



Australian Government

**Department of Infrastructure, Transport,
Regional Development and Local Government**

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Dear Dr Chadwick

**Virgin Blue Group and Delta Air Lines Inc Applications for Authorisation
A91151 & A91152**

Thank you for your letter of 16 July 2009. The Department of Infrastructure, Transport, Regional Development and Local Government (the Department) thanks the ACCC for its invitation to provide a submission on the proposed joint venture between the Virgin Blue Group and Delta Air Lines Inc (Delta). I apologise for the delay in responding.

Roles and responsibilities

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 the effect on competition of the proposed joint venture. However, to assist the ACCC in coming to a determination, the Department thought it would be useful to provide the ACCC with contextual information on Australia's air services arrangements with the US and the current state of the market.

As you would be aware, the Department is responsible for negotiating air services agreements with foreign governments. These bilateral agreements typically set out the number of flights that airlines of the two countries can operate, cities they can serve in the other country and rights to operate via or beyond to third countries. The agreements typically also include provisions related to such matters as airline ownership and control, competition law, safety and security.

The IASC is responsible for allocating the available capacity negotiated under air services agreements to the Australian airlines that apply to use it. The Department notes the IASC has provided a submission to the ACCC in relation to the current inquiry.

In the case of the US, a so called "open skies" agreement is in place between our two countries. Specifically, the *Air Transport Agreement between the Government of*

Australia and the Government of the United States of America done at Washington on 31 March 2008 [2008] ATNIF 3 (the open skies agreement), given interim effect by the Memorandum of Consultation between aeronautical authorities signed in Washington on 14 February 2008, allows Australian and US airlines to operate without any capacity constraints between our respective countries. They are also able to operate via any third country and beyond to any third country. It is then a commercial decision for the individual airlines of each country to determine whether to access these rights by providing services.

Article 8(7) of the open skies agreement provides express authority for airlines to enter into cooperative marketing arrangements such as blocked-space, code-sharing, or leasing arrangements.

Article 13 of the open skies agreement recognizes that competition among airlines in the U.S.-Australia market is important to promote the objectives of the agreement, and confirms that each party will apply their respective competition regimes to protect and enhance overall competition and not to benefit individual competitors.

The proposed joint venture is therefore consistent with the authority granted to airlines under Article 8(7), subject to compliance with the respective competition laws applying in each country. In Australia's context this means the competition framework administered by the ACCC.

Status of the market

The ACCC would be aware that the Australian Government is currently developing a National Aviation Policy White Paper. In the National Aviation Policy Green Paper, released in December 2008, the Australian Government indicated it was committed to pursuing the liberalisation of international aviation to benefit consumers and to provide Australia's airlines with the opportunity to compete effectively with their global rivals.

In recent years the air route between Australia and mainland United States (the trans-Pacific route) has been dominated by two airlines: Qantas Airways and United Airlines. For the six years prior to V Australia's entry into the market in February 2009, Qantas and United were the only airlines to offer non-stop services. With the commencement of services by V Australia in February and Delta in July 2009, there are now four airlines serving the route non-stop.

Historically the air services arrangements between Australia and the United States were relatively restrictive. Any US or Australian airline wanting to enter the market was limited to providing four services per week. This restriction limited the attractiveness of the market to new participants.

As outlined above, the 2008 open skies agreement allows for unlimited access for Australian and US carriers between the two countries. This has facilitated the entry of V Australia and then Delta into the market.

There are now no economic regulatory barriers for any current or future Australian or US international carrier to enter the market. In addition, airlines of ten other countries (New Zealand, Canada, Fiji, Cook Islands, Germany, Switzerland, India, Macau,

Indonesia and Taiwan) also currently have access to the Australia-US market, albeit some with the restriction that the flight must operate from its home country.

Obviously, it is a commercial decision for any particular carrier to determine whether or not it will introduce services into the market.

For example, under the terms of the Australia-New Zealand air services arrangements, New Zealand's airlines have unrestricted access to the Australia-US market. Air New Zealand previously operated non-stop flights between Sydney and Los Angeles, ceasing the service in April 2003, and is able to re-introduce services at any time.

In addition to the non-stop services, travellers have several one-stop options, including Air New Zealand via Auckland, Air Pacific via Fiji and Hawaiian Airlines via Honolulu.

Since the increase in competition in the Australia-US market, there has been a significant reduction in the cost of available airfares. While the reductions can be partially attributed to the general slowdown in demand for air travel brought about by the global financial crisis, the increase in competition is clearly a significant factor.

Current state of international aviation

The global financial crisis is causing all airlines to carefully examine their operations. Many airlines have responded to falls in demand by reducing capacity, but capacity reductions have lagged behind falling demand, resulting in increased discounting and yield pressures.

The impact of the global financial crisis on international aviation is captured by the International Air Transport Association's (IATA) June 2009 airline industry financial forecast, which has revised the 2009 financial forecast to be a global loss of US\$9 billion, double its previous March estimate of a loss of US\$4.7 billion.

While carriers in all regions are expected to report losses in 2009, the Asia-Pacific region is expected to be particularly hard hit. IATA has forecast Asia-Pacific carriers will post the largest losses at US\$3.3 billion, while North America carriers are expected to show a loss of only US\$1.0 billion up from the US\$5.1 billion loss in 2008.

In terms of international markets served from Australia, for the year ending June 2009, the US is ranked third behind New Zealand and the United Kingdom, with total origin/destination traffic at 1 925 110 an increase in annual growth of 0.3%.

The table below provides a five year overview of the market share of origin/destination traffic between the Australia and the US.

MARKET SHARE OF AUSTRALIA - UNITED STATES OF AMERICA O/D TRAFFIC

Airline	Year ended June									
	2005	%	2006	%	2007	%	2008	%	2009	%
Qantas	934 323	54.4%	989 589	54.6%	1 036 016	56.1%	1 036 718	54.0%	997 510	51.8%
United Airlines	357 295	20.8%	375 424	20.7%	344 299	18.6%	316 019	16.5%	328 080	17.0%
Air New Zealand	131 410	7.7%	137 694	7.6%	134 696	7.3%	142 920	7.4%	137 721	7.2%
Jetstar International			5 038	0.3%	53 212	2.9%	114 087	5.9%	111 208	5.8%
Australia									56 175	2.9%
Qantas Australian Airlines	64 695	3.8%	72 766	4.0%	57 108	3.1%	55 311	2.9%	52 315	2.7%
Singapore Airlines	42 000	2.4%	41 675	2.3%	38 640	2.1%	41 177	2.1%	34 104	1.8%
Air Pacific	18 685	1.1%	16 399	0.9%	23 156	1.3%	33 471	1.7%	33 197	1.7%
Cathay Pacific Airways	18 991	1.1%	20 152	1.1%	17 897	1.0%	26 836	1.4%	24 429	1.3%
Emirates	8 969	0.5%	11 814	0.7%	11 883	0.6%	14 575	0.8%	16 484	0.9%
Other	140 725	8.2%	140 563	7.8%	129 206	7.0%	137 429	7.2%	133 887	7.0%
Total	1 717 094	100.0%	1 811 112	100.0%	1 846 113	100.0%	1 918 543	100.0%	1 925 109	100.0%

Note: These market shares do not distinguish passengers carried via code shared arrangements.
 Source: Australian Passenger Card data - DIAC

The proposed joint venture

It has been the nature of the aviation industry for airlines to enter into co-operative alliances or arrangements. Major airlines around the world have joined one of the three major alliances: Oneworld, Star Alliance and Sky Team. Taken together, the three dominate world air traffic. Airlines have also entered into individual agreements, including within alliances, such as Air New Zealand and United code sharing arrangements on services across the Pacific, and across alliances, such as Qantas and South African Airways across the Indian Ocean.

The Department notes the proposed joint venture, if approved, is likely to result in a situation in which three comparably sized airline groupings - Oneworld (Qantas/American Airlines), Star Alliance (United Airlines/US Airways/Air Canada/Air New Zealand), and V Australia/Delta Air Lines - all with domestic feeder networks on at least one side of the Pacific, would be competing in a contestable environment in which any other Australian and US international airline (and some other third-party carriers) could immediately commence services should they choose to do so.

Thank you again for inviting the Department to provide a submission. I can be contacted on 02 6274 7739 should you wish to discuss this matter further or require any additional information.

Yours sincerely



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 3 September 2009