

26 September 2008



Committee Secretary
Senate Select Committee on Fuel and Energy
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Committee Secretary

Virgin Blue has prepared the attached submission for the information and consideration by members of the Senate Select Committee on Fuel and Energy.

I hope that the views expressed above in Virgin Blue's submission are of assistance to the members of the Committee and sufficiently inform them of Virgin Blue's views on this matter.

Virgin Blue is willing to appear before the Committee to further articulate our views and/or to answer any questions that Committee members might have. I can be contacted on either (07) 32955079 or 0403 046474.

Yours sincerely

A handwritten signature in black ink, appearing to read "Mike Thomas".

Mike Thomas
Manager – Government Relations
Virgin Blue, Pacific Blue and Polynesian Blue Airlines Pty Ltd



VOTED
WORLD'S
BEST LOW
COST
AIRLINE
2004
& 2005.

SUBMISSION TO THE



**SENATE SELECT COMMITTEE
ON FUEL AND ENERGY**

EXECUTIVE SUMMARY

Virgin Blue welcomes the opportunity to make a submission to the Senate Select Committee's Inquiry into the impact of higher petroleum diesel and gas prices. As has been well publicised, higher fuel costs are having significant impacts on the aviation industry, with flow on effects to the tourism industry and the broader Australian economy. Fuel currently represents between 30 and 40% of an airline's cost base. To provide some perspective, just two years ago, fuel represented approximately 15% of our cost base. In response to the recent spike in fuel prices, all airlines have announced mitigation measures to address the spiralling cost of fuel including service reductions and fare increases.

In this submission we focus on the following key areas:

- the impact of higher prices on the tourism and transport sectors;
- the impact of an emissions trading scheme; and
- the role of alternative fuels.

THE IMPACT OF HIGHER PRICES ON THE TOURISM AND TRANSPORT SECTORS

In response to the escalating cost of fuel, over the past five years Virgin Blue has rigorously implemented measures throughout its business to reduce and minimise our fuel usage. Such measures include:

- investment in the latest and most technologically advanced passenger aircraft;
- the retro-fitting of winglets on aircraft to reduce fuel burn;
- the application of a polymer coating on our aircraft to further reduce drag;
- the use of the most up-to-date meteorological data in live flight planning resulting in a more efficient flight missions;
- an initiative, called *Weight Watcher*, which is minimising aircraft weight by reducing potable water loads, removal of ovens and utilising light-weight catering packaging to further reduce fuel burn; and
- more efficient design of flight plans and profiles, such as flex-tracks, which allow aircraft to take advantage of optimal winds.

Despite these ongoing initiatives, when fuel prices hit record levels earlier this year a programme of strategies to mitigate the impact on the business was required:

- an increase in ticket prices by an average of \$5 across approximately 55% of Australian domestic routes;
- a 12% reduction in planned 2008/09 capacity growth via deferral of five committed aircraft deliveries into 2010/11;
- the redeployment of aircraft to trans-Tasman and Pacific routes, increasing frequencies and also launching new services on uncontested routes;
- an internal cost saving programme of an initial \$50 million in 2008/09;
- ceasing to operate direct services on some under-performing routes (but not totally withdrawing from any markets);

- implementing a salary freeze for all management positions for the 2008/09 fiscal year;
- the introduction of new baggage fees; and
- an increase in the airline's flexible fares.

Our competitors announced similar measures. Given that domestic aviation is the lifeblood of Australia's \$85 billion tourism industry and is key to the ongoing viability of many of our regional economies, these necessary capacity reductions and fare increases will clearly have a direct flow-on affect for the tourism and associated transport industries.

THE IMPACT OF AN EMISSIONS TRADING SCHEME

The fundamental premise of an Emissions Trading Scheme is to impose a cost on carbon emissions, thereby driving behavioural change through investment in fuel efficient or alternative technology or through reduction in usage of carbon emitting products. As the aviation industry will only participate in the scheme indirectly as a consumer of fuel, the cost of carbon emissions will be reflected in a higher cost of fuel. To the extent that this cost is passed on to consumers, the only behavioural change that can achieve reduced emissions is a reduction in air travel with flow on consequences for the Australian economy as discussed above.

As already noted, the high cost of fuel already drives the fuel efficient behaviour that is sought through the CPRS. A further increase in fuel costs as a result of the introduction of the CPRS is not likely to have a significant impact on this behaviour. The greatest scope for gains in fuel efficiency is in areas which are outside of the direct control of the airlines – aircraft and engine design, alternative fuels and air traffic control technology. Through ongoing investment in new state of the art aircraft, airlines support investment in new fuel efficient technology. In order to accelerate innovation and research and development in aircraft and engine technology, incentives and support for investment in these areas must be provided.

Virgin Blue is also concerned that the operation of the CPRS will be distorted by applying the scheme's obligations to upstream fuel suppliers. There is little if any motivation for fuel suppliers to seek the best price for permits, and as such they will simply pass the cost through to the airlines, further increasing the cost of fuel. Virgin Blue urges the Government to allow large fuel users, such as airlines, the option to directly manage and reconcile their own emission obligations, as is proposed under the New Zealand Emissions Trading Scheme.

THE ROLE OF ALTERNATIVE FUELS

Virgin Blue believes that the development and use of alternative fuels has the potential to reduce the overall cost of fuel.

The aviation industry has been actively pursuing the development of alternatives to petroleum based jet fuel. The drivers for this vary, but include fuel security, price and environmental considerations.

However, from the perspective of the aviation industry, the utilisation of alternative fuels is potentially limited by the current technology of aircraft engines and alternative fuel sources. Australian airlines have a limited ability to influence clean engine technology and must pursue this with manufacturers.

Airframe and engine manufacturers in partnership with global airlines and fuel companies have made significant advances in fuel development with the focus now on developing second generation fuels that do not rely on productive farmland, divert food crops or require excessive amounts of water to grow.

Processes are being developed to enable a fuel to be produced from biomass that has identical characteristics to existing jet fuel. This will potentially allow new fuels to be used in the existing aircraft fleet without modification. These "drop-in" fuels will allow blending with traditional petroleum-based fuels until volumes are sufficient to allow 100% biofuels to be used.

While most of the development and testing of these lower carbon fuels is occurring in Europe and the United States, Australia has a role to play in supporting these developments and investigating local feedstock that can be used in the developing processes. Australia should also ensure that the necessary infrastructure will be in place to allow any new fuels to be available to the industry.

Airlines along with Government must encourage continued research and development into alternative renewable aviation fuels industry for the region. In particular, the Government has a significant role to play in encouraging research and development through appropriate incentives and funding mechanisms.