Submission re: Virgin Blue Airlines Pty Ltd & Ors - Authorisations - A91151 & A91152

1. **Overview**

1.1 Air New Zealand Limited (**Air NZ**) makes the following comments on the applications for authorisation filed on 09 July and 24 July by:

(a) Delta Air Lines Inc. (**Delta**); and

(b) Pacific Blue Airlines (Aust) Pty Ltd, Pacific Blue Airlines (NZ) Ltd, Virgin Blue Airlines Pty Ltd and Virgin Blue International Airlines Pty Ltd (**Virgin Blue**),

(collectively, the **Applicants** and the **Alliance**).

1.2 While Air NZ believes that in many circumstances integrated alliances between airlines give rise to net public benefits, that is not always the case.

1.3 In the current case, Air NZ does not believe the Applicants have satisfied the relevant net public benefit thresholds in the Trade Practices Act 1974 Cth (**TPA**) and therefore Air NZ believes the ACCC should decline to grant authorisation.

1.4 The principal reasons for Air NZ's view are as follows.

(a) The claimed benefits largely rely on either:

(i) the counterfactual involving a reduction in services (be they new routes foregone, frequencies reduced, etc.); or

(ii) the Alliance giving rise to additional services.

The Applicants have failed to provide sufficient evidence to support either. In fact, in Air NZ's view there are a range of operational and other reasons why the Alliance is *unlikely* to give rise to such an increase in services vis a vis the counterfactual.

(b) To the extent it could be said there are benefits arising from some form of co-operation between the Applicants, Air NZ does not believe the Applicants have evidenced why, in this case, those benefits would not be available in the counterfactual (which involves, inter alia, codesharing) and hence why they are benefits that flow from the Alliance.

(c) The Applicants have not sufficiently addressed the prospect of fare increases as a result of an increase in market concentration, which is particularly relevant in a market which they maintain is difficult to enter on a sustainable basis.

(d) Finally, the constraint imposed by indirect carriers such as Air NZ has been overstated.

2. Claimed benefits are overstated

2.1 In Air NZ's view, notwithstanding the issue of whether the claimed benefits would be available in the counterfactual in any event, there is insufficient support for the claimed benefits more generally.

Claim of greater choice and convenience for customers [Sections 8.1 and 8.2]

New routes and frequencies

2.2 The Applicants at various points suggest the Alliance will result in new services (routes and/or frequencies), new services occurring *sooner* than would have otherwise been the case, and also that the Alliance will help preserve *existing* services. In light of this, it is difficult to identify what the Applicants claim the factual and the counterfactual entail, and hence how they differ. In any event, Air NZ does not believe the Applicants have evidenced that the Alliance gives rise to additional services vis-a-vis either of the counterfactuals Air NZ has considered below.

If a status quo counterfactual is assumed

2.3 By their own admission, "the Applicants have not yet been able to discuss in detail the routes and frequencies that may be offered".[1]

2.4 The Applicants have claimed confidentiality for the routes they appear to have advanced as candidates for introduction, meaning it is difficult for third parties to comment on any impact the Alliance may or may not have in that regard, and hence the ability of the ACCC to properly test the claims. That said, Air NZ makes the following comments.

(a) As acknowledged by the Applicants, the distance between Australia and North America means direct services can only be offered between a limited number of ports. Operational constraints preclude services to Adelaide, which Air NZ believes in practice leaves SYD, MEL and BNE as Australian ports, with LAX and San Francisco (**SFO**) being the only realistic US ports to service ex-Australia (in light of these operational constraints and also having regard to catchment size and network feed).[2]

(b) All three viable ports in Australia already have flights to LAX, and SYD also has services to SFO, which realistically leaves BNESFO and MELSFO as candidates for direct routes not currently available to the travelling public.

(c) Given Qantas' greater network presence in Australia, and American Airlines' presence in the US, Air NZ believes it is reasonable to expect that if there was commercially sustainable demand for a BNESFO or MELSFO service – or any other route for that matter – Qantas/American Airlines would have instituted such a service already.

(d) Finally, while Delta offers a handful of services from domestic US points to SFO, it does not have a hub at SFO and so comparatively speaking cannot offer a great deal in terms of feed from the US mainland – feed and city 'presence' being key factors influencing the viability of such services.

2.5 In relation to new frequencies, Air NZ notes the claims about the financial difficulties facing the airlines on the routes and the recent increases in capacity are inconsistent with an assertion that the Alliance increases the prospect of yet further additional frequencies. As the Applicants acknowledge at section 4.5 of their submission, "additions of capacity are relatively large

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[1] Section 8.1

[2] While Delta has a hub at Salt Lake City, the fact it has chosen to operate ex-LAX suggests that there is insufficient demand for it to offer services direct to Salt Lake City. There is no reason to suggest that Virgin could offer additional strengths that would justify a direct service to/from Salt Lake City.

compared to the annual rate of growth on the route. That is, it is not possible to easily increase or decrease seat capacity in increments matched to small changes in demand."

2.6 To operate an additional daily service would require at least 2 additional aircraft, and services on a less than daily frequency tend to be sub-optimal. The Applicants have advanced no evidence to suggest that such a deployment is likely. In fact, in their filing to the DOT, the Applicants have stated (at page 40) only that the cooperation envisaged "**may** eventually lead to the acquisition of more aircraft than would be required without such integration." However, they go on to say that "The timing of such acquisitions, however, cannot be anticipated and will depend on future commercial and economic considerations." (Emphasis added)[3]

If the counterfactual involves a reduction in services

2.7 Under such a counterfactual, the claimed benefit would involve the Alliance avoiding a reduction in services that would otherwise occur. However, the Applicants' own comments suggest the Alliance is unlikely to prevent such a reduction in services.

(a) The counterfactual discussion in section 7.2 of the submission does not claim the counterfactual involves a reduction in capacity vis a vis the status quo.[4]

(b) This is consistent with the Applicants' comments noted below regarding the difficulties of removing capacity from the Trans-Pacific routes (emphasis added):

> [One of the issues carriers face] is the geography involved on Trans-Pacific routes, which necessitates the use of specialised long range and large gauge aircraft (**not easily redeployed on other routes**). [Executive Summary, page 2]
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> These [specialist long range] aircraft are not easily redeployed on other routes. **This is particularly true for new carriers such as V Australia that do not have established long-haul operations in other markets.**[5] [Section 4.5]
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> the Applicants have limited incentive and ability to remove capacity from Trans-Pacific routes (either **before** or after commencement of the Joint Venture)...Any such reduction in capacity would ... diminish the scope of the network routes and frequencies the Applicants offer in competition to Qantas and United Airlines. [Section 9]

2.8 In addition, Air NZ notes the following comments made by the ACCC in its decision in relation to the application by Air NZ and Air Canada, and is unaware of any reason why a similar line of analysis should not apply to the current case.

> 6.62 In this context, and based on the information before it, the ACCC is not convinced that risk sharing through revenue sharing necessarily underpins the continued operation of the Direct Services when the primary risk relates to overall demand. As variations in overall demand are likely to have very similar effects on Air Canada and Air New Zealand, revenue sharing is unlikely to reduce this risk. One way in which the revenue sharing may reduce financial risk is by limiting competition between the parties.
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> 6.64 Overall, the ACCC remains unconvinced about the extent to which the Cooperation Agreement actually underpins the operation of the Direct Services.

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[3] Air NZ acknowledges that Virgin has additional wide body aircraft on order, although understands that it has sought to defer delivery of at least some of the additional aircraft. In any event, the issue is where the Alliance gives rise to additional services vis a vis the counterfactual, in which Air NZ expects Virgin will take delivery of the new aircraft.

[4] The closest the Applicants appear to come to such a claim is the reference in the DOT Application that authorisation is a key component of Delta's business plan.

[5] As regards Delta, the acknowledgment at 4.6 that a carrier with a large US domestic network but no Australian domestic network is better able to service a significant proportion of the United States – Australia market due to the relative concentration of the population on the east coat of Australia suggests that the relative importance of Virgin's Australian feed to Delta is less

2.9 In the absence of the Alliance giving rise to new services, there can be no consumer benefit in terms of greater convenience etc. arising from such services.[6]

Wider choice of arrival and departure times

2.10 The Applicants offer no evidence to substantiate the assertion that the Alliance will lead to a wider choice of arrival and departure times:

(a) <u>The Applicants already have well spread flights leaving SYD</u>. Virgin and Delta have one flight per day on SYDLAX: Virgin's SYDLAX flight leaves at 9.30pm and Delta's leaves at 11.20am; which could not be described as wingtip flying.[7]

(b) <u>There are operational and network reasons that drive departure times, which will persist in the factual</u>. While the return LAXSYD flights currently depart at 11.15pm (Virgin) and 10.50pm (Delta) there are operational and network reasons why this is the case, which will continue to drive close departure times under the Alliance.

(i) These reasons mean that today the Qantas, United, Delta and Virgin LAXSYD flights *all* depart LAX within around 90 minutes of each other (10.17pm-11.45pm).

(ii) Qantas itself operates two flights within 75 minutes of each other (10.30pm and 11.45 pm). If there was an opportunity to better serve passengers by spacing flights then those incentives would already apply to Qantas.

(iii) The reasons for the ex LAX timings include:

(A) The SYD curfew of 10.30pm-6.05am, meaning LAX departures can leave no earlier than around 8.15pm.

(B) All carriers, including Delta (and Virgin) will seek to depart at a time that maximises connectivity with their own (or codeshare) services inbound into LAX. The first "bank" (or wave) of Delta's mid to east coast US domestic flights into LAX arrives around 10.00am-midday. This means a departure before 1pm will provide <u>in</u>sufficient connectivity with those flights (and of course a departure from LAX <u>after</u> 1pm but before approximately 8.15pm is not available given the SYD curfew).

(C) In fact, the Virgin flight arrives into LAX at 4.10pm so can't depart before around 6pm in any event. Even if Virgin departed SYD earlier, so that it could depart LAX earlier (at say, 11am), not only would it miss the all-important inbound LAX feed, its later arrival into SYD (at around 9pm) would reduce its connectivity with its domestic Australian services.

(D) Delta would be reluctant to change its departure ex LAX for the reasons set out above, and therefore its ex SYD departure will largely drive from its arrival time. (Its aircraft is on the ground in SYD for only 2.40, in order to maximise its utilisation.)

(c) <u>There is invariably less scope to remove wingtip flying on long haul routes</u>, if for no reason other than the fact there tend to be far fewer flights to adjust.

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[6] In this regard, Air NZ also notes the reported comments of Sir Richard Branson, founder and chairman of Virgin Atlantic and 'Life President' of Virgin Blue, that inefficient airlines which continue to lose money "should be allowed to die peacefully" and that "I'm not sure that carriers merging is actually a good idea...I think that, generally speaking, carriers should get on and compete with each other." (http://in.reuters.com/article/businessNews/idINIndia-41357320090728?sp=true)

[7] Timings are for the Northern Winter scheduling season.

While there are no curfews in BNE or MEL, the same network connectivity considerations will apply. In any event, for the reasons outlined above, Air NZ does not believe the Alliance will lead to any additional services (and certainly not to such an increase that there is wingtip flying ex BNE or ex MEL that could be avoided by the Alliance).

2.12 Finally, at page 39 of the DOT filing, the Applicants state "The Joint Applicants anticipate that they will continue serving these routes after their joint application is approved, and **they do not have plans to change their services that are contingent upon approval being obtained**." (Emphasis added)

Claim of lower fares [Section 8.3]

2.13 For the reasons set out in section 4 below, Air NZ does not believe, based on the Applicants' public submission, that the Alliance will lead to lower fares.

Claims of sustained effective price and product competition [Section 8.4] / increased tourism [Section 8.5] / additional employment [Section 8.6]

2.14 These claimed benefits rely on the Alliance giving rise to additional services vis a vis the counterfactual which, for the reasons discussed above, Air NZ does not believe is the case.

2.15 In relation to the Applicants' claim that one of the key constraints on Trans-Pacific tourism growth has been a lack of available seats and relatively high seat prices, Air NZ suggests that such a constraint no longer exists (and even if it did, would not be alleviated by the Alliance).

Claimed joint procurement cost savings

2.16 To the extent this could be said to be a public benefit, Air NZ considers these should be able to be achieved in the counterfactual.

3. Claimed benefits not linked to arrangements

3.1 The Applicants' application to the DOT in relation to codesharing states that the parties have entered into a "comprehensive" codesharing arrangement, and goes on to say that additional codesharing will make the carriers more competitive for trans Pacific traffic. The codeshare forms part of the counterfactual (as per section 7.5). Moreover, the Applicants have not yet been able to assess the extent to which a codeshare itself gives rise to benefits, given they have only recently sought approval for it.

3.2 Any benefits arising from an increased availability of online connections (i.e. on a single code) will also arise from the codeshare agreement and will thus occur in the counterfactual.

3.3 Even if it could be said that the feed from each carrier's domestic network to the other's trans-Pacific services will support additional services (bearing in mind there is only so much feed to be distributed, i.e. to the extent that Delta feeds a passenger to a LAXSYD Virgin flight then that is one less it can feed onto its own flight), then Air NZ believes that support would also occur in the counterfactual under the codeshare.

4. The Applicants have failed to properly address the potential for price increases

4.1 There are currently four carriers operating direct services, and the Applicants are seeking approval for two of those carriers to (among other things) fix prices. While in many situations an effective increase in concentration will not lead to an increase in prices (e.g. where there is constraint from new entry) Air NZ does not believe the Applicants have evidenced why that is the case under the Alliance. The Applicants' suggestion the market is a difficult one to enter sustainably is relevant in this regard.

4.2 The Applicants' discussion regarding double marginalisation does not contain any 'netting off' of a price rise that might flow from two independent competitors being authorised to fix price.

The constraint from the indirect carriers is overstated.

4.3 Air NZ does not believe its indirect services impose any material constraint on the carriers offering direct services.

4.4 Furthermore, Air NZ is not a potential entrant on the SYD-LAX route: as the Applicants note, feed is important to support trans-Pacific services and Air NZ has no domestic Australian or US operations, no meaningful domestic Australian feed and is reliant on other carriers to feed its outbound US services.

4.5 Finally, Air NZ understands that Qantas owns approximately 46% of the shares in Air Pacific, which is relevant to the assessment of any constraint Air Pacific's indirect services may impose over and above Qantas.