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LAWYERS

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By email

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Public register version

Dear Mr Hatfield,

Virgin Australia and Singapore Airlines – Applications for Authorisation of Alliance

We refer to the draft determination issued on 13 October 2011 by the ACCC in respect of the applications by Virgin Australia and Singapore Airlines for authorisation of their proposed Alliance. We refer also to the submission provided on 20 June 2011 by the Applicants in support of the applications for authorisation.

The purpose of this letter is to clarify the scope of authorisation being sought by the Applicants and to address the comments of the ACCC on future possible implementation of revenue sharing arrangements under the proposed Alliance.

In its draft determination, the ACCC proposes to grant authorisation to Virgin Australia and Singapore Airlines to make and give effect to the Alliance Framework Agreement and associated agreements for five years. However, the ACCC's proposed decision in respect of the grant of authorisation assumes that authorisation does not extend to revenue sharing under the proposed Alliance because:

"The applicants have not sought authorisation for revenue sharing as part of the current applications for authorisation and submit that it is unnecessary as they do not currently operate materially overlapping services."¹

¹ ACCC, *Determination: Applications for authorisation lodged by Virgin Australia and Singapore Airlines in respect of an airline alliance between the applicants* (2011) 10 [2.38].

The ACCC has further indicated that if revenue sharing is implemented in the future, as potentially contemplated by the Alliance Framework Agreement, the Applicants will need to seek authorisation for those arrangements.²

The Applicants seek authorisation for the proposed Alliance including possible future revenue sharing

Virgin Australia and Singapore Airlines have submitted that they do not at this stage intend to revenue share under the Alliance as, given the limited overlap in the Applicants' services, it is not necessary in order to align incentives under the Alliance. However, the Applicants wish to clarify that they are seeking authorisation to make and give effect to the entirety of the Alliance Framework Agreement. This includes the possible future implementation of metal neutral policies and revenue sharing mechanisms in relation to future overlapping or new routes operated by the Applicants.³

The Applicants require the ability to implement metal neutral policies in order to ensure that their incentive to cooperate under the Alliance remains aligned in the event that either party begins to operate international services that overlap with those operated by the other party or the Applicants jointly determine to add new international services under the Alliance.

One of the benefits of the Alliance is the opportunity that it creates for new routes, or additional frequencies on existing routes, which would not be viable in the absence of the Alliance. The Applicants anticipate that the Alliance will result in increased passenger numbers on existing services, and potential demand for new services. This is because:

- the combination of the Applicants' networks will provide access to feeder traffic from both Singapore Airlines' international network and Virgin Australia's domestic network;
- the improved product available under the Alliance will be valued by customers, stimulating demand; and
- the Applicants will be able to jointly market and more efficiently promote their services.⁴

As a result, over the term of the Alliance Virgin Australia may consider it commercially viable to commence operating services to destinations already serviced by Singapore Airlines. Alternatively, the parties may decide to jointly operate a new route enabled by the Alliance. [Confidential – Restriction of publication claimed] If the Applicants commenced services on [Confidential – Restriction of publication claimed] as a result of the Alliance, these may be operated by one carrier but marketed by both carriers, or operated by both and marketed by both. In these circumstances, the ability to implement metal neutral policies, such as revenue sharing, would be essential to ensure that each party had the incentive to cooperate, including by selling tickets without preference as to operating carrier or agreeing to operate services in the most efficient way to optimise schedules and connections, without preference as to operation times and days of the week. It is also essential in order to ensure that both parties are fairly recompensed for their contribution to the services.

² ACCC, *Determination: Applications for authorisation lodged by Virgin Australia and Singapore Airlines in respect of an airline alliance between the applicants* (2011) 10 [2.38].

³ Clause 5.4 of the Alliance Framework Agreement.

⁴ Applicants' submission in support of application, 20 June 2011, 34-35.

The ACCC has previously recognised that revenue sharing is important in order to achieve the benefits associated with airline alliances⁵

Revenue sharing and other metal neutral policies will only be implemented by the Applicants if they commence new overlapping or joint international services. The Applicants do not envisage that there will be any future overlap or joint operations on domestic Australian routes as Singapore Airlines does not operate within domestic Australia. Under any circumstance, the Applicants will not revenue share in relation to domestic-only Australian services. As the Alliance Framework Agreement does not explicitly state that that metal neutral policies will only be implemented in relation to international routes, the Applicants would be happy for the ACCC to make this restriction on the scope of revenue sharing policies clear in its determination.

Possible future revenue sharing does not change the assessment of Alliance benefits and detriments

The extension of the proposed authorisation to possible future implementation of revenue sharing mechanisms, as contemplated by the Alliance Framework Agreement, will not materially impact on the ACCC's conclusions in the draft determination. In particular:

- the significant public benefits associated with the Alliance and their pro-competitive effects, accepted by the ACCC in its draft determination, are unchanged. As the ACCC has previously recognised, the ability to implement revenue sharing and other metal neutral policies is important in order to ensure that the Applicants' incentives are aligned in order to achieve material benefits such as new services and optimised schedules; and
- the potential for revenue sharing does not change the competitive effects of the Alliance in any market. As any revenue sharing would apply only to overlapping or jointly operated **international** routes, the ability to revenue share would not have any effect on the domestic Australian market.

The ACCC has suggested that without revenue sharing, the Alliance is less likely to impact on Singapore Airlines' incentives to influence Tiger Airways to compete less vigorously in the market for Australian domestic air passenger transport services.⁶ However, for the reasons set out in the draft determination⁷ Singapore Airlines would not have the ability or incentive to influence Tiger Airways to compete less vigorously in the domestic market, regardless of whether revenue occurs under the Alliance. As revenue sharing would only ever take place on overlapping or jointly operated international routes, it can have no effect on incentives within the domestic market.

⁵ ACCC, *Determination: Applications for authorisation lodged by Virgin Blue Airlines Pty Ltd and Others in respect of an airline alliance between the applicants* (2010) 52; 63 [5.170; 5.241]; ACCC *Determination: Applications for authorisation lodged by Virgin Blue Airlines Pty Ltd and Others in respect of a joint venture between the applicants* (2009) 38 [4.125].

⁶ ACCC, *Determination: Applications for authorisation lodged by Virgin Australia and Singapore Airlines in respect of an airline alliance between the applicants* (2011) 37 [4.140].

⁷ ACCC, *Determination: Applications for authorisation lodged by Virgin Australia and Singapore Airlines in respect of an airline alliance between the applicants* (2011) 36-7 [4.139; 4.141].

Please contact us if you would like to discuss this letter.

Yours faithfully

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