Australian Government

Department of Transport and Regional Services

File Reference: P2004/0382

Ms Isabelle Arnaud
Director
Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

Dear Ms Arnaud

Qantas and Air New Zealand applications for authorisation (your ref A91001, A91002 and A91003)

Thank you for your letter of 19 April 2006 seeking submissions on the applications for authorisation from Qantas Airways Limited (Qantas) and Air New Zealand (Air NZ) and their subsidiaries (the Applicants) in relation to a Tasman Networks Agreement (TNA).

The Department recognises that it is a matter for the ACCC to determine the relative merits of arguments presented by the Applicants on the public benefits and anti-competitive effects of the proposed TNA. To assist the ACCC in coming to a determination, the Department is pleased to provide information on trends in trans-Tasman market conditions and the outcomes of the Australian Government's review of international aviation policy. This information is attached.

Should you wish to discuss this submission please call Ann Redmond in the Aviation Markets Branch on 6274 7738.

Yours sincerely

Stephen Borthwick
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18 May 2006

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Introduction

The Department recognises that it is a matter for the airlines to make their case before the Australian Competition and Consumer Commission (ACCC), and for the ACCC to determine the relative merits of arguments on the anti-competitive effects and public benefits from the proposed Tasman Networks Agreement (TNA) between Qantas and Air New Zealand (the Applicants). To assist the ACCC in coming to a determination DOTARS would like to offer the ensuing comments.

DOTARS notes that the intensity of competition in relevant markets is a key factor in the ACCC determining the public benefit of the proposal pursuant to the public benefit test in the *Trade Practices Act 1974*. The first part of this submission will examine the actual and potential for competition in the trans-Tasman market.

DOTARS also notes that our aviation policy interests are best served by maintaining a viable and competitive Australasian aviation sector. The dynamic nature of the global and domestic aviation sector and the challenges facing the industry were considered in the Australian Government's recent review of international aviation policy. The second part of this submission seeks to summarise the Australian Government's announced international aviation policy settings and outline some of the factors affecting the sector in general.

The Trans-Tasman Market

A number of carriers currently operate on the trans-Tasman – including Qantas Group (including Jetstar International), Air New Zealand Group (including Freedom Air International), Emirates, Virgin Blue, Aerolineas Argentinas, Garuda Indonesia, LAN Chile and Royal Brunei Airlines. The number of competitors in this market has resulted in surplus capacity and industry has indicated it believes that yields from the market are unsustainable. As part of its deliberations the ACCC may wish to examine the sustainability of current air fares in the medium to longer term.

Qantas and Air New Zealand are by far the largest players in the market, with both holding approximately one third of the overall market share. Significantly no competition to the Applicants exists on 15% of trans-Tasman services[1].

A breakdown of market share for the main trans-Tasman routes as of February 2006 is provided in an attachment and is summarised here.[2]

Auckland route (Sydney-Auckland, Melbourne-Auckland, Brisbane-Auckland)
Flights to and from Auckland comprise 59.5% of all flights in the trans-Tasman market. Air New Zealand Group and Qantas Group have a combined market share of 73.5%; Virgin Blue comprises 2.5% of the market share, Emirates 16% and other fifth freedom carriers, 8%. Emirates provides a significant level of competition particularly on the Brisbane-Auckland route where its market share (at 28.3%) is greater at the present time than Qantas (at 17%).

Christchurch route (Sydney-Christchurch, Melbourne-Christchurch, Brisbane-Christchurch)
Flights to and from Christchurch represent 23.2% of the trans-Tasman market. Emirates is the only fifth freedom carrier to serve this market. Currently Emirates

[1] Measured by seats available.

[2] Measured by seats available

only operates a Sydney-Christchurch route on which it carries 21.4% of passengers providing competition to Qantas Group (43.3%), Air New Zealand (24.2%) and Virgin Blue (10.1%). Virgin Blue's total market share of the Christchurch market is 17%. It holds 19.9% of the Melbourne-Christchurch market and 34.5% of the Brisbane-Christchurch market.

Wellington (Sydney-Wellington, Melbourne-Wellington, Brisbane-Wellington)
Flights to and from Wellington comprise 10.2% of the trans-Tasman market. Qantas Group and Air New Zealand Group collectively hold 100% of market share of both the Sydney-Wellington and Melbourne-Wellington routes and 69.8% of the Brisbane-Wellington route. The remaining 30.2% of the Brisbane-Wellington route is held by Virgin Blue. There are currently no fifth freedom carriers serving Wellington due to the inability of Wellington International Airport to receive the wide-body aircraft currently utilised by these carriers on the Tasman.

In summary, the trans-Tasman is a dynamic competitive market that has changed significantly since Virgin Blue and Emirates commenced serious initiatives in January 2004 and August 2003 respectively. The following tables show the origin/destination statistics for the trans-Tasman route for the years ending December 2003 and December 2005 respectively[3].

Table 1. Trans-Tasman passenger traffic by airline (year ended December 2003)

Airline	Passengers each way	Passengers each way (%)
Qantas	1,209,562	40.0
Air New Zealand	1,025,510	33.9
Freedom Air International	503,954	16.6
Thai Airways International	107,273	3.5
Emirates	79,282	2.6
Malaysia Airlines	23,169	0.8
Garuda Indonesia	17,333	0.6
Aerolineas Argentinas	8,746	0.3
LAN-Chile	7,267	0.2
Singapore Airlines	6,474	0.2
Other fifth freedom carriers	38,766	1.3
Total	3,027,337	100.0

Table 2 Trans-Tasman passenger traffic by airline (year ended December 2005[4])

Airline	Passengers each way	Passengers each way (%)
Air New Zealand	1,327,047	33.8
Qantas	1,236,364	31.5
Freedom Air International	444,691	11.3
Emirates	382,817	9.8
Virgin Blue	300,309	7.7
Thai Airways International	53,438	1.4
Royal Brunei Airlines	37,196	0.9
Jetstar International	23,424	0.6
LAN-Chile	22,405	0.6
Aerolineas Argentinas	21,993	0.6
Other fifth freedom carriers	70,718	1.8
Total	3,920,403	100.0

[3] Department of Immigration and Multicultrual Affairs passenger card data.
[4] DOTARS notes that Thai Airways have since withdrawn their services and that Jetstar only commenced operations in the final quarter of 2005.

The statistics illustrate that the combined Qantas (including Jetstar) and Air New Zealand (including Freedom Air) market share of the trans-Tasman dropped from 90.5% to 77.3% in 2 years. During this time the market also experienced: a 30% growth in passenger travel; a 64% growth in the market share of fifth freedom carriers; the emergence of Emirates as the dominant fifth freedom carrier; as well as the entry of Virgin Blue.

The entry of Emirates in the market has significantly contributed to traffic growth. Emirates is one of a number of fifth freedom carriers on this route. While some of these carriers have withdrawn from the route since 2003 others have entered demonstrating both the low barriers to entry and exit in this market and the continued interest of international carriers to fly the trans-Tasman. Significantly the total fifth freedom carrier market share has increased from 9.5% in 2003 (absent Emirates) to 15.6% in 2005. In addition to the five fifth freedom carriers currently serving the market at least 16 others have the rights to serve it. In a number of instances major airlines that at this stage are choosing not to serve New Zealand from Australia offer direct services to New Zealand from their home markets while others operate to Australia and then codeshare to New Zealand on Qantas or Air New Zealand. With limited barriers to entry in this market DOTARS considers that fifth freedom carriers are likely to be an ongoing feature of competition in the trans-Tasman market.

Limited barriers to entry and expansion in the market
Australia's existing bilateral agreements provide significant opportunities for airlines from third countries to enter the trans-Tasman market and the Australian market and the Australian Government's aviation policy does not prevent the current competitors from expanding in the market. There also appears to be no barrier to other new or existing market participants developing arrangements similar to the proposed TNA subject to the approval of the relevant competition authorities in Australia and New Zealand.

DOTARS recognises that access to facilities may initially present an issue on some market segments most notably on the Wellington route. As mentioned Wellington International Airport is currently unable to receive wide-bodied aircraft due to its short runway length. While this doesn't remove the competitive threat of domestic carriers such as Virgin Blue entering this market (it currently serves Brisbane-Wellington but not Sydney-Wellington nor Melbourne-Wellington), it may present a barrier for fifth freedom carriers who currently utilise such aircraft on the trans-Tasman. DOTARS understands however that the airport has commenced an upgrade program in preparation for the entry into service of the Boeing 787 in 2008 which has the ability to take-off from a short runway. Media reports suggest that a number of airlines with fifth freedom rights on the trans-Tasman have expressed interest in purchasing the Boeing 787 including Emirates, Air New Zealand, Aerolineas Argentinas, Singapore Airlines, Lan Chile and Thai Airways.

While Wellington comprises only a small part of the total trans-Tasman market and the prospect for competition still exists, the ACCC may wish to consider the impacts on this sub-market separately from other routes.

International Aviation Policy

The Australian Government has recently reviewed its international aviation policy settings. The restated policy continues to recognise international air transport as a key driver of the Australian economy providing access to markets for our exports and crucial for serving and growing the tourism industry. Although Australia would prefer a more liberal global aviation environment it must operate within the constraints of the complex bilateral system of gaining rights to international air services. While competition plays a vital role in the aviation sector, Australia remains disadvantaged by restricted access to many key markets and Australian based carriers face competition in many markets from government-owned or subsidised airlines. Accordingly the Australian Government must consider a range of competing interests to ensure the national interest is served through these bilateral negotiations.

On 21 February 2006 the Minister for Transport and Regional Services, the Hon Warren Truss MP, announced the results of a review of Australia's International Aviation Policy settings, and outlined how the refined negotiating objectives of these policy settings would best serve the national interest. These objectives include:

- recognising 'open skies' as an aspirational goal to be sought on a case-by-case basis;
- negotiating capacity for air services ahead of demand, to allow airlines to make decisions and provide for competition and growth;
- maintaining and expanding access to a range of aviation hubs;
- recognising the contribution an Australian-based airline industry makes to the economy;
- encouraging major foreign carriers to commit to a long-term presence in Australia;
- addressing Australia's trade and economic interests;
- continuing to attract more services to the regions and smaller states by offering unlimited access for airlines to all airports other than the four gateways of Sydney, Melbourne, Brisbane and Perth;
- growing the air freight market by seeking unlimited access for freight aircraft from Australian markets to and beyond the markets; and
- continuing to reform the bilateral air services system by:
  - seeking to designate airlines through their principal place of business, rather than through ownership criteria; and
  - continuing to seek liberalisation through multilateral forums such as the International Civil Aviation Organisation (ICAO) and World Trade Organisation (WTO).

Industry response to current challenges

A number of significant challenges have faced the aviation industry over the last 6 years. Threats to international security, the downturn in many parts of the global economy, SARS and the subsequent decline in passengers resulted in substantial financial losses and in some circumstances, bankruptcy. Fuel prices have recently emerged as a significant threat to the viability of the industry. The Bureau of Transport and Regional Economics Jet Fuel Price Index in US dollars peaked at $264 in September 2005, an increase of 50.1% on September 2004 and 171.9% on September 2003. Airlines globally continue to restructure their businesses in order to remain viable. Some have been afforded direct subsidy support and/or bankruptcy protection by their governments. In this context it is important to note that the Australian Government does not provide financial support to Australian international airlines.

The TNA reflects a strong global trend toward alliances and consolidation as a way of maintaining a sustainable industry. Full service carriers in particular are exploring cost-saving consolidation strategies as a method of remaining competitive and profitable in the face of fuel costs and increased competition from new market entrants including innovative low cost carriers. These strategies range from code share operations and airline alliances to take overs and mergers. Consolidation not only delivers efficiency gains for the industry but it can also be an effective means of growth for an airline by increasing the size of its resource base and, importantly for consumers, providing access to a wider range of markets and services.

Airlines face the challenge of adapting their consolidation plans to cater with the requirements created by the bilateral air services system. Such plans affect competition within aviation markets, and as a result, may require the approval of competition authorities with resulting costs from having to seek approval in multiple jurisdictions. Mergers between major players in the international aviation industry appear inevitable and accordingly it is not surprising that Australian based airlines such as Qantas are considering the strategic advantages to be gained from an alliance within the region.

Conclusion

While the Department notes that it is the responsibility of the ACCC to determine the impact of the TNA on competition, it considers Australia's aviation policy and the capacity available on this route accessible under many of our bilateral aviation agreements as not prohibiting entry or expansion in the trans-Tasman market. In particular, the prospect of competition would appear to mitigate to a large extent any potential anti-competitive effects of the proposed behaviour. This is consistent with the Australian Competition Tribunal assessment of the former alliance proposed by the Applicants.

However, we also recognise that the global aviation market is volatile and dynamic. Accordingly should the ACCC proceed with authorisation of the TNA it may wish to consider authorising subject to a fixed period review. This will enable the ACCC to assess competition impacts on a regular basis and ensure that the proposed arrangement remains appropriate to contemporary market conditions. While recognising the ACCC can review authorisation at any time, a fixed time expiry provides some certainty to the market and the carriers. Recognising the cost to the Applicants and Government in assessing the TNA, DOTARS suggests that a review period of 3-5 years would be reasonable.

Department of Transport and Regional Services
May 2006

Attachment

Market share on main trans-Tasman routes (%) as measured by seats available. February 2006.

	Air New Zealand	Freedom Air	Qantas	Jetstar	Emirates	Virgin Blue	Aerolineas Argentinas	Royal Brunei	Garuda Indonesia	LAN Chile
Sydney-Auckland	30.3	0.0	45.9	0.0	12.5	0.0	4.8	0.0	0.0	6.4
Melbourne-Auckland	40.6	0.0	41.7	0.0	17.7	0.0	0.0	0.0	0.0	0.0
Brisbane-Auckland	34.3	0.0	17.0	0.0	28.3	7.6	0.0	6.5	6.2	0.0
Australia-Auckland	35.6	2.1	35.8	0.0	16.0	2.5	2.3	1.4	1.3	3.0
Sydney-Wellington	51.5	0.0	48.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Melbourne-Wellington	55.3	0.0	44.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Brisbane-Wellington	50.0	0.0	19.8	0.0	0.0	30.2	0.0	0.0	0.0	0.0
Australia-Wellington	50.0	4.1	38.6	0.0	0.0	7.4	0.0	0.0	0.0	0.0
Sydney-Christchurch	24.2	0.0	23.3	21.0	21.4	10.1	0.0	0.0	0.0	0.0
Melbourne-Christchurch	36.2	0.0	0.0	43.9	0.0	19.9	0.0	0.0	0.0	0.0
Brisbane-Christchurch	31.7	0.0	0.0	33.9	0.0	34.5	0.0	0.0	0.0	0.0
Australia-Christchurch	27.1	3.6	11.8	29.7	10.8	17.0	0.0	0.0	0.0	0.0

Total seats on the trans-Tasman	574,780		
Auckland	341,801	59.5%	
Christchurch	133,409	23.2%	
Wellington	58,722	10.2%	
Other	40,848	7.1%	Only operated by the Applicants