decisions about who will enter which route) but without Virgin having to incur the cost of acquiring control of Alliance.

Because there is no baseline as to independent pricing by the parties on the same route (other than the one overlapping route), there is no proposal as to any pricing condition of the kind proposed by Rex in its authorisation (see para 4.39 of the Rex authorisation):

*If any of the Participating Airlines agree to coordinate flight schedules and/or share revenue on a Relevant Route while the authorisation is in effect, the Participating Airlines must not set a fare for a Coordinated Flight that is higher than the equivalent fare specified in their respective fare schedules in place as at 1 February 2020.*

Furthermore, there is no proposal for any ACCC reporting obligations, as have been included in all COVID related authorisations (e.g. see the reporting obligations in para 4.40 of the Rex authorisation).

In any event, it will be hard to monitor exactly how cost information is used to inform decision making, and whether decisions about route entry are being made jointly or independently (including potentially decisions about routes not specified in the authorisation). In addition, once such decisions are made, it is unlikely that they will be changed once the authorisation ends.

Another concern is that the Qantas stake in Alliance increases the risk that authorisation might open the door to long-term understandings or concerted practices between Virgin and Qantas via Alliance. In assessing Rex's authorisation application, the ACCC specifically considered the risk of whether that authorisation might facilitate long term understandings (paragraph 4.31). At paragraph 4.37, the ACCC pointed to the following key factors that reduced this risk:

- *The value of any information on price and capacity shared under the Proposed Conduct during these unprecedented circumstances will predominantly be time-limited. That is, the information shared by the Participating Airlines will lose relevance as demand for air transport on the Relevant Routes recovers following the COVID-19 pandemic.*
- *Most or all of the information required to coordinate flight schedules and reduce capacity is already in the public domain, albeit accessed less efficiently.*

The above factors do not apply to the application by Virgin and Alliance. They have explicitly sought authorisation to share highly sensitive information that is not in the public domain and has longer-term strategic significance (e.g. costs and future pricing). The parties cannot simply pretend not to know what they have learned at the end of the authorisation period.

## **6. This authorisation is too dangerous.**

Rex is disappointed by the ACCC's decision to grant interim authorisation and we repeat the concerns raised in our 6 November submission about the lack of any monitoring or reporting and the inability of the ACCC to "unscramble the egg". The conduct that the ACCC has authorised on an interim basis, and in relation to which the ACCC must now make a final determination, will irrevocably harm the competitive process in circumstances where there is no public benefit that could justify allowing that harm.

The parties make a number of claims that seek to downplay the dangers of this authorisation, specifically that this is just a two year, temporary measure, with limited impact, that will only be used as needed. Rex explains below why this is not correct.

## **(1) This is not a temporary measure**

The parties argue that they are only seeking authorisation of a two year “temporary measure”.

However, the public benefits claimed by the parties involve services which they assert they would not be able to provide without this authorisation, and which they say will provide increased competition *in the long run*. This is inconsistent with a reversible temporary measure. For example, on page 42 of the submission, the parties state that:

*Rather than reducing competition, the Proposed Conduct allows the Applicants to:*

- *Provide competitive services that would not otherwise take place; and*
- *Provide the services that would take place more efficiently (e.g., by better matching the aircraft type to demand) or with better scheduling outcomes for customers.*

*This will result in increased competition for regional services both in the short and long run. The Proposed Conduct, through its ability to enable lower risk and lower cost or more cost-efficient service provision, will increase the likelihood that those services and that level of competition can be sustained, allowing stronger regional providers to survive and emerge post crisis and continue to promote competition in the long run.*

*Without authorisation of the Proposed Conduct, there will likely be fewer services and fewer competitors on the Relevant Routes for a longer period of time. For example, on 9 September 2020, Virgin Australia announced it would be withdrawing from Sydney-Tamworth as it was not commercially viable. Currently, only Qantas provides RPT services on this route. Under the authorisation, the Applicants can discover whether through appropriate risk sharing a competing service can be provided on this route.*

Furthermore, it is not clear why the assertion is made that these service could not be provided via less damaging forms of cooperation that do not remove the independence of decision-making by each party (for example, wet-lease or code share arrangements as previously used).

## **(2) This does not have limited impact**

The parties assert that the proposed conduct ... “*applies in relation to specified routes and will not have industry-wide implications*”.

There is no certainty that this will be the case, as explained above, particularly as there is no transparency or monitoring as to what information is shared, how it is used in decision-making and whether decisions about matters such as route entry are being made jointly or independently.

The industry-wide implications of this authorisation cannot be assessed until the ACCC has completed its investigation into Qantas' 19.9% stake in Alliance and resolved whether Qantas still intends to move to a majority position (subject to regulatory approval) as was its original intent.

The parties also assert that there is limited impact because the proposed conduct... *“does not involve coordination of schedules by all operators on the Relevant Routes”*.

Yet the public benefit claimed by the parties is to... *“help provide certainty to support essential travel to and from regional communities during the COVID-19 pandemic in circumstances where the current reduction in demand could potentially threaten the viability of operating on the Relevant Routes”*.

Dealing with a COVID impact was the public benefit recognised by the ACCC in the Rex authorisation, but as explained above, to achieve this outcome it requires all operators on the route to cooperate to deal with total load factors.

The fact that this authorisation does not involve coordination of schedules by all operators on the relevant routes means it cannot deal with the COVID impact on route load factors. It reveals that the authorisation is not about dealing with COVID, it is about longer-term strategic positioning by Virgin as it re-builds after financial collapse.

Furthermore, the fact that Virgin does not intend to participate in any cooperation under the Rex authorisation, and is not seeking authorisation to allow all operators to cooperate on any of the relevant routes, makes it hard to see how it could be claiming this authorisation is about this public benefit.

### **(3) This is not something that will only be used as needed**

The parties claim that... *“Consistent with the REX Interim Authorisation, the Proposed Conduct will be implemented only as necessary”*.

However, this is a very different situation to the Rex authorisation.

The ACCC is able to monitor whether or not cooperation is occurring under the Rex authorisation because there are monitoring and reporting conditions. The parties in relation to this authorisation have proposed no such conditions.

Furthermore, the Rex authorisation involves cooperation based on public information, so until there is actual cooperation there is no conduct (as is currently the case). On the other hand, the nature of the conduct proposed in this authorisation involves immediate sharing of highly sensitive information to make decisions about cooperation. Once shared, the parties cannot un-learn what they know.

By granting interim authorisation the ACCC has opened the door to a dangerous precedent for competitors to share highly sensitive information, with no monitoring or safeguards, allowing them to jointly shape under cover of a temporary authorisation what they do “independently” in the future, post-authorisation. Rex urges the ACCC to rectify this in its final determination.