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Form A

Commonwealth of Australia
Trade Practices Act 1974 --- Sub-section 88(1)

A91001

EXCLUSIONARY PROVISIONS: APPLICATION FOR AUTHORISATION

To the Australian Competition and Consumer Commission:

Application is hereby made under subsection 88(1) of the *Trade Practices Act 1974* for an authorisation under that subsection

- to make a contact or arrangement, or arrive at an understanding, where a provision of the proposed contract, arrangement or understanding would be, or might be, an exclusionary provision within the meaning of section 45 of that Act.
- to give effect to a provision of a contract, arrangement or understanding where the provision is, or may be, an exclusionary provision within the meaning of section 45 of that Act.

(PLEASE READ DIRECTION AND NOTICES ON BACK OF FORM)

1. (a) Names of Applicants

Qantas Airways Limited ABN 16 009 661 901 (**Qantas**)
Air New Zealand Limited ABN 70 000 312 685 (**Air NZ**)

(See Direction 2 on the back of this Form)

(b) Short description of business carried on by Applicants

The provision of domestic and international air transportation services.

(c) Address in Australia for service of documents on the Applicants

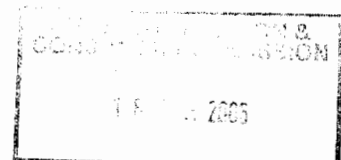
Qantas Airways Limited
c/- Aldo Nicotra
Partner
Johnson Winter & Slattery
Level 30 Australia Square
264 George Street
SYDNEY NSW 2000

Air New Zealand Limited
c/- Michael Gray
Partner
Freehills
Level 32, MLC Centre
19 - 21 Martin Place
SYDNEY NSW 2000

2. (a) Brief description of contract, arrangement or understanding and, where already made, its date

A Tasman Networks Agreement (**TNA**) dated 12 April 2006 between the Applicants under which they will co-ordinate the activities of the Qantas Group and the Air NZ Group in respect of any flight operated on the Tasman Networks (as defined in the TNA). It involves a free sale codeshare supported by revenue and pricing arrangements. The TNA is attached as Annexure A to the supporting submission to this application.

Pursuant to the TNA the Applicants may also, from time to time, enter into contracts and arrangements, and arrive at understandings, where provisions of the proposed contracts, arrangements and understandings would be, or might be, exclusionary provisions, including but not limited to in connection with the joint supply or joint acquisition by the Applicants of international air transportation services and other goods and services.



- (b) **Brief description of those provisions of the contract, arrangement or understanding that are, or would or might be, exclusionary provisions**

See attached submission.

(See Direction 4 on the back of this Form)

- (c) **Names and addresses of other parties or proposed parties to contract, arrangement or understanding**

Not applicable

3. **Names and address (where known) of parties and other persons on whose behalf application is made**

Not applicable

4. (a) **Grounds for grant of authorisation**

See attached submission

- (b) **Facts and contentions relied upon in support of those grounds**

See attached submission

(See Notice 1 on the back of this Form)

5. **This application for authorisation may be expressed to be made also in relation to other contracts, arrangements or understandings or proposed contracts, arrangements or understandings, that are or will be in similar terms to the above mentioned contract, arrangement or understanding.**

- (a) **Is this application to be so expressed?**

No

- (b) **If so, the following information is to be furnished:**

- (i) **the names of the parties to each other contract, arrangement or understanding**

Not applicable

- (ii) **the names of the parties to each other proposed contract, arrangement or understanding which names are known at the date of this application**

Not applicable

(See Direction 5 and Notice 2 on the back of this Form)

6. (a) **Does this application deal with a matter relating to a joint venture (See section 4J of the *Trade Practices Act 1974*)?**

Yes

- (b) **If so, are any other applications being made simultaneously with this application in relation to that joint venture?**

Yes

- (c) **If so, by whom or on whose behalf are those other applications being made?**

Qantas and Air NZ

7. Name and address of persons authorised by the Applicants to provide additional information in relation to this application

Aldo Nicotra
Partner
Johnson Winter & Slattery
Level 30 Australia Square
264 George Street
SYDNEY NSW 2000
Phone: (02) 8274 9536
E-mail: aldo.nicotra@jws.com.au

Michael Gray
Partner
Freehills
Level 32 MLC Centre
19 – 21 Martin Place
SYDNEY NSW 2000
Phone: (02) 9225 5286
E-mail: michael.gray@freehills.com

Dated: 18 APRIL 2006

Signed on behalf of Qantas:


.....
(Signature)

MICHELE LAIDLAW
(Full Name)

SOLICITOR
(Description)

Signed on behalf of Air New Zealand:


.....
(Signature)

MICHAEL JOHN GRAY
(Full Name)

SOLICITOR
(Description)

DIRECTIONS

1. Where there is insufficient space on this form to furnish the required information, the information is to be shown on separate sheets, numbered consecutively and signed by or on behalf of the applicant.
2. Where the application is made by or on behalf of a corporation, the name of the corporation is to be inserted in item 1(a), not the name of the person signing the application and the application is to be signed by a person authorised by the corporation to do so.
3. In item 1(b), describe that part of the applicant's business relating to the subject matter of the contract, arrangement or understanding in respect of which the application is made.
4. Furnish with the application particulars of the contract, arrangement or understanding in respect of which the authorisation is sought. Those particulars shall be furnished ---
 (a) in so far as the particulars or any of them have been reduced to writing --- by lodging a true copy of the writings; and
 (b) in so far as the particulars or any of them not been reduced to writing --- by lodging a memorandum containing a full and correct statement of the particulars that have not been reduced to writing.
5. Where the application is made also in respect of other contracts, arrangements or understandings, which are or will be in similar terms to the contract, arrangement or understanding referred to in item 2, furnish with the application details of the matter in which those contracts, arrangements or understandings vary in their terms from the contract, arrangements or understanding referred to in item 2.

NOTICES

1. In relation to item 4, your attention is drawn to sub-sections 90(8) of the *Trade Practices Act 1974* which provide as follows: ---
 "(8) The Commission shall not ---
 (a) make a determination granting:
 (i) an authorisation under sub-section 88(1) in respect of a provision of a proposed contract, arrangement or understanding that is or may be an exclusionary provision; or
 (ii) an authorisation under sub-section 88(7) of (7A) in respect of proposed conduct; or
 (iii) an authorisation under sub-section 88(8) in respect of proposed conduct to which sub-section 47(6) or (7) applies; or
 (iv) an authorisation under sub-section 88(8A) for proposed conduct to which section 48 applies:
 unless it is satisfied in all the circumstances that the proposed provision of the proposed conduct would result, or be likely to result, in such a benefit to the public that the proposed contract or arrangement should be allowed to be made, the proposed understanding should be allowed to be arrived at, or the proposed conduct should be allowed to take place, as the case may be; or
 (b) make a determination granting an authorisation under subsection 88(1) in respect of a provision of a contract, arrangement or understanding that is or may be an exclusionary provision unless it is satisfied in all the circumstances that the provision has resulted, or is likely to result , in such a benefit to the public that the contract, arrangement or understanding should be allowed to be given effect to."
2. If an authorisation is granted in respect of a proposed contract, arrangement or understanding the names of the parties to which are not known at the date of this application, the authorisation shall, by sub-section 88(14) of the *Trade Practices Act 1974*, be deemed to be expressed to be subject to a condition that any party to the contract, arrangement or understanding will, when so required by the Commission, furnish to the Commission the names of all the parties to the contract, arrangement or understanding.

Form B

Commonwealth of Australia
Trade Practices Act 1974 --- Sub-section 88(1)

**AGREEMENTS AFFECTING COMPETITION:
 APPLICATION FOR AUTHORISATION**

To the Australian Competition and Consumer Commission:

Application is hereby made under subsection 88(1) of the *Trade Practices Act 1974* for an authorisation under that subsection

- to make a contact or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of that Act.
- to give effect to a provision of a contract, arrangement or understanding which provision has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of section 45 of that Act.

(PLEASE READ DIRECTION AND NOTICES ON BACK OF FORM)

1. (a) Name of Applicants

Qantas Airways Limited ABN 16 009 661 901 (**Qantas**)
 Air New Zealand Limited ABN 70 000 312 685 (**Air NZ**)

(See Direction 2 on the back of this Form)

(b) Short description of business carried on by Applicants

The provision of domestic and international air transportation services.

(c) Address in Australia for service of documents on the application

Qantas Airways Limited
 c/- Aldo Nicotra
 Partner
 Johnson Winter & Slattery
 Level 30 Australia Square
 264 George Street
 SYDNEY NSW 2000

Air New Zealand Limited
 c/- Michael Gray
 Partner
 Freehills
 Level 32, MLC Centre
 19 – 21 Martin Place
 SYDNEY NSW 2000

2. (a) Brief description of contract, arrangement or understanding and, where already made, its date

A Tasman Networks Agreement (**TNA**) dated 12 April 2006 between the Applicants under which they will co-ordinate the activities of the Qantas Group and the Air NZ Group in respect of any flight operated on the Tasman Networks (as defined in the TNA). It involves a free sale codeshare supported by revenue and pricing arrangements. The TNA is attached as Annexure A to the supporting submission to this application.

Pursuant to the TNA the Applicants may also, from time to time, enter into contracts and arrangements, and arrive at understandings, provisions of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of that Act.

(b) Names and address of other parties or proposed parties to contract, arrangement or understanding

Not applicable

(See Direction 4 on the back of this Form)

3. Names and address (where known) of parties and other persons on whose behalf application is made

Not applicable

4. (a) Grounds for grant of authorisation

See attached submission

(b) Facts and contentions relied upon in support of those grounds

See attached submission

(See Notice 1 on the back of this Form)

5. This application for authorisation may be expressed to be made also in relation to other contracts, arrangements or understandings or proposed contracts, arrangements or understandings, that are or will be in similar terms to the above mentioned contract, arrangement or understanding.

(a) Is this application to be so expressed?

No

(b) If so, the following information is to be furnished:

(i) the names of the parties to each other contract, arrangement or understanding

Not applicable

(ii) the names of the parties to each other proposed contract, arrangement or understanding which names are known at the date of this application

Not applicable

(See Direction 5 and Notice 2 on the back of this Form)

6. (a) Does this application deal with a matter relating to a joint venture (See section 4J of the Trade Practices Act 1974)?

Yes

(b) If so, are any other applications being made simultaneously with this application in relation to that joint venture?

Yes

(c) If so, by whom or on whose behalf are those other applications being made?

Qantas and Air NZ

7. Name and address of person authorised by the Applicants to provide additional information in relation to this application

Aldo Nicotra
Partner
Johnson Winter & Slattery
Level 30 Australia Square
264 George Street
SYDNEY NSW 2000
Phone: (02) 8274 9536
E-mail: aldo.nicotra@jws.com.au

Michael Gray
Partner
Freehills
Level 32 MLC Centre
19 – 21 Martin Place
SYDNEY NSW 2000
Phone: (02) 9225 5286
E-mail: michael.gray@freehills.com

Dated: 18 APRIL 2006

Signed on behalf of Qantas:



(Signature)

MICHELE LAIDLAW
(Full Name)

SOLICITOR
(Description)

Signed on behalf of Air New Zealand:



(Signature)

MICHAEL JOHN GRAY
(Full Name)

SOLICITOR
(Description)

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3. In item 1(b), describe that part of the applicant's business relating to the subject matter of the contract, arrangement or understanding in respect of which the application is made.
4. Furnish with the application particulars of the contract, arrangement or understanding in respect of which the authorisation is sought. Those particulars shall be furnished ---
 - (a) in so far as the particulars or any of them have been reduced to writing --- by lodging a true copy of the writings; and
 - (b) in so far as the particulars or any of them not been reduced to writing --- by lodging a memorandum containing a full and correct statement of the particulars that have not been reduced to writing.
5. Where the application is made also in respect of other contracts, arrangements or understandings, which are or will be in similar terms to the contract, arrangement or understanding referred to in item 2, furnish with the application details of the matter in which those contracts, arrangements or understandings vary in their terms from the contract, arrangements or understanding referred to in item 2.

NOTICES

1. In relation to item 4, your attention is drawn to sub-sections 90(6) and (7) of the *Trade Practices Act 1974* which provide as follows:-

“(6) The commission shall not make a determination granting an authorisation under sub-section 88(1), (5), or (8) in respect of a provision (not being a provision that is or may be an exclusionary provision) of a proposed contract, arrangement or understanding, in respect of a proposed covenant, or in respect of proposed conduct, unless it is satisfied in all the circumstances that may be, would result, or be likely to result, in a benefit to the public and that that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if

 - (a) the proposed contract or arrangement were made, or the proposed understanding were arrived at, and the provision concerned were given effect to;
 - (b) the proposed covenant were given, and were complied with or;
 - (c) the proposed conduct were engaged in, as the case may be.

“(7) The commission shall not make a determination granting an authorisation under sub-section 88(1) or (5) in respect of a provision (not being a provision that is or may be an exclusionary provision) of a contract, arrangement or understanding, or, in respect of a covenant, unless it is satisfied in all the circumstances that the provision of the contract, arrangement or understanding, or the covenant, as the case may be, has resulted, or is likely to result, in a benefit to the public and that that benefit outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted, or is likely to result, from giving effect to the provision or complying with the covenant.”
2. If an authorisation is granted in respect of a proposed contract, arrangement or understanding the names of the parties to which are not known at the date of this application, the authorisation shall, by sub-section 88(14) of the *Trade Practices Act 1974*, be deemed to be expressed to be subject to a condition that any party to the contract, arrangement or understanding will, when so required by the Commission, furnish to the Commission the names of all the parties to the contract, arrangement or understanding.

Form E

Commonwealth of Australia
Trade Practices Act 1974 --- Sub-section 88(8)

EXCLUSIVE DEALING: APPLICATION FOR AUTHORISATION

To the Australian Competition and Consumer Commission:

Application is hereby made under subsection 88(8) of the *Trade Practices Act 1974* for an authorisation under that subsection to engage in conduct that constitutes or may constitute the practice of exclusive dealing.

(PLEASE READ DIRECTION AND NOTICES ON BACK OF FORM)

1. (a) Name of Applicants

Qantas Airways Limited ABN 16 009 661 901 (**Qantas**)
Air New Zealand Limited ABN 70 000 312 685 (**Air NZ**)

(See Direction 2 on the back of this Form)

(b) Short description of business carried on by Applicants

The provision of domestic and international air transportation services.

2. (a) Description of the goods or services in relation to the supply or acquisition of which this application relations

International air transportation services and any other goods and services encompassed by the operation of a Tasman Networks Agreement (**TNA**) dated 12 April 2006 between the Applicants under which they will co-ordinate the activities of the Qantas Group and the Air NZ Group in respect of any flight operated on the Tasman Networks (as defined in the TNA). It involves a free sale codeshare supported by revenue and pricing arrangements. The TNA is attached as Annexure A to the supporting submission to this application.

(b) Description of the conduct that would or may constitute the practice of exclusive dealing

Pursuant to the TNA one or more members of the Qantas Group and one or more members of the Air NZ Group may, from time to time, as part of their co-ordinated activities:

- (a) supply, or offer to supply, goods or services;
 - (b) supply, or offer to supply, goods or services at a particular price; or
 - (c) give or allow, or offer to give or allow, a discount, allowance, rebate or credit in relation to the supply or proposed supply of goods or services,
- on conditions referred to in subsections 47(2), (6) or (8) of that Act.

One or more members of the Qantas Group and one or more members of the Air NZ Group may, from time to time, as part of their co-ordinated activities, refuse to:

- (a) supply goods or services;
- (b) supply goods or services at a particular price; or
- (c) give or allow a discount, allowance, rebate or credit in relation to the supply or proposed supply of goods or services,

for reasons referred to in subsections 47(3), (7) or (9) of that Act.

One or more members of the Qantas Group and one or more members of the Air NZ Group may, from time to time, as part of their co-ordinated activities:

- (a) acquire, or offer to acquire, goods or services; or
 - (b) acquire, or offer to acquire, goods or services at a particular price,
- on conditions referred to in subsection 47(4) of that Act.

Finally, one or more members of the Qantas Group and one or more members of the Air NZ Group may, from time to time, as part of their co-ordinated activities, refuse to:

- (a) acquire goods or services; or
- (b) acquire goods or services at a particular price,
for reasons referred to in subsection 47(5) of that Act.

(See Direction 4 on the back of this Form)

3. (a) Class or classes of persons to which the conduct relates

Unable to be determined at this time

(b) Number of those persons-

- (i) **At the present time:** Unknown
- (ii) **Estimated within the next year:** Unknown

(c) Where number of persons stated in item 3(b)(i) is less than 50, their names and addresses

Not applicable

4. (a) Grounds for grant of authorisation

See supporting submission

(b) Facts and contentions relied upon in support of those grounds

See supporting submission

(See Notice 1 on the back of this Form)

5. (a) Does this application deal with a matter relating to a joint venture (See section 4J of the Trade Practices Act 1974)?

Yes

(b) If so, are any other applications being made simultaneously with this application in relation to that joint venture?

Yes

(c) If so, by whom or on whose behalf are those other application being made?

Qantas and Air NZ

6. Name and address of person authorised by the applicant to provide additional information in relation to this application.

Aldo Nicotra
Partner
Johnson Winter & Slattery
Level 30 Australia Square
264 George Street
SYDNEY NSW 2000
Phone: (02) 8274 9536
E-mail: aldo.nicotra@jws.com.au

Michael Gray
Partner
Freehills
Level 32 MLC Centre
19 – 21 Martin Place
SYDNEY NSW 2000
Phone: (02) 9225 5286
E-mail: michael.gray@freehills.com

Dated 18 APRIL 2006

Signed on behalf of Qantas:


.....
(Signature)

MICHELE LAIDLAW
(Full Name)

SOLICITOR
(Description)

Signed on behalf of Air New Zealand:


.....
(Signature)

MICHAEL JOHN GRAY
(Full Name)

SOLICITOR
(Description)

DIRECTIONS

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2. Where the application is made by or on behalf of a corporation, the name of the corporation is to be inserted in item 1(a), not the name of the person signing the application and the application is to be signed by a person authorised by the corporation to do so.
3. In item 1(b), describe that part of the applicant's business in the course of which the conduct is engaged in.
4. Where particulars of a condition or of a reason of the type referred to in sub-section 47(2) to (9) (inclusive) of the *Trade Practice Act 1974* have been reduced in whole or in part to writing, a copy of the writing is to be furnished with the application.
5. In item 3(a)(ii), state an estimate of the highest number of persons with whom that applicant is likely to deal in the course of engaging in the conduct at any time during the next year.

NOTICES

In relation to item 4, your attention is drawn to sub-sections 90(6) and (7) of the *Trade Practices Act 1974* which provide as follows:-

“(6) The Commission shall not make a determination granting an authorisation under sub-section 88(1), (5), or (8) in respect of a provision (not being a provision that is or may be an exclusionary provision) of a proposed contract, arrangement or understanding, in respect of a proposed covenant, or in respect of proposed conduct, unless it is satisfied in all the circumstances that may be, would result, or be likely to result, in a benefit to the public and that that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if:

- (a) the proposed contract or arrangement were made, or the proposed understanding were arrived at, and the provision concerned were given effect to;
- (b) the proposed covenant were given, and were complied with or;
- (c) the proposed conduct were engaged in, as the case may be.

Applications for Authorisation

Submission to ACCC in support of Applications for Authorisation

**Qantas Airways Limited
ABN 16 009 661 901**

and

**Air New Zealand Limited
ABN 70 000 312 685**

Date: 13 April 2006

SUBMISSION TO ACCC REGARDING APPLICATIONS FOR AUTHORISATION

13 April 2006

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1. EXECUTIVE SUMMARY

Introduction

- 1.1 This submission is made by Qantas Airways Limited ABN 16 009 661 901 (**Qantas**) and its subsidiaries and Air New Zealand Limited ABN 70 000 312 685 (**Air NZ**) and its subsidiaries (collectively, the **Applicants**) in support of applications for authorisation pursuant to sub-sections 88(1) and 88(8) of the *Trade Practices Act 1974* (Cth) (the **Act**) for certain collaborative arrangements between the Applicants.
- 1.2 The collaborative arrangements between the Applicants will be entered into pursuant to a Tasman Networks Agreement (**TNA**). It is conditional upon authorisation being granted by the Australian Competition and Consumer Commission (the **Commission**) under the Act and the New Zealand Minister of Transport under Part IX of the *Civil Aviation Act 1990* (NZ).

Rationale

- 1.3 In October 2004 the Australian Competition Tribunal (**Tribunal**) authorised a proposed alliance between Qantas and Air NZ in relation to all flights into, within and out of New Zealand (the **Proposed Alliance**). The Tribunal found that the Proposed Alliance resulted in a net public benefit, primarily due to the limited barriers to entry and expansion on Tasman routes and the competition the Proposed Alliance would face, in particular, from Emirates and Virgin Blue.
- 1.4 The Tasman is an intensely competitive market, due in part to its geographic location, time zone and liberal aviation policies. The high level of competition results from the competitive strategies of:
- (a) Emirates (operating as a full service carrier (or **FSA**) pursuant to fifth freedom rights); and
 - (b) low cost carriers such as Virgin Blue (operating on the Tasman and Pacific Island routes as "Pacific Blue"),¹ (**LCCs**),
- and also from the number of carriers (and hence capacity) deployed on the Tasman.
- 1.5 The lower cost airlines – Emirates (which, despite being an FSA, has a marginal cost model for the Tasman, arising from its position as a fifth freedom carrier on these routes) and Virgin Blue (which employs a low cost point to point model) – effectively set fare levels on the Tasman, with intense competition occurring for price sensitive travellers (or "marginal" passengers). Competition for marginal passengers is not

confined to those customers and extends to all passengers. The fare levels set to attract the marginal passenger are available throughout the market.

- 1.6 The conduct and business models of Emirates and Virgin Blue keep Qantas and Air NZ on constant competitive alert.² In this respect, the factual circumstances facing the Applicants have not changed since the Tribunal's decision.
- 1.7 This competitive environment has resulted in significant surplus capacity on the Tasman driven by the growth of Virgin Blue and Emirates, as well as by Qantas and Air NZ as they strive to maintain comparable network offerings. Indeed, the number of empty seats flown on the main Tasman routes is now estimated by the Applicants to be approximately 5,200 one-way seats per day.
- 1.8 Qantas and Air NZ both recognise that to continue their competitive stance on the Tasman they must secure cost reductions, increase load factors and improve their revenue per ASK (available seat kilometre)³ performance. The Applicants have already undertaken a range of initiatives (for example, Air NZ's Tasman Express strategy and Qantas' subsidiary Jetstar) and have achieved material, but insufficient, cost reductions.
- 1.9 The TNA between Qantas and Air NZ is necessary to further reduce cost by removing some of the existing surplus capacity, thereby improving load factors whilst still maintaining connectivity with the rest of their networks. This will have no impact on existing low fares and can only be achieved via the TNA.
- 1.10 The agreement delivers the following unique efficiency gains:
- (a) the cost savings associated with the better matching of supply to demand, allowing for the removal of some surplus capacity; and
 - (b) a more efficient use of the remaining capacity, in terms of increased load factors and better schedule spread, whilst meeting current and forecast demand.
- 1.11 As network airlines, neither Qantas nor Air NZ would unilaterally remove the surplus capacity that will exit the Tasman as a result of the TNA. On a unilateral basis such a decision (say by Qantas) creates a serious risk that Qantas' schedule would be

¹ Unless the context requires otherwise, the term "Virgin Blue" is used to describe the Virgin Blue/Pacific Blue operations.

² As the Virgin Blue CEO stated: "... *make no mistake, Virgin Blue will continue to use innovation and "out of the box" thinking to stay at the forefront of competition*". ("Virgin Blue woos business travellers with 'Velocity', powered by Virgin Blue – The world's next generation loyalty program", Media Release, 15 November 2005.)

³ Revenue per ASK is essentially the average revenue per seat, expressed in cents, generated by a flight for each kilometre travelled.

considered inferior to its competitors' and passengers would "spill" to those competitors. This would have material negative consequences for Qantas on the Tasman and across its wider network.

Net public benefit analysis

- 1.12 The TNA is a natural and necessary response by network carriers such as Qantas and Air NZ to the intense competitive environment that exists on the Tasman.
- 1.13 There will be no scope for damage to the Tasman competitive process arising from the TNA because there are no barriers to the expansion of either Virgin Blue or Emirates, or other fifth freedom carriers. These carriers have the incentive to expand (or enter) if the Applicants attempt to raise fares above the competitive level.
- 1.14 Furthermore, there are substantial benefits from the TNA:
- (a) cost savings from the removal of some surplus capacity, which will enhance the scope for sustainably low fares for consumers;
 - (b) reduction of wingtip flying, leading to a better spread of departure times;
 - (c) reduced waiting times for connecting passengers and an enhanced "seamless" service;
 - (d) greater flexibility for consumers to change itineraries;
 - (e) increased benefits for each Applicant's respective frequent flyer members – members will be able to earn and redeem points on all services carrying the code of the operator of the relevant frequent flyer program;
 - (f) the strengthening of Australia's national network carrier;
 - (g) more direct flight options; and
 - (h) increased likelihood of new direct routes.
- 1.15 The reasoning and findings of the Tribunal in respect of the Proposed Alliance should be directly applied to conclude that the TNA will result in a net public benefit to Australia. Developments on the Tasman since the Tribunal's decision only serve to reinforce the appropriateness of that reasoning.

2. THE PARTIES AND THE TRANSACTION

Qantas

- 2.1 Qantas was incorporated in Queensland in 1920 and is Australia's largest international and domestic airline. The main business of Qantas and its subsidiaries (the **Qantas Group**) is the transportation of passengers and air freight.
- 2.2 The Qantas Group's flying businesses are grouped under two major brands – Qantas and Jetstar, both of which operate on Tasman routes.
- 2.3 A copy of the Qantas annual report for the year ending 30 June 2005 and interim report for 2006 can be obtained from <http://www.qantas.com.au/info/about/investors/annualReports>.

Air New Zealand

- 2.4 Air NZ was incorporated in New Zealand in 1940 and is New Zealand's only international airline and largest domestic airline. The main business of Air NZ and its subsidiaries (the **Air NZ Group**) is the transportation of passengers and air freight.
- 2.5 The Air NZ Group operates international services to Australia, the Pacific Islands, North America, Asia and the United Kingdom. Its Tasman services are branded Air New Zealand and Freedom Air.
- 2.6 A copy of Air NZ's annual report for year ending 30 June 2005 and interim report for 2006 can be obtained from <http://www.airnz.co.nz/aboutus/investorcentre/annualreport/default.htm>

The Transaction

- 2.7 The TNA is an agreement between Qantas and Air NZ to co-operate in respect of any flight operated on the "Tasman Network" by any member of the Qantas Group and the Air NZ Group respectively. It involves a free sale codeshare⁴, supported by revenue and pricing arrangements.
- 2.8 Under the TNA, the term "Tasman Network" is defined to include the scheduled passenger networks of each of the Qantas Group and the Air NZ Group on any of the Tasman sectors⁵, or routes which depart from within Australia and arrive within New

⁴ A "free sale codeshare arrangement" is one in which the marketing carrier does not assume the risk of ticket sales. This is to be contrasted with a "block space codeshare arrangement", under which the marketing carrier assumes the risk associated with the sale of a particular block of allocated seats.

⁵ A "sector" is a non-stop (excluding technical stops where no passengers or cargo are picked up or dropped off) flight leg between two points.

Zealand, and vice versa. The TNA specifically excludes sectors solely within New Zealand or Australia and between New Zealand or Australia and any other country.

- 2.9 The TNA involves the co-ordination of activities between the Qantas Group and the Air NZ Group, to the extent reasonably possible, in the following areas:
- (a) scheduling and planning of flights (including the allocation of capacity);
 - (b) the pricing of passenger services;
 - (c) frequent flyer programs – members will be able to earn and redeem frequent flyer points on all services carrying the code of the operator of the relevant frequent flyer program;
 - (d) processing of passengers and baggage at airports in the Tasman Networks;
 - (e) co-ordinating the minimum inflight service offering;
 - (f) codesharing; and
 - (g) cargo services (as determined from time to time).
- 2.10 Under the TNA the Applicants are required to implement a one-off alignment of the basis for paying incentive commissions to travel agents. Both airlines will pay agents based upon who is the marketing carrier. The Applicants will continue to unilaterally determine the level of commissions each pays.
- 2.11 The TNA includes a revenue allocation (rather than a profit allocation) model (the **TNA Model**). The allocation of revenue between the Applicants (or **TNA Payments**) will occur on a quarterly basis and will be a function of two elements:
- (a) the revenue performance of each airline (expressed as revenue per ASK), which is calculated from a base period of the 12 months to December 2005 and
 - (b) each airline's proportionate share of the capacity actually deployed on the Tasman Network.
- 2.12 Flights operated by Jetstar or Freedom Air will not automatically form part of the codeshare arrangements, but may be introduced at a later date. However, these airlines are included in the co-operation under the TNA and their revenue on the Tasman will be subject to the TNA Model from the outset.
- 2.13 Management of the Tasman Network will be undertaken by a Committee in accordance with certain governance principles set out in the TNA. The Committee will

initially comprise six members, with three members appointed by each Applicant. The Committee's role will be to oversee the operation of the TNA and its functions will include (but are not limited to):

- (a) setting strategic objectives for the Tasman Network, including as to scheduling, pricing, passenger processing, codesharing, frequent flyer programmes, lounge and check-in facilities at airports included in the Tasman Networks, co-ordinating in-flight product standards and marketing plans (the **Activities**);
- (b) ensuring optimisation of the Tasman Network schedule;
- (c) ensuring coordination between each of the Applicants with respect to the Activities; and
- (d) assuming responsibility for decisions that have a material impact on the base Revenue per ASK including aircraft type and configuration changes and all capacity additions, reductions and deployments.

2.14 The Committee will meet at least once every calendar month and all decisions of the Committee must be unanimous of all members attending. A quorum requires no less than one member appointed by each of the Applicants.

2.15 A Working Group will also be established to take responsibility for the day-to-day operation of the TNA and to provide operational support to the Committee. The Working Group will comprise eight members, with four appointed by each Applicant. The Working Group will meet at least once a week and all decisions of the Working Group must be unanimous of all members attending.

2.16 In accordance with the Networks Plan (as defined in the TNA), the Working Group will manage all day to day commercial aspects of the Tasman Network, including pricing and revenue management, sales strategies and network capacity and scheduling.

2.17 The TNA provides for the Applicants to agree tariffs and allocate revenues on the Tasman. These provisions are a necessary and fundamental part of the TNA. In broad terms, the tariff setting and TNA Model align the individual incentives of each airline to act in the interests of both airlines so as to ensure that the full benefits of the TNA are realised.

2.18 Absent these provisions, each airline would have the ability and incentive to act to further its own interests at the expense of the TNA. Such behaviour would rapidly lead to a breakdown of the TNA. That would lead to the benefits of the TNA not being achieved.

2.19 Further details can be found in the TNA at **Annexure A**.

3. THE APPLICANTS' RATIONALE

3.1 The Applicants continue to face the unabated challenges of a global aviation industry where:

- (a) LCCs (or low cost carriers)⁶ have meant passengers expect cheaper fares;
- (b) network airlines can only remain viable if they take steps to lower their cost base; and
- (c) the international regulatory regime precludes consolidation of different international airlines into a single airline entity. While mergers are the traditional means by which cost savings and other efficiencies can be secured, those opportunities are precluded by the regulatory regimes which govern international aviation.

3.2 The emergence of a sustainable low cost carrier model in the late 1990s permanently altered the competitive dynamics of the airline industry. It created a new competitive dimension for network airlines in which they have had to rethink business plans and their responses to low cost operators in the marketplace. In the Tasman context, these changes are occurring on routes where the Applicants face a number of additional challenges, namely:

- (a) the degree of excess capacity presently operating on the main Tasman routes, which the Applicants estimate amounts to approximately 5,200 empty seats per day on flights across the Tasman (and 6,300 empty seats across all Tasman routes);
- (b) the presence of significant fifth freedom carriers, particularly Emirates, who have the capacity, ability and commercial incentive to price on a marginally costed basis (see **Annexure B** for a discussion of the cost advantages inherent in fifth freedom operations);
- (c) the presence of Virgin Blue – a low cost, innovative and opportunistic carrier;
- (d) the absence of barriers to entry or expansion;
- (e) the capability and readiness of carriers such as Emirates or Virgin Blue to expand; and

⁶ The key features of low cost carriers are set out in *Qantas Airways Limited* [2004] ACompT 9 at para. 89.

- (f) the fact that the vast majority of the passengers travelling on Tasman services are price sensitive.
- 3.3 The TNA (and its associated agreements) are being entered into in pursuit of objectives similar to those associated with the Proposed Alliance. Though on a much smaller scale (there is no equity component and co-operation is strictly limited to the Tasman), the actions of the Applicants are a competitive response that recognises in today's global aviation market, and particularly on the Tasman, connectivity must be combined with a lower cost base if network airlines are to remain viable market competitors.
- 3.4 The TNA acknowledges the practical reality that to maintain their competitive stance on the Tasman routes both Qantas and Air NZ need to continually secure any available cost reduction initiatives and improve their revenue per ASK performance.
- 3.5 Labour and aircraft ownership costs are the largest two controllable costs for airlines and therefore any meaningful cost reduction must inevitably address them. The TNA allows both Qantas and Air NZ to reduce costs, principally by removing some of the surplus capacity from their respective Tasman networks while still maintaining connectivity and sufficient capacity to meet demand (at current and forecast levels). By operating collectively, the Applicants can utilise their combined fleets to more efficiently operate a joint schedule to service the various Tasman routes.
- 3.6 There are two distinct efficiency gains associated with the TNA:
- (a) the cost savings associated with better matching supply to demand, allowing the removal of some of the surplus capacity; and
 - (b) a more efficient use of remaining capacity, in terms of increased load factors and a better schedule spread,
- whilst meeting current and forecast demand.
- 3.7 These identifiable cost savings are solely attributable to the joint decision making which is facilitated by the TNA.
- 3.8 The business models of FSAs work in such a way that any removal of capacity on a route must be considered in light of the broader network impacts. The consequences of a network carrier unilaterally removing capacity from a market, such as the Tasman, would be to cede competitive advantage to the competing airline's network while effectively marginalising its own network. The effect of this would be reduced passenger appeal and loss of market share on the wider network. For that reason, Qantas and Air NZ each have strong incentives not to remove surplus capacity even when the outcome would be continued higher costs. In particular:

- (a) **(Removal of capacity would undermine competitive network advantage)**
When faced with a choice between network airlines (such as Qantas and Air NZ), consumers (particularly business passengers) are more likely to choose the network airline that offers: more destinations and frequencies. Air NZ and Qantas compete on this basis on the Tasman (and throughout their networks).
- (b) **(Each airline aims to maximise revenue)** A related point is that all airlines want to have a schedule that maximises revenues. Both Qantas and Air NZ face the same market characteristics and, hence, make similar decisions when it comes to setting schedules for routes including the Tasman. As a result, Qantas and Air NZ have historically scheduled flights at approximately the same time.
- (b) **(Lower Costs)** Airlines have economic incentives to optimise aircraft use and produce a schedule with efficient crewing costs. On the major Tasman (city pairs), aircraft can be used for four sectors (for example, two return flights Melbourne to Auckland) if the pattern starts at 6.30am and finishes around midnight. Both Qantas and Air NZ seek to gain this increased utilisation by starting flights at around 6.30am. Absent the TNA, removing a flight would have two effects: first, it may have a negative effect on aircraft utilisation and hence on unit costs, and second, for the reasons outlined above, it would mean ceding a schedule advantage to the other network airline. Accordingly, this is highly unlikely to be a commercial option for either Qantas or Air NZ.

3.9 For example, if Qantas decided to reduce capacity unilaterally, this would simply spill customers to its network competitor, Air NZ. In turn, this would have an impact on Qantas' wider network, coupled with a reduction in Qantas' "city presence". The exact same logic applies to any reduction unilaterally considered by Air NZ. The net result is generally larger increases in capacity than warranted by market demand (as network airlines respond to each other) or the retention of surplus capacity, neither of which is cost effective.

4. QANTAS/AIR NZ PROPOSED ALLIANCE

4.1 On 12 October 2004, the Tribunal authorised the Proposed Alliance pursuant to subsections 88(1) and 88(9) of the Act, following a negative determination by the Commission (the **Qantas/Air NZ Decision**)⁷. The Proposed Alliance involved

⁷ *Qantas Airways Limited* [2004] ACompT 9. Though authorised, the Proposed Alliance was not ultimately given effect to.

collaborative arrangements between the Applicants in relation to, inter alia, all flights into, within and out of New Zealand.

Minimal anti-competitive detriment

4.2 In authorising the Proposed Alliance, the Tribunal made the following key findings with respect to Tasman air passenger services:

- (a) **(Price sensitivity)** A significant demand characteristic of Tasman origin/destination passengers is price sensitivity, as evidenced by the recent success of online internet bookings of cheap fares and the continued prevalence of discounted fares.⁸ This has not changed.
- (b) **(No barriers)** There are no significant barriers to expansion on Tasman routes facing Virgin Blue or Emirates.⁹ This has not changed.
- (c) **(Emirates)** The ability of Emirates and other fifth freedom carriers (or FFCs) to engage in marginal cost pricing allows them to target price-sensitive, Tasman origin/destination passengers and, in so doing, provide a competitive constraint on the Applicants. This constraining effect would extend to routes other than those where the FFCs directly operate.¹⁰ This has not changed.
- (d) **(Virgin Blue)** Virgin Blue acts as a pricing constraint on the routes it serves as well as on some routes it does not serve. This is primarily because it poses a threat to other airlines that it will enter routes if fares are artificially high.¹¹ This has not changed.
- (e) **(Mavericks)** Virgin Blue and Emirates both have the ability to play the role of a "maverick" in the market, thereby keeping the Applicants on a continual competitive alert, both proactively and reactively.¹² This has not changed
- (f) **(Sufficient excess capacity)** Although there might be a tendency for the Applicants to reduce capacity under the Proposed Alliance, there was sufficient capacity available to compensate for any reduction.¹³ This has not changed – indeed, load factors are lower today than at the time of the Proposed Alliance, which indicates even greater surplus capacity.

⁸ *Ibid.* at para. 399.

⁹ *Ibid.* at para. 327.

¹⁰ *Ibid.* at para. 399 & 401.

¹¹ *Ibid.* at para. 355.

¹² *Ibid.* at para. 423.

¹³ *Ibid.* at para. 498.

- (g) **(Alliance constrained)** Even though the Proposed Alliance would, in the short-run, command a high share of the Tasman air passenger services market, there would be little scope for any significant long-run damage to the competitive process. If the Alliance were to go ahead, there would be no barriers to significant entry or effective expansion by either or both of Virgin Blue or Emirates. Thus, the Tribunal expected that the Alliance would be promptly and competitively constrained should it seek to raise fares.¹⁴ This has not changed.
- (h) **(Market shares not conclusive)** The Tribunal was not dissuaded from its conclusions by the fact that, as at the time of the hearing, the Applicants had a relatively high market share on the Tasman. The combined market share of the Applicants as at the time of the hearing did not reveal the full picture of competition for the marginal customer.¹⁵ This has not changed.

4.3 Ultimately, the Tribunal concluded that the only significant anti-competitive detriment that might occur as a result of the Proposed Alliance involved "the time-sensitive traveller who wishes to travel between cities in Australia and New Zealand at short notice and within a particular timeframe."¹⁶ The size of this class of passenger was thought to be relatively small compared to the overall number of passengers travelling on the Tasman. With this exception, the Tribunal, who heard substantial evidence from industry participants, concluded that the level of competition on the Tasman and the ability for other airlines to expand meant there was no scope for sustainable price increases on the Tasman. The Tribunal said:

"Thus, in the absence of barriers to expansion for Virgin Blue and Emirates, and given the capacity available to Virgin Blue and Emirates, we expect that the Alliance will be promptly and competitively constrained should it seek to raise fares. Such a fare increase would likely be welcomed by the two newer carriers, as it would provide them with the opportunity to increase their market shares without having to lower their own fares, advertise more heavily, or otherwise engage in expensive brand and product differentiation. We do not expect that the Alliance would be so commercially inept as to present Virgin Blue and Emirates with such a golden opportunity to expand at its expense."¹⁷ [Emphasis added]

4.4 For precisely the same reasons as those articulated in the Qantas/Air NZ Decision, the TNA will not produce any anti-competitive detriment in the Tasman market.

¹⁴ *Ibid.* at para. 419 & 445.

¹⁵ *Ibid.* at para. 429.

¹⁶ *Ibid.* at para. 523.

¹⁷ *Ibid.* at para. 445

Market developments that have occurred in the interim are outlined in section 5. These simply underscore the validity of the Tribunal's reasoning in this regard.

Tangible and real public benefits

- 4.5 In the Qantas/Air NZ Decision the detriment identified in paragraph 4.3 above was outweighed by public benefits that "although not so quantifiable, can be seen to be tangible, credible and real."¹⁸ The Tribunal reached its conclusion:¹⁹

".... on the basis of looking at the benefits which flow from the Alliance and which accrue not only generally to members of the public, but also specifically to the travelling public, and to Qantas in the form of cost savings and the ability to re-arrange flight schedules. We are satisfied that such cost savings and re-scheduling of flights, although initially accruing to Qantas and its shareholders, are capable of being passed through in the form of either a potential lowering of fares, or a delay in increasing fares."

- 4.6 The TNA also delivers benefits that will accrue to members of the public and to Qantas, which outweigh any detriment. These benefits only accrue as a result of the TNA and include many of those recognised and accepted by the Tribunal in respect of the Proposed Alliance, namely the promotion of national interest, sustainably low fares, cost savings, reduction in wingtip flying leading to a better schedule spread, reduced waiting times for connecting passengers and enhanced "seamless" services, greater flexibility for consumers to change itineraries, an increased likelihood of new direct flights and destinations and benefits for frequent flyers (for further details see section 11).

5. MARKET DEVELOPMENTS

- 5.1 In the Qantas/Air NZ Decision, the Tribunal concluded its analysis of competition issues with respect to the Tasman air passenger market as follows²⁰: "*The dynamic market having been established, it has now moved on and will continue to move, ebb and flow according to the competitive interplay of market forces of supply and demand, particularly in relation to the marginal passenger*".
- 5.2 Since the Tribunal hearing in May 2004, the Tasman routes have indeed seen the competitive interplay of market forces. Some important features and developments are outlined below.

¹⁸ *Ibid.* at para. 768.

¹⁹ *Ibid.* at para. 770.

²⁰ *Ibid.* at para. 447.

Intense capacity growth

5.3 There are currently eight carriers providing air services on the Tasman routes:

- (a) Qantas (and Jetstar);
- (b) Air NZ (and Freedom Air);
- (c) Emirates;
- (d) Virgin Blue;
- (e) Aerolineas Argentinas;
- (f) Garuda Indonesia;
- (g) Lan Chile; and
- (h) Royal Brunei.

5.4 There are nine main Tasman routes, which account for approximately 85% of all Tasman non-stop capacity. The capacity shares of the competing airlines on those routes are as follows:

Table 1: Capacity Shares on Main Tasman Routes

Route	Qantas ²¹	Air NZ ²²	Emirates	Virgin Blue	Other 5 th Free.	Wkly Seats
SYD-AKL vv	44.0%	30.9%	13.2%	0	11.9%	38,560
MEL-AKL vv	41.8%	41.5%	16.7%	0	0	21,690
BNE-AKL vv	17.5%	33.7%	28.2%	7.6%	13.0%	18,904
AUST-AKL* vv	34.8%	38.5%	16.1%	2.5%	8.1%	87,078
SYD-WLG vv	49.0%	51.0%	0	0	0	6,864
MEL-WLG vv	45.1%	54.9%	0	0	0	3,724
BNE-WLG vv	20.3%	49.3%	0	30.4%	0	3,552
AUST-WLG* vv	40.8%	51.6%	0	7.6%	0	14,140
SYD-CHC vv	43.4%	24.4%	21.5%	10.7%	0	16,772
MEL-CHC vv	43.9%	36.2%	0	19.9%	0	7,254
BNE-CHC vv	33.9%	31.7%	0	34.4%	0	7,314
AUST-CHC* vv	40.6%	31.4%	10.8%	17.2%	0	33,548
ESTIMATED TOTAL SEATS						134,766

* Includes all routes between the two destinations (including provincial routes)

Based on scheduled services as at 01.01.06 for the week commencing 20.02.06 (except AKL-SYD and AKL-BNE as at 01.02.06)

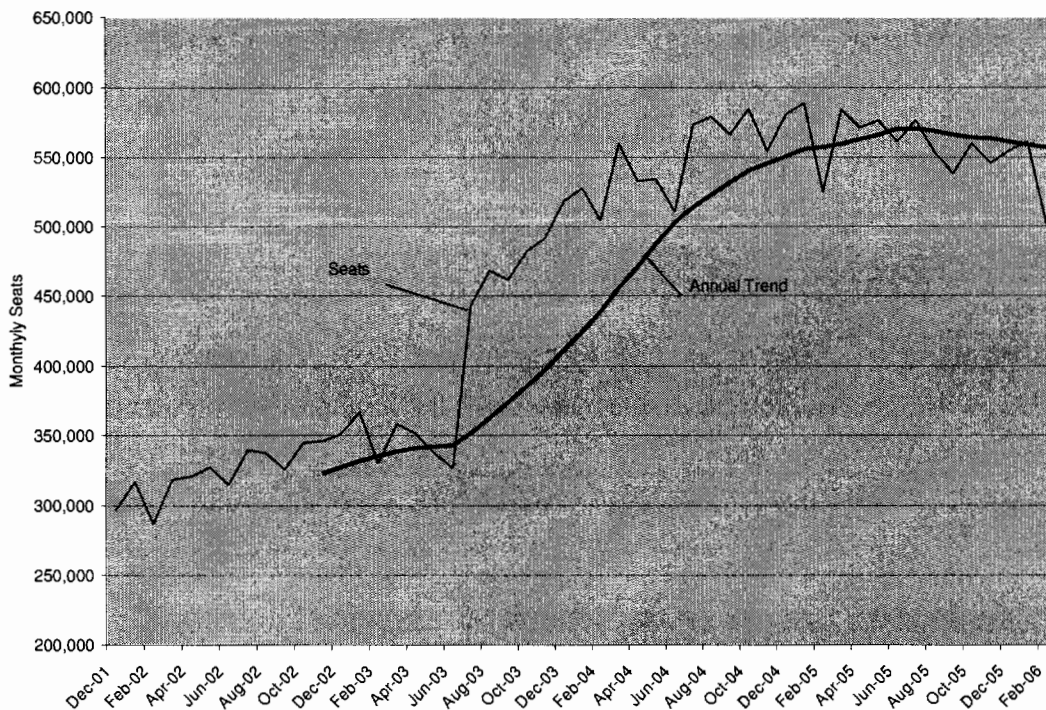
²¹ Includes Jetstar.

²² Includes Freedom Air.

5.5 A more detailed breakdown of the routes serviced by the Tasman carriers, the capacity on those routes and the frequency of services is also provided at **Annexure D** to this submission. In particular, it is noteworthy that the Applicants' combined Tasman share (including all provincial non stop Tasman services) has fallen markedly – from 93.4% in 2000 to 76.6%²³ in February 2006 – as competitors have expanded.

5.6 **Figure 1** below illustrates the capacity growth the Tasman has undergone in recent times. This capacity growth has not been accompanied by similar growth in passenger numbers, resulting in an escalation in the level of surplus capacity. This surplus capacity has been driven by the growth of Virgin Blue and Emirates, as well as by Qantas and Air NZ as they strive to maintain comparable network offerings. The recent small dip in the annual trend between June and December 2005 reflects the suspension of services by Thai Airways, and is minor when compared to the extent of capacity growth since 2003. The apparent reduction in capacity in early 2006 simply reflects seasonality and is consistent with earlier years.

Figure 1 Tasman Capacity Growth: All Carriers (Services between AKL-WLG-CHC & BNE-SYD-MEL)



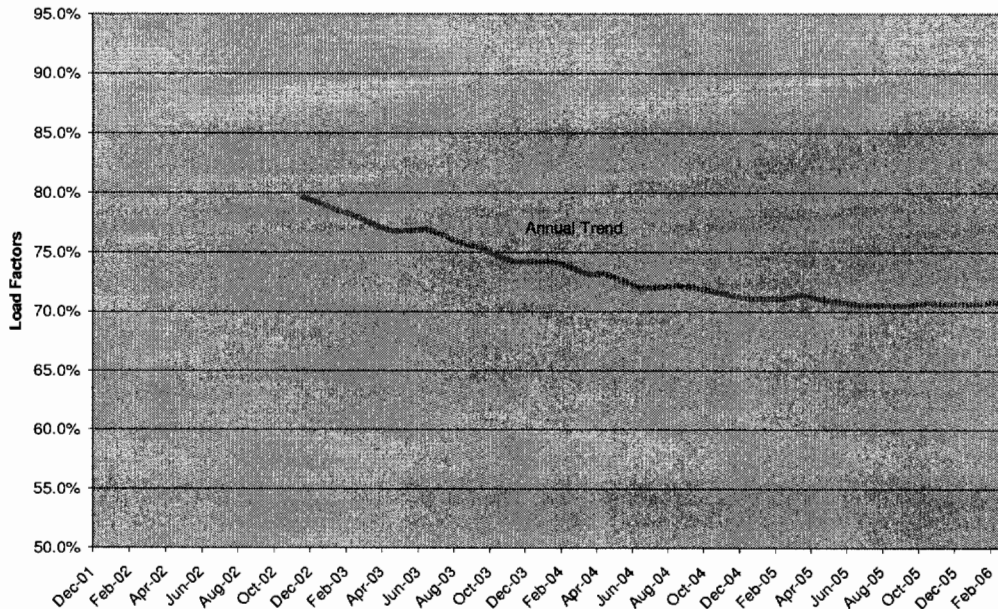
5.7 Despite decisions by Polynesian Airlines²⁴, Malaysia Airlines and, most recently, Thai Airways in December 2005 to suspend their services on the Tasman (the latter two in favour of direct services ex New Zealand), there continues to be surplus capacity

²³ Based on scheduled services as at 01.01.06 for the week commencing 20.02.06

²⁴ Managed by Virgin Blue

relative to demand.²⁵ Overall load factors on the main nine Tasman routes, a key measure of efficiency, have fallen over the same period, as illustrated in **Figure 2** below.

Figure 2 Tasman Load Factors: All Carriers (Services between AKL-WLG-CHC & BNE-SYD-MEL)²⁶



5.8 Air NZ estimates there is currently an estimated 6,300 empty one-way seats flown across the Tasman every day (with 5,200 of those empty seats on the main Tasman routes). This equates to the equivalent of close to 11 empty A320 aircraft per day on the Tasman, each making two return flights.²⁷

5.9 The competitive environment on the Tasman routes has not materially changed since the Tribunal examined it in the Qantas/Air NZ Decision.

Emirates

5.10 Emirates is a Dubai-based international airline owned by the Dubai government of the United Arab Emirates. It was launched as recently as 1985 as a two aircraft airline

²⁵ The withdrawal of these airlines from the Tasman routes highlights the limited barriers to exit and re-entry facing fifth freedom carriers in the Tasman passenger market. These airlines, together with the other carriers that have fifth freedom rights on the Tasman, have the ability to recommence services at short notice.

²⁶ This is an Air NZ estimate.

²⁷ Air NZ's A320s seat 146 passengers and are capable of operating two return Tasman trips per day. The calculation is (3150 return empty seats)/(146 empty seats per A320)/(2 return Tasman services) = 10.8.

serving destinations in Pakistan and India. As the Tribunal, which had the benefit of direct evidence from Emirates' Area Manager for Australia, Mr Eddie Lim, acknowledged, "*(u)nlike the Applicants, as a comparatively young airline, it is not burdened by legacy costs*".²⁸

- 5.11 As one of the world's leading airlines, Emirates operates a large, modern fleet of 88 Boeing and Airbus jets. At the Dubai Air Show in late November 2005 Emirates announced an order for 42 Boeing 777 jets worth US\$9.7 billion, with an option to buy 20 more. In announcing the order, the Emirates' Chairman noted: "*We are investing in more new aircraft to meet escalating demand for Emirates' services from our customers across the globe. This new order will support the airline's growth plans, and enhance our fleet's range and versatility*".²⁹ This latest order has increased Emirates' current order book to 127 wide-body aircraft at a total value of US\$35 billion, including 43 passenger and two cargo A380s.³⁰ Ten of these A380s are expected to enter Emirates' fleet between April 2007 and December 2007 alone.
- 5.12 (**Global expansion**) Since its launch and particularly in the recent past, Emirates has undertaken significant investments in new aircraft and expanded its routes. The Tribunal found that Emirates "*is a rapidly expanding, high quality international airline creating a global network, including Australia and New Zealand, from its Dubai hub and specialises in top end services*".³¹ This growth has continued since the Tribunal's determination, during a period in which other network carriers have needed to reduce their networks, consolidate their operations and minimise their costs. Emirates' stated global expansion strategy is to become the world's largest global mega-carrier.
- 5.13 (**Profitability**) Emirates is currently one of the most profitable airlines in the world. It has substantial financial resources at its disposal and significant global strength. In a press release on 15 November 2005, Emirates announced a net profit of US\$251 million for the first six months of the financial year to 30 September 2005.³² Emirates is not required to pay corporate tax in the United Arab Emirates.
- 5.14 (**Tasman presence**) Emirates entered the Tasman market in August 2003. At the time of the Tribunal hearing in May 2004 it operated 21 flights per week across the Tasman between Auckland – Sydney, Melbourne and Brisbane and Christchurch – Melbourne. The Tribunal found, based on evidence from the airline, that it only took

²⁸ See **note 7** at para. 361

²⁹ This new order is made up of 24 x 777-300 ERs, plus 10 x 777-200 LR Worldliners and 8 x 777 freighters: Emirates Press Release, 21 November 2005

³⁰ In 2003, Emirates announced orders for 71 aircraft valued at US\$19 billion, at the time the biggest aircraft order in civil aviation history. In particular, Emirates is awaiting delivery of 45 Airbus A380s (two of which are dedicated freighters).

³¹ See **note 7** at para. 361

³² "Emirates posts half-year profits of US\$251 million", Press Release, 15 November 2005

Emirates eight months from the commencement of its Tasman services to operate profitably. As recently as January 2006, Emirates stated that "*The state of the business in New Zealand is absolutely superb*".³³

5.15 Since that time Emirates has demonstrated its commitment to the Tasman and expanded its services, such that it now operates 28 return flights per week, with a total capacity share on Tasman routes of approximately 12.23%, with a more detailed breakdown of Emirates' capacity share on a route by route basis as follows:³⁴

- (a) 13.2% on Sydney – Auckland (daily B777-300);
- (b) 16.7% on Melbourne – Auckland (daily A340-500);
- (d) 28.2% on Brisbane – Auckland (daily B777-300ER); and
- (e) 21.5% on Sydney – Christchurch (daily A340-500).

5.16 (**Cost advantage**) As explained in **Annexure B**, Emirates benefits from a significant cost advantage inherent in deploying otherwise idle aircraft across the Tasman (i.e. the aircraft cannot be flown in domestic Australia and there are no other accessible international destinations given the relevant time period before the plane leaves Australia to return to Dubai), as well as providing additional "through traffic" for its services to and from Dubai. This was acknowledged by the Tribunal:³⁵

"Operating the Tasman leg is economically rational for an FFC [fifth freedom carrier] if it can generate sufficient traffic on the Tasman leg to cover the marginal costs of that additional leg. The main marginal costs of operating a flight are personnel costs, fuel costs, landing charges and fees for the use of airport facilities. Therefore, generally it is more profitable for FFCs to be flying Tasman routes than for their aircraft to remain on the ground in Australia or New Zealand."

5.17 The cost advantage associated with being a fifth freedom carrier on the Tasman means that Emirates needs to fill fewer seats than the Applicants to cover its marginal costs and generate a positive return. As Emirates only needs to cover its marginal costs, it has increased pricing freedom relative to the Applicants. This enables Emirates to target price-sensitive Tasman passengers with low promotional fares and ensures its continued competitive presence on Tasman routes:³⁶

³³ Chris Lethbridge, Emirates, New Zealand Herald, 9 January 2006, C14

³⁴ Based on scheduled services as at 01.01.06 for the week commencing 20.02.06

³⁵ See **note 7** at para. 44.

³⁶ *Ibid.* at para. 378

“As Emirates prices its Tasman operations on an incremental cost basis, it is unlikely that it will stop flying Tasman routes because it is more profitable for Emirates to be flying Tasman routes than for its aircraft to remain on the ground in Australia.”

- 5.18 Emirates' continued ability to take advantage of its unique cost position in respect of the Tasman was highlighted earlier in 2005 when the airline publicly claimed "... it only has to fill 40% of its seats to be profitable over the Tasman".³⁷
- 5.19 The nature and scale of Emirates' operation on the Tasman makes the effect of its presence very different from a "typical" fifth freedom carrier that uses the Tasman routes as a way of utilising otherwise idle aircraft and to "top up" a wider network service. Its sheer size and Australasian presence means it derives significant economies of scale in terms of promotion of its brand and of Dubai, for example. Although it utilises fifth freedom bilateral rights, the Tasman is a major route for Emirates in its own right. Emirates operates substantially more capacity across the Tasman than is warranted by the demand for its wider services to and beyond the United Arab Emirates.
- 5.20 (**Tasman growth**) Emirates has an aircraft on the ground in Melbourne which it can readily deploy across the Tasman, without any changes to its current Dubai – Melbourne service.
- 5.21 Furthermore, the capacity shares outlined in **Table 1** appear certain to increase further if Emirates follows its stated intention to fly A380 aircraft, which can seat 500+ passengers, on Tasman routes after it takes delivery of the first aircraft.³⁸ This is now expected to occur in April 2007.
- 5.22 Emirates' presence on, and commitment to, the Tasman routes is part of its wider commitment to developing a strong and abiding presence within Australasia. Emirates itself has clearly stated its intention to establish a significant long-term presence in Australasian markets. In a press release on 5 October 2003, Emirates' Executive Vice-President, Ghaith Al Ghaith stated with reference to the Tasman:
- “These flights are a demonstration of our commitment not only to our Australian and New Zealand customers but also to our determination to become a serious player on the Tasman route. We are here to stay.”*
- 5.23 In early November 2005 Emirates approached the Australian Government to express its desire to double its current operating capacity into and out of Australia from 42 to 84 flights per week. It already serves Brisbane, Sydney, Melbourne and Perth,

³⁷ Scott Rochford, "Emirates moves in on Tasman routes", The Age, 1 April 2005.

³⁸ *Ibid.*

connecting them via Singapore and Bangkok, as well as serving the last three non-stop using the ultra-long range A340-500. In outlining this objective, Emirates' President noted: "*Australia is a very strong market for us ... (i)n fact, in terms of income generation Australia is now No. 3 in the world for Emirates, which is quite amazing given that many other foreign carriers have backed away from the market*".³⁹

- 5.24 Additional services to Australia would increase the scope for Emirates to strategically deploy additional capacity across the Tasman.
- 5.25 **(Australasian promotion)** Emirates' commitment to continuing to operate on the Tasman is highlighted by its promotion of its brand and Dubai within Australasia and throughout its international network, with A\$33.8m spent to date on such promotional activities.⁴⁰ It is also underscored by Emirates' promotion of the Emirates brand through association with significant organisations and events in both Australia and New Zealand, including:
- (a) Australia's pre-eminent horse race, the "Emirates" Melbourne Cup, of which the airline is now the main sponsor for seven years from 2005 (this is in addition to other sponsorship arrangements between Emirates and the Victorian Racing Club);
 - (b) the Emirates Team New Zealand ("America's Cup") yachting syndicate, to which it has committed a reported NZ\$30-40 million⁴¹;
 - (c) its relationship with the International Cricket Council, which has been extended until 2008 with the sponsoring of umpires and referees for all test and one-day international cricket matches and sponsorship of the ICC Super Series (Australian team playing the "Rest of the World");
 - (d) the Sydney, Melbourne and West Australian Symphony Orchestras, which it has sponsored as Principal Partner since 2003;
 - (e) the Perth-based "Emirates Western Force" Super 14 rugby team – Emirates is the principal, naming-rights sponsor until 2008;
 - (f) the Collingwood AFL Football Club, as "Premier Partner" until 2010;
 - (g) the 2006 FIFA Soccer World Cup, as official airline sponsor; and
 - (h) all IRB international rugby union referees until 2009.

³⁹ Stephen Dabkowski & Rod Myer, "Qantas in Emirates' flight path", SMH, 2 November 2005.

⁴⁰ *Here for the Long Haul – Emirates in Australia: 1996–2005*, Emirates publication, June 2005 at p.2.

⁴¹ *The Independent Business Weekly*, 16 June 2004. "Emirates is believed to be putting up between \$30 million and \$40 million."

- 5.26 Finally, Emirates' involvement as a foundation partner of Virgin Blue's new frequent flyer program, Velocity, launched on 15 November 2005 (for more details see paragraph 5.36 below) is further evidence of its long term intention to remain as an operator on the Tasman. Velocity members are able to 'earn' and 'burn' frequent flyer points on its services⁴², which increases the incentives for domestic business travellers to utilise Emirates' services on the Tasman or to other international destinations. This is in addition to the benefits and incentives associated with Emirates' own loyalty program.
- 5.27 Emirates' commitment to the Australasian region is clearly evidenced in the Emirates document at **Annexure C**, "Here for the Long Haul – Emirates in Australia". Emirates is a formidable competitor.

Virgin Blue

- 5.28 (**Business model**) Pacific Blue is a wholly owned subsidiary of Virgin Blue⁴³, a domestic Australian airline that has established a significant Australian presence in the years since it began operating on 31 August 2000. By 7 February 2006 Virgin Blue had 51 aircraft operating more than 300 daily flights to 22 Australian destinations.⁴⁴ Its capacity share of the Australian domestic passenger market is approximately 33%. Through Pacific Blue, the airline also offers services to six international destinations: New Zealand, Vanuatu, Fiji, Rarotonga, Samoa and Tonga.
- 5.29 The Tribunal acknowledged that Virgin Blue's business model is based on an LCC approach, which "*seeks to minimise costs by adopting efficient business strategies and cutting out extras, such as free meals. It passes on cost savings to passengers through low fares. An important part of Virgin Blue's brand and business model is to be seen always to offer low fares. Accordingly, if demand is strong, Virgin Blue is likely to increase capacity by putting on additional services rather than increasing fare levels*"⁴⁵ (emphasis added).
- 5.30 In late November 2005 Virgin Blue re-defined its approach as the process of developing a "new world carrier" (NWC) and predicted "*the evolution of some LCCs into New World Carriers will expand the scope of competition with full service legacy carriers. New World Carriers will seek to leverage their low cost foundations and ability to add valuable new products to increasingly penetrate the lucrative business*

⁴² Clause 3 (Earning Points) & clause 4 (Redemptions), Velocity Terms & Conditions: <http://www.velocityrewards.com.au/content/conditions.html>

⁴³ On occasions we will refer to Pacific Blue and Virgin Blue interchangeably.

⁴⁴ "Virgin Blue woos business travellers with 'Velocity', powered by Virgin Blue – The world's next generation loyalty program", Media Release, 15 November 2005

⁴⁵ See **note 7** at para. 37.

market to strengthen yields and profitability".⁴⁶ The key elements of the NWC model include:⁴⁷

- (a) a low cost base, driven by high asset and people productivity;
- (b) an ability to develop valuable new products on a profitable pay-per-use basis;
- (c) competition based on customer segments, as opposed to the traditional route-by-route competition of LCCs (in other words, broadening the range of passengers they appeal to); and
- (d) innovative development of "many of the trappings" that afford legacy carriers healthy yields, with a "barely perceptible" impact on costs.

5.31 At the same time, Virgin Blue continues to incorporate many of the typical LCC features, such as implementing flexible labour arrangements, operating a single type of aircraft⁴⁸ and operating on routes and at times which maximise operating efficiency, whilst customising its product for the Australasian market.

5.32 The development of the NWC is consistent with the Tribunal's view of Virgin Blue's forward-looking strategies in the Qantas/Air NZ Decision: "*We have recognised that Pacific Blue does not satisfy the needs of all time-sensitive passengers, but we have formed the view that it is likely that it will be successful in acquiring more business travellers as it continues to target the corporate market and to increase frequencies on existing routes and eventually enter the Auckland routes*".⁴⁹

5.33 **(Recent innovations)** In line with the stated NWC philosophy, Virgin Blue has recently introduced a number of strategic and valuable innovations. These include:

- (a) The introduction of Blue Plus fares in March – April 2005. Designed for business travellers, passengers who book a Blue Plus fare and can no longer travel for any reason are given the option of obtaining either a refund or a credit. In addition, all Blue Plus fare holders can take advantage of new priority check-in counters, free entry to Virgin Blue lounges (the Blue Rooms) in Brisbane, Sydney and Melbourne, and forward aircraft seating (subject to availability).
- (b) A commitment to a faster check-in process achieved through the roll-out of Blue-Check self check-in kiosks in airports across Australia and the

⁴⁶ "Virgin Blue announces birth of "New World Carrier" in CAPA Report" Media Release, 30 November 2005.

⁴⁷ *Ibid.*

⁴⁸ To reduce training and fleet support costs.

⁴⁹ See **note 7** at para. 354.

introduction of "Web Check-in Facilities" from 1 October 2005. The web check service allows passengers to check-in, print a boarding pass, select seats and arrange for check-in of luggage before they get to the airport.

- (c) A codeshare arrangement with Virgin Atlantic, announced in August 2005.
 - (d) The introduction of a new Application Program Interface that will allow Virgin Blue to codeshare with any international carrier.
 - (e) The introduction of "DigEplayer" personal video units on certain domestic flights from April 2006. These personal "video on demand" units will be available on a pay-for-use basis of \$15 for the duration of the flight and feature unlimited access to 10 preloaded feature length movies, other short programs and music.
 - (f) The introduction of a frequent flyer program, which is elaborated on in paragraphs 5.36 – 5.39 below.
- 5.34 While not all these initiatives are available on Tasman services, they are all available in domestic Australia and the Applicants expect that those innovations not already part of Virgin Blue's Tasman offering will be introduced as demand requires.
- 5.35 Virgin Blue's commitment to ensuring these developments have a "barely perceptible" impact on costs is reflected in its announced costs per ASKs (or Available Seat Kilometre) for the 12 months ended 30 September 2005. Excluding fuel costs, costs per ASK were 6.03 cents relative to 6.22 cents for the previous 12 months (or a 3.0% decline).⁵⁰
- 5.36 ("**Frequent Flyer**" program) On 15 November 2005 Virgin Blue launched its loyalty program – "Velocity", in conjunction with launch partners National Australia Bank, Emirates, Virgin Atlantic and Europcar. In so doing, Virgin Blue highlighted its ambition to ensure the program will be cost neutral, in line with its cost containment philosophy⁵¹ and confirmed its commitment "... to our original charter to drive competition by offering a high quality product at consistently lower fares."⁵²

⁵⁰ "Virgin Blue Holdings Limited results for the 12 months ended 30 September 2005", Media Release, 16 November 2005. The inclusion of fuel costs results in a cost/ASK of 7.84 cents.

⁵¹ Peanuts, The Low Cost Airline Weekly, Issue #97, 22 November 2005 at p.22

⁵² See **note 46**

- 5.37 Velocity's key point of differentiation⁵³ is "any seat redemption", or the ability to use points to book a seat on any flight across all routes on any day of the year (including Easter, Christmas and public holidays).
- 5.38 Velocity is a concrete manifestation of Virgin Blue's aim to develop into a NWC, which walks the line between low cost operations driving affordable airfares on one side and a desire to appeal to frequent (often business) travellers on the other. In order to successfully execute this strategy, Virgin Blue must continue to operate as an economic "maverick" – or alternatively, as the Virgin Blue CEO recently stated: "... make no mistake, Virgin Blue will continue to use innovation and "out of the box" thinking to stay at the forefront of competition".⁵⁴
- 5.39 By increasing the airline's appeal to the business traveller, at the same time as continuing to appeal to leisure travellers, Virgin Blue has further increased the level of constraint it imposes on the Applicants relative to that outlined in the Qantas/Air NZ Decision. This broadening in appeal should be considered in conjunction with a general trend in business travel on short haul routes like the Tasman towards foregoing a higher level of service or broader schedules for the price and value offered by an LCC or NWC. For example, the majority of business travellers flying with Qantas across the Tasman elect to purchase discounted economy fares. Taken together, these two factors highlight that Virgin Blue remains a serious, long-run source of commercial rivalry for the Applicants.
- 5.40 **(Financial support)** Virgin Blue continues to be a well funded company with "deep pockets". In 2003 the airline undertook a successful initial public offering that gave Virgin Blue a market capitalisation of A\$2.3 billion. As of 30 March 2006, its market capitalisation of approximately A\$2 billion was more than twice that of Air NZ. Virgin Blue has access to significant financial resources as an ASX-listed company. It is also currently a subsidiary of Patrick Corporation⁵⁵, which provides it with strong financial backing.
- 5.41 At its Annual General Meeting on 7 February 2006 Virgin Blue announced a net profit after tax of \$105.2 million for the 12 months ended 30 September 2005. Though this represented a decline relative to the previous 12 months, Virgin Blue was able to report its non-fuel related costs were still well under control, driven by scale and productivity initiatives, such that it was "still the lowest cost airline in Australia".⁵⁶

⁵³ The Air NZ frequent flyer program offers "any seat redemption" but the Qantas Frequent Flyer Program does not.

⁵⁴ See **note 44**

⁵⁵ Patrick Corporation, and hence Virgin Blue, is currently the subject of a takeover bid by Toll Holdings. Market speculation suggests that in the event the bid is successful, Richard Branson's Virgin group of companies may regain a controlling interest in Virgin Blue.

⁵⁶ Virgin Blue, Annual General Meeting Slides, 12 months ended 30 September 2005, 7 February 2006.

5.42 (**Tasman presence**) In January 2004 Virgin Blue commenced flights between Brisbane and Christchurch (and now accounts for 34.4% of all seats operated on that sector). In the little over 2 years it has been operating on the Tasman, Virgin Blue has expanded its offering and as recently as 31 March 2006, announced additional services from Christchurch and Auckland to Brisbane. It has now achieved the following capacity shares (which are forecast to increase further from May 2006 when its additional Brisbane frequencies take effect⁵⁷).⁵⁸

- (a) 34.4% on Brisbane - Christchurch;
- (b) 19.9% on Melbourne - Christchurch;
- (d) 10.7% on Sydney – Christchurch;
- (e) 30.4% on Brisbane - Wellington;
- (f) 7.6% on Brisbane – Auckland; and
- (g) 25.5% on Coolangatta – Auckland.

5.43 These are substantial shares achieved in a relatively short time. They are also significant when viewed in the context of the high level of constraint that lower cost airlines such as Virgin Blue impose on pricing, even where they have relatively low shares and even where they do not operate across all routes.

5.44 Virgin Blue remains in an extremely strong position to enter or expand on Tasman routes. As highlighted above, Virgin Blue continues to implement a business model that fundamentally seeks to minimise costs and offer passengers low fares. Furthermore, Virgin Blue faces no regulatory restrictions, nor any problems gaining access to facilities (including terminal space, counter space and slots) at Wellington, Christchurch and Auckland Airports (or airports in Australia) for the purpose of providing Tasman services.

5.45 Virgin Blue's rate of capacity expansion on the Tasman has slowed more recently. This is simply a reflection of the high degree of surplus capacity and competition on the Tasman routes, which has meant that deployment of capacity on Pacific Island routes has proven more profitable. Even so, Virgin Blue has steadily expanded over the past two years and now operates services on six Tasman sectors. Its recent announcement to expand its Auckland – Brisbane and Christchurch – Brisbane services demonstrate Virgin Blue remains poised to expand where it sees an opportunity.

⁵⁷ Business Traveller. NBR. Friday 31 March 2006, reporting Pacific Blue's launched four new services

- 5.46 Most critically, this reduced rate of expansion does not, in any way, reduce the pricing constraint Virgin Blue imposes on the Applicants, which is illustrated in section 9 below. In no way has it reduced Virgin Blue's ability to "cherry pick" or otherwise affects its ever-present ability to enter or expand and thereby effectively constrain attempted price increases.
- 5.47 With respect to Tasman passenger services the Tribunal found Virgin Blue "*..acts as a pricing constraint on routes it currently serves as well as some routes which it does not currently serve. This is primarily because it poses a threat to other airlines that it will enter routes where fares are artificially high*".⁵⁹ This finding is still directly applicable today for the reasons expanded upon in section 9.

Qantas and Jetstar

- 5.48 Another Tasman development since the Qantas/Air NZ Decision has been the launch of Qantas' lower cost airline, Jetstar, on certain Tasman routes with a focus on predominantly leisure-based routes. From 1 December 2005 Jetstar commenced the following Tasman services using two A320 aircraft:
- (a) Sydney – Christchurch: 10 weekly return flights;
 - (b) Melbourne – Christchurch: 9 weekly return flights;
 - (c) Brisbane – Christchurch: 7 weekly return flights; and
 - (d) Gold Coast – Christchurch: 2 weekly return flights.
- 5.49 The Jetstar Tasman services include baggage connectivity being offered to international passenger flight connections and assigned seating. Furthermore, Qantas Frequent Flyer members can earn points when flying on a JetFlex fare and can redeem Frequent Flyer points on the Tasman services.⁶⁰
- 5.50 Jetstar's presence on certain Tasman routes has seen it effectively replace the Qantas mainline services, which have been withdrawn from the Brisbane – Christchurch and Melbourne – Christchurch routes. However, Qantas has continued to offer a daily Sydney – Christchurch service.
- 5.51 The introduction of Jetstar to certain Tasman routes represents the latest in a range of generic and Tasman-specific cost reduction initiatives which have been undertaken

from Auckland or Christchurch to Brisbane in May 2006

⁵⁸ Based on scheduled services as at 01.01.06 for the week commencing 20.02.06

⁵⁹ See **note 7** at para. 355.

⁶⁰ Jetstar Media Release "Jetstar commences first international flights", 1 December 2005

by Qantas over the past 18 months in order to remain competitive in all of its markets, including the Tasman market.

Air NZ and Freedom Air

5.52 Both prior to and since the Qantas/Air NZ Decision, Air NZ's management team has undertaken a range of Tasman cost-reduction initiatives and has made substantial progress. In addition to the launch of "Tasman Express", a key initiative has been to place Air NZ's entire A320 fleet into a single operating group to service the Tasman and Pacific Island operations of both Freedom and Air New Zealand.

5.53 By leveraging the relative strengths of the Freedom Air and Air New Zealand business models, Air NZ aims to lower its short-haul costs by approximately 10 percent on a cost-per-seat basis.⁶¹

Other fifth freedom carriers

5.54 At the time of the Tribunal hearing there was approximately eight carriers exercising fifth freedom rights on Tasman routes. In the interim three of those carriers have suspended services (see paragraph 5.7), leaving the following operators in addition to Emirates: Aerolineas Argentinas, Garuda Indonesia, Lan Chile and Royal Brunei. The routes they service are outlined in **Annexure D**.

5.55 In addition to the fifth freedom carriers mentioned above, a number of other airlines that fly to either Australia or New Zealand have fifth freedom rights to operate on the Tasman routes but do not currently exercise them. They include Singapore Airlines, British Airways, United Airlines, Cathay Pacific, Thai International Airways, Malaysia Airlines, Polynesian Airlines and Virgin Atlantic. A table setting out the various air services agreements between Australia and other countries that include full traffic rights (i.e. fifth freedom rights) on the Tasman routes is at **Annexure E**.

Airports

5.56 It remains the case that there are no barriers to access at any of the Australian airport facilities that service Tasman routes, including at Sydney Airport. The same is true in New Zealand. In particular, the Applicants note the on-going development and expansion of international terminal facilities at Auckland International Airport, where a

⁶¹ <http://www.freedomair.co.nz/en/about-us/news/short-haul.jsp>

major project involving the construction of a second level for the international terminal was completed in December 2005.⁶²

Conclusion

5.57 Ultimately, the cumulative effect of these market developments since the Qantas/Air NZ Decision is evidenced by the highly competitive environment that has been fostered on the Tasman routes over the past 18 months, which has seen increasing market capacity and declining revenue per ASK performance for the Applicants.

6. RELEVANT PROVISIONS OF THE ACT

6.1 The Applicants seek authorisation of the TNA under sub-sections 88(1) and 88(8) of the Act. These authorisation applications are being made for the reason that there are provisions of the TNA that contravene Part IV of the Act.

6.2 The relevant authorisation tests for sub-sections 88(1) and 88(8) are set out in sub-sections 90(6) and 90(8) as follows.⁶³

"90(6) The Commission shall not make a determination granting authorisation ... unless it is satisfied in all the circumstances that the provision of the proposed contract, arrangement or understanding ... or the proposed conduct, as the case may be, would result or be likely to result in a benefit to the public and that that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result or be likely to result if ... the proposed conduct were engaged in" [emphasis added].

"90(8) The Commission shall not make a determination granting an authorisation unless it is satisfied in all the circumstances that the proposed provision or the proposed conduct would result, or be likely to result, in such a benefit to the public that the proposed contract or arrangement should be allowed to be made, the proposed understanding should be allowed to be arrived at, or the proposed conduct should be allowed to take place, as the case may be" [emphasis added].

6.3 In identifying and weighing the public benefits and detriments associated with the proposed conduct, the Commission must compare the 'future with' the co-operation (the factual) compared to the 'future without' (the counterfactual).⁶⁴

⁶² Aviation Week, "Auckland Airport Eyes Further Runway, Terminal Developments", 21 February 2006 (http://www.aviationnow.com/avnow/news/channel_airports_story.jsp?id=news/AUCK02216.xml)

⁶³ Whilst it was observed in *Re ACCC by Australian Association of Pathology Practices* (2004) 206 ALR 271 that the tests are formulated differently, each requires the use of the "future with and without test". In this application, we submit that the practical application of the two tests should be the same.

- 6.4 In the Qantas/Air NZ Decision, the Tribunal acknowledged the difficulty of applying a forward looking test in the airline industry given the highly dynamic nature of competition in the industry.⁶⁵ It concluded, that for a benefit or detriment to be taken into account, it must be satisfied that there is a real chance, and not a mere possibility, of the benefit or detriment eventuating. There must be "commercial likelihood" that the parties will act in a manner that brings about the likely benefit or detriment.⁶⁶
- 6.5 In undertaking this analysis it must be borne in mind that competition is essentially a long-run phenomenon and in a competition assessment "*significant consideration should be given to predictions of dynamic changes and competitive initiatives in the future by rival firms*".⁶⁷

7. DEFINING THE MARKET

- 7.1 The Commission has considerable experience identifying markets in the aviation industry. Relatively recent authorisation applications involving consideration of aviation markets include:
- (a) the re-authorisation of the Joint Services Agreement between Qantas and British Airways (A30226 and A30227) on 8 February 2005 (**RJSA Determination**);
 - (b) the Commission's negative determination with respect to the Proposed Alliance dated 9 September 2003; and
 - (c) the Tribunal's positive determination in the Qantas/Air NZ Decision, with reasons delivered on 16 May 2005.

Tasman Air Passenger Services Market

- 7.2 (**Market definition**) This application is based on a single product market for air passenger services on the routes between any point in Australia and any point in New Zealand (ie the Tasman routes).
- 7.3 There are nine main routes in this market, being Sydney-Auckland, Melbourne-Auckland, Brisbane-Auckland, Sydney-Wellington, Melbourne-Wellington, Brisbane-Wellington, Sydney-Christchurch, Melbourne-Christchurch and Brisbane-

⁶⁴ See *Re QIW Ltd* (1995) 132 ALR 225 at 276; *Re AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41-593 at 44,174-5

⁶⁵ See **note 7** at para. 152.

⁶⁶ *Ibid.* at para. 156.

Christchurch. As noted above, these routes account for approximately 85% of all Tasman non-stop capacity.⁶⁸ Each of the routes that make up the Tasman market can be classified as a "short-haul" (i.e. less than 5 hours) route.

7.4 There is no relevant distinction between business and leisure passengers, or economy and business/first class passengers in respect of this market, primarily as a result of the routes' "short-haul" nature. This is consistent with:

- (a) the Commission's Statement of Facts, Contentions and Issues filed with the Tribunal in respect of the Proposed Alliance: "*The extent to which there will be separate markets for such travellers will depend on the degree of demand substitution likely in the geographic markets concerned. Given the mainly short haul nature of the routes involved here it is unlikely that separate markets would be an issue in this matter.*"⁶⁹;
- (b) the Tribunal's reasoning in the Qantas/Air NZ Decision: "*.. the difference in the overall demand characteristics of business and leisure travellers is therefore not so great that a discontinuity in substitution possibilities between business and leisure travellers can be said to exist, justifying the characterisation that the applicants supply air passenger services into two distinct markets in the Tasman This is particularly so given the short-haul nature of the Tasman routes in which substitution between both the class of travel and the travel product more generally is more likely...*"⁷⁰; and
- (c) the Commission's reasoning in the RJSA Determination: "*... Depending on levels of frequency and given the lesser importance of the comfort factor, it is possible that the degree of substitution across fare structures in short haul markets could be significant and point to a single passenger market on those routes*"⁷¹.

7.5 It is also consistent with commercial reality. As network airlines, the Applicants must target leisure travellers as well as business travellers to ensure the financial viability of their flights (see the outline of the Applicants' revenue management processes at **Annexure F**). Virgin Blue also clearly targets business as well as leisure passengers.⁷² Finally, given the distances involved, most business and leisure

⁶⁷ *Ibid.* at para. 431.

⁶⁸ The other relevant routes include Adelaide, Cairns, Gold Coast and Perth to Auckland; Gold Coast to Christchurch; Gold Coast to Wellington; Sydney and Brisbane to Palmerston North; Sydney, Brisbane and Gold Coast to Dunedin; Sydney, Brisbane and Gold Coast to Hamilton; and Sydney to Queenstown.

⁶⁹ *Commission Statement of Facts, Contentions and Issues* at para. 48 (filed with the Tribunal on 2 February 2004).

⁷⁰ See **note 7** at para 244.

⁷¹ *Commission Final Determination A30226 and A30227* (RJSA between Qantas and British Airways), 8 February 2005 at para. 9.83.

⁷² See para. 5.30 to 5.39 above for a range of examples which support this claim.

travellers regard the offerings of the Applicants, Virgin Blue and Emirates on the Tasman routes as close substitutes.

7.6 **(Market shares)** In the Qantas/Air NZ Decision the Tribunal noted that “*there has been a general downward trend in the Applicants’ combined market share of origin/destination passengers in the Tasman market between January 2003 and June 2004.*”⁷³ From a combined share of approximately 91.6%, the Applicants moved to a share of approximately 81.6% by June 2004.

7.7 Data produced by the ABS for Australia/New Zealand origin/destination passengers on the Tasman routes over the period June 2004 to October 2005 illustrates that this trend has not been reversed. Instead, the combined passenger share of the Applicants’ has continued a downward trend to between 75% - 80% of the Tasman market:

Table 2: Applicants’ shares of total origin/destination passengers

Month	Qantas (including Jetstar)		Air New Zealand (including Freedom Air)		Combined share	
	2004	2005	2004	2005	2004	2005
January	---	31%	---	44%	---	75%
February	---	32%	---	43%	---	75%
March	---	31%	---	44%	---	75%
April	---	31%	---	46%	---	77%
May	---	33%	---	46%	---	79%
June	38%	32%	44%	47%	82%	79%
July	37%	33%	42%	44%	81%	77%
August	37%	34%	43%	46%	80%	80%
September	34%	33%	43%	45%	77%	78%
October	34%	32%	45%	45%	79%	77%
November	35%	---	47%	---	82%	---
December	31%	---	46%	---	77%	---

7.8 This has been accompanied by a continuation of the upward trend in the combined market share of origin/destination passengers of Emirates, Virgin Blue and other fifth freedom carriers. In June 2004, this combined share stood at approximately 18.4%⁷⁴. Based on **Table 3** below, in October 2005 the combined share of these carriers had

⁷³ See note 7 at para. 296.

⁷⁴ *Id.*

increased to approximately 23%, after reaching around 24 – 26% in the early months of 2005:

Table 3: Emirates and Virgin Blue shares of total origin/destination passengers

Month	Emirates		Virgin Blue		Combined share (including all fifth freedom carriers)	
	2004	2005	2004	2005	2004	2005
January	---	11%	---	8%	---	26%
February	---	11%	---	8%	---	24%
March	---	12%	---	8%	---	25%
April	---	11%	---	7%	---	23%
May	---	10%	---	6%	---	21%
June	5%	9%	8%	7%	19%	21%
July	7%	9%	9%	8%	21%	23%
August	6%	7%	9%	8%	20%	20%
September	9%	9%	8%	8%	23%	22%
October	8%	10%	7%	8%	21%	23%
November	7%	---	6%	---	19%	---
December	9%	---	7%	---	22%	---

7.9 All other things being equal, when Emirates deploys its A380 aircraft on the Tasman, the combined share column of **Table 3** will experience another "spike" in market share.

Tasman Air Freight Market

7.10 Air freight is transported in the belly hold of passenger aircraft or in dedicated, freight-only configured aircraft. Both Qantas and Air NZ offer belly hold air freight capacity on the Tasman routes, along with a number of competitors offering belly hold or dedicated freight capacity. This application is based on a single Tasman air freight market, which encompasses a range of traffic from general cargo to express and airmail freight. This definition was accepted by the Tribunal in the Qantas/Air NZ Decision⁷⁵. It is also consistent with the Commission's approach to freight markets in

⁷⁵ *Ibid.* at para. 251.

the RJSA Determination, which did not distinguish between time critical and non-time critical freight.⁷⁶

7.11 The current operators offering freight services in the Tasman air freight market are set out in **Table 4** below, together with the market share by tonnes carried by each operator.

Table 4: Overall market for freight (2005)

Organisation	Market Share	Aircraft Type	Tonnes Carried (Jan – Dec 2005) [Source: DOTARS]
Qantas	37.5%	B767 / B737 / B747	51,222
Air New Zealand	24.6%	B767 / B747 / A320 / B777 / B747F	33,622
Emirates	18.8%	B777	25,773
HJ Asian Express DHL	5.8%	B727F	7,869
CV Cargolux	4.2%	B744F	5,699
Singapore Cargo	3.3%	B744F	4,445
Thai Airways*	3.1%	B747	4,209
Aerolineas	0.9%	A340	1,194
Garuda Airways	0.8%	A330	1,042
Lufthansa	0.4%	B747F	556
Lan Chile	0.4%	A343	525
Virgin Blue	0.1%	B737	128
Royal Brunei	0.3%	B767	476

Source: DoTaRS

* Thai Airways suspended its Tasman services in December 2005

8. FACTUAL & COUNTERFACTUAL

8.1 The factual scenario is outlined in the TNA (see section 2 above) and involves Qantas and Air NZ operating a combined Tasman passenger business, including making combined capacity, scheduling and pricing decisions. The Applicants have developed an indicative combined schedule for the first relevant schedule period (see the TNA at **Annexure A**). However, given the highly dynamic nature of the market, it is expected that this may need to be adjusted prior to implementation.

⁷⁶ See **note 71** at para. 11.117.

- 8.2 Going forward, the Applicants will work together to maintain a combined schedule which enables both Qantas and Air NZ to continue their network presence on the Tasman whilst concurrently eliminating some of the surplus or unused capacity.
- 8.3 As to the counterfactual, given the highly dynamic nature of the aviation industry and its sensitivity to exogenous shocks and the global economic cycle, there are inherent difficulties associated with postulating a precise view of the future without the TNA beyond one scheduling season (6 months). On any view of the counterfactual, the Tasman routes will continue to be a dynamic marketplace in which Virgin Blue and Emirates operate as vigorous and effective competitors, each with the ability to expand their service offering and competitively respond to the conduct of Qantas and Air NZ.

9. DETRIMENT IN THE TASMAN AIR PASSENGER SERVICES MARKET

- 9.1 In respect of the Proposed Alliance, the Tribunal noted: "*Whether the Alliance would result in any anti-competitive detriment in the Tasman air passenger services market depends on the competitive interaction of the airlines that currently operate in this market in the factual, as against the counterfactual (no evidence was provided as to likely new entrants in the foreseeable future)*".⁷⁷ The same analysis should apply to the TNA.
- 9.2 Giving effect to the TNA will involve co-operation between Qantas and Air NZ across the Tasman routes. However, the competitive constraints on these routes are such that this will not result in anti-competitive detriment relative to the counterfactual.
- 9.3 The key competitive constraints faced by the Applicants on the Tasman have been outlined above, namely:
- (a) the presence of Emirates and Virgin Blue, who have the ability and incentive to set the market price and act as "maverick" competitors; and
 - (b) the absence of significant barriers to the entry or expansion of Emirates, Virgin Blue and other carriers.

Barriers to entry or expansion

- 9.4 In *Re Queensland Co-operative Milling Association Limited (1976)* (QCMA), the then Trade Practices Tribunal laid out the principles to be applied in assessing whether a

⁷⁷ See note 7 at para. 522.

market is likely to remain competitive post arrangement. The Tribunal relevantly noted⁷⁸:

".... The elements of market structure which we would stress as needing to be scanned in any case are these: (1) the number and size distribution of independent sellers, especially the degree of market concentration; (2) the height of barriers to entry, that is the ease with which new firms may enter and secure a viable market; (3) the extent to which the products of the industry are characterised by extreme product differentiation and sales promotion; (4) the character of "vertical relationships" with customers and with suppliers and the extent of vertical integration; and (5) the nature of any formal, stable and fundamental relationships between firms which restrict their ability to function as independent entities. Of all these elements of market structure, no doubt the most important is (2), the condition of entry. For it is the ease with which firms may enter which establishes the possibilities of market concentration over time; and it is the threat of entry of a new firm or a new plant into a market which operates as the ultimate regulator of competitive conduct" [emphasis added].

9.5 These principles have been quoted with approval and applied by the Tribunal and the Courts ever since the decision in QCMA.

9.6 In the Qantas/Air NZ Decision, the Tribunal dismissed submissions that factors such as capital requirements, customer preferences, access to feeder services and a large network were barriers to entry or expansion in the Tasman passenger market for Virgin Blue or Emirates and reached the following conclusion:⁷⁹

"As there are no natural or strategic barriers to their long-run expansion, Virgin Blue and Emirates are in a position to expand their current market shares. We consider they are likely to do so, and in the process will act to constrain any anti-competitive tendencies that might follow from the formation and implementation of the Alliance."

"If the Alliance were to go ahead, there would not be any barriers to significant entry nor would there be any barriers to effective expansion by either or both of Virgin Blue or Emirates."

9.7 The Applicants submit that their existing rivals on the Tasman routes, Emirates and Virgin Blue, continue to be presented with no barriers to their entry or expansion. Taking each in turn, Emirates remains in a strong position to enter and expand on the principal Tasman city pairs in the very short run. This is because:

⁷⁸ *Re Queensland Co-operative Milling Association Limited* (1976) ATPR 40-012 at p.17,246

⁷⁹ See **note 7** at para. 416 and 419.

- (a) Emirates has a high growth profile, both globally and specifically in Australasia:
 - (i) Even without any scheduling changes, Emirates has an aircraft flying services from Dubai to Melbourne that could immediately be deployed across the Tasman on a marginal cost basis to increase its share at the expense of the Applicants.
 - (ii) Emirates operates wide-bodied aircraft, meaning it already has significant capacity "head room" to carry additional passengers if needed.
 - (iii) The capacity Emirates could make available for Tasman services will increase if it achieves its objective and doubles its flights into Australia.
 - (iv) Emirates will also be able to expand its capacity offering with the advent of its A380 aircraft on routes into Australasia in April 2007. Even assuming Emirates only operates its A380s on Tasman services to Auckland and that it operates in a 500 seat configuration (less than the "standard" 555 seat A380 configuration) its capacity will significantly increase.
- (b) Emirates' has cultivated a strong brand image in Australia and New Zealand, supplemented by its sponsorship of significant sporting and cultural events.
- (c) Emirates is a highly profitable airline with significant financial resources at its disposal.
- (d) Emirates operates its Tasman services at a significant cost advantage to the Applicants, which enables the carrier to target leisure passengers with low fare offerings whilst offering business travellers high quality service.
- (e) Apart from the inability of its wide-bodied aircraft to land at Wellington airport, Emirates faces no supply side factors that could hamper its expansion over the long-term. In particular, it faces no long-term problems obtaining access to airport gates and slots.

9.8 Despite its different business model, Virgin Blue similarly remains in a strong position to enter and expand on all Tasman city pairs:

- (a) Virgin Blue has aircraft deployed elsewhere that could be quickly redeployed to the Tasman if it were more profitable to do so.

- (b) Virgin Blue (and Pacific Blue) each have highly recognised, well-established brands in both Australia and New Zealand.
- (c) Virgin Blue has access to sufficient aircraft and financial resources in its own right as well as through its ownership links with the Virgin group and Patrick Corporation.
- (d) Virgin Blue faces no regulatory restrictions to its service offering, nor any problems gaining access to facilities (including terminal space, counter space and slots) at Wellington, Christchurch and Auckland Airports for the purpose of providing Tasman services.
- (e) Pacific Blue (through Virgin Blue) continues to implement a business model that fundamentally seeks to minimise costs and offer passengers low airfares. Many of the recent innovations adopted by Virgin Blue as part of the NWC model appear to be targeted towards improving the airline's appeal to the business traveller. However, these developments have been undertaken with a stated commitment by the airline that it will maintain its low fare offering, which is likely to broaden the base of passengers for whom Virgin Blue offers a legitimate alternative to the Applicants' services.

9.9 In the Qantas/Air NZ Decision the Tribunal noted that Emirates and Virgin Blue had experienced rapid growth in their collective share of passenger traffic on the Tasman routes up until May 2004. The Applicants submit that the collective share figures set out in **Table 3** illustrate that this was not a temporary aberration. A collective passenger share of 23% on the Tasman routes in October 2005 highlights that Emirates and Virgin Blue face no long term disadvantages with respect to route expansion, brand credibility or product differentiation.

9.10 Other fifth freedom carriers also have the bilateral rights to fly across the Tasman in response to an incentive to do so.

Conduct of Emirates and Virgin Blue

9.11 (**Competitive constraint**) In the Qantas/Air NZ Decision the Tribunal took note of a number of pertinent points regarding the constraints imposed on Qantas and Air NZ in the Tasman passenger market:⁸⁰

- (a) *"competitive constraints occur at the margin, and impact on the marginal passenger. Rivals or potential competitors do not need to appeal to all of the incumbent's passengers to exercise a competitive constraint on them. Rather,*

⁸⁰ See **note 7** at para. 352.

it is necessary only that enough customers are affected at the margin to make any increase in fares by the incumbents unprofitable;

- (b) *while an LCC's product may be different from that of an FSA [or network carrier], LCC's can and do constrain the conduct of the FSA;*
- (c) *constraints imposed by entrants do not depend on an immediate ability to increase capacity, but on their ability to implement a sound business plan over a well-defined period of time; and*
- (d) *incumbents will be constrained from charging supra-competitive fares, not by the threat of entry on a particular route, but by the potential for new entrants to enter Tasman routes and gain profitable market share." [emphasis added]*

All these points remain directly applicable to the Qantas and Air NZ today, regardless of whether the TNA is in operation or not.

- 9.12 The Applicant acknowledge they have historically had a high share of capacity on the Tasman (93.4% in 2000), though it has fallen to 76.6%⁸¹ as of February 2006 as competitors have expanded. It is forecast to reduce marginally under the TNA due to the removal of surplus capacity. However, as outlined below, it is the extent of competition for the *marginal* customer that determines overall pricing, not the level of combined share.
- 9.13 Competition from the marginally-costed Emirates and the low cost Virgin Blue, coupled with competition from the other fifth freedom carriers, means the Applicants are, and will continue to be, effectively constrained on the Tasman so that there will be no substantial lessening of competition.
- 9.14 As the Tribunal recognised, because competitive constraints occur at the margin, rival airlines do not need to appeal to all of the Applicants' passengers to exercise a competitive constraint upon them.
- 9.15 Competition for these critical marginal passengers is provided by existing competitors introducing a new set of competitive strategies generally (for example, Virgin Blue), to which incumbent airlines are compelled to respond or by other existing airlines seeking to fill spare capacity by marginal cost pricing (for example, Emirates) or by new entrants (for example, other fifth freedom carriers).
- 9.16 This is because an unsold seat on a flight represents revenue lost. Network airlines such as Air NZ and Qantas necessarily incur significant fixed costs, which represent a high proportion of total costs. Because the fixed costs will not fall as passengers and

revenue are lost, the profitability of the network airlines can be significantly affected by a relatively small loss of paying passengers. Given the relatively low marginal cost associated with one seat on an aircraft, the resulting loss of profit on an empty seat is almost as much as the lost revenue. This means that airlines prefer to sell a seat even at a very low fare rather than have it depart empty.

9.17 If the Applicants were to raise fares above prevailing levels in an attempt to exploit their market position under the TNA, Virgin Blue or Emirates would treat this as an invitation to keep their fares at their current level, in order to attract the customers at the margin who may be quite indifferent as to the airline with which they fly. Accordingly, the Applicants must monitor and respond to both the actual and potential behaviour of Emirates, Virgin Blue and other carriers to ensure that the critical marginal customer is not lost.⁸² This will occur regardless of whether the TNA is implemented.

9.18 In the Qantas/Air NZ Decision, the Tribunal explained the pricing constraint that would operate on the Proposed Alliance in the following terms:

"We therefore expect that competition for passengers at the margin will be intense. Each percentage point of market share gained is worth a considerable amount of profit to the airlines. Further, because airlines cannot easily discriminate between passengers at the margin and committed passengers, the low fares offered by Virgin Blue and Emirates in their attempts to gain market share at the expense of the Alliance will flow through to all passengers in the market who wish to take advantage of them."⁸³

...

"In short, we believe that Virgin [Pacific] Blue and Emirates are well placed to act, and would act, in response to any attempt by the applicants to reduce capacity, increase fares or offer poorer quality or more limited Tasman services."⁸⁴

...

"We query whether any airline would be prepared to raise its fares first in such a scenario, given the uncertainties as to whether its rivals would follow its lead, and the financial penalties that it would incur should no other airline increase its fares to the same level or at all. It should be clear to any airline that it is not optimal to raise ticket

⁸¹ Based on scheduled services as at 01.01.06 for the week commencing 20.02.06

⁸² Even in respect of schedule advantages, one consequence of the introduction of one way fares has been that passengers can, and do, choose different carriers for each leg, according to price and schedule convenience.

⁸³ See **note 7** at para. 444.

⁸⁴ *Ibid.* at para. 452

prices on a sustained basis in a market with the competitive characteristics of the Tasman air passenger services market.”⁸⁵

- 9.19 The pricing constraint on the Applicants, driven by competition for the marginal passenger, has an effect that extends beyond the fares offered to these passengers. The Tribunal explained this effect in the Qantas/Air NZ Decision as follows:⁸⁶

“The competition for the customer at the margin does not stay with that customer, but those fares necessary to attract the marginal customers will be available to all buyers in the market. The competition for an extra 1% of market share has an advantage and benefit for all passengers who are within a similar passenger profile as the marginal passengers. All customers have the ability to get the same advantage and benefit. Therefore, the competition for the marginal passenger spreads throughout the market.”

- 9.20 **(Maverick competition)** The competitive constraints imposed on market participants can be magnified where those participants face "maverick" competitors, who introduce to the market different strategic initiatives. Since their respective entries on to certain Tasman routes, Emirates and Virgin Blue have acted in this way, with each exhibiting its own unique set of endowments and competitive characteristics.

- 9.21 As a fifth freedom carrier, Emirates is unique in its ability to offer marginally-costed fares on Tasman routes in conjunction with a high quality service, given it is utilising aircraft designed for long haul travel. This is attractive to leisure passengers, but also to the many business travellers. In more recent times Emirates' service offering has also been augmented by its involvement in Virgin Blue's Velocity frequent flyer program.

- 9.22 The cost advantage associated with being a fifth freedom carrier on the Tasman delivers Emirates a lower profitability threshold and significant pricing freedom relative to the Applicants. As the Tribunal accepted in the Qantas/Air NZ Decision, this enables Emirates to target price-sensitive Tasman passengers with low promotional fares and ensure its continued competitive presence on Tasman routes.⁸⁷

- 9.23 This means Emirates can offer extremely low promotional fares in an effort to attract price-sensitive passengers, which in turn affects passengers' expectations regarding the appropriate fare level across all airlines. The existence of websites that provide detailed comparisons of fares (eg www.webjet.com.au) and increasing pervasiveness of the internet generally means that consumers are becoming increasingly aware of the various fares offered in the market. If Emirates offers seats at a particularly low

⁸⁵ *Ibid.* at para. 466

⁸⁶ *Ibid.* at para 429.

sale fare, Qantas and Air NZ must respond to that fare to reassure the public that the airlines are maintaining competitive offerings on the Tasman. If the Applicants do not offer fares commensurate to those being offered by their competitors, they are likely to lose a substantial number of price sensitive passengers. It is the experience of both Qantas and Air NZ that these passengers tend to switch in significant numbers from one airline to another in response to cheaper airfares.

- 9.24 Emirates leverages its marginal cost advantage to sell approximately 87% of its seats in its low priced lead-in and tactical fare classes.⁸⁸ In contrast, Qantas and Air NZ, without the ability to deploy aircraft on a marginally costed basis, sell approximately [RESTRICTION OF PUBLICATION CLAIMED] of their seats in lead-in and tactical fare classes respectively. Not only does Emirates offer such a high proportion of total seats at its lead-in and tactical fares, it does so while paying travel agents a level of commission in excess of that which can be offered by airlines operating fully costed models on the Tasman.
- 9.25 Emirates' higher product specification, current high levels of surplus capacity, and its ability to price at close to marginal cost, mean that it is a formidable competitor.
- 9.26 In addition to the substantial constraint imposed by Emirates, Virgin Blue has also had, and continues to have, a major impact on the Applicants' pricing. Virgin Blue's low cost structure allows it to sustainably carry traffic at lower average fares than Qantas and Air NZ, meaning the constraint it imposes is much greater than its market share alone might otherwise suggest.
- 9.27 Airlines employing a low cost model, such as Virgin Blue, have had a significant impact upon the operations of network carriers such as the Applicants:
- (a) By leveraging their simple business model and low cost base, they have contributed to significantly lower prices in the market: directly, by offering those prices themselves; and indirectly, by prompting the incumbent(s) to lower their price across all related routes in expectation of their entry.
 - (b) They have introduced different pricing models which have seriously and permanently undermined many of the pricing mechanisms traditionally employed by full service carriers to "fence off" seats for time sensitive passengers. For example, the offering of low priced one way tickets by LCCs has removed the ability of FSAs to implement traditional conditions such as return tickets or Saturday night stayovers

⁸⁷ *Ibid.* at para. 378.

⁸⁸ 6 months to December 2005. Air NZ estimate, based on data collated by travel agents.

- 9.28 This impact is evidenced by the market behaviour of the Applicants on the Tasman to date:
- (a) Qantas simplified its fare structure on the Tasman in an environment where Virgin Blue had signalled an intention to expand its services to the Tasman. As the Tribunal accepted, the launch in Australia and now on the Tasman of Jetstar by Qantas was also a competitive response.
 - (b) The short haul changes introduced by Air NZ in 2003 were primarily in response to the rise of the LCC model – Tasman Express was particularly directed at the anticipated entry of Virgin Blue (and more recently the expansion of Emirates). These “Express” initiatives – “everyday low fares” – have resulted in fare reductions across all routes (including routes where Air NZ is the only airline operating) and the removal and simplification of fare conditions.
- 9.29 In more recent times, Virgin Blue's newest innovations mark a developing strategic initiative, designed to marry broader business traveller appeal with low cost, low fare principles. Virgin Blue suggests its low fares, reliability, increased frequencies on existing routes and the continued expansion have all contributed to the carrier becoming increasingly attractive to business customers. Jon Marshall, Virgin Blue's global sales manager, reported in March 2004 that corporate-government travel accounts for 40 per cent of Virgin Blue's traffic. This was highlighted at the launch of “Velocity”, where Brett Godfrey, CEO of Virgin Blue said: *“Velocity powered by Virgin Blue, is for all of our Guests and is also part of our strategy to broaden Virgin Blue's appeal to frequent travellers, and the corporate and Government sectors.”*
- 9.30 As already highlighted in section 5 above, by increasing the airline's appeal to the business traveller, at the same time as continuing to appeal to leisure travellers, Virgin Blue has increased the level of constraint it imposes on the Applicants. This broadening in appeal should be considered in conjunction with a general trend in business travel on short haul routes like the Tasman towards foregoing a higher degree of service or broader schedules for the price and value offered by an LCC. These two factors highlight that Virgin Blue remains a serious, long-run source of commercial rivalry for the Applicants.
- 9.31 The Applicants' must limit the deployment of their lower cost subsidiaries, Jetstar and Freedom, due to the “cannibalising” impact that their widespread deployment would have on the network feed traffic upon which their parent airlines rely.
- 9.32 **(Revenue management & pricing)** As network carriers, the Applicants attempt to fill each flight by appealing to a mix of higher and lower yielding passengers. A detailed

outline of the revenue (or yield) management practices adopted in order to optimise the performance of each flight on the Tasman routes is provided at **Annexure F**. **Annexure F** illustrates the close relationship between the various fare categories and how competitors such as Emirates and Virgin Blue can exercise a significant competitive constraint on Qantas and Air NZ across a range of fare categories and routes by appealing to "marginal passengers".

- 9.33 When Virgin Blue, Emirates or a fifth freedom carrier offer low fares on a route, this invariably results in forward bookings for Qantas that are below what the airline forecast. Forward bookings falling below forecast load factors will reduce the probability of a Qantas flight being filled which, through the operation of the revenue management system described in **Annexure F**, will automatically see more seats being re-allocated toward the lower fare classes as the revenue management system creates more discounted seats on a flight.
- 9.34 In addition to these reactions by the revenue management systems of the Applicants, Qantas and Air NZ actively monitor the pricing behaviour of Virgin Blue, Emirates and the other fifth freedom carriers in order to ensure their own fares are competitive. By way of illustration, Air NZ's pricing department sets a fare structure by reference to the competitive environment (that is, the current and projected prices and products offered by competitors) as well as route yield and revenue requirements. As mentioned in paragraph 9.23 above, if Qantas and Air NZ do not offer fares comparable to those being offered by their competitors, especially at the cheaper fare levels, they are likely to lose a substantial number of price sensitive passengers, who may be either business or leisure travellers.
- 9.35 The presence of Emirates and Virgin Blue has also meant that passenger perceptions of "appropriate" fare levels across all Tasman routes have been permanently altered. In the experience of the Applicants, once Emirates (or Virgin Blue or another competitor) establishes a benchmark fare in respect of a particular Tasman route which is matched by Qantas or Air NZ, there is significant consumer pressure to make Qantas/Air NZ fares consistent across other city pairs. Furthermore, inconsistent fares allow price sensitive passengers to take advantage of indirect routes in order to obtain a better overall fare package. Invariably, these competitive pressures result in the higher fares falling to a consistent level.
- 9.36 The Applicants generally react swiftly to the promotional fares both Emirates and Virgin Blue offer to Tasman travellers. For example:
- (a) Between 8 and 18 April 2005 Emirates offered one-way fares of A\$120 on the Sydney – Auckland and Melbourne – Auckland routes for travel between 27

April and 30 June 2005. Qantas responded with an offer of A\$128 one-way on the same routes for the same travel period.

- (b) Between 11 November and 5 December 2005 Qantas initiated its own sale of one-way business class fares of A\$749 and A\$759 on the Sydney – Auckland and Melbourne – Auckland routes respectively for travel between 1 December 2005 and 6 January 2006. A significant driver behind this decision was the business fare of A\$849 return being offered by Emirates over the same period.
- (c) Virgin Blue offered A\$99 one-way fares on the Sydney – Christchurch and Melbourne – Christchurch routes for sale between 23 December 2004 and 9 January 2005 for travel between 17 January 2005 and 23 March 2005. In response, Qantas offered one-way sales fares of A\$149 and extended the sale period to 14 January 2005.
- (d) Virgin Blue initiated another sale in late April 2005, with the offer of A\$99 one-way fares across all the Virgin Blue routes⁸⁹ for travel between 1 May 2005 and 30 June 2005. Qantas responded with one-way fares for the same period of A\$129.

Other factors – fifth freedom carriers

9.37 In addition to Emirates and Virgin Blue, the Applicants contend that the fifth freedom carriers currently offering services on the Tasman routes impose, and will continue to impose, a competitive constraint on Qantas and Air NZ. Furthermore, a large number of other carriers, in particular Singapore Airlines, have similar, unexercised rights and could elect to enter the Tasman market at any time, given no barriers to entry and expansion. Thai Airways and Malaysia Airlines are two carriers who have operated on the Tasman in the past and, given the incentive, will do so again.

9.38 As with Emirates, the other fifth freedom carriers are an effective competitive constraint on the Applicants' pricing conduct because they have the ability and incentive to price fifth freedom flights on the basis of marginal costs only. This means that in the face of fare increases by either of the Applicants, fifth freedom carriers are able to offer an attractive alternative to the marginal passenger.

9.39 This analysis is particularly powerful when applied to Singapore Airlines, a network carrier with a high quality service that operates a large number of weekly services between the east coast of Australia and Singapore. Even though Singapore Airlines

⁸⁹ The one exception was Melbourne-Christchurch, where Pacific Blue offered A\$89 one-way fares.

does not presently offer Tasman services, it is well understood that it is constantly seeking to increase its presence into and out of Australasia. Whilst it sold its shareholding in Air NZ in 2002, the existence of that equity interest evidences a clear focus on the Australasian region, including the Tasman market.

- 9.40 The constant presence of Singapore Airlines on the fringes of the Tasman market is yet another constraint which will operate to ensure any anti-competitive detriment potentially arising from the TNA is minimised.

Conclusion

- 9.41 In addition to being "maverick" competitors, Emirates and Virgin Blue represent committed, long-run sources of commercial rivalry for Qantas and Air NZ on the Tasman routes. As some of the examples outlined above demonstrate, they have the ability and incentive to seek out and win marginal passengers and are viewed by Qantas and Air NZ as ever-present competitive threats.
- 9.42 Acting alone or jointly, the Applicants simply cannot afford to ignore the pricing, scheduling and product initiatives of these rivals. Competition from the marginally-costed Emirates and the low cost Virgin Blue, coupled with competition from the other fifth freedom carriers, means the Applicants are, and will continue to be, effectively constrained on the Tasman so that there will be no substantial lessening of competition.
- 9.43 Should the Applicants attempt to take advantage of any benefits delivered by the TNA to the detriment of passengers, the Applicants are well aware that both Emirates and Virgin Blue (and the remaining fifth freedom carriers) can and will act to win additional market share through a combination of low fares and high quality service (Emirates) or with a stated practice of being a "price leader" (Virgin Blue). This competition for the "marginal passenger" and its associated constraint upon the Applicants is such that the TNA will not result in any anti-competitive detriment in the Tasman air passenger market.

10. DETRIMENT IN THE TASMAN AIRFREIGHT MARKET

- 10.1 Under the TNA the Applicants agree that they may co-ordinate cargo services and agree cargo rates from time to time. The timing and extent of such co-ordination will be determined by the Committee at its discretion.
- 10.2 The Applicants submit that there will be no substantial anti-competitive detriment associated with any co-ordination between them in respect of air freight services in the Tasman market. The factors outlined below support this submission.

- 10.3 **(Barriers to Entry/Expansion)** There are minimal (if any) regulatory barriers to entry or expansion in the Tasman air freight market. Any Australian or New Zealand carrier is free to establish unlimited freight services on the Tasman. Freight services can also be provided by any foreign carrier with fifth freedom freight rights on the Tasman routes. Furthermore, Australia and New Zealand have exchanged unlimited seventh freedom cargo rights with the United States. This allows United States' freight carriers to freely operate stand-alone services on the Tasman and on other international routes to and from both Australia and New Zealand. As the Commission itself noted in the course of the Tribunal hearing, entry into the Tasman air freight market was relatively easy.⁹⁰
- 10.4 **(Dedicated Freighter Services)** As illustrated in **Table 4** above, in addition to the passenger aircraft carrying cargo on the Tasman routes, the following dedicated freighter services all operate on the Tasman in competition with the Applicants:
- (a) Singapore Cargo (B744F Auckland-Sydney-Auckland – Saturday);
 - (b) CV Cargolux (B744F Melbourne-Auckland (one way) – Friday and Sunday);
and
 - (c) HJ Asian Express DHL (B727F Auckland-Sydney-Auckland – Monday to Saturday).
- 10.5 **(Fifth Freedom Carriers)** In contrast to the Applicants, each of whom operate a mix of narrow and wide bodied aircraft, fifth freedom carriers use only wide bodied aircraft, which are the best suited for the carriage of freight.⁹¹ The pricing offered by all the fifth freedom operators on the Tasman routes significantly impacts the prices the Applicants are able to charge for air freight services and acts as a direct constraint on their conduct.
- 10.6 The commencement of Emirates' Tasman operations in September 2003 had a particularly significant competitive effect on the Tasman air freight market. The Applicants had to take immediate steps to reduce prices and/or provide greater discounts to retain customers. By way of illustration, since the date of Emirates' entry, market prices in respect of freight forwarders' consolidations (the primary traffic segment) from New Zealand to Australia have fallen from between [RESTRICTION OF PUBLICATION CLAIMED] per kilogram to approximately [RESTRICTION OF PUBLICATION CLAIMED] per kilogram.

⁹⁰ See **note 7** at para. 526.

⁹¹ Narrow bodied aircraft cannot carry pallets and containers of the type generally used for the transportation of general cargo. Narrow bodied aircraft can carry one type of container, the LD3-45, but these have limited uses and are suitable for transporting small items of freight, primarily mail and passenger luggage.

- 10.7 **(Other Operators)** Finally, as is the case with passenger services, there are many suppliers of cargo services who are not capacity constrained and who would readily be able to respond to increased demand if the Applicants attempted to increase cargo rates.
- 10.8 In conclusion, the reasoning and findings of the Tribunal with respect to the Tasman air freight market are still applicable today. That is, the TNA will not have a material anti-competitive effect on the Tasman air freight market.⁹²

11. BENEFITS

- 11.1 Substantial public benefits will arise from the operation of the TNA. The Applicants note that in the Qantas/Air NZ Decision the Tribunal took a broad approach to the phrase "public benefit" and adopted "*a total welfare standard – subject to a caveat regarding the weight to be given to public benefits to the extent to which they are not shared among members of the community generally.*"⁹³

International competitiveness and the national interest

- 11.2 In relation to the Proposed Alliance the Tribunal acknowledged that "... *it is in the national interest of Australia for Qantas to be a strong and efficient airline, particularly in light of experience over the last few years when a number of international airlines have withdrawn services to and from Australia.*"⁹⁴ The Tribunal went on to conclude⁹⁵:

"We consider that any alliance which will strengthen Qantas' ability to compete on the international scene will be in the national interest, and therefore a public benefit, so long as there is no significant detriment from such alliance which outweighs that benefit." [our emphasis]

- 11.3 The Applicants submit the TNA will strengthen Qantas' financial position in an international aviation industry where it continues to face a number of critical regulatory and foreign ownership challenges in its effort to remain a strong and commercially viable business able to deliver tangible benefits to its shareholders and Australia. These challenges include:

- (a) The geographic location of Australia (and New Zealand), which means Qantas (and Air NZ) are "end of route" carriers, without the advantage of the natural hubs available to midpoint carriers such as Singapore Airlines and Emirates.

⁹² See **note 7** at para. 528.

⁹³ *Ibid.* at para. 190.

⁹⁴ *Ibid.* at para. 658.

⁹⁵ *Ibid.* at para. 660.

- (b) The international aviation framework that has historically governed, and continues to govern, global aviation and the resulting distortion of natural market evolution.
- (c) The support offered to a number of Qantas' major international competitors by government policies directed at supporting local airlines. This creates two particular problems. Firstly, the policies contribute to overcapacity, with many governments acting to prevent the failure of unsustainable flag carriers. Secondly, favourable national policies create a significant competitive advantage for their recipients.
- (d) Uneven global progress towards airline industry liberalisation, which has meant that in some cases Qantas' market access opportunities have remained limited.
- (e) The financial challenges facing Qantas, including rising oil prices and a high sensitivity to unexpected shocks and the economic cycle.

11.4 By strengthening Qantas' competitive presence internationally, the TNA helps to ensure Qantas remains a strong and sustainable airline that is uniquely placed to deliver certain important benefits to Australia. These include "... *the most complete and sustained coverage of domestic Australian and international routes between the rest of the world and Australia (unlike the opportunistic entry and exit of many other international carriers), and generating significant economic benefits for Australia through its investment and employment and through its high standards of corporate social responsibility and corporate sponsorships.*"⁹⁶

Increased efficiency via cost reductions

- 11.5 By operating jointly, the Applicants can utilise their combined fleets to more efficiently service the various Tasman routes. There are two distinct efficiency gains:
- (a) the on-going cost savings associated with removing some of the surplus capacity, which is addressed in paragraphs 11.6 to 11.9; and
 - (b) a more efficient use of remaining capacity, in terms of a better schedule spread and greater aircraft utilisation. By way of illustration, the Applicants' load factors (which are a key measure of aircraft utilisation) are forecast to improve from approximately 72.7% today to approximately 75.0 - 76.5% by Year 3 of the TNA. This is addressed in paragraphs 11.10 to 11.18.

⁹⁶ *Ibid.* at para. 655.

- 11.6 Details of the cost savings associated with the removal of surplus capacity by Qantas and Air NZ under the TNA are set out in Confidential **Annexure G**. These cost savings are unique to the TNA and could not have been achieved in its absence for the reasons already outlined above.
- 11.7 In evaluating the public benefit associated with the Applicants' claimed cost savings, the Commission should apply the finding of the Tribunal in the Qantas/Air NZ Decision⁹⁷:
- "... cost savings achieved by a firm in the course of providing goods or services to members of the public are a public benefit which can and should be taken into account for the purposes of s 90 of the Act, where they result in pass through which reduces prices to final consumers, or in other benefits, for example, by way of dividends to a range of shareholders or being returned to the firm for future investment" [our emphasis].*
- 11.8 The Applicants submit that the competitive nature of the Tasman market is sufficient for the cost savings attributable to the TNA to be passed on to consumers in the form of reductions in fares or delays in fare increases. This is consistent with the Tribunal's findings in the Qantas/Air NZ Decision, which are directly applicable today (see paragraph 715 of that Decision).
- 11.9 Under the TNA each airline bears its own cost. Reductions in cost therefore flow straight to each airline's individual "bottom line", meaning the on-going incentive to reduce costs is maintained.

Better scheduling – removal of wing-tip flying

- 11.10 The TNA will result in scheduling efficiencies which reduce the level of "wingtip" flying, resulting a more even spread of flight times for consumers. Wingtip flying is detrimental because passengers who wish to fly during a scheduling gap must fly at an inconvenient time.
- 11.11 The removal of wingtip flying is directly related to the TNA. As highlighted in section 3 above, where Qantas and Air NZ are in competition with each other on a route, each has a strong incentive to schedule flights at roughly the same times as its rival because:
- (a) the airlines will seek to operate their flights at those times when there is the greatest level of high yield traffic, in order to maximise their load factors and revenue; and

- (b) each airline will seek to draw business away from the other.
- 11.12 On the Tasman, an additional factor contributing to the high level of existing wingtip flying is the logistical issues associated with maximising aircraft utilisation. By scheduling aircraft to leave New Zealand early in the morning it is possible to operate two return services per day. Although this is an attractive means by which to maximise utilisation when operating independently, it does mean that Qantas' and Air NZ's departure times are closely aligned. Under the TNA, the Applicants can achieve equivalent or better aircraft utilisation via other means, reducing the level of wingtip flying.
- 11.13 Absent the TNA, Qantas and Air NZ will continue to have the same incentives to schedule flights at roughly the same times. However under the TNA, the Applicants will co-operate to arrange schedules such that optimum frequency is provided to consumers. As a result, consumers receive a greater choice of flight times and benefits will accrue to consumers who are presently unable to fly at a time convenient to them.
- 11.14 The combined management of the Tasman Network is likely, on some routes, to replace two overlapping flights with one flight and to offer an additional flight at a new time. This benefit applies equally to connecting customers, who gain the benefit of a wider spread of connection options. Taking Auckland – Sydney for example, under the TNA schedule, the Applicants will operate services at 0630, 0800 (using the larger B744) and 0930, rather than the current 0605, 0700 and overlapping 0900 services.
- 11.15 The Applicants have agreed the default departure schedule for the first scheduling period under the TNA, although this can be amended by the Committee if needed in response to market conditions at the time. **Annexure I** graphically illustrates the improvement to the spread of departures under the TNA using the default schedule.
- 11.16 Passengers who value flexibility, and are willing to pay more for the fare types that offer flexibility, will choose the carrier (or combination) that offers the most alternatives for changing flights. Those passengers who would have purchased a more restrictive fare absent the opportunity to change flights could choose to buy a higher fare that allows such flexibility when presented with a greater opportunity to change flights (as is the case with the Applicants' services under the TNA). The consequence is that under the TNA, it is possible that more passengers will purchase tickets for the higher fare buckets than would otherwise be the case.
- 11.17 In these circumstances, there is a potential for an increase in the Applicants' average fares on account of passengers choosing to pay a higher fare because they perceive

⁹⁷ *Ibid.* at para. 189.

a higher value in an improved product offering. Average fares will only increase if passengers value the changes made and make their purchasing decisions accordingly, and there will be no ability for the Applicants to charge prices higher than the competitive market price. If passengers do not value the changes, they will not choose to pay the higher fare.

- 11.18 The Tribunal considered and accepted these arguments in the Qantas/Air NZ Decision and made the following finding:⁹⁸

"We therefore accept that there may, or probably will, be situations arising whereby the applicants might achieve higher average fares under the Alliance. Such a situation would occur where passengers who value flexibility will choose a carrier that offers the greatest alternatives for flexibility in relation to changing flights. This may result in passengers choosing flights which nevertheless require them to pay a higher price because they fall into a different fare bucket. In such circumstances we consider that, in this respect, there will be little, if any, detriment arising out of the Alliance as it will be within the power of passengers to choose their own times to fly and the point of time at which they wish to book their tickets."

Connectivity and a seamless travel experience for consumers

- 11.19 The TNA will enhance the product offering to consumers by providing for better connectivity and a more seamless travel experience in terms of baggage thru-checks, multiple boarding passes and reduced waiting times.
- 11.20 The TNA will reduce the waiting times for passengers connecting to Tasman services from domestic or other international points at the key Tasman ports for two principal reasons:
- (a) Tasman codesharing – this means Qantas is indifferent as to whether a Canberra passenger travelling to New Zealand (for example), connects from the Qantas domestic service to an Air NZ or Qantas Tasman service. As a result, customers will have a far greater number of online connections across the Tasman, thus reducing connection times and having more flexibility when planning their itineraries.
 - (b) Schedule co-ordination – this results in a better spread of Qantas and Air NZ departures, *further* enhancing the connection options for connecting passengers as described above.

⁹⁸ *Ibid.* at para. 457

11.21 **Annexure H** lists the 55 airports in Australia (and 17 in New Zealand) that do not currently have direct Qantas or Air NZ services to New Zealand (and Australia). People living within the catchment areas of these airports who want to travel across the Tasman require a connection at the Tasman gateways and therefore stand to benefit from the TNA.

Greater flexibility for consumers to change itineraries

11.22 The TNA will also provide for greater flexibility in relation to itinerary changes. For example, a passenger that has purchased a flexible Tasman airfare ticketed by Qantas may be able to change their booking to a flight operated by either Air NZ or Qantas. This will provide passengers with a greater range of flight times to choose from in the event they wish to change their itinerary.

"Frequent Flyer" benefits

11.23 Although Air NZ and Qantas will continue to have independent frequent flyer programs, members of each Applicant's scheme will be able to earn and redeem points on all services carrying the code of the operator of the relevant frequent flyer program.

11.24 For example, a member of the Qantas Frequent Flyer Program will be able to earn and redeem Qantas points on Tasman flights carrying the "QF" designator code for that passenger, whether the flight is operated by Qantas or Air NZ.

11.25 This will increase the number of flights on which earning and redemption opportunities are available to members.

More direct route options

11.26 The TNA will permit Qantas passengers travelling from Perth and Cairns to Auckland to fly on an Air NZ direct service (on a Qantas code).

Increased likelihood of new services

11.27 While the Applicants are not currently forecasting any new direct services, the incentives to provide new direct services are greater under the TNA than where each airline acts independently. Absent the TNA, Air NZ's entry on to a new service would be likely to encourage Qantas to enter. (Given the importance of the Tasman market for both Air NZ and Qantas in terms of local and connecting traffic, it is most unlikely that either airline would permit the other airline a network advantage through being

the sole operator on a particular direct route in the medium term.) The need for network airlines to match a competitor's new direct service in order to defend their wider network revenues is the key reason why many routes are not served directly where airlines compete, but could be served directly where they can co-operate.

- 11.28 The ability to consolidate demand and take advantage of feed traffic from both airlines' networks, means the Applicants have significantly more incentive to offer additional services with the TNA.

12. CONCLUSION

- 12.1 The findings and reasoning of the Tribunal in the Qantas/Air NZ Decision should be applied to this application. On this analysis, the TNA provides substantial public benefits with no countervailing detriment in any relevant market. As a result, it meets the net public benefit test imposed under the Act and should be authorised by the Commission.

13. TERM

- 13.1 The Applicants submit the Commission should authorise the TNA for a period of not less than five years.

14. CONFIDENTIALITY

- 14.1 This submission includes commercially sensitive and valuable information which is confidential to the Applicants. Disclosure of that information could unreasonably prejudice the commercial position of one, or both, of Qantas or Air NZ.
- 14.2 Pursuant to sub-section 89(5) of the Act, the Applicants apply for certain information contained in this submission to be kept confidential by the Commission and excluded from the public register.