



Australian
Competition &
Consumer
Commission

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Luke Woodward
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Louise Klamka
Lawyer
Gilbert + Tobin
2 Park Street
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Sent via email: LWoodward@gtlaw.com.au; LKlamka@gtlaw.com.au

Dear Mr Woodward & Ms Klamka

First auditor's report in relation to compliance by Virgin Australia & Air New Zealand with conditions 1(a) and 1(b) of authorisations A91227 & A91228 Northern Summer 2011 scheduling season – comments on audit report

I refer to the audit report dated 1 December 2011 prepared by Pitcher Partners pursuant to clause 3.5 of the conditions of Authorisations A91227 & A91228 (the **Conditions**). The audit report was forwarded to the Australian Competition and Consumer Commission by you on 5 December 2011 (the **Report**).

I note that the Report advises on Virgin Australia and Air New Zealand's compliance with the Conditions for the period 1 April 2011 to 31 October 2011 (the Northern Summer 2011 scheduling season) and focuses on whether Virgin Australia and Air New Zealand have met the minimum seat capacity requirements for the relevant period in compliance with the Conditions.

While Pitcher Partners appears to have made factual findings on the seat capacity achievements of each airline for the relevant routes in the Northern Summer 2011 scheduling season as compared with the required capacity, there are a number of matters which the Report does not address. These are as follows.

Measuring compliance

While the Report examines and assesses compliance with the minimum seating requirements for the relevant period, there is no reference made in the Report as to the

methodology applied by each airline to measure seat capacity in order to make a finding on whether there has been compliance. In preparation of its Report, the auditor contacted the ACCC regarding the most appropriate measure to use given the different measures available in the industry. There is no discussion in the Report on how this issue was resolved or even that it was raised.

Please arrange for the provision of the auditor's analysis of this issue and its resolution in a supplementary report to the ACCC. Further, please arrange for this matter to be addressed in subsequent reports.

Detailing reasons for the conclusions reached

The auditor is required under clause 3.5(b)(ii) to provide a detailed report that includes "*all of the reasons for the conclusions reached in the Auditor's report*". This obligation was understood and accepted by Pritchard Partners in their acceptance of the terms of appointment dated 25 January 2011.

The ACCC considers that the auditor's 3 page letter does not sufficiently explain the basis on which the Pritchard Partners reached the view that the airlines have complied with the Conditions. While the table on page 3 of the letter sets out the seat capacity figures achieved and the figures against which compliance will be measured for the period, there is no explanation as to how the auditor obtained these figures, the number of services over which the figures were amassed and the measure used to reach the Actual Alliance Capacity figures in the table.

I would expect that an audit report that complies with clause 3.5 of the Conditions would provide the type of detail outlined above.

Next steps

The ACCC considers that the Report dated 1 December 2011 requires considerable revision as noted above to be considered satisfactory. Specifically, the ACCC would expect to see included in a supplementary report and in all subsequent reports:

- an outline of the scope of the audit
- how the data used to measure compliance was gathered
- the method used by each airline to measure compliance with its seat capacity obligations
- the auditor's analysis of this data and the measure used by the auditor in concluding that seat capacity requirements were met by the airlines
- any other material that is relevant to the auditor's analysis of compliance.

For the purpose of this Report if the matters raised in this letter have been addressed by **23 January 2012** the ACCC will take Virgin Australia and Air New Zealand (through Pitcher Partners) as having met the requirements of clause 3.5(a) of the Conditions regarding the timeframe for provision of the first audit report. The ACCC

reserves its right to assess substantial compliance at that stage. In the future, the ACCC expects that the matters outlined above will be addressed in each written audit report to be provided pursuant to clause 3.5 of the Conditions.

This letter has been placed on the ACCC's public register. If you wish to discuss any aspect of this matter, please do not hesitate to contact Imogen Hartcher-O'Brien on (02) 6243 1049.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D Hatfield', written in a cursive style.

David Hatfield
A/g General Manager
Adjudication Branch