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APPLICATIONS A91127 & A91128: APPLICATIONS BY VIRGIN BLUE GROUP AND AIR NEW ZEALAND FOR AUTHORISATION OF ALLIANCE

- 1 This letter is a submission by the New Zealand Airports Association (NZ Airports) in relation to the application made by the Virgin Blue Group and Air New Zealand to the ACCC for authorisation of a proposed trans-Tasman alliance between those two airlines.
- 2 NZ Airports has a number of concerns about the proposed alliance. We write to set out those concerns and to explain why NZ Airports opposes the proposed alliance. We understand that some individual New Zealand Airports will also make submissions to the ACCC.
- 3 Contact details for NZ Airports are as follows:

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Executive summary

- 4 NZ Airports is opposed to the authorisation of the proposed alliance. It is the strong view of NZ Airports and its international airport members that the interests of the flying public on both sides of the Tasman are best promoted by encouraging competition and independent carriers, not by sanctioning anti-competitive arrangements such as the alliance.
- 5 In NZ Airports' view, there are real and substantial benefits to the flying public from promoting greater competition in the trans-Tasman air passenger services market. Where there is real competition on a trans-Tasman route, passengers have benefited from lower fares and more convenient services. That competitive dynamic should continue.

Who is the New Zealand Airports Association?

- 6 NZ Airports is the industry association for New Zealand's airports and related businesses and includes all international airports. It is a not-for-profit organisation whose members operate 31 airports that span New Zealand and enable the essential air transport links between each region of New Zealand and between New Zealand and the world.

Trans-Tasman services from New Zealand airports

- 7 As the ACCC will know, the three main international airports in New Zealand are at Auckland, Wellington and Christchurch. Historically, these were the only airports in New Zealand from which international services, including trans-Tasman services, operated.

- 8 In the last 15 years or so, trans-Tasman services have also been offered at various regional airports in New Zealand, namely Hamilton, Dunedin, Queenstown, Palmerston North and Rotorua. Trans-Tasman services are no longer offered at Palmerston North, but they are currently offered at the other regional airports mentioned, either all year round or on a seasonal basis.

The history: competition matters

- 9 It is the experience of our international airport members that increased competition in the trans-Tasman market leads to increased passenger numbers, lower fares and improved services. In particular, the existence of an independent operator can be critical to the provision of competitively-priced trans-Tasman services.
- 10 It is certainly true that passengers using regional airports in New Zealand have historically faced a real lack of competition domestically and no international services. In the last 15 years or so, low-cost carriers have stimulated market demand by offering services to Palmerston North, Hamilton, Queenstown and Dunedin.
- 11 That experience informs NZ Airports' concern regarding the proposed Alliance between the Virgin Blue Group and Air New Zealand. There is, for example, already very limited competition on trans-Tasman flights into and out of Dunedin, Hamilton, Queenstown and Rotorua. What services there are have often had to be hard fought for.
- 12 The proposed alliance will inevitably reduce or eliminate that hard-won competition on the trans-Tasman services flying into and out of New Zealand's airports. Market power will enable price to be increased, demand will therefore decrease and capacity will reduce. Without competitive choice, incumbents can route passengers through other ports, reducing the service levels offered to passengers.
- 13 There is obvious support for our concerns when the existing competitive dynamics on trans-Tasman routes are considered.
- 14 By way of example, the only direct service between Australia and Dunedin on which there is any competition is the Brisbane-Dunedin route. That route is presently serviced by both Pacific Blue and Air New Zealand. The proposed alliance will remove all competition from that route, because the purpose of the alliance is effectively to merge Pacific Blue's and Air New Zealand's trans-Tasman operations into a single business. Competition on other direct routes between Dunedin and

Australia is already non-existent, with Air New Zealand alone offering seasonal services to Melbourne and Sydney.

- 15 Other routes will be similarly affected. At present, passengers flying from Hamilton are offered direct flights to both Sydney and Brisbane by Pacific Blue. Connecting services on these routes are available on Air New Zealand, but these are generally more expensive and less attractive.
- 16 In NZ Airports' view, it was the emergence of Pacific Blue as an independent third force on the Tasman that led to sustainable direct trans-Tasman services from Hamilton, and real increased competition on other trans-Tasman routes. We are very concerned for the future of the Hamilton services particularly if Pacific Blue is effectively removed from the market as an independent operator, which is exactly what the proposed alliance will do.
- 17 We also expect detrimental effects on capacity and on fares in more competitive markets, such as the Queenstown-Sydney route. Currently, that route is served by all three of the main players plying the Tasman. The proposed alliance will mean that Queenstown is served by only two carriers. It seems very doubtful to us that two carriers will offer the same competitive pressures and dynamics as are currently provided by three independent carriers.
- 18 These examples are not intended to be exhaustive, and NZ Airports understands that some individual airports in New Zealand will make their own submissions to the ACCC on the proposed alliance.

An example: the positive effects of competition at Dunedin

- 19 We think that the benefits of competition in the trans-Tasman market generally are well illustrated by the position at Dunedin.
- 20 As the ACCC may know, Air New Zealand established a low-cost subsidiary called "Freedom Air" in the 1990s. Until 2006, Freedom Air was operated as an independent business, separate from the rest of Air New Zealand's operations.
- 21 Historically, international services had not been offered from Dunedin. However, in the mid 1990s, Freedom Air commenced direct international flights between Dunedin Airport and the eastern seaboard of Australia. These flights were provided in competition with a service that had been started by Kiwi Air, a low-cost carrier that pioneered discount flights between regional New Zealand cities and Australia. The Kiwi Air services were short lived, as that airline collapsed in September 1996. By contrast, the Freedom Air services continued for a decade or so.
- 22 In effect, Freedom Air's direct trans-Tasman services from Dunedin were competing against Air New Zealand's indirect trans-Tasman services from Dunedin. That competition generated real benefits to passengers, because average fares ex Dunedin on the direct Freedom Air services were considerably lower than the fares on Air New Zealand's indirect services.
- 23 Experience proved that the competition provided by Freedom Air stimulated passenger demand and resulted in strong market growth on the Dunedin routes.

- 24 That growth can be seen in the following data, which have been provided to us by Dunedin International Airport Limited. The data show international passenger movements on direct flights between Dunedin and Australia for the calendar years between 1998 and 2006 inclusive.

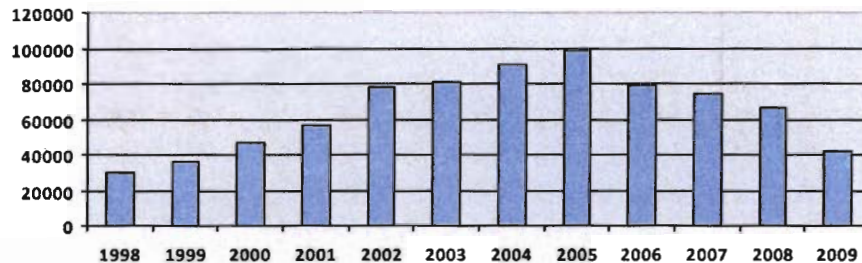
Year	1998	1999	2000	2001	2002	2003	2004	2005
Total Trans-Tasman Passengers	30,254	36,197	46,497	56,297	78,144	81,420	90,495	98,503

- 25 As can be seen, the trans-Tasman air passenger market for direct services out of Dunedin more than trebled between 1998 and 2005. However, Air New Zealand decided in 2006 that Freedom Air should cease operations as an independent business. At first, the Freedom Air brand continued, but its operations were absorbed within the operations of the Air New Zealand group.
- 26 After that, Dunedin Airport observed that Freedom Air's average fares increased. Over time, the fares offered by Freedom Air out of Dunedin became more aligned with those of Air New Zealand. In many cases, Freedom Air's fares were higher than Air New Zealand's.
- 27 The end of Freedom Air as an independent operator also saw a reduction in capacity and trans-Tasman services at Dunedin. The market was effectively encouraged to travel via other airports, because connecting services via other airports became a more competitive option for many travellers.
- 28 In 2008, Freedom Air stopped operating altogether and was replaced by Air New Zealand-branded services. Further capacity and service reductions occurred, with the result that only seasonal direct services were being offered.
- 29 The effect of this lack of competition can be seen in the international passenger movements on direct flights between Dunedin and Australia for the calendar years 2006 to 2009 inclusive:

Year	2006	2007	2008	2009
Freedom	79,329	73,870	20,354	0
Air New Zealand	0	0	46,317	28,833
Pacific Blue	0	0	0	13,297
Total Trans-Tasman passengers	79,329	73,870	66,671	42,130

- 30 The effect can also be seen when the total trans-Tasman passenger numbers from Dunedin Airport over the period 1998 to 2009 are considered:

Total Trans-Tasman Passenger Numbers at Dunedin Airport 1998 - 2009



- 31 In September 2009, Pacific Blue began a year-round direct Dunedin-Brisbane service three times weekly. We understand that Pacific Blue will increase that direct service to four times a week from October 2010.
- 32 Obviously, it is too early to have passenger movement data for the full calendar year 2010. However, the experience of Dunedin Airport has been that the trans-Tasman market is responding well to this competition from Pacific Blue, and that patronage on the Dunedin-Brisbane service is up. That competition came after significant investment by Dunedin Airport in trying to bring competition back into the market.

There is insufficient competition if the alliance is approved

- 33 NZ Airports is also concerned about the proposed alliance because it does not believe that much competition will be provided by other airlines if the alliance proceeds and the Pacific Blue and Air New Zealand trans-Tasman operations are merged.
- 34 While fifth freedom carriers may provide some competitive constraint at Auckland and Christchurch, they do not do so for the other international airports in New Zealand. Effectively, that leaves Qantas-Jetstar as the only competitive constraint on a merged Pacific Blue-Air New Zealand operation for the other international airports in New Zealand.
- 35 NZ Airports questions whether Jetstar, as part of the Qantas group, will provide widespread competitive pressure, as it is generally considered a leisure-focused low-cost airline with its route network co-ordinated at the Qantas level.
- 36 NZ Airports would also question Qantas's ambitions for future international expansion in New Zealand after its withdrawal from the New Zealand domestic market and its focus generally on thick business-dominated routes. Indeed, the Qantas Group's apparent strategy of market segmentation (using Qantas for the business market and Jetstar for leisure travellers) suggests that it is unlikely to provide strong competition for routes such as Dunedin that are part business, part leisure and part education/visiting friends and relatives.

37 Finally, we note that there are structural restrictions on future new entrants, such as Tiger, given that bilateral arrangements between New Zealand and Australia mean that a new entrant such as Tiger would need seventh freedom rights to operate.

Conclusion: real benefits from competition, and real risks from removing it

38 In NZ Airports' view, the experience at Dunedin Airport proves the real benefit to the travelling public of promoting competition on the trans-Tasman routes. It is our experience, and the experience of our members, that competition will lead to lower fares, more convenient services and stimulation of demand in the market.

39 The experience at Dunedin Airport is also instructive of what the likely effects of reduced competition will be on other routes such as Wellington-Brisbane and Auckland-Cairns, which are in a similar position in terms of moving from two carriers to effectively one.

40 The impact that even a single independent operator can have in the market is clear. So, too, is the effect of removing competition and independent competitive decision-making.

41 For these reasons, NZ Airports and its members are particularly concerned about the detrimental effects the proposed alliance between Pacific Blue and Air New Zealand will have on competition. In our view, the proposed alliance will result in an effective monopoly on many routes in the trans-Tasman market, with the sort of uncompetitive and unattractive fares that customers previously had to suffer.

42 Our concern is that, over time, there will be a reduction in capacity and in the services offered on the trans-Tasman market, and particularly on those routes operating out of regional airports, which is exactly what happened at Dunedin between 2006 and 2009 when real competition was removed from that market.

43 We are also concerned that there will be an inevitable "spill over" into the New Zealand domestic market if the proposed alliance proceeds. Although the alliance relates to domestic travel only where it is associated with a trans-Tasman journey, it seems inevitable that jointly planning network and revenue management will have detrimental effects domestically, through a reduced incentive on the part of Pacific Blue and Air New Zealand to compete against each other in this market.

44 Regional New Zealand already suffers the most through a lack of domestic competition, which manifests in higher air fares and limited services. In our view, it is not worth the risk to exacerbate that situation and extend that lack of competition to the trans-Tasman market by granting authorisation.

General

45 For these reasons, NZ Airports opposes the alliance proposed by Virgin Blue Group and Air New Zealand. It believes that the ACCC should decline their applications for authorisation.

46 If, contrary to this submission, the ACCC is minded to grant the applications, that outcome could only be because the ACCC considers that some public benefit will flow from the alliance. In that case, NZ Airports strongly encourages the ACCC to attach conditions to any authorisation to ensure that whatever public benefits are thought

to flow from the alliance do actually eventuate and are in fact passed on to the travelling public.

- 47 We commend these matters to the ACCC's consideration. If you have any queries, please contact me.

Yours faithfully



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