

Statement of Issues

7 February 2013

Virgin Australia - proposed acquisition of 60% of Tiger Airways Australia

Introduction

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (**ACCC**) on the proposed acquisition of 60% of Tiger Airways Australia (**Tiger Australia**) by Virgin Australia Holdings Limited (together with its subsidiaries **Virgin Australia**) (**proposed acquisition**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC's Merger Review Process Guidelines (at www.accc.gov.au/processguidelines) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC anticipates completing further market inquiries by 22 February 2013 and anticipates making a final decision on 14 March 2013. However, the anticipated timeline can change in line with the Merger Review Process Guidelines. To keep abreast of possible changes in relation to timing and to find relevant documents, market participants should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

Background

5. On 2 November 2012 Virgin Australia provided its submission seeking informal clearance from the ACCC. The ACCC commenced a review on 2 November 2012 and commenced market inquiries on 7 November 2012.

The parties

The Acquirer: Virgin Australia Holdings Limited

6. Virgin Australia is a domestic and international airline that commenced operations in Australia in August 2000 as a low cost carrier¹ under the 'Virgin Blue' brand.
7. Over time, Virgin Australia has changed its business model, moving away from its origins as a low cost carrier and offering additional services (such as a frequent flyer program, airport lounges and business class cabin service) to increase its appeal to higher yielding (higher fare) customers.
8. In 2010, Virgin Australia announced a new 'Game Change' strategy, with a stated intention to diversify Virgin Australia's customer base and therefore revenue sources by targeting corporate and business customers in addition to leisure customers. As part of this strategy, in May 2011 Virgin Australia replaced and consolidated its 'Virgin Blue', 'Pacific Blue' and 'V Australia' brands under the 'Virgin Australia' brand.
9. Virgin Australia has also entered into a number of alliances with international airlines including Delta Air Lines, Etihad Airways, Singapore Airlines and Air New Zealand which involve varying degrees of cooperation and coordination of operations.
10. Today, Virgin Australia operates approximately 100 aircraft in a fleet of five aircraft types to supply approximately 3200 flights per week to 50 domestic and international destinations.
11. Virgin Australia Holdings Limited is listed on the Australian Securities Exchange (ASX). Its largest shareholders include the Virgin Group (founded by Richard Branson and with interests in various airlines worldwide) (23.5%), Air New Zealand (20%), Singapore Airlines (10%), and Etihad Airways (9%).

The Target: Tiger Airways Australia

12. Tiger Australia is a domestic airline that commenced operations in Australia in November 2007. Tiger Australia operates under a low cost business model which primarily focuses on price sensitive domestic leisure travellers.
13. Tiger Australia currently operates 11 Airbus A320-200 aircraft (an aircraft type not operated by Virgin Australia) servicing 11 domestic routes, namely:
 - a. Sydney - Brisbane;
 - b. Sydney – Mackay;
 - c. Sydney – Gold Coast (Coolangatta);
 - d. Sydney – Melbourne;
 - e. Melbourne – Adelaide;

¹ By low cost carrier the ACCC means broadly an airline with a low operating cost structure (e.g. by operating a limited number of aircraft on a point-to-point basis and offering a 'no frills' level of service), which enables it to charge a low fare for a standard ticket. Some additional services may be offered by a low cost carrier at an additional charge to the customer (e.g. choice of seat, meals and beverage, checked-in baggage allowance).

- f. Melbourne – Brisbane;
 - g. Melbourne – Cairns;
 - h. Melbourne – Hobart;
 - i. Melbourne – Gold Coast (Coolangatta);
 - j. Melbourne – Perth; and
 - k. Melbourne – Mackay.
14. On 15 February 2013, Tiger Australia will commence flying a 12th domestic route: Sydney – Coffs Harbour.
15. On 2 July 2011 Tiger Australia's operations were suspended by the Civil Aviation Safety Authority (**CASA**) on the basis that it posed a serious and imminent risk to aviation safety. CASA gave Tiger Australia conditional clearance to resume flying on 10 August 2011. All restrictions on Tiger Australia's operations associated with the 2011 grounding have since been removed.
16. Tiger Australia is a wholly owned subsidiary of Tiger Airways Holdings Limited (**Tiger Holdings**). Tiger Holdings also:
- a. owns Tiger Airways Singapore, a leading low cost carrier in the Asia Pacific region operating out of Singapore. As at 30 September 2012 Tiger Airways Singapore operated a fleet of 19 aircraft;
 - b. has a 40% shareholding in Southeast Asian Airlines Inc (SEAir), a low cost airline offering domestic and international flights from the Philippines; and
 - c. has a 33% shareholding in Mandala Airlines, a low cost Indonesian airline that operates under the 'Tiger' brand.
17. Singapore Airlines is the largest shareholder in Tiger Holdings with a 32.7% shareholding.

Other industry participants

Qantas Group

18. Qantas Group has a range of subsidiary businesses including domestic and international passenger airlines, freight, and catering. As at August 2012, Qantas Group operated a total passenger fleet of 286 aircraft. For the purposes of this document, the main businesses of interest are the domestic operations of Qantas Group's two main airlines – Qantas Airlines (**Qantas**) and Jetstar Airways (**Jetstar**). Other subsidiaries of Qantas Group include the regional airline Qantaslink and the charter service provider Network Aviation.
19. Qantas was incorporated in Queensland, Australia in 1920 and is Australia's largest domestic and international airline. Qantas is a full service airline² with an extensive domestic network. The ACCC understands that it has a combined domestic and international fleet of approximately 140 aircraft.

² By full service airline the ACCC means broadly that it includes a number of additional services in its standard service offer (e.g. checked baggage allowance, choice of seat, a meal or snack and some beverages) without additional charge and a broader range of add-on services for an additional charge than offered by low cost carriers (e.g. loyalty reward program, airport lounge access, etc).

20. Jetstar, established in 2004, is Australia's largest low cost airline. Its Australian and New Zealand based fleet comprises around 60 aircraft and it operates around 800 domestic return services per week to 17 Australian destinations.
21. Since the launch of Jetstar, Qantas Group has implemented a 'dual brand strategy' in Australia that involves collaboration and coordination of capacity (network and schedule) and pricing activities between Qantas and Jetstar's operations. The dual brand strategy seeks to ensure that all network and capacity decisions maximise profitability for the Qantas Group as a whole while maintaining a clear profit focus for the separate airlines.³

The proposed acquisition

22. Virgin Australia proposes to acquire 60% of the issued shares in Tiger Australia. As part of the transaction, Virgin Australia and Tiger Holdings propose to enter into a Shareholders Agreement, Brand Licensing Agreement and Services Agreement.
23. The proposed acquisition was publicly announced on 30 October 2012 and is subject to ACCC approval.
24. Virgin Australia has publicly stated that the commercial rationale for the proposed acquisition is that it "enables Virgin Australia to access the budget market and enables Tiger Australia to expedite its growth."⁴

Market inquiries

25. On 7 November 2012 the ACCC commenced market inquiries regarding the proposed acquisition. Submissions from interested parties closed on 28 November 2012. A range of interested parties provided responses, including consumers, other airlines, airports, industry bodies, travel agents and tourism bodies.
26. The ACCC is now calling for further information from interested parties to assist with its investigation as set out below.

With/without test

27. In assessing a proposed acquisition pursuant to section 50 of the *Competition and Consumer Act 2010* (Cth) (**the Act**), the ACCC considers the effects of the acquisition by comparing the likely future competitive environment if the acquisition proceeds (the 'with' position) to the likely future competitive environment if the acquisition does not proceed (the 'without' position) to determine whether the acquisition is likely to substantially lessen competition in any relevant market.
28. It is the ACCC's view that if the proposed acquisition did not proceed, Tiger Holdings would have the options of continuing to operate Tiger Australia in some

³ 28 June 2012 application for authorisation lodged by Qantas Airways Limited and Jetstar Airways Pty Limited in respect of proposed coordination between the applicants and existing and future Jetstar branded airlines (Authorisation numbers: A91314 & A91315) at [2.13]

⁴ Virgin Australia ASX release dated 30 October 2012 "*Virgin Australia announces agreement to acquire 60% stake in Tiger Australia to bring strong competition to the budget market.*"

form, attempting to sell part or all of Tiger Australia to another buyer, or shutting Tiger Australia down and transferring some of its assets (such as aircraft) to its overseas operations.

29. The ACCC is aware that Tiger Australia has for some time incurred operating losses, which has affected the financial performance of Tiger Holdings. According to publicly announced results, Tiger Australia:
- declared a breakeven result in 2009/10;
 - made an operating loss of \$9m SGD in 2010/11;⁵
 - made an operating loss of \$77m SGD in 2011/12; and
 - has made accumulated operating losses of \$53.8m SGD in the first three quarters of its 2012/13 financial year.
30. Tiger Holdings' Statement of Financial Position as at 31 December 2012⁶ shows accumulated losses of almost \$185m SGD for the Tiger Group (comprising Tiger Holdings and its subsidiaries). These accumulated losses equate to approximately 45% of the total share capital of Tiger Group (\$408m SGD).
31. The ACCC is continuing its analysis as to the likely future without the proposed acquisition, but has not yet formed a concluded view.
32. In the event that the ACCC were to ultimately conclude that Tiger Australia would exit the market in the absence of the proposed acquisition, this would be highly relevant to its assessment as to whether the proposed acquisition would be likely to result in a substantial lessening of competition as compared to the situation if the proposed acquisition did not proceed.

The ACCC invites market participants to comment on what is likely to occur in the event that the proposed acquisition does not proceed. In particular, the ACCC is interested in whether, in the absence of the proposed acquisition:

- i. Tiger Australia would be likely to exit Australia;
- ii. Tiger Australia would be likely to continue operations within Australia under current ownership, and if so, the nature and scale of those operations;
- iii. another purchaser would be interested in acquiring an interest in Tiger Australia, and if so, the nature of that interest and its implications for Tiger Australia's operations within Australia; and
- iv. Virgin Australia would be likely to establish its own low cost carrier operating under a separate brand.

⁵ Tiger Holdings publicly reports its results in Singapore Dollars (SGD). The current exchange rate is approximately \$1 SGD = \$0.77 AUD.

⁶ Available at http://www.tigerairways.com/news/FR_20130123_Tiger_Airways_SGX_Results_Announcement_3Q13.pdf

Areas of competition/overlap

Geography

33. Virgin Australia and Tiger Australia both provide regular domestic air passenger transport services to the public (referred to in the industry as regular passenger transport (**RPT**) services).
34. Paragraphs 13 and 14 above identify 12 domestic routes that are either currently serviced by Tiger Australia, or will be serviced in the near future. Virgin Australia also operates on 11 of these 12 routes (all except Melbourne - Mackay).
35. At its peak, prior to its grounding by CASA in July 2011, Tiger Australia operated 21 routes across Australia. Accordingly, Virgin Australia and Tiger Australia have previously had a greater overlap in terms of number of domestic routes serviced than they do today. Since the grounding by CASA, Tiger Australia has not resumed a number of services that it has operated on in the past, including:
 - services between Adelaide and Gold Coast, Hobart, Alice Springs, Canberra, Perth, Sydney, Brisbane;
 - services between Melbourne and Rockhampton, Alice Springs, Canberra, Darwin, Launceston, Newcastle, Sunshine Coast; and
 - services between Brisbane and Rockhampton.

Service level and customer type

36. Virgin Australia has submitted that there is limited overlap in terms of the type of services provided by each of Tiger Australia and Virgin Australia, and therefore there is limited overlap in terms of the type of customer that acquires each of their services.
37. As a low cost carrier, Tiger Australia has a particular type of service offering. Tiger Australia:
 - a. retains a fleet composed of a single aircraft type, configured with economy class cabin only;
 - b. operates a point to point network (rather than hub and spoke model which caters to multi-sector journeys);
 - c. offers low standard fares that include an allocated seat and carry-on baggage only;
 - d. charges customers separately for add-on services such as checked baggage, seat selection, food and beverages, and booking changes; and
 - e. offers only a limited number of additional services. For example, Tiger Australia does not offer a rewards program, airport lounge access, or through check of baggage on multi-sector journeys. Tiger Australia also does not refund airfares in the event that a passenger fails to meet a connecting service.
38. Accordingly, Tiger Australia's services primarily appeal to price sensitive leisure travellers.
39. As noted at paragraph 6 above, Virgin Australia commenced operations in Australia in August 2000 as a low cost carrier under the 'Virgin Blue' brand, but has taken steps to increase its appeal to higher yield leisure customers, as well

as corporate and government business customers. As a result, the nature of Virgin Australia's service offering has changed over time. For example, Virgin Australia has commenced offering extras such as frequent flyer programs and airport lounges and has reconfigured aircraft cabins to cater to the demands of business class passengers. Despite these changes, leisure customers remain an important part of Virgin Australia's business.

40. The ACCC recognises that, as a result of these developments, Virgin Australia has a higher operating cost structure than it has had in the past as a low cost carrier. This means that, where possible, Virgin Australia is likely to deploy its capacity and set fares to meet the demands of higher yielding passengers in preference to lower yielding, price sensitive leisure passengers, all other things equal.
41. However, outside peak periods, demand from higher yielding leisure, government and corporate customers may be insufficient to fully utilise Virgin Australia's capacity. At such times, the most profitable strategy for Virgin Australia may be to discount fares to entice customers away from one of the low cost carriers (Jetstar or Tiger Australia).
42. While Virgin Australia's higher operating cost structure may not allow it to match Tiger Australia's best fares in off-peak periods, there may nevertheless be a material proportion of price sensitive leisure passengers who would compare the different offers and consider switching between Tiger Australia and Virgin Australia, depending on how close Virgin Australia comes to matching Tiger Australia's fare.
43. The ACCC is still considering the extent to which price sensitive leisure travellers remain an important part of Virgin Australia's overall passenger mix, particularly outside peak periods when there may be lower demand for Virgin's higher service, higher fare offering.

Market definition

44. In assessing the potential competitive effects of a proposed acquisition the ACCC must consider the appropriate market or markets within which to assess those potential effects.
45. In its consideration of previous matters in the aviation industry (particularly in applications for authorisation concerning aviation alliances), the ACCC has considered the impact on competition in a market for Australian domestic air passenger transport services.⁷
46. Having regard to the activities of the merger parties and their competitors and to the substitution opportunities available to consumers, the ACCC considers that this is the appropriate market definition for the purposes of this Statement of Issues. However, given the nature of the overlap between the services provided by the merger parties, the ACCC's assessment of the effect of the proposed acquisition will focus on particular aspects of competition within this market. In particular the ACCC is focussing on:

⁷ E.g. see the Draft Determination in respect of the applications for authorisation lodged by Qantas Airways Limited and Emirates in respect of a Master Coordination Agreement to coordinate the operations of the applicants (Authorisation numbers: A91332 & A91333) at [69].

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- a. competition between service offerings aimed primarily at leisure travellers, particularly price sensitive leisure travellers; and
- b. competition on the particular routes serviced by both Virgin Australia and Tiger Australia. Unlike Virgin Australia, Tiger Australia does not have an extensive domestic network. As such, any competition effects associated with the proposed acquisition are expected to be concentrated on those routes that are either presently serviced by Tiger, or that Tiger might plausibly service in the future in the absence of the proposed acquisition.

The ACCC invites comments from market participants on its proposed definition of the relevant market. In particular market participants may wish to comment on whether it is appropriate (in the context of this proposed acquisition) to consider a single market for Australian domestic air passenger transport services or whether separate markets should be identified for services to leisure travellers or price sensitive leisure travellers.

Market concentration

47. The information in Tables 1 and 2 below has been provided to the ACCC by the merger parties. These tables contain airline share figures for the regular passenger transport operations of the largest domestic airlines, calculated on a network-wide (all routes) basis. Four potential measures by which to consider airline share are represented:
 - number of seats flown (Seats) – a measure of capacity;
 - average seat kilometres (ASK) - a measure of capacity adjusted for distance flown;
 - number of paying passengers (Pax); and
 - revenue passenger kilometres (RPK) - number of paying passengers adjusted for distance flown.
48. The ACCC notes that capacity and passenger figures that have been adjusted for distance flown will provide greater airline share figures for Qantas (which has a large share of trans-continental routes) and lower figures for regional airlines and other airlines that tend to operate on shorter routes.

Table 1: Airline share by capacity (Seats, ASK) – domestic RPT all routes calendar year 2012

Carrier	Seats (%)	ASK (%)
Qantas Group	60.3%	63.4%
Qantas ⁸	42.2%	43.9%
Jetstar	18.1%	19.5%
Virgin Australia	30.3%	30.4%
Tiger Australia	3.3%	3.4%
Regional Express	2.9%	0.9%
Skywest Airlines	0.9%	0.6%
Others	2.2%	1.3%
Domestic total	100%	100%

Source: provided by merger parties, derived from information provided to Official Airline Guide (OAG)⁹

Table 2: Airline share by passengers (Pax, RPK) – domestic RPT all routes FYE June 2012

Carrier	Pax (%)	RPK (%)
Qantas Group	60.6%	64.7%
Qantas	31.1%	39.1%
Jetstar	19.8%	20.2%
QantasLink	9.6%	5.4%
Virgin Australia	31.3%	30.4%
Tiger Australia	2.2%	2.3%
Regional Express	2.2%	0.7%
Skywest Airlines	0.7%	0.5%
Others	3.2%	1.5%
Domestic total	100%	100%

Source: provided by merger parties, derived from airline annual reports and information made publicly available by Bureau of Infrastructure, Transport and Regional Economics (BITRE)

⁸ Includes QantasLink.

⁹ Based on operating seat capacity (by number of seats) sourced from OAG, accessed 29 October 2012. Figures for calendar year 2012 includes projections filed by carriers with OAG to the end of 2012.

49. As discussed above, Tiger Australia does not have a broad domestic network. As such, Tables 1 and 2, which reflect Tiger Australia's share across all routes, including those on which it does not operate, will understate the competitive impact of Tiger Australia on those 11 domestic routes on which it provides services. Table 3 below contains airline share figures for the regular passenger transport operations of Qantas, Jetstar, Virgin Australia and Tiger Australia on the 10 routes on which Tiger Australia and Virgin Australia currently overlap. The information in Table 3 has been provided to the ACCC by the merger parties.

Table 3: Annual operating seat capacity (ASK) shares for Qantas Group, Virgin Australia and Tiger Australia on overlapping Australian domestic routes calendar year 2012

City Pairs	Qantas Group	Qantas	Jetstar	Virgin Australia	Tiger Australia
MEL – ADL	55.8%	43.0%	12.8%	37.6%	n/a ¹⁰
MEL – BNE ¹¹	49.9%	40.9%	9.0%	39.2%	9.7%
MEL – CNS	67.4%	20.4%	47.0%	24.1%	8.5%
MEL – HBA	60.1%	16.9%	43.2%	36.6%	3.3%
MEL – OOL ¹²	41.1%	0%	41.1%	43.8%	15.1%
MEL – PER	60.8%	47.9%	12.9%	28.6%	10.6%
MEL – SYD	57.0%	45.6%	11.5%	32.6%	10.3%
SYD – BNE	56.7%	49.2%	7.5%	39.8%	3.5%
SYD – MKY	0%	0%	0%	100%	n/a ¹³
SYD – OOL	47.2%	2.1%	45.0%	45.9%	6.9%

Source: provided by merger parties, derived from information provided to OAG¹⁴

Statement of issues

50. When releasing a Statement of Issues, the ACCC may identify 'issues of concern', 'issues that may raise concerns' or 'issues unlikely to pose concerns'.
51. This Statement of Issues outlines two key issues, both of which have been identified by the ACCC as issues that may raise concerns:
- that the proposed acquisition may increase the likelihood of coordinated conduct in the relevant market; and

¹⁰ Figures not available at the date the information was gathered.

¹¹ OAG data still reflects Strategic Airlines' operating seat capacity share of 1.2% on this route, but Strategic Airlines has since ceased flying on this route.

¹² OOL is Gold Coast (Coolangatta) airport.

¹³ Figures not available at the date the information was gathered.

¹⁴ Based on operating seat capacity (by number of seats) sourced from OAG, accessed 29 October 2012. Figures for calendar year 2012 includes projections filed by carriers with OAG to the end of 2012.

- b. that the proposed acquisition would remove all competition between Virgin Australia and Tiger Australia.

Issues that may raise concerns

Increased potential for “coordinated effects” in the market

- 52. The ACCC is concerned that the proposed acquisition would increase the likelihood of airlines coordinating their pricing, capacity or related commercial decisions (i.e. give rise to “coordinated effects”). Concerns about coordinated effects arise because mergers and acquisitions can enhance the ability and incentive of firms in a market to act in their mutual interest (e.g. by not competing aggressively) rather than their individual interest (e.g. by competing aggressively). Coordinated effects rely on either an explicit communication between the parties or tacit conditioning of firms through their repeated market interactions over time.
- 53. The ACCC considers that the proposed acquisition may increase the ability and incentive of airlines to coordinate by (i) reducing the number of competitors in the market from three to two¹⁵ and (ii) removing Tiger Australia as an independent low cost carrier whose incentives differ sharply from those of its competitors, and which draws a competitive reaction from other airlines.
- 54. When assessing whether a merger is likely to give rise to coordinated effects the ACCC takes into account whether:
 - a. the markets under consideration have characteristics that are conducive to coordinated conduct (e.g. small number of firms, high degree of price transparency and information sharing, firms have similar operations and cost structures, and firms interact repeatedly in a number of markets);
 - b. there are market characteristics that are likely to disrupt or undermine coordinated conduct (e.g. whether there is a credible threat of new entry or if there is an aggressive ‘maverick’ competitor in the market); and
 - c. the merger weakens the constraints on market players successfully coordinating their pricing, output or related commercial decisions (e.g. by removing a maverick from the market).
- 55. There are certain factors that may tend to make the market for domestic air passenger transport services conducive to coordinated conduct:
 - a. the small number of independent airline groups amongst major domestic airlines. Although Australia has four prominent domestic airlines, there are only three groups: Qantas Group (Qantas and Jetstar), Virgin Australia and Tiger Australia;
 - b. major airlines have repeated market interactions across a number of routes (providing a greater opportunity to learn rivals’ behaviour and effectively retaliate if a rival deviates from a common strategy/understanding); and
 - c. airfares are largely transparent and published well in advance, making it easy for each airline to detect the pricing behaviour of the others.
- 56. In addition to these existing factors, the proposed acquisition may increase the ability and/or incentives of airlines to coordinate their conduct by:

¹⁵ Excluding regional airlines.

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- a. reducing the number of airline groups within Australia from three to two (excluding regional airlines), and making those groups more similar (in that each will be comprised of a full service and a low cost domestic carrier);
- b. removing Tiger Australia as an independent low cost carrier and instead aligning its incentives with those of Virgin Australia; and
- c. reducing the threat of further entry by a new airline.

These factors are discussed in greater detail in the following paragraphs.

Reduction in the number of airline groups

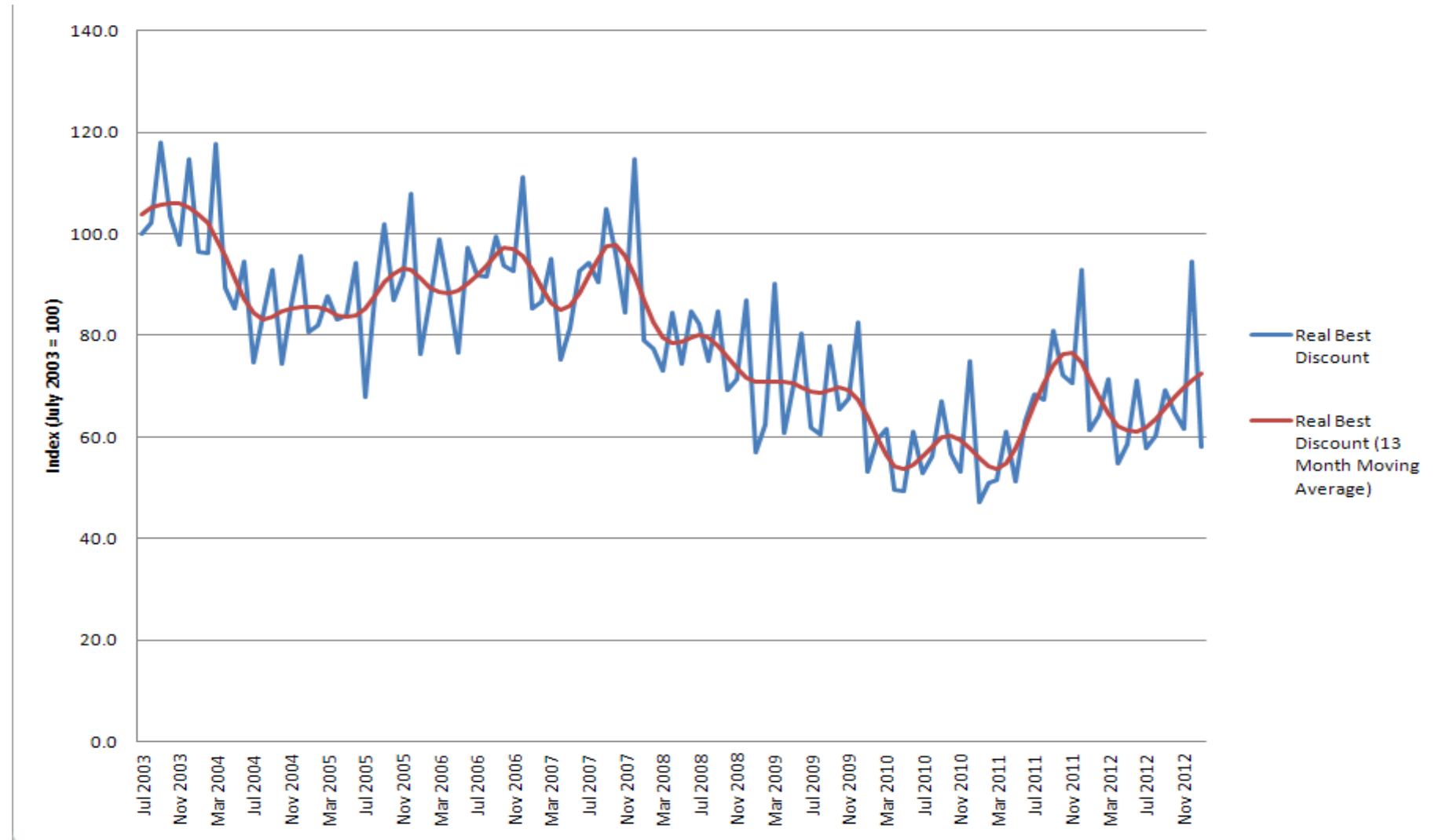
57. First, the proposed acquisition would reduce the number of airline groups within Australia from three to two. As a result, the proposed acquisition would reduce the number of firms whose agreement or acquiescence is needed in order for coordination to succeed. In bringing Tiger Australia under Virgin Australia's ownership the acquisition would also serve to make the two remaining airline groups more similar in market presence, operating structure and cost structure.
58. A greater symmetry between the market presence, operations and cost structures of Virgin Australia and Qantas Group may make it more likely that these airline groups would have, and would recognise and act in accordance with, a shared incentive for reduced competition on prices and/or capacity. It may also make it easier to detect and punish any deviation from any (tacit or explicit) agreement between the airline groups; if one group engaged in strongly competitive activity in one route or segment, it would risk retaliation from the other group not only on that route or segment, but across all segments.

Loss of competition from Tiger as an independent low cost carrier which draws a competitive response from other airlines

59. Second, Tiger Australia is a significant domestic airline with a reputation for low fares. Market participants have told the ACCC that historically the introduction of Tiger Australia onto new routes has triggered a competitive response from all operators on those routes in terms of fares and/or capacity.
60. Figure 1 below is a graph that has been created by the ACCC from information made publicly available by the Bureau of Infrastructure, Transport and Regional Economics (BITRE). It graphs the movement in BITRE's Domestic Air Fares (Best Discount) Index from July 2003 to January 2013.¹⁶
61. The data suggests there may be a correlation between:
 - Tiger Australia's entry into the market in 2007 and a downward movement in the index; and
 - an upwards movement in the index over the course of 2011, a year in which Tiger Australia was grounded for 6 weeks by CASA.

¹⁶ BITRE creates four domestic air fare indexes. Each is an index of the lowest available fare in a given fare category, weighted over selected routes. The fare category measured by the 'Best Discount' index is the cheapest available fare, excluding baggage surcharges. The other three fare categories for which BITRE creates an index are: 'Business', 'Full Economy' and 'Restricted Economy'. Further details about the indexes are available at http://www.bitre.gov.au/statistics/aviation/air_fares.aspx

Figure 1: BITRE Domestic Air Fares (Best Discount) Index



62. Tiger Australia has itself in the past claimed credit for reducing the price of discount airfares in Australia since it entered the market in late 2007 with reference to movements in the same BITRE Domestic Air Fares (Best Discount) Index. For example, at paragraphs 13-14 of Tiger Australia's 2009 response to the National Aviation Policy Green Paper: Flight Path to the Future (2008) ¹⁷ Tiger Australia referred to a graph of BITRE's Domestic Air Fares (Best Discount) Index and stated that the graph:
- "demonstrates the dramatic result of true low fare competition since the entry of Tiger Airways in November 2007."*
63. At paragraph 16 of that same submission, Tiger Australia stated that:
- "Tiger Airways' entry into the domestic aviation market has helped the domestic tourism market and has lead to greater availability of discount fares. It has been interesting to observe the competitive response to the entry of Tiger Airways including the greater availability of discount fares from the incumbent airlines."*
64. The ACCC recognises that movements in an index of this kind may be the result of multiple factors and that it cannot necessarily be inferred that the entry or exit of Tiger Australia was the primary factor responsible for these movements. For example, the period over which real best discount airfares declined also roughly coincides with the commencement and expansion of Jetstar services, and the increase in real best discount airfares in 2011 could also be due to higher input prices.
65. Nevertheless, the ACCC considers that Tiger Australia's presence on a route may draw a competitive response and act as a disciplining force that limits the potential for tacit coordination between Virgin Australia and Qantas/Jetstar on routes on which Tiger Australia operates.
66. For example, Tiger Australia commenced flying on the Melbourne – Sydney route in July 2009. Qantas Group subsidiary Jetstar, which until that point had not operated on the Melbourne-Sydney route, entered shortly afterwards with five daily services from October 2009. More recently Tiger Australia increased its frequencies on this route from 5 per weekday in March 2012 to 11 per weekday in July 2012. Both Jetstar and Qantas increased frequencies between Sydney and Melbourne soon afterwards. All else being equal, such an increase in the number of services on a route leads to downward pressure on fares on that route, to the benefit of consumers.
67. The ACCC also considers that the threat of competition from Tiger Australia on a route on which it presently does not operate may also act as a constraint on any potential for tacit coordination on that route (albeit a lesser constraint than Tiger Australia's actual presence on that route).
68. The ACCC will continue to examine the effect that Tiger Australia has had in the market, with a particular focus on market prices when Tiger Australia entered the market in 2007 and then when it was temporarily shut down in 2011.

¹⁷ Tiger Australia's submission in response to the National Aviation Policy Green Paper is available at http://www.infrastructure.gov.au/aviation/nap/files_green_paper/Tiger_Airways_Australia.pdf

Reduction in the threat of further entry

69. The ACCC notes that the threat of entry is relevant to analysis of both unilateral effects (discussed below from paragraph 83) and coordinated effects arising from the proposed acquisition.
70. The proposed acquisition may reduce the threat of further entry into the domestic market by another airline. The threat of new entry into a market has the potential to dampen coordinated conduct because the existing market participants do not wish to create an incentive for a new entrant who is not a party to the coordination to enter the market and compete for any excess profits.
71. The main barriers to entry and expansion that are faced by airlines considering entry into the market for Australian domestic air passenger transport services include:
 - sunk costs associated with assets necessary to establish a network of efficient scale and scope;
 - sunk marketing expenses associated with advertising, building brand recognition, and overcoming customer loyalty to existing airlines; and
 - the threat of strategic response to entry by incumbent operators.
72. Some market participants have told the ACCC that they consider present barriers to entry to the market are not particularly high. These submissions have noted that:
 - a. the growth in aircraft leasing companies allows airlines to access new aircraft quickly, often with minimal capital outlay and minimal long term obligations; and
 - b. the streamlined nature of low cost carriers – offering minimal lounge / terminal facilities and generally using third party providers for ground handling and check in staff – allows operations in new markets to be established quickly.
73. The ACCC is also aware of a number of airlines that have entered the domestic airline industry (albeit with mixed levels of success) over the last two decades: Compass Airlines (mark 1 and 2) in 1990 and 1992; Virgin Blue in 2000; and Impulse Airlines in 2000 (which formed the basis of Jetstar after it was acquired by Qantas in 2001); Jetstar in 2004; Tiger Australia in 2007; and Air Australia (Strategic Airlines) in 2011.
74. However, by expanding Virgin Australia's presence in the price sensitive leisure traveller segment of the market (as majority owner of Tiger), the proposed acquisition creates a second dual-branded incumbent operator providing RPT and charter domestic aviation services to leisure, corporate and government customers. The ACCC is concerned that this may increase the prospect of any potential new entrant being deterred from entry since they face a potential strategic response from either or both of the two large dual-branded incumbents that would exist post-acquisition. This may reduce the threat to existing market participants associated with new entry.
75. In light of the factors identified above, the ACCC's preliminary view is that the proposed acquisition may increase the risk of coordination between Virgin Australia and Qantas Group and their respective airlines. Any such coordinated conduct may lead to muted competition between the airlines on fares and services.

Factors that may make coordinated effects less likely

76. In considering whether the proposed acquisition would increase the risk of coordination, the ACCC is also examining factors that may tend to make coordination more difficult, less likely or unprofitable for the remaining airlines.
77. As noted above at paragraph 32, in the event that the ACCC were to ultimately conclude that Tiger Australia would exit the market in the absence of the proposed acquisition, this would be highly relevant to its assessment as to whether the proposed acquisition would be likely to give rise to coordinated effects.
78. Another relevant consideration is whether the proposed acquisition would in fact make Tiger Australia a stronger competitor which may in turn draw a competitive response from others, especially Jetstar. The merger parties have publicly announced an intention to expand Tiger Australia's fleet from its current 11 aircraft to 35 aircraft by 2018. If it is accepted that such an increase in capacity would take place, this would diminish the prospect of any increase in coordinated conduct in the market, both because it would increase supply in its own right and because this capacity increase may induce Qantas/Jetstar to respond competitively.
79. Tiger Australia's ability to compete and draw competitive responses from others may also be improved through an ability to leverage the strengths of its shareholders in network planning, operational management, and procurement, as well as any enhanced ability for Tiger Australia to invest in its fleet and network.

ACCC assessment and invitation to comment

80. The ACCC is assessing the overall effect that the proposed acquisition would have on the likelihood of coordinated conduct taking into account all of these factors.

The ACCC invites comments from market participants on whether the proposed acquisition would increase the likelihood of coordinated conduct. In particular market participants may wish to comment on:

- i. the current state of competition in the domestic airline industry, including whether and in what ways competition is muted by coordinated conduct, and the nature and extent of entry barriers;
- ii. the effect that Tiger Australia has on competition, including what responses it draws from Virgin Australia, Qantas and Jetstar.
- iii. any effect that the stated intention of the JV parties to increase Tiger Australia's fleet would have on competition between Virgin Australia/Tiger Australia and Qantas/Jetstar;
- iv. whether, if the proposed acquisition does not proceed, Tiger Australia would be a vigorous and effective competitor capable of destabilising future coordinated conduct; and
- v. whether the proposed acquisition would affect the likelihood of (and therefore the level of threat posed by) new entry into domestic air passenger transport services.

Loss of competition between Tiger Australia and Virgin Australia (unilateral effects)

81. Within the broader context of competition in the relevant market, Tiger Australia and Virgin Australia also compete directly with one another.
82. The ACCC is analysing the extent and closeness of current competition between Virgin Australia and Tiger Australia, and in particular, is considering whether the elimination of this direct competition following the proposed acquisition would enable Virgin Australia to profitably increase the price (or decrease the quality) of either Virgin Australia's or Tiger Australia's offer post-acquisition. In economic terms, this may be referred to as a concern about 'unilateral effects' arising from the proposed acquisition.
83. For example, if Virgin Australia were to increase its fares on a route, it would expect that as a result of its higher pricing, it would lose some customers to other airlines operating on that route. However, post-acquisition, if this price increase is on a route on which Tiger Australia also operates, and if a sufficient proportion of those customers lost by Virgin Australia switch to Tiger Australia, Virgin Australia may find this price increase profitable overall, once it takes into account both Virgin Australia and Tiger Australia's revenue streams.
84. While the proposed acquisition would not remove Tiger Australia from the market, it would change its incentives as Tiger Australia would cease to be independent of Virgin Australia. Presently, when deciding whether to enter a route and how to set prices, Tiger Australia seeks to maximise its own profits without taking into account the interests of other airlines. Post-acquisition, Tiger Australia, when controlled by Virgin Australia, would take into account the effect of its decisions on Virgin Australia's profitability.
85. For instance, Tiger's decision to enter the Sydney to Melbourne route (and the responses from Jetstar and Qantas) led to increased capacity and lower fares. This would have impacted on the profitability of Virgin Australia's operations on the Melbourne-Sydney route. Had Tiger Australia been in a position where its incentives were to take into account Virgin Australia's interests as well as its own, as it will be if the proposed acquisition proceeds, it may not have chosen to enter that route in the way that it did.
86. A similar analysis would apply to any future pricing and route decision Tiger Australia makes following the proposed acquisition. Tiger Australia's changed incentives may reduce the likelihood of Tiger Australia actually entering a new route, and also the extent of any competitive constraint associated with the perceived threat of Tiger Australia entering a route.
87. Other manifestations of potential unilateral effects competition concerns include whether Virgin Australia could increase its profits post-acquisition by:
 - a. reducing the quality of the service provided by Tiger Australia and/or Virgin Australia;
 - b. amending the times of the flights provided by Tiger Australia and/or Virgin Australia (e.g. moving lower priced Tiger Australia flights on trunk routes to less convenient time slots so as to encourage more passengers onto higher priced Virgin Australia flights); and/or
 - c. reducing the number of flights on a given route operated by Tiger Australia and/or Virgin Australia.

Factors that may make unilateral effects less likely

88. As noted above at paragraph 32, in the event that the ACCC were to ultimately conclude that Tiger Australia would exit the market in the absence of the proposed acquisition, this would be highly relevant to its assessment as to whether unilateral effects are likely to arise from the proposed transaction.
89. In addition, the ACCC notes that although Virgin Australia continues to offer low fares as part of its fare mix, the ACCC recognises that in recent years it has repositioned itself to provide a full service product and may now be most closely in competition with Qantas. Accordingly, competition between Tiger Australia and Virgin Australia may be less close and direct than it has been previously.
90. If it is accepted that the closest competitor to Tiger Australia is Jetstar, and the closest competitor to Virgin Australia is Qantas, then any attempt by Tiger Australia or Virgin Australia to raise prices or reduce service levels on routes on which they both provide services may be unprofitable due to the resulting loss of passengers to Jetstar or Qantas respectively.

ACCC assessment and invitation to comment

91. While the ACCC accepts that the degree of direct competition between Tiger Australia and Virgin Australia has decreased, it remains the case that leisure passengers are important to both airlines. Further, airline seats are a highly perishable product and full service carriers endeavour to fill empty seats with heavily discounted (and highly restrictive) fares.
92. The ACCC is still considering whether Virgin Australia and Tiger Australia are sufficiently close competitors that the loss of the direct competition between them would have a material impact on the price or other aspects of one or both of the merger parties' offers post acquisition. This is being done in part through analysis of quantitative information, but the ACCC also invites interested parties to comment on this issue.

The ACCC invites comments from market participants on how close Virgin Australia and Tiger Australia presently are as competitors.

In particular market participants may wish to comment on:

- i. the extent to which passengers who would otherwise have flown on Virgin Australia would choose (or currently do choose) to fly with Tiger Australia instead (rather than Jetstar or Qantas), in response to any increase in Virgin Australia's fares;
- ii. the extent to which passengers who would otherwise have flown on Tiger Australia would choose (or currently do choose) to fly with Virgin Australia instead (rather than Jetstar or Qantas), in response to any increase in Tiger Australia's fares;
- iii. the extent to which Virgin Australia has decreased its fares or otherwise improved the quality of its offer in the past in response to Tiger Australia's entry onto a route in competition with Virgin Australia (and whether this has been reversed when Tiger exited a route); and
- iv. any other aspects of Virgin Australia or Tiger Australia's offers that make them particularly strong (or weak) substitutes for one another.

ACCC's future steps

93. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.
94. The ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter.
95. Submissions are to be received by the ACCC no later than 22 February 2013. The ACCC will consider the submissions received from the market and the merger parties in light of the issues identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view in light of the issues raised above.
96. The ACCC intends to publicly announce its final view by 14 March 2013. However the anticipated timeline may change in line with the Merger Review Process Guidelines. A Public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement.