Rationale

Introduction

3.12 FSAs operating in today's air transport markets face a dual challenge. They must continue to maximise revenue by offering customers increasing levels of network breadth. They must achieve this by building connectivity, starting new non-stop services, codesharing, and interlining while also offering network depth through multiple frequencies in the highest demand city pairs. They also must maintain competition based on onboard product innovation, eg, comfort and entertainment.

3.13 Just as FSAs are seeking to expand and secure their presence, they face a threat that was, until recently, substantially overlooked, namely the emergence of aggressive, highly successful airlines operating on a VBA business model. The VBA model offers low fares, generally courtesy of a very low cost base, driven by operating a rapid turn around, point to point service, avoiding most low demand city pairs, adopting a single class offering, and utilising a "greenfield" cost base. The model generally operates on short-haul routes, ie, up to 5 hours, using narrow-body aircraft that are widely available.

3.14 The success of VBA entry internationally, and particularly Virgin Blue in Australia, provides cogent evidence that VBAs are able to establish themselves quickly and effectively. Experience also shows that the competitive constraints of VBAs are significant and extend beyond the reach of the specific routes serviced by them. In addition, competition between VBAs and FSAs is much more intense than competition among FSAs, principally due to the VBAs' much lower cost base and simplified fare structure.

3.15 Australia and New Zealand are "end of route" destinations. In addition, from a commercial perspective, the Australasian market does not have a large enough base to support two sustainable FSAs with independent global networks. This is because of the relatively low number of destinations served non-stop, and because many of the Australasian city pairs which are currently supported by FSAs are too "thin" profitably to support more than one FSA network structure.

3.16 Nevertheless, the Australasian short-haul routes are ideally suited for VBA entry due to the fact that:

(a) there are a limited number of city pairs which comprise a high percentage of overall traffic. This permits a VBA to replicate very quickly that key part of the full service network; and

(b) consumers, both leisure and many business customers, give preference to price and frequency. This limits the effectiveness of FSA product differentiation including loyalty programmes and lounges.

3.17 Australasia is one of the most de-regulated aviation markets in the world. There are no material regulatory barriers to entry. There is an "open skies" arrangement between Australia and New Zealand and numerous fifth freedom operators provide services on the trans-Tasman routes with only marginal costs of providing these services.

3.18 A number of these fifth freedom operators are key global network competitors for Air NZ and Qantas. These airlines, however, mostly operate with natural geographic hub advantages and distorted market conditions and incentives that enable them to focus on expanding their international networks, insulated from market forces that would otherwise apply. Many such airlines, including Singapore Airlines, Thai Airways and Malaysia Airlines, already have a strong (and growing) presence in Australasia.

3.19 The Single Aviation Market created by the Australian and New Zealand Governments, together with the relative closeness of the countries, has ensured that for the foreseeable future, Australian and New Zealand carriers are bound to perceive their home market to be Australasia, not national. (Indeed, for Qantas, Auckland is closer to Sydney than Perth is.) It was the driver for Air NZ entering domestic Australia through the acquisition of Ansett, and for Qantas entering the New Zealand main trunk routes. Virgin Blue clearly views the market in the same way. Having commenced operations in Australia, Virgin Blue immediately announced its intention to enter the trans-Tasman and the New Zealand main trunk routes.

3.20 Qantas has determined that in order to achieve a sustainable base in the domestic New Zealand segment of the Australasian market, it must enlarge its current fleet of aircraft that are dedicated to this segment. This requirement is driven by the need to have sufficient frequency of flights to be attractive to customers, particularly high value business passengers. Given the importance, in particular of the domestic New Zealand routes to Air NZ's operations, Air NZ would be forced to engage in a debilitating and expensive period of unsustainable competition.

3.21 The options for Air NZ are limited. Air NZ does not have the size or strength to wrestle with Qantas for the position of FSA of choice for Australasia. In addition, market conditions are conducive to VBA entry and growth, and Virgin Blue's presence in Australia means it already occupies an estimated 70% of the available Australasian VBA space.[5]

Air NZ's Specific Rationale

3.22 From Air NZ's perspective, the Transactions are a unique opportunity to remove the threat to its medium to long term viability and to remove the likelihood of material contraction of its international networks (which could otherwise only be maintained through continuing and extensive shareholder support). It is also the means to maintain a New Zealand owned and controlled flag carrier having the necessary incentives and capability to encourage tourism growth in New Zealand as well as providing increasing support for New Zealand's export industries. It provides an opportunity for Air NZ to regain feed from Australia which is important to its domestic New Zealand, trans-Tasman, and international networks.

3.23 Air NZ's ability to invest in necessary fleet upgrades and improved IT would be severely prejudiced without the Transactions – currently it is expected to achieve only around a 3% return on investment on its international operations. This is less than its cost of capital and therefore is unsustainable.

Qantas' Specific Rationale

3.24 Qantas also sees itself vulnerable to pressure exerted on its markets by other international airlines, and by the VBA impact that it is already experiencing in the Australasian market. Despite Qantas' strong performance relative to industry peers at the moment, there is a risk of its being marginalised by failing to recognise the extreme pressures on the global aviation industry, and also by failing to participate in global industry developments and to compete effectively beyond the immediate region. For Qantas, the Transactions

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5 In revenue terms, Australia is approximately 70% of the combined Australian, trans-Tasman and New Zealand market.

represent a unique opportunity to establish a significant airline grouping within Australasia and an important step towards securing Qantas' long term position as an Australasian based global network carrier.

The Joint Rationale

3.25 From the perspective of both airlines, the Transactions provide a one-off window of opportunity to combine two strongly branded, locally based international airlines into a sustainable regional airline group. If they do not achieve that combination now, it is unlikely that the opportunity will remain for the future. Damage from the ongoing battle to develop sustainable networks will substantially erode the benefits of an alliance now available to New Zealand and Australia.

3.26 For the Australian and New Zealand economies, the Transactions will maintain dedicated flag carriers with strong international networks which are sustainable in global markets and committed to advancing each country's important tourism and export industries. The Transactions will allow the airline industry to play a key role in developing and enhancing those industries.

4. TRADE PRACTICES ACT ISSUES

4.1 The result of the Transactions will be that Qantas will obtain a minority shareholding of up to 22.5% in Air NZ and the Parties will have reciprocal Board representation. In addition, the two airlines will seek to co-ordinate their activities as if they were part of one airline group. The objective of the Transactions is for Air NZ and Qantas to be able to work closely together to develop maximum synergies and efficiency gains from the Alliance. In effect, the Transactions will result in a contractual merger of the commercial operations of Air NZ and those parts of Qantas that operate to, from or within New Zealand.

4.2 Air NZ and Qantas believe that there are substantial and demonstrable public benefits arising from the Transactions, which more than offset or outweigh any detriments. Furthermore, the enforceable undertakings will facilitate and protect new entry and enhance the quality of competition to the benefit of consumers.

4.3 Accordingly, Air NZ and Qantas are making this application for authorisation of the transaction pursuant to sub-sections 88(1) and (9) of the TPA. The tests are set out in sub-sections 90(6), (8) and (9). Under sub-section 90(6), the ACCC may make a determination granting authorisation of conduct if it is satisfied in all the circumstances that the conduct would result, or be likely to result, in a benefit to the public that outweighs any detriment to the public constituted by any lessening of competition resulting from the conduct. Under sub-sections 90(8) and (9), the ACCC may make a determination granting authorisation of conduct if the conduct would result, or be likely to result, in such a benefit to the public that the conduct should be allowed to take place.

4.4 While in practice the tests for authorisation have been treated as being the same,[6] the Parties note that the tests are expressed in different terms.

4.5 This submission considers the competitiveness of the air services markets to and from Australia in which Qantas and Air NZ compete and which may be affected by the Transactions. This submission also considers in detail the public benefits that will result

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6 *Re Media Council of Australian (No. 2) (1987) ATPR 40-774 at 48,419*, referred to in the ACCC *Guide to authorisations and notifications.*

from the Transactions and clearly demonstrates that the public benefits arising from the Transactions outweigh any detriment.

4.6 The meaning of benefit to the public is not defined in the TPA, although section 90(9A) of the TPA provides, in respect of authorisations pursuant to section 88(9), that:

> 'In determining what amounts to a benefit to the public:
>
> (a) the Commission must regard the following as benefits to the public (in addition to any other benefits to the public that may exist apart from this paragraph):
>
> (i) a significant increase in the real value of exports;
>
> (ii) a significant substitution of domestic products for imported goods; and
>
> (b) without limiting the matters that may be taken into account, the Commission must take into account all other relevant matters that relate to the international competitiveness of any Australian industry.'

4.7 The underlying purpose for the section is described in the second reading speech in respect of section 90(9A):

> 'There has been some concern that a more stringent merger test could impede firms' abilities to achieve the necessary scale to develop export markets or to compete effectively with imported products. To allay these concerns this Bill contains amendments to the merger authorisation provisions....[7]

4.8 The Trade Practices Tribunal (as it then was) has indicated that public benefit should be interpreted very broadly:

> '... we would not wish to rule out of consideration any argument coming within the widest possible conception of public benefit. This we see as anything of value to the community generally, any contribution to the aims pursued by the society including as one of its principal elements ... the achievement of the economic goals of efficiency and progress'.[8]

4.9 The Trade Practices Tribunal expanded on the meaning of the words "efficiency and progress" by saying:

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7 Second reading speech for *Trade Practices Legislation Amendment Bill* No 222 of 1992.

'Plainly, the assessment of efficiency and progress must be from the perspective of society as a whole: the best use of society's resources. We bear in mind (in the language of today) efficiency is a concept that is usually taken to encompass 'progress'; and that commonly efficiency is said to encompass allocative efficiency, production efficiency and dynamic efficiency'.[9]

4.10 In its determination in *ACI Operations Pty Ltd*,[10] the ACCC identified a large range of matters which may constitute a public benefit. These include:

(a) economic development, through encouragement of exploration, research and capital investment;

(b) fostering business efficiency, especially where this results in improved international competitiveness;

(c) industrial rationalisation resulting in more efficient allocation of resources and in lower or contained unit production costs;

(d) expansion of employment and employment growth in particular regions;

(e) improvement in the quality and safety of goods and services and expansion of consumer choice;

(f) promotion of industry cost savings resulting in contained or lower prices at all levels in the supply chain;

(g) development of import replacements;

(h) growth in export markets; and

(i) steps to protect the environment.

4.11 The ACCC has had the opportunity to consider the nature of public benefits in the aviation industry in a number of previous determinations. In the *JSA* determination, the ACCC accepted that cost savings arising from the original JSA would be public benefits if

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8 *Re Queensland Co-op Milling Association Limited* (1976) ATPR 40-012 at 17,242.

9 *Re 7 Eleven Stores* (1994) ATPR 41-357 at 42,667.

those benefits were passed onto the public in the form of lower prices or better quality service at existing prices.

4.12 In the *SQ/AN/NZ* determination, the ACCC accepted that efficiency gains and cost reductions should be recognised as public benefits because they release some of society's scarce resources for other uses.[11]

4.13 The ACCC has noted in other determinations that improved efficiency leads to a more efficient allocation of resources, which in turn equates to a public benefit.[12] The resource savings that will result from the Alliance will be "real savings in resources" in the sense outlined by the ACCC in *Wattyl (Australia) Pty Limited, Courtalds (Australia) Pty Limited & Ors,* and not mere "pecuniary savings".[13] They will be achieved through synergies inherent in the close integration of the resources of Air NZ and Qantas. The NECG Report demonstrates that real savings in resources will result from the Alliance and that these real savings will be substantial.

4.14 The increase in producer surplus resulting from the Transactions is a public benefit. Furthermore, most of the cost savings and efficiencies generated from the implementation of the Transactions are likely to be passed on to consumers in the competitive aviation markets in which Air NZ and Qantas operate, particularly having regard to the undertakings which will be offered by the Parties.

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10 (1991) ATPR 50-108.

11 A90649, A90655, *Alliance Agreement between Ansett Australia, Ansett International, Air New Zealand and Singapore Airlines*, 10 June 1998 ('***SQ/AN/NZ***'), page 62.

12 For example, *Du Pont (Australia) Limited and Ors* (1996) ATPR 50-231 at paragraph 9.22, *Davids Limited* (1996) ATPR (Com) 50-224 at paragraph 7.61.

13 (1996) ATPR 50-231 at paragraph 7.12.

5. MARKET DEFINITION

Introduction

5.1 The markets which will be affected by the Transactions fall within two categories: those markets which are within the JAO and those markets which fall outside the scope of the JAO.

5.2 The Australasian airline industry has previously been examined closely by:

(a) the ACCC in its *RJSA,*[14] *JSA*[15] and *SQ/AN/NZ*[16] determinations;

(b) the NZCC in *Kiwi Airlines,*[17] *Bodas*[18] and *Brierley/Air NZ;*[19] and

(c) the New Zealand Ministry of Transport in respect of the Air NZ alliance agreements with Singapore Airlines and Ansett (1997) and United Airlines (2002).

5.3 The only material variation to ACCC precedent (although a finding on this matter is not necessary for the Parties to succeed in satisfying the test for authorisation of the Transactions) is the submission that Australia and New Zealand should be considered as a single Australasian market for the purposes of this submission. The Parties also submit that there is a single customer market for passenger air services, in line with the ACCC's decision in *SQ/AN/NZ.* This issue was left open by the ACCC following the *RJSA* determination and *IATA PAP* determination.

5.4 Having regard to previous determinations in Australia and New Zealand and the NECG Report, the primary markets in which the competitive impact of the Alliance needs to be assessed, are those within the JAO network. They are:

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14 A30202 *Qantas Airways Limited and British Airways Plc* Joint Services Agreement, 10 May 2000 ('***JSA***').

15 A90565 *Qantas Airways Limited and British Airways Plc*, 12 May 1995 ('***RJSA***').

16 ACCC, *SQ/AN/NZ Determination.*

17 Termination Report: *Kiwi Airlines International/Air NZ*, 12 August 1997 ('***Kiwi/Air NZ***').

18 NZCC, Decision No 278: *Air New Zealand/Ansett Holdings/Bodas*, 3 April 1996 ***('Bodas').***

19 NZCC, Decision No 229A: *Brierley Investments Limited, Qantas Airways Limited, Japan Air Lines Co Ltd, American Airlines Inc and Air New Zealand Limited*, 27 April 1989.

(a) the markets for the provision of passenger air services:

(i) in Australasia, ie, within each of and between Australia and New Zealand; and

(ii) between Australia and North America,

(together the '**Passenger Air Services Markets**');

(b) the markets for the provision of freight services:

(i) in Australasia, ie, within each of and between Australia and New Zealand/Oceania; and

(ii) between Australia and North America;

(together the '**Freight Markets**');[20] and

(c) the market for travel distribution services (the '**Travel Distribution Services Market**').

5.5 The Parties acknowledge the need to assess the impact of the Alliance in each of the above JAO markets, but consider that the primary area of Australian competition law significance occurs in respect of the trans-Tasman segment of the Australasian Passenger and Air Services and Freight Markets (the '**trans-Tasman**').

5.6 As noted at paragraph 2.34, the SAA also contemplates that the Parties may agree to extend their co-ordination to include non-JAO operations. Accordingly, for the sake of completeness, the Parties also seek authorisation of the Transactions in relation to the following additional markets in which the Parties may offer services:

(a) between Australia and North Asia;

(b) between Australia and South-East Asia;

(c) between Australia and Asia-Pacific Destinations;

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20 NECG has, for modelling purposes, assessed narrower markets, ie, between Australia and New Zealand, between Australia and the Pacific Islands and between New Zealand and the Pacific Islands, on the basis that this is the most conservative approach.

(d) between Australia and Europe;

(e) between Australia and India/Middle East;

(f) between Australia and South America; and

(g) between Australia and Africa.

Approach to Market Definition

5.7 This section of the submission discusses the air services markets in which Qantas and Air NZ compete and which may be affected by the proposed Alliance.

5.8 An accepted starting point in Australia when identifying the relevant markets is the Australian Trade Practices Tribunal's *Re Queensland Co-op Milling Association Ltd*[21] decision. At page 190 the Tribunal commented:

> 'A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them. (If there is no close competition there is of course a monopolistic market). Within the bounds of a market there is substitution - substitution between one product and another, and between one source of supply and another, in response to changing prices. *So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive.* Let us suppose that the price of one supplier goes up. Then on the demand side buyers may switch their patronage from this firm's product to another, or from this geographic source of supply to another.
>
> As well, *on the supply side, sellers can adjust their production plans, substituting one product for another in their output mix, or substituting one geographic source of supply for another.* Whether such substitution is feasible or likely depends ultimately on customer attitudes, technology, distance, and cost and price incentives.' (Emphasis added.)

5.9 Accordingly, the boundaries of a market are defined by substitution possibilities on both the demand and supply sides. On the demand side, substitution is measured by the extent to which buyers will choose alternative products or geographic sources of supply given a sufficient price incentive. On the supply side, the market is measured by the

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21 (1976) 25 FLR 169.

extent to which sellers will substitute a product in their output mix or an area of supply given a sufficient price incentive.

5.10 In examining market definition, it is common to consider at least 3 dimensions:

(a) the product market – to consider which products are substitutable for one another;

(b) the geographic market – to consider which geographic sources of supply are substitutable;

(c) the functional market – which examines the level on the supply chain at which competition occurs.

5.11 The ACCC has examined air services in authorisation determinations such as the RJSA and *SQ/AN/NZ*. Given that those determinations were made relatively recently, the Parties believe that the conclusions reached by the ACCC remain current and reliable. Accordingly, this submission does not endeavour to analyse this issue in detail, but adopts the principal conclusions of the ACCC in those determinations.

5.12 The product and geographic dimensions are discussed in relation to the relevant markets below.

Passenger Air Services

Product dimension

5.13 This application is based on a single product market for air passenger services, which is consistent with the ACCC's *SQ/AN/NZ* determination, where it found that "different passenger types (business/leisure) represent different segments of the passenger market", rather than representing different markets.[22] For the purposes of market definition, there is no relevant distinction between business and leisure passengers or economy and business/first class passengers.

5.14 The classes of travel available to passengers, including business class and economy class, simply reflect "physical" features of the product or service offering. The Parties submit that it is not differences between the physical features of products that are key to

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22 ACCC, *SQ/AN/NZ* determination, page 50.

delineating markets. Rather, an informed investigation of the legitimacy of distinctions made on the basis of product features begins with an analysis of the manner in which these features are related to the demand for the products.[23]

5.15 The labels which are given to types of passengers, including "leisure" and "business", merely reflect a passenger's reason for travel and not the entirety of, nor the most important of, the demand characteristics of the customer. Accordingly, these labels are not appropriate market delineators either.

5.16 Travellers demonstrate a range of demand characteristics, relating to time sensitivity, flexibility in regard to conditions, complexity of itinerary, and product quality (both "in-flight" and "pre- and post- flight" services). Airlines offer an array of fare types to meet those demand characteristics. Demand characteristics are not uniform among travellers. The same customer may exhibit different demand characteristics at different times. Customers who purchase tickets with special fare conditions are usually less time sensitive and more flexible than customers who purchase unrestricted fare types. Customers, whether or not they are business or leisure travellers, select the fare type that is most appropriate to their needs at that time.

5.17 On the supply side, airlines offer an array of fare types to maximise yield and this is done in a flexible and variable way, responding to demand and competition. Tickets with special fare conditions are generally discounted because they help an airline manage inventory and in that sense cost less for the airline to produce. Importantly, they are not targeted exclusively at any one reason for travel.

5.18 The NECG analysis demonstrates that, even if there are some customers who are not willing to substitute fare types, the cross-section of customers who are willing to substitute is significant enough to prevent a price increase by a hypothetical monopolist. Accordingly, the existence of some passengers who are not willing to substitute between fare types does not support a conclusion that these passenger types are in separate markets, or that there are separate markets for different fare types. At best, it is indicative only of separate segments within the one market.

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23 See Office of Fair Trading research paper, *Market Definition in UK Competition Policy*, prepared by National Economic Research Associates (NERA), February 1992, page 71.

5.19 This conclusion is consistent with the approach taken by overseas authorities to the identification of product and customer markets. A paper on market definition commissioned by the United Kingdom Office of Fair Trading notes that even where there is a group of customers "captive"[24] to a particular product, if the size of this group is small compared to customers who are willing to choose between alternatives, the relevance of the customer group for market definition is limited.[25] United States authorities have required that a captive group be substantial enough that a hypothetical monopolist would find it profitable to impose an increase in price, before this group is treated as a separate market.[26]

5.20 In *Bodas*, the NZCC rejected the argument that there are separate customer markets or sub-markets, despite recognising that there may exist distinct customer segments. The NZCC stated:

> "The Commission does not believe that the domestic air services markets should be separated into categories for business and VFR *[Visiting Friends and Relatives]* travellers. Rather than each passenger type constituting separate markets, the Commission believes that they are different segments of the same markets".[27]

5.21 Commercial reality in Australia supports a single product market definition. In Australia, large numbers of business travellers fly in economy class, particularly on short haul services. Virgin Blue is strongly contesting corporate accounts, stating that:

> 'We are very much focussed now on the business market as well. We're focussed on all markets and we're pricing accordingly.'[28]

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24 Consumers who are clearly unable or unwilling to switch from one product to another in the event of a relative price change. The US DOJ Merger Guidelines refer to these customers as "targeted buyers" (paragraph 1.12).

25 Office of Fair Trading research paper, *Market Definition in UK Competition Policy*, prepared by National Economic Research Associates (NERA), February 1992.

26 *US v SunGard and Comdisco* (2001) 172 F. Supp 2D 172.

27 NZCC, *Bodas* determination , at paragraph 125.

28 ninemsn, Business Sunday Interview: Brett Godfrey, CEO, Virgin Blue, 26 November, 2000, http://finance.ninemsn.com.au/businesssunday/Interviews/stories/story_1317.asp.

In doing so, Virgin Blue offers services such as valet parking, which is wholly inconsistent with a market participant seeing itself as operating only in discount or leisure travel.

5.22 The relevant market does not include the provision of passenger services using other modes of transport for the reasons set out in the NECG Report.

5.23 The economic support for a single passenger market, including a critical loss analysis, is set out in the NECG Report.

Geographic Extent

5.24 Aviation geographic market boundaries are blurred. Airlines themselves view the geographic extent of the market in terms significantly wider than those a conventional SSNIP analysis would suggest. As set out in the NECG Report, there are strong arguments that the relevant geographic market is a single market that includes passenger air services provided along Australian domestic main trunk routes, New Zealand domestic main trunk routes and trans-Tasman routes (an Australasian passenger air services market).

Australasian market

5.25 The Parties treat the Australasian market as the natural base for their local operations. The basis for this view is:

- the open skies and Single Aviation Market agreements between Australia and New Zealand which remove legal and regulatory barriers to Australian airlines providing services along trans-Tasman and domestic Australian and New Zealand routes; and

- the actual and potential supply side substitution, ie, the scope for airlines operating domestically within Australia to transfer aircraft on to the trans-Tasman routes and on to domestic New Zealand routes, and vice versa.

5.26 The ACCC noted in its *RJSA* determination that the distinction between international and domestic markets was not as clear cut as it was 5 years earlier for the following reasons:[29]

(a) The increasing occurrence of codeshares involving international airlines on flights on domestic routes has blurred the distinction, which was furthered by the granting of unrestricted rights for foreign carriers to codeshare to all destinations in Australia on Australian domestic airlines.

(b) Linkages between international carriers and domestic carriers mean that alliances between Australian and foreign carriers on international routes can impact on the performance of the Australian domestic segment.

(c) In addition, the Australian Government has eased foreign ownership restrictions on Australian airlines, such that a foreign airline can operate a wholly owned subsidiary in domestic Australia.

5.27 Ultimately, however, the ACCC concluded in the *RJSA* that, so long as foreign owned international carriers are precluded by cabotage policy from operating in domestic Australia, it would be difficult for the ACCC to form any conclusion other than that the domestic market is distinct from the international market. These conclusions were reaffirmed recently by the ACCC in its *IATA PAP* determination.

5.28 The Parties submit that, for the purposes of this Application, the relevant geographic market is an Australasian one, comprising main trunk routes in domestic Australia, the trans-Tasman, and main trunk routes in domestic New Zealand. The grounds for distinction given in the *RJSA* – preclusion from operation in domestic markets – plainly do not apply in the present context.

5.29 New Zealand based carriers have had the right, as designated Single Aviation Market carriers under the Single Aviation Market arrangements, to fly domestically in Australia since 1996. Similarly, Australian majority owned carriers have the right to fly domestically in New Zealand which, indeed, Qantas does and Virgin Blue intends to do. Both Australian (including Virgin Blue) and New Zealand carriers are unrestricted in flying across the Tasman.

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29 ACCC, *RJSA* determination, page 191.

5.30 Furthermore, once a carrier has committed to supplying services on a particular route, the costs associated with servicing an additional route in that market are marginal by comparison. Airlines can quickly, and at minimal cost, offer (or increase) services on other routes in response to a SSNIP, for example by changing the type of aircraft flown on affected routes.

5.31 While the issues in relation to international services are still relevant, commercial reality and the similarity of the competitive characteristics of the routes in each geographic region are wholly supportive of the Parties' geographic market definitions for the following reasons:

(a) commercial reality suggests that an entrant would, in time, almost certainly seek to service, either directly or through some form of alliance, all main trunk routes in Australia and New Zealand and at least the principal trans-Tasman routes; and

(b) the routes in each of the above markets display similar characteristics such that they can be grouped for the purposes of a competition law assessment.

5.32 For example, Virgin Blue, having established its position in Australia, sees expansion on the trans-Tasman, and ultimately in domestic New Zealand, as the logical next step in its growth (see paragraphs 6.75 onwards). While Virgin Blue has contradicted itself on occasion (discussed at paragraph 6.110), Virgin Blue's stated expansion plans are obvious, logical and credible. The ACCC should therefore receive such statements as prima facie accurate statements of intention – without the application of any gloss or discount. In addition to the public statements, the NECG Report models the likely profitability of Virgin Blue's entry on certain key routes. The NECG modelling reinforces the credibility of successful and meaningful entry. Finally, Air NZ's own day to day business planning, prior to agreeing to the Transactions, assumed the entry of Virgin Blue (see Appendix 9). The Federal Court and the Australian Competition Tribunal have consistently held that great weight needs to be given to the proven intentions and views of business people.[30]

5.33 The legal and regulatory environment, theoretical SSNIP analysis, and commercial reality all indicate that there is a single Australasian aviation market. However, despite the

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30 For example, "[t]he best evidence of the dimensions of the relevant market may be the behaviour of people in the particular trade": *Mark Lyons Pty Ltd v Bursill Sportsgear Pty Ltd* (1987) ATPR 40-809 at 48,798 per Wilcox J cited in *Davids Holdings Pty Ltd v Attorney-General* (1994) ATPR 41-304 at 42,093.

Parties' view that this broader geographic market is correct, the Transactions qualify for authorisation even if narrower markets are adopted.

5.34 In the context of international air services, the ACCC has generally defined geographic markets on a regional basis. In its *RJSA* determination, the ACCC defined the relevant markets as: Australia-South East Asia; Australia-Europe; Australia-New Zealand/Oceania; Australia-North Asia; Australia-India/Middle East; and Australia–North/South America. The ACCC took account of the extent of indirect travel as a factor in travel with passengers having the option of travelling directly to a destination or via a number of other countries. The ACCC also noted the practice of common rating fares to points within a region, for example, a passenger paid the same price for a ticket to virtually any point in Europe with a given airline.

5.35 For these reasons the Parties adopt regional markets in respect of Australia and North America and any other international destinations that may be affected by the Transactions, such as Australia-Europe or Australia-Asia.

5.36 Therefore, for the purposes of the Application, the relevant geographic markets in respect of passenger air services are:

(a) Australasia; and

(b) between Australia and North America.

5.37 These geographic definitions are supported by ACCC precedent, commercial reality and the NECG Report.

Freight

Product Dimension

5.38 The Parties agree with the ACCC's conclusion in *SQ/AN/NZ*, which the ACCC confirmed more recently in the *RJSA* determination,[31] that there is a single product market for

[31] ACCC, *RJSA* determination, page 50.

freight air services different types of freight represent market segments of the overall market.[32]

Geographic Extent

5.39 Arguments as to geographic definition in respect of the Passenger Air Services Market apply equally to the Freight Market, although indirect routes impose a greater degree of constraint on direct freight services.

5.40 The ACCC has previously determined that there is a national Australian market for the provision of freight services and a market between Australia and a combined region of New Zealand and Oceania.[33]

5.41 For the reasons set out above from paragraph 5.25, the Parties submit that there is a single Australasian market for the provision of freight services (which may also include Oceania, in accordance with the ACCC's determination in *SQ/AN/NZ*). Nevertheless, the analysis in this submission will not be significantly affected whether the market is defined as a single regional market or as consisting of the separate markets in domestic Australia, domestic New Zealand and the trans-Tasman.

Travel Distribution Services

5.42 The Travel Distribution Services Market is the market for supply of services by travel agencies and other distributors to consumers. These services include an assortment of travel related products, including airline tickets and holiday packages and advice to consumers. The geographical extent of the market is national.

5.43 In broad terms, airline tickets are now sold or distributed by:

(a) airlines directly to the public, via the internet and telephone, to businesses direct, and via airline owned tour package wholesalers and airline owned retail travel centres;

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32 ACCC, *SQ/AN/NZ* determination, page 50.

33 ACCC, *SQ/AN/NZ* determination, page 51.

(b) airlines to "consolidators" who purchase tickets (frequently constructing multi-hop itineraries) and on-sell to travel distributors, who then on-sell in their own right to the public;

(c) airlines to "wholesalers" who purchase tickets and package them with other products, eg, accommodation, and then on-sell to travel distributors, who then sell in their own right to the public; and

(d) airlines to the public via travel agents, interline airline partners and internet travel portals.

5.44 In the *SQ/AN/NZ* determination, the ACCC accepted submissions that there is a product market for airline ticket sales, in which passengers could purchase tickets from any segment of the distribution chain. In the *RJSA*, the ACCC reaffirmed this decision and noted that consumers view airlines as an alternative source of airline tickets to travel agents.[34]

5.45 The ACCC has recently stated in its *IATA PAP* determination that there is a market for the sale of air travel (including ticket sales), which includes all segments of the distribution system, including retail travel agents, airlines and package tour operators.[35]

5.46 The Parties agree with the ACCC's definition of the market for travel distribution services.

Other Ancillary Markets

5.47 The ACCC has recognised other markets as being ancillary to the air services market. These include CRS/GDS, engineering services and terminal and ground handling services.

5.48 The Transactions have a minimal impact on these markets, if any, in Australia. To the extent that any discussion or analysis is necessary in respect of these markets, the Parties will provide it on request.

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34 ACCC, *RJSA* determination, pages 50 and 51.

35 ACCC, *IATA PAP* determination, page 67.

Markets Affected by the Transactions

5.49 Having regard to the above market definitions, the Parties believe that the Transactions will primarily affect passenger and freight air services on the trans-Tasman routes and between Australia and North America (the '**Relevant Markets**').

5.50 In respect of the other markets listed in paragraph 5.6, Air NZ does not currently, and under the counterfactual would not, provide services directly from Australia. For many of these markets, indirect services via New Zealand would not be a competitive substitute for Australian originating passengers.

5.51 The destinations where indirect services would be substitutable (eg, Tahiti) form part of a wider leisure destination market. The extent of likely competitive detriment in this market is minimised by:

(a) the presence of competing airlines offering travel to the same destinations;

(b) the low barriers to entry and expansion by existing airlines, particularly United States-based carriers;

(c) the significant countervailing power imposed by travel wholesalers and consolidators;

(d) the constraint imposed by the large number of carriers servicing alternative holiday destinations;

(e) the high degree of price-sensitivity of passengers; and

(f) Virgin Blue's announcement to enter the Pacific – which fits the core profile of an important segment of its targeted business.

5.52 Therefore, the Transactions will not have a material effect on competition in the markets listed in paragraph 5.6. Accordingly, we do not propose to deal with them further but if the ACCC requires information, it will be provided.

5.53 The Transactions may also have some effect on Travel Distribution Services. To the extent that any discussion or analysis is necessary in respect of other ancillary markets which may be affected by the Transactions, the Parties will provide it on request.

5.54 The competition effects in respect of the Relevant Markets are discussed below.