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16 June 2010

Darrell Channing
Director
Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 3131
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ACT 2601
AUSTRALIA

Email: adjudication@accc.gov.au

VIRGIN BLUE AIRLINES PTY LTD & ORS - APPLICATIONS FOR AUTHORISATION A91127 & A91128

1. I refer to the applications for authorisation filed with the ACCC by Virgin Blue and Air New Zealand, to your letter of 12 May 2010 to parties interested in those applications and to my exchange of e mails on 2 June 2010 with Teresa Nowak regarding an extension of the period for making a submission.

2. Auckland Airport's submission in connection with those applications is set out in the Schedule to this letter.

3. Auckland Airport would appreciate the opportunity to present our submission orally.

4. We would also appreciate being kept apprised of the progress of the applications. You may contact me by email at the below address.

Yours faithfully,

Jan Frazer
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SUBMISSION TO THE

AUSTRALIAN COMPETITION AND CONSUMER COMMISSION ON

THE APPLICATIONS FOR AUTHORISATION OF

THE VIRGIN BLUE AND AIR NEW ZEALAND AUSTRALASIAN AIRLINE ALLIANCE

16 JUNE 2010

1. SUMMARY

1.1 This submission is provided by Auckland International Airport Limited ("**Auckland Airport**") in relation to the applications made to the Australian Competition and Consumer Commission ("**ACCC**") by the Virgin Blue Group ("**Virgin Blue**") and Air New Zealand Limited ("**Air New Zealand**") (together "**the Applicants**") seeking authorisation of an Australasian Alliance Agreement and associated Code Share Agreement (together "**the Alliance**").

1.2 Auckland Airport is committed to ensuring that the travel market remains competitive, accessible and viable for all stakeholders (particularly where our airport is involved). For that reason, Auckland Airport is generally very supportive of airlines endeavouring to improve their products and services in ways that will result in real public benefits such as lower fares, increased competition, or improved air links supporting increased tourism.

1.3 We nevertheless have concerns in relation to some aspects of the Applicants' current proposal, and encourage the ACCC to carefully test the arguments raised by the Applicants. We have the following specific concerns:

(a) It is vital to consider the effect of the Alliance on individual routes or city-pairs (not just on a single overall Trans Tasman market). The ACCC needs to adopt a 'route by route' approach in order to accurately identify the impact of the Alliance on the travelling public. This could be obscured if too broad a market framework is adopted.

(b) The Alliance could have a real anti-competitive effect on some routes:

(i) Three Trans Tasman routes would become fully monopolised by the Alliance (so that there would only be one option for consumers wishing to travel on that route).

(ii) Six other Trans Tasman routes would become shared in a 'cosy duopoly' with the Qantas / Jetstar group.

(iii) On other routes, the Alliance would remove an important potential competitor.

Recent experience suggests that, when individual routes become dominated in this way, competitive pressure reduces or even disappears, fares rise, and passenger volumes fall significantly. The effects of any co-operation could be magnified if the cooperating airlines' product offering would otherwise be likely to converge.

(c) The Applicants have not yet provided concrete and reliable evidence that the claimed benefits will actually materialise, and will end up in the hands of consumers. For instance:

(i) Enhanced products and services arising from schedule optimisation and the addition of new routes (about which the Applicants have so far provided little detail) may not materialise.

(ii) Cost savings may not arise from schedule optimisation or operational efficiencies in the way suggested by the Applicants, and may not be fully passed through to travellers through lower fares as a result of increased competition.

(iii) The projected increase in tourism may not transpire if the asserted improvements in product offering and fare reductions do not materialise.

The ACCC needs to be convinced that the claimed public benefits will be both significant and sustained. In particular, the ACCC should look for strong evidence that return frequencies will be maintained and increased as suggested by the Applicants.

1.4 This submission does not analyse every aspect of the Alliance. Rather, it identifies some key issues and examples which we believe warrant close consideration by the ACCC. To provide some context to our submission we have asked Pacific Aviation Consulting ("**PAC**") to carry out some targeted analysis on market capacity share data, which is incorporated at the appropriate points. We would be happy to consult in more detail with the ACCC if that would assist.

1.5 If the ACCC does decide to authorise the Alliance, it should include in any authorisation appropriate checks and balances. These are required to ensure that the claimed benefits actually materialise and that, if they do, they outweigh, and continue to outweigh, the detriments to the public which are an inevitable consequence of the Alliance. At a minimum, any authorisation should:

(a) be conditional on the Applicants following through on their commitments not to reduce capacity or frequency or increase fares, particularly in relation to the routes which will be impacted by a material reduction in the number of carriers on that route; and

(b) be reviewed regularly to allow the ACCC to assess whether the touted public benefits of the proposal have in fact proven to exceed any public detriments flowing from the Alliance.

2. AUCKLAND AIRPORT'S INTEREST IN THESE APPLICATIONS

2.1 Auckland Airport is New Zealand's largest and busiest airport and accommodates over 13 million passengers each year. Around 73% of all international travellers arriving in or departing from New Zealand, and 58% of all Trans Tasman travellers, pass through the airport.

2.2 Auckland Airport has a direct interest in a sustainable and prosperous travel industry - internationally, domestically in New Zealand, and also domestically in Australia (insofar as it affects travel to and from Auckland).

2.3 In this regard, our interests are closely aligned with those of many other industries (including the tourism industry), and - most importantly - with the interests of the travelling public. Any unqualified reduction in competition leading to higher fares or poorer service and so to a reduction in the number of passengers travelling would be as undesirable for us as it would be for consumers.

3. RELEVANT MARKETS

3.1 The Applicants have presented their analysis in the context of a single Trans Tasman market, (although they have also acknowledged that it is appropriate for the ACCC to have regard to particular Trans Tasman routes and passenger segments (Application to ACCC, section 3.1)).

3.2 In our view that does not go far enough. It is vital that the ACCC consider the effect of the Alliance on particular routes or city-pairs:

(a) The Alliance will have a real and distinct impact on the consumers flying on specific routes. It will lead to monopolisation or significant consolidation on specific routes, as explained below. Recent experience (discussed below) has been that, when that happens, competition falls and prices rise on that route.

(b) The Applicants suggest that supply-side substitution is high because other airlines could easily redeploy aircraft onto monopolised or consolidated routes. That suggestion needs to be properly substantiated. There may be regulatory requirements, operational and other business drivers, which would prevent or at least delay an airline in redeploying an aircraft onto a new route. For example, crewing capability, plane types, check-in and ground-handling arrangements, overall fleet capacities, and the advertising costs associated with starting new routes are just some of the significant considerations that a carrier would factor into a decision whether to fly a particular route.

(c) The ACCC should also require the Applicants to provide concrete and reliable evidence of real demand-side substitution before preferring the broader market framework promoted by the Applicants (Application to ACCC, section 4.5(b)). Although we accept that factors like price and frequent flyer programs may influence consumers, it is somewhat simplistic to assume blanket substitutability between direct and connecting flights. A passenger who wants to travel from Adelaide to Auckland is unlikely to choose to connect through Sydney if he or she could fly direct at a competitive price.

4. EFFECTS OF ALLIANCE ON COMPETITION

4.1 A proper analysis of the effects of the Alliance suggests that the arrangement will lead to a significant lessening of competition, both on the Tasman generally and on specific routes. That lessening of competition would itself be likely to have a detrimental effect on consumers, and would decrease the likelihood of any public benefits generated by the Alliance being passed through to the end consumer.

4.2 As noted above, we have arranged for PAC to carry out some analysis of market share capacity data in relation to the routes affected by the Alliance. That analysis uses published schedule and aircraft capacity information available from OAG in respect of the coming year. We note that the capacity share figures put forward by the Applicants are described only as "estimates" (Application to ACCC, Annexure K).

The Alliance would be dominant on the Tasman

4.3 Even within the context of a single overall Trans Tasman market, it seems clear the Alliance will have a strongly anti-competitive effect. PAC have analysed published seat capacity figures on Trans Tasman routes for the year ended 30 April 2011, as set out in Figure 1.

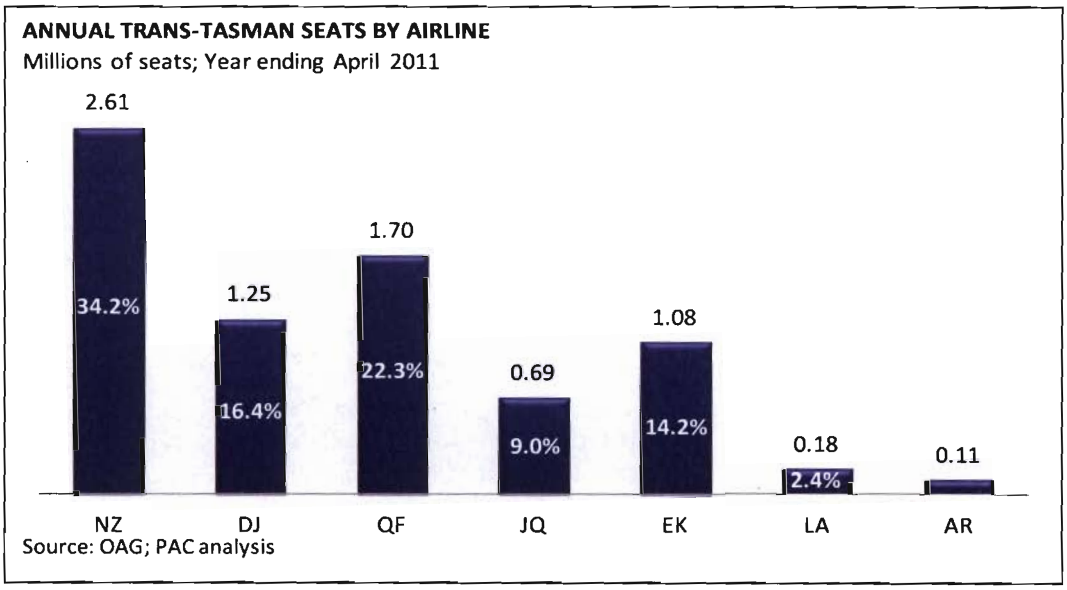

Figure 1

4.4 As Figure 1 shows, Air New Zealand presently has the largest market share by seat capacity on the Tasman (34.2%). Significantly, that is more than the combined seat capacity of Qantas and Jetstar (31.4%). No other airline or airline grouping is expected to match or surpass Air New Zealand in terms of seat capacity on the Tasman in the coming year.

4.5 As Figure 2 shows, if the Alliance goes ahead then Air New Zealand and Virgin Blue will together control more than half the seat capacity on the Tasman (50.6%). That is 1.5 million seats and 19.3% more than the Alliance's closest competitor (the Qantas / Jetstar group).

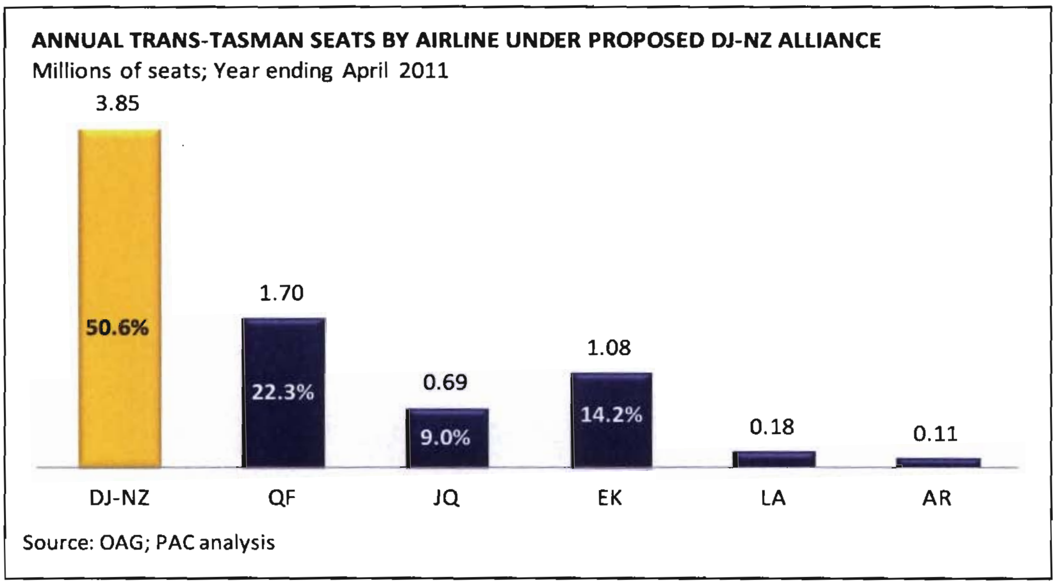

Figure 2

4.6 Furthermore, the simple analysis shown in Figure 2 does not take into account existing codeshare agreements. The Virgin Blue group (and specifically V Australia) presently operates a codeshare with Emirates on the Sydney-Auckland and Sydney-Christchurch routes. Similarly, Qantas presently places its QF code on LAN Airlines flights on the Sydney-Auckland route. While a codeshare arrangement does not typically involve any coordination of fares, it does provide the non-operating carrier[1] with additional seat capacity. Assuming for the sake of this analysis that those codeshare arrangements operate on a 'free-sale' basis (ie the non-operating carrier sells from the same seat inventory as the operating carrier) the dominance of the Alliance on the Tasman becomes even more apparent. The position is shown in Figure 3.

[1] The non-operating carrier is the airline selling a seat on the operating carrier's aircraft.

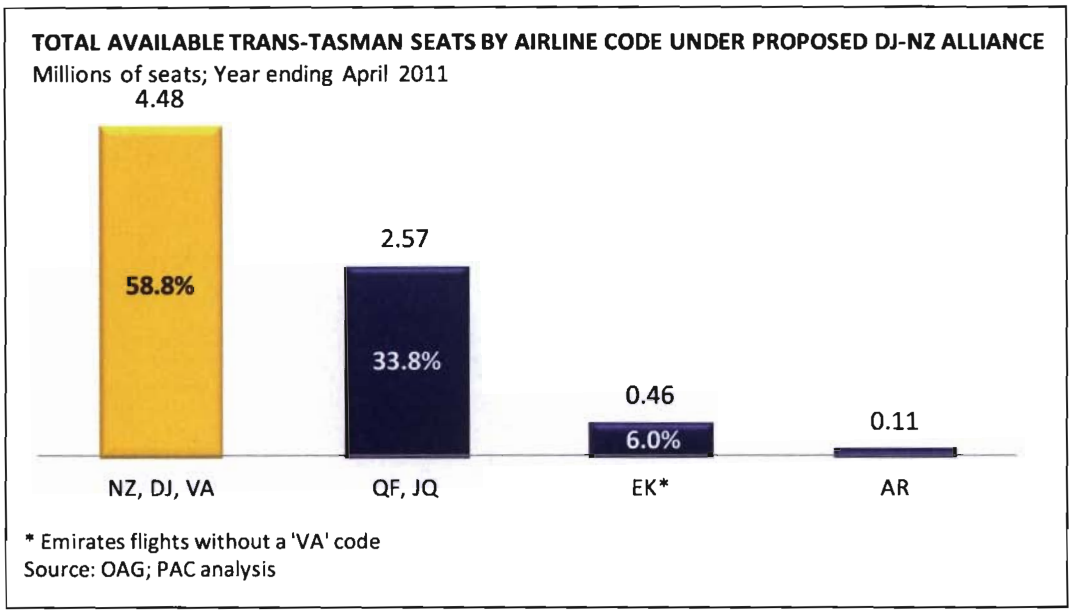

Figure 3

4.7 As Figure 3 shows, the Alliance would have marketing and operating sales access to 58.8% of total Trans Tasman operating capacity. The Alliance's nearest competitor would be the Qantas / Jetstar group (33.8%).

4.8 That greater aggregation in market share merely underlines the dangers of allowing the Alliance to proceed without giving it very careful consideration. The ACCC should require the Applicants to provide strong evidence that these very significant increases in market concentration will not result in a lessening of competition on the Tasman overall, with increased fares and decreased passenger numbers being obvious corollaries.

4.9 It is also important to bear in mind that overall market share figures are likely to understate the market power which the Alliance would possess on Trans Tasman routes as a result of its clear dominance on domestic New Zealand routes (arising especially from Air New Zealand's position in regional New Zealand). The Applicants' ability to funnel travellers originating in regional New Zealand onto their Trans Tasman services (by way of frequent flyer programs, lounge access, frequency/scheduling, or other tools) means that their market power on the Tasman may be even greater than their considerable market share would suggest. A similar problem might arise in relation to traffic funnelled onto the Alliance's Trans Tasman services from Virgin Blue's domestic Australian network.

The Alliance would become dominant or even a monopoly on some routes

4.10 The risks of the Alliance become even more evident when attention is directed to individual Trans Tasman routes. On some of those routes the Alliance would lead to very significant consolidation (and even to new monopolies).

4.11 Air New Zealand or Virgin Blue already hold a monopoly on eight non-stop Trans Tasman routes (no other carrier presently holds a monopoly on any Trans Tasman route):

(a) Perth-Auckland (Air New Zealand);

(b) Norfolk Island-Auckland (Air New Zealand);

(c) Adelaide-Auckland (Air New Zealand);

(d) Sydney-Rotorua (Air New Zealand);

(e) Sydney-Dunedin (Air New Zealand);

(f) Melbourne-Dunedin (Air New Zealand);

(g) Brisbane-Hamilton (Virgin Blue); and

(h) Sydney-Hamilton (Virgin Blue).

4.12 If the arrangement is authorised, the Alliance would hold 100% of the available seat capacity on three further routes:

(a) Cairns-Auckland;

(b) Brisbane-Dunedin; and

(c) Brisbane-Wellington.

4.13 In addition, if the arrangement is authorised the Alliance would end up with more than 50% of the available seat capacity on seven other routes:

(a) Brisbane-Queenstown (87%);

(b) Melbourne-Queenstown (73%);

(c) Brisbane-Christchurch (70%);

(d) Melbourne-Christchurch (61%);

(e) Gold Coast-Auckland (60%)[2];

(f) Sydney-Queenstown (60%);

(g) Brisbane-Auckland (54%).

4.14 In contrast, the Qantas / Jetstar group would have more than 50% of the available seat capacity on only three routes, and only marginally so (Sydney-Wellington; Gold Coast-Christchurch; and Melbourne-Wellington).

4.15 The Alliance would also involve significant consolidation between Air New Zealand and Virgin Blue on several other important links between principal cities in Australia and New Zealand (none of which the Applicants has analysed in any real detail):

(a) Sydney-Wellington: The Alliance would have 49% of the capacity on this route, shared in a duopoly with Qantas.

(b) Melbourne-Wellington: The Alliance would have 47% of the capacity on this route.

(c) Melbourne-Auckland: The Alliance would have 45% of the capacity on this route.

[2] The Applicants appear to have treated Brisbane and Gold Coast as falling into the same market, but have not explained why that is the case. Although Brisbane and Gold Coast are treated as "co-cities" for many long-haul markets, it must be borne in mind that the airports are located a considerable distance apart, and serve different cities. In the absence of strong evidence, the starting point must be that they fall into separate markets.

(d) Sydney-Auckland: The Alliance would have 34% of the capacity on this route, which is significantly more than any other carrier.

4.16 A summary is shown in Figure 4.

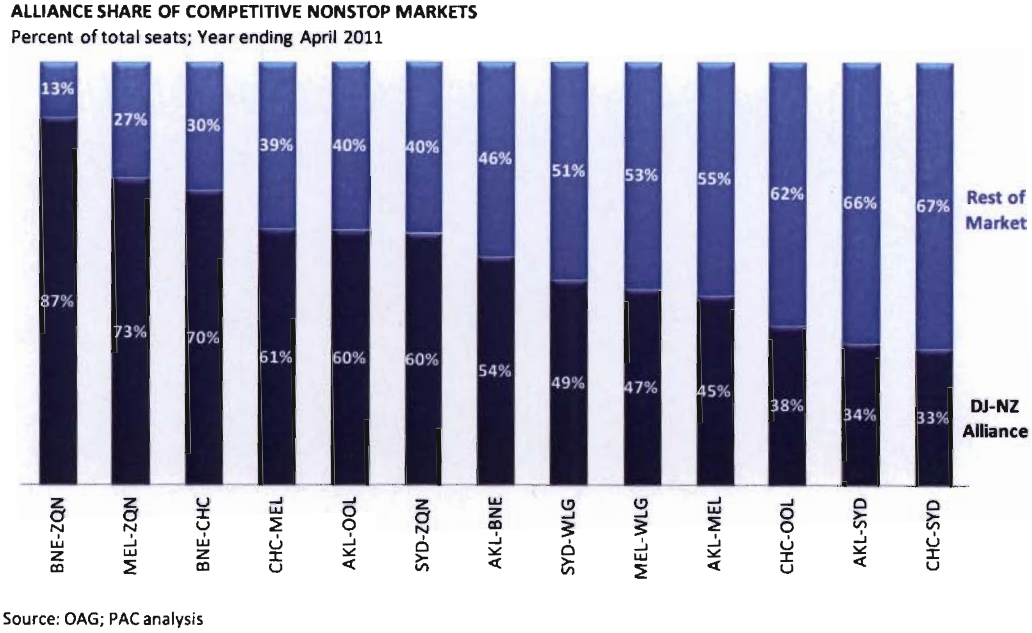

Figure 4

4.17 It is important for the ACCC to carefully consider the effect of the Alliance on the routes. Even aggregating from five to four or from four to three can have a tangible effect on competition. Aggregating from three to two or even two to one is obviously detrimental.

4.18 The conclusion that such aggregation is detrimental is borne out by recent experience on the Tasman. Granting an airline a monopoly on a particular route usually leads to reduced competition and increased fares. In nonstop markets where Air New Zealand is the sole carrier, average yields[3] are up to 70% higher than in comparable markets where there is competition. Figure 5 shows the impact of competition on Air New Zealand's average yields.

[3] Airline passenger yield is defined as passenger revenue per kilometre flown and is expressed mathematically as:

$$Yield = \frac{R_{pax}}{RPK}$$

Where:
R_{pax} = Total Passenger Revenue
RPK = Revenue Passenger Kilometres

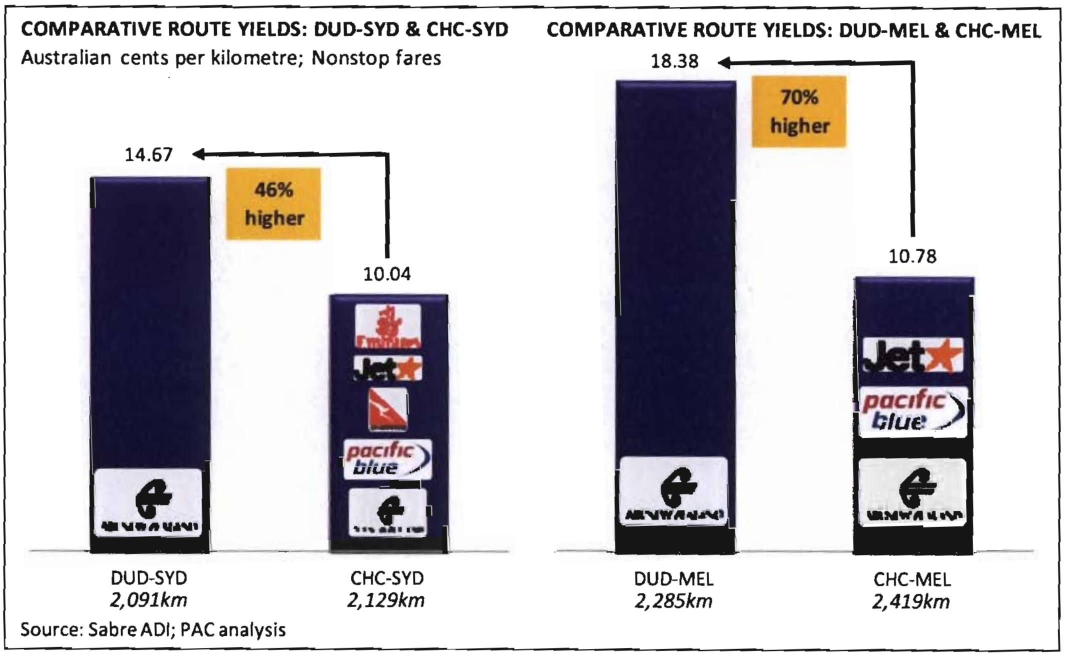

Figure 5

4.19 When more carriers enter a market, capacity and passenger volumes grow (which generally leads to a fall in prices). When a carrier exits the reverse is true.

4.20 Market evidence also demonstrates that when a competitor exits a Trans Tasman route passenger numbers fall and average airfares rise. A good example of this is the Adelaide-Auckland route. Initially, that route was served solely by Qantas. In March 2006, Air New Zealand began flying the route. Air New Zealand and Qantas then competed until July 2007 when Qantas exited, leaving Air New Zealand as the sole nonstop carrier. Passenger and fare data for the relevant period is shown in Figure 6.

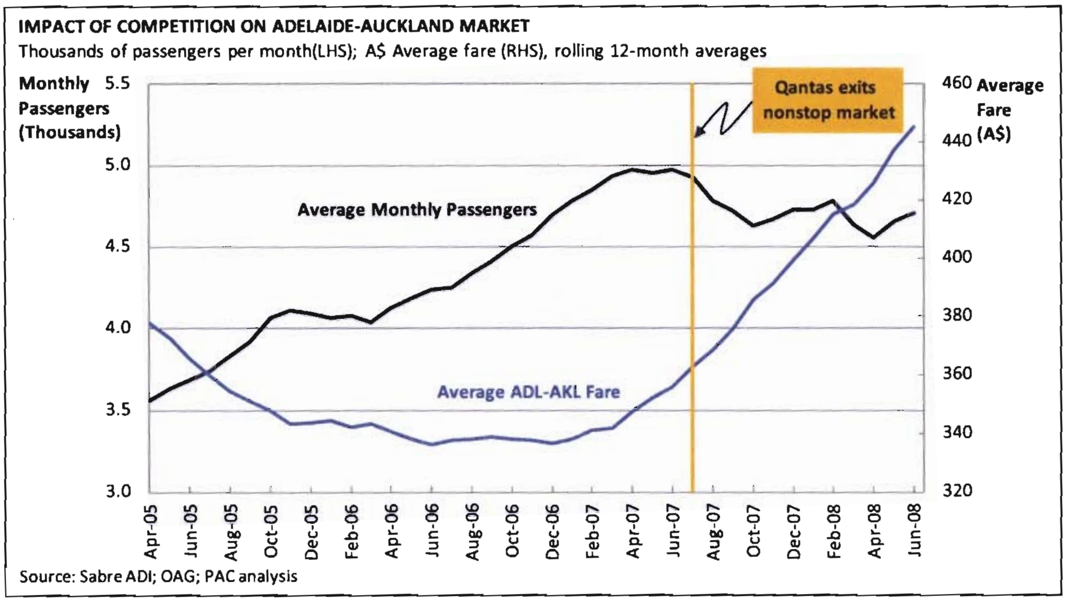

Figure 6

4.21 As Figure 6 shows, the period of competition between Qantas and Air New Zealand was characterised by rising passenger numbers and falling airfares. During the 12 months following Qantas' exit, average fares rose by 23% while passenger numbers fell by 5%. From a carrier's perspective, it is likely that that increase in average fares more than offset the reduction in passenger volume, so it can be inferred that Air New Zealand's revenue on that route increased following Qantas' exit. It could fairly be expected that a similar pattern would emerge under the Alliance (for instance, on newly monopolised routes like Cairns-Auckland, Brisbane-Wellington or Brisbane-Dunedin).

4.22 The Applicants have not analysed some routes, on the basis that those routes are said to be excluded from the Alliance (including routes to the Pacific Islands, domestic Australia and domestic New Zealand). The Applicants have not yet explained why they believe that the effects of their coordination on the Alliance routes will not spill over onto those non-Alliance routes. If the Applicants are to fully coordinate their operations on Trans Tasman routes, it could well be expected that their operations on other routes will become similarly coordinated.

The Alliance would remove an important potential competitor from some routes

4.23 As noted above, Air New Zealand or Virgin Blue presently hold a monopoly on eight non-stop Trans Tasman routes. There are also a number of other routes which one of the Applicants presently shares with one other airline. For instance, Air New Zealand currently competes only with Qantas on Melbourne-Queenstown and Melbourne-Wellington.

4.24 The Applicants have not acknowledged that they are presently each potential competitors on those routes. For instance, Virgin Blue might otherwise consider entering the Perth-Adelaide route to compete with Air New Zealand; or the Melbourne-Queenstown route to compete with Air New Zealand and Qantas. The Alliance would remove any prospect of that occurring.

4.25 Likewise, the Alliance would seem to make it unlikely that either airline would enter certain routes which are excluded from the Alliance. For instance, Virgin Blue would have little incentive to enter other routes in domestic New Zealand (and might even retire from some of the domestic New Zealand routes on which it presently competes); and Air New Zealand would have little incentive to start flying in domestic Australia (in order to acquire the Australian feeder traffic which it suggests will be so important to it under the Alliance). Such reductions in potential competition should not be disregarded in considering the impact of the Alliance.

The Alliance would strengthen Air New Zealand's position on online routes

4.26 The Alliance would also have a significant impact on indirect Trans Tasman routes connecting to regional New Zealand destinations, given that a number of smaller regional New Zealand airports are served only by Air New Zealand. We have considered the Top 100 Trans Tasman origin-destination routes (which represent 97% of all origin-destination travel between Australia and New Zealand). Air New Zealand is the only 'online carrier' (ie the only carrier which can market and/or operate its own services for the entire itinerary) in 34 of those routes (such as Sydney-Nelson, or Melbourne-Rotorua).

4.27 For the year ending April 2010, those 34 routes represent 195,000 origin-destination travellers.[4] In contrast, Qantas is the sole online carrier in only two of the Top 100 routes (Avalon-Christchurch and Alice Springs-Auckland). For the year ending April 2010, those two routes represented 12,000 origin-destination passengers.

4.28 Under the Alliance, the number of Trans Tasman markets where Virgin Blue or Air New Zealand is the only online carrier will increase by eight:

(a) Brisbane-Dunedin;

(b) Brisbane-Hamilton;

(c) Gold Coast-Hamilton;

(d) Sydney-Hamilton;

(e) Sydney-Dunedin;

(f) Melbourne-Hamilton; and

(g) Melbourne-Dunedin.

4.29 None of these markets currently suffer from a lack of online (and competitive) services. The Alliance would not 'connect' any of these city-pairs for the first time. Several of these additional markets are relatively large, and (for the year ending April 2010) would increase the total passenger market size where a Virgin airline or Air New Zealand is the only online carrier to nearly 337,000 passengers. This means that, if the Alliance were to go ahead, 8% of passengers in the Top 100 Trans Tasman markets would have a sole online carrier.

4.30 PAC's analysis shows that yields are 44% higher in markets where Air New Zealand is the only online carrier than yields in markets where there are multiple online carriers. Air New Zealand average yields in markets where it is the only online carrier are 30% higher than in the eight markets listed above which are currently competitive between Pacific Blue and Air New Zealand. The position is shown in Figure 7.

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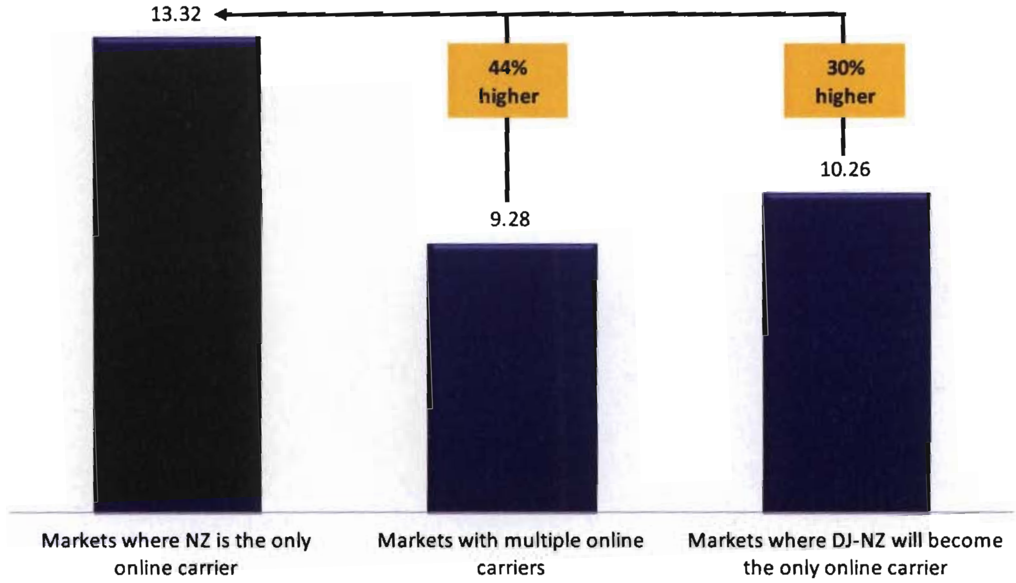
[4] Sabre ADI data.

AVERAGE YIELD IMPACT OF COMPETITION IN TOP 100 TRANS-TASMAN MARKETS
Australian cents per kilometre; Year-ending April 2010



Source: Sabre ADI; PAC analysis

Figure 7

4.31 Yields may be higher in markets where Air New Zealand is the only carrier providing online connections for several reasons:

(a) Firstly, there is the 'convenience' and 'visibility' factor that means that passengers travelling between two points pay a premium for same-airline service. In most markets, this quantum of this factor is limited by multiple airlines offering same-airline connections.

(b) Secondly, the alternative to travelling with Air New Zealand for a passenger travelling in a market with only Air New Zealand online connections is to purchase a fare from two different carriers. For example, a passenger travelling between Brisbane and Palmerston North, should they not elect to travel with Air New Zealand for the entire journey, could purchase a Brisbane-Auckland fare with Qantas and then a separate (or interline) fare with Air New Zealand between Auckland and Palmerston North. As fares (in this case) would be priced individually, a passenger is often likely to face higher total fares and greater inconvenience by selecting a non-Air New Zealand carrier. In such cases of passengers 'self-connecting', passengers often bear the risk of missed connections and the time-cost of longer minimum connecting time between flights. In markets where the only alternative is to purchase separate (and more expensive) fares, Air New Zealand is therefore able to extract a fare premium.

Competitive constraint from other airlines

4.32 We have not sought here to fully explore the competitive constraints which the Applicants say would be exerted upon their Alliance by other airlines competing on the Tasman. However, we would encourage the ACCC to look for concrete and reliable evidence in support of the Applicants' assertions before concluding that any such constraint will be material.

5. **PUBLIC BENEFITS**

5.1 While coordination and cooperation of the type proposed by the Alliance may produce commercial advantages for the airlines involved, such arrangements do not always deliver real long term benefits to consumers. It will be important for the ACCC to look for real evidence that each claimed benefit will in fact arise under the Alliance, and will end up in the hands of consumers.

Enhanced products and services

5.2 Our main concern here is that the Applicants have not yet provided any real detail about precisely how they plan to optimise their respective schedules and improve their network offering. In particular, they indicate that they are still in the process of an "initial review" of what an optimised network would look like (Application to ACCC, section 2.5(b)). That must make it difficult to be certain whether the Alliance will lead to any reductions in wingtip flying, or improvements in schedule spread, or addition of new routes, which in turn must make it difficult to be certain that the Alliance will indeed lead to substantial public benefits of the type claimed.

Cost savings

5.3 The Applicants have not yet explained precisely what cost savings they hope to realise through the Alliance, again indicating that they have not yet been able to share enough detail to accurately quantify the expected cost savings (Application to ACCC, section 5.4). The ACCC should demand good evidence as to just what cost savings will accrue and why, and how those cost savings will be passed through to consumers. In particular, the ACCC should look for strong evidence to support the Applicants' suggestion that cost savings will not be realised by reducing capacity or services on any route (Application to ACCC, section 5.4). Our real concern is that there is unlikely to be sufficient competition on individual routes to ensure that any cost savings which do arise are passed through to consumers (rather than the airlines' shareholders by way of increased profitability).

Lower fares

5.4 As noted above, we presently think it unlikely that there will be sufficient competition on individual routes to ensure that cost savings are passed through to consumers in the form of lower fares. Again it is imperative that the ACCC actively monitor the operations under the Alliance if authorisation is granted, to ensure that the claimed reductions in fares actually eventuate.

Increased tourism

5.5 Our concern is that if the increased benefits to the public in the form of increased services and lower fares do not materialise, passenger numbers will decline and this will have a consequential negative impact on tourism. As illustrated earlier in this submission (Auckland-Adelaide), reduced competition usually leads to reduced volumes and so to fewer passengers/tourists.