Australian
Competition &
Consumer
Commission

Determination

Applications for authorisation

lodged by

Virgin Blue Airlines Pty Ltd and Others

in respect of

an airline alliance between the applicants

Date: **16 December 2010**

Commissioners: Samuel
Kell
Schaper
Court
Dimasi
Walker
Willett

Authorisation no.: A91227 &
A91228

Public Register no.: C2010/453

Summary

The ACCC grants conditional authorisation for an alliance between Virgin Blue and Air New Zealand in relation to air passenger services between Australia and New Zealand until 31 December 2013.

On 6 May 2010, Virgin Blue and Air New Zealand lodged applications for authorisation to make and give effect to the Australasian Airline Alliance Agreement, an associated Code Share Agreement and proposed related agreements which are contemplated by the Alliance Agreement (the Alliance).

The Alliance provides for coordination and agreement between Virgin Blue and Air New Zealand on all aspects of their passenger services between Australia and New Zealand.

The ACCC considers that the Alliance is likely to result in material public benefits in the form of:

- enhancement of the applicants' products and service offering (including increased access to existing frequencies, increased online connection options, better schedule spread, enhanced value added services and new frequencies) and associated increased consumer choice
- potential for lower fares as a result of cost savings and efficiency improvements through removal of double marginalisation and higher load factors
- promotion of competition, particularly in the business traveller segment of the trans-Tasman market and
- stimulation of tourism.

The ACCC considers that the Alliance is likely to result in public detriment through its effect on competition on a number of routes comprising the market for trans-Tasman air passenger services.

Specifically, the ACCC is of the view that the Alliance raises material competition issues on the trans-Tasman routes to and from Wellington (Wellington-Sydney, Wellington-Melbourne and Wellington-Brisbane) as well as Dunedin-Brisbane. Together, these routes account for around 12% of the trans-Tasman air passenger services market.

Based on the information currently available, the ACCC considers that the effect of the Alliance on competition on the Auckland-Brisbane (13% of the market) and Queenstown-Sydney (1% of the market) routes is uncertain.

The Trade Practices Act allows the ACCC to grant authorisation subject to conditions.

In this case, the ACCC has decided to impose conditions to address the identified competition concerns. Broadly speaking, the conditions require the applicants to maintain, and grow, a base level of capacity on the routes of concern for the term of the authorisation.

The objective of the conditions is to restrict the discretion of the Alliance to limit its capacity or limit the growth of its capacity on each of the routes of concern. If in practice the conditions are effective in achieving this objective the ACCC considers they will limit the circumstances under which the Alliance could profitably raise fares on the routes of concern.

The ACCC is satisfied that the identified public benefits in combination with the conditions of authorisation are likely to be sufficient to outweigh the detriment to the public constituted by any lessening of competition arising from the Alliance.

The applicants have sought authorisation for a period of five years. Given the fine balance of benefits and detriments in this case, and the significant role of conditions in that balance, the ACCC considers it appropriate to review developments earlier. As such, the ACCC grants authorisation until 31 December 2013.

If no application for review of the determination is made to the Australian Competition Tribunal, the determination will come into effect on 7 January 2011.

Contents

List of abbreviations

ACCC	Australian Competition and Consumer Commission
The Act	Trade Practices Act 1974
The Agreement	The *Agreement between the Government of Australia and the Government of New Zealand relating to Air Services*
BITRE	Bureau of Infrastructure, Transport and Regional Economics
Code sharing	Code sharing refers to arrangements involving the assignment of one airline's designator code to a flight operated by another airline
Department of Infrastructure	Department of Infrastructure and Transport
DIAC	Department of Immigration and Citizenship
Fifth freedom	The right of an airline of one country to land in a foreign country and pick up and deliver traffic from that country to a second foreign country
FFC	Fifth freedom carrier
Free sale	A type of code share where the marketing carrier effectively only pays for the seats it sells
FSA	Full service airline
Interlining	Interlining involves the carriage of passengers and/or freight between two points using more than one airline under an arrangement which typically involves baggage check through and the honouring of tickets between airlines
IASC	International Air Services Commission
Load factor	Load factors measure the percentage of seats filled on an aircraft on any given route. This is derived from dividing the number of passengers travelled by the number of seats available
LCC	Low cost carrier
Online connections	A passenger itinerary of two or more flight segments where connections are made between flights of the same airline or its code share partners
Sector	A sector is a non-stop flight leg between two points (excluding technical stops where no passengers or cargo are picked up or dropped off)
The Tribunal	The Australian Competition Tribunal
Virgin Blue	Virgin Blue Airlines Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd, Pacific Blue Airlines (NZ) Ltd
Yield	Airline revenue per unit of traffic. Passenger yield is airline revenue per passenger kilometre

1. The applications for authorisation

1.1. On 6 May 2010, Virgin Blue Airlines Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd, Pacific Blue Airlines (NZ) Limited (together Virgin Blue) and Air New Zealand Limited (Air New Zealand) lodged applications for authorisation A91227 and A91228 with the ACCC.

1.2. Authorisation is a transparent process where the ACCC may grant immunity from legal action for conduct that might otherwise breach the *Trade Practices Act* 1974 (the Act). The ACCC may 'authorise' businesses to engage in anti-competitive conduct where it is satisfied that the public benefit from the conduct outweighs any public detriment. The ACCC conducts a public consultation process when it receives an application for authorisation, inviting interested parties to lodge submissions outlining whether they support the application or not. Further information about the authorisation process is contained in Attachment A. A chronology of the significant dates in the ACCC's consideration of these applications is contained in Attachment B.

1.3. Application A91227 was made under sections 88(1A) and 88(1) of the Act to:

- make and give effect to a contract, arrangement or understanding, a provision of which is or may be an exclusionary provision within the meaning of section 45 of the Act.

- make and give effect to a provision of a contact, arrangement or understanding, a provision of which is, or may be, a cartel provision and which is also, or may also be, an exclusionary provision within the meaning of section 45 of that Act.

1.4. Application A91228 was made under sections 88(1A) and 88(1) of the Act to:

- make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act.

- make and give effect to a contract or arrangement, or arrive at an understanding a provision of which would be, or might be, a cartel provision (other than a provision which would also be, or might also be, an exclusionary provision within the meaning of section 45 of that Act).

1.5. In particular, Virgin Blue and Air New Zealand applied for authorisation to make and give effect to the Australasian Airline Alliance Agreement, an associated Code Share Agreement and proposed related agreements which are contemplated by the Alliance Agreement (the Alliance).

1.6. The applicants seek authorisation for a period ending no earlier than five years from the date of implementation (that is, the operational date as defined in the Alliance Agreement).

1.7. The Alliance provides for coordination and agreement between the applicants in respect of trans-Tasman passenger services. The Alliance covers cooperation across:

- trans-Tasman sectors, which are any sectors between a point in Australia and a point in New Zealand, including when the ultimate destination of the service is another point in Australia, New Zealand or another country and
- Network Alliance Routes, which are international routes comprising the trans-Tasman sectors plus any domestic Australian or New Zealand sectors connecting to a trans-Tasman sector as part of an international itinerary.

1.8. The applicants submit that under the Alliance they will:

- fully cooperate and coordinate on all aspects of their international services on the trans-Tasman sectors of the Network Alliance routes
- code share on a free sale basis on the Network Alliance routes
- work together to align their customer facing products and systems on the trans-Tasman sectors to achieve metal neutrality
- cooperate in relation to frequent flyer programs and lounge access to improve the Alliance's overall service offering on the Network Alliance routes
- cooperate in achieving cost savings and cost sharing and other efficiencies so as to lower the parties operating costs on the Network Alliance routes and
- work together to agree a plan to optimise their operations on the trans-Tasman sectors as soon as practicable by developing a network that matches aircraft type to route and focuses each operating carrier on its market strengths and primary operating hubs and to implement that plan as soon as practicable after the commencement date (as defined in the Alliance Agreement).

Draft determination

1.9. Section 90A(1) requires that before determining an application for authorisation the ACCC shall prepare a draft determination.

1.10. On 10 September 2010, the ACCC issued a draft determination proposing to deny authorisation for the Alliance.

1.11. Wellington International Airport Limited (Wellington Airport) requested a conference in relation to the draft determination and this was held on 18 October 2010, chaired by ACCC Deputy Chair Peter Kell.

2. Background to the application

The applicants

Virgin Blue Group[1]

2.1. The Virgin Blue Group commenced operations in Australia in August 2000. It is listed on the Australian Stock Exchange.

2.2. The Virgin Blue Group currently operates 88 aircraft on approximately 3 000 flights per week, to 48 Australian and international destinations under the following domestic and international brands:

- Virgin Blue
- Pacific Blue
- Polynesian Blue (a joint venture with the Samoan Government) and
- V Australia.

Virgin Blue

2.3. Virgin Blue was launched in 2000 and is the flagship carrier of the Virgin Blue Group of carriers. In late November 2005, Virgin announced its move towards becoming a New World Carrier (NWC). Virgin Blue advises that a NWC is a low cost, high value airline model that is pitched between a full service carrier and a low-cost carrier. Virgin Blue is planning further changes to its service and product model under its Airline of the Future project, the main elements of which are confidential as between the applicants and have been provided to the ACCC on a confidential basis.

2.4. Virgin Blue operates a fleet of 69 Boeing 737-700, 737-800 and Embraer E190 and E170 E-Jet aircraft.

2.5. Virgin Blue is headquartered in Brisbane and its domestic flights have two classes, Premium Economy and Economy.

Pacific Blue

2.6. Virgin Blue services the Tasman through its Pacific Blue subsidiary. Pacific Blue operates under a low cost carrier (LCC) model largely targeting lower traffic volume and lower yield routes but also serving, at lower frequencies, the major trans-Tasman routes. Pacific Blue was launched in 2004 and operates through two subsidiaries: Pacific Blue Australia and Pacific Blue New Zealand.

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[1] Information under this sub-heading is sourced from *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance* and the Annexures, 4 May 2010, and the *Submission in support of the application for authorisation of the proposed alliance between Virgin Blue and Etihad Airways,* August 2010.

2.7. Pacific Blue operates flights between Australia and New Zealand and on services between Australia, Fiji, Bali, Thailand, Samoa, Vanuatu, Papua New Guinea, the Cook Islands, the Solomon Islands and Tonga. It also operates flights between New Zealand, Tonga and Rarotonga. Services between New Zealand and Samoa are operated by Polynesian Blue. Pacific Blue currently operates a fleet of 12 Boeing 737-800 aircraft.

2.8. On 16 August 2010 Pacific Blue announced its withdrawal from the domestic aviation market in New Zealand.[2]

Air New Zealand[3]

2.9. Air New Zealand is New Zealand's national flag carrier offering air services in New Zealand and internationally. The New Zealand government owns 75.49% of ordinary shares in Air New Zealand,[4] with the remainder owned by private investors.

2.10. Air New Zealand is listed on the New Zealand and Australian stock exchanges.

2.11. Air New Zealand has operated on the Tasman since April 1940 through its predecessor airline, Tasman Empire Airways Limited.

2.12. Air New Zealand's Tasman offering principally utilises the narrow body A320, although it also utilises some wide body B767, B747 and B777 aircraft.

2.13. Air New Zealand is a member of the Star Alliance. Star Alliance includes airlines such as Adria, Air Canada, ANA, Asiana Airlines, Austrian Airlines, Blue1, Brussels Airlines, bmi, Continental, Croatia Airlines, Egyptair, LOT Polish Airlines, Lufthansa, Shanghai Airlines, Singapore Airlines, SAS, South African Airways, Spanair, SWISS, TAP Portugal, Thai Airways, Turkish Airlines, United Airlines and US Airways.

2.14. Air New Zealand has code share agreements with several Star Alliance members, including United Airlines, Air Canada, Continental and Lufthansa.

The Alliance[5]

2.15. The applicants seek authorisation to establish an integrated alliance in relation to their Tasman services.

2.16. On 3 May 2010, Virgin Blue and Air New Zealand entered into the Australasian Airline Alliance Agreement (Alliance Agreement) and an associated Code Share Agreement (Code Share Agreement). As part of the Alliance, the applicants propose to also enter into further agreements contemplated by the Alliance Agreement, including

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[2] Virgin Blue Press Release, *The Virgin Blue Group of Airlines Annoucnes First Phase of Network Review*, 16 August 2010.

[3] The majority of the information under this sub-heading is sourced from *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance* and the Annexures, 4 May 2010.

[4] 2009 Annual Financial results, Air New Zealand, page 68, available at **http://www.airnewzealand.com.au/2009-annual-results/**.

[5] Information under this sub-heading is sourced from *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance* and the Annexures, 4 May 2010.

in relation to frequent flyer benefits, lounge access and one or more Special Prorate Agreements.

2.17. Subject to regulatory approval in Australia and New Zealand, the Alliance provides for coordination and agreement between the applicants in respect of trans-Tasman passenger services.

2.18. As noted at paragraph 1.7, the Alliance covers cooperation across trans-Tasman sectors and Network Alliance Routes.

2.19. The applicants' domestic networks are outside the scope of the Alliance, except to the extent that a particular service is part of a connecting service across the Tasman.

2.20. Pursuant to the Alliance, the applicants will:

- fully cooperate and co-ordinate on all aspects of their international services on the trans-Tasman sectors of the Network Alliance Routes
- code share on a free sale basis on the Network Alliance Routes
- work together to align their customer facing products and systems on the trans-Tasman sectors to achieve 'metal neutrality'[6]
- cooperate in relation to frequent flyer programs and lounge access to improve the Alliance's overall service offering on the Network Alliance Routes
- cooperate in achieving cost savings and cost sharing and other efficiencies so as to lower the parties' operating costs on the Network Alliance Routes
- work together to agree a plan to optimise their operations on the trans-Tasman sectors as soon as practicable by developing a network that matches aircraft type to route and focuses each operating carrier on its market strengths and primary operating hubs and to implement that plan as soon as practicable after the commencement date (as defined in the Alliance Agreement).

2.21. The applicants have agreed certain principles which underpin the formation of the Alliance and which support all commercial and operational activities undertaken as part of the Alliance. Under the Alliance:

- the parties will align their commercial interests in relation to the Alliance activities and create the incentive for each member to maximise net benefits for the Alliance
- the parties will take all practicable steps to achieve metal neutrality on Network Alliance Routes and

[6] 'Metal neutrality means a state where the applicants will implement programs and policies that ensure the applicants are incentivised to sell, and consumers are willing to buy, tickets on Network Alliance Routes without preference as to which applicants' aircraft a passenger travels on… the Alliance provides for a free sale code share on the Network Alliance Routes and for the proportionate allocation of revenue from the trans-Tasman Sectors under revenue allocation arrangements founded on the principle of metal neutrality,' *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance* dated 4 May 2010, page 13.

- all parties participate in the risk/reward of the Alliance.

2.22. On the trans-Tasman sectors, the applicants also propose to cooperate in relation to sales and marketing policies, airport operations, service policies, information technology, the development of new or enhanced products and services and to align their customer facing products and systems.

2.23. In relation to the Network Alliance Routes, the applicants also propose to set the level of any commissions, rebates, or incentives payable to travel agents, or the basis on which they may be paid.

2.24. The Alliance Agreement also provides for the establishment of a three tier management system, comprised of representatives of each applicant:

- Alliance Board – responsible for the governance and the strategic direction of the Alliance

- Alliance Revenue Team – reports to the Alliance Board and is responsible for the implementation and operation of the Alliance including revenue management and pricing

- Joint Sales Team – reports to the Alliance Board and is responsible for sales and marketing planning and co-ordination under the Alliance.

2.25. The Alliance excludes charter flights, freighter operations and cargo belly space on scheduled flights.

The aviation industry

International aviation regulation

2.26. The international airline industry is highly regulated. The 1944 *Convention on International Civil Aviation* established the principle that each country has exclusive sovereignty over its airspace. This principle continues to guide the regulatory framework today.

2.27. International air transport cannot occur unless it is specifically authorised pursuant to a government to government bilateral air services agreement (ASA).

2.28. An ASA specifies the terms and conditions of airline activity between two countries. An ASA may indicate the destinations that can be served in a particular country, the permitted frequencies per week and any rights to operate via or beyond to third countries. Typically, the rights granted under an ASA can only be exercised by designated carriers of the countries that are parties to them.

2.29. An Open Skies Agreement is one form of ASA between two countries. In essence, it is an agreement which provides minimal (or no) restrictions on the ability of the airlines of two countries to operate services between countries.

Air services arrangements between Australia and New Zealand

2.30. The Department of Infrastructure and Transport (Department of Infrastructure) submits that the Australia/New Zealand air services market is one of the most open in the world and notes that the *Agreement between the Government of Australia and the Government of New Zealand relating to Air Services* (the Agreement), made at Auckland on 8 August 2002 has no restrictions on capacity, frequency or routes that airlines of either country can operate to, within or beyond the two countries.

2.31. The Agreement provides for eligible airlines to be authorised as Single Aviation Market (SAM) airlines.

2.32. In order to operate services in the SAM, carriers must meet the following criteria:

- at least 50% ownership and effective control by Australian and/or New Zealand nationals
- at least two-thirds of the Board members are Australian and/or New Zealand nationals
- the Chairperson of the Board is an Australian or New Zealand national
- the airline's head office is in Australia or New Zealand and
- the airline's operational base is in Australia or New Zealand.

2.33. Australian and New Zealand airlines can also continue to be designated under the Agreement using the incorporation and principal place of business criteria.

2.34. In conjunction with SAM arrangements, the mutual recognition of safety and operational regulatory approvals streamlines airlines' flying within the SAM.

2.35. Article 13 of the Agreement provides for eighth-freedom rights to airlines that are authorised as SAM airlines, allowing them to operate both international services between, and domestic services within, either country.

2.36. The airlines currently operated on the Tasman by the applicants qualify for both SAM and Open Skies privileges.[7]

[7] *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance* and the Annexures, 4 May 2010, page 108.

3. Submissions received by the ACCC

3.1. The ACCC tests the claims made by the applicant in support of an application for authorisation through an open and transparent public consultation process. To this end the ACCC aims to consult extensively with interested parties that may be affected by the proposed conduct to provide them with the opportunity to comment on the application.

3.2. The ACCC sought submissions from 70 interested parties potentially affected by the application, including other airlines, travel agents, government departments, consumer groups and tourism and aviation industry associations. A summary of the public submissions received from interested parties follows.

Prior to the draft determination

The applicants' original submissions

3.3. Broadly, the applicants submitted that the Alliance will result in an increased number of passengers travelling on the applicants' services; greater network connections and code share frequencies and enhanced distribution; a second integrated Australasian network, in competition with the Qantas-Jetstar Group, as well as Emirates and other fifth freedom carriers; and an overall increase in competition on the Tasman.

3.4. The applicants claimed that the Alliance will deliver public benefits in the form of enhanced products and services, lower fares, increased efficiencies, opportunities for additional frequency and capacity, promotion of competition, and stimulation of tourism.

3.5. The applicants submitted that no anti-competitive detriment will arise given the presence of other strong competitors in the market and the low barriers to entry and expansion.

Submissions supporting the Alliance

3.6. Gold Coast Airport submitted that it generally supports the Alliance, but was concerned to ensure that the Alliance does not result in reduction in capacity. Gold Coast Airport considered that the Alliance may in fact increase capacity into Australian airports and felt that the positive economic impact created is an important factor that should be considered by the ACCC.

Submissions opposing the Alliance

3.7. Cairns Airport Pty Ltd (Cairns Airport) submitted that the ACCC should exclude the Cairns-Auckland route from the Alliance because the arrangement would result in substantial anti-competitive detriment and higher airfares on what will become a non-competitive route.[8]

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[8] Since the date of this submission, the Qantas Group has announced that Jetstar will be commencing services on the Cairns-Auckland route from 12 April 2011.

3.8. KISS Travel International submitted that if the Alliance is allowed to progress, capacity would reduce and average fares would increase.

3.9. Tiger Airways submitted that the applicants, if allowed to combine their activities, have the ability to reduce flights and seat numbers, reduce frequencies or services on marginal routes and could utilise their increased market power to raise prices and prevent potential new entrants from entering the market. Tiger Airways also submitted that, given the foreign ownership restrictions in the Open Skies Agreement, Tiger Airways does not currently satisfy the requirements for automatic designation under the Agreement and is unlikely to enter the market.

3.10. The New Zealand Airports Association considered 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. The New Zealand Airports Association considered that where there is real competition on a trans-Tasman route, passengers have benefited from lower fares and more convenient services and that such competitive dynamic should continue.

3.11. Hamilton International Airport was unconvinced that the trans-Tasman market has the low barriers to entry and the level of strong competitors (apart from Jetstar) claimed by the applicants. Hamilton International Airport suspected that the Alliance could severely reduce competition in the Tasman market, which would result in higher airfares, reduced trans-Tasman tourism and increase trans-Tasman business costs.

3.12. The Wellington Regional Chamber of Commerce submitted that many of the claimed benefits of the Alliance around frequency and fares are speculative only. The Wellington Regional Chamber of Commerce acknowledged the applicants' stated benefits in the form of onward connectivity, better connections, expanded lounge access and loyalty scheme reciprocity but considers these benefits are overstated relative to the likely impact of diminished competition, higher fares and reduced flights. The Wellington Regional Chamber of Commerce considered that the proposal is likely to substantially lessen competition in the trans-Tasman market and potentially result in higher fares and reduced opportunities to fly between New Zealand and Australia.

3.13. The Key Wellington Stakeholders Group[9] was concerned that the Alliance would have the effect of substantially lessening competition in the trans-Tasman air passenger services market between Wellington and Australia, without providing any countervailing public benefits.

3.14. Wellington Airport considered that the trans-Tasman market and passengers have been well served by allowing the ordinary competitive processes to play out and by subjecting airlines to the discipline of competition. Wellington Airport submitted that there is no reason to think that any substantial and ongoing public benefits are going to arise by allowing two of the main players to collude and that there is good reason to think that significant public detriment will flow from that course.

[9] A group of business, local government and tourism organisations from the Wellington region (comprising Greater Wellington Regional Council, Grow Wellington, Positively Wellington Tourism, Wellington Employers' Chamber of Commerce, Wellington City Council, Wellington International Airport Limited).

3.15. Auckland International Airport Limited (Auckland Airport) submitted that it is committed to ensuring that the travel market remains competitive, accessible and viable for all stakeholders and is therefore generally very supportive of airline alliances 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. Nevertheless, Auckland Airport submitted that it has concerns in relation to some aspects of the applicants' current proposal and considers that the applicants have not yet provided concrete and reliable evidence that the claimed benefits will actually materialise, and will result in a benefit to consumers.

3.16. As discussed further below, Auckland Airport, Wellington Airport and the Key Wellington Stakeholders Group have subsequently withdrawn their opposition to the Alliance in light of the capacity conditions proposed by the applicants.

Submissions neither supporting nor opposing the Alliance

3.17. The Department of Infrastructure provided contextual information on the relevant aviation market, the air service arrangements which underpin it and the Australian Government's aviation policy. The Department of Infrastructure noted that the Australia/New Zealand air services market is one of the most open in the world, with no restrictions on capacity, frequency or routes that airlines of either Australia or New Zealand can operate to, within or beyond the two countries. The Department of Infrastructure noted that Air New Zealand and the Qantas Group are the dominant long standing operators, while the Virgin Blue Group is a growing and significant competitor.

3.18. The International Air Services Commission (IASC) noted that it has allocated unlimited passenger and freight capacity to Qantas and Pacific Blue Australia on the New Zealand route. The IASC also noted that (in addition to Emirates, Lan Chile and Aerolineas Argentinas) a number of other third party country carriers hold rights to operate on the trans-Tasman but do not currently do so. The IASC agreed with the applicants' claims that Air New Zealand would gain access to extensive behind-gateway networks as part of the proposed arrangements but noted that this access could be achieved independently of other aspects of the arrangements, such as revenue sharing. The IASC also submitted that V Australia offers business class product and there would be no regulatory impediment to it entering the New Zealand route should it wish to do so.

3.19. Tourism Australia submitted that the trans-Tasman market is highly competitive with low fares continuing to stimulate tourism between New Zealand and Australia. Tourism Australia also notes that the applicants are important carriers on this route, servicing key trunk routes as well as smaller regional routes. Tourism Australia also noted the combined market share of the applicants was 53% in the year ended March 2010.

3.20. JumpJet described the increasingly predatory nature of global carriers (and provides the example of Air Asia) and their potentially unlimited capacity to enter the SAM. JumpJet submitted that, should the applications be granted, the applicants would be in a position to vary fares and capacity in an avaricious sense.

3.21. David Maclure submitted that the proposed alliance may be necessary taking into account, among other things, the recession of the past two years and a struggling aviation market. David Maclure considered that the alliance should be subject to certain conditions including in relation to matters relating to the governance of the Alliance.

The applicants' response to interested party submissions

3.22. The applicants submitted that:

- the public benefits of the Alliance have been substantiated and that the Alliance would not result in competitive detriment on any individual route
- barriers to entry are low and supply side substitutability is high on the trans-Tasman route
- even on the three routes which will be served by a single direct operator on day one of the Alliance, which together constitutes less than 5% of the Tasman market, there will be no net detriment because competitive constraints will continue from indirect services and potential entrants, particularly Jetstar; and the Alliance will result in benefits on these routes, including passenger stimulation benefits, as shown by the QSI results.

3.23. The applicants also submitted an expert report prepared by Dr Michael Tretheway (the Tretheway Report).

Following the draft determination

3.24. The applicants and interested parties provided further submissions in response to the ACCC's draft determination and the subsequent pre-determination conference.

3.25. Qantas Airways Limited and Emirates also provided oral submissions in response to ACCC inquiries.

3.26. A summary of submissions following the draft determination is set out below.

The applicants' further submissions

3.27. The applicants have provided further information in relation to public benefits and submit that:

- the public benefits of the Alliance are significant and will enable the applicants to offer enhanced products and services
- the predicted passenger stimulation effects from the Alliance are both substantial and reliable
- the Alliance will enable fully identified and material additional cost savings and efficiencies particularly through increased load factors.

3.28. The applicants submit that Virgin Blue is changing its strategy to improve its network and product in order to expand its passenger base and challenge Qantas across more market segments, particularly for corporate accounts. The applicants also submit that the Alliance is the only commercially and financially viable option available to enable Air New Zealand to improve its access to domestic Australian services.

3.29. With regard to competition effects the applicants submit that:

- Jetstar is a strong competitive constraint and faces no operational barriers to expansion on the trans-Tasman routes
- the market conditions for coordinated effects are not present on the Tasman on the basis of factors such as low barriers to entry and expansion, the different cost bases of different carriers, the high price sensitivity of the majority of passengers, and the dynamic nature of the market encompassing a high degree of innovation and product differentiation
- they will not have the ability to raise prices on any individual route.

3.30. The applicants are confident that the Alliance will result in increased passenger numbers, and accordingly, are willing to commit to capacity conditions which require them to maintain capacity for each year of the authorisation period; and increase capacity over nominated sectors by 10% by year 3 of the authorisation and 15% by year 5 of the authorisation.

Submissions supporting the Alliance

3.31. Auckland Airport, Wellington Airport and the Key Wellington Stakeholders Group were generally supportive of the ACCC's draft determination. However, all of these interested parties have withdrawn their opposition to the Alliance in light of the capacity conditions proposed by the applicants.

- Auckland Airport submits that its concerns regarding the potential anti-competitive detriment of the proposed Alliance have been significantly allayed by the authorisation conditions offered by the applicants. Auckland Airport provides comments on discrete aspects of the condition, however, notes that as it has only seen the non-confidential version of the proposed condition, it has not been able to consider the proposal fully.
- Wellington Airport submits that it no longer opposes the Alliance in principle, provided that the ACCC includes authorisation conditions at the capacity levels proposed by the applicants. Wellington International Airport requests that the ACCC give careful consideration to a robust framing of the authorisation conditions.
- The Key Wellington Stakeholders Group submits that the guaranteed level of capacity in the applicants' proposed commitments would address its main concerns about the potential impact of the Alliance on Wellington, subject to reviewing the precise form of the conditions and any associated caveats or review mechanisms.

3.32. Canberra Airport does not believe that the Alliance would substantially lessen competition in the trans-Tasman airline service market. Rather, Canberra Airport believes that the Alliance would in fact foster greater competition between the other airlines in the market and Virgin Blue/Air New Zealand.

3.33. Melbourne Airport is supportive of Virgin Blue and Air New Zealand's application as it has the potential to provide more travel time, price and destination options for consumers.

3.34. Sydney Airport Corporation is not opposed to the Alliance and submits that there would be no meaningful impact on competition between airlines servicing trans-Tasman routes.

3.35. The Department of Economic Development, Tourism and Arts (Tasmania) supports the applicants' authorisation application. The Department considers that the Alliance will connect many regional centres in Australia and New Zealand through code share arrangements and for Tasmania that provides new opportunity for New Zealand visitor growth given many origins in New Zealand will now be connected to both Hobart and Launceston directly (albeit by a code share partner). The Department does not agree that the Alliance will inhibit competition on the trans-Tasman route, but instead, for regional destinations, will provide additional competitive opportunities given the multiple destinations in either country potentially directly connected in the eyes of consumers.

3.36. Tourism NT submits that the proposed alliance could potentially allow Virgin Blue and Air New Zealand to expand their network coverage to take advantage of new opportunities (such as Darwin) rather than continue to focus on the limited number of existing routes between New Zealand and the east coast Australia.

3.37. Tourism NSW considers that the proposed Alliance will produce public benefit through greater service choice and the maintenance of downward pressure on airfares and is more likely to promote than lessen competition in the trans-Tasman market over time.

3.38. VIPA (an organisation representing Virgin Blue Group pilots) submits that the Alliance would strengthen the Australian aviation industry with greater economic efficiencies and synergies between Virgin Blue and Air New Zealand. VIPA considers that the proposal will strengthen the Virgin Blue Group Australian operations and allow greater stability for the Group as a whole to operate and service the Australian international market. VIPA supports the application on the basis that not only will the proposed arrangement strengthen Virgin Blue, but it will also see an increase of Australian pilots employed by the Virgin Blue Group.

3.39. Grant Edelsten submits that a combined airline with combined marketing power and the ability to share operational costs would make regional routes a more viable commercial option.

3.40. Mark Konemann submits that he does not wish to see a Qantas monopoly with Jetstar on the trans-Tasman routes. Mark Konemann considers that Virgin Blue should be allowed to compete on the same terms as Qantas.

Submissions opposing the Alliance

3.41. The New Zealand Airports Association agrees with the ACCC's draft determination and in light of the evidence provided by the applicants, considers that the Alliance is likely to reduce competition in trans-Tasman air passenger services, and that the possible public benefits would not outweigh the detriment caused by the lessening of competition.

3.42. Peter Wakeman agrees with the ACCC's draft determination, noting that one million passengers would be adversely affected, as well as tourist related businesses.

Submissions neither supporting nor opposing the Alliance

3.43. Emirates notes that Air New Zealand and Qantas are already part of two large alliances, which exert considerable market influence. Emirates views itself as an important independent carrier. Emirates considers that participation in an alliance would constrain its ability to make independent decisions. Emirates considers that alliances act to dissolve competition over time, with carriers who are part of an alliance seeking to carve up the world map.

3.44. Qantas has not taken a position on the applications for authorisation. However, Qantas considers that the Alliance is not necessary to create a stronger competitor, noting that the market is already very competitive and Virgin Blue and Air New Zealand are individually strong competitors. Qantas makes a number of points about its business model and Jetstar, which are discussed in more detail under **Public detriment**.

3.45. Hamilton International Airport considers that key negative competition impacts will be on the smaller New Zealand airports rather than the three main centres. Hamilton International Airport considers that Auckland and Hamilton airports serve the same market given their close geographical distance, and that Air New Zealand competes with Pacific Blue on the Hamilton-Brisbane route with flights via Auckland.

3.46. The views of the applicants and interested parties are outlined in the ACCC's evaluation of the Alliance in Chapter 5 of this determination. Copies of public submissions may be obtained from the ACCC's website (www.accc.gov.au/AuthorisationsRegister) and by following the links to this matter.

4. Trans-Tasman airline operations

4.1. New Zealand is Australia's largest international origin/destination market, with a total of 5.4 million passenger movements in the year ended June 2010.

4.2. Table 4.1 shows the number of passengers travelling between Australia and New Zealand based on uplift/discharge data.

Table 4.1 Australia-New Zealand passenger numbers (1)

Year ended June	Number of passengers	Percentage change from previous year
2010	5,404,839	4.8
2009	5,156,875	-0.3
2008	5,173,083	2.7
2007	5,036,228	3.3
2006	4,873,461	0.5
2005	4,850,699	13.1
2004	4,287,516	17.7
2003	3,642,898	3.7
2002	3,514,281	-0.3
2001	3,524,777	15.8
2000	3,044,538	10.3

(1) Sourced from *International Airline Activity*, produced by BITRE

Airlines

4.3. Air New Zealand, Pacific Blue, Qantas and Jetstar operate on the trans-Tasman as SAM airlines. As such they do not face regulatory restrictions on their activity in terms of the destinations they can serve or the capacity they can deploy.

4.4. Air New Zealand operates the most frequencies across the widest range of trans-Tasman routes. Specifically, Air New Zealand operates 140 frequencies over 17 routes.

4.5. Pacific Blue operates 71 frequencies over 14 routes.

4.6. The Qantas Group operates 139 frequencies across 11 routes, with Jetstar operating 38 frequencies over 6 routes and Qantas operating 101 frequencies over 7 routes.

4.7. Emirates, Aerolineas Argentina and Lan Chile operate on the trans-Tasman as fifth freedom carriers (FFCs) meaning that their regulatory rights when accessing Australia as a destination also allow them to fly to ports beyond or on the way to Australia.

4.8. Emirates could be regarded as the most substantial of the FFCs operating on the trans-Tasman with 28 trans-Tasman flights per week.

4.9. A number of other international airlines operating to Australia have fifth freedom rights which enable them to carry trans-Tasman traffic, including Garuda, Royal Brunei, Singapore Airlines, Thai Airways and China Southern. Garuda, Royal Brunei, Malaysian Airways, Polynesian Airways and Thai Airways previously operated on the trans-Tasman but subsequently withdrew their services.

4.10. Some of the FFCs that have withdrawn from the trans-Tasman now supply trans-Tasman services beyond Australia through code share arrangements with Qantas (Air Tahiti, American Airlines, British Airways, China Eastern and Etihad) and Air New Zealand (Air China, Air Canada, Asiana, Austrian, Singapore Airlines, South African Airways, Thai Airways, United Airlines and US Airways).

Trans-Tasman routes

4.11. There are nine main[10] trans-Tasman routes which accounted for 88 per cent of trans-Tasman capacity in April 2010:[11]

- Auckland-Sydney
- Auckland-Melbourne
- Auckland-Brisbane
- Christchurch-Sydney
- Christchurch-Melbourne
- Christchurch-Brisbane
- Wellington-Sydney
- Wellington-Melbourne
- Wellington-Brisbane

4.12. The minor trans-Tasman routes are:

- Auckland-Adelaide
- Auckland-Cairns
- Auckland-Gold Coast
- Auckland-Perth
- Christchurch-Gold Coast
- Dunedin-Brisbane
- Hamilton-Brisbane
- Hamilton-Sydney
- Queenstown-Sydney
- Rotorua-Sydney

4.13. There are also seasonal routes from Queenstown to Melbourne, Brisbane and the Gold Coast.

[10] The Australian Competition Tribunal in 2004 recognised nine main trans-Tasman routes with other routes being described as minor – see [2004] ACompT 9 (12 October 2004)
[11] Traffic carried via Australia to/from New Zealand is not recorded

4.14. The following tables show there is currently a mix of competition over the trans-Tasman routes depending on the nature of the route:

- Qantas and Air New Zealand are relatively high cost base airlines operating full service operations with strong representation on sectors where there is a high proportion of high yielding business passengers

- Pacific Blue and Jetstar are relatively low cost operators targeted at price sensitive leisure passengers and not necessarily offering a product sought by business passengers

- the FFCs are full service airlines constrained to certain of the main routes because of airport limitations and limited by their international schedules beyond New Zealand/Australia in terms of the number and spread of frequencies they can offer.

Data by route

4.15. Table 4.2 below shows each of the trans-Tasman routes, the airlines operating the route, the number of services they operate and their share of seat capacity operated on the route.

Table 4.2. Trans Tasman routes by airline (number of services per week - percentage share of route capacity), April 2010 (1)

Route	Pacific Blue	Air New Zealand	Qantas	Jetstar	Emirates	Lan Chile	Aerolineas Argentina
Main routes							
Auckland-Sydney	7-6%	33-31%	35-34%	7-6%	7-17%	5-3% (2)	4-3% (2)
Auckland-Melbourne	7-13%	15-34%	21-36%	(3)	7-18%		
Auckland-Brisbane	7-14%	20-44%	14-22%		7-20%		
Christchurch-Sydney	4-9%	11-21%	7-21%	7-16%	7-33%		
Christchurch-Melbourne	6-29% (6)	8-33%		8-38%			
Christchurch-Brisbane	10-42%	8-29%		7-29%			
Wellington-Sydney	4-18%	9-33%	14-49%				
Wellington-Melbourne		7-51%	7-49%				
Wellington – Brisbane	7-54%	7-46%					
Minor routes							
Auckland-Adelaide		5-100%					
Auckland-Cairns	2-44%	3-56%		(5)			
Auckland-Gold Coast	7-39%	5-23%		7-38%			
Auckland-Perth		7-100%					
Christchurch-Gold Coast		2-46%		2-54%			
Dunedin-Brisbane	3-64% (6)	2-36%					
Hamilton-Brisbane	3-100% (6)						
Hamilton-Sydney	2-100%						
Queenstown – Brisbane	(4)	(4)	(4)				
Queenstown – Melbourne		(4)	(4)				
Queenstown-Sydney	2-35%	1-15%	3-50%				
Rotorua – Sydney		2-100%					

(1) Sourced from Table 1 at page 37 of the applicants' submission of 4 May 2010 and from the Northern Summer 2010 Timetable Summary produced by the Department of Infrastructure, Transport, Regional Development and Local Government. (2) The capacities of Aerolineas Argentinas and Lan Chile have been adjusted to assume that only 50% is available for trans-Tasman origin/destination traffic. While all of the capacity of Emirates has been shown as available for trans-Tasman passengers, some of that capacity is taken by passengers only transiting in Australia. (3) Jetstar announced on 28 July 2010 it would be operating daily flights on this route from 13 December 2010. (4) Seasonal operations only. (5) Jetstar announced on 29 July 2010 it would be operating three services per week on this route from 12 April 2011. (6) Pacific Blue announced on 16 August 2010 it would be increasing capacity on these routes in coming months.

4.16. Table 4.3 below shows trans-Tasman routes by airline share of passengers.

Table 4.3 Trans Tasman routes by airline share of passengers carried, April 2010 (1)

Route	Pacific Blue	Air New Zealand	Qantas	Jetstar	Emirates	Aerolineas Argentina	Total Pax (No.)
Main routes							
Auckland-Sydney	(2)	(2)	(2)	(2)	(2)	6%	121,191
Auckland-Melbourne	(2)	(2)	(2)		(2)		67,141
Auckland-Brisbane	(2)	(2)	(2)		(2)		58,496
Christchurch-Sydney	(2)	(2)	(2)	(2)	(2)		41,930
Christchurch-Melbourne	(2)	(2)		(2)			26,345
Christchurch-Brisbane	(2)	(2)		(2)			28,638
Wellington-Sydney	(2)	(2)	(2)				22,761
Wellington-Melbourne		(2)	(2)				12,524
Wellington-Brisbane	(2)	(2)					14,148
Minor Routes							
Auckland-Adelaide		100%					5,327
Auckland-Cairns	(2)	(2)					4,344
Auckland-Gold Coast	(2)	(2)		(2)			22,538
Auckland-Perth		100%					11,397
Christchurch-Gold Coast		(2)		(2)			4,070
Dunedin-Brisbane	(2)	(2)					4,848
Hamilton-Brisbane	100%						2,913
Hamilton-Sydney	100%		(2)				2,139
Queenstown-Melbourne		100%					267
Queenstown-Sydney	(2)	(2)					5,543
Rotorua-Sydney		100%					1,755
All Routes	18%	39%	23%	10%	10%	2%	458,315

(1) Sourced from Department of Infrastructure. (2) Figures confidential.

Data by airline

4.17. Table 4.4 below shows the total number of seats flown by airline and the airlines' shares of the seats flown on the trans-Tasman in the period 2006 to 2009.

Table 4.4 Seats flown on trans-Tasman routes and per cent, by airline, 2006 to 2009 '000 seats (1) (2)

Airline	2006		2007		2008		2009	
	No.	%	No.	%	No.	%	No.	%
Qantas	2,095	27.4%	1,890	26.1%	1,827	24.4%	1,732	22.7%
Jetstar	504	6.6%	516	7.1%	511	6.8%	676	8.9%
Group	2,599	*34.0%*	2,406	*33.2%*	2,338	*31.2%*	2,408	*31.5%*
Air New Zealand	2,755	36.0%	2,639	36.4%	3,042	40.7%	2,733	35.9%
Freedom Air	556	7.3%	458	6.3%	106	1.4%	0	0.0%
Group	3,311	*43.3%*	3,097	*43.7%*	3,148	*42.1%*	2,733	*35.9%*
Pacific Blue	504	6.6%	530	7.3%	743	9.9%	1,180	15.5%
Emirates	915	11.9%	913	12.6%	905	12.1%	956	12.6%
Aerolineas Argentina	74	1.0%	80	1.1%	97	1.3%	97	1.3%
LAN Air	136	1.8%	160	2.2%	177	2.4%	166	2.2%
Royal Brunei	65	0.8%	66	0.9%	69	0.9%	74	1.0%
Garuda	54	0.7%	0	0.0%	0	0.0%	0	0.0%
Total	*7,658*	*100.0%*	*7,252*	*100.0%*	*7,477*	*100.0%*	*7,614*	*100.0*

(1) Source: *International Airline Activity* published by BITRE. (2) Source: Statistical Report of International Airline Activity produced by BITRE.

4.18. The total number of seats flown on trans-Tasman routes has not changed significantly over the past four years. The main development has been the expansion of the LCCs at the expense of the non-FFC full service carriers. The share of seats flown by Jetstar and Pacific Blue has increased from 13.2% in 2004 to 24.4% in 2009 with most of the increase coming from Pacific Blue, which increased its number of seats flown on trans-Tasman routes by 134% in that period. The share of the non-FFC full service airlines has decreased from 63.4% to 56.6% in the same period.

4.19. Table 4.5 below shows the total number of passengers flown on the trans-Tasman by airline in the period 2006 to 2009.

Table 4.5 Trans-Tasman uplift/discharge traffic and per cent, by airline, 2006 to 2009 by 000s of passengers (1)

Airline	2006		2007		2008		2009	
	No.	%	No.	%	No.	%	No.	%
Qantas	1,341	27.2%	1,296	25.2%	1,244	24.2%	1,162	22.0%
Jetstar	356	7.2%	387	7.5%	377	7.3%	538	10.2%
(Group)		*34.4%*		*32.7%*		*31.5%*		*32.2%*
Air New Zealand	1,925	39.1%	2,035	39.6%	2,207	43.0%	2,093	39.5%
Freedom Air	361	7.3%	349	6.8%	81	1.6%	..	..
(Group)		*46.4%*		*46.4%*		*44.6%*		*39.5%*
Pacific Blue	371	7.5%	426	8.3%	559	10.9%	848	16.0%
Emirates	442	9.0%	547	10.6%	552	10.8%	530	10.0%
Aerolineas Argentina	26	0.5%	34	0.7%	32	0.6%	29	0.5%
LAN Air	53	1.1%	43	0.8%	54	1.0%	61	1.2%
Royal Brunei	33	0.7%	28	0.6%	28	0.6%	33	0.6%
Garauda	16	0.3%	..	..	..	..	..	..
Total	*4,925*	*100.0%*	*5,145*	*100.0%*	*5,133*	*100%*	*5,294*	*100.0%*

(1) Source: Statistical Report of International Airline Activity produced by BITRE.

Load factors

4.20. Table 4.6 below shows the percentage of capacity offered by airlines used for the carriage of passengers.

Table 4.6 Airline load factors for trans-Tasman uplift/discharge traffic, 2006 to 2009 (per cent) (1)

Airline	2006	2007	2008	2009
Qantas	64%	69%	68%	67%
Jetstar	71%	75%	74%	80%
Air New Zealand	70%	77%	73%	77%
Freedom Air	65%	76%	76%	..
Pacific Blue	74%	80%	75%	72%
Emirates	48%	60%	61%	55%
Aerolineas Argentina	35%	43%	33%	30%
LAN Air	39%	27%	31%	37%
Royal Brunei	51%	42%	41%	45%
Garauda	30%			
All airlines	*64%*	*71%*	*69%*	*70%*

(1) Source: Statistical Report of International Airline Activity produced by BITRE.

4.21. Apart from the FFCs, Qantas has the lowest load factors but as an FSA targeting higher yielding passengers it would probably be sustainable at lower load levels than LCCs

4.22. The LCCs would be expected from their low cost/low fare operating models to have reasonably high load levels and the table shows that they have been able to sustain such levels while at the same time growing capacity.

4.23. The fact that Air New Zealand has been able to achieve loads approaching those of the low cost carriers while providing full service operation suggests that Air New Zealand has been a strong competitor in the market.

4.24. The low loads of the FFCs relative to other carriers in the market likely reflects the presence of through traffic.

5. ACCC evaluation

5.1. The ACCC's evaluation of the Alliance is in accordance with tests found in the following sections of the Act:

- section 90(8) of the Act which states that the ACCC shall not authorise a proposed exclusionary provision of a contract, arrangement or understanding, unless it is satisfied in all the circumstances that the proposed provision would result or be likely to result in such a benefit to the public that the proposed contract, arrangement or understanding should be authorised.

- sections 90(6) and 90(7) of the Act which state that the ACCC shall not authorise a provision of a proposed contract, arrangement or understanding, other than an exclusionary provision, unless it is satisfied in all the circumstances that:

  - the provision of the proposed contract, arrangement or understanding in the case of section 90(6) would result, or be likely to result, or in the case of section 90(7) has resulted or is likely to result, in a benefit to the public and

  - that benefit, in the case of section 90(6) would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed contract or arrangement was made and the provision was given effect to, or in the case of section 90(7) has resulted or is likely to result from giving effect to the provision.

- sections 90(5A) and 90(5B) of the Act which state that the ACCC shall not authorise a provision of a proposed contract, arrangement or understanding that is or may be a cartel provision, unless it is satisfied in all the circumstances that:

  - the provision, in the case of section 90(5A) would result, or be likely to result, or in the case of section 90(5B) has resulted or is likely to result, in a benefit to the public and

  - that benefit, in the case of section 90(5A) would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed contract or arrangement were made or given effect to, or in the case of section 90(5B) outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted or is likely to result from giving effect to the provision.

5.2. For more information about the tests for authorisation and relevant provisions of the Act, please see Attachment C.

The market

5.3. The first step in assessing the effect of the conduct for which authorisation is sought is to consider the relevant markets affected by that conduct.

5.4. The ACCC has previously considered applications seeking authorisation for airline alliances on the trans-Tasman, most recently the applications lodged by Qantas and Air

New Zealand in 2006. In that matter, the ACCC identified the following areas of competition as being relevant to assessing the impact of that proposal:

- trans-Tasman air passenger services having regard to particular geographic and product segments
- trans-Tasman air freight and
- the sale of air travel.

5.5. The ACCC notes, therefore, that there may be a number of areas of competition relevant for the purposes of assessing the present applications for authorisation. The ACCC's assessment of the areas of competition likely to be relevant for the purpose of assessing the Alliance follows.

Trans-Tasman air passenger services

5.6. As set out above, the Alliance provides for cooperation and coordination between the applicants in respect of air passenger services on the trans-Tasman. The applicants' provision of these services overlaps, with each of Virgin Blue and Air New Zealand currently operating air passenger services on routes between Australia and New Zealand.

5.7. For the purposes of determining the relevant product and geographic dimensions of the market or markets, the ACCC has examined the extent of supply and demand side substitutability with regard to the provision of air passenger services on the trans-Tasman.

Product dimension

5.8. In determining the relevant product dimension of the market, the ACCC notes that it is appropriate to examine whether or not separate markets should be considered for different types of passengers.

5.9. The ACCC recognises that, in general, a broad distinction may be drawn between business passengers who are more time sensitive and leisure passengers who are more price sensitive. The ACCC notes that generally, the premium sections of the aircraft are mainly occupied by business passengers while most leisure passengers tend to occupy non-premium seating towards the rear of the plane. However, the ACCC considers that the general distinction between business and leisure passengers may be less pronounced on short haul routes such as the trans-Tasman routes.

5.10. On the demand side, the ACCC notes that business passengers are generally less sensitive to price, and more sensitive to factors such as time, flexibility, connectivity, convenience and comfort. On the other hand, leisure passengers are generally more price sensitive and less concerned about factors such as travel time, fare flexibility and comfort. In this regard, business passengers, who generally do not personally incur expenditure, are less likely to consider service offerings that are indirect and involve longer timeframes for travel, and less comfort and convenience to be viable substitutes. Leisure passengers are generally less likely to consider more expensive service offerings aimed at business passengers to be viable substitutes.

5.11. However, in comparison to long-haul routes, business passengers may have relatively less need to secure a differentiated service on trans-Tasman routes given that most services are direct and involve less travel time. Accordingly, business passengers may be more likely to consider switching to non-premium service offerings on the trans-Tasman routes.

5.12. In his expert report prepared for the applicants, Dr Tretheway acknowledges that for trans-Tasman routes, many travellers already use nonstop routings, indicating that most demand can be accommodated on non-stop flights.

5.13. Accordingly, the ACCC considers there to be some continuum of demand side substitution possibilities between business and leisure passengers on the trans-Tasman routes, where business passengers may be more willing to consider non-premium services, and some leisure passengers may consider certain premium offerings.

5.14. On the supply side, the ACCC generally considers there to be limited substitution with regard to the provision of service offerings for business and leisure passengers. The ACCC notes for example that the reconfiguration of aircraft cabins (premium and non-premium cabins) is generally a timely and costly exercise. However, on short haul routes where business and leisure passenger requirements may involve less points of distinction, and particularly where some business passengers may be more willing to switch to non-premium offerings, the ability of carriers to serve both business and leisure passengers with a single cabin offering becomes enhanced.

5.15. The ACCC notes that the applicants are proposing to modify their service models in a way that will enable them to meet the requirements of different passenger types through a combination of product/service offerings rather than by offering distinct cabin types. The ACCC considers that these modified service models, once implemented, have the potential to enhance supply side substitution by enabling the carriers to serve both business and leisure passengers without incurring costs to reconfigure cabins. In this regard, the ACCC notes the following.

- The applicants' submission that in March 2010, Air New Zealand announced changes to its Tasman services which will be implemented from May 2010 (for flights commencing late August 2010) including standardising its A320 Tasman Pacific fleet to one class with 171 seats, through the removal of business class. This will result in the removal of business class offerings on flights between Australia and Wellington and Christchurch and on A320 flights to and from Auckland. The applicants indicate that the removal of business class from Wellington and Christchurch was driven by the fact that just one of eight seats available in business class on those routes was being sold on average per flight. The applicants submit that Air New Zealand's long haul wide body fleet will retain a business class cabin such that Air New Zealand will continue to offer business class on its Tasman services which utilise a wide body aircraft – being certain flights to and from Auckland.

- Air New Zealand's submission that under its new service model, the carrier will provide customers with a choice of four different product offerings ranging from a basic offering with carry-on baggage, tea, coffee, water and entertainment to a more comprehensive offering including meals, premium check in, priority baggage, lounge access, and 'neighbour free guarantee'.

- Virgin Blue's submission that, in the absence of the Alliance, it will seek to implement where possible, NWC features (such as lounge facilities, self check-in kiosks, premium economy seating, fares with flexible terms and conditions) on Pacific Blue services. The Virgin Blue NWC model is described as a low cost, high value airline model that aims to attract a broader cross section of passengers than the traditional LCC model, through leveraging the airline's low cost foundations and adding valuable new products which appeal to higher yielding passengers.

5.16. However, while Air New Zealand's decision to remove business class from its A320s indicates some fluidity between the supply of business and leisure passenger service offerings on trans-Tasman flights, the ACCC considers that Air New Zealand's new service model still preserves some points of distinction that appear to be aimed at meeting the different requirements of business and leisure passengers. The ACCC also considers that, while Pacific Blue's shift towards a modified business model theoretically may lessen limitations to supply side substitution by enabling Pacific Blue to target business passengers without having to reconfigure seating and cabin arrangements, the extent to which NWC features will be implemented on Pacific Blue services is unclear.

5.17. The ACCC also notes that carriers such as Qantas and the FFCs operating on the trans-Tasman routes continue to provide premium class offerings on their trans-Tasman services.

5.18. On balance, the ACCC considers that on the trans-Tasman routes there is likely to be a degree of demand and supply side substitutability in respect of the service offerings for business and leisure passengers such that it would be appropriate to consider business and leisure passengers broadly in the same product market. Nevertheless, the ACCC considers it important to take into account the differences between the business (time sensitive) and leisure (price sensitive) passenger segments of the market for the purposes of assessing the Alliance. In particular, the ACCC notes that there may be varying levels of constraint on the Alliance in respect of these segments taking into account the different characteristics of the carriers (e.g FSAs, FFCs, LCCs and the modified service models of the applicants) operating on the routes and the different characteristics of individual routes.

Geographic dimension

5.19. In determining the relevant geographic dimension of the market, the ACCC has examined whether or not it would be appropriate to assess the impact of the Alliance on individual routes or more broadly on air passenger travel across the trans-Tasman (comprising travel between any point in Australia and any point in New Zealand).

5.20. The applicants consider that while it may be appropriate to have regard to the effect of the Alliance on different customer segments and different routes, consistent with previous regulatory decisions and commercial reality, there is no basis for a market definition narrower than a single trans-Tasman market.

5.21. The applicants submit that the broader Australasian market provides context and competitive disciplines that must form part of the overall net benefits analysis of the Alliance. However, the applicants have presented the principal analysis of the Alliance in the context of a single market for trans-Tasman services, where routes between any point in Australia and any point in New Zealand are all assessed within one overall market.

5.22. The ACCC considers that different trans-Tasman routes may be considered close demand-side substitutes where a significant proportion of passengers would be likely to switch in response to a fare increase. In this regard, the ACCC notes that passengers are generally unlikely to consider different destinations to be viable substitutes. For example, passengers travelling for business purposes or to visit family and friends would be unlikely to consider flights to alternative trans-Tasman or Australian destinations to be substitutable. Queenstown for example is a seasonal route with many passengers travelling to this destination during the winter to participate in the ski season. The reasons passengers travel to Queenstown are therefore likely to be quite different to the reason for travel to other trans-Tasman destinations.

5.23. The ACCC also notes that the extent of demand side substitutability between indirect and direct services may also indicate whether or not it would be appropriate to consider a trans-Tasman geographic dimension as opposed to a point to point market. For example, on long-haul routes, a regional approach is often appropriate in considering a leisure passenger market taking into account, among other things, the fact that leisure passengers are more likely to accept indirect routes involving longer travel time but less expensive fares. Submissions indicate however that, due to the short haul nature of the trans-Tasman routes, passengers on the whole, including price sensitive leisure passengers, are unlikely to consider indirect routes as a viable alternative to direct services.

5.24. Wellington Airport submits that the trans-Tasman markets involve short-haul flights, and customers in these markets are highly sensitive to convenience and the need to change flights. They are markedly more sensitive to connections than customers in long-haul markets, where the time consumed by a connection or transfer is relatively insignificant compared to the total trip duration and the period of travel. Wellington Airport submits further that for most travellers on the Tasman, a direct service is highly valued and there is very limited or zero substitution with connections via other city-pairs. Wellington Airport notes that this absence of substitution is particularly the case for leisure passengers on tight itineraries and for business passengers on short trips, noting that some business passengers travel across the Tasman just for the day.

5.25. The Wellington Regional Chamber of Commerce submits that in travelling the three hour flight from Sydney to Wellington, travel via Melbourne or Auckland is not usually an option due to the doubling of time taken, unless there are no seats offered directly on the preferred day at the required price. The Wellington Regional Chamber of Commerce considers therefore that the number of direct flights from centre to centre is the relevant metric and not the number of trans-Tasman flights generally.

5.26. Auckland Airport considers it to be somewhat simplistic to assume blanket substitutability between direct and connecting flights, noting that 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.

5.27. In the context of the Cairns-Auckland route, Cairns Airport submits that indirect flights transiting through Brisbane Airport or Sydney Airport are poor substitutes. Cairns Airport notes that due to the change of terminal, the minimum connection time is around two hours, making the trip from Auckland-Brisbane-Cairns or Auckland-Sydney-Cairns unappealing, to the point where passengers are willing to fly a 'red-eye' overnight direct flight on Pacific Blue rather than take a daytime indirect flight via Brisbane.

5.28. As noted above, Dr Tretheway acknowledges that for trans-Tasman routes, many travellers already use nonstop routings. Dr Tretheway considers that this indicates that substantial nonstop capacity is available, such that most demand can be accommodated on nonstop flights. However, Dr Tretheway considers that this does not rule out that indirect routings will act as a constraint on trans-Tasman fares.

5.29. On the basis of the factors outlined above, the ACCC considers that there is likely to be limited demand side substitutability across different trans-Tasman routes.

5.30. On the supply side, the ACCC considers it relevant to assess whether or not carriers could profitably switch a significant proportion of their capacity between different trans-Tasman routes quickly and without significant investment in response to a fare increase.

5.31. The applicants submit that no trans-Tasman route can be considered in isolation given the ease with which existing competitors can redeploy aircraft between routes in response to market opportunities. The applicants further submit that the public benefits and competition assessment must also consider the Alliance within the context of a broader Australasian aviation market, in which there is a range of significant long-haul and short haul carriers operating, or capable of operating, services on the Tasman.

5.32. In his expert report prepared for the applicants, Dr Tretheway considers that supply side substitutability is high in general in deregulated airline markets, and is high in particular on trans-Tasman routes as barriers to entry are low, both for Australia/New Zealand owned carriers and for fifth freedom operators. Dr Tretheway also considers that supply side substitutability has been observed on trans-Tasman routes. In this regard, Dr Tretheway notes that Emirates has reallocated its capacity as to how it would serve Christchurch and Jetstar has entered routes then withdrawn and reallocated capacity to other routes in the market.

5.33. Dr Tretheway considers that on the trans-Tasman, the conditions for supply side substitutability are met taking into account the factors set out below.

- Production is easily shifted as the very nature of aircraft and the mobility of the labour operating them makes reallocation to other routes easy, rapid and feasible.

- An airline operating one trans-Tasman route has the skills necessary to operate others. The same would generally apply to domestic operators in New Zealand and Australia – they have the skills necessary to enter a trans-Tasman route.

- Sunk costs such as advertising are not insurmountable challenges. Jetstar, for example, already operates at many New Zealand and Australian points, and can add new services “connecting the dots” with limited new costs.

- In the trans-Tasman market, airport access is not the significant barrier to entry that it is in European markets and at some airports in the Americas.

5.34. With regard to the redeployment of aircraft, Auckland Airport submits that 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. Auckland Airport notes for example that 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.

5.35. The ACCC notes that the ability and likelihood of incumbent carriers on the trans-Tasman to quickly, and without significant investment, shift capacity to routes they currently do not serve is likely to depend on a variety of factors including carrier aircraft types, regulatory requirements and airline strategy. In particular, the ACCC observes that:

- FSAs, FFCs and LCCs generally adopt different strategies in determining whether or not they will serve a particular route. FSAs generally seek to provide an integrated network and easy connections between flights, taking advantage of complementarities of demand across different routes. FFCs and LCCs tend to be influenced by other factors such as estimates of revenue versus cost from operating on a particular route, thus operating on a more ‘point to point’ basis.[12] In this regard, the ACCC notes that FFCs currently operate on only four trans-Tasman routes.

- Jetstar is the only other LCC apart from Pacific Blue, operating on trans-Tasman routes. The ACCC notes the IASC’s submission that Qantas has been allocated unlimited passenger capacity on the trans-Tasman routes and that capacity is able to be used by its wholly owned subsidiaries, and this is the basis for Jetstar’s operations on the route. Notwithstanding such allocation, however, the ACCC considers that Jetstar is not a typical LCC that is driven by its ability to undercut other players on a route on an origin-destination basis without regard to network factors. The ACCC notes that as a wholly owned subsidiary of Qantas, any deployment of Jetstar on trans-Tasman routes is likely to be considered in the context of its overall impact on the Qantas Group.

- As a consequence of airport restrictions, wide-bodied aircraft such as A380s commonly flown by FFCs are limited to Auckland and Christchurch. The ACCC notes that the trans-Tasman services currently offered by FFCs Emirates, Aerolineas Argentinas and LAN Airlines do not extend beyond routes to/from Auckland and Christchurch. Hamilton International Airport submits that airlines using fifth freedom rights with long-haul aircraft have been operating on the Tasman for a number of years, with the most successful being Emirates. Hamilton

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[12] ACCC Draft Determination in relation to applications for authorisation A91001, A91002 and A91003 lodged by Qantas Airways Limited and Air New Zealand Limited, November 2006, page 43.

International Airport submits however that the route appears to be competitively difficult to be operated by airlines flying long-haul via Australia to New Zealand. Hamilton International Airport notes that this has been evident with a number of international long-haul airlines dropping the trans-Tasman market over the last six years, with the most recent being Royal Brunei.

5.36. The ACCC also notes that the ability and likelihood of carriers operating exclusively outside the trans-Tasman to quickly and without significant investment, shift capacity to trans-Tasman routes is likely to be similarly dependent on carrier aircraft types, regulatory requirements and airline strategy. In particular, the ACCC observes the following.

- The same potential constraints on supply side substitution mentioned in the previous paragraph in the context of incumbent trans-Tasman carriers are also relevant for carriers operating outside the trans-Tasman.

- In order to offer services on the trans-Tasman, carriers who are not FFCs must meet the following criteria:

  - at least 50% ownership and effective control by Australian and/or New Zealand nationals

  - at least two-thirds of the Board members are Australian and/or new Zealand nationals

  - the Chairperson of the Board is an Australian or New Zealand national

  - the airline’s head office is in Australia or New Zealand and

  - the airline’s operational base is in Australia or New Zealand.

- Carriers who are not FFCs and who operate domestic services in Australia, but do not operate services on the trans-Tasman, may not satisfy the requirement for automatic designation under the 2002 Australia New Zealand Open Skies Agreement because of foreign ownership restrictions. In this context, the ACCC notes that Tiger Airways submits that while it has aircraft and operational procedures that could successfully mount competitive services on trans-Tasman routes, it is unlikely to do so without a change to the Open Skies Agreement that would allow for airline designation on the basis of ‘principal place of business’.

- Sunk costs associated with advertising and marketing of trans-Tasman services represent an additional impediment to supply side substitution by carriers operating outside the trans-Tasman.

5.37. While recognising the possibility of redeployment of aircraft by carriers on the trans-Tasman routes, the ACCC considers that the factors outlined above indicate some limitation on the extent of such re-deployment. Accordingly, the ACCC considers that while the relevant geographic scope of the market is likely to be trans-Tasman wide, it is important to have regard to particular trans-Tasman routes where substitution possibilities are likely to be constrained. The ACCC does not consider that a geographic market wider than the trans-Tasman is warranted taking into account the regulatory restrictions, airport restrictions and sunk costs outlined above.

Trans-Tasman air freight

5.38. In the 2006 Qantas/Air New Zealand matter, the ACCC considered a single trans-Tasman air freight market for the purposes of the assessment.

5.39. The ACCC has not been provided with information that suggests it should depart from a consideration of a single market for trans-Tasman freight.

The sale of air travel

5.40. In the 2006 Qantas/Air New Zealand matter, the ACCC recognised a separate market for the sale of air travel. The ACCC noted that while the geographic dimension has traditionally tended to be the whole of Australia, this has become increasingly blurred through the development of internet web sales sites by both agents and airlines. The ACCC considered that the product dimension includes tickets sold directly by airlines to travellers as well as those sold through indirect channels, such as travel agents.

5.41. The ACCC has not been provided with information that suggests it should depart from a consideration of a market for the sale of air travel.

Australian domestic air passenger services

5.42. The applicants submit that their domestic networks are outside the scope of the Alliance, except to the extent that a particular service is part of a connecting service across the Tasman.

5.43. Wellington Airport submits that while the activities under the Alliance relate specifically to the trans-Tasman operations of the applicants, there is an obvious competition risk that this cooperation will "leak" into other markets, and particularly the Australian and New Zealand domestic markets and the trans-Tasman freight market.

5.44. The ACCC has previously considered a market for Australian domestic passengers.[13] The ACCC notes that the primary way that an international alliance could lessen competition for domestic services is where the Alliance directs domestic on-carriage or feeder traffic to a particular carrier, in this case Virgin Blue, at the expense of the competitive position of other domestic carriers.

5.45. The ACCC has not received any information which suggests that it should depart from a consideration of the impact of the Alliance on domestic services.

[13] ACCC Determination in relation to applications for authorisation A91195 and A91196 lodged by Qantas Airways Limited and British Airways plc, March 2010.

Conclusion on relevant areas of competition

5.46. On the basis of the issues outlined above, the ACCC considers that the areas of competition set out below are relevant for the purpose of assessing the impact of the Alliance:

- trans-Tasman air passenger services with regard to particular geographic and product segments
- trans-Tasman air freight
- the sale of air travel
- Australian domestic air passenger services.

The counterfactual

5.47. The ACCC applies the 'future with-and-without test' established by the Tribunal to identify and weigh the public benefit and public detriment generated by conduct for which authorisation has been sought.[14]

5.48. Under this test, the ACCC compares the public benefit and anti-competitive detriment generated by arrangements in the future if the authorisation is granted with those generated if the authorisation is not granted. This requires the ACCC to predict how the relevant markets will react if authorisation is not granted. This prediction is referred to as the 'counterfactual'.

5.49. The applicants submit that, in the absence of the Alliance:

- Air New Zealand will move towards its new product model[15] but will lack Australian domestic connections and as a network carrier will be constrained in its ability to support a fully low cost product.
- Virgin Blue will continue to operate Pacific Blue on the Tasman and, where possible, seek to implement the NWC features on its Pacific Blue services. The applicants submit, however, that it will continue to have low frequencies on the Tasman and, as a result, be constrained in its ability to compete for higher yield or corporate passengers.
- neither of them would have any incentive to, and would not, enter into a reciprocal code share with the other as this would drive passengers onto the other carrier's services without allowing the parties to share in the benefit. The applicants

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[14] *Australian Performing Rights Association* (1999) ATPR 41-701 at 42,936. See also for example: *Australian Association of Pathology Practices Incorporated* (2004) ATPR 41-985 at 48,556; Re *Media Council of Australia* (No.2) (1987) ATPR 40-774 at 48,419.

[15] In March 2010, Air New Zealand announced prospective changes to its Tasman services, which will be implemented from May 2010 with or without the Alliance. The applicants submit these include: cutting the price of Air New Zealand's lead-in fares, changes aimed at reducing airport waiting time and standardising the Airbus A320 Tasman, Pacific and short haul fleet to one class with 171 seats, *Applicants' Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance*, 4 May 2010, page 11.

consider that the fact they have not entered into a code share arrangement to date is evidence that they consider that such an arrangement would not be commercially viable.

- and without the benefits of metal neutrality, they would have no incentive to change their schedule if it would result in one airline gaining a greater share of passengers at the expense of the other.

5.50. Further, Virgin Blue submits the following:

> Pacific Blue’s Tasman services were loss-making in 2009 and again in 2010. In contrast, Pacific Blue’s services to Fiji, the Pacific Islands and South East Asia were profitable over this period as were Virgin Blue’s domestic Australian services.
>
> In these circumstances, the likely counterfactual is that Pacific Blue will maintain a Tasman presence; however it cannot be assumed that Pacific Blue will continue to expand its services and add capacity as it has in the past. In fact, it is more likely that Pacific Blue will cut Tasman capacity in order to reduce its losses and to more profitably redeploy capacity, as it has on other loss-making routes.
>
> Under the new CEO John Borghetti, Virgin Blue is implementing a "Game Change Program" to improve the airline's competiveness against Qantas, particularly in the business market. One of the pillars of the Game Change Strategy is the optimisation of Virgin Blue's network so as to use the aircraft more productively. This involves reviewing loss-making routes with a view to redeploying aircraft to more profitable routes. As part of this strategy, Virgin Blue has already announced the withdrawal of Pacific Blue from domestic New Zealand due to unsustainable losses over 2 years. As part of the same strategic network review, Virgin Blue has also announced that V Australia will cease operating its loss-making Johannesburg and Phuket routes.
>
> If the Alliance is not approved, Virgin Blue will be forced to review its services on loss-making Tasman routes with non-trunk routes the most likely target of a review, due to lower passenger demand levels and reduced network feed. Any Pacific Blue capacity withdrawn from the Tasman could more profitably be deployed to Fiji, the Pacific Islands, South East Asia and to Australian domestic routes. It is worth noting that many of Pacific Blue's current Tasman services were commenced during the GFC and resulted from redeployment of aircraft previously allocated to Australian domestic market growth. Pacific Blue has recently been granted additional capacity to fly to Bali which Virgin Blue plans to utilise from mid April 2011.
>
> The Alliance is critical to enable Pacific Blue to maintain a substantial and competitive presence on the Tasman.

5.51. In relation to existing carriers on the trans-Tasman, the applicants submit that under the counterfactual:

- the Qantas-Jetstar Group will remain the best placed airline in the region to service both the high yield, or corporate, passengers and to service passengers on low cost, predominantly lower traffic routes; and

- Emirates will remain a significant and committed competitor through fifth freedom services.

5.52. The applicants submit that the potential for new entry is the same under both the factual and counterfactual and that the Alliance will not impact in any way on the ability of other operators to enter the Tasman.

5.53. Wellington Airport submits that:

- the correct counterfactual is the future without the Alliance, and with Air New Zealand and Pacific Blue continuing to operate as independent major carriers on the Tasman, competing with the Qantas Group

- in the counterfactual, it can be expected that Pacific Blue and Air New Zealand will continue to develop new services, new innovations and derive efficiency and cost savings to their individual benefit and to the benefit of their customers.

- if the Alliance is not authorised, Air New Zealand and Pacific Blue will continue, on an individual basis, to make decisions about current prices and supply on some routes based on their own strategy and assessment of potential route profitability and brand. Those decisions may involve reduction of services or price increase.

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

5.55. Tiger Airways submits that, despite the fact that its aircraft and operational procedures could successfully mount competitive services on trans-Tasman routes, it is unlikely that without a change to the prevailing Agreement between Australia and New Zealand to allow for airline designation based on ‘principal place of business’ criteria, that Tiger Airways would enter the market.

5.56. The ACCC considers that the most likely counterfactual will involve a situation where Virgin Blue and Air New Zealand continue to operate independently and compete on the trans-Tasman routes.

5.57. The information available to the ACCC suggests that both parties will continue to develop their business models and this is likely to be reflected in their product offerings on trans-Tasman routes.

5.58. The ACCC notes Virgin Blue’s submission regarding the financial performance of Pacific Blue on the trans-Tasman.

5.59. Notwithstanding this, the ACCC considers that Pacific Blue will continue to operate a number of services on the trans-Tasman in light of Virgin Blue’s submissions regarding the importance of the trans-Tasman to its overall network.

5.60. However, the ACCC accepts that the change in the business model Pacific Blue plans to employ on the trans-Tasman combined with its recent poor financial performance may mean that, absent the Alliance, it is less likely to expand its services and add capacity as it has in the past.

5.61. The ACCC notes the applicants’ submission that neither of them would have any incentive to, and would not, enter into a reciprocal code share with the other as this would drive passengers onto the other carrier’s services without allowing the parties to share in the benefit. Based on the information available, the ACCC accepts that the parties would have limited commercial incentives to enter into alternative bilateral arrangements between themselves, absent authorisation.

5.62. In light of Tiger Airway's submission, the ACCC considers it unlikely that they would enter the market in either the factual or the counterfactual unless the regulatory environment changes such that they can enter based on their principal place of business being in Australia or New Zealand.

5.63. The ACCC notes that FFC market share has remained relatively unchanged over the period 2006-2009, with Emirates being the only FFC with a market share of substance. The ACCC considers that the potential for FFCs to enter onto trans-Tasman routes, under both the counterfactual and the factual, will depend on the characteristics of specific routes.

5.64. The ACCC considers that the Qantas Group will continue with its two brand offering. For example, the ACCC notes recently reported expected expansions in domestic flights by Qantas and Jetstar.[16]

Public benefit

5.65. Public benefit is not defined in the Act. However, the Tribunal has stated that the term should be given its widest possible meaning. In particular, it includes:

> …anything of value to the community generally, any contribution to the aims pursued by society including as one of its principle elements … the achievement of the economic goals of efficiency and progress.[17]

5.66. In considering public benefits, the ACCC considers the extent to which the benefit has an impact on members of the community and the weight that should be given to it, having regard to its nature, characterisation and the identity of the beneficiaries. In relation to cost savings the ACCC will consider who is likely to take advantage of them and the time period over which the benefits are likely to be received.

5.67. Pursuant to the objects of the Act in section 2, public benefit is to be identified and assessed having regard to its effect on the promotion of competition and the enhancement of welfare in Australia. The ACCC recognises that public benefits resulting from the Alliance are likely to affect both Australia and New Zealand. However, the nature of some material in this case is such that the ACCC has not been able to reliably apportion identified public benefit as between the two countries. Accordingly, the ACCC has considered potential public benefits at the transaction level, consistent with its approach to public detriment.

5.68. The applicants submit that the proposed Alliance will deliver the following public benefits:

- enhanced products and services
- cost savings and other efficiencies
- promotion of competition

[16] 'Qantas to boost domestic flights', *The Age*, 26 August 2010, page 5.
[17] See *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,242.

- stimulation of tourism.

5.69. The applicants' specific claims, the views of interested parties and the ACCC's assessment of the likely public benefits from the proposed conduct is set out below.

Enhanced products and services

5.70. The applicants submit that the Alliance will result in enhanced products and services for Pacific Blue and Air New Zealand customers, including:

- increased choice of trans-Tasman flights for Pacific Blue and Air New Zealand customers. Currently Pacific Blue offers 71 frequencies and Air New Zealand operates 145 frequencies. Under the Alliance, Pacific Blue customers would have access to Air New Zealand frequencies and vice versa, meaning customers of either airline would have access to 216 flights per week.

- increased network connectivity for Pacific Blue and Air New Zealand customers. The Alliance would enable Air New Zealand to offer its customers online connection[18] to 22 additional destinations in Australia that are served by Virgin Blue but not Air New Zealand. It would also enable Pacific Blue to offer its customers online connection to 20 additional online destinations in New Zealand that are served by Air New Zealand but not Pacific Blue. The applicants submit that this will result in an additional 420 online origin/destination combinations being offered under the Alliance.

- better schedule spread for Pacific Blue and Air New Zealand customers. The applicants submit that under the Alliance they will be able to, and will have an incentive to optimise their schedules, including through removal of wingtip flying[19] where a broader schedule spread is valued by passengers. In this regard, the applicants note that, currently, 52 Pacific Blue flights per week depart within a few minutes of Air New Zealand services on the same trans-Tasman route.

- reciprocal access to lounge and loyalty programs. Under the Alliance, members of Air New Zealand's Airpoints frequent flyer program will be able to earn and use frequent flyer points under Virgin Blue/Pacific Blue's Velocity loyalty program (and vice versa). The applicants submit that passengers (and in particular business passengers) will value reciprocal access to these 'value added' services.

- expected new frequencies. The applicants submit that the Alliance's improved service offering (as reflected in the preceding bullet points) and marketing strength would attract additional traffic to the Alliance, meaning that new routes and frequencies would reach acceptable load factors earlier than would be the case for each applicant operating individually.

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[18] Dr Tretheway defines online connection as 'a passenger itinerary of two or more flight segments where connections are made between flights of the same airline, or its code share partners', *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 116.

[19] The applicants define wingtip flying as when two or more different carriers fly the same route at the same time, practically wingtip to wingtip alongside each other.

5.71. The applicants commissioned studies from InterVISTAS and Seabury to estimate anticipated passenger increases as a result of the enhanced product offering under the Alliance. The applicants submit that the forecast increase in passenger numbers in these studies is the clearest demonstration of a public benefit from the Alliance.[20]

Increased frequency of flights

5.72. Under the Alliance, Pacific Blue customers would have access to 145 Air New Zealand frequencies and Air New Zealand customers would have access to 71 Pacific Blue frequencies.

5.73. At present, a person who holds a Pacific Blue ticket but values the option of switching to an Air New Zealand flight can only switch to an Air New Zealand coded flight by purchasing a separate Air New Zealand fare. Similarly, a person who holds an Air New Zealand ticket but values the option of switching to a Pacific Blue flight can only switch to a Pacific Blue coded flight by purchasing a separate Pacific Blue fare.

5.74. Under the Alliance, customers can purchase either a Pacific Blue ticket or an Air New Zealand ticket and access any Alliance flight. In other words, under the Alliance, a person who holds a Pacific Blue (Air New Zealand) ticket has the option of switching to an Air New Zealand (Pacific Blue) flight, subject to seat availability, on similar terms as they would face to switch to an alternate Pacific Blue (Air New Zealand) flight.

5.75. The ACCC considers that the increase in flight choice through the replacement of separate Virgin Blue and Air New Zealand coded frequencies with consolidated Alliance coded frequencies is likely to directly benefit consumers who:

(a) under the Alliance prefer to fly with Pacific Blue or Air New Zealand rather than Qantas or any other trans-Tasman airline; and

(b) value the increased flexibility associated with the greater number of frequencies.

5.76. In relation to (a), the ACCC notes that 55% of trans-Tasman passengers in the period February 2009 to January 2010 flew with either Pacific Blue or Air New Zealand.[21]
EXCLUDED FROM PUBLIC REGISTER Modelling by InterVISTAS suggests that the applicants' combined market share may increase by around **[confidential]** under the Alliance.[22]

5.77. In relation to (b), in the draft determination the ACCC suggested that the public benefit associated with increased choice of flights was likely to be confined to Alliance business passengers on the grounds that business travellers tend to be relatively time sensitive, while leisure passenger tend to be relatively price sensitive.

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[20] Applicants' *Submission in response to interested party submissions*, 26 July 2010, p.9.
[21] Based on passenger card data for the year ended 31 January 2010, collected and compiled by DIAC (from Overseas Arrivals and Departures data - unpublished tables).
[22] InterVISTAS 2010, The Effect of the Alliance on Passenger Traffic, 3 May, p.10. The ACCC notes that this figure does not take into account the effects of changes in fares offered by the applicants or rivals as a result of the Alliance.

5.78. In response, the applicants submit that all Alliance passengers (i.e. leisure as well as business passengers) value non-price dimensions of service, including the frequency of flights to destination. In support of this claim the applicants refer to a survey of Australian air passengers' reasons for selecting an airline domestically or on the trans-Tasman that was carried out by Fiftyfive5 in July 2010. The Fiftyfive5 survey found that **[confidential]** of leisure passenger respondents and **[confidential]** of business passenger respondents cited frequency of flights to destination as one reason for selecting a particular airline. **EXCLUDED FROM PUBLIC REGISTER**

5.79. Applying these survey results to the applicants' claimed passenger numbers post Alliance, this suggests that around **[confidential]** of trans-Tasman passengers stand to directly benefit from increased access to existing frequencies under the Alliance.

Increased online connection options

5.80. The applicants submit that by providing for 420 additional online connection options, the Alliance would confer significant customer benefits in the form of:

- baggage transfers from domestic flights to international flights
- shorter connection times as a result of through check (i.e. passengers do not need to allow time for a second check-in). For example, a customer travelling Napier/Auckland/Gold Coast can allow 60 minutes between flights when through checked, but would need to allow at least 2 hours when not through checked and
- no risk of forfeiting non-refundable fares if their first flight is delayed.

5.81. Dr Tretheway, in his expert report, submits that consumers value online connections much more than interline connections and that benefits to passengers from online connections are almost a uniform finding in the literature, and is an underpinning of aviation industry management techniques.[23]

5.82. The ACCC notes the significant literature in this area[24] and considers that increased online connection options for consumers is a direct source of public benefit under the Alliance. These benefits take the form of convenience in not having to collect and bear baggage mid journey, time savings associated with through check and removal of the risk of forfeiting non-refundable fares if the first flight in their journey is delayed.

5.83. In the draft determination, the ACCC expressed doubt about the magnitude of direct public benefit associated with increased online connections under the Alliance given that:

[23] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 39.

[24] See, for example, Carlton, D., W. Landes, and R. Posner, 1980, 'Benefits and costs of airline mergers: a case study', *Bell Journal of Economics*, Vol. 11, pp. 65-83; Graham, D. R., D. P. Kaplan and D. S. Stribley 1983, 'Efficiency and competition in the airline industry, *Bell Journal of Economics*, Vol. 14, pp. 118-138; and Bamberger, G. E., D. W. Carlton and L. R. Neumann 2004, 'An empirical investigation of the competitive effects of domestic airline alliances', *Journal of Law and Economics*, Vol. 47, pp. 195-222.

- there is a very high percentage of origin destination traffic on the trans-Tasman, which suggests that the current trans-Tasman routes meet most customers' travel requirements and

- as noted by the applicants and Dr Tretheway, neither the New Zealand points or the East Coast Australian points have extensive, high traffic beyond points.

5.84. In response to the ACCC's draft determination, the applicants submit that in 2009 around 550,000 of passengers (10%[25]) who travelled the trans-Tasman did so via an Australian connection. The applicants also submit that in the year to 29 August 2010 around **[confidential]** of Air New Zealand's trans-Tasman passengers travelled trans-Tasman with a domestic New Zealand connection.

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5.85. The ACCC notes that the majority of these trans-Tasman passengers are likely to already have an online connection option through Qantas, Jetstar, Virgin Blue/Pacific Blue or Air New Zealand absent the Alliance.

5.86. This leads the ACCC to conclude that the Alliance only creates new online connections for trans-Tasman passengers who utilise connections at both ends of their trans-Tasman journey – that is, connection to a destination within Australia that is beyond one of the Australian gateways (Sydney, Melbourne, Brisbane, Perth, Adelaide, Cairns, Coolangatta) and connection to a destination in New Zealand that is beyond the New Zealand gateways (Auckland, Christchurch, Wellington or Queenstown). Passengers who meet this profile are likely to represent a modest proportion of the numbers submitted by the applicants.

5.87. Notwithstanding this, the ACCC accepts that there is a direct public benefit from increased online connections under the alliance. This benefit takes the form of increased choice for many travellers who connect beyond trans-Tasman gateways,.

Better schedule spread

5.88. The applicants submit that under the Alliance they will be able to, and will have an incentive to, optimise their schedules, including through the removal of wingtip flying[26] where a broader passenger spread is valued by passengers. Currently, 52 Pacific Blue flights per week depart within a few minutes of Air New Zealand services on the same trans-Tasman route.

5.89. Dr Tretheway, in his expert report, submits that the incentives for schedule optimisation are strong under a revenue sharing Alliance. In particular, he claims:

- an Alliance might induce one or both carriers to shift timings of whole complexes of flights to better flow passengers through their systems given time zone, airport curfew, passenger preference and other considerations[27]

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[25] The ACCC has calculated this figure based on BITRE data for the year ended December 2009 (5 293 501 passengers travelled between Australia and New Zealand).

[26] Wingtip flying occurs when flights depart within short periods of each other.

[27] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 31.

- with alliances involving revenue sharing, the incentives for the partners to work together and potentially undertake significant schedule changes to optimise the network to the benefit of travellers are stronger (compared to simple code share alliances)[28] and

- wingtip flying is an example of this. Wingtip to wingtip flying occurs because there are certain times preferred by a number (but not all passengers), with first departures in the morning often an example of this. Dr Tretheway submits that, with simple codesharing, both partners will still want their own flight at the most popular departure time but that with an alliance in which revenue sharing is permitted, the incentives change dramatically. Collectively, the two carriers could increase service convenience by retaining one early morning departure at the preferred time, and moving the other flight to a somewhat later time, perhaps one hour later. The carriers may find the retiming of one flight to be of net benefit.[29] Dr Tretheway submits that, with the removal of one of the wingtip flights, the reduced capacity at the preferred time will generally be allocated through the seat management system to the highest value (business) traveller, with pricing incentives given to leisure travellers to move to the later, less preferred flight.[30]

5.90. Dr Tretheway submits that it is his observation that schedule optimisation is a high priority management task immediately after implementation of revenue sharing and capacity coordinating alliances. Dr Tretheway also submits that, for the travelling public, the ability to replace wingtip to wingtip flying through schedule optimisation is a major benefit, especially to business and other time sensitive travellers.[31]

5.91. Prior to the draft determination, several interested parties including Auckland Airport, Wellington Airport and the Key Wellington Stakeholders Group, queried the extent of benefits in the form of reduced wingtip flying in the absence of any detail provided by the applicants.

5.92. The ACCC accepts that, under the Alliance, the applicants will have an incentive to review their current schedules with a view to optimising them. The ACCC considers that the removal of some wingtip flying is a likely outcome of this process.

5.93. The ACCC understands that wingtip flying often reflects competition between airlines during peak periods. By aligning flight schedules during peak periods airlines are able to maximise the number of their potential customers and, hence, revenue or profits. However, from society's perspective it may be beneficial for airlines to vary their flight schedules so that people who would prefer to fly earlier or later have the option of doing so by varying the airline they fly with. Thus, alliances that result in removal of wingtip flying on a route provide opportunity for greater variation in flight schedules, which is a source of public benefit to consumers who value greater choice of departure or arrival time.

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[28] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, pages 31-32.
[29] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 32.
[30] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 32.
[31] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 32.

5.94. In the draft determination, the ACCC accepted that business passengers were likely to value greater choice of departure or arrival time and suggested that, while leisure travellers may not particularly value an increased schedule spread in its own right, they may value more highly the opportunity to trade-off time and price that comes about as a result of increased schedule spread.

5.95. In response to the draft determination, the applicants submit that better schedule spread is of value to all Alliance passengers, including leisure passengers. They provided survey results in support of this claim. For example, a Colmar Brunton survey of business passengers conducted in December 2009 found that **[confidential]** of business passengers mention flight schedule in their top 3 reasons for choosing a particular airline. As noted previously, the Fiftyfive5 survey suggests that **[confidential]** of business passengers and **[confidential]** of leisure passengers value flight frequency, which may be viewed as being synonymous with schedule spread.

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5.96. The ACCC accepts that, in addition to business passengers, a significant proportion of leisure passengers are likely to positively value increased schedule spread to the extent that it improves connectivity with other transport options, allows passengers to avoid overnight accommodation costs, provides greater flexibility for coordination with friends and relatives' schedules and allows them to access cheaper fares, etc.

5.97. In the draft determination, the ACCC suggested that the extent of direct public benefit from increased schedule spread was likely to vary across trans-Tasman routes, depending on the likelihood that other carriers would step in to meet any unmet (spilt) demand for peak services if the Alliance were to reallocate peak period capacity to off-peak periods.

5.98. Specifically, the ACCC commented that the extent of public benefit from increased schedule spread is likely to be greatest on trans-Tasman routes where Virgin Blue and Air New Zealand both operate and there is significant competition at the peak demand periods from other carriers, who can step in to meet any unmet demand for peak services following the removal of one of the wingtip services. In this situation there is little risk that the removal of wingtip flying would result in a loss of route capacity during the peak time. The ACCC noted that the trans-Tasman routes that appeared to fit this profile include Sydney-Auckland, Melbourne-Auckland and Brisbane-Auckland.

5.99. The applicants submit that schedule spread is also likely to confer public benefits in situations where the wingtip flying that would be removed does not occur in peak demand periods. The applicants submit that this is the case for the Sydney-Queenstown route. On this route for the month of December 2010, the applicants each are scheduled to operate two services a week. Both airlines operate these services on a Tuesday and a Saturday and depart within 30 minutes of each other. The applicants submit that this wingtip flying does not reflect higher demand at this time.

5.100. As a consequence, a person wishing to travel on a direct service from Sydney to Queenstown can only fly with Pacific Blue or Air New Zealand on a Tuesday or Saturday, enabling either a 4 or a 7 night stay. Under the Alliance, the applicants submit that they can optimise their schedule to remove this wingtip flying, enabling flights on 4 separate days of the week (e.g. Tuesday, Wednesday, Friday and Saturday). A person travelling directly from Sydney to Queenstown could then choose between four departure or arrival days, enabling a 1, 2, 3, 4, 5, 6 or 7 night stay. The applicants submit that this is a clear benefit that will be valued by leisure passengers.

5.101. The ACCC accepts that on routes where wingtip flying does not occur in peak demand periods, increased schedule spread is more likely to confer net public benefits. The Sydney-Queenstown illustrative example cited by the applicants appears to be a clear demonstration of the potential for public benefits in such cases.

5.102. In the draft determination the ACCC expressed concern that on trans-Tasman routes such as Brisbane-Wellington and Brisbane-Christchurch where Pacific Blue and Air New Zealand do not face significant competition from other carriers at peak demand periods, removal of wingtip flying under the Alliance could result in reduced route capacity during the peak period. On these routes, the ACCC indicated it is less clear that consumers would place a higher value on the additional frequency (one flight per day) than they would the loss of capacity during peak times.

5.103. In response to the draft determination the applicants have repeated their claim that the Alliance would only have an incentive to remove wingtip flying where it resulted in a benefit to the Alliance (i.e. is profit maximising for the Alliance). They submit that they would not remove capacity at periods of high demand and to do so would merely result in them spilling passengers to competitors, which would not be profit maximising.

5.104. In relation to routes such as Brisbane-Wellington, the applicants submit that wingtip flying does not reflect demand levels but, rather results from the necessity to build a schedule which efficiently utilises aircraft to operate four sectors per day. To accommodate this, the majority of Pacific Blue trans-Tasman routes commence in New Zealand, which allows the operation of four sectors a day. As a result, Pacific Blue's schedule reflects more morning departures ex New Zealand ports and more evening departures ex Australian ports.

5.105. On the Brisbane-Wellington route, the applicants submit that both Air New Zealand and Pacific Blue have similar evening departures from Brisbane on four days of the week. These services depart as little as 25 minutes apart. Currently, people flying from Brisbane to Wellington have very limited choice regarding departure time and are 'forced' to travel on this evening service four days of the week, arriving in Wellington around midnight, necessitating an overnight stay and preventing any onward connections. Under the Alliance, the applicants submit they have an increased ability to operate morning services that start in Australia, enabling better spread of schedules. Any resulting decrease in aircraft utilisation is expected to be more than mitigated by the increased attractiveness of the route to travellers.

5.106. The ACCC accepts that increased schedule spread is a likely direct source of public benefit under the Alliance. It is difficult for the ACCC to be definitive about the extent of this public benefit as the applicants have not submitted details on how they would modify their schedules under the Alliance.

Enhanced value added services

5.107. The applicants submit that the Alliance will benefit passengers by providing for reciprocal access to airport lounges and loyalty programs. Under the Alliance, members of Air New Zealand's frequent flyer program will be able to earn and use frequent flyer points under Virgin's loyalty program and vice versa. Virgin Blue will also be able to offer its passengers access to Air New Zealand's seven international lounges on the Tasman.

5.108. The Key Wellington Stakeholders Group submits that, if the applicants seek to make their frequent flyer schemes more attractive to consumers, there is nothing to stop them doing so unilaterally. They also submit that there is nothing stopping Pacific Blue from setting up airport lounges in New Zealand, if it is happy to incur the cost of investing in that perceived benefit.

5.109. The Wellington Regional Chamber of Commerce acknowledges a benefit in the form of expanded lounge access and loyalty scheme reciprocity, but thinks these benefits are overstated relative to the likely impact of diminished competition, higher fares and reduced flights.

Loyalty program benefits

5.110. In the draft determination the ACCC accepted that there are public benefits from increased opportunities for passengers of either of the applicants being able to earn and redeem frequent flyer points on each others' flights.

5.111. However, the ACCC considered that the extent of any such public benefit was likely to be very limited given that (i) the number of passengers who might benefit from such arrangements is not large and, (ii) 2009 CHOICE survey data indicates that 13% of Virgin Blue customers cited availability of frequent flyer program as a reason for choosing to fly with Virgin.

5.112. In response to the ACCC's draft determination, the applicants submit that there are a large number of Australians who are members of airline loyalty programs. They note that 54% of respondents to the 2009 CHOICE survey nominated frequent flyer program as a reason for choosing to fly with Qantas. The applicants also submit **[confidential]** of Virgin Blue's customers (i.e. in the Australian domestic market) are members of its Velocity loyalty program.

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5.113. The applicants also cite Fiftyfive5 survey data indicating that **[confidential]** of business passengers and **[confidential]** of leisure passengers cited the ability to earn points as one reason they selected a particular airline.

5.114. The applicants submit that the 2009 Choice survey results, which suggest that loyalty program is relatively less important in decision making by Virgin Blue passengers than it is for Qantas passengers, is a function of Virgin Blue's more limited network offering as well as its relatively small share of the corporate travel market. The attractiveness of loyalty programs is defined by the ability to earn and burn on a wide range of network options. The applicants submit that a significant proportion of frequent flyer points and corresponding loyalty is generated through an employee's ability to travel for leisure using points earned while travelling for business with their employer's preferred airline.

5.115. The applicants further submit that without a reasonable share of corporate business and without a competitive network offering on which to earn and burn points, Virgin Blue's loyalty program will never be as influential in leisure and business travel decision making as the Qantas frequent flyer program. In their view the Alliance will enhance the attractiveness of Virgin Blue's Velocity program by providing more opportunities for passengers to earn and burn points on the Tasman.

5.116. The ACCC accepts that the attractiveness of Virgin Blue's loyalty program will be enhanced under the Alliance and considers that the direct public benefits from reciprocal access to loyalty programs are likely to accrue to trans-Tasman passengers who:

(a) under the Alliance, prefer to fly with Pacific Blue or Air New Zealand, rather than Qantas, Emirates or other airlines flying the Trans-Tasman;

(b) are members of an Alliance loyalty program; and

(c) value the ability to earn or use frequent flyer points.

5.117. In relation to (a), the ACCC notes that 55% of trans-Tasman passengers in the period February 2009 to January 2010 flew with either Pacific Blue or Air New Zealand. Modelling by InterVISTAS suggests that the applicants' combined market share may increase by around **[confidential]** under the Alliance.[32] **EXCLUDED FROM PUBLIC REGISTER**

5.118. In relation to (b), the ACCC notes that the applicants submit that **[confidential]** of Virgin Blue passengers are members of its Velocity program and **[confidential]** of Air New Zealand trans-Tasman fares were purchased by Airpoints members. The ACCC notes that the Alliance may enhance the attractiveness and thus membership of both the Velocity and Airpoints frequent flyer programs

5.119. In relation to (c), the ACCC notes Fiftyfive5 survey data submitted by the applicants indicating that **[confidential]** of leisure passengers and **[confidential]** of business passengers cite the ability to earn points as a reason for flying with a particular airline.

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5.120. On this basis, the ACCC considers that at least **[confidential]** of trans-Tasman passengers are likely to value reciprocal access to the applicants' frequent flyer programs under the Alliance.

Lounge access

5.121. In the draft determination, the ACCC accepted that some public benefit would likely arise under the Alliance from increased lounge access. However, the ACCC noted that absent the Alliance, Virgin Blue was able to pursue the provision of lounge service either by the development of its own lounges or through accessing third party lounges on a fee for service basis. V Australia passengers, for example, are able to access the lounges of other carriers in Auckland (Emirates' lounge) and in Sydney and Melbourne (the lounges of Malaysian Airlines). The ACCC also noted a Virgin Blue press release announcing an agreement that allows Pacific Blue Corporate Plus Guests and Velocity

[32] InterVISTAS 2010, The Effect of the Alliance on Passenger Traffic, 3 May, p.10. The ACCC notes that this figure does not take into account the effects of changes in fares offered by the applicants or rivals as a result of the Alliance.

Gold members to have complimentary use of Wellington Airport's Wild at Heart Lounge.[33]

5.122. On this basis, the ACCC considered that any benefit associated with lounge access was likely more in the form of cost efficiency of access and presumably allowed for by the applicants in their submissions on cost savings under the Alliance, rather than a direct benefit to passengers.

5.123. In response to the ACCC's draft determination the applicants submit that Virgin Blue lacks the scale, and in particular the volume of higher yield traffic, on the Tasman to justify the substantial investment in its own lounges.

5.124. The applicants also submit that absent the Alliance it may be possible for Virgin Blue to obtain lounge access from other carriers on a pay per passenger basis. However, this is not considered to be a feasible option. The applicants claim that such arrangements are very costly as other carriers do not have the incentive to provide this access on favourable terms, if at all. The applicants submit in particular that Air New Zealand would have no incentive to provide favourable lounge access to Virgin Blue passengers absent a broader Alliance.

5.125. The applicants submit that airport lounges such as Wellington Airport's Wild at Heart lounge are land-side, not airside. This means passengers cannot use them once they have passed security and they are therefore significantly less attractive or convenient to passengers.

5.126. The applicants further submit that lounge access is one of the factors valued by business passengers. Without lounge access it is difficult to attract corporate accounts and without higher yielding corporate accounts and business travellers Virgin Blue cannot justify the investment in lounges on the trans-Tasman.

5.127. The ACCC accepts that:

- lounge access is important to business passengers and to the Alliance's plans to better target corporate accounts and business travellers
- air-side lounges are of greater value to business customers than land-side lounges
- the Alliance is likely to provide Air New Zealand with stronger incentives to serve Virgin Blue/Pacific Blue customers on an equal basis under the Alliance than under an access arrangement between rivals.

5.128. On this basis, the ACCC considers that direct public benefits from reciprocal access to Alliance lounges are likely to accrue to trans-Tasman passengers who:

(a) under the Alliance, prefer to fly with Virgin Blue or Air New Zealand, rather than Qantas, Emirates or other airlines flying the Trans-Tasman. In this regard, the ACCC notes that 55% of trans-Tasman passengers in the period February 2009 to January 2010 flew with either Pacific Blue or Air New Zealand. Modelling by

[33] Virgin Blue Press Release, *Pacific Blue announces lounge access for guests at Wellington Airport*, 16 February 2010.

InterVISTAS suggests that the applicants' combined market share may increase by around **[confidential]** under the Alliance[34] and

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(b) are eligible to utilise lounge facilities. In this regard, the ACCC notes that **[confidential]** of Air New Zealand's trans-Tasman passengers are eligible to utilise Air New Zealand lounge facilities.

Expected new frequencies under the Alliance

5.129. In their original submission, the applicants stated that under the Alliance they would be able to increase frequencies on at least the following existing routes: Adelaide-Auckland, Perth-Auckland, Melbourne-Wellington, Coolangatta-Auckland, and Sydney-Wellington.

5.130. Prior to the draft determination, Wellington Airport submitted that the public benefit claimed by the applicants in respect of opportunities for additional frequency and capacity is speculative.

5.131. Since the draft determination the applicants have further reviewed their schedules and confirm that from implementation of the Alliance they will introduce additional frequencies according to the following schedule.

- Auckland-Adelaide. Daily services from November to and including March and five to six services weekly from April to October. This is up from the current seasonal schedule of four to six services per week. This represents an additional 97 frequencies per annum.

- Auckland-Gold Coast. Double daily services from July to and including September and 12 services weekly from October to and including June. This is up from up from the current seasonal schedule of 11 to 13 services per week. This represents an additional 65 frequencies per annum.

- Auckland-Perth. Year round daily services. This is up from the current seasonal schedule of five to seven services per week. This represents an additional 47 frequencies per annum.

- Wellington-Sydney. Double daily services from January to and including April, 13 services weekly from July to and including December and 12 services weekly from May to and including June. This is up from the current seasonal schedule of 11 to 14 services per week. This represents an additional 83 frequencies per annum.

- Wellington-Melbourne. Daily services from November to and including April, six services weekly from July to and including October, and five services weekly from May to and including June. This is up from the current seasonal schedule of five to seven services per week. This represents an additional 16 frequencies per annum.

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[34] InterVISTAS 2010, The Effect of the Alliance on Passenger Traffic, 3 May, p.10. The ACCC notes that this figure does not take into account the effects of changes in fares offered by the applicants or rivals as a result of the Alliance.

- Wellington-Brisbane. Year round double daily services. This is up from the current seasonal schedule of 13 to 14 services per week. This represents an additional 18 frequencies per annum.

5.132. The ACCC notes that four of these routes (Auckland-Adelaide, Auckland-Gold Coast, Auckland-Perth and Wellington-Melbourne) are expected by the applicants to have a strong passenger response to the Alliance. If all of the increase in frequencies is attributed to the Alliance, the schedule proposed by the applicants provides for an additional 326 frequencies on the trans-Tasman per annum.

5.133. The ACCC accepts that the Alliance will result in a significant number of new trans-Tasman frequencies, which will directly benefit Alliance passengers.

Overall public benefits from enhanced products and services

5.134. The ACCC recognises that the enhanced product and service offering under the Alliance is a key source of public benefit. The ACCC considers that the Alliance will materially enhance the applicants' product and service offering by providing increased access to existing frequencies, increased online connection options, better schedule spread, enhanced value added services and supporting the introduction of new frequencies.

5.135. The applicants commissioned studies from InterVISTAS and Seabury APG (SAPG) to quantify the service improvements under the Alliance and estimate the effect of this improvement on passenger numbers using QSI analysis. Both studies suggest that the Alliance would improve service and stimulate passenger numbers.

5.136. The applicants submit that together and individually these studies provide the clearest evidence that the Alliance will result in service improvements which are valued by passengers and will result in passengers choosing to fly on the Alliance's services as well as overall market stimulation.

5.137. In the draft determination, the ACCC accepted that the Alliance would enhance the applicants' product and service offering. The ACCC noted that there is substantial economic literature on the relationship between airlines' product and service quality and passenger numbers.[35]

5.138. The ACCC also accepted that QSI is a modelling tool that is used widely and relied upon in the aviation industry to inform commercial decisions. In response to InterVISTAS' representation of its QSI modelling results as capturing the effects of the Alliance on trans-Tasman passenger traffic (as opposed to just one aspect of the Alliance; namely, improved services),[36] the ACCC expressed concern about whether

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[35] See, for example, Ippolito, R. A 1981, 'Estimating airline demand with quality of service variables', *Journal of Transport Economics and Policy*, Vol. 15, No. 1, pp. 7-15; Suzuki, Y., Tyworth, J. E. and R. A. Novack 2001, 'Airline market share and customer service quality: a reference-dependent model', Transportation Research Part A: Policy and Practice, vol. 35, Issue 9, November, pp. 773-778; and Lederman, M. 2008, 'Do enhancements to loyalty programs affect demand? The impact of international frequent flyer partnerships on domestic airline demand', *The Rand Journal of Economics*, Vol. 38, Spring, pp. 1134-1158.

[36] For example, this was reflected in the title of the study and the author's specific claim that he was asked by counsel to estimate the traffic changes and passenger shares of the carriers with the proposed Alliance. InterVISTAS 2010, *The Effect of the Alliance on Passenger Traffic*, 3 May, Page 2.

the InterVISTAS QSI modelling (i) reliably captured and measured changes in the airlines' service quality likely to result from the Alliance, and (ii) translated those measured service quality improvements into estimates of stimulated traffic that can be relied on as a good approximation of actual traffic stimulated by the Alliance. Key among the ACCC's concerns were:

- that the InterVISTAS QSI model was calibrated to replicate US domestic market (not trans-Tasman) conditions. There was no sensitivity testing or 'goodness of fit' statistics that would allow the ACCC to verify the extent of any statistical error that may have been introduced to the analysis by the lack of calibration for trans-Tasman conditions.

- that the QSI analysis assumes that the applicants will not alter fares on any trans-Tasman route post-Alliance. To the extent that the applicants raise prices on certain routes, the analysis may overstate stimulated traffic. To the extent that the applicants reduce fares on certain routes, the analysis may understate stimulated traffic.

- that the QSI analysis does not take into account rivals' price and capacity responses to the Alliance (and the Alliance's responses to those rival responses). Post-Alliance some carriers may unilaterally or in concert decide to raise prices/reduce capacity on certain trans-Tasman routes, prompting lower traffic levels than predicted by the model for those routes. On other routes, carriers may reduce fares/increase capacity, prompting more traffic than is predicted by the model for those routes.

5.139. In view of the concerns described above, the ACCC considered it appropriate to place a reasonably large confidence interval around the empirical results reported by InterVISTAS.

5.140. In response to these concerns, the applicants engaged Seabury APG (SAPG) to review the InterVISTAS QSI modelling. Since they were not provided with InterVISTAS' QSI model or its underlying data, SAPG elected to use its own model to quantify service improvements associated with the implementation of code-sharing under the Alliance and then to estimate the effect of the measured service improvements on trans-Tasman passenger traffic.

5.141. SAPG's QSI model was calibrated to trans-Tasman conditions. In view of the uncertainty surrounding the applicants' schedule optimisation plans, SAPG assumed that the applicants' schedule was unchanged under the Alliance. The sole driver of the estimated service quality improvement in SAPG's analysis therefore is the relative relationship between operating and code share flights (as reflected in the different coefficients assigned to code share connections, code share non-stop, and single online connect).

5.142. SAPG used a different method (regression analysis) to estimate the additional traffic that may be stimulated as a result of the measured service quality improvement under the Alliance. The advantage of this method is that it generates statistical information about the performance of the model (e.g. goodness of fit and confidence intervals). The analysis predicted slightly higher traffic numbers than the InterVISTAS analysis and these results were found to be statistically significant, although reported confidence intervals are likely understated due to heteroskedacity in the model.

5.143. The ACCC is concerned that the regression analysis may be falsely attributing some passenger growth to service quality improvements that actually reflects changes in other variables that may be correlated with service quality improvements. For example, when an airline introduces a new frequency or a new code share arrangement on a route it may at the same time engage in a number of activities to attract additional passengers to that service. For example, it may offer fare discounts, cooperate with travel agents to build new holiday packages incorporating the enhanced service and/or increase investment in direct promotion of the service. The resultant passenger growth would likely reflect a combination of enhanced service quality, fare changes, travel agent's success in selling the new holiday packages and the success of the airlines' promotion campaign. However, in SAPG's model all passenger growth on the service that was enhanced appears to be attributed to service enhancement. This phenomenon is referred to as omitted variable bias. As a result, the model may overstate the extent to which service quality improvements, on a standalone basis, stimulate passenger traffic.

5.144. The ACCC also notes that the SAPG's QSI analysis, like the InterVISTAS analysis, does not take into account the potential for the Alliance to affect fares on the trans Tasman. However, unlike InterVISTAS, SAPG does not claim to model the effect of the Alliance on passenger traffic, only the (standalone) impact of codesharing and online connections under the Alliance.

5.145. The ACCC views the QSI modelling studies commissioned by the applicants as confirming what has been well documented in the literature; that passengers value the increased choice of flights and increased online connection options under an Alliance.

5.146. The ACCC also interprets these studies as suggesting that the value that trans-Tasman passengers place on such service enhancements may be of a magnitude that stimulates passenger demand by around **[confidential]**. However, the ACCC considers that this may be overstating the true effect of service enhancements to the extent that models used to generate these estimates are prone to omitted variable bias.

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5.147. Nevertheless, the ACCC accepts that the Alliance will enhance the applicants' product and service offering and that these enhancements will be of direct benefit to trans-Tasman passengers.

5.148. The ACCC also accepts that to the extent that the enhanced product and service offering under the Alliance triggers a competitive reaction from the Qantas Group, the Alliance may confer further indirect benefits to Qantas Group passengers. These benefits are discussed below in **Promotion of Competition**.

Cost savings and other efficiencies

5.149. The applicants submit that the Alliance would result in cost savings and create efficiencies through removal of double marginalisation and higher load factors.

Cost savings

5.150. Dr Tretheway submits that there are real and immediate cost savings that can be achieved by an alliance (or by the Alliance), and notes that sharing frequent flyer lounges and eliminating duplication at overlapping stations is a commonly realised benefit. Dr Tretheway submits that replacing ground handling contracts with service by the Alliance partner can produce cost savings and economies.[37]

5.151. Each of the applicants has provided preliminary estimates of costs savings to the ACCC on a confidential basis.

5.152. In the draft determination, the ACCC accepted that the Alliance was likely to facilitate cost savings with respect to the services covered by the Alliance. The ACCC also remarked that it would be surprising if two substantial businesses such as Virgin Blue and Air New Zealand were not able to achieve some cost savings through joint rationalisation of aircraft operations and support services.

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5.153. However, the ACCC considered that the (preliminary) cost saving identified by the applicants was not substantial. They amount to a saving of **[confidential]** per annum for Pacific Blue and **[confidential]** per annum for Air New Zealand. The ACCC estimates this to be less than **[confidential]** per trans-Tasman passenger per annum under the Alliance.

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5.154. In response to the ACCC's draft determination, the applicants resubmitted their original annual cost saving estimates, multiplied by a factor of five (the term of authorisation initially sought). On this basis, the Alliance will result in cost savings of **[confidential]** for Virgin Blue (5 x **[confidential]**) and **[confidential]** for Air New Zealand (5 x **[confidential]**). The applicants submit this is clearly substantial.

5.155. The applicants further submit that they anticipate the cost savings that would be achievable under their Alliance would be similar in scope and relative scale to those achieved by Qantas and British Airways under the Joint Services Agreement (JSA).

5.156. In this respect, the applicants noted that Qantas and British Airways submitted in their application to the ACCC that under the JSA they would be able to achieve significant cost savings in areas associated with sharing IT development and operations, including yield management, reservations and other systems. Qantas and British Airways submitted that they were also able to achieve cost savings through the sharing of facilities such as offices, sales staff and distribution and customer services facilities and lounges.[38]

5.157. The applicants submit that these are the same categories of savings that the applicants expect to achieve under the Alliance and there is no reason why they would be less substantial in the context of the Tasman than the anticipated savings achieved by Qantas and British Airways in the context of the JSA.

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[37] Annexure H to the *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance*, 4 May 2010, page 47.
[38] ACCC Determination Application for revocation and substitution of authorisation A91195&A91196, Qantas Airways Limited and British Airways plc, 31 March 2010 at 4.70.

5.158. The ACCC considers that irrespective of whether cost savings are reported on an annual or five year basis, the cost savings identified by the applicants are considerably narrower in scope and lower in scale relative to the comparatively detailed estimates provided by Qantas and British Airways in the context of the JSA.

5.159. The ACCC notes that some airlines in the past have provided very detailed information about expected cost savings under their respective alliances, but considers that it is inappropriate to presume that other airlines would automatically realise similar benefits. The ACCC assesses aviation alliance authorisations on a case by case basis and it is incumbent on applicants to provide information about the scope and scale of expected cost savings under their particular alliance.

5.160. The ACCC accepts the preliminary estimates provided by the applicants and remains of the view that the Alliance is likely to facilitate cost savings. In the absence of further information by the applicants in relation to their own alliance, the ACCC also remains of the view that the cost savings anticipated by the applicants are non-trivial but not substantial.

5.161. The ACCC notes that the actual figure may be higher or lower, depending on the applicants' ability to find additional opportunities for cost savings post-Alliance and their ability to realise cost savings to the magnitude projected.

Removal of double marginalisation

5.162. The applicants submit that another source of public benefit is the availability of lower connecting fares between the applicants under the Alliance as a result of the removal of what is described in academic literature in the aviation industry as "double marginalisation".

5.163. Dr Tretheway submits that through the elimination of double marginalisation (among other reasons), passengers travelling beyond gateway benefit from lower fares.[39]

5.164. In the draft determination, the ACCC explained its understanding of double marginalisation as a situation that occurs where suppliers of vertically related or complementary products each enjoy a degree of market power and independently charge a price which includes a markup over their costs and do not take account of the impact on the other firm's profit.[40] The net result is both higher prices and lower profits than if the two firms coordinated their pricing, for example through vertical integration or a joint venture.

5.165. The ACCC noted that, to the extent that either Virgin Blue on the domestic Australian segment or Air New Zealand on the trans-Tasman segment possesses a degree of market power, then the ACCC accepts that double marginalisation could be a problem on complementary flight segments of an itinerary from New Zealand to Australia utilising the services of two or more airlines.

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[39] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 44.

[40] The ACCC notes that in practice most firms have some degree of market power and charge a price which is above marginal cost. That is, most firms face a downward sloping demand curve.

5.166. The ACCC also accepted that, to the extent that either Air New Zealand on the domestic New Zealand segment or Pacific Blue on the trans-Tasman segment possess a degree of market power, then double marginalisation could be a problem on complementary flight segments of an itinerary from Australia to New Zealand utilising the services of two or more airlines.

5.167. In response to the draft determination, the applicants submit that while the favourable connecting rates that may be provided under an alliance may not fall within an economic theory of double-marginalisation, there is no doubt that the Alliance partners are likely to provide a lower connecting rate to each other than under an interline arrangement.

5.168. In support of this claim, the applicants provided confidential information to the ACCC to demonstrate that when Air New Zealand sets connecting sector fares internally it does so at a significant discount to the rate offered under interline and non-revenue sharing alliances.

5.169. The applicants submit that, while the rates that each of Virgin Blue and Air New Zealand will offer each other under the Alliance are a matter for final commercial negotiation, the carriers have agreed that the final rate will be a significantly more attractive connecting sector rate than either would be able to achieve absent the Alliance.

5.170. The ACCC accepts that revenue sharing under the Alliance would give the applicants an incentive to offer fares on complementary flights that incorporate a lower margin than the margin embodied in the fares that Air New Zealand currently offers under its interline agreements.

5.171. In the draft determination, the ACCC noted that the extent of public benefit arising as a result of the removal or reduction of double marginalisation is likely to depend on:

- the proportion of total trans-Tasman passengers that are expected under the Alliance to purchase onward (complementary) flights beyond current destination points in Australia and New Zealand

- the degree of market power held by Virgin Blue in the Australian domestic market, Pacific Blue in the trans-Tasman market and Air New Zealand in the trans-Tasman and domestic New Zealand markets. This will be reflected in the magnitude of the markup above cost that these carriers currently realise on specific routes

- the extent to which the parties expect these markups will be reduced under the Alliance.

5.172. The ACCC invited the applicants to provide this information by route and by carrier. In the absence of this information, the ACCC considered that while in theory there is the potential for public benefit from removal of double marginalisation incentives, in practice the availability of such benefits is unlikely to be widespread across the trans-Tasman.

5.173. In response to the draft determination the applicants submit that in 2009 more than 550,000 passengers (10%[41]), took a trans-Tasman flight with a connection in Australia, almost 50% of those passengers were carried on Qantas/Jetstar, 23.4% on Virgin Blue and 21% on Air New Zealand. The applicants noted that they do not have data on the number of trans-Tasman travellers that travelled to their final destinations via connections in New Zealand, but note that there were approximately **[confidential]** travellers who had itineraries like this on Air New Zealand alone. **EXCLUDED FROM PUBLIC REGISTER**

5.174. The applicants submit that all of these passengers will directly benefit from the increased competitiveness of connecting fares and increased connection options under the Alliance. They further submit that this is a very substantial public benefit which should be given substantial weight.

5.175. The ACCC considers that the majority of the trans-Tasman passengers who utilised a connection in Australia in 2009 likely completed their entire journey with Qantas, Jetstar or Virgin Blue. These passengers would therefore not have been subject to double marginalisation on complementary flights.

5.176. The ACCC considers that all of the Air New Zealand travellers who utilised a connection in New Zealand would have been able to complete their entire journey with Air New Zealand. They therefore would not have been subject to double marginalisation on complementary flights.

5.177. The ACCC considers that the removal of double-marginalisation under the Alliance is a direct benefit to trans-Tasman passengers who:

(a) prefer to travel with one of the applicants post-Alliance and

(b) utilise both a connection in Australia and a connection in New Zealand beyond the trans-Tasman gateway destinations.

5.178. In relation to (a), the ACCC notes that 55% of trans-Tasman passengers in the period February 2009 to January 2010 flew with either Pacific Blue or Air New Zealand. Modelling by InterVISTAS suggests that the applicants' combined market share may increase by around **[confidential]** under the Alliance.[42]

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5.179. In relation to (b), the ACCC considers that passengers that meet this profile are likely to represent a modest proportion of the approximately 550,000 trans-Tasman passengers who utilised an Australian connection in 2009.

5.180. Passengers who do not fit the profile set out at paragraph 5.177 already have access to internal discounts on connecting fares that may be more generous (provide for lower margins) than the discounts negotiated under the Alliance, depending on whether commercial negotiations between the applicants result in less favourable discounts than those available on complementary flights with the same airline.

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[41] Based on BITRE data for the year ended December 2009 – 5 293 501 passengers travelled between Australia and New Zealand.

[42] InterVISTAS 2010, The Effect of the Alliance on Passenger Traffic, 3 May, p.10. The ACCC notes that this figure does not take into account the effects of changes in fares offered by the applicants or rivals as a result of the Alliance.

5.181. The extent of benefit available to each of these passengers is unclear at this point in time and will depend on commercial negotiations between the applicants. It will also likely vary across routes. However, if the applicants were to match the discount on internal fares then this may permit fare reductions (relative to those available under an interline agreement) in the range of **[confidential]**, based on confidential information provided by Air New Zealand. **EXCLUDED FROM PUBLIC REGISTER**

Improved efficiency through higher load factors

5.182. The applicants expect that the Alliance will deliver considerable increases in passenger loads and incremental revenue per available seat kilometre (ASK).[43]

5.183. Dr Tretheway submits that higher load factors, lowering the cost per seat sold, is a potential, but not inevitable benefit, which depends on whether the carriers deploy more capacity or not.[44] If the carriers leave their capacity as is, they will achieve higher load factors. However, in his view a more likely response may be to add additional capacity to their trans-Tasman routes. This could result in somewhat lower load factors, although with great benefit to travellers in the form of new routes or additional frequency and capacity on existing routes.[45]

5.184. In the draft determination, the ACCC accepted that increased load factors, to the extent that they are realised under the Alliance, represent a source of efficiency improvement through lowering of cost per seat sold.

5.185. However, the ACCC noted Dr Tretheway's comment about higher load factors being a potential, but not inevitable benefit, depending on whether the carriers deploy more capacity or not. The ACCC invited the applicants to provide more information about the routes on which they expect to realise increased load factors and the magnitude of cost savings expected from these higher load factors.

5.186. In response, the applicants submit that the improved load factors under the Alliance will result in public benefit either directly through greater efficiency (i.e. lower the cost per seat sold) or indirectly by supporting greater total output (i.e. increased capacity).

5.187. Assuming no additional capacity post-Alliance, the applicants have estimated the magnitude of the cost savings, in terms of the reduction in cost per seat sold or cost per passenger, from these higher load factors to be broadly in the range of **[confidential]** per city pair with a few outliers above that. **EXCLUDED FROM PUBLIC REGISTER**

5.188. The applicants submit that this reduction in cost per seat sold and therefore breakeven fares is material. The applicants submit that they have prepared a conservative illustration of the magnitude of this value. They estimate cost savings from reduction in the breakeven fares due to expected passenger stimulation alone could exceed **[confidential]** per year. This illustrative estimate assumes a breakeven fare of

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[43] *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance*, 4 May 2010, page 17.

[44] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 44.

[45] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 70.

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[confidential] and current capacity. It is based on InterVISTAS' QSI estimate of **[confidential]** additional passengers on the Alliance services from stimulation and does not include passengers diverted onto the Applicants services. The applicants note that if extra aircraft are added these cost savings will be reduced.

5.189. The applicants have performed sensitivity testing suggesting that for each 1% reduction in predicted stimulation, this cost saving falls by 1%. For example, if the additional passengers due to market stimulation under the QSI analysis was discounted by 50%, the estimated cost saving would reduce to **[confidential]** per year.

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5.190. The applicants submit that where the stimulated passengers can substantially be accommodated via an increased load factor on additional services, to the extent there was a need for additional services, then the cost saving remains positive, but is reduced to reflect the cost of additional capacity.

5.191. The ACCC considers that the public benefits associated with increased load factors under the Alliance may be material, but depend on the additional trans-Tasman traffic that the Alliance actually stimulates.

5.192. As noted previously, the ACCC does not accept that QSI analysis commissioned by the applicants is a reasonable proxy for the additional passenger traffic that may be stimulated by the Alliance. Nevertheless, after reflecting on the potential pro-competitive and potential anti-competitive effects of the Alliance (both discussed below) the ACCC accepts that, on balance, the alliance is likely to have an overall stimulatory effect on trans-Tasman traffic. On this basis the ACCC considers that the Alliance is likely to generate some public benefits through increased load factors.

5.193. The illustrative cost savings submitted by the applicants are based on **[confidential]** traffic stimulation and suggest that improved load factors could deliver an efficiency benefit of the order of **[confidential]** per trans-Tasman passenger in 2009.

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5.194. The sensitivity analysis undertaken by the applicants suggests that if the actual traffic stimulation under the Alliance is half that predicted in InterVISTAS' QSI analysis, the efficiency benefit associated with improved load factors is also halved (i.e. **[confidential]** per trans-Tasman passenger in 2009).

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Pass through of cost savings and efficiencies

5.195. The ACCC considers that cost saving and efficiencies are a public benefit in and of themselves. However, the ACCC gives greater weight to cost savings where they are likely to be passed through to consumers in the form of lower fares.

5.196. The ACCC considers that the likelihood of cost savings and efficiencies achieved by the Alliance being passed through to consumers depends on competitive conditions post-Alliance. The ACCC is concerned that on certain trans-Tasman routes the Alliance may find it more profitable to raise fares rather than lower them. These concerns are discussed in the **Public detriment** section below. The ACCC notes, however, that the proposed conditions of authorisation will go some way toward preserving incentives for pass through of cost savings and efficiencies by the Alliance.

Promotion of competition

5.197. The applicants submit that the Alliance will particularly strengthen Pacific Blue for ex-Australia outbound travel on the Tasman, and the overall position of Virgin Blue vis-a-vis the Qantas Group.

5.198. The applicants state that:

> Qantas clearly recognizes Virgin Blue as its most significant competitor. At the same time, Qantas sees itself as having a dominant position for corporate travel, which is reflected in its fare positioning and its business share to capacity premium on the Tasman. The Alliance will strengthen the competitive offer of Virgin Blue and Air New Zealand against Qantas.[46]

5.199. The applicants also submit the following.

- The additional brand strength and network access resulting from the Alliance will strengthen the regional product of both applicants and allow them to build a stronger network presence internationally, in closer competition with the Qantas Group.[47]

- Virgin Blue's key rationale for entering into the Alliance is to enable it to attract higher yield passengers, including corporate traffic, on its Tasman services. The applicants submit that, together with the NWC and Airline of the Future strategies, the proposed Alliance would allow Virgin Blue to better target higher yield passengers and, in particular, to attract corporate passengers to its broader Australasian network.

- Pacific Blue lacks the scale necessary to attract corporate business and that Virgin Blue considers that an alliance is the most effective and efficient way to achieve scale without incurring the cost and facing the risks associated with unilateral expansion in a highly competitive aviation market in which competitors such as the Qantas Group have key advantages.

- The key value of the Alliance to Air New Zealand is that it will increase the number of passengers on its flights, principally as a result of access to behind gateway points in domestic Australia and the increased number of NZ coded flights on the Tasman. The applicants submit that the absence of a presence in the Australian market has limited Air New Zealand's ability to compete for Tasman passengers travelling beyond the main gateway ports in Australia, as well as reducing its brand presence and competitive offering in Australia.[48]

- The Alliance is about growing Air New Zealand's and Virgin Blue's combined market presence and not about reducing capacity so as to realise cost savings.

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[46] *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance*, 4 May 2010, page 54.
[47] *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance*, 4 May 2010, page 19.
[48] *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance*, 4 May 2010, page 20.

5.200. In his expert report, Dr Tretheway notes the following with regard to promotion of competition under the Alliance.

- With the Alliance, Virgin Blue enhances its trans-Tasman product and strengthens its beyond New Zealand gateway access for trans-Tasman passengers. Its limited domestic New Zealand product is not enhanced by the proposed Alliance with Air New Zealand, but nevertheless it will be much more competitive to Qantas-Jetstar. Virgin Blue will gain in its ability to compete for the business traveller.[49]

- With the Alliance, Air New Zealand is able to increase its beyond-the-Australian-gateway access for trans-Tasman passengers and thus becomes a much stronger carrier in the Australasian market. Air New Zealand will still have no presence in domestic Australia markets, and thus Dr Tretheway would not characterise it as having the same strength as the Qantas-Jetstar Group as an integrated Australasian carrier.

- The Alliance will enhance two Australasian carriers toward more comprehensive and integrated services better able to serve broader market segments, with potential to grow into a strong integrated carriers.[50]

5.201. In the draft determination, the ACCC accepted that the Alliance would result in a broader and more integrated network. However, the ACCC did not accept that this would automatically or necessarily result in public benefit in the form of promotion of competition in the trans-Tasman market and invited the applicants to provide more information in support of their claims.

5.202. In response, the applicants submit that the Alliance will trigger a competitive reaction from Qantas. The applicants claim that it is a fact that Qantas sees Virgin Blue as a significant threat but, at the same time, the limitations in Virgin Blue's Tasman frequency and the relative value of its frequent flyer and lounge offer prevent it from effectively competing with Qantas.

5.203. The ACCC accepts that the Alliance is likely to enhance the applicants' product and service offering, and may lead to lower fares (to the extent that cost savings and efficiency gains are passed through to consumers). The ACCC considers that this has the potential to trigger a competitive reaction from Qantas Group. This may lead to better price and service offerings and potentially lower fares for Qantas Group passengers. In turn, Qantas Group's reaction to the Alliance could stimulate a second round competitive response from the Alliance.

5.204. The applicants submit that in particular the Alliance will facilitate Virgin Blue's strategy to more strongly compete with Qantas for corporate passengers. They note CEO John Borghetti's remarks at a conference in Melbourne concerning Qantas' competitive reaction.

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[49] The ACCC notes that on 16 August 2010 Virgin Blue announced its withdrawal from domestic New Zealand. Virgin Blue Press Release, *The Virgin Blue Group of Airlines Announces First Phase of Network Review*, 16 August 2010.

[50] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 69.

> Qantas has had a virtual monopoly at the high end yield of the market and we want some of it – and of course no one knows better than Virgin how to really shake things up. In fact since stating that we will be going after the corporate market, we have seen Qantas change its direction again and refocus on business travellers after publicly stating only 12 months ago that the business market would never return as strongly after the GFC and it would reconfigure at a cost of hundreds of millions of dollars. Therefore, without even taking our first step, we have already caused our competitors to react.

5.205. The applicants also explain that the Alliance will utilise a different model to the Qantas-Jetstar model. They submit that Qantas uses a dual-brand strategy while Virgin Blue and Air New Zealand serve all passengers within the same brand and within the same plane. What they lack on the trans-Tasman to effectively compete with Qantas for corporate travellers is trans-Tasman frequencies (in the case of Virgin/Pacific Blue) and access to domestic Australian connections (in the case of Air New Zealand).

5.206. The ACCC acknowledges that the Alliance gives Virgin Blue/Pacific Blue an ability to offer additional trans-Tasman frequencies and domestic connections in New Zealand. The ACCC also acknowledges that the Alliance gives Air New Zealand the ability to offer additional trans-Tasman frequencies and domestic connections in Australia. The ACCC has recognised the public benefits associated with these product and service enhancements, which accrue to Alliance business and leisure passengers (see **Enhanced products and services** above).

5.207. The central issue here is whether, by enabling these additional frequencies and connections, the Alliance stimulates a more vigorous competitive response in the business traveller segment of the trans-Tasman market than would occur absent the Alliance. The ACCC notes that this segment accounts for around 16.5% of trans-Tasman travellers.[51]

5.208. The ACCC notes that independently and absent the Alliance, each of Pacific Blue and Air New Zealand is making changes to their business models that have the effect of aligning their products and converging their cost structures:

- Virgin Blue is looking to enable Pacific Blue to maintain its attractiveness to its core leisure customers but to move into the corporate segment, while better integrating Pacific Blue's offering with the Virgin Blue New World Carrier business model

- Air New Zealand has announced changes to its product offering where business passenger seating will be removed from its A320s and instead passengers will be offered four fare categories with products ranging from basic to premium (seat, seat and bag, the works, and works deluxe). These changes mean that most trans-Tasman Air New Zealand flights will offer these product categories while the traditional business class cabin offering will be restricted those flights to/from Auckland which utilise wide body aircraft.

[51] Based on passenger card data for the year ended 31 January 2010, collected and compiled by DIAC (from Overseas Arrivals and Departures data - unpublished tables). This figure reflects the number of passengers who nominated either 'convention/conference' or 'business' as their reason for travel as a proportion of total trans-Tasman passengers citing reason for travel as either convention/conference, business, visiting friends/relatives or holiday.

5.209. The ACCC considers that, while it is early days, Virgin Group's new business model appears to be helping to win corporate and government customers in Australia away from Qantas absent the Alliance. For example, the ACCC notes that Virgin Blue was recently successful in securing the Australian Football League official airline contract which was previously held by Qantas.[52]

5.210. The ACCC accepts that the Alliance would enhance the applicants' prospects of attracting additional corporate and government customers who might otherwise have signed with Qantas. The ACCC also accepts that the Alliance may increase competitive pressure on Qantas in the market for business passengers, meaning the Alliance could benefit Qantas passengers as well.

5.211. However, the Alliance also removes competition between Virgin Blue (the third largest player) and Air New Zealand (the largest player), including in the business traveller segment of the trans-Tasman market. It is difficult to assess the implications of this since Virgin Blue and Air New Zealand are still in the process of rolling out their new business models and the nature and extent of their future rivalry in this segment absent the Alliance is unknown.

5.212. The ACCC therefore considers that the Alliance will likely strengthen Virgin Blue's capacity to contest the business traveller segment of the trans-Tasman market. However, it may not trigger substantially lower prices or substantially higher levels of service than would occur absent the Alliance because it also removes rivalry between Virgin Blue and Air New Zealand.

5.213. The ACCC concludes that the Alliance has the potential to confer material public benefits by stimulating competition, particularly in the business traveller segment of the trans-Tasman market.

Stimulation of tourism

5.214. The applicants submit that the stimulation of passenger traffic on the trans-Tasman under the Alliance will also stimulate tourism.[53] In particular, the applicants submit that the Alliance is likely to increase the attractiveness of Australia for New Zealanders when choosing a travel destination within the region. The ACCC notes that New Zealand is Australia's largest inbound market with 1.1 million New Zealand tourists visiting Australia in year ended March 2010, representing around 20% of total inbound tourist arrivals to Australia.[54]

5.215. The applicants submit that the key drivers of incremental tourists as a result of the Alliance will arise from:

- the improved product offered by the Alliance

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[52] http://www.theaustralian.com.au/business/virgin-blue-steals-afl-official-airline-contract-from-qantas/story-e6frg8zx-1225955659609

[53] Applicants' *Submission in response to interested party submissions*, 26 July 2010, page 8.

[54] Tourism Australia data.

- the increased competition in the Australasian market and greater consumer choice via the creation of a second comprehensive Australasian network in competition with the Qantas-Jetstar Group

- incentives to jointly promote travel on Alliance services on a metal neutral basis and

- the Alliance's improved distribution channels.[55]

5.216. The applicants submit that these benefits would not arise absent the Alliance.

5.217. Dr Tretheway considers that the Alliance is highly likely to result in improved frequency, connections and enhanced products; higher passenger traffic; and enhanced competitiveness of the Alliances' carriers as integrated Australasian network operators. Dr Tretheway submits that tourism benefits from all of these outcomes.[56]

5.218. In their submissions to the ACCC, Wellington and Auckland Airports and Tourism Australia all commented on the link between stimulation of tourism and the degree of competition on the trans-Tasman. In particular:

- Wellington Airport submits that its experience is that passenger numbers and therefore stimulation of tourism are higher when there is more competition on the Tasman rather than less. It also submits that tourism is discretionary travel and is therefore strongly affected by airfare levels and that an increase to the level and number of lowest priced available fares would adversely impact trans-Tasman tourism.

- Auckland Airport submits that it is concerned that if benefits in the form of increased services and lower fares do not materialise, passenger numbers will decline and result in a negative impact on tourism. Auckland Airport submits that reduced competition usually leads to reduced volumes and so fewer passengers/tourists.

- Tourism Australia submits that strong aviation capacity and competition on the New Zealand-Australia route is vital to continued growth of this market and to enable Tourism Australia to fulfil its role.[57]

5.219. The ACCC has noted previously that there are a wide range of factors which influence tourism demand for Australia as a destination, including general purchasing power in source countries, the relative cost of other destinations, the total cost of visiting Australia (land as well as air component) and the perceived quality of Australia as a destination.[58]

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[55] *Submission in support of the Application for Authorisation of the Virgin Blue and Air New Zealand Australasian Airline Alliance*, 4 May 2010, page 50-51.
[56] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 52.
[57] Tourism Australia submits its role is to grow demand for both leisure tourism (international and domestic) and business events (international) and to support industry to increase visits, dispersal and economic value, Submission from Tourism Australia, dated 4 June 2010, page 1.
[58] ACCC Determination for applications A91097 and A91098 lodged by Air New Zealand Limited and Air Canada, January 2009, page 23.

5.220. The ACCC accepts that stimulation of tourism is a potential source of public benefit under the Alliance. The ACCC considers that the principal ways in which the Alliance is likely to stimulate tourism is through:

- increased passenger traffic as a result of enhanced products and services and, potentially, lower fares to the extent that, on balance, the Alliance promotes rather than lessens competition and the applicants pass through cost savings and efficiency gains to consumers; and
- exploitation of synergies through joint rather than separate tourism promotion activity.

Stimulation of tourism through increased passenger traffic

5.221. The ACCC accepts that the Alliance makes it more convenient for travellers who wish to travel beyond trans-Tasman gateway destinations in Australia and New Zealand to do so.

5.222. In the draft determination the ACCC invited the applicants to provide information about the number of passengers who are expected to take advantage of this opportunity, separately for Australian and New Zealand destinations and by passenger origin (Australia, New Zealand and other).

5.223. In response, the applicants submit that:

- approximately 550,000 passengers travelled the trans Tasman in 2009 via an intermediate point in Australia.
- currently, 55.6% of international visitors to New Zealand from source markets other than Australia, visit New Zealand in conjunction with another destination.[59]
- for the 12 months ending January 2010, 21% of all non-New Zealand original international passengers to Australia also visited New Zealand as part of the same trip (with the next largest co-destination being Singapore at 15.9%).[60]
- 64% of people in the US considering visiting New Zealand intend to visit both New Zealand and Australia on the same trip.[61]

5.224. In reference to Tourism Australia data indicating that around 20% (over 1.1 million) of all international tourists to Australia in 2009 arrived from New Zealand, the applicants acknowledge that despite these large numbers of tourists, few New Zealand tourists visit destinations beyond the East Coast Gateways.

5.225. However, the applicants submit that by providing online connections between Air New Zealand's domestic New Zealand network and Virgin Blue's domestic Australian network via high frequencies across the Tasman, the convenience and attractiveness of

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[59] New Zealand Ministry of Economic Development 2010, *International Visitors Survey*, June.
[60] BITRE 2010, *Statistical Report – Aviation, International Airline Activity*, January, page 9.
[61] Tourismnewzealand.com 2010, Understanding the Active Considerers Market in USA, July.

visiting such destinations would be greatly increased for New Zealand travellers under the Alliance. The applicants submit this will have significant benefits for tourism in the Northern Territory, Western Australia and South Australia in particular.

5.226. The applicants submit that InterVISTAS' QSI analysis shows that the Alliance will result in stimulation of passenger numbers, and that this stimulation has the biggest effect on thin routes which are not currently well serviced by direct services.

5.227. The ACCC considers that the number of origin-destination combinations where the Alliance creates a new online connection option (rather than an alternative online connection option) is likely to be very small given that:

- there are already reasonably extensive point to point origin-destination options between New Zealand and East Coast Australia; and

- neither the New Zealand points or the East Coast Australian points have extensive, high traffic beyond points.

5.228. As noted previously, the majority of the trans-Tasman travellers who utilised an Australian connection in 2009 absent the Alliance already have an online connection option through Qantas, Jetstar and/or Virgin Blue/Pacific Blue.

5.229. For trans-Tasman origin-destination traffic, the ACCC considers that the Alliance only creates the option of online connection for travellers who utilise both a connection in Australia and a connection in New Zealand beyond the trans-Tasman gateway airports. These passengers are the only source of tourism benefits from origin-destination traffic, absent market growth as a result of the Alliance.

5.230. The applicants rely on InterVISTAS' QSI modelling to support their claim that the Alliance will result in stimulation of traffic numbers. The ACCC does not accept that it is appropriate to use InterVISTAS' QSI results as a proxy for the additional traffic that might be stimulated by the Alliance because it does not take into account other important variables affecting passenger demand under the Alliance, including average Alliance fares and rivals' response to the Alliance's price and service offering.

5.231. The applicants submit that in offshore markets the Alliance will take the opportunity to promote joint Australian and New Zealand online itineraries that will make it simpler and easier for potential visits to plan an Australasian trip. For example, in the US, the Alliance partners can promote complete Air New Zealand itineraries from the US to New Zealand and Australia involving Australian regional destinations. This would allow the Alliance partners to compete with Qantas-Jetstar in the large market of dual-destination travellers from the US to Australia/New Zealand.

5.232. The applicants further submit that Virgin Blue's strategy of building an international long haul network (which it has begun with its proposed alliances with Delta and Etihad), will mean the Alliance will enable new online itineraries from important source markets of Europe and the US. The additional trans-Tasman frequencies under the Alliance will facilitate better connections and more choice of travel days.

5.233. The ACCC recognises that the increased online connection options under the Alliance are also available to long-haul international passengers. This has the potential to confer tourism benefits to Australia and New Zealand to the extent that the Alliance makes it easier for potential visitors to plan an Australia and New Zealand trip.

Stimulation of tourism through joint tourism promotion

5.234. The ACCC notes that the Alliance provides opportunity for the applicants to exploit synergies through joint promotion of tourism.

5.235. The ACCC considers that the realisation of tourism-related public benefit in practice will depend on the strength of incentives for the applicants to jointly promote tourism under the Alliance as well as their level of commitment to such joint promotion.

5.236. The ACCC accepts that, under the Alliance, the applicants have an incentive to jointly operate their activities in respect of tourism promotion. The ACCC has been provided with confidential cost information in respect of this claimed benefit.

5.237. In the draft determination the ACCC requested that the applicants provide information about how they propose to implement joint promotion of tourism in Australia under the Alliance.

5.238. In response, the applicants submit that they have consulted with national, state and regional tourism bodies. As a result of this process, they have determined to establish a joint tourism task force in order to:

- promote growth of tourist visitors between Australia and New Zealand (bi-directional)
- facilitate air travel beyond the trans-Tasman entry ports, including through the provision of competitive pro-rates for domestic travel and
- promote dual-destination travel, ensuring the greatest number of visitors to each of New Zealand and Australia also visits the other.

5.239. The applicants submit that the tourism task force will work with national, state and tourism bodies in order to bring about these outcomes. The ACCC views this development as a demonstration that the applicants are highly motivated to promote dual destination tourism.

5.240. The ACCC also notes Dr Tretheway's observation in relation to joint marketing of Alliance services, that some alliances achieve their goal of joint marketing, while others find it difficult to achieve. Dr Tretheway submits that whether there is joint marketing of Alliance services is the intent of the carriers and he offers no opinion on the matter.[62]

Conclusion on tourism benefits

5.241. Overall, the ACCC accepts that the Alliance has the potential to stimulate tourism spend in Australia (and New Zealand). The revenue sharing arrangement underpinning

[62] *Expert Statement of Dr Michael Tretheway: The Effects of the Australasian Airline Alliance Between the Virgin Blue Group and Air New Zealand*, 25 July 2010, page 52.

the Alliance will provide a strong incentive for the applicants to pursue joint marketing opportunities. The applicants commit to establish a tourism task force, which suggests that they may be actively pursuing these opportunities.

5.242. The ACCC considers that the extent of tourism benefits realised under the Alliance would be highly (positively) correlated with the additional trans-Tasman traffic that may be stimulated under the Alliance. While the ACCC does not accept the specific estimates submitted by the applicants, the ACCC accepts that on balance the Alliance is likely to have an overall stimulatory effect on trans-Tasman traffic. On this basis, the ACCC considers that the Alliance is likely to generate some tourism-related public benefits.

ACCC conclusion on public benefits

5.243. The ACCC considers that the Alliance is likely to result in material public benefits in the form of:

- enhancement of the applicants' products and service offering (including increased access to existing frequencies, increased online connection options, better schedule spread, enhanced value added services and new frequencies) and associated increased consumer choice
- potential for lower fares as a result of cost savings and efficiency improvements through removal of double marginalisation and higher load factors
- promotion of competition, particularly in the business traveller segment of the trans-Tasman market and
- stimulation of tourism.

Public detriment

5.244. Public detriment is not defined in the Act but the Tribunal has given the concept a wide ambit, including:

> …any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.[63]

5.245. The ACCC considers that any public detriment resulting from the Alliance is likely to arise from its effect on competition in the relevant markets.

5.246. Pursuant to the objects of the Act in section 2, public detriment is to be identified and assessed having regard to its effect on the promotion of competition and the enhancement of welfare in Australia. The ACCC recognises that detriments resulting from the Alliance are likely to affect both Australia and New Zealand. However, the nature of some material in this case is such that the ACCC has not been able to reliably apportion identified public detriment as between the two countries. Accordingly, the

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[63] *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,683.

ACCC has considered potential public detriment at the transaction level, consistent with its approach to public benefit.

Trans-Tasman air passenger services

Market concentration

5.247. The applicants' services overlap on 12 trans-Tasman routes.

5.248. At the trans-Tasman aggregate level, the Alliance would result in the applicants having a joint market share of around 56% compared to 23% for Qantas, 10% for Jetstar and 12% for the FFCs.[64]

5.249. However, the ACCC does not believe that market concentration at the trans-Tasman aggregate level provides the most appropriate guide to the potential impact of the Alliance on competition within that market.

5.250. The ACCC notes that the trans-Tasman passenger market is composed of a large number of city pair routes, many of which are distinct in terms of passenger mix, traffic density and regulatory and operational access. Airline presence on these routes reflects these factors with different mixes of FSAs, LCCs and FFCs occurring across the range of city pairs.

5.251. Under these circumstances, the ACCC believes that there will not necessarily be a homogeneity of impact of the Alliance across all city pair routes. Accordingly, the ACCC has examined the impact of the Alliance on competition on a city pair by city pair basis.

Applicants' submissions

5.252. The applicants submit that, rather than lessening competition on the trans-Tasman, the Alliance will promote competition by creating an improved product offering that is likely to stimulate further product innovation and fare competition.

5.253. The applicants state that the removal of direct competition between Pacific Blue and Air New Zealand is unlikely to have a material adverse effect on competition across the market due to:

- the presence of strong competitors across the market with a history of strong fare competition and announced plans for further expansion and
- low barriers to expansion and entry on the Tasman generally and by route.

5.254. These issues are discussed in detail below.

Interested party submissions

5.255. A number of interested parties raise concerns that the Alliance would be likely to result in increased fares and a reduction in capacity on trans-Tasman routes.

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[64] By share of passengers carried, April 2010.

5.256. Tiger Airways submits that the Alliance would enable the applicants to eventually reduce flights and seat numbers, reduce frequencies or services on marginal routes and utilise their increased combined market power to raise prices and prevent potential new entrants from entering the market.

5.257. Hamilton International Airport considers that the Alliance would be likely to result in rising airfares, and constraints on seat capacity in order to reduce costs and maximize return. Hamilton International Airport remains unconvinced that the trans-Tasman market has the low barriers to entry and the level of strong competitors (apart from Jetstar) as the applicants' state in their submission.

5.258. The New Zealand Airports Association submits that the Alliance will inevitably reduce or eliminate competition on the trans-Tasman services flying into and out of New Zealand's airports. The Association considers that market power will enable price to be increased, demand will therefore decrease and capacity will reduce. The New Zealand Airports Association also considers that without competitive choice, incumbents can route passengers through other ports, reducing the service levels offered to passengers.

5.259. The Wellington Regional Chamber of Commerce submits that combining the operations of Air New Zealand and Pacific Blue is effectively a reduction in the number of competing airlines operating on the Tasman and most likely a reduction in flights and passenger numbers.

5.260. Prior to the draft determination, Auckland Airport, Wellington Airport and the Key Wellington Stakeholders Group lodged submissions opposing the Alliance, raising concerns about the potential for fare increases and/or capacity reductions. All three of these interested parties have now withdrawn their opposition to the Alliance in light of the capacity conditions proposed by the applicants.

Competitors in the market

5.261. The applicants submit that the Qantas Group, Emirates and a number of FFCs act as competitive constraints on the trans-Tasman.

5.262. The applicants identify Jetstar as a particularly strong competitive constraint arguing that:

- Jetstar faces no operational barriers to expansion
- Jetstar is an aggressive price competitor regardless of whether or not Qantas is also present on a route
- the potential impact of Jetstar's deployment on Qantas' yields must be considered in light of Jetstar's much lower cost base – it is the relative margin, not the relative fares which will determine which carrier is more profitable on a particular route
- the reduction in average fares brought about by the widespread deployment of Air New Zealand's new business model from November 2010 is likely to reduce Qantas' yields regardless of Jetstar entry, thus increasing the likelihood that continued Jetstar expansion is in the overall interests of the Qantas Group

- Jetstar has announced increases in capacity of over 40% in New Zealand since Pacific Blue announced its withdrawal – coupled with increases in capacity by Air New Zealand, this will more than replace Pacific Blue's withdrawn capacity.

5.263. The Qantas Group makes the following points about Jetstar.

- The mantra of the Qantas Group is group profitability not individual carrier profitability.

- Jetstar operates on a point to point basis, entering routes at a low cost base, without any route network focus but with a focus on predominately leisure routes.

- At Jetstar's launch, the Qantas Group decided that Jetstar should replace Qantas on a number of predominately leisure based routes. This allowed Qantas to remain on those routes with sufficient business and leisure demand or other network considerations.

- Decisions on the routes flown by the Qantas Group are made by the Flying Committee. The focus of the Committee has changed over time. At Jetstar's launch, Jetstar and Qantas focused on separate non-overlapping routes. There are now instances where both carriers operate on the same route.

- Decisions on the deployment of Jetstar are made on the basis of whether the route under consideration is predominately a leisure, business or combination route.

- It is correct that the Tasman as a whole is predominantly a leisure market and the business traffic represents a smaller proportion of the passenger traffic. This does not mean that Qantas can deploy Jetstar onto the Tasman without consideration of its impact on Qantas and total group profitability. This analysis would be performed on a route by route basis.

- The manner in which the Qantas Group deploys Jetstar has changed over time, however, a primary consideration for the Qantas Group remains to enhance Group profitability.

5.264. Taking these factors into account, the ACCC considers the competitive constraint posed by Jetstar on any given trans-Tasman route needs to be assessed in the context of that route and the likely strategic objectives of the Qantas Group.

5.265. Emirates makes the following points about its operations on the trans-Tasman.

- As an important competitive element on the trans-Tasman, Emirates operates wide bodied aircraft offering four daily return services. Emirates' unique selling point is that it offers three class service and global connectivity, however the combination of a restricted schedule, inflexible departure/arrival times (AU morning and NZ evening departures) in line with the broader network, limited frequency and aircraft-type, all constrain Emirates' ability to influence market dynamics on the routes.

- In terms of the passenger mix flying on Emirates' trans-Tasman services; Emirates pursues all market segments. Leisure traffic tends to dominate bookings due to scheduling, while demand for premium cabins is strongly supported across the business community and is augmented by 'through' passengers.

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- Traffic on the trans-Tasman routes has increased consistent with a maturing market. It's incorrect to characterise Emirates as an operator who could flood the market as the airline is constrained by its global schedule and the points that it can effectively operate. In 2009/10 Emirates carried approximately 9.95% of total trans-Tasman traffic.

5.266. These comments suggest to the ACCC that there are some limitations on the competitive constraint imposed by Emirates on the trans-Tasman. These are considered in more detail below in the ACCC's assessment of the Alliance's effect on competition on trans-Tasman routes.

5.267. The ACCC notes that some of the limitations identified above are also likely to apply to other FFCs operating in the market, and need to be taken into account when assessing the extent to which they represent competitive constraints on the Alliance.

Barriers to entry/expansion

5.268. The applicants submit that there are no material regulatory, commercial or operational barriers to entry or expansion on the Tasman with it being one of the most liberal international markets in the world.

5.269. They claim that competition on the Tasman will be maintained not just through competition among the existing operators but also the threat of expansion by Qantas and Jetstar and Emirates and of entry from other carriers with unutilised fifth freedom rights. The applicants also suggest that other substantial carriers in the region such as Tiger Airways may seek to enter the Tasman.

5.270. The ACCC notes however that there are still regulatory barriers to entry and expansion which impact on individual routes:

- while international air service agreements do provide access for a number of international airlines on a fifth freedom basis, those same agreements can also restrict the ports flown to and the number of flights to be operated

- airlines seeking to operate in the trans-Tasman market via the SAM are subject to the requirement that the carrier be owned and operated by nationals of either Australia or New Zealand. Tiger Airways submits that this requirement is a barrier to it entering the trans-Tasman market.

5.271. For carriers operating under the SAM arrangements there are no regulatory constraints affecting the level of frequency or capacity offered or the routes flown in the trans-Tasman market.

5.272. The Department of Infrastructure submits that the de-regulated nature of the SAM means that there are no economic regulatory barriers for new market entrants from either Australia or New Zealand. The Department of Infrastructure notes that there are similarly no barriers for existing market participants to add or change services and airlines can make air services decisions based solely on commercial considerations. The Department of Infrastructure submits that the SAM has also provided New Zealand airlines with the ability to operate services in the Australian domestic market, subject to safety considerations.

5.273. While access to airport facilities and services is not generally a barrier to entry or expansion, Auckland and Christchurch are the only New Zealand airports which can physically accommodate the wide bodied aircraft typically operated by FFCs. Effectively this means that FFCs cannot be regarded as contributing to any competitive constraint on routes not involving Auckland or Christchurch. This is noted by the New Zealand Airports Association.

5.274. Hamilton International Airport also submits that because only two New Zealand airports have runways long enough for long-haul aircraft the effect of the Alliance is likely to mean that only two organisations (Air New Zealand/Pacific Blue and Jetstar/Qantas) will be controlling most of the trans-Tasman destinations to New Zealand.

5.275. As long-haul carriers, FFCs are further constrained by global scheduling considerations which are likely to limit their ability to compete with a consolidated Air New Zealand or the Qantas Group on the basis of frequency.

5.276. There are a range of other operational factors which can constrain carriers from entering the market or existing carriers from expanding in the market. For new entrants such factors include the scale and scope of entry, capital requirements, profitability, sunk costs associated with advertising and marketing of trans-Tasman services and building brand recognition, and customer loyalty.

5.277. The ACCC notes that Pacific Wings, a new start-up Australian based airline, obtained rights from the IASC in June 2009 to fly on trans-Tasman sectors but has yet to commence operations. The ACCC further notes that the granting of such approval means that the airline has been able to satisfy the IASC in relation to technical requirements and in term of capital adequacy.

5.278. While the ACCC acknowledges that entry into the trans-Tasman and expansion onto additional routes is possible in response to the Alliance partners raising fares, it believes that such entry is more likely on some city pair routes than others and will take into account the nature of each route when examining the likelihood of such an entry acting as a competitive constraint on the Alliance.

Empirical analysis of trans-Tasman airfares

5.279. In support of their applications for authorisation, Virgin Blue and Air New Zealand provided a quantitative analysis of trans-Tasman airfares by Dr Tretheway.[65]

5.280. Dr Tretheway draws the following conclusions from his analysis of Air New Zealand's average fare data.

- An increase in the number of carriers operating on a route only has a small effect on Air New Zealand's average airfares – with an additional carrier reducing Air New Zealand's average airfares on the route by an estimated **[confidential]**. **EXCLUDED FROM PUBLIC REGISTER**

- An increase in market concentration on a route (measured by the HHI) has a small effect on Air New Zealand's average airfares.

- The presence of a low cost carrier (Pacific Blue or Jetstar) on a route reduces Air New Zealand's average airfares.

- The presence of Jetstar on a route has the highest impact in terms of reducing Air New Zealand's average airfares.

- The presence of Emirates on a route has an ambiguous effect on Air New Zealand's average airfares.

5.281. The ACCC has also undertaken an analysis of fares across trans-Tasman routes, using data provided by Air New Zealand. This is similar to the data Dr Tretheway used to undertake his analysis.

5.282. The ACCC's conclusions from its analysis of Air New Zealand's trans-Tasman airfares data differ in a number of respects to those drawn by Dr. Tretheway.[66] The ACCC's analysis indicates the following:

- The entry of particular carriers on trans-Tasman routes has had the effect of reducing Air New Zealand's average economy airfares – this suggests that actual competition on a route has had an effect over and above potential competition.

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[65] Dr Tretheway's analysis is reported in *Econometric Investigation of the Impact of Market Structure on Average Fares in trans-Tasman markets - using average fare data* attached to the Expert Statement of Dr. Michael W. Tretheway: *The Effects of the Australasian Airline Alliance Between the Pacific Blue Group and Air New Zealand*, 25 July 2010 as Appendix G. Dr Tretheway revised some of the results from his analysis in response to ACCC questions dated 1 September 2010. These revisions were not material.

[66] There are number of reasons for the differences in the results of the ACCC's analysis and those of Dr. Tretheway's analysis. The ACCC analysed Air New Zealand's airfares over the period July 2002 to July 2010. This covers the period of entry of Pacific Blue on trans-Tasman routes (which commenced in 2004). Dr. Tretheway concentrated his analysis on Air New Zealand's airfares over the period January 2006 to December 2009. The ACCC examined Air New Zealand's average economy airfares, where Dr. Tretheway concentrated his analysis on Air New Zealand's average total airfares. The ACCC considers it is more appropriate to examine economy airfares as the entry of Pacific Blue, Emirates or Jetstar on a route is more likely attract Air New Zealand's economy class passengers than its business class passengers. Dr Tretheway's analysis did not, in the ACCC's view, adequately address the significant heterogeneity in trans-Tasman routes. The ACCC used route-specific fixed effects to control for this heterogeneity.

- The entry of Pacific Blue on a trans-Tasman route has typically had the effect of reducing Air New Zealand's average economy fares by around 8% to 10%, with the larger effects on major routes such as Auckland-Sydney, Auckland-Melbourne and Auckland-Brisbane.

- The entry of Emirates on a trans-Tasman route has had the effect of reducing Air New Zealand's average economy fares by around 5% to 7%.

- The entry of Jetstar on a trans-Tasman route has had differing effects on Air New Zealand's average economy airfares. Specifically:

    - on routes where Qantas was not operating (eg Auckland-Gold Coast) Jetstar's entry has had the effect of reducing Air New Zealand's airfares by around 5% to 7%

    - on routes where Jetstar replaced Qantas (Christchurch-Melbourne and Christchurch-Brisbane) Jetstar's entry reduced Air New Zealand's airfares by around 4% to 6%

    - on routes where Qantas was operating and remains on the route (Christchurch-Sydney and Auckland-Sydney) the effect of Jetstar's entry on Air New Zealand's airfares is unclear – while Jetstar's entry on Christchurch-Sydney appeared to have no effect on Air New Zealand's average economy airfares, there is some evidence that Jetstar's entry on Auckland-Sydney may have had the effect of reducing Air New Zealand's average economy airfares by around 10%.

5.283. The analysis undertaken by the ACCC shows that Pacific Blue has been a significant competitor to Air New Zealand on trans-Tasman routes. The entry of Pacific Blue on trans-Tasman routes has had the effect of significantly reducing Air New Zealand's average economy fares. Air New Zealand has also lost significant share of passengers to Pacific Blue on trans-Tasman routes.

5.284. The analysis also suggests that Air New Zealand's airfares have been strongly constrained by Jetstar (especially on routes where Qantas is not operating) and Emirates.

5.285. The analysis is based on the effect on Air New Zealand's fares resulting from entry by these airlines on a route-by-route basis. As the Alliance will not result in the removal of Pacific Blue from the market, the results from the analysis cannot be used to predict the effects of the Alliance on Air New Zealand's airfares. [67]

5.286. However, the Alliance will eliminate the competitive rivalry between Air New Zealand and Pacific Blue. This will occur on a significant number of trans-Tasman routes including major ones such as Auckland-Sydney, Auckland-Melbourne and Auckland-Brisbane. The elimination of competitive rivalry creates scope for the Alliance to exercise market power (for example, through unilaterally raising airfares). Whether this will occur in practice depends on two key factors.

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[67] For example, just because the entry of Pacific Blue has had the effect of reducing Air New Zealand's average economy airfares by around 8% to 10%, it cannot be concluded that the Alliance will reverse that result.

5.287. The first factor is whether the Alliance generates benefits that will make the Alliance partners a more effective competitor than Air New Zealand or Pacific Blue acting independently. This issue has been discussed in more detail under **Public benefit**.

5.288. The second factor is the competitive constraint imposed by other carriers operating on trans-Tasman routes and their incentive and ability to expand capacity in the event that the Alliance partners attempt to exercise market power, whether through raising fares, reducing or withholding capacity or otherwise decreasing service quality.

5.289. In this regard, the analysis of Air New Zealand’s airfares suggests that Emirates and Jetstar have, in the past, provided a sufficient constraint on the Alliance partners’ pricing. Whether Emirates and Jetstar will provide a competitive constraint in the future depends on the propensity of those airlines to increase capacity (by a sufficient amount) and/or enter new routes in response to the Alliance partners increasing fares. This propensity is likely to differ across routes.

Effect on competition on trans-Tasman routes

5.290. In light of the preceding discussion, the ACCC has examined the potential impact of the Alliance on competition on the various routes constituting the trans-Tasman market.

5.291. In making this assessment the ACCC has had regard to the nature of the constraints provided by the other carriers operating on the trans-Tasman – that is, whether any of these carriers would have the incentive and/or ability to enter or increase capacity in response to the Alliance partners increasing fares, reducing capacity or otherwise reducing their service offering on a route.

5.292. The ACCC has paid particular attention to the extent of any constraint provided by the Qantas Group and Emirates.

5.293. In relation to the latter, the ACCC notes Emirates’ submission that the combination of a restricted schedule, inflexible departure/arrival times (Australian morning and New Zealand evening departures) in line with the broader network, limited frequency and aircraft-type, all constrain Emirates’ ability to influence market dynamics on the routes. This tends to suggest that Emirates would be less likely to increase its capacity on any trans-Tasman route in response to an increase in fares by the Alliance partners.

5.294. As a result, the following assessment of trans-Tasman routes places particular emphasis on the likely constraint posed by the Qantas Group.

5.295. The ACCC notes that there are significant differences between the operations of Qantas and Jetstar. As discussed earlier, Jetstar is an LCC operating on a point-to-point basis. Qantas is an FSA operating a network of services.

5.296. There are clear differences in the manner in which LCC and FSAs compete. The major point of difference for LCCs is price. FSAs compete on a broader range of factors including flight frequency and in-flight service.

5.297. The ability of LCCs to select more profitable routes, combined with their lower cost base, typically enables them to offer lower fares than FSAs. This makes them significant price competitors to FSAs. This can occur on routes where the passenger share of the LCC is small.

5.298. To the extent that Jetstar operates independently of Qantas on a route (i.e. Jetstar's behaviour on the route does not adversely affect the profitability of Qantas services), its competitive influence on airfares is likely to be similar to an independent LCC. Moreover, for a similar market share, Jetstar's influence on price is likely to be more significant than Qantas services operating on the same route.

5.299. As submitted by Qantas to the Australian Competition Tribunal, 'the level of competition between LCCs and FSAs was more intense than that between FSAs.'[68]

5.300. This is particularly the case in relation to price competition. As noted by the Tribunal:

> Overseas, and now local, experience shows that the result of the entry of an LCC into a market is an increased emphasis in the market on price competition, rather than service offerings." (para. 97)

5.301. While Qantas is likely to constrain the Alliance partners' service offering on a route, Jetstar (operating on routes in the absence of Qantas) is likely to pose a more significant constraint on the Alliance partners' fares.

5.302. There are a number of trans-Tasman routes where either Pacific Blue or Air New Zealand does not currently operate. In these cases, the ACCC has considered whether the Alliance has had an impact on competition by removing the potential entry of that airline onto that route.

5.303. As discussed in Chapter 4 of this determination, the trans-Tasman routes can be divided into major and minor ones.

Major trans-Tasman routes

5.304. The major trans-Tasman routes include:

1. The Christchurch routes:
    a. Christchurch-Sydney
    b. Christchurch-Melbourne
    c. Christchurch-Brisbane
2. The Auckland routes:
    a. Auckland-Sydney

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[68] (See Australian Competition Tribunal, re: Application for Review of the Determination of the Australian Competition and Consumer Commission made on 9 September 2003 denying authorisation in relation to Applications A30220, A30221, A30222, A90862 and A90863 (proposed acquisition by Qantas of ordinary shares in Air New Zealand and cooperative arrangements between Qantas, Air New Zealand and Air Pacific by Qantas Airways Limited (ABN 16 009 661 901) and Air New Zealand Limited (ABN 70 000 312 685), 16 May 2005, para 335)

b. Auckland-Melbourne

c. Auckland-Brisbane

3. The Wellington routes:

a. Wellington-Sydney

b. Wellington-Melbourne

c. Wellington-Brisbane

1. The Christchurch routes

a. Christchurch-Melbourne

5.305. There are three airlines operating on this route which in April 2010 accounted for 26,345 passengers (around 6% of total trans-Tasman traffic) with 11% of those passengers travelling for business purposes.

5.306. Table 5.1 below shows the number of flights operated by the three airlines and their share of capacity on the route.

Table 5.1 Scheduled services on Christchurch-Melbourne route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	6	29%
Air New Zealand	8	33%
Jetstar	8	38%

5.307. The Alliance would provide the applicants with a 64% share of flights and a 62% share of capacity.

5.308. The ACCC notes that Jetstar entered this route in 2005, completely replacing Qantas. The ACCC's empirical analysis indicates that this had the effect of reducing Air New Zealand's airfares by around 4% to 6%.

5.309. Looking forward, the ACCC considers that Jetstar is likely to operate more like an independent LCC on this route and act as a competitive constraint on the Alliance.

5.310. The ACCC considers it unlikely that the applicants would have the incentive or ability to unilaterally increase prices or reduce capacity on this route.

b. Christchurch-Brisbane

5.311. There are three airlines operating on this route which in April 2010 accounted for 28,638 passengers (around 6% of total trans-Tasman traffic) with 7% of those passengers travelling for business purposes.

5.312. Table 5.2 below shows the number of flights operated by the three airlines and their share of capacity on the route.

Table 5.2 Scheduled services on Christchurch-Brisbane route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	10	42%
Air New Zealand	8	29%
Jetstar	7	29%

5.313. The Alliance would provide the applicants with a 72% share of flights and a 71% share of capacity.

5.314. The ACCC notes that, like Christchurch-Melbourne, the Qantas Group fully replaced its Qantas capacity with Jetstar capacity on this route in 2005 and this had the effect of reducing Air New Zealand's airfares.

5.315. Again, the history of Jetstar's deployment on this route suggests to the ACCC that Jetstar is more likely to operate more like an independent LCC and act as a competitive constraint on the Alliance.

5.316. The ACCC considers it unlikely that the applicants would have the incentive or ability to unilaterally increase prices or reduce capacity on this route.

c. Christchurch-Sydney

5.317. There are five airlines operating on this route which in April 2010 accounted for 41,930 passengers (around 9% of total trans-Tasman traffic) with 10% of those passengers travelling for business purposes.

5.318. Table 5.3 below shows the number of flights operated by the five airlines and their share of capacity on the route.

Table 5.3 Scheduled services on Christchurch-Sydney route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	4	9%
Air New Zealand	11	21%
Jetstar	7	16%
Qantas	7	21%
Emirates	7	33%

5.319. The Alliance would provide the applicants with a 42% share of flights and a 30% share of capacity.

5.320. The applicants note that this was the first route to offer Air New Zealand's new product (that is, A320 aircraft with business class removed to increase seating from 152 to 171 and an unbundled product allowing passengers to choose one of four bundles ranging from a ‘seat only’ fare to a complete ‘Works Deluxe’ bundle) and the result was that lead-in fares on this route dropped by 26%.[69]

5.321. The ACCC’s empirical analysis suggests that the entry of Jetstar on this route did not have the effect of reducing Air New Zealand’s average airfares. This may be due to the fact that Qantas Group replaced half of its existing Qantas capacity with the entry of Jetstar and continued to operate both Qantas and Jetstar on the route.

5.322. Looking forward, the ACCC notes the similarities in the reasons for travel between the Christchurch-Sydney route and the Christchurch-Melbourne and Christchurch-Brisbane routes (where the Qantas Group completely replaced Qantas with Jetstar). Although it is not clear-cut, the ACCC considers the Qantas Group may be less concerned about any adverse effect on Qantas resulting from expanding Jetstar’s capacity in response to the Alliance partners raising prices on this route.

5.323. On balance, the ACCC considers that the Qantas Group is likely to act as a competitive constraint on the Alliance partners, such that they would be unlikely to unilaterally raise fares, reduce capacity or reduce their service offering on this route.

2. The Auckland routes

a. Auckland-Sydney

5.324. There are seven airlines operating on this route which in April 2010 accounted for 121,191 passengers (around 26% of total trans-Tasman traffic) with 21% of those passengers travelling for business purposes.

5.325. Table 5.4 below shows the number of flights operated by the seven airlines and their share of capacity on the route.

Table 5.4 Scheduled services on Auckland-Sydney route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	7	6%
Air New Zealand	33	31%
Jetstar	7	6%
Qantas	35	34%
Emirates	7	17%
Aerolineas Argentinas	4	3%
LAN Chile	5	3%

5.326. The Alliance would provide the applicants with a 41% share of flights and a 37% share of capacity.

5.327. For the reasons outlined at 5.293, the ACCC considers it unlikely that Emirates would increase its capacity on the Auckland-Sydney route in response to the Alliance partners raising fares. For similar reasons, the ACCC believes that Aerolineas Argentinas and

[69] *Submission in response to Draft Determination*, 11 October 2010, page 48.

LAN Chile would also be unlikely to increase capacity on the route in response to the Alliance partners raising fares.

5.328. For the reasons discussed earlier, the ACCC considers that Qantas is more likely to act as a constraint on the applicants' service offering than on their pricing on this route.

5.329. Jetstar entered this route in May 2009. The empirical evidence suggests that this had the effect of significantly decreasing Air New Zealand's airfares although it is difficult to be precise about this effect because Jetstar's entry coincided with Emirates' introduction of A380 aircraft on this route.

5.330. Based on the information available, it is not clear to the ACCC whether the Qantas Group would be likely to expand Jetstar's capacity in response to the Alliance partners raising fares or reducing capacity on this route. However, the ACCC does note that Jetstar's capacity on this route is similar to Pacific Blue's, and it probably would not require much additional Jetstar capacity to act as a constraint.

5.331. On balance, the ACCC considers that the Qantas Group is likely to act as a competitive constraint on the Alliance partners, such that they would be unlikely to unilaterally raise fares, reduce capacity or reduce their service offering on this route.

b. Auckland-Melbourne

5.332. There are currently four airlines operating on this route which in April 2010 accounted for 67,141 passengers (around 15% of total trans-Tasman traffic) with 23% of those passengers travelling for business purposes.

5.333. Jetstar will commence operations on this route in December 2010.

5.334. Table 5.5 below shows the number of flights operated by the current four airlines and their share of capacity on the route.

Table 5.5 Scheduled services on Auckland-Melbourne route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	7	13%
Air New Zealand	14	32%
Qantas	21	36%
Emirates	7	19%

5.335. The Alliance would provide the applicants with a 43% share of flights and a 45% share of capacity.

5.336. For the reasons outlined at 5.293, the ACCC considers it unlikely that Emirates would increase its capacity on the Auckland-Melbourne route in response to the Alliance partners raising fares.

5.337. For the reasons discussed earlier, the ACCC considers that Qantas is more likely to act as a constraint on the applicants' service offering than on their pricing on this route.

5.338. The Qantas Group has announced its intention to deploy Jetstar with a daily service on this route from December 2010, which creates a similar competitive structure to Auckland-Sydney. As with that route, there is uncertainty about whether the Qantas Group would be likely to further expand Jetstar's capacity in response to the Alliance partners raising fares or reducing capacity on this route. Again, however, the ACCC notes that Jetstar's capacity on this route will be similar to Pacific Blue's, and it probably would not require much additional Jetstar capacity to act as a constraint.

5.339. On balance, the ACCC considers that the Qantas Group is likely to act as a competitive constraint on the Alliance partners, such that they would be unlikely to unilaterally raise fares, reduce capacity or reduce their service offering on this route.

c. Auckland-Brisbane

5.340. There are four airlines operating on this route which in April 2010 accounted for 58,496 passengers (around 13% of total trans-Tasman traffic) with 13% of those passengers travelling for business purposes.

5.341. Table 5.6 below shows the number of flights operated by the four airlines and their share of capacity on the route.

Table 5.6 Scheduled services on Auckland-Brisbane route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	7	14%
Air New Zealand	20	44%
Qantas	14	22%
Emirates	7	20%

5.342. The Alliance would provide the applicants with a 56% share of flights and a 58% share of capacity.

5.343. In the draft determination, the ACCC considered that the Alliance partners would be likely to unilaterally raise fares on this route. The ACCC reached this view in light of uncertainty about the competitive constraint posed by Qantas and Emirates on this route.

5.344. In response to the draft determination, the applicants submit the following.

- Qantas is, and will remain, a significant competitor on this route.
- Emirates has announced that it is up-gauging its aircraft on this route from an A340 to a B777 which represents a 38% increase in Emirates' capacity (from 258 seats per day to 356 seats per day).
- The heavy leisure orientation of passengers on this route means that a substantial proportion of passengers would consider the Auckland-Gold Coast route to be a viable substitution service. This is supported by Virgin Blue's internal analysis of the passengers it carries on its Auckland-Brisbane and Auckland-Gold Coast services.

- Jetstar is likely to enter because:
  - there are approximately seven leisure passengers for every one business passenger on this route, and these passengers will be particularly attracted to a low priced Jetstar offer
  - the route is large enough to support both Qantas and Jetstar services given that
    - the Auckland-Brisbane route is only slightly smaller in terms of passenger numbers than the Auckland-Melbourne route and is larger than the Christchurch-Sydney route, which are both routes on which both Qantas and Jetstar operate services
    - Auckland-Brisbane is a larger route than many of the Australian routes operated by both Qantas and Jetstar
    - the fact that Jetstar already operates on the Auckland-Gold Coast route is unlikely to stop Jetstar entering Auckland-Brisbane if it believes it is profitable to do so
    - Jetstar already operates on the Christchurch-Brisbane and Christchurch-Gold Coast routes which attract less than half the number of passengers than the same routes to Auckland
    - both Virgin Blue and Air New Zealand operate services on both the Auckland-Brisbane and Auckland-Gold Coast routes.
- There is a likelihood of further FFC entry onto this route. The applicants note that from 1 January 2011, China Airlines will offer A330-300 Brisbane-Auckland services three times per week. The applicants also submit that China Southern Airlines has announced its intention to extend its terminating Brisbane services on to Auckland, and that Air Asia X has announced its intention to enter the trans-Tasman and is considering services between Auckland and the Gold Coast.

5.345. The ACCC acknowledges that Emirates is up-gauging its aircraft on this route from an A340 to a B777. However, Emirates submits that this provides additional capacity of 96 seats which is in direct response to strong demand on the route and is marginal when looking at the total capacity offered by other market players.

5.346. Emirates adds that it is incorrect to characterise it as an operator who could flood the market, as the airline is constrained by its global schedule and the points that it can effectively operate.

5.347. The ACCC also acknowledges that China Airlines intends to commence operations on this route from 2011. However, for similar reasons to those articulated by Emirates, the ACCC is of the view that China Airlines and other prospective FFCs are likely to have limited incentive and ability to expand capacity in response to the Alliance partners raising fares.

5.348. As a result, the ACCC considers that Emirates and other FFCs offer a limited competitive constraint on this route.

5.349. The ACCC has given further consideration to the competitive constraints on the Alliance partners' pricing on Auckland-Brisbane.

5.350. For the reasons discussed earlier, the ACCC considers that Qantas is more likely to act as a constraint on the applicants' service offering than on their pricing on this route.

5.351. Turning to Jetstar, the ACCC notes the pattern of its deployment on the other Auckland routes where Qantas continues to operate. On Auckland-Sydney, Jetstar has been operating for around 18 months with a similar amount of capacity to Pacific Blue. Around 12 months after commencing services on Auckland-Sydney, Jetstar announced that it will be entering the Auckland-Melbourne route with about the same capacity that Pacific Blue currently operates.

5.352. It is relevant to note that the Auckland-Brisbane route attracts relatively less business passengers (13%) than either of Auckland-Sydney (21%) or Auckland-Melbourne (23%). This would tend to suggest that the Qantas Group may be less concerned about any adverse effect on Qantas resulting from the deployment of Jetstar on the Auckland-Brisbane route.

5.353. On the other hand, it is relevant to note the relativities of the Qantas Group operations on the Auckland routes. That is, on Auckland-Sydney there are five Qantas flights per day and one Jetstar flight while on Auckland-Melbourne there are three Qantas flights per day and one Jetstar flight. On Auckland-Brisbane there are only two Qantas flights per day so the introduction of one Jetstar flight per day would represent a 50% increase in the Qantas Group flights on that route, compared to a 20% increase on Auckland-Sydney and a 33% increase on Auckland-Melbourne.

5.354. The ACCC also notes that the applicants have provided evidence in support of their submission that the high proportion of relatively price sensitive leisure passengers on this route makes Auckland-Gold Coast services a viable substitute. This information would tend to suggest that any fare increase by the Alliance partners may be constrained by passengers switching to the Auckland-Gold Coast route (which is serviced by Pacific Blue, Air New Zealand and Jetstar).

5.355. Ultimately, the information currently available makes it difficult to be definitive about the likely effect of the Alliance on competition on this route. The ACCC remains concerned about the ability of the Alliance partners to raise prices or reduce capacity given the existing competitors. However, the ACCC acknowledges that entry onto the route by Jetstar and/or the viability of the Auckland-Gold Coast route as a substitute, while uncertain, cannot be ruled out.

3. The Wellington routes

a. Wellington-Sydney

5.356. There are three airlines operating on this route which in April 2010 accounted for 22,761 passengers (around 5% of total trans-Tasman traffic) with 24% of those passengers travelling for business purposes.

5.357. Table 5.7 below shows the number of flights operated by the three airlines and their shares of capacity and traffic on the route. Pacific Blue entered this route in March 2004, subsequently withdrew in June 2005 and then re-entered in September 2009.

Table 5.7 Scheduled services on Wellington-Sydney route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	4	18%
Air New Zealand	9	33%
Qantas	14	49%

5.358. The Alliance would provide the applicants with a 48% share of flights and a 51% share of capacity.

5.359. In the draft determination, the ACCC concluded that the Alliance partners would be likely to unilaterally raise fares on this route. The ACCC reached this view on the basis that Qantas would be unlikely to deploy Jetstar on the route given the significant proportion of business passengers and the operational barriers to entry facing FFCs.

5.360. In response to the draft determination, the applicants submit the following.

- The analysis overlooks the constraint provided by Qantas which effectively yield manages to attract both price sensitive leisure passengers and price insensitive business passengers.

- The applicants consider they will be able to win business passengers from Qantas, consistent with a key rationale of the Alliance.

- Air New Zealand’s new business model is likely to reduce average fares, making Jetstar deployment more likely.

5.361. The ACCC remains concerned about the lack of competitive constraints on the Alliance partners on this route.

5.362. It is a matter of fact that Wellington Airport cannot physically accommodate the wide bodied aircraft typically operated by FFCs and therefore, FFCs cannot impose any competitive constraint on this route.

5.363. The ACCC acknowledges that Qantas has a well developed yield management strategy for price discriminating between price sensitive passengers and other passengers. However, the ACCC notes that there are other considerations relevant to an airline’s passenger mix – indeed, the Qantas Group states that the rationale for the creation of Jetstar was that a mixed product offering could start to damage the Qantas brand.

5.364. For the reasons discussed earlier, the ACCC considers that Qantas is more likely to act as a constraint on the applicants’ service offering than on their pricing on this route.

5.365. Significantly, the Qantas Group also states that it has not historically deployed Jetstar on routes to and from Wellington because of the strong government and business demand into that city and the thin nature of the routes. The ACCC has not been provided with any information that suggests that these factors are likely to change in the foreseeable future and therefore, the ACCC considers it unlikely that Jetstar will enter the Wellington-Sydney route.

5.366. Although it appears that Pacific Blue will remain on the route, the ACCC considers that the Alliance will alter its incentives in such a way that Pacific Blue will no longer represent the sort of competitive pressure that an independent LCC would typically create.

5.367. The ACCC considers that the Alliance partners face limited competitive constraints on this route and as a result, would have the incentive and ability to raise fares or reduce capacity.

b. Wellington-Melbourne

5.368. There are only two airlines operating on this route which in April 2010 accounted for 12, 524 passengers (around 3% of total trans-Tasman traffic) with 24% of those passengers travelling for business purposes.

5.369. Table 5.8 below shows the number of flights operated by the two airlines and their shares of capacity and passenger traffic on the route. Pacific Blue has not entered this route to date.

Table 5.8 Scheduled services on Wellington-Melbourne route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Air New Zealand	7	51%
Qantas	7	49%

5.370. In the draft determination, the ACCC concluded that the Alliance will remove a significant competitive constraint on this route, namely the threat of Pacific Blue entering as an independent competitor.

5.371. The applicants submit that the Alliance will not result in any lessening of competition on this route because Pacific Blue does not operate on it.

5.372. The ACCC remains of the view that entry by Pacific Blue on this route is a key competition issue. In this regard, the ACCC notes that Pacific Blue has demonstrated a propensity to operate on the Wellington routes, with over 50% of capacity on Wellington-Brisbane and entry into Wellington-Sydney (which has a similar level of business traffic) in 2009.

5.373. Based on the information available, the ACCC believes that entry by Pacific Blue onto the Wellington-Melbourne route absent the Alliance could not be ruled out in the medium term and would likely have had an impact of fares especially for leisure travellers.

5.374. The ACCC considers that the Alliance will remove a significant competitive constraint on this route, namely the threat of Pacific Blue entering as an independent competitor.

c. Wellington-Brisbane

5.375. Pacific Blue and Air New Zealand are the only two airlines operating on this route which in April 2010 accounted for 14,148 passengers (around 3% of total trans-Tasman traffic) with 8% of those passengers travelling for business purposes.

5.376. Table 5.9 below shows the number of flights operated on the route and airlines' capacity shares. Pacific Blue entered the route in September 2008.

Table 5.9 Scheduled services on Wellington-Brisbane route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	7	54%
Air New Zealand	7	46%

5.377. The Alliance would provide the applicants with a monopoly on this route.

5.378. In the draft determination, the ACCC concluded that the Alliance partners would unilaterally raise fares on this route.

5.379. In response to the draft determination, the applicants submit the following.

- There are no barriers to Jetstar entry onto this route.
- Qantas does not operate on this route so there is no consideration of balancing any purported competing interests of the Qantas and Jetstar brands.
- The route is around three times the size of the Auckland-Cairns route which Jetstar has recently entered and the Christchurch-Gold Coast route which Jetstar has operated for some time. It is also around the same size as many other Tasman routes on which Jetstar operates.
- Recent experience in the New Zealand domestic market provides ample evidence of Jetstar's ability to move quickly to deploy capacity in response to any business opportunity.

5.380. The ACCC notes the points raised by the applicants. However, the ACCC also notes the Qantas Group's submission that it has not historically deployed Jetstar on routes to and from Wellington because of the strong government and business demand into that city and the thin nature of the route.

5.381. The ACCC recognises that the level of business traffic on Wellington-Brisbane is lower than on Wellington-Sydney and Wellington-Melbourne. However, it remains unclear whether deployment of Jetstar on Wellington-Brisbane would fit the strategic objectives of the Qantas Group.

5.382. The ACCC considers that the Alliance partners face limited competitive constraints on this route and as a result, would have the incentive and ability to raise fares, reduce capacity or otherwise reduce their service offering.

Minor trans-Tasman routes

5.383. There are ten minor trans-Tasman routes which include:

- Auckland-Adelaide
- Auckland-Cairns
- Auckland-Gold Coast
- Auckland-Perth
- Christchurch-Gold Coast
- Dunedin-Brisbane
- Hamilton-Brisbane
- Hamilton-Sydney
- Queenstown-Sydney
- Rotorua-Sydney

5.384. These are grouped below into those routes raising competition concerns and those that are unlikely to do so.

Minor trans-Tasman routes which may raise competition concerns

Dunedin-Brisbane

5.385. Pacific Blue and Air New Zealand are the only two airlines operating on this route which in April 2010 accounted for 4,848 passengers (around 1% of total trans-Tasman traffic).

5.386. Table 5.10 below shows the number of flights operated on the route and airlines' capacity and traffic shares. Pacific Blue entered the route in September 2009. Air New Zealand was previously on the route but left in October 2009 following the entry of Pacific Blue only to re-enter in April 2010.

Table 5.10 Scheduled services on Dunedin-Brisbane route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	3	64%
Air New Zealand	2	36%

5.387. The Alliance would provide the applicants with a monopoly on this route.

5.388. In the draft determination, the ACCC concluded that the Alliance partners would unilaterally raise fares on this route.

5.389. In response to the draft determination, the applicants submit the following.

- This route is currently operated year round by Pacific Blue and on a seasonal basis by Air New Zealand (four months of the year), therefore the extent of any aggregation is only for a third of the year.

- There is nothing to stop Jetstar entry onto this route – Qantas does not operate on it.

- The experience in domestic New Zealand suggests that were the applicants to reduce capacity on this route, Jetstar would be likely to respond to such an opportunity by entering quickly.

5.390. It remains unclear to the ACCC whether the level of traffic on this route is such that an increase in fares under the Alliance would see another carrier enter the route.

5.391. The ACCC considers that the Alliance partners face limited competitive constraints on this route and as a result, would have the incentive and ability to raise fares, reduce capacity or otherwise reduce their service offering.

Queenstown-Sydney

5.392. There are three airlines operating on this route which in April 2010 accounted for 5,543 passengers (around 1% of total trans-Tasman traffic) with 8% of those passengers travelling for business purposes.

5.393. Table 5.11 below shows the number of flights operated by the three airlines and their share of capacity on the route. Air New Zealand and Qantas are long term participants on the route. Pacific Blue entered the route in September 2009.

Table 5.11 Scheduled services on Queenstown-Sydney route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	2	35%
Air New Zealand	1	15%
Qantas	3	50%

5.394. This route has seasonal elements and in winter caters for snowfields traffic. Qantas used to service the route on a seasonal basis but has recently moved to operating three services per week all year round. Pacific Blue operates its twice weekly services all year round as well. However Air New Zealand adjusts its schedule according to the season with number of flights varying between one and five per week.

5.395. The Alliance would provide the applicants with a 50% share of flights at low season and a 70% share at peak season.

5.396. In the draft determination, the ACCC concluded that the Alliance partners would unilaterally raise fares on this route.

5.397. In response to the draft determination, the applicants submit the following.

- This is a seasonal tourism route with ‘over 9 out of every 10’ passengers flying for non-business purposes.

- Jetstar has recently announced its entry from December 2010 onto the Gold Coast-Queenstown and Melbourne-Queenstown routes.

- There is nothing to suggest that the Qantas Group would not deploy both the Qantas and Jetstar brands on this route, consistent with its strategy on Melbourne-Queenstown, which will soon be operated by both Qantas and Jetstar. This is the best evidence of the Qantas Group’s likely strategy on Sydney-Queenstown.

- The effect of Air New Zealand’s new business model will increase the likelihood Jetstar will be deployed.

5.398. The ACCC has given further consideration to the competitive constraints faced by the applicants on this route.

5.399. For the reasons discussed earlier, the ACCC considers that Qantas is more likely to act as a constraint on the applicants’ service offering than on their pricing on this route.

5.400. The ACCC notes that the recent pattern of deployment of Jetstar on Queenstown-Melbourne and Queenstown-Gold Coast may provide some indication of whether Jetstar is likely to be deployed on Queenstown-Sydney in response to the Alliance partners raising fares. However, it remains to be seen whether the deployment of Jetstar on this route meets the strategic objectives of the Qantas Group.

5.401. Ultimately, there are uncertainties about the extent of the competitive constraints on this route, such that the ACCC remains concerned about the ability of the Alliance partners to raise prices or reduce capacity.

Minor trans-Tasman routes that are unlikely to raise competition concerns

Auckland-Adelaide

5.402. Air New Zealand is currently the only airline operating on this route with five services per week. In April 2010 the route accounted for 5,327 passengers (around 1% of total trans-Tasman traffic) with 18% of those passengers travelling for business purposes.

5.403. The key issue in this case is whether absent the Alliance, Pacific Blue might have entered the route offering competition to Air New Zealand.

5.404. In the ACCC’s view, the basis for any assumption that Pacific Blue would have entered this route would also apply to potential entry by Jetstar.

5.405. The ACCC considers that the Alliance does not remove the threat of competitive entry on this route.

Auckland-Cairns

5.406. Pacific Blue and Air New Zealand are the only two airlines operating on this route which in April 2010 accounted for 4,344 passengers (around 1% of total trans-Tasman traffic) with 7% of those passengers travelling for business purposes.

5.407. Table 5.12 below shows the number of flights operated on the route and airlines' capacity and traffic shares.

Table 5.12 Scheduled services on Auckland-Cairns route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	2	44%
Air New Zealand	3	56%

5.408. Prior to the draft determination, Cairns Airport provided a submission prepared for it by Access Economics Pty Limited. Cairns Airport submitted that the Alliance is likely to result in substantial anti-competitive detriment and higher airfares on the Cairns-Auckland route because there is no competition from the Qantas-Jetstar Group or Emirates on the route.

5.409. Since that submission was lodged, Jetstar has announced it will be operating three services per week on this route from 12 April 2011.

5.410. The ACCC considers that Jetstar is likely to operate more like an independent LCC on this route and act as a competitive constraint on the Alliance.

5.411. The ACCC considers it unlikely that the Alliance partners would have the incentive or ability to unilaterally increase prices or reduce capacity on this route.

Auckland-Gold Coast

5.412. There are three airlines operating on this route which in April 2010 accounted for 22,628 passengers (around 5% of total trans-Tasman traffic) with 7% of those passengers travelling for business purposes.

5.413. Table 5.13 below shows the number of flights operated by the three airlines and their share of capacity on the route.

Table 5.13 Scheduled services on Auckland-Gold Coast route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Pacific Blue	7	39%
Air New Zealand	5	23%
Jetstar	7	38%

5.414. The Alliance would provide the applicants with a 63% share of flights and a 62% share of capacity.

5.415. The ACCC's empirical analysis indicates that Jetstar's entry onto this route had the effect of reducing Air New Zealand's airfares by around 5% to 7%.

5.416. The ACCC considers that Jetstar is likely to operate more like an independent LCC on this route and act as a competitive constraint on the Alliance.

5.417. The ACCC considers it unlikely that the Alliance partners would have the incentive or ability to unilaterally increase prices or reduce capacity on this route.

Auckland-Perth

5.418. Air New Zealand is currently the only airline operating on this route with daily services using wide bodied B767-300 aircraft. In April 2010 the route accounted for 11,397 passengers (around 3% of total trans-Tasman traffic) with 13% of those passengers travelling for business purposes.

5.419. The key issue in this case is whether absent the Alliance, Pacific Blue might have entered the route offering competition to Air New Zealand.

5.420. The length of this route is at the extreme limit of the range of the B737 aircraft used by Virgin Blue in Australia and Pacific Blue on the trans-Tasman. Any assumption that Pacific Blue might enter this route would need to be predicated by the willingness of Pacific Blue to acquire long range aircraft suitable for the task. Under these circumstances it would be difficult to predict with any confidence that Pacific Blue might have entered this route in the future.

5.421. The ACCC considers that the Alliance does not remove the threat of competitive entry on this route.

Christchurch-Gold Coast

5.422. Air New Zealand and Jetstar are the only two airlines operating on this route which in April 2010 accounted for 4,070 passengers (around 1% of total trans-Tasman traffic) with 4% of those passengers travelling for business purposes.

5.423. Table 5.14 below shows the number of flights operated on the route and airlines' capacity and traffic shares.

Table 5.14 Scheduled services on Christchurch-Gold Coast route

Airline	Flights per week April 2010	Share of seats offered per week April 2010
Air New Zealand	2	46%
Jetstar	2	54%

5.424. The ACCC considers that Jetstar is likely to operate more like an independent LCC on this route and act as a competitive constraint on the Alliance.

5.425. The ACCC considers it unlikely that the Alliance partners would have the incentive or ability to unilaterally increase prices or reduce capacity on this route.

Hamilton-Brisbane

5.426. Pacific Blue is currently the only airline operating on this route with three services per week. In April 2010 the route accounted for 2,913 passengers (around 1% of total trans-Tasman traffic) with 5% of those passengers travelling for business purposes. Pacific Blue commenced this service in September 2009.

5.427. The key issue in this case is whether absent the Alliance, Air New Zealand might have entered the route offering competition to Pacific Blue.

5.428. Given the thinness of the route and the apparent long term lack of interest by Air New Zealand it would be difficult to assume that Air New Zealand might otherwise enter the route.

5.429. The ACCC considers that the Alliance does not remove the threat of competitive entry on this route.

Hamilton-Sydney

5.430. Pacific Blue is currently the only airline operating on this route with two services per week. In April 2010 the route accounted for 2,139 passengers (around 1% of total trans-Tasman traffic) with around 10% of those passengers travelling for business purposes. Pacific Blue commenced this service in September 2009.

5.431. As with the Hamilton-Brisbane route it would be difficult to assume that Air New Zealand might enter this route absent the Alliance.

5.432. The ACCC considers that the Alliance does not remove the threat of competitive entry on this route.

Rotorua-Sydney

5.433. Air New Zealand is currently the only airline operating on this route with two services per week. In April 2010 the route accounted for 1,755 passengers (less than 1% of total trans-Tasman traffic). Air New Zealand commenced this service recently in December 2009.

5.434. This appears to be a niche route under development by Air New Zealand and current traffic levels are such that Pacific Blue is unlikely to enter absent the Alliance.

5.435. The ACCC considers that the Alliance does not remove the threat of competitive entry on this route.

Summary of effect on competition on trans-Tasman city pair routes

5.436. The ACCC considers that the Alliance is likely to result in material competition issues on the following trans-Tasman routes:

- Wellington-Sydney
- Wellington-Melbourne

- Wellington-Brisbane
- Dunedin-Brisbane

and may adversely affect competition on:

- Auckland-Brisbane
- Queenstown-Sydney.

Likelihood of coordinated effects

5.437. The ACCC has considered the extent to which the Alliance may enhance the ability or incentives of airlines operating on trans-Tasman routes to coordinate their pricing, output or related commercial decisions.

5.438. In assessing whether the likelihood of coordinated effects is increased by the Alliance, the ACCC has had regard to the conditions for explicit and/or tacit coordination in the counterfactual (absent Alliance) and factual (with Alliance) worlds. The ACCC took into account factors that potentially facilitate coordination and factors that potentially constrain coordination.

5.439. The ACCC investigated two important sources of constraint on coordination that may be affected by the Alliance. These are:

- the effect of the Alliance on market concentration on the trans-Tasman; and
- the effect of the alliance on maverick conduct on the trans-Tasman.

Effect of the alliance on market concentration on the trans-Tasman

5.440. The ACCC considers that the increased market concentration as a result of the Alliance could potentially enhance the ability and incentive of airlines operating on the trans-Tasman to engage in coordinated conduct by:

- allowing the Alliance to achieve a strong position in the trans-Tasman market. From this position of strength, there is an increased likelihood of the Alliance being acknowledged as the price leader and other airlines following the Alliance's price leadership.
- reducing the size of the coordination task by effectively reducing the number of airlines contesting the trans-Tasman. As a result of the Alliance, only four of the trans-Tasman routes are effectively contested by three or more airlines. Absent the Alliance, nine trans-Tasman routes are effectively contested by three or more airlines.

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5.441. However, the ACCC considers that increased market concentration by itself is unlikely to significantly enhance the likelihood of coordinated effects under the Alliance.

Effect of the Alliance on maverick conduct on the trans-Tasman

5.442. The ACCC's analysis of fare data on trans-Tasman routes suggests that historically Pacific Blue has behaved as a maverick[70] on the trans-Tasman, wielding price influence that is disproportionate to its market share.

5.443. In the draft determination, the ACCC was concerned that the Alliance effectively removes this maverick from the trans-Tasman market and that this could spell the difference between effective and ineffective coordination on the trans-Tasman.

5.444. Maverick firms have a strong economic incentive to deviate from the terms of coordination (i.e. strong incentives to cheat) relative to other firms in a market. This is because the expected payoff from deviating (increased sales) often substantially exceeds the expected payoff from complying with the terms of coordination, given their position in the market.

5.445. Mavericks can disrupt coordination by initiating price wars, aggressively discounting or by not following rivals attempts to raise the market price. The ACCC considers that Pacific Blue's ability to disrupt coordination on trans-Tasman routes stems from its independence from other airlines, relatively low cost structure, and available capacity.

5.446. The ACCC considers that Jetstar, as a result of its governance arrangements and very close relationship with Qantas, cannot be relied on to initiate price wars, aggressively discount and/or refuse to follow any attempt by the Alliance to raise the market price to the same extent as a standalone maverick LCC on all routes where Qantas is present.

5.447. On routes where Jetstar is present but not Qantas, the ACCC considers there is some risk that an attempt by Jetstar to disrupt coordination could be met by a reaction from the Alliance on other routes, which could have the overall effect of making the Qantas-Jetstar group worse off relative to a situation where Jetstar complies with the terms of coordination. This could deter maverick-like conduct by Jetstar on such routes.

5.448. On some routes where Qantas is present, but not Jetstar (e.g. the Wellington routes), the ACCC considers that Jetstar may not have a commercial incentive to disrupt coordination unless the reward for such conduct at least matched the payoff to the Qantas Group as a whole for complying with the terms of coordination.

5.449. Overall, this leads the ACCC to conclude that Jetstar cannot be relied on to behave in the same way as a standalone maverick LCC on the trans-Tasman.

5.450. However, there is conflicting information on whether it would be reasonable to expect that Pacific Blue absent the Alliance would behave as it has historically on the trans-Tasman.

5.451. On the one hand, the applicants submit that the Alliance will not remove Pacific Blue's low cost product from the market.[71]

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[70] A maverick firm is a firm with a relatively small market share in a particular industry that is considered a vigorous and effective competitor and which generally drive significant aspects of competition, such as pricing, innovation and/or product development.

[71] Applicants' submission, 11 October, page 41

5.452. On the other hand, Virgin Blue has indicated that Pacific Blue's Tasman services were loss-making in 2009 and again in 2010. Virgin Blue submits that while the likely counterfactual is that Pacific Blue will maintain a Tasman presence, it cannot be assumed that Pacific Blue will continue to expand its services and add capacity as it has in the past. In fact, Virgin Blue submits it is more likely that Pacific Blue will cut Tasman capacity in order to reduce its losses and to more profitably redeploy capacity, as it has on other loss-making route.[72]

5.453. The ACCC notes that Virgin Blue CEO, John Borghetti, recently informed shareholders at the company's annual general meeting in Brisbane on 24 November that the Virgin Group is implementing a 'game change program with a view to increasing the carrier's share of the corporate traveller segment of the market. At the same meeting, the chairman of Virgin Blue, Neil Chatfield, stated that while Virgin Blue was not abandoning the leisure segment of the market 'the airline's "initial no frills, low-cost carrier model is well behind us. That segment has become highly commoditised and best left to others.'[73]

5.454. While Pacific Blue would continue to act as a significant competitive constraint in the absence of the Alliance, it is unclear whether it would continue to operate as a maverick on trans-Tasman routes. It appears that the change in Virgin Blue's business model, which will proceed absent the Alliance, will change the way that Pacific Blue competes on the trans-Tasman over the next five years.

5.455. As noted above, the relevant question is whether the Alliance increases the likelihood of coordinated conduct relative to the situation in the absence of the Alliance. The change in the business model Pacific Blue plans to employ on the trans-Tasman combined with its recent poor financial performance suggests that Pacific Blue's influence as a maverick on trans-Tasman routes will weaken with or without the Alliance.

5.456. The ACCC is of the view that it is unlikely that the Alliance will substantially increase the likelihood of coordinated conduct on trans-Tasman routes.

Trans-Tasman air freight

5.457. The applicants submit that the Alliance will have no impact on the freight market, noting that:

- freight services, including freighter operations and cargo belly space on scheduled flights, are explicitly excluded from the Alliance

- Pacific Blue and Air New Zealand do not directly compete for the provision of freight services – Pacific Blue subcontracts its freight services by selling its cargo belly space to Toll Air Express who controls the yield management and retail rates for freight services.

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[72] Letter from applicants to ACCC dated 10 December 2010, p.1.
[73] 24 November 2010, 'Virgin Blue flags capacity growth', AAP story reported by News.com.au, available at http://www news.com.au/business/breaking-news/virgin-blue-flags-capacity-growth/story-e6frfkur-1225960149334

5.458. According to the applicants, in 2009, Air New Zealand carried 34.4%, Qantas carried 27%, and Emirates carried 21.4% of freight on the Tasman while Pacific Blue carried only 1%.

5.459. The applicants note that the majority of freight on the Tasman is transported on the main routes between Sydney/Melbourne/Brisbane and Auckland/Christchurch as these gateways are the main sources of and destinations for freight. The applicants state that freight bound for other locations is most commonly transported by indirect routes.

5.460. The applicants also note that other than on specialist freighter service routes, freight is usually carried in the cargo hold of wide-body aircraft rather than the narrow-body aircraft operated by Pacific Blue.

5.461. The applicants consider it possible that most of the Auckland routes will be operated by Air New Zealand, utilising wide-body aircraft. In this scenario, Toll Air Express would be unable to contract with Pacific Blue to utilise its belly space on those routes where Pacific Blue would no longer operate. However, the applicants claim that this would have no effect on competition because:

- even if Air New Zealand and Pacific Blue competed in the sale of cargo belly space to Toll, the share of freight carried across the Tasman in the belly of Pacific Blue planes is negligible
- there is significant amount of wide body capacity available and Toll Air Express would be able to acquire alternative belly space on the route from any of Qantas, Emirates or Air New Zealand
- the loss of any potential competition between Air New Zealand and Pacific Blue for the supply of belly space to Toll Air Express (or other freight companies) would not affect prices because Toll Air Express negotiates rates on a network wide basis and not on a route by route basis
- Pacific Blue would continue to offer cargo belly space on other routes.

5.462. Wellington International Airport considers there to be a competition risk that cooperation under the Alliance would leak into other markets including the trans-Tasman freight market.

5.463. The ACCC considers that the Alliance is unlikely to adversely impact the market for trans-Tasman freight, taking into account:

- the small market share held by Pacific Blue
- the availability of indirect route options and
- the existence of other carriers including Qantas and Emirates, FFCs and specialist freight operators.

The sale of air travel

5.464. The ACCC considers that the Alliance is unlikely to adversely affect the market for the sale of air travel given the wide range of mechanisms for ticket purchases available to consumers.

5.465. The ACCC notes that while the Alliance provides for both airlines to sell directly to the public and the applicants would be involved in joint marketing of their services, there is strong competition in the sale of air travel from travel agencies (online and in shop fronts) as well as increasingly from the internet through global portals such as Zuji, Expedia and Webjet.

Australian domestic air passenger services

5.466. As noted above, the primary way that an international alliance could lessen competition for domestic services is where the alliance directs domestic on-carriage or feeder traffic to a particular carrier (in this case Pacific Blue) at the expense of the competitive position of other domestic carriers.

5.467. The applicants submit that domestic networks are outside of the scope of the Alliance except to the extent that a particular service is part of an online connecting service across the Tasman. In this regard, the ACCC notes that the volume of passengers that would constitute feeder traffic for Pacific Blue would therefore be limited to those passengers travelling as part of an online connection on an Alliance flight.

5.468. The ACCC also notes that passengers may opt to purchase the domestic leg of their journey separately and further that most demand on trans-Tasman routes can be accommodated on direct services.

5.469. On this basis, the ACCC considers that the Alliance is unlikely to adversely impact the market for Australian domestic passenger services.

ACCC conclusion on public detriment

5.470. The ACCC considers that the Alliance is likely to result in public detriment through its effect on competition on a number of routes comprising the market for trans-Tasman air passenger services.

5.471. The ACCC is of the view that the Alliance is likely to result in material competition issues on the following trans-Tasman routes (which together account for around 12% of the trans-Tasman air passenger services market):

- Wellington-Sydney
- Wellington-Melbourne
- Wellington-Brisbane
- Dunedin-Brisbane

5.472. Based on the information currently available, the ACCC considers that the effect of the Alliance on competition on the Auckland-Brisbane (13% of the market) and Queenstown-Sydney (1% of the market) routes is uncertain.

Balance of public benefit and detriment

5.473. The ACCC may only grant authorisation if it is satisfied that, in all the circumstances, the Alliance is likely to result in a public benefit, and that public benefit will outweigh any likely public detriment.

5.474. In the context of applying the net public benefit test in section 90(8)[74] of the Act, the Tribunal commented that:

> … something more than a negligible benefit is required before the power to grant authorisation can be exercised.[75]

5.475. For the reasons outlined in this chapter, the ACCC considers that the Alliance is likely to result in material public benefits in the form of:

- enhancement of the applicants' products and service offering (including increased access to existing frequencies, increased online connection options, better schedule spread, enhanced value added services and new frequencies) and associated increased consumer choice;
- potential for lower fares as a result of cost savings and efficiency improvements through removal of double marginalisation and higher load factors;
- promotion of competition, particularly in the business traveller segment of the trans-Tasman market; and
- stimulation of tourism.

5.476. The ACCC considers that the Alliance is likely to result in public detriment through its effect on competition on a number of routes comprising the market for trans-Tasman air passenger services.

5.477. The ACCC considers that the Alliance is likely to result in material competition issues on the following trans-Tasman routes (which together account for around 12% of the trans-Tasman air passenger services market):

- Wellington-Sydney
- Wellington-Melbourne
- Wellington-Brisbane

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[74] The test at 90(8) of the Act is in essence that conduct is likely to result in such a benefit to the public that it should be allowed to take place.

[75] *Re Application by Michael Jools, President of the NSW Taxi Drivers Association* [2006] ACompT 5 at paragraph 22.

- Dunedin-Brisbane

5.478. Based on the information currently available, the ACCC considers that the effect of the Alliance on competition on the Auckland-Brisbane (13% of the market) and Queenstown-Sydney (1% of the market) routes is uncertain.

5.479. The ACCC considers that the public benefits and public detriments likely to result from the Alliance are finely balanced.

Conditions of authorisation

5.480. The TPA allows the ACCC to grant authorisation subject to conditions.[76]

5.481. The applicants submit that the Alliance will not give rise to any competition concerns on any Tasman route including those identified by the ACCC, and in particular, Auckland-Brisbane. Nonetheless, the applicants have proposed and indicated their willingness to commit to authorisation conditions to maintain and increase capacity over time on those routes nominated by the ACCC as potentially subject to unilateral competition effects, namely:

- Auckland-Brisbane
- Wellington-Sydney
- Wellington-Brisbane
- Dunedin-Brisbane
- Queenstown-Sydney

5.482. Further, in recognition of the concerns set out in the draft determination, the applicants are willing to also include Wellington-Melbourne as a nominated sector for the purposes of the conditions.

5.483. Under the proposed conditions, in respect of each of the nominated sectors, the applicants would make available the same level of capacity as applied in the 12 month period prior to implementation of the Alliance, adjusted to take into account the recently announced Air New Zealand seat reconfiguration (resulting in an increase in base year capacity) and a proposed change in Virgin Blue's capacity.

5.484. The applicants' proposed conditions would:

- apply for each year of the authorisation period with a minimum capacity commitment for each route for scheduling season
- involve an annual increase in the applicants' capacity commitment on each route[77]

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[76] Section 91(3).

[77] Equal to the greater of (a) the percentage change in the average of Australian and New Zealand real GDP from the 12 month GDP reporting period applicable to the base year to the 12 month GDP reporting period ending immediately preceding the applicable annual period plus an annual growth margin of 0.5 per cent or (b) the

- require the applicants to notify the ACCC of the total seat capacity made available on each trans-Tasman sector for each relevant period.

5.485. The applicants proposed that they be permitted to seek written approval of the ACCC to vary conditions in the event of exceptional circumstances (i.e. force majeure events and events outside the applicants' control that cannot be anticipated), a material change in market conditions, or a material adverse financial performance on the nominated routes or the trans-Tasman.

5.486. The applicants consider that the proposed conditions will address any residual ACCC competition concerns because carriers will set prices and service levels to fill their capacity in a profit maximising fashion, on the basis that capacity drives both fares and service levels.

5.487. Auckland Airport notes that it has not been able to consider the applicants' proposed commitments fully as it has not seen the full confidential version of the proposal.

5.488. In respect of the non-confidential version of the proposed conditions, Auckland Airport submits that the commitments provided by the applicants appear to provide some degree of comfort that the Alliance will not have a significantly detrimental effect on travellers. In particular, Auckland Airport considers that it would be appropriate to calculate relevant base year levels with reference to capacity levels in a normal year (such as the year ended May 2009, adjusted to take account of Air New Zealand's recently announced seat configuration) rather than a year where capacity levels were adversely affected by the global recession.

5.489. While not included as part of the formal proposed conditions, Auckland Airport also submits that it assumes that the applicants will also follow through with their further commitments to introduce additional frequencies on six routes being Auckland-Adelaide, Auckland-Gold Coast, Auckland-Perth, Wellington-Sydney, Wellington-Melbourne and Wellington-Brisbane.

5.490. Wellington Airport no longer opposes the authorisation on the basis of the capacity commitments proposed by the applicants. However, Wellington Airport raises a number of issues for consideration by the ACCC including concerns that:

- the conditions should clarify that the commitment to make available seat capacity is in respect of flown seats
- the third and fifth year capacity obligations should be imposed in respect of each nominated sector to address the concern that additional capacity is placed wholly on one or some of the nominated sectors and not on others
- the definition of exceptional circumstances where the applicants may seek the ACCC's approval to alter its capacity commitments should be tightened so that it clarifies that the applicants are not afforded such a right on any unilateral basis and an exhaustive list of exceptional circumstances should be outlined.

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percentage change in total industry seat capacity across the Trans Tasman from the base year to the 12 month period ending immediately preceding the applicable annual period.

5.491. Hamilton International Airport submits that if individual routes are to be protected as a condition of authorisation, then secondary international airports should be included as well as those airports identified as being at risk of airfare increases. Hamilton International Airport is supportive of the proposed Alliance if capacity guarantees are also applied to maintaining existing capacity on those routes exposed to reduced capacity, including the Hamilton-Brisbane. The ACCC acknowledges these views but notes that the Alliance does not appear to raise competition issues in relation to the Hamilton routes given that they are relatively thin routes which are currently only served by Pacific Blue.

5.492. The ACCC views the objective of the conditions as being to restrict the discretion of the Alliance to limit its capacity or limit the growth of its capacity on each of the trans-Tasman routes of concern.

5.493. The most profitable way for the Alliance to raise fares on these routes is by limiting its capacity. This is likely to create a ‘scarcity’ of seats on these routes and result in higher average fares. The Alliance would gain from both the higher average fares and the lower costs (from operating less capacity). The conditions aim to limit the ability of the Alliance to employ such a strategy.

5.494. While the conditions may prevent such a strategy, the ACCC notes that they will not prevent the Alliance from raising fares on these routes.

5.495. The absence of effective competition on the routes of concern may enable the Alliance to profitably raise fares without limiting its capacity. In this case the Alliance will operate its aircraft at lower load factors. While such a strategy is unlikely to be as profitable as a strategy of limiting capacity, the ACCC notes that it cannot be ruled out.

5.496. If in practice the conditions are effective in achieving the objective of restricting the discretion of the Alliance to limit its capacity or the growth of its capacity, the ACCC considers they will limit the circumstances under which the Alliance could profitably raise fares on the routes of concern.

5.497. Accordingly, the ACCC imposes conditions of authorisation to address the unilateral competition issues on identified routes. These conditions are similar but not identical to those proposed by the applicants. The ACCC’s conditions of authorisation are set out at Attachment A. Broadly speaking, the conditions require the applicants to:

- at least maintain capacity on each route of concern irrespective of the rate of economic growth or trans-Tasman passenger demand growth over the term of authorisation

- grow capacity seasonally on each of the routes of concern in line with most recent economic growth or growth in trans-Tasman passenger demand (whichever is greater) for the term of the authorisation

- provide an independently audited report to the ACCC on their compliance with the conditions.

5.498. On balance, the ACCC considers that the conditions in combination with the identified benefits are likely to be sufficient outweigh the anti-competitive detriment.

Length of authorisation

5.499. The Act allows the ACCC to grant authorisation for a limited period of time.[78] The ACCC generally considers it appropriate to grant authorisation for a limited period of time, so as to allow an authorisation to be reviewed in the light of any changed circumstances.

5.500. In this instance, the applicants seek authorisation for five years. Given that the likely benefits and detriments resulting from the Alliance are finely balanced, the ACCC has considered whether it would be appropriate to review any authorisation in a shorter time frame.

5.501. The ACCC recognises that there is likely to be a period required for the applicants to implement the Alliance agreements and integrate their business systems.

5.502. On the other hand, the ACCC expects that many of the applicants' public benefit claims (for example increased frequencies and cost savings) would materialise within the first two to three years of the Alliance and therefore, the applicants should be able to present evidence of these public benefits to the ACCC in support of any re-authorisation sought. The ACCC also considers that this time period would be sufficient to observe the nature of competition on the Tasman with the Alliance in place and the effectiveness of the conditions of authorisation.

5.503. The ACCC notes the applicants' submission that they will be able to unwind the Alliance in the event that it is not reauthorised and will apply for reauthorisation in a timeframe that would allow for the Alliance to be unwound within the existing authorisation term if it is not reauthorised.[79]

5.504. As such, the ACCC considers it appropriate to grant authorisation for the Alliance between Virgin Blue and Air New Zealand for a three year period, until 31 December 2010.

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[78] Section 91(1).
[79] Letter from the applicants to the ACCC dated 10 December 2010, p.1.

6. Determination

The application

6.1. On 6 May 2010, Virgin Blue Airlines Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd, Pacific Blue Airlines (NZ) Limited (together Virgin Blue) and Air New Zealand Limited (Air New Zealand) lodged applications for authorisation A91227 and A91228 with the ACCC.

6.2. Application A91227 was made using Form A Schedule 1, of the Trade Practices Regulations 1974. The application was made under subsections 88(1A) and 88(1) of the Act to:

- make and give effect to a contract, arrangement or understanding, a provision of which is or may be an exclusionary provision within the meaning of section 45 of the Act.

- make and give effect to a provision of a contact, arrangement or understanding, a provision of which is, or may be, a cartel provision and which is also, or may also be, an exclusionary provision within the meaning of section 45 of that Act.

6.3. Application A91227 was made using Form B Schedule 1, of the Trade Practices Regulations 1974. Application A91228 was made under sections 88(1A) and 88(1) of the Act to:

- make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act.

- make and give effect to a contract or arrangement, or arrive at an understanding a provision of which would be, or might be, a cartel provision (other than a provision which would also be, or might also be, an exclusionary provision within the meaning of section 45 of that Act).

6.4. In particular, Virgin Blue and Air New Zealand applied for authorisation to make and give effect to the Australasian Airline Alliance Agreement, an associated Code Share Agreement and proposed related agreements which are contemplated by the Alliance Agreement (the Alliance).

The net public benefit test

6.5. For the reasons outlined in Chapter 5 of this determination, the ACCC is satisfied that the conduct for which authorisation is sought is likely to result in a public benefit that would outweigh the detriment to the public constituted by any lessening of competition arising from the conduct.

6.6. The ACCC is satisfied that the conduct for which authorisation is sought is likely to result in such a benefit to the public that the conduct should be allowed to take place.

6.7. The ACCC therefore **grants** authorisation to applications A91227 and A91228 **subject to the conditions set out in Attachment A**.

Conduct for which the ACCC grants authorisation

7.1 Authorisation extends to Virgin Blue and Air New Zealand for an alliance until 31 December 2013

6.8. This determination is made on 16 December 2010.

6.9. Section 90(4) requires that the Commission state in writing its reasons for a determination. The attachments form part of the written reasons for this determination.

Date authorisation comes into effect

6.10. This determination is made on 16 December 2010. If no application for review of the determination is made to the Australian Competition Tribunal (the Tribunal), it will come into force on 7 January 2011.

Attachment A — Conditions of authorisation

1. Minimum Seat Capacity Conditions

(a) In respect of each Nominated Route, the Applicants must fly in each Scheduling Season, not less than 100% of the Scheduling Season Alliance Seat Capacity for that Route.

(b) In respect of the Trans-Tasman, the Applicants must fly in respect of each Scheduling Season, not less than 100% of the Trans-Tasman Base Year Alliance Seat Capacity.

2. Variation to these Conditions

(a) The Applicants may apply to the ACCC for a variation to these Conditions, in the following circumstances:

(i) Exceptional Circumstances;

(ii) Material Change in Market Conditions;

(iii) Material Adverse Financial Performance.

(b) Any application by the Applicants to the ACCC for a variation to these Conditions must indicate the nature of the variation applied for and must be accompanied by such information as required by the ACCC to assess the request for variation.

(c) The ACCC will consult with the Applicants in good faith concerning whether or not such variation to these Conditions is necessary.

(d) The ACCC may also undertake such consultation as it considers necessary to consider any such request for a variation to these Conditions including inviting submissions within a specified period from any person who appear to the ACCC to be interested in the variation.

(e) In undertaking an assessment of an application to vary these Conditions, the ACCC may publish or otherwise make publicly available the Applicants' written submission in support of its request for variation.

(f) After considering an application to vary these Conditions and any submissions received in respect of an application to vary the ACCC may vary these Conditions or dismiss the application for variation.

(g) The ACCC may vary the requirement to comply with these Conditions either permanently or on a temporary basis.

(h) The ACCC will advise the Applicants in writing of its decision in respect of an application for variation under clause 2(a) within six weeks or such other period advised to the Applicants by the ACCC.

(i) In the event that the ACCC consents to a variation to these Conditions, the variation will be effective from the next Scheduling Season or such other date that the ACCC advises the Applicants that it considers is appropriate.

3. Audit of compliance

3.1 Obligation to Appoint an Independent Auditor

(a) The Applicants must appoint and maintain an independent auditor to report to the ACCC with respect to the compliance by the Applicants with these Conditions.

3.2 Proposed Auditor

(a) By 14 January 2011, the Applicants must identify a prospective independent auditor **(Proposed Auditor)** and provide the ACCC written notice of the identity and contact details of the Proposed Auditor.

(b) The written notice referred to in clause 3.2(a) is to include such information or documents as the ACCC requires to assess whether to object to the appointment of the Proposed Auditor, including a copy of the proposed terms of engagement.

(c) The Proposed Auditor must be a person who has the relevant skills necessary to carry out the functions of the Auditor and is independent of the Applicants and their Related Bodies Corporate.

(d) Without limitation, an Auditor is not independent if he or she:

(i) is a current employee or officer of either or both of the Applicants;

(ii) is a person who has been an employee or officer of either or both of the Applicants in the past three years;

(iii) is a person who, in the opinion of the ACCC, holds a material interest in either or both of the Applicants;

(iv) is a professional adviser of either or both of the Applicants, whether current or in the past three years;

(v) is a person who has a contractual relationship, or is an employee or contractor of a firm or company that has a contractual relationship with either or both of the Applicants, but for the terms of any Auditor agreement with the Applicants;

(vi) is a supplier, or a person who is an employee or contractor of a firm or company that is a supplier of either or both of the Applicants;

(vii) a material customer of, or a person who is an employee or contractor of a firm or company that is a material customer of, either or both of the Applicants; or

(viii) has, or has had, any other relationship with either or both of the Applicants which, in the opinion of the ACCC, is likely to affect the ability of that person to act independently.

3.3 Appointment of Auditor

(a) If, within five Business Days of receipt by the ACCC of the written notice referred to in clause 3.2(a), or such further period as is required by the ACCC and notified to the Applicants:

(i) the ACCC does not object to the Proposed Auditor, the Applicants must appoint the Proposed Auditor as Auditor as soon as practicable (but in any event within five business days) on terms approved in writing by the ACCC and consistent with the performance by the Auditor of his or her functions under these Conditions and forward to the ACCC a copy of the executed terms of appointment of the Auditor within one Business Day of its execution; or

(ii) the ACCC does object to a Proposed Auditor, the Applicants will appoint a person identified by the ACCC at its absolute discretion as the Auditor on terms approved by the ACCC and consistent with the performance by the Auditor of his or her functions under these Conditions and forward to the ACCC a copy of the executed terms of appointment of the Auditor within one Business Day of its execution.

3.4 Obligations relating to the Auditor

(a) The Applicants must procure that the terms of appointment of the Auditor include obligations on the Auditor to:

(i) continue to satisfy the independence criteria in clause 3.2(d) for the period of his or her appointment;

(ii) provide any information or documents requested by the ACCC about the Applicant's compliance with these Conditions directly to the ACCC;

(iii) report or otherwise inform the ACCC directly of any issues that arise in the performance of his or her functions as Auditor or in relation to any matter that arises in connection with these Conditions; and

(iv) follow any direction given to him or her by the ACCC in relation to the performance of his or her functions as Auditor under these Conditions.

3.5 Compliance Audit

(a) The Applicants must within 25 Business Days of the end of a Scheduling Season, provide to the ACCC a written audit report as set out in clause 3.5(b) from the Auditor in relation to the Applicant's compliance with its obligations under clause 1.

(b) The Auditor is to prepare a detailed report (Auditor's Report) on:

(i) the Applicants' compliance with these Conditions;

(ii) all of the reasons for the conclusions reached in the Auditor's Report;

(iii) any qualifications made by the Auditor in forming his or her views; and

(iv) any recommendations by the Auditor to improve the integrity of the auditing process and any reasonable recommendations to improve the Applicants' operations, processes or reporting systems in relation to compliance with these Conditions.

(c) The Applicants must implement any recommendations of the Auditor made pursuant to clause 3.5(b)(iv), and notify the ACCC of the implementation of the recommendations, within 10 Business Days of receiving the Auditor's Report or within a period agreed with the ACCC.

(d) The Applicants must:

(i) comply with any direction of the ACCC in relation to the matters arising from the Auditor's Report, within 10 Business Days of being so directed to do so (or such longer period as is agreed with the ACCC);

(ii) direct its personnel, including directors, managers, officers, employees and agents to act in accordance with the obligations set out in these Conditions and ensure that such personnel are aware of the Auditor and its role; and

(iii) ensure that the Auditor will provide information and documents requested by the ACCC directly to the ACCC.

(e) The Applicants must maintain and fund the Auditor and must indemnify the Auditor for reasonable expenses and any loss, claim or damage arising from the proper performance by the Auditor of functions required to be performed by the Auditor under these Conditions.

3.6 Resignation or termination of appointment of the Auditor

(a) The Applicants must immediately notify the ACCC in writing in the event that an Auditor resigns or otherwise stops acting as an Auditor before the termination of this Authorisation on 31 December 2013.

(b) The ACCC may approve any proposal by, or alternatively may direct, the Applicants to terminate the appointment of an Auditor if in the ACCC's view the Auditor acts inconsistently with the provisions of these Conditions or the terms of his or her appointment.

(c) If either clause 3.6(a) or 3.6(b) applies, the ACCC may nominate an alternative auditor to be the Auditor.

(d) The Applicants must, within five Business Days of the ACCC nominating an alternative Auditor:

(i) appoint the alternative Auditor nominated by the ACCC on terms approved by the ACCC and consistent with the performance by the Auditor of his or her functions under these Conditions; and

(ii) forward to the ACCC a copy of the executed terms of appointment within one Business Day.

4. Information

(a) The Applicants must respond in a timely manner to any queries or requests for information or documents made by the ACCC.

(b) The ACCC may direct the Applicants in respect of compliance with these Conditions to, and the Applicants must:

(i) furnish information, documents and materials to the ACCC in the time and in the form requested by the ACCC;

(ii) produce information, documents and materials to the ACCC within the Applicants' custody, power or control in the time and in the form requested by the ACCC; and/or

(iii) direct its personnel, including its directors, contractors, managers, officers, employees and agents, to attend the ACCC at a reasonable time and place appointed by the ACCC to answer any questions the ACCC (including its Commissioners, its staff or its agents) may have.

(c) Information furnished, documents and material produced or information given in response to any request or direction from the ACCC under these Conditions may be used by the ACCC for any purpose consistent with the exercise of its statutory duties.

(d) Nothing in these Conditions requires the provision of information or documents in respect of which the Applicants have a claim of legal professional privilege.

5. Definitions and Interpretation

5.1 Definitions

In these Conditions:

ACCC: means the Australian Competition and Consumer Commission and includes any external legal advisers, consultants or agents engaged by the ACCC to assist it to assess compliance with these Conditions or to undertake work or provide services in relation to the Alliance.

Auckland-Brisbane: means the Route between Auckland, New Zealand and Brisbane, Australia.

Alliance: means the Alliance to be established by Australasian Airline Alliance Agreement between the Applicants dated 3 May 2010 and the subject of applications for authorisation A91227 and A91228 lodged by the Applicants with the ACCC.

Annual Period: means a 12 month period from 31 October 2010 or the anniversary of 31 October 2010.

Applicants: means Virgin Blue Airlines Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd, Pacific Blue Airlines (NZ) Limited (together Virgin Blue), and Air New Zealand Limited (Air New Zealand) and includes Related Bodies Corporate of an Applicant.

Auditor: means the independent auditor appointed at the direction of the ACCC in accordance with clause 3.3 or 3.6.

Authorisation: means this determination of the Applicants' applications A91227 and A91228 for authorisation.

Base Year: means the 12 month period ending on 31 October 2010.

Base Year Alliance Seat Capacity: means the seat capacity specified in respect of a Nominated Route or the Trans-Tasman as set out in Schedule A to these Conditions.

Base Year Industry Seat Capacity: means, in respect of a Nominated Route, the seat capacity specified in respect of that Route as set out in Schedule B to these Conditions.

Base Year Scheduling Season Alliance Seat Capacity: means, in respect of a Nominated Route, the seat capacity as set out in Schedule A to these Conditions.

Brisbane-Dunedin: means the Route between Brisbane, Australia and Dunedin, New Zealand.

Brisbane-Wellington: means the Route between Brisbane, Australia and Wellington, New Zealand.

Business Day: means a day that is not a Saturday, Sunday or public holiday in the Australian Capital Territory.

Capacity Growth Factor: for any Scheduling Season the greater of:

(a) the sum of quarterly changes in Australia’s Trend Chain Volume GDP, as published by the Australian Bureau of Statistics in Catalogue No 5206.0, data series A2298668K over the period from:

(i) December quarter 2009 to the most recent December quarter for the NW Scheduling Season or

(ii) June quarter 2010 to the most recent June quarter for the NS Scheduling Season; or

(b) the sum of the annual percentage changes in Total Industry Seat Capacity across the Trans-Tasman over the period from 2 months prior to the end of the relevant Scheduling Season in 2010 to 2 months prior to the end of the most recent Scheduling Season. Total Industry Seat Capacity across the Trans-Tasman is to be sourced from *International Airline Activity data collection* published by the Australian Bureau of Infrastructure, Transport and Regional Economics (BITRE).

Conditions: mean these conditions on which the Authorisation is granted and include the Schedules.

Exceptional Circumstances: include but are not limited to:

(a) force majeure events including severe natural disasters and pandemics;

(b) events or factors outside of the control of the Applicants such that the Applicants cannot or reasonably anticipate that they cannot practically comply with these Conditions or which have or are reasonably anticipated to have a material adverse impact on the demand for travel on the Applicants’ services or the Applicants’ service operating costs.

Material Adverse Financial Performance: includes an actual decline in profit performance (whether the result is a profit or a loss) for the Alliance, which the ACCC considers is material and that the ACCC has advised to the Applicants in writing that view, on:

(a) the Nominated Routes; or

(b) the Trans-Tasman;

when compared to the Base Year financial performance of the Applicants.

Material Change in Market Conditions: means a change to the market conditions, on a Route or a group of Routes on the Trans-Tasman, which the ACCC has advised in writing to the Applicants that it considers is material.

Melbourne-Wellington: means the Route between Melbourne, Australia and Wellington, New Zealand.

Minimum Seat Capacity: means the minimum required Alliance seat capacity on a Nominated Route or the Trans-Tasman for a particular period derived by reference to clause 2 of these Conditions.

Nominated Route: means direct flights operating Auckland-Brisbane; Brisbane-Wellington; Brisbane-Dunedin; Melbourne-Wellington; Sydney-Wellington; Sydney-Queenstown.

NS: means the Northern Summer.

NW: means the Northern Winter.

Related Body Corporate: has the meaning given in section 4A of the *Trade Practices Act 1974* Cth.

Route: means all air travel between a particular Australian and a particular New Zealand location.

Scheduling Season: means either the NS season from 1 April to 31 October or the NW Season from 1 November to 31 March.

Scheduling Season Alliance Seat Capacity: means the Minimum Seat Capacity for a Nominated Route in a particular Scheduling Season derived by reference to the Base Year Scheduling Season Alliance Seat Capacity adjusted by the Capacity Growth Factor applicable to that Scheduling Season. The Base Year Scheduling Season Alliance Seat Capacity is set out in Schedule A to these Conditions.

Sydney-Wellington: means the Route between Sydney, Australia and Wellington, New Zealand.

Sydney-Queenstown: means the Route between Sydney, Australia and Queenstown, New Zealand.

Total Industry Seat Capacity: means all seats flown by any commercial airline operator on the Trans-Tasman.

Trans-Tasman: the group of all Routes between Australia and New Zealand.

5.2 Interpretation

In the interpretation of these Conditions, the following apply unless the context otherwise requires:

(a) headings are inserted for convenience only and do not affect the interpretation of these Conditions;

(b) a reference in these Conditions to any company includes its Related Bodies Corporate;

(c) a reference to a clause is a reference to a clause of these Conditions;

(d) if the day on which any act, matter or thing is to be done under these Conditions is not a Business Day, the act, matter or thing must be done on the next Business Day;

(e) a word which denotes the singular also denotes the plural and vice versa,

(f) a reference to the words ‘include’ and ‘including’, and similar expressions is to be construed without limitation; and

(g) a party includes its successors and permitted assigns.

Schedule A – Base Year Alliance Seat Capacity

The Base Year Alliance Seat Capacity set out in the table below has been derived by reference to the actual seat capacity of the Applicants in the year to 31 October 2010 on each Nominated Route, adjusted for changes in seat configuration as if they applied for the whole of the Base Year.

	NW seats	NS seats	Full Year seats
Auckland-Brisbane	202,816	322,732	525,548
Brisbane-Dunedin	23,447	48,478	71,925
Brisbane-Wellington	102,043	144,422	246,465
Melbourne-Wellington	51,320	55,555	106,875
Sydney-Wellington	100,101	108,771	208,872
Sydney-Queenstown	26,896	46,873	73,769
Total Nominated Route Alliance Seat Capacity	506,622	726,831	1,233,454
Trans-Tasman Base Year Alliance Seat Capacity	1,725,205	2,360,250	4,085,456

Schedule B – Base Year Industry Seat Capacity

The Base Year Industry Seat Capacity has been derived by adding the Alliance Seat Capacity to the scheduled capacity of other airlines in the year to 31 October 2010 on each of the nominated routes, adjusted for changes in Alliance seat configuration as if they applied for the whole of the Base Year.

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	NW seats	NS seats	Full Year seats
Auckland-Brisbane	398,349	574,256	945,605
Brisbane-Dunedin	23,447	48,478	71,925
Brisbane-Wellington	102,043	144,422	246,465
Melbourne-Wellington	91,000	114,213	205,213
Sydney-Wellington	180,341	222,749	403,090
Sydney-Queenstown	44,923	74,641	119,564
Total Nominated Route Industry Seat Capacity	840,102	1,151,760	1,991,862
Trans-Tasman Base Year Industry Seat Capacity	3,318,748	4,521,320	7,840,068

Attachment B — the authorisation process

The Australian Competition and Consumer Commission (the ACCC) is the independent Australian Government agency responsible for administering the *Trade Practices Act 1974* (the Act). A key objective of the Act is to prevent anti-competitive conduct, thereby encouraging competition and efficiency in business, resulting in a greater choice for consumers in price, quality and service.

The Act, however, allows the ACCC to grant immunity from legal action in certain circumstances for conduct that might otherwise raise concerns under the competition provisions of the Act. One way in which parties may obtain immunity is to apply to the ACCC for what is known as an 'authorisation'.

The ACCC may 'authorise' businesses to engage in anti-competitive conduct where it is satisfied that the public benefit from the conduct outweighs any public detriment.

The ACCC conducts a public consultation process when it receives an application for authorisation. The ACCC invites interested parties to lodge submissions outlining whether they support the application or not, and their reasons for this.

After considering submissions, the ACCC issues a draft determination proposing to either grant the application or deny the application.

Once a draft determination is released, the applicant or any interested party may request that the ACCC hold a conference. A conference provides all parties with the opportunity to put oral submissions to the ACCC in response to the draft determination. The ACCC will also invite the applicant and interested parties to lodge written submissions commenting on the draft.

The ACCC then reconsiders the application taking into account the comments made at the conference (if one is requested) and any further submissions received and issues a final determination. Should the public benefit outweigh the public detriment, the ACCC may grant authorisation. If not, authorisation may be denied. However, in some cases it may still be possible to grant authorisation where conditions can be imposed which sufficiently increase the benefit to the public or reduce the public detriment.

Attachment C — chronology of ACCC assessment for applications A91227 & A91228

The following table provides a chronology of significant dates in the consideration of the application by Virgin Blue and Air New Zealand.

DATE	ACTION
6 May 2010	Applications for authorisation A91227 & A91228 lodged with the ACCC.
2 June 2010	Closing date for submissions from interested parties in relation to the substantive application for authorisation.
25 July 2010	Submission received from applicants in response to interested party submissions.
10 September 2010	Draft determination issued.
28 September 2010	Period for consideration of the applications for authorisation extended to 20 December 2010 at the request of the applicants.
1 October 2010	Meeting between the ACCC and the applicants.
8 October 2010	Submission received from the applicants in response to the draft determination.
18 October 2010	Pre-determination conference.
29 October 2010	Closing date for submissions from interested parties in relation to the draft determination. Further submission by the applicants.
5, 12, 22, 25, 29, 30 November 2010	Further submissions by the applicants.
10 December 2010	Further submission by the applicants.
16 December 2010	Determination issued.

Attachment D — the tests for authorisation and other relevant provisions of the Act

Trade Practices Act 1974

Section 90—Determination of applications for authorisations

(1) The Commission shall, in respect of an application for an authorization:

(a) make a determination in writing granting such authorization as it considers appropriate; or

(b) make a determination in writing dismissing the application.

(2) The Commission shall take into account any submissions in relation to the application made to it by the applicant, by the Commonwealth, by a State or by any other person.

Note: Alternatively, the Commission may rely on consultations undertaken by the AEMC: see section 90B.

(4) The Commission shall state in writing its reasons for a determination made by it.

(5) Before making a determination in respect of an application for an authorization the Commission shall comply with the requirements of section 90A.

Note: Alternatively, the Commission may rely on consultations undertaken by the AEMC: see section 90B.

(5A) The Commission must not make a determination granting an authorisation under subsection 88(1A) in respect of a provision of a proposed contract, arrangement or understanding that would be, or might be, a cartel provision, unless the Commission is satisfied in all the circumstances:

(a) that the provision would result, or be likely to result, in a benefit to the public; and

(b) that the benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if:

(i) the proposed contract or arrangement were made, or the proposed understanding were arrived at; and

(ii) the provision were given effect to.

(5B) The Commission must not make a determination granting an authorisation under subsection 88(1A) in respect of a provision of a contract, arrangement or understanding that is or may be a cartel provision, unless the Commission is satisfied in all the circumstances:

(a) that the provision has resulted, or is likely to result, in a benefit to the public; and

(b) that the benefit outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted, or is likely to result, from giving effect to the provision.

(6) The Commission shall not make a determination granting an authorization under subsection 88(1), (5) or (8) in respect of a provision (not being a provision that is or may be an exclusionary provision) of a proposed contract, arrangement or understanding, in respect of a proposed covenant, or in respect of proposed conduct (other than conduct to which subsection 47(6) or (7) applies), unless it is satisfied in all the circumstances that the provision of the proposed contract, arrangement or understanding, the proposed covenant, or the proposed conduct, as the case may be, would result, or be likely to result, in a benefit to

the public and that that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if:

(a) the proposed contract or arrangement were made, or the proposed understanding were arrived at, and the provision concerned were given effect to;

(b) the proposed covenant were given, and were complied with; or

(c) the proposed conduct were engaged in;

as the case may be.

(7) The Commission shall not make a determination granting an authorization under subsection 88(1) or (5) in respect of a provision (not being a provision that is or may be an exclusionary provision) of a contract, arrangement or understanding or, in respect of a covenant, unless it is satisfied in all the circumstances that the provision of the contract, arrangement or understanding, or the covenant, as the case may be, has resulted, or is likely to result, in a benefit to the public and that that benefit outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted, or is likely to result, from giving effect to the provision or complying with the covenant.

(8) The Commission shall not:

(a) make a determination granting:

(i) an authorization under subsection 88(1) in respect of a provision of a proposed contract, arrangement or understanding that is or may be an exclusionary provision; or

(ii) an authorization under subsection 88(7) or (7A) in respect of proposed conduct; or

(iii) an authorization under subsection 88(8) in respect of proposed conduct to which subsection 47(6) or (7) applies; or

(iv) an authorisation under subsection 88(8A) for proposed conduct to which section 48 applies;

unless it is satisfied in all the circumstances that the proposed provision or the proposed conduct would result, or be likely to result, in such a benefit to the public that the proposed contract or arrangement should be allowed to be made, the proposed understanding should be allowed to be arrived at, or the proposed conduct should be allowed to take place, as the case may be; or

(b) make a determination granting an authorization under subsection 88(1) in respect of a provision of a contract, arrangement or understanding that is or may be an exclusionary provision unless it is satisfied in all the circumstances that the provision has resulted, or is likely to result, in such a benefit to the public that the contract, arrangement or understanding should be allowed to be given effect to.

(9) The Commission shall not make a determination granting an authorization under subsection 88(9) in respect of a proposed acquisition of shares in the capital of a body corporate or of assets of a person or in respect of the acquisition of a controlling interest in a body corporate within the meaning of section 50A unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

(9A) In determining what amounts to a benefit to the public for the purposes of subsection (9):

(a) the Commission must regard the following as benefits to the public (in addition to any other benefits to the public that may exist apart from this paragraph):

(i) a significant increase in the real value of exports;

(ii) a significant substitution of domestic products for imported goods; and

(b) without limiting the matters that may be taken into account, the Commission must take into account all other relevant matters that relate to the international competitiveness of any Australian industry.

Variation in the language of the tests

There is some variation in the language in the Act, particularly between the tests in sections 90(6) and 90(8).

The Australian Competition Tribunal (the Tribunal) has found that the tests are not precisely the same. The Tribunal has stated that the test under section 90(6) is limited to a consideration of those detriments arising from a lessening of competition but the test under section 90(8) is not so limited.[1]

However, the Tribunal has previously stated that regarding the test under section 90(6):

> [the] fact that the only public detriment to be taken into account is lessening of competition does not mean that other detriments are not to be weighed in the balance when a judgment is being made. Something relied upon as a benefit may have a beneficial, and also a detrimental, effect on society. Such detrimental effect as it has must be considered in order to determine the extent of its beneficial effect.[2]

Consequently, when applying either test, the ACCC can take most, if not all, public detriments likely to result from the relevant conduct into account either by looking at the detriment side of the equation or when assessing the extent of the benefits.

Given the similarity in wording between sections 90(6) and 90(7), the ACCC considers the approach described above in relation to section 90(6) is also applicable to section 90(7). Further, as the wording in sections 90(5A) and 90(5B) is similar, this approach will also be applied in the test for conduct that may be a cartel provision.

Conditions

The Act allows the ACCC to grant authorisation subject to conditions.[3]

Future and other parties

Applications to make or give effect to contracts, arrangements or understandings that might substantially lessen competition or constitute exclusionary provisions may be expressed to extend to:

- persons who become party to the contract, arrangement or understanding at some time in the future[4]

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1 *Australian Association of Pathology Practices Incorporated* [2004] ACompT 4; 7 April 2004. This view was supported in *VFF Chicken Meat Growers' Boycott Authorisation* [2006] AcompT9 at paragraph 67.

2 *Re Association of Consulting Engineers, Australia* (1981) ATPR 40-2-2 at 42788. See also: *Media Council case* (1978) ATPR 40-058 at 17606; and *Application of Southern Cross Beverages Pty. Ltd., Cadbury Schweppes Pty Ltd and Amatil Ltd for review* (1981) ATPR 40-200 at 42,763, 42766.

3 Section 91(3).

- persons named in the authorisation as being a party or a proposed party to the contract, arrangement or understanding.[5]

Six- month time limit

A six-month time limit applies to the ACCC's consideration of new applications for authorisation[6]. It does not apply to applications for revocation, revocation and substitution, or minor variation. The six-month period can be extended by up to a further six months in certain circumstances.

Minor variation

A person to whom an authorisation has been granted (or a person on their behalf) may apply to the ACCC for a minor variation to the authorisation.[7] The Act limits applications for minor variation to applications for:

> … a single variation that does not involve a material change in the effect of the authorisation.[8]

When assessing applications for minor variation, the ACCC must be satisfied that:

- the proposed variation satisfies the definition of a 'minor variation' and
- if the proposed variation is minor, the ACCC must assess whether it results in any reduction to the net benefit of the conduct.

Revocation; revocation and substitution

A person to whom an authorisation has been granted may request that the ACCC revoke the authorisation.[9] The ACCC may also review an authorisation with a view to revoking it in certain circumstances.[10]

The holder of an authorisation may apply to the ACCC to revoke the authorisation and substitute a new authorisation in its place.[11] The ACCC may also review an authorisation with a view to revoking it and substituting a new authorisation in its place in certain circumstances.[12]

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4 Section 88(10).
5 Section 88(6).
6 Section 90(10A)
7 Subsection 91A(1)
8 Subsection 87ZD(1).
9 Subsection 91B(1)
10 Subsection 91B(3)
11 Subsection 91C(1)
12 Subsection 91C(3)