Australian Government

International Air Services Commission

Mr Darrell Channing
Director
Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 1199
DICKSON ACT 2602

Dear Mr Channing

VIRGIN BLUE GROUP AND AIR NEW ZEALAND – APPLICATIONS FOR AUTHORISATION A91151 AND A91152

Thank you for your letter of 12 May 2010 inviting comments on the application for authorisation from Virgin Blue Group airlines and Air New Zealand for the Alliance Agreement between them in respect of trans-Tasman passenger services. The International Air Services Commission (IASC) welcomes the invitation to comment.

As with other similar cases considered by the ACCC, the IASC would take careful account of the ACCC's assessment of the arrangements sought by Virgin Blue and Air New Zealand in considering any subsequent application to the IASC to use capacity allocated by the IASC in joint services. The IASC does not anticipate receiving an application from the Virgin Blue Group for joint services approval unless the ACCC authorises the proposed arrangements. I will contact you in the event such an application is made.

The IASC wishes to provide some information about decisions it has made in relation to the New Zealand route which might be useful background for the ACCC in its considerations, as well as some observations about the proposed arrangements which the ACCC might like to take account of.

As you would know, the air services arrangements between Australia and New Zealand are very liberal, with multiple designation permitted and unlimited capacity available to nominated carriers of the two parties. The IASC has allocated unlimited passenger and freight capacity to Qantas and Pacific Blue Australia on the New Zealand route. In the case of the allocation to Qantas, that capacity is able to be used by Qantas and its wholly-owned subsidiaries and this is the basis for Jetstar's operations on the route. The Qantas Group carriers and Pacific Blue Australia are major operators on the New Zealand route and each of course has extensive domestic networks supporting the flow of traffic onto trans-Tasman services.

The IASC also allocated unlimited passenger capacity to Pacific Wings, a new entrant carrier, in July 2009. That airline's initial operating plans are modest in scale and it recently postponed the start of services, with the IASC extending until 31 October 2010 the time by which Pacific Wings must utilise its allocated capacity.

As you know, Australian carriers with allocated capacity may seek IASC authority to use that capacity in joint services arrangements with other airlines. Qantas has received such approval to code share with Jetstar as well as seven third-country carriers. A condition of approval of code sharing with all of the third-country carriers, but not with Qantas' wholly-owned subsidiaries, is that Qantas and its partners must price and sell their services independently of each other and not share or pool revenues. These arrangements enable the third-country carriers concerned to market and sell trans-Tasman carriage, providing some additional competition to operating carriers on the New Zealand route.

The IASC has also authorised Pacific Blue Australia to use its allocated capacity on the New Zealand route in joint services with its sister carrier V Australia. As with the Qantas/Jetstar arrangement, there are no restrictions in relation to pricing, selling services, or revenue sharing.

The New Zealand market is Australia's largest and there is strong competition on the route. The largest market shares, as might be expected, are held by Air New Zealand, the Qantas Group carriers combined, and Pacific Blue Australia respectively. Emirates has by far the largest market share of the third-country carriers on the route. Lan Chile and Aerolineas Argentinas have much more modest shares of the market. The IASC understands that a number of other third country carriers hold rights to operate on the trans-Tasman but do not currently do so.

On the face of it, the arrangements proposed seem to have potential to result in some weakening of competition compared with the current situation on the route, as they involve an alliance between two of the three major airlines groups operating on the route which would result in that grouping having somewhat over 50% of the market share based on recent data. The IASC notes the applicants argue the arrangements will not result in reduced competition and that public benefits will be generated such as through the stimulation of additional demand and efficiencies arising from the ability to co-ordinate scheduling and eliminate parallel services.

The IASC agrees with the applicants' claims that Air New Zealand would gain access to extensive behind-gateway networks as part of the proposed arrangements. As the ACCC would know, the collapse of Ansett in 2001 resulted in the loss to Air New Zealand of a similar network. However, the IASC notes that this access could be achieved independently of other aspects of the arrangements, such as revenue sharing, proposed by the applicants.

The proposed arrangements would also appear to give Pacific Blue Australia some improved ability to increase access to the business sector as it claims, particularly as its frequency, aircraft seating and ancillary airport services do not seem to be well structured to compete strongly in that sector. The IASC notes that V Australia offers a business class product and there would be no regulatory impediment to it entering the New Zealand route should it wish to do so. The Virgin Group has such an arrangement in the Australia – Fiji market, with both Pacific Blue Australia and V Australia

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operating. However, such a possibility on the New Zealand route does not appear to be foreshadowed under the proposed arrangements.

The IASC expects that competition from third-country carriers would continue, whether or not the arrangements were authorised, as would the potential for entry of new carriers.

Yours sincerely

Michael Bird

Michael Bird
Executive Director

8 June 2010

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