## Pfitzner, Laura

| | |
|---|---|
| **From:** | Rebecca Dollisson <rdollisson@gtlaw.com.au> |
| **Sent:** | Thursday, 25 July 2013 7:35 PM |
| **To:** | Basile, Mark; Hartcher-O'Brien, Imogen; Channing, Darrell |
| **Cc:** | Luke Woodward |
| **Subject:** | VA/NZ - Submission in response to the ACCC Draft Determination - Public Register Version [G+T-Docs.FID20084916] |
| **Attachments:** | 30203963_1_PUBLIC VERSION - VA-NZ Submission in response to ACCC Draft D....pdf |

Dear Mark and Imogen

Please find attached the public version of the response of the Alliance Parties to the Commission's Draft Determination.

Relevant to the request in the Draft Determination for further information on the competitive effect of the Alliance on Auckland-Brisbane we note that:

China Airlines has today announced that it will increase capacity on its three times weekly Auckland-Brisbane-Taipei route from Airbus A330 to its flagship Boeing 747-400 aircraft. This increase in capacity is to cater for increased demand, both inbound and outbound, over the New Zealand summer, from November 29 2013 to February 28 2014. The larger aircraft features an additional 82 seats per flight, or over 6500 extra seats across the busy summer season.

Please let us know if you would like to discuss this further.

Kind regards,

Luke and Rebecca

Rebecca Dollisson | Lawyer | Gilbert + Tobin | T +61 2 9263 4349 | F +61 2 9263 4111 | E rdollisson@gtlaw.com.au
2 Park Street Sydney NSW 2000 Australia | www.gtlaw.com.au

**Restriction of publication claimed in part**

GILBERT + TOBIN

LAWYERS

# Applications for reauthorisation of the Virgin Australia and Air New Zealand Australasian Airline Alliance

## Confidential submission in response to Draft Determination

**24 July 2013**

**PUBLIC VERSION**

# Contents

# 1 Executive Summary

**Draft Determination**

On 10 July 2013, the Commission released a Draft Determination which proposed to re-authorise the Alliance for a period of three years.

Whilst the Applicants welcome the Commission's positive Draft Determination, they make the following comments:

- The public benefits generated by the Alliance are substantial.
- There is no evidence of any anti-competitive effect from the Alliance on the Tasman or any individual route and there has been no evidence of any adverse fare effect.
- Public benefits from the Alliance will continue to substantially outweigh any potential for public detriment on reauthorisation.
- Proposed conditions should be proportionate and appropriate so as not to create market distortions and interfere with the realisation of public benefits under the Alliance.
- Benefits of a 5 year term, versus a 3 year term, are substantial.

**ACCC Conditions**

The Draft Determination proposes a set of three conditions to address the Commission's competition concerns including:

- **a reduced term**: three years rather than the requested term of no less than five years;
- **capacity conditions**: in some cases grouped (to address the adverse effects of route specific conditions) and for others on a route-specific basis; and
- **reporting of specific Alliance performance data at the end of each scheduling season (ie, every 6 months):** allowing the Commission to monitor and assess the impacts of the Alliance on competition.

In effect, the three conditions overlap in addressing the same concern as to potential anti-competitive effects.

**Applicants' proposal**

The Applicant's consider that the proven public benefits of the Alliance will continue to substantially outweigh any potential public detriment following reauthorisation such that no conditions are required. However, if the Commission remains of the view that conditions are necessary, the Applicants propose the following:

- a 5 year term of authorisation from 1 January 2014. Capacity conditions and continuing reporting obligations are in place to address any potential competition concerns and as such there is no greater competition risk of a 5 year term than a 3 year term.
- capacity conditions commencing from Northern Summer 2014 on the following routes: Brisbane – Wellington; Brisbane – Christchurch; Brisbane – Dunedin; Brisbane – Queenstown; and
- regular reporting of specific Alliance performance data

The Applicants proposal would address the concerns highlighted by the Commission in the Draft Determination whilst minimising the distortionary effect of the capacity conditions on the market and maximising the potential to achieve the further public benefits available under the Alliance.

# 2 Public benefits will continue to outweigh any public detriment

### 2.1 Balance of public benefits and detriments

The Draft Determination notes that the public benefits and public detriments likely to result from the Alliance are finely balanced. Further, in order to assist in its assessment of the benefits and detriments and allow it to reach a concluded view the Commission has requested additional information.[1]

The Applicants are of the view that the public benefits and detriments of the Alliance are not finely balanced. Public benefits will continue to outweigh any public detriment following reauthorisation. This is strongly reflected by the market dynamics of the Tasman, market evidence and experience to date and the fact that there is no evidence to date of any anti-competitive effect. As discussed further, the opposite is the case.

### 2.2 Public benefits achievable under the Alliance are substantial

The Draft Determination accepted that the Alliance has resulted in material public benefits and that there are further material benefits to be realised following reauthorisation.

The Applicants have provided a significant body of evidence to show that:

- despite the short operation of the Alliance, these public benefits are not only material but substantial;
- the Alliance has been critical to providing greater competition on the Tasman generally and in domestic Australia, particularly in relation to competition for corporate and frequent travellers; and
- without the Alliance, the Tasman operations of both Applicants would be diminished to the detriment of consumers.

Evidence of public benefits in response to the areas identified in the Draft Determination is set out below and referenced at **Annexure A**.

Also, Virgin Australia would welcome the opportunity to meet with the Commission to discuss the supplementary evidence it has provided on the relevant counterfactual and the impact of the Alliance on competition on the Tasman and in domestic Australia.

### 2.3 There is no evidence of any anti-competitive effects on the Tasman or any individual route

The Draft Determination raises the concern that the Alliance will increase the ability and incentives of Virgin Australia and Air New Zealand to unilaterally reduce or limit growth in capacity in order to raise airfares. The experience of the Alliance to date shows the opposite. The Draft Determination also raises a general concern as to the potential for coordinated effects which is discussed below.

[1] ACCC, Draft Determination to application for authorisation lodged by Virgin Airlines Pty Ltd and Air New Zealand Limited and Others, dated 10 July 2013 (**Draft Determination**), at paragraph 552.

The Applicants acknowledge the proposed removal of conditions on Wellington-Melbourne/Sydney routes because the Commission is of the view that the Alliance is unlikely to have an increased ability or incentive to unilaterally reduce or limit capacity[2]. The Applicants agree with this conclusion.

*The Alliance parties have increased capacity*

From the Pre-Alliance Year to Year 1, the Applicants increased trans-Tasman capacity by 10.1% excluding Christchurch routes (5% including Christchurch routes).[3] Over a similar period, Australian GDP (which is used in the current capacity conditions as a proxy for growth in demand) increased by 3.3%, while New Zealand GDP increased by 2.5%.

The Alliance provides the Applicants with the commercial opportunity and incentive to increase capacity. The commercial rationale behind the Alliance is to provide a more competitive offering that passengers value which incentivises an increase in capacity rather than a reduction. The incentive has been realised through increased demand for Alliance services and actual capacity increases by the Alliance. The evidence is clear that the Alliance parties would not have been in the same position to increase capacity and would not have implemented the level of capacity increases without the Alliance.

In fact, there is clear evidence that absent the Alliance, Tasman capacity would be reduced. As noted in its public submissions on the counterfactual, absent the Alliance, both Virgin Australia and Air New Zealand would not grow capacity on the Tasman and would be required to withdraw capacity and services on some routes in accordance with commercial business performance.[4] This would reduce competition.

Nor can it be said that Alliance capacity increases are purely the result of capacity conditions.

On non-condition routes the Applicants have increased seat capacity on all routes with the exception of the earthquake affected Christchurch routes and Auckland-Cairns (which is a highly seasonal, predominantly leisure route which suffers from low demand). The Applicants have grown capacity by 7.6% on non-condition routes excluding Christchurch markets. They have also launched two new routes, Auckland-Maroochydore and Christchurch-Perth on the basis of the greater ability to generate traffic onto Alliance services with the combined marketing strength and feeder traffic of both airlines.

Contrary to the concerns raised in the Draft Determination, the evidence shows that the Alliance has actually increased the opportunity and incentive of the Applicants to increase trans-Tasman capacity. Furthermore, where there is the demand to support it, the Applicants have grown capacity on condition routes beyond what is required by the conditions. For example, under the current conditions the Applicants were required to increase capacity on Sydney-Queenstown by 3.5% from the Pre-Alliance year to Year 1. Instead, the Applicants have grown capacity by 18.1%. Capacity on SYD-ZQN has

---

[2] Draft Determination paragraph 548.

[3] The ACCC acknowledged the impact of the Christchurch earthquakes on demand when it agreed to vary the conditions. In February 2011, compliance with the capacity conditions was varied by the ACCC in response to the Christchurch earthquakes on 27 July 2011 for the Northern Summer 2011 and Northern Winter 2011 scheduling seasons. The ACCC made a further variation on 31 May 2012 for the Northern Summer 2012 and Northern Winter 2012 scheduling seasons due to the continued impact of the February 2011 earthquakes and the series of high magnitude aftershocks that followed.

[4] Virgin Australia, Confidential submission on the counterfactual (**Virgin Australia's Counterfactual Submission**) provided to the Commission by email on 25 June 2013, at pages1 and 5.

grown in response to demand. This is the best outcome for the market as opposed to capacity increases which are the result of imposed capacity conditions.

*The Alliance parties have reduced fares, despite substantial increases in fuel costs*

The Applicants firmly consider that the Alliance has allowed them to lower overall fares and that this in turn will have resulted in lower overall market fares as Qantas in particular has had to respond to the more competitive service offering provided by the Applicants.

Even if the Commission considers the evidence of causation equivocal, there has been no evidence of an anti-competitive effect on overall fare levels or the availability of fares in lower fare classes.

Under the Alliance, the Applicants have been able to:

- provide consumers with a better product offering at a better price than would be possible without the Alliance;
- reduce combined average fares by **[CONFIDENTIAL]**% from the Pre-Alliance Year to Year 1[5] despite at least a 35% increase in the price of Singapore Jet kerosene over the same period. A **[CONFIDENTIAL]**% reduction in combined average fares in a market where there has been a 35%-45% increase in the fuel cost per passenger (based on the CASA published fuel burn rates for a 737-800 flying with a 80% load factor) is clearly inconsistent with the conclusion that the Alliance has resulted in anti-competitive unilateral effects;[6]
- increase the number of Alliance economy customers paying lead-in or sales fares on Alliance services. From the Pre Alliance Year to Year 1 the number of Alliance total Tasman customers sold lead-in or sales fares increased by **[CONFIDENTIAL]** which is an increase of **[CONFIDENTIAL]**%;[7]
- provide consumers with lower connecting domestic fares than would be possible without the Alliance by passing through to consumers the reduced pro-rate costs and the cost reduction from the reduction in double marginalisation. In Year 1, Air New Zealand sold journeys that included a domestic Australian sector at significantly lower fares than in the Pre Alliance Year; and[8]
- provide consumers with lower fares in corporate/government packages than would otherwise be the case.[9]

As noted above, the reduced fares under the Alliance have been realised despite very substantial increases in fuel prices and costs over this period in an industry where fuel is

---

[5] Australasian Airline Alliance between Virgin Australia Group and Air New Zealand, Confidential submission in support of application for reauthorisation (**Reauthorisation Submission**), dated 8 March 2013, at Confidential Annexure H.

[6] see Applicant's response to the ACCC's further questions of 28 June 2013. Specifically, the fuel cost information provided by Air New Zealand on 9 July 2013 and the fuel cost information provided by Virgin Australia on 8 July 2013.

[7] Reauthorisation Submission, dated 8 March 2013, at pages 34-35.

[8] Refer to previous submissions re lower pro rates; See Air NZ Confidential Annexure J to the Original Submission; Air NZ confidential response to Q6 and 7 of 13.0-5.14 information request.

[9] See Virgin Australia's Counterfactual Submission provided by email on 25 June 2013, as well as the confidential supplementary evidence on the importance of the Alliance to competition for corporate and high frequency travellers in Australia and on the Tasman as provided by email on 1 July 2013.

a major cost driver.[10] This is clear evidence of the highly competitive nature of the Tasman.

The Average Alliance fare movement by sector in A$ as a percentage change from the Pre-Alliance Year to Year 1 is set out in the table below.

| [CONFIDENTIAL] | | | |
|---|---|---|---|
| **Sector** | | **Sector** | |
| ADL-AKL | [CONFIDENTIAL] | BNE-ZQN* | [CONFIDENTIAL] |
| AKL-BNE | | CHC-MEL* | |
| AKL-CNS | | CHC-OOL | |
| AKL-MCY | | CHC-SYD | |
| AKL-MEL | | DUD-MEL* | |
| AKL-OOL* | | DUD-SYD* | |
| AKL-PER | | MEL-WLG | |
| AKL-SYD | | MEL-ZQN | |
| BNE-CHC* | | ROT-SYD | |
| BNE-DUD* | | HLZ-SYD | |
| BNE-HLZ | | SYD-WLG | |
| BNE-WLG* | | SYD-ZQN | |
| **TOTAL** | [CONFIDENTIAL] | | |

*ACCC proposed capacity condition routes

Consumers are not only benefiting from lower average fares, lower connecting fares and more fares in lower classes, they are also benefiting from having a better service offering which in turn stimulates demand and enables further cost reductions through higher load factors and other efficiency savings. The Alliance is effectively providing better choice for consumers with products and fares that appeal to both price sensitive holiday makers, and time-poor corporate travellers. This has created a competitive response from other competitors, who have responded by lowering their prices to compete with the Alliance offering on the Tasman (as reflected in the increase in sales activity on the Tasman since the Alliance) as well as on connecting flights into domestic Australia and New Zealand. This is particularly the case in relation to the provision of corporate packages. [11]

Contrary to the concerns raised in the Draft Determination, the evidence shows that the Alliance has actually increased the ability of:

- the Applicants to provide lower fares than would otherwise have been the case; and

[10] See Applicant's response to the ACCC's further questions of 28 June 2013. Specifically, the fuel cost information provided by Air New Zealand on 9 July 2013 and the fuel cost information provided by Virgin Australia on 8 July 2013.

[11] The Draft Determination recognises that the Alliance has resulted in material public benefits from the promotion of competition on the Tasman, particularly in relation to the business traveller segment and the Alliance is likely to result in similar benefits in the domestic market. See Draft Determination at paragraph 3.10. See also the information provided in Virgin Australia's confidential supplementary evidence on the importance of the Alliance to competition for corporate and high frequency travellers in Australia and on the Tasman, as sent by email on 1 July 2013.

- consumers to receive lower fares whether or not they fly on an Alliance service or on a competitor's service.

*There is no evidence of any anti-competitive effects on the Tasman or on any individual route*

In particular, there is no evidence of anti-competitive effects on the routes identified as of concern in the Draft Determination. This is reflected in the reduction in airfares on 7 out of 8 of the Commission's proposed condition routes under the Alliance, as set out in the table above. Further information on these routes is provided at **Annexure B**.

*There is no evidence of any adverse coordinated effects*

Market experience is not consistent with the existence of coordinated effects on the Tasman for the following reasons.

- Such behaviour is not reflected in the fare or capacity outcomes of the Alliance discussed above.
- The Tasman is a highly competitive, dynamic market with low barriers to entry and expansion. It has a history of frequent innovation by all carriers and is subject to instability in demand levels as a result in external shocks (eg, earthquakes) and dramatic fluctuations in costs (eg, fuel).
- Different carriers have different cost bases and differentiated products.
- Air New Zealand, Qantas Group/Emirates and Virgin Australia have different incentives in other markets and any ability to coordinate on scheduling decisions would involve consideration of the different impacts on each airline's broader network offering which would increase the cost/difficulty of coordination.
- Unsold seats on a departing plane are worthless. Once capacity is in the market (and there is substantial capacity in the Tasman market), the commercial pressure to sell seats would likely swamp any theoretical gains from setting fares high. The Tasman has a history of demand for trans-Tasman air passenger services being consistently supported by substantial capacity growth and there is currently excess capacity across the Tasman overall as well as on particular routes.

It is noted that the Commission granted authorisation to the Qantas/Emirates alliance after concluding that the Alliance will provide the major competitive constraint on the Qantas/Emirates alliance for the foreseeable future (while noting that the Alliance by itself is not a sufficient constraint).[12] The Applicants agree with this conclusion. However, this conclusion is not consistent with a suggestion that following reauthorisation of the Alliance, Qantas/Emirates and Virgin/Air New Zealand would explicitly or tacitly compete less aggressively.

## 2.4 Strong competitive constraints and incentives will remain after reauthorisation

The Tasman is, and has consistently been, a highly competitive market. It is one of the most competitive and open international routes out of Australia.

---

[12] ACCC, Determination in response to application for authorisation lodged by Qantas Airways Limited and Emirates (**Determination re Qantas/Emirates Alliance**), dated 27 March 2013, at paragraph 501.

The Tasman has a large number of carriers, including FFCs (which can engage in marginal cost flying with large planes) and is also served by Jetstar, Qantas's international short and medium haul low cost carrier.

There are no material regulatory, infrastructure or other barriers to entry, as noted in the submission of the Department of Infrastructure and Transport.

The Tasman has a history of persistent strong capacity growth and, in fact, over capacity, as noted in previous submissions.

The Tasman has a history of strong fare competition, also as noted in previous submissions, and consistent with the Commission's own econometric analysis conducted for the purpose of the original authorisation decision. This analysis is discussed in **Annexure C**. It shows that Jetstar provided a strong competitive constraint to both Air New Zealand and Virgin Blue (as it then was).

The Alliance will also continue to face a strong competitive constraint from Qantas, Jetstar and Emirates under their authorised Alliance.

Jetstar poses a significant constraint on the Alliance, irrespective of its inclusion in the above mentioned Qantas Group/Emirates Alliance. Jetstar has a strong Australian and New Zealand domestic network, great brand presence, and has shown its ability to rapidly deploy and expand in response to market opportunities.

The Applicants note that the Draft Determination has questioned the ability of Jetstar to continue to constrain the Alliance, given Virgin Australia's changed product offering away from being an LCC. However, this is not reflected by market evidence (a market which is ideal for LCC's given 77% of traffic is VFR and leisure) and is not consistent with the Commission's recent quantitative findings as to the constraint of Jetstar in the 2010 authorisation decision. The Applicants have also previously provided detailed and substantial econometric evidence to the Commission showing the competitive fare response of both Air New Zealand and Virgin Australia to the Jetstar product offer.

For further information on the significant constraint that Jetstar poses, see **Annexure C**.

The particular routes that the ACCC has identified as of concern also demonstrate strong competition, or otherwise are marginal routes, which can sustain only limited operations (in some cases single operator services). Further information on competitive constraints on the routes identified as of concern in the Draft Determination is provided in **Annexure B**.

Finally, it is noted that the commercial rationale and incentives generated by the Alliance are pro-competitive and enable the Alliance to increase capacity and provide lower fares than would otherwise be the case.

As discussed above, contrary to the concerns raised in the Draft Determination, the Alliance has resulted in the Applicants having a greater incentive and ability to increase capacity and provide lower fares than would otherwise be the case on the Tasman but also in relation to domestic connections and in the provision of corporate/government packages. These incentives continue post reauthorisation.

# 3 Proposed conditions to address perceived competition concerns

## 3.1 Proposed measures to address perceived concerns

### (a) The proposal in the Draft Determination

The Draft Determination proposes a set of three conditions to address the Commission's competition concerns including:

- **a reduced term**: three years rather than the requested term of no less than five years;
- **capacity conditions**: both route specific and grouped (to address the distortion and inflexibility of route-specific conditions) covering:

  Dunedin-Melbourne; Dunedin-Sydney; Auckland-Gold Coast; Christchurch-Melbourne; Christchurch-Brisbane; Brisbane-Dunedin; Brisbane-Queenstown; and Brisbane-Wellington; and

- **reporting of specific Alliance performance data at the end of each scheduling season:** allowing the Commission to monitor and assess the impacts of the Alliance on competition over the term of the authorisation. This obligation is in addition to the independent audit of capacity condition compliance.

Even if it is accepted that the balance of public benefits and detriments is "fine", the Draft Determination is effectively imposing three overlapping conditions to address the same concern as to potential anti-competitive effects.

These conditions, particularly the reduced term and route conditions have the potential to undermine the achievement of public benefits and impede the efficient and competitive operations of the Alliance.

While the Applicants maintain that no conditions are necessary, where the Commission remains of the view that conditions are required, the Applicants submit that the Commission's concerns can appropriately be addressed through a less restrictive set of conditions.

### (b) Applicants proposal

| Term | |
|---|---|
| | 5 years<br>(from 1 January 2014) |
| **Routes covered** | |
| | Brisbane – Wellington |
| | Brisbane – Christchurch |
| | Brisbane – Dunedin |
| | Brisbane – Queenstown |
| **Commencement** | |
| | From Northern Summer 2014 |

This proposal addresses the concerns highlighted by the Commission in the Draft Determination whilst minimising the distortionary effect of regulatory intervention in the market and maximising the potential to achieve the further public benefits available under the Alliance.

### 3.2 Term – Reauthorisation should be for 5 years from 1 January 2014

The Applicants submit that the term of the authorisation should be 5 years from 1 January 2014. A five year term provides no materially greater risk of anticompetitive detriment outweighing consumer benefits than a 3 year term. In addition, it provides an increased level of certainty and the confidence for the Applicants to continue to invest in key projects that will drive benefits from the Alliance **[CONFIDENTIAL]**.

#### (a) Route conditions and reporting are sufficient to address concerns as to a potential anti-competitive effect

The Applicants submit that a reduced term is not required in conjunction with the capacity conditions and detailed reporting requirements which allow the Commission to monitor the competitive performance on the Tasman. The Commission has the power to reopen authorisation where it has reason to believe that a material change in circumstances (which would include competitive effects) has occurred.

The route conditions provide a direct safeguard against competition concerns on those routes identified as potentially giving rise to a specific competition issue. More generally, if the ACCC has concerns with any trends that are showing in the data the Applicants are reporting, the Commission has the ability to review the authorisation.

Accordingly, the Applicants seek authorisation for 5 years from 1 January 2014, as the competition concerns are addressed through the capacity conditions and the continuing reporting obligations.

#### (b) Ability for the Commission to review the authorisation

Section 91B(3) of the Competition and Consumer Act 2010 provides that the Commission may review (and ultimately decide to revoke) an authorisation if it is satisfied that:

- the authorisation was granted on evidence or information that was materially false or misleading;
- a condition of authorisation has not been complied with; or
- there has been a material change of circumstances since the authorisation was granted.

For example, it would be open to the Commission to review performance under the authorisation in the first 3 years of the reauthorisation, using the data provided as part of the reporting obligations and then initiate a review of the grant of authorisation if it were to consider there had been be a material adverse change in circumstances.

#### (c) There are significant risks and costs associated with having a shorter authorisation term

*Removal of a competitive constraint on Qantas/Jetstar/Emirates Alliance*

There is a material competition risk in a reduced term, as it leaves open the potential that there will not be a viable competitive alternative to the Qantas/Jetstar/Emirates Alliance. It is clear that stand-alone Virgin Australia is not in a position to provide a competitive constraint to Qantas/Jetstar/Emirates and Air New Zealand would also be in a materially weaker position, particularly for Australian travellers.

The removal, or imminent removal, of a competitive alternative to the Qantas/Jetstar/Emirates Alliance will potentially distort market behaviour (eg, allowing it to increase prices or lower prices and display dominant behaviour) . As noted by the Commission in the Qantas/Emirates Determination, the Virgin Australia/Air New Zealand Alliance is critical to providing an effective constraint on the Qantas/Jetstar/Emirates Alliance.

The Qantas/Jetstar/Emirates Alliance has been authorised for the standard 5 year term typical for airline alliances. If the Virgin Australia/Air New Zealand Alliance is only authorised for a 3 year term, this creates a gap, and creates uncertainty, in the Alliance's ability to constrain the Qantas/Jetstar/Emirates Alliance. One implication of this is that at the time of any reauthorisation application for the Virgin Australia/Air New Zealand Alliance, the Commission would need to seek to revisit the Qantas/Jetstar/Emirates Alliance on the basis that if the Virgin Australia/Air New Zealand Alliance is not reauthorised that would be a material adverse change in circumstances.

*Undermine integration and implementation under the Alliance*

Three years is not a long time given the way that airlines operate and the timeframes involved in airline planning and decision making. This is not a long enough time to fully achieve all the benefits that could be derived from deeper integration between the Applicants. Nor does it provide the ability and certainty required to engage in the planning necessary for longer term decisions and opportunities such as **[CONFIDENTIAL]**.

In addition, a longer period allows the Applicants to realise the benefits and amortise the high cost of deeper integration over a longer period. There would also be a high cost to the parties if they have to unwind joint arrangements after only three years.

The greater uncertainty created by a shorter authorisation term restricts the Applicants from making the most of the Alliance.

**[CONFIDENTIAL]**

This is particularly significant given that this Alliance, compared to other airline alliances, has the opportunity to have such deep integration and deliver substantial benefits to consumers.

The relationship between the term of an authorisation and the ability to realise benefits was recognised by the Commission in its determination to grant authorisation to the Australian Dairy Farmers Ltd on 4 August 2011[13] when the Commission determined to grant authorisation for a term of 10 years, rather than the 5 years sought by the applicant. Several of the factors listed by the Commission in support of its decision in that case apply to this application, including:

[13] ACCC, Determination in response to application for revocation of A90966 and substitution with A91263, as lodged by Australian Dairy Farmers Ltd, dated 1 August 2011, at paragraphs 4.91 to 4.97.

- the Commission has the ability to review the grant of authorisation in light of any changed circumstances;
- time and money are likely to be saved through reduced administrative burden with a longer term authorisation; and
- the authorised arrangements have been in place for a number of years and are well understood by the applicants and other relevant parties.[14]

In respect of the Commission's view that the benefits/detriments are "finely balanced", a reduced term actually undermines the ability to achieve and deliver the benefits of the Alliance, even over the same three year period, let alone enhanced benefits that will cumulatively grow over the longer period.

Undermining the ability and incentive of the Applicants to further develop the Alliance is also likely to undermine its competitive position against the Qantas/Jetstar/Emirates Alliance.

A 5 year term has been standard for airline alliances, even those that have been described as finely balanced. A 5 year term reflects the significant investments that are required for a deep airline alliance, and recognises that the real benefits of such an alliance flow over time. This is particularly the case for the Virgin Australia/Air New Zealand Alliance. This can also be contrasted with the Qantas/Jetstar/Emirates Alliance on the Tasman for whom any investment in their Tasman coordination is incidental to and mitigated by the benefits from their global alliance.

*In three years' time, there will be a similar lack of relevant data to draw firm conclusions*

In considering this reauthorisation, the Commission has only the benefit of data for effectively 18 months of authorisation operation. By the time, the Applicants are required to again apply for reauthorisation the Commission will be in a similar position in that it will only have an additional 18-24 months of opportunity and data to properly assess the public benefits and detriments generated by the Alliance under the new authorisation and conditions.

While the combined data set will be longer, there remains a limited period for the collation of additional data between the end of the current authorisation and the application for further reauthorisation.

Importantly, the Commission is likely to have only 18-24 months of data in the period of operation of the Qantas/Jetstar/Emirates alliance. Consequently, in 2 and a half years' time when the Commission is considering further reauthorisation, it will again have the data gaps that have left it in a position where it is unable to fully evaluate the benefits and detriments of the Alliance.

Further, given the program of further integration initiatives, the Commission will have a very small period of time and insufficient data available to properly assess the outcomes of the opportunities for deeper integration under the Alliance.

---

[14] The Applicants acknowledge that the Alliance has been in place for a relatively short period (in industry terms), however their experience is that the Alliance is well understood in the industry.

*Conclusion*

The evidence to date, summarised in this submission, as to the competitive incentives under the Alliance, and the highly competitive nature of the Tasman market, is such that there is no materially greater risk of anticompetitive detriment outweighing consumer benefits by granting a 5 year term over a 3 year term. The competition risks will not grow over time, and the public benefits will clearly grow over time.

This is particularly the case where there are tailored route conditions and on-going reporting, with the opportunity to review actual experience under the authorisation over time.

On the other hand, there are costs to imposing a conditional 3 year authorisation. It undermines the ability of the Alliance parties to commit to and fully develop the Alliance, resulting in the prospect of lower overall achieved benefits and importantly a weaker constraint to the authorised Qantas/Jetstar/Emirates Alliance on the Tasman.

Further, in 2 and a half years' time, when the Commission is considering the case for reauthorisation it is likely to be in a similar position to today, where it has insufficient experience under the Alliance to fully evaluate its benefits and potential detriments.

### 3.3 Routes covered – Market dynamics do not support the application of conditions on DUD-MEL; DUD-SYD; AKL-OOL and CHC-MEL

The Draft Determination proposed conditions on: Dunedin-Melbourne; Dunedin-Sydney; Auckland-Gold Coast; Christchurch-Melbourne; Christchurch-Brisbane; Brisbane-Dunedin; Brisbane-Queenstown; and Brisbane-Wellington.

The routes identified as being of concern to the Commission in its Draft Determination cover only 18% of total Tasman traffic.[15] The Applicants have provided further information on why conditions are not appropriate or necessary on these routes in **Annexure B**. Conditions on DUD-MEL; DUD-SYD; AKL-OOL and CHC-MEL are unsupportable in light of actual market dynamics and the counterfactual.

We note that the Draft Determination did not find the Auckland-Brisbane and Auckland-Cairns route to have competition concerns but did request further information on the competition effects of the Alliance on these routes. This is also provided in **Annexure B**.

*Dunedin-Melbourne and Dunedin-Sydney*

As set out further in **Annexure B**, Dunedin-Melbourne and Dunedin-Sydney are thin seasonal routes, which have always been served by a single operator. It is extremely unlikely that both Virgin Australia and Air New Zealand would compete on these routes in the counterfactual. **[CONFIDENTIAL]** Capacity conditions, including conditions with growth factors, on these routes are likely to have particularly adverse effects on overall optimal network planning, to the likely detriment of developing alternative routes.

*Auckland-Gold Coast*

As set out further in **Annexure B**, Auckland-Gold Coast is a highly competitive route, that fits with the set of Brisbane/Gold Coast/Maroochydore-Auckland routes, serving the

[15] Draft Determination, at paragraph 543.

South East Queensland region. There is a high degree of competitive overlap between these routes. Further, the route, which is largely a leisure/VFR route is particularly suited to the budget travel product of Jetstar. As discussed in **Annexure C**, and consistent with the Commission's previous quantitative findings, Jetstar is the major competitive constraint on this route and has 37% market share.

*Christchurch-Melbourne*

As set out further in **Annexure B**, Christchurch-Melbourne is also a highly competitive route, where Jetstar is the major competitive constraint with a 37% market share. The route has been operated in the past by both Qantas and Emirates and is likely to be attractive to FFC entry/re-entry when route conditions improve as Christchurch recovers following the 2011 earthquake.

As a result, if conditions are to be applied at all, they should only apply to BNE-WLG; BNE-DUD; BNE-CHC and BNE-ZQN. As previously noted, while the Applicants consider that market evidence does not support conditions being applied to these routes either (further information on the competitive constraints on these routes is provided in **Annexure B**), the Applicants proposal includes capacity conditions on these routes.

### 3.4 Structure – Grouping routes is less distortionary than route specific conditions

The Draft Determination considers capacity conditions in terms of groups of routes in order to provide the flexibility to adjust capacity across the routes of concern to respond to changes in market conditions. The Applicants support this approach as, although it requires the maintenance of capacity across several routes, it makes it somewhat easier for the Alliance to react to changes in demand and respond to external events. This in turn increases operational efficiency and therefore provides the Alliance with a greater ability to decrease fares.

Individual route capacity conditions artificially distort the allocation of capacity much more significantly than conditions on a group of routes. There is no public benefit in growing capacity beyond demand but route-specific capacity conditions that require a growth factor can result in this outcome. For example, our experience on the Wellington routes under the current conditions as noted in the original submission, has resulted in capacity that has grown ahead of the demand growth resulting in significant excess capacity[16]. **[CONFIDENTIAL]**

Inflexible capacity conditions have a distortive effect on resource allocation and competition, and route development. They also effect price tension between substitute airports and suppliers, as discussed in detail in the Applicants' original submission to the Commission. For example, capacity conditions may:

- discourage new entrants;
- create distortive effects caused by competitor and supplier knowledge of the Applicants' obligation to operate according to a rigid, formula driven capacity floor per scheduling season;

[16] Reauthorisation Submission at paragraph 5.21.

- lessen operational and scheduling efficiencies by mandating a specified level of capacity on particular routes when there are better places to direct that capacity to satisfy changes in consumer demand.

The distortive effects described above are decreased with the application of conditions to route groupings rather than specific routes.

**(a) Proposed South Island grouping**

The Applicants propose that Brisbane-Queenstown, Brisbane-Dunedin and Brisbane-Christchurch be grouped together. This grouping is based around the origin/destination of Brisbane (instead of the Draft Determination's origin/destination bases of Dunedin and Christchurch). All three routes service lower South Island destinations, which are used interchangeably by customers. Not only does the grouping reflect consumer behaviour, it also provides the Applicants with the level of flexibility required to enable them to respond to market demands and allocate capacity dynamically during the scheduling season.

*The three routes are complementary*

Brisbane-Queenstown is a relatively thin route operated on a seasonal basis, which has higher demand during the ski season. In comparison, demand on the Brisbane-Dunedin sector is focussed around the school holidays when demand from leisure passengers and those visiting friends and family is greatest. Combining these routes as a group gives the Applicants the ability to usefully match capacity to demand year round while taking into account the travel requirements of all passenger groups.

*The three South Island destinations are often used interchangeably by customers*

The three routes also operate interchangeably for both New Zealand and Australian passengers. Christchurch Airport is seen as the "gateway to the South Island" including Queenstown and Dunedin, and promotes itself as such.[17] The significance of Christchurch Airport to the economic wellbeing of the entire South Island is demonstrable. Last year, Business and Economic Research Limited found that Christchurch Airport generated $1.7 billion in regional GDP, 6% of the total GDP for Canterbury and 3.9% of total GDP for the South Island.[18]

Due to the capacity and regularity of the flights, Christchurch is often used as an arrival destination (or departure point) for travellers who drive between Christchurch and other destinations in the South Island such as Dunedin or Queenstown. Flights in and out of Christchurch are also often paired with less regular flights in and out of other South Island origin/destinations.

For example,

- Australian travellers will commonly fly Brisbane-Christchurch, drive to Queenstown and fly home via Queenstown-Brisbane;

[17] See the CIAL website, which focusses on South Island travel and states that it is "bringing the world South": eg,http://www.christchurchairport.co.nz/en/south-island-travel/activities/.

[18] Assessment was based on the 2010 calendar year. See http://www.christchurchairport.co.nz/en/about-us/media-centre/media-releases/2013/christchurch-airport-opens-new-terminal-building/ for more detail.

- as there are less than daily services on the Brisbane-Dunedin route, travellers often fly in or out of Dunedin using this route, and then use a domestic connection for the other leg of their 'return' flight, thereby maximising the benefit of the comprehensive Alliance schedule (eg, flying BNE-DUD one way, and DUD-CHC-BNE the other way).

- New Zealanders living in the lower South Island will choose which of the three ports best suits their needs by taking into consideration the scheduled time and day of departure, price and drive time (eg, a passenger living in Invercargill may choose to either drive to Queenstown or Dunedin to fly direct to Brisbane, or alternatively may choose to fly IVC-CHC-BNE).

*South Island routes are interchangeable from an Alliance perspective*

In addition, these 3 routes all compete for the same aircraft time. For example, the aircraft servicing a Brisbane-Queenstown flight is usually scheduled to travel this route as part of a greater series of flights between CHC-BNE-ZQN-BNE-CHC. However, because Dunedin and Queenstown are approximately the same flight time, the same aircraft can alternatively be used to fly a daily service into Dunedin or to fly a second daily service into Christchurch (hence CHC-BNE-**DUD**-BNE-CHC or CHC-BNE-**CHC**-BNE-CHC). Note that the Alliance cannot operate in or out of Queenstown at night due to operational restrictions, and therefore operates the Brisbane-Queenstown flight in the middle of the schedule to ensure that the flight can perform a second Tasman journey and return to Christchurch. When the Christchurch-Brisbane service is operating at double daily (which is 83% of the year) the CHC-BNE-**CHC**-BNE-CHC option provides the best spread of timings on the Christchurch-Brisbane route – to operate a second service using a different aircraft would be inefficient and would most likely result in wing-tip flying. The Applicants' proposed grouping therefore enables the Applicants to interchange services as necessary to provide the best possible schedule to meet the needs of the consumer (ie, providing enough capacity on each route), while minimising the downside of scheduling limitations (eg, wingtip flying and congestion in peak season and limited operational windows into Queenstown airport due to daylight restrictions). In addition, the proposed grouping provides the Applicants with the ability to spread additional frequencies between the markets depending on seasonal demand.

**(b) Brisbane-Wellington**

If route conditions are maintained on the Brisbane-Wellington route, there are two options.

One option is to have a route-specific condition. This poses the greatest risks and costs, as recognised by the Commission.

The other option is to group this route together with the South Island grouping. This has the benefit of mitigating the adverse route specific effects recognised by the Commission and addressed in previous submissions. While Brisbane-Wellington may be seen to differ from the other South Island condition routes, the benefits of its inclusion in a group would offset that. It is noted that the Qantas/Emirate route conditions are grouped together across non-alike routes.

Irrespective of which option is chosen it is particularly important that the capacity condition for Brisbane-Wellington has a zero growth factor, **[CONFIDENTIAL]**. Please see **Annexure B** for further details regarding the excess capacity on Brisbane-Wellington.

**(c) Other proposed routes**

If, despite the Applicants' submissions, the Commission still considers capacity conditions are required on the other routes of concern (AKL-OOL, CHC-MEL, DUD-SYD and DUD-MEL), then, given the matters raised above, these routes should also be included in a grouping such that there are no route specific conditions. The Applicants would wish to discuss with the Commission appropriate grouping options.

### 3.5 The conditions should commence from Northern Summer 2014

The new capacity commitments should commence from the start of NS14 (commencing April 2014). Commencing the capacity conditions earlier would have a material negative impact on the Applicants and consumers. Capacity for NW13 has already been planned and slots were confirmed at the recent Copenhagen slot conference.

If the Applicants were required to grow capacity in NW13 on the nominated sectors this may require last minute additional capacity to be added and altered, which would be difficult for the Applicants to achieve without adversely affecting flights already scheduled, and the passengers already booked on these flights. It also has the potential for the Applicants to offer capacity for which there would not be demand.

It is noted that the existing capacity commitments will effectively continue until the end of NW13, as they have applied in the network planning for the NW13 season, which has already been completed. The Applicants have already begun selling this schedule and key dates, especially around Christmas and New Year, already have significant loads and therefore redeploying capacity to meet the new capacity conditions will lead to customer disruption.

If capacity conditions were to commence in NW13, the addition of new conditions to existing markets (eg, Auckland-Gold Coast and Brisbane-Christchurch) may require the addition of capacity during the season. Adding this capacity in September will be highly commercially disadvantageous given the reduced selling window.

The Applicants' experience shows that, as a general rule, to increase capacity to meet capacity conditions requires planning to start many months prior to the date required for compliance – that includes the allocation of that physical capacity (arranging or scheduling the applicable aircraft time), as well as the sales lead time necessary to maximise revenue. Close in changes on the existing NW13 network plan would also create additional operational cost to both businesses, for example through changes to crew rosters.

### 3.6 Base year

The Applicants agree with the Commission that the proposed base year should be the 12 months ending October 2013. For the avoidance of doubt this means that:

- Nov-12 to Mar-13 would be used for future NW planning; and
- Apr-13 to Oct-13 would be used for future NS planning.

### 3.7 Initial growth factor should be set at 0%

The Applicants consider that an automatic growth factor imposes significant distortions in the market. A capacity condition should not be set so as to attempt to mimic the anticipated outcome of the market without authorisation or as a driver to influence capacity decisions that would otherwise be made by the airline. Rather capacity conditions should only apply as a floor against anti-competitive capacity reductions. The ongoing reporting obligations permit the ACCC to monitor capacity and properly consider the actual capacity decisions in light of relevant market circumstances prevailing over the period of the authorisation.

This is particularly significant where there is already substantial capacity in the market. The Tasman market is characterised by substantial excess capacity which will continue in the medium term. The Commission has acknowledged this.[19] This means that any required growth factor would cause capacity to grow well in advance of passenger demand, and cause further distortion in the market.

Applying any kind of pre-specified growth factor would be impractical and does not effectively serve to address the Commission's concerns about any potential for the Alliance to limit growth in capacity and raise airfares by restricting capacity growth. Furthermore, applying capacity conditions with a capacity floor, as opposed to a growth factor, will enable the ACCC to assess the true Alliance impact as opposed to the impact created by the growth factor. In this situation the ongoing reporting obligations will allow the ACCC to monitor this from the commencement of the new authorisation period.

As already submitted, in a market as competitive as the Tasman market, it would be contrary to rational commercial business judgment to withhold capacity as this effectively concedes market share and provides a yield boost to the other carriers with which the Alliance competes.

In addition, applying a pre-specified growth factor would be impractical, given that airline capacity cannot be added on an incremental 'seat-by-seat' basis and can instead only be added in 'lumpy' increments (i.e. one return trip at a time) and that certain routes already operate double daily services (eg, BNE-WLG and BNE-CHC).

Adding extra capacity on a number of the proposed capacity condition routes would effectively add capacity that is out of line with passenger demand, and result in the Alliance being forced to redirect capacity away from other, better performing routes where the addition of capacity is required to meet demand.

The Applicants therefore propose an initial growth factor of 0% for the capacity condition routes given the level of excess capacity **[CONFIDENTIAL]** of some of these sectors. The practical difficulties and implications of increasing capacity, particularly on thin routes, also support this proposal.

The Commission has, very recently, made the decision to apply an initial zero growth factor in relation to the Qantas/Emirates alliance based on the significant amount of excess capacity in the Tasman market.

Excess capacity on a route can be reflected either in low relative load factors or the overall level of route profitability, where a higher load factor is achieved through low priced inventory. **[CONFIDENTIAL]**.

A load factor of above 80% is the generally accepted target across the aviation industry. This is certainly the case for the Applicants, and in fact, due to the business model of the Applicants they are typically aiming for higher than 80%. The Applicants business model targets high loads through lower fares. This is a distinguishing feature in comparison to the model operated by Qantas. It is also a distinguishing feature compared to Emirates

---

[19] Determination re Qantas/Emirates Alliance, at paragraph 504, and ACCC's earlier Draft Determination, at paragraph 487.

and FFCs, which operate on the Tasman on a utilisation flying basis. As supporting evidence, the Commission should note the load factor on the various routes which the Applicants have exited over time were not all substantially below 80%.

In respect of the four routes that the Applicants have proposed capacity conditions on (Brisbane-Wellington; Brisbane-Christchurch; Brisbane-Dunedin; Brisbane-Queenstown) the grouped load factor for FY13 of the Alliance was **[CONFIDENTIAL]**. This is below the applicants' Tasman average of **[CONFIDENTIAL]**. Even assuming a 2.5% growth each year for the next 3 years and a seat growth of 1%, the load factor only reaches **[CONFIDENTIAL]** in year 3.

When considering individual routes on the Tasman, it should be noted that even where load factors may be closer to 80%, in a number of cases this **[CONFIDENTIAL]**. [20]

In particular, the growth factor should be 0% on the Brisbane-Wellington route given the significant distortive effect that a capacity condition with GDP-related growth factor would have (as the Applicants have previously submitted). The Brisbane-Wellington route is characterised by a significant amount of excess capacity, **[CONFIDENTIAL]** and further, there is no passenger demand to support the addition of the capacity, nor would it be of public benefit to require mandatory growth on this route.

### 3.8 Calculation of growth factor if the Applicants' proposal is not accepted

The Draft Determination proposes calculation of the capacity growth factor "to exclude negative quarterly changes in Australia's Trend Chain Volume GDP". The Applicants submit that this could result in the Applicants being required to grow capacity ahead of GDP.

The buoyant Australian economy has meant that there have been no instances of negative quarterly changes in Australia's Trend Chain Volume GDP in recent years. However, going forward, if the Australian economy trends downwards, this may not always be the case.

Further, a year of moderate growth of 2% may be the result of quarterly results comprising 1% growth in March, -1% growth in June, 0.5% growth in September and 1.5% growth in December. On these figures, with the calculation of capacity growth factor excluding negative quarterly changes, the capacity growth factor of 3% would be 50% higher than actual GDP growth of 2%.

### 3.9 Terms of the route conditions

The Applicants wish to further discuss the terms of the route conditions in Attachment B - Consultation Draft. The Applicants will provide a separate set of comments on the proposed route condition terms.

### 3.10 Reporting obligations

In principle, the Applicants have no objection to a reporting regime and to providing information in general in accordance with what is proposed in Attachment B - Consultation Draft. The Applicants seek to align the data that is reported to data that is

---

[20] **[CONFIDENTIAL]**

routinely generated within the existing financial reporting systems within each business. A detailed breakdown of route profitability has been provided to the Commission and the Applicants would seek to resolve the particular reporting regime with the Commission following review of that material and further discussion.

# 4 Conclusion

The Applicants submit, having regard to the above, that it is appropriate to grant authorisation with a 5 year term commencing 1 January 2014 with capacity conditions on the following routes, with an initial 0% growth factor:

- Brisbane-Wellington
- Brisbane-Christchurch
- Brisbane-Dunedin
- Brisbane-Queenstown

The Applicants further have no objections to the existence of a reporting regime, and are happy to discuss the terms and issues surrounding their practical compliance in relation to the Consultation Draft more generally.

# ANNEXURE A – Response to Particular Matters Raised in the Draft Determination

| # | Paragraph | Draft Determination | Response |
|---|---|---|---|
| **1** | **[99]** | The extent to which scheduling coordination under the Alliance in relation to international air passenger transport services may have an effect on scheduling of air freight transport services, and whether this raises potential competition concerns. | The Applicants consider that there has been no adverse impact, and there is unlikely to be any adverse impact, on competition for air freight transport services. In particular the Applicants note the following.<br>• As the Commission has noted, freight services are outside the scope of the Alliance (both in terms of the commercial arrangements, and the authorisations obtained and sought in Australia and New Zealand). The Applicants do not coordinate pricing and capacity for freight services.<br>• Virgin Australia operates a very low proportion of the cargo capacity on the trans-Tasman and therefore the potential for any adverse competitive impact is extremely low.<br>• **[CONFIDENTIAL]**<br>• In terms of the market, wide body aircraft provide the bulk of the freight capacity across the Tasman as a whole. Air New Zealand itself only operates wide body services from Auckland along with Emirates, supplemented by the dedicated freighter services operated by Singapore and Qantas. Virgin Australia does not operate any wide body aircraft across the Tasman at all. There are no wide body operators operating into or out of Wellington and Christchurch. |
| **2** | **[267]** | Information about the effect of the Alliance giving greater access to sales and distribution channels, and specifically, the proportion of business that the airlines generate through on the ground sales channels located in their country of origin, and the cost associated with creating and maintaining these sales channels. | A joint confidential response in relation to the proportion of business that the airlines generate through on-the-ground sales channels located in their country of origin was provided to the Commission on 9 July 2013.<br>A confidential Virgin response about the costs associated with creating and maintaining these sales channels was also provided to the Commission on 9 July 2013. Air New Zealand information as to the costs associated with creating and maintaining these sales channels will be provided separately. |

| # | Paragraph | Draft Determination | Response |
|---|---|---|---|
| **3** | **[271]** | Evidence of frequency, depth and total number of tickets sold as tactical fares both pre- and post- Alliance as a competitive response by Qantas, Jetstar and Emirates, if possible. | The Applicants have previously provided the Commission with detailed information about the Alliance pricing principles on trans-Tasman routes and how the Alliance sets fares in response to its competitors. This information was provided in the joint confidential response provided on 17 May 2013 in relation to Q4 of the Commission's information request of 17 April 2013.<br>The Applicants also provide specific information in relation to their response to Jetstar (and Jetstar's constraint upon the Alliance) in Annexure C: Competitive Constraint of Jetstar on the Alliance of the Applicants' confidential submission responding to the Draft Determination.<br>The Applicants provide additional information on the response of competitors in Annexure B: Competition Analysis of Specific Routes of the Applicants' confidential submission responding to the Draft Determination.<br>The Applicants are further considering what additional information, if any, can be provided on this point. |
| **4** | **[422]; [428]** | The competitive effect of the Alliance on the Auckland routes (specifically the Auckland-Brisbane route) and the competitive scenario on these routes in the likely future without the Alliance. | The Applicants address the competitive effect of the Alliance on the Auckland routes in Annexure B: Competition Analysis of Specific Routes to their confidential submission responding to its Draft Determination.<br>The Applicants confidential submission in support of its application for reauthorisation dated 8 March 2013 also includes relevant evidence in this regard. See Annexure I.<br>Virgin Australia also provided confidential supplementary evidence on the importance of the Alliance to competition for corporate and high frequency travellers in Australia and on the Tasman in an email dated 1 July 2013.<br>Virgin Australia also provided relevant information in its confidential submission on the counterfactual, provided to the Commission by email on 25 June 2013. |
| **5** | **[508]** | The competitive effect of the Alliance on Auckland-Cairns and the competitive scenario of this route in the likely future without the Alliance. | The Applicants address the competitive effect of the Alliance on the Auckland routes in Annexure B: Competition Analysis of Specific Routes to its confidential submission responding to its Draft Determination.<br>The Applicants confidential submission in support of its application for reauthorisation dated 8 March 2013 includes the relevant evidence in Annexure I. |
| **6** | **[600]** | Whether there is excess capacity on the relevant routes between Australia and New Zealand. | There is substantial excess capacity on the relevant routes between Australia and New Zealand.<br>The Tasman has a history of demand for trans-Tasman air passenger services being consistently supported by substantial capacity growth, and there is currently excess capacity across the Tasman overall as well as on particular routes.<br>The existence of excess capacity is evidenced by the relevant load factors and airfares, as well as the financial performance on the relevant trans-Tasman routes. |

| # | Paragraph | Draft Determination | Response |
|---|---|---|---|
| | | | The Applicants have provided the Commission with a range of evidence demonstrating the existence of the overcapacity. A list of this evidence is set out below.<br>The Applicants provided information evidencing excess capacity on the trans-Tasman in section 2 of the Alliance's confidential submission in support of its application for reauthorisation dated 8 March 2013. Confidential Annexure E of this submission provides detailed information about load factors on the various Alliance services by sector. Confidential Annexure H to the submission sets out average Alliance fares by sector.<br>On 10 May 2013, the Applicants provided, in their response to the Commission's information request dated 22 April 2013, the fare data behind confidential Annexure H. This data evidences the impact of excess capacity, demonstrating in particular an overall decline in fares. It should be considered in the context of the material fuel cost increases (referenced separately).<br>The Applicants also provided further information evidencing excess capacity in Annexure B: Competition Analysis of Specific Routes of the Applicants' confidential submission responding to the Draft Determination.<br>**[CONFIDENTIAL]**<br>Finally, Qantas and Emirates evidenced the substantial excess capacity in their submissions, in particular in the response to the Commission's draft determination of their applications for authorisation (A91332 and A91333), at pages 4 and 5. The Commission accepted this existence of excess capacity in the trans-Tasman market in its Final Determination, and therefore set the initial growth rate for the Qantas/Emirates Alliance at zero. |
| **7** | **[600]** | Comments on the structure of the condition and the proposed growth factor. | Please see sections 3.3 to 3.7 of Applicants' confidential submission responding to the Draft Determination. It is proposed to provide detailed comments on the draft capacity terms separately. |
| **8** | **[287]** | The impact the Alliance has had on the attractiveness of Virgin Australia to domestic Australian corporate customers, given that customers may acquire the domestic and trans-Tasman components separately and non-exclusively. | Virgin Australia also provided confidential supplementary evidence on the importance of the Alliance to competition for corporate and high frequency travellers in Australia and on the Tasman in an email dated 1 July 2013.<br>The conclusion that customers "contract separately for their domestic and trans-Tasman travel" is not correct, and is not supported by any material provided by the Applicants. Both Applicants offer corporate discounts based on total travel spend. If a customer has a requirement for a trans-Tasman and domestic travel, a discount level will be offered to that customer that is greater than separate discounts that would have been offered if either requirement was addressed in isolation. This is consistent with the approach taken by Qantas in the Australian market.<br>The parties may also assess total alliance spend (across both airlines) in establishing a "total spend" to determine discounts. Without this approach neither applicant could compete against the |

| # | Paragraph | Draft Determination | Response |
|---|---|---|---|
| | | | Qantas corporate offer in the Australian market. While individual contracts may be drafted to fulfil different components of a corporate offer (for example, an Air New Zealand trans-Tasman contract may be executed in combination with a Virgin Australia trans-Tasman and domestic contract), the total spend has still been considered in arriving at the discount level. Customers may not acquire domestic and trans-Tasman components separately and receive the same level of discount.<br>Furthermore all passengers (be it corporate or leisure) will purchase through fares for any journey that includes both a Tasman and a domestic sector. This is because through fares are always cheaper than two point to point fares combined, and the passenger and baggage can be through checked providing a faster and quicker connection. It also avoids the risk of missing the second sector and having to buy a new ticket if there is a delay on the first sector.<br>Virgin Australia would welcome the opportunity to meet with Commission to go through this evidence and discuss it in more detail. |

# ANNEXURE B – Competition analysis of specific routes

This annexure sets out the competition analysis for the routes where the ACCC has considered there may be adverse unilateral effects, as well as additional routes where the ACCC has either not drawn a conclusion on the anticompetitive effects (Auckland-Brisbane) or has considered there are no adverse unilateral effects but has requested further information (Auckland-Cairns).

## Dunedin-Melbourne

The Draft Determination considers that the Alliance faces limited competitive constraint on the Dunedin routes, despite acknowledging their thinness and seasonal nature. The Draft Determination considers that given this thinness, there is little likelihood of entry by another operator, however it also considers that Air New Zealand may consider entering any of the Dunedin routes absent the Alliance, as it did operate on the Dunedin-Brisbane route prior to the Alliance.

### (a) Route performance overview under the Alliance

The Dunedin-Melbourne route comprises less than 1% of Tasman traffic and there is no evidence to suggest that the Alliance has had an anti-competitive effect. The Alliance has not withheld capacity and average fares have not increased between the Pre-Alliance Year and Year 1.

| | **Pre-Alliance Year** | | | **Year 0** | | | **Year 1** | | | **Year 1 % variance to Pre-Alliance Year** |
|---|---|---|---|---|---|---|---|---|---|---|
| | **NZ** | **VA** | **NZ/ VA** | **NZ** | **VA** | **NZ/VA** | **NZ** | **VA** | **NZ/VA** | **NZ/VA** |
| **Average Fares** | **[CONFIDENTIAL]** | | | | | | | | | |
| **Capacity (seats)** | | | | | | | | | | **187.6%** |

Furthermore, the competitive conditions on the route are such that make it unlikely that there would be an increase in Alliance's incentives or ability to unilaterally raise price or reduce service in the future.

### (b) Virgin Australia entry on the route was a result of the Alliance only

As the Dunedin-Melbourne route has always been a single operator route, the Alliance will not result in any competitive detriment on this route.

Air New Zealand and Virgin Australia have never operated the Dunedin-Melbourne route at the same time. Additionally, Virgin Australia had no intention to operate this route prior to the Alliance; it only commenced services on this route in December 2011 as part of the Alliance Network realignment from October 2011.

Over the years, three different carriers have operated these routes as sole operators and all have struggled to make them viable, despite the absence of any competitor. Prior to the Alliance, the routes were operated solely by Freedom Air, a subsidiary of Air New Zealand. When Freedom Air ceased operating this route at the end of March 2008, Air New Zealand began to operate services by itself. After the Alliance was originally authorised in 2010, the Applicants carried out an assessment of their joint network and as part of their Alliance Network realignment it was decided that Virgin Australia was the best operator to run both of these seasonal services. This was because, prior to the Alliance Virgin Australia operated into Dunedin all year around through the operation of Dunedin-Brisbane services, whereas Air New Zealand only operated this route seasonally. It was on this basis that Air New Zealand ceased operating the services in the summer of 2011 and Virgin Australia began operating services on the routes in December 2011.

**(c) Thinness of the route**

The Alliance will not result in anti-competitive detriment on the Dunedin-Melbourne route also because the route is very 'thin' in nature and cannot support two carriers.

At present, the Alliance only operates services on this route in the months of December and January, which are typically the peak travel months of the year, and during this period the Alliance only operates 2 services per week. Load factors are highest during the peak travel months of December and January, however during Year 1 the Dunedin-Melbourne route had a load factor of only **[CONFIDENTIAL]**%. **[CONFIDENTIAL]** Alliance load factor on the Tasman for Year 1 of the Alliance and the **[CONFIDENTIAL]**% load factor for all airlines on the Tasman for FY13.[1]

This low load factor cannot be explained by reference to high fares. During the course of the current authorisation, average fares on the two routes fell substantially – average Alliance fares on the Dunedin-Melbourne route have fallen by **[CONFIDENTIAL]**%, as noted above.

In its Draft Determination, the ACCC notes that "absent the Alliance, the ACCC considers that there is little likelihood of entry by another operator given the thinness of the Dunedin routes".[2] However, the ACCC also suggests that Air New Zealand may re-enter the route in the absence of the Alliance.

This is not the case. As demonstrated above, the route is thin and seasonal, and only capable of supporting one carrier. **[CONFIDENTIAL]**[3]

There is also excess capacity on this route, with the market load factor for Dunedin-Melbourne at only **[CONFIDENTIAL]**% for December 2012/January 2013. This makes any unilateral conduct by the Alliance to raise fares on this route even less likely to occur.

**(d) Conclusion: Capacity conditions should not apply to this route**

Having regard to the above in relation to the strength of the competitiveness of the route and its particular demand and supply characteristics, the Applicants submit that capacity

---

[1] **[CONFIDENTIAL]**

[2] Draft determination, at paragraph 523.

[3] **[CONFIDENTIAL]**

conditions would be inappropriate. Capacity conditions would prevent the Applicants from shifting capacity away from marginal routes or increasing capacity on better performing routes if demand continues to worsen or if this capacity can better be deployed elsewhere.

**[CONFIDENTIAL]**

Secondly, imposing capacity conditions on the Dunedin-Melbourne route prevents the Alliance from making the best use of its resources to meet consumer demand. The amount of capacity the Applicants can operate during any given month is limited due to aircraft availability. The assessment of where to best operate services is driven by commercial considerations such as market demand as well as aircraft flow considerations. However, if capacity conditions dictate a certain amount of capacity on the Dunedin-Melbourne route, the Alliance's choice is limited.

Additionally, a requirement to maintain and/or grow capacity on the Dunedin-Melbourne route will disadvantage other, higher demand sectors (**[CONFIDENTIAL]**) and its passengers. **[CONFIDENTIAL]**

Therefore, while the capacity condition on this route does provide some benefit to Dunedin Airport and localised regional interests, it does so at the expense of consumers and overall competition on the Tasman.

## Dunedin-Sydney

The Draft Determination considers that the Alliance faces limited competitive constraint on the Dunedin routes, despite acknowledging their thinness and seasonal nature. The Draft Determination considers that given this thinness, there is little likelihood of entry by another operator, however it also considers that Air New Zealand may consider entering any of the Dunedin routes absent the Alliance, as it did operate on the Dunedin-Brisbane route prior to the Alliance.

### (a) Route performance overview under the Alliance

The Dunedin-Sydney route comprises less than 1% of Tasman traffic and there is no evidence to suggest that the Alliance has had an anti-competitive effect. The Alliance has not withheld capacity and average fares have not increased between the Pre-Alliance Year and Year 1.

| | Pre-Alliance Year | | | Year 0 | | | Year 1 | | | Year 1 % variance to Pre-Alliance Year |
|---|---|---|---|---|---|---|---|---|---|---|
| | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ/VA |
| **Average fares** | **[CONFIDENTIAL]** | | | | | | | | | |
| **Capacity (seats)** | | | | | | | | | | **28.9%** |

Furthermore, similar competitive conditions exist on this route, as on the Dunedin-Melbourne route which make it unlikely that there would be an increase in Alliance's incentives or ability to unilaterally raise price or reduce service in the future.

**(b) Virgin Australia entry on the route was a result of the Alliance only**

As for the Dunedin-Melbourne route, Air New Zealand and Virgin Australia never operated the Dunedin-Sydney route at the same time. Air New Zealand operated on the Dunedin-Sydney route on a seasonal basis until March 2011 and Virgin Australia commenced on this route on a seasonable basis in December 2011 with a shortened season (providing services in December and January peak times only), as a result of the Alliance Network optimisation in 2011. Virgin had no intention to enter these routes prior to the 2010 authorisation.

**(c) Thinness of the route**

Furthermore, as in the case of Dunedin-Melbourne, the Alliance will not result in anti-competitive detriment on the Dunedin-Sydney route because the route is very 'thin' in nature and will not support two carriers. During Year 1, the Dunedin-Sydney route had a load factor of **[CONFIDENTIAL]**%, **[CONFIDENTIAL]**. Additionally, average airfares on the route fell by **[CONFIDENTIAL]**% from the Pre-Alliance Year to Year 1.

**[CONFIDENTIAL]**[4]

There is also excess capacity on this route, with the market load factor for Dunedin-Sydney at only **[CONFIDENTIAL]**% for FY2013. This makes any unilateral conduct by the Alliance to raise fares on this route even less likely to occur.

**(d) Conclusion: Capacity conditions should not apply to this route**

The Applicants' submit that capacity conditions should not be imposed on this route for the same reasons outlined above in relation to the Dunedin-Melbourne route.

- **[CONFIDENTIAL]**
- Imposing capacity conditions on the Dunedin-Sydney route prevents the Alliance from making the best use of its resources to meet consumer demand.
- Additionally, a requirement to maintain and/or grow capacity on the Dunedin-Sydney route will disadvantage other sectors (**[CONFIDENTIAL]**) and its passengers. **[CONFIDENTIAL]**[5] **[CONFIDENTIAL]**

Therefore, while the capacity condition on this route does provide some benefit to Dunedin Airport and localised regional interests, it does so at the expense of consumers and the overall competition across the Tasman.

[4] **[CONFIDENTIAL]**
[5] **[CONFIDENTIAL]**

## Auckland-Gold Coast

The Draft Determination considers that the Alliance is likely to increase the ability and incentive of the Applicants to reduce capacity on the Auckland-Gold Coast route. To draw this conclusion, the Draft Determination notes that Qantas' presence on this route appears to be ad hoc and limited and that Jetstar is likely to operate as less of a constraint on the Alliance in the future because of the changing nature of Virgin Australia's product offering. This conclusion is drawn despite the Draft Determination noting that the Auckland-Gold Coast route is characterised by price sensitive leisure travel which is the segment that Jetstar targets.

### (a) Route performance overview under the Alliance

The Auckland-Gold Coast route comprises 4% of Tasman share and the evidence, in combination with the competitiveness of the route, do not suggest the Alliance has had, or will continue to have an anti-competitive effect.

| | Pre-Alliance Year | | | Year 0 | | | Year 1 | | | Year 1 % variance to Pre-Alliance Year |
|---|---|---|---|---|---|---|---|---|---|---|
| | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ/VA |
| **Average fares** | **[CONFIDENTIAL]** | | | | | | | | | |
| **Capacity (seats)** | | | | | | | | | | **2.4%** |

As set out below the Auckland-Gold Coast route is highly competitive. It is noted that while there has been a fare increase on this route, the overall increase of **[CONFIDENTIAL]**% can be contrasted with the evidence of very substantial increases in fuel costs over the same period, which are in the order of **[CONFIDENTIAL]** times greater. The fact that these cost increases have not been passed through in fare increases, and that the Alliance parties have grown overall capacity on the route, is strong evidence of the competitiveness of the route.

### (b) Both Qantas and Jetstar are strong competitors on the route and will remain so into the future

Both Jetstar and Qantas operate on this route, with Jetstar having a significant 37.2% of total capacity by seats flown. Jetstar provides strong competition to the Alliance, and Qantas (either itself or via Jetstar) could readily expand faster on the route.

The overwhelming majority of passengers on the route are point to point passengers on holiday or visiting friends and relatives (approximately 88%[6]) and as a result are highly price sensitive. Jetstar provides strong competition to the Alliance in this regard.

The Applicants consider that the assertion from the ACCC that Jetstar is likely to operate as less of a constraint on the Alliance in the future is misconceived.

Virgin Australia's product improvements as part of its Game Change Strategy do not mean that price competition from Jetstar has no competitive constraint upon the Alliance. The high proportion of Air New Zealand's more price-competitive value options ('Seat', 'Seat & Bag' fares) and Virgin Australia's more price-competitive value options ('Saver Lite' and 'Saver' fares) sold by the Alliance is evidence that the Virgin Australia, and the Alliance more broadly, still competes on price with Jetstar. Virgin Australia's product improvements have not and would not necessarily lead to prices rises. Effectively, Virgin Australia's product improvements offer more choice to consumers on what is a very price sensitive market.

Furthermore, the Alliance is also highly responsive to Jetstar's tactical fare initiatives and Jetstar operates as a constraint on the Alliance's price setting behaviour. Not only does the Alliance Revenue Team, as a general rule, respond specifically to tactical activity by Jetstar, but also the Alliance responds strongly to Jetstar-led tactical sales irrespective of whether Jetstar was the sole competitor or not. In the past two years, the number of Jetstar proactive tactical sales has increased significantly. The experience of the Alliance Parties is that there has been a discernible increase in the tactical fare activity by Jetstar, Qantas and Emirates since the commencement of the alliance.

Additionally, further detail on Jetstar's ability to constrain the Alliance is set out in **Annexure C**.

**(c) The Alliance has resulted in benefits on the route which are valued by consumers**

The Alliance has also, in the short space of time which it has had in its operations, resulted in important benefits on the route. The Alliance has undertaken re-alignment of the Auckland-Gold Coast schedule which has seen the Alliance remove wing-tip flying on the route with Air New Zealand operating morning rotations and Virgin Australia operating afternoon rotations.

Furthermore, as indicated above, the Alliance has resulted in improved product choice on Virgin Australia whereby passengers can now choose between the low cost options of Saver and Saver Lite fares (comparable to Jetstar fares offered) and the fully inclusive offering of Flexi and Premium economy which include food, beverage and IFE.

**(d) Auckland-Brisbane and Auckland Maroochydore are effective competitive partial substitutes**

The Auckland-Brisbane route, and to an extent, Auckland-Maroochydore, are viable substitutes for consumers and further constrain the incentive and ability of the Alliance to raise prices on the Auckland-Gold-Coast route. A significant proportion of the traffic on Auckland – Brisbane travels beyond, usually by road, to the Gold Coast. The Auckland-

[6] Based on Statistics NZ MAT May 2013 data.

Brisbane route has recently had significant capacity added to it,[7] and is set to have further capacity added in NW13 with the upgrade of Emirates aircraft from B777-300ER to A380 which will see an increase in capacity of 135 seats for sale per flight.[8] The Applicants expect this will result in a greater availability of low fares on Auckland – Brisbane, and therefore operates as a constraint on Auckland – Gold Coast.

**(e) Capacity conditions will hinder competition**

Having regard to the level of constraint through the existence of strong and effective competitors on this route and substitute routes, the Applicants consider capacity conditions would not be appropriate. The application of a route-specific capacity condition to this route would hinder competition. Requiring the Alliance to ensure a particular level of capacity, subject to specified growth requirements, in effect ensures that the Alliance's 60+% share of capacity is maintained. This therefore discourages Qantas/Jetstar from expanding on the route. It particularly discourages Jetstar from growing its capacity on the route, which is a key leisure route that they would target, as they know that, under the proposed conditions, despite any exterior influences or challenges, the Alliance will be forced to maintain a certain level of capacity.

**(f) Conclusion: Capacity conditions should not apply to this route**

For the reasons set out above, the Applicants' submit that capacity conditions should not be imposed on this route.

**Christchurch-Melbourne**

The Draft Determination considers that on the Christchurch-Melbourne route the Alliance reduces the service offering from three to two, and Jetstar (the only other operator) is likely to offer a limited constraint to the Alliance in the future, given Virgin Australia's changing product offering as part of the Game Change strategy and its shift away from operating as a low cost carrier.

**(a) Route performance overview under the Alliance**

There is sufficient competitive tension to constrain the Alliance and, taking into account the extraordinary events of the Christchurch earthquakes on the route, a conclusion of material adverse unilateral or coordinated effects on this route is inconsistent with the evidence. This route comprises 3.8% of total Tasman traffic.

| | Pre-Alliance Year | | | Year 0 | | | Year 1 | | | Year 1 % variance to Pre-Alliance Year |
|---|---|---|---|---|---|---|---|---|---|---|
| | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ/VA |
| **Average** | [CONFIDENTIAL] | | | | | | | | | |

[7] The Alliance has added 12% capacity from the Pre-Alliance Year until Year 1 on the Auckland-Brisbane route.

[8] Emirates news release, "Emirates' Airbus A380 to be launched to Brisbane and Auckland, 16 May 2013, http://www.emirates.com/english/about/news/news_detail.aspx?article=1223102

| | | |
|---|---|---|
| **fares** | | |
| **Capacity (seats)** | | **-18.1%** |

The competitive conditions on Christchurch-Melbourne act to constrain the behaviour of the Alliance. The reduction in capacity can be attributed to the Christchurch earthquakes. Additional capacity is now being added back onto the route as demand for the sector improves.

**(b) Jetstar is a strong competitor on the route and will remain so into the future**

The Christchurch-Melbourne route is one that Jetstar competes strongly on, having close to 40% capacity share.

The overwhelming majority of passengers on the route are holiday or VFR passengers (approximately 83%[9]) and as a result are highly price sensitive**.** Jetstar provides strong competition on such a leisure route and is a proven and effective competitor.

As discussed above in relation to the Auckland-Gold Coast route, the assertion from the ACCC that Jetstar is likely to operate as less of a constraint on the Alliance in the future appears to be incongruous with previous findings and the evidence that the Applicants have submitted in both this application for authorisation, as well as the previous application for authorisation in 2010.

Virgin Australia's product improvements offer more choice to consumers on what is a very price sensitive market, but their (and Air New Zealand's) more price-competitive options compete directly with Jetstar's offering. Virgin Australia's product improvements have not and would not necessarily lead to prices rises.

As discussed above, the experience of the Applicants is that the Alliance is highly responsive to Jetstar's tactical fare initiatives and that Jetstar operates as a constraint on the Alliance's price setting behaviour. Also see further **Annexure C** for further detail on Jetstar's ability to constrain the Alliance.

**(c) The route has been operated by other carriers in the past and remains open for re-entry**

Both Qantas and Emirates have operated on the route in the past. The opportunity remains for either carrier to re-enter the route under the Qantas/Emirates alliance. Therefore, this threat of re-entry remains a constraint for the Alliance as, despite what the Qantas Group has indicated based on the current position, if the Alliance were to raise prices or withhold capacity from the market, it would present the opportunity for Qantas or Emirates to enter.

Furthermore, the opportunity exists for another fifth freedom carrier to enter the route, and like Emirates, could do so on a marginal cost basis.

---

[9] Based on Statistics NZ MAT May 2013 data.

**(d) The Alliance has resulted in benefits on the route which are valued by consumers**

In the short timeframe that the Alliance has had so far to generate public benefits, it has undertaken re-alignment of the Christchurch-Melbourne schedule which has seen the Alliance remove the majority of wing-tip flying on the route. This has resulted in Air New Zealand operating morning rotations and Virgin Australia operating afternoon rotations.

Furthermore, as has been submitted previously, as part of the core rationale, the Alliance has resulted in improved product on Virgin Australia aircraft. It has also resulted in improved connectivity options at both Christchurch and Melbourne through improved scheduling.

These are benefits which the ACCC has accepted have arisen from the Alliance.

**(e) Conclusion: Capacity conditions should not be imposed on this route**

The Applicants submit that conditions would not be appropriate for the Christchurch-Melbourne route given the significant level of competition that the route faces, as discussed above. The imposition of any capacity conditions on this route would severely undermine competition on this route and disincentivise growth by competitors like the Qantas Group/Emirates alliance.

## Brisbane-Christchurch

In relation to the Brisbane-Christchurch route, the Draft Determination notes the Alliance reduces the number of service offerings from two to one, and that the Alliance will face no immediate competitive constraint given that the Qantas Group is not planning any re-entry on the route.

**(a) Route performance overview under the Alliance**

The Alliance faces a number of constraints on the Brisbane-Christchurch route and, when the effect of the Christchurch earthquakes is taken into account, the evidence is not consistent with the Alliance resulting in or increasing the likelihood of anticompetitive detriments on the route. From the Pre-Alliance Year to Year 1, the average fares of the Alliance on this route have in fact decreased by **[CONFIDENTIAL]**%. The reduction in capacity can be attributed to the Christchurch earthquakes, along with the withdrawal of Jetstar from the route.

The Brisbane-Christchurch route accounts for 3% of Tasman traffic.

| | Pre-Alliance Year | | | Year 0 | | | Year 1 | | | Year 1 % variance to Pre-Alliance Year |
|---|---|---|---|---|---|---|---|---|---|---|
| | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ/VA |
| **Average fares** | **[CONFIDENTIAL]** | | | | | | | | | |
| **Capacity (seats)** | | | | | | | | | | **-6.0%** |

The Alliance has not had an anticompetitive effect on the Christchurch-Brisbane route.

**(b) The Alliance is constrained significantly by Jetstar, but also by the Qantas/Emirates alliance**

Jetstar operates as a constraint to the Alliance on the Brisbane-Christchurch route as through both direct and indirect route competition.

There is indirect route competition for the Brisbane-Christchurch route. This route is substitutable with the Christchurch-Coolangatta which is a route that Jetstar operates on as well. This therefore poses a significant constraint to the Alliance's behaviour.

The Brisbane-Christchurch route is highly price sensitive and has a high proportion of leisure travellers, travelling for the purpose of a holiday or visiting friends and relatives (approximately 86%[10]). This is a segment that Jetstar targets.

More detailed information about the constraint that Jetstar poses on the Alliance is set out in **Annexure C**.

**(c) Potential for re-entry**

The Applicants note that the Draft Determination considers that entry by the Qantas Group is unlikely given their public statements. However, Jetstar could re-enter or Qantas/Emirates could re-enter this route if the Alliance were to anti-competitively raise fares or in the event that demand returned to pre-earthquake levels. Therefore this threat of re-entry still poses a constraint to the Alliance. Jetstar has shown its ability to rapidly deploy capacity on the Tasman in response to market opportunities, and following authorisation of the Qantas/Emirates alliance, this ability would potentially be enhanced as Qantas Group and Emirates optimise their collective Tasman operations and jointly market and sell their Tasman network.

**(d) Demand on the route**

Demand on the route has decreased substantially over the last 2 years following the Christchurch earthquake in 2011. Based on BITRE city pair data, passengers on the Brisbane to Christchurch city pair have declined by 21% for the YE March 2013 compared to YE March 2011.

A number of airlines have already reduced capacity or exited the Christchurch routes including Jetstar which withdrew services on the Brisbane-Christchurch route in March 2012. While demand has improved on the route, it is not expected to return to pre-earthquake levels for some time.

The Applicants note that Christchurch routes were not subject to capacity conditions in the 2010 authorisation.

**(e) Conclusion: capacity conditions may not be required on this route and an initial growth factor is not required**

---

[10] Based on Statistics NZ MAT May 2013 data.

Having regard to the above comments, and in particular, having regard to the demand on the route, the competitiveness of the route and the continued constraint that the Alliance would face, the Applicants submit that it may not be necessary to impose capacity conditions on this route. If the ACCC determines capacity conditions are appropriate on this route the Applicants submit they should form part of a grouping.

Further, it is not necessary to impose an initial growth factor on this route. Given the potential adverse effects of a growth factor, it is desirable that any route condition that applies to this route not have a growth factor.

**Brisbane-Dunedin**

The Draft Determination considers that the Alliance faces limited competitive constraint on the Dunedin routes, despite acknowledging their thinness and seasonal nature. The Draft Determination considers that given this thinness, there is little likelihood of entry by another operator, however it also considers that Air New Zealand may consider entering any of the Dunedin routes absent the Alliance, as it did operate on the Brisbane-Dunedin route prior to the Alliance.

**(a) Route performance overview under the Alliance**

There is no evidence to suggest that the Alliance has had an anti-competitive effect. The Alliance has not withheld capacity and average fares have not increased between the Pre-Alliance Year and Year 1.

| | Pre-Alliance Year | | | Year 0 | | | Year 1 | | | Year 1 % variance to Pre-Alliance Year |
|---|---|---|---|---|---|---|---|---|---|---|
| | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ/VA |
| Average fares | [CONFIDENTIAL] | | | | | | | | | |
| Capacity (seats) | | | | | | | | | | 7.2% |

**(b) Thinness of the route**

The Dunedin-Brisbane route is one of the thinnest on the Tasman with just over **[CONFIDENTIAL]** passengers a week on average and is also very seasonal. This is less than 1% of passengers that are carried on the Tasman. It is not capable of supporting substantial direct operating capacity.

**(c) There is excess capacity on the Brisbane-Dunedin route**

Virgin Australia is the only operator on the route, its average load factor is approximately **[CONFIDENTIAL]** which is well below most other trans-Tasman sectors and the industry Tasman average of **[CONFIDENTIAL]**%.

Capacity conditions on the route have also made the task of managing capacity on a seasonal basis a further challenge which has contributed to **[CONFIDENTIAL]**.

### (d) The evidence shows that there has been no anti-competitive detriment on the route

The Applicants have increased capacity on this route by 7.2% from the Pre-Alliance Year to Year 1. The Applicants have not anti-competitively increased overall fare levels or reduced the number and availability of low fares on this route. In fact, despite the Alliance's improved service offering and increased numbers of premium travellers in the fare class mix, the average fares of the Alliance have decreased **[CONFIDENTIAL]**% from the Pre-Alliance Year to Year 1.

### (e) The route remains open to entry from other airlines

Furthermore, the Alliance faces constraint from Jetstar which could deploy aircraft onto this route if the opportunity arose. The overwhelming majority of passengers on this route travel for a holiday or to visit friends and relatives (approximately 87%[11]), who are highly price sensitive, therefore Jetstar's threat of entry is stronger as it would target this route.

### (f) Conclusion: capacity conditions may not be required on this route and an initial growth factor is not appropriate

Having regard to the above comments, and in particular, having regard to the demand on the route, the competitiveness of the route and the continued constraint that the Alliance would face, the Applicants submit that it may not be necessary to impose capacity conditions on this route. If the ACCC determines capacity conditions are appropriate on this route the Applicants submit they should form part of a grouping.

Further, it is not necessary to impose an initial growth factor on this route. Given the potential adverse effects of a growth factor, it is desirable that any route condition that applies to this route not have a growth factor.

## Brisbane-Queenstown

The Draft Determination considers that the Alliance is likely to increase the ability and incentive of the Applicants to reduce capacity on the Queenstown-Brisbane route because of a lack of constraint by Qantas. To draw this conclusion, the Draft Determination notes that the Alliance has the dominant capacity share on this route (92.3%), and although Qantas could deploy more capacity on the route, it considers that the route is too small to make this decision commercially attractive. Additionally, the Draft Determination notes that Kiss Travel International made a submission that the Alliance has resulted in increased fares on this route.

### (a) Route performance overview under the Alliance

The Alliance has not resulted in anticompetitive detriment on the Queenstown-Brisbane route. Such a conclusion is not consistent with the evidence. From the Pre Alliance Year to Year 1, Alliance capacity on this route has increased by 35.8% while frequencies have increased by 21%. Additionally, over this period, average fares have decreased by **[CONFIDENTIAL]**%.

---

[11] Based on Statistics NZ MAT May 2013 data.

| | Pre-Alliance Year | | | Year 0 | | | Year 1 | | | Year 1 % variance to Pre-Alliance Year |
|---|---|---|---|---|---|---|---|---|---|---|
| | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ/VA |
| Average fares | [CONFIDENTIAL] | | | | | | | | | |
| Capacity (seats) | | | | | | | | | | 35.8% |

The Alliance's presence on this route is subject to competition from Qantas, which is capable of relatively easily and quickly increasing their capacity if the competitive conditions warranted them doing so. Given the seasonal nature of this route, even a small increase in capacity by Qantas would have a significant impact on Alliance profitability on this route.

Furthermore, the overwhelming majority of travellers travel for the purpose of a holiday or visiting friends and relatives (approximately 90%[12]) which is a highly price sensitive segment. The Alliance therefore additionally faces potential entry by Jetstar, given this is its main target sector.

**(b) Conclusion: capacity conditions may not be required on this route and an initial growth factor is not required**

Having regard to the above comments, and in particular, having regard to the demand on the route, the competitiveness of the route and the continued constraint that the Alliance would face, the Applicants submit that it may not be necessary to impose capacity conditions on this route. If the ACCC determines capacity conditions are appropriate on this route the Applicants submit they should form part of a grouping.

Further, it is not necessary to impose an initial growth factor on this route. Given the potential adverse effects of a growth factor, it is desirable that any route condition that applies to this route not have a growth factor.

**Brisbane-Wellington**

The Draft Determination notes that the Alliance reduces the number of independently determined service offering from two to one, and that absent the Alliance, Air New Zealand is likely to see to re-enter given it operated on this route prior to the Alliance and its strong product offering to corporate and government customers (which makes up the majority of demand on this route). Furthermore, the Draft Determination considers that the Alliance faces limited competitive constraint, which appears to be concluded from the fact that no other airlines currently operate on the route and the Key Wellington

[12] Based on Statistics NZ MAT May 2013 data.

Stakeholders Group submitted that it had no information to suggest that Qantas or Jetstar would enter.

### (a) Route performance overview under the Alliance

There is strong competition on the Brisbane-Wellington route which operates to constrain the Alliance. A conclusion that there are anticompetitive detriments that need to be remedied by a capacity condition is inconsistent with the evidence in relation to fares and capacity. This route comprises 3% of Tasman traffic.

| | Pre-Alliance Year | | | Year 0 | | | Year 1 | | | Year 1 % variance to Pre-Alliance Year |
|---|---|---|---|---|---|---|---|---|---|---|
| | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ/VA |
| **Average fares** | [CONFIDENTIAL] | | | | | | | | | |
| **Capacity (seats)** | | | | | | | | | | **10.6%** |

This shows that the Applicants have not anti-competitively increased overall fare levels or reduced the number and availability of low fares on this route. In fact, despite the Alliance's improved service offering and increased number of premium travellers in the fare class mix, the average fares of the Alliance on this route decreased.

### (b) There is excess capacity on the Brisbane-Wellington route

The Brisbane-Wellington route currently has excess capacity which constrains how the Alliance is likely to price its fares. The load factor for Year 1 was **[CONFIDENTIAL]**, down **[CONFIDENTIAL]** points from the Pre-Alliance Year and **[CONFIDENTIAL]** points below the Alliance Tasman average for Year 1. If the Alliance were to unilaterally raise fares on this route, the load factor would be likely to further decrease, with an obvious adverse impact on the financial performance of the Alliance.

The Applicants estimate that the demand on this route would not allow the load factor to reach 80% until after Year 4 of the Alliance. The current load factor is already well below the 80% factor that the aviation industry considers reasonable in practice. Even assuming passenger growth of 3% annually and no increase in capacity, the load factor on this route would not reach 80% by Year 4 (see **Table 1** below). However, the Alliance considers that passenger demand is unlikely to grow at this rate. In this regard, it is notable that when Qantas/Emirates responded to the ACCC's Draft Determination earlier this year, they provided projected load factors based on a passenger growth rate of 2.6%, which they stated they considered "too high". Therefore the Alliance is unlikely to result in any public detriment on the Brisbane-Wellington route within the time period of the authorisation.

**Table 1: Load factor increase assuming 3% growth rate and no increase in capacity (ie, capacity equals 261,054 seats as per Year 1)**

| Load | Actual | Projected |
|---|---|---|

| Factor | Pre-Alliance Year | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 |
|---|---|---|---|---|---|---|
| | [CONFIDENTIAL] | | | | | |

**(c) There are strong competitors operating on this route**

Qantas already competes on this route by the provision of indirect services with flights via Sydney and Auckland with Jetstar. However, the Alliance considers that there are no barriers to either Qantas or Jetstar entering into the provision of direct services between Brisbane and Wellington. Both Qantas and Jetstar have operations at each of Brisbane and Wellington airports and therefore could readily commence direct services. Jetstar in particular offers strong constraint on the Alliance, given approximately 83%[13] of passengers on this route travel for the purpose of taking a holiday or visiting friends and relatives, which is the highly price sensitive segment that Jetstar targets. Furthermore, Jetstar has shown that it can and will deploy aircraft onto routes if the opportunity arises. Further information on the constraint that Jetstar poses to the Alliance is found in **Annexure C**.

The Alliance considers that, realistically, the main factor likely to dissuade Qantas or Jetstar from commencing services on this route is the current state of overcapacity, which makes it commercially unattractive for them to do so.

**(d) There are no availability issues on the direct route**

The Applicants' data also shows that indirect travel between Brisbane and Wellington has remained unchanged at 3% in both 2010 and 2012**.** No increase in indirect traffic since the commencement of the Alliance indicates there are no availability issues on the direct Brisbane to Wellington route.

**(e) Conclusion: capacity conditions may not be required on this route and it is critical that an initial growth factor is not applied to this route**

Having regard to the above comments, and in particular, having regard to the demand on the route, the competitiveness of the route and the continued constraint that the Alliance would face, the Applicants submit that it may not be necessary to impose capacity conditions on this route.

Further, it is critical that an initial growth factor is not applied to this route **[CONFIDENTIAL]**.

## Auckland-Brisbane

The Draft Determination considers that the likely effect on competition of the Alliance is uncertain. It concludes that in relation to the Auckland routes more generally, the Qantas Group/Emirates alliance will pose the major competitive constraint on the Alliance for the foreseeable future. Additionally, the Draft Determination acknowledges that the combination of Qantas Group / Emirates (Emirates which recently announced it was

[13] Based on Statistics NZ MAT May 2013 data.

increasing capacity on the route) and China Airlines (which was a new entrant since the 2010 authorisation) may provide some constraint to the Alliance on the Auckland routes generally. However, it considers that Virgin Australia has a greater presence on the Auckland-Brisbane route than on the Auckland-Sydney or Auckland-Melbourne routes and therefore presents a stronger constraint in the future without the Alliance.

**(a) Route performance overview under the Alliance**

The Auckland-Brisbane route is highly competitive, featuring a number of other competitors, substantial capacity and substitution on routes. As a proportion of total Tasman traffic, it comprises 14.4%. The evidence does not suggest that there has been any anti-competitive or adverse unilateral effects resulting from the Alliance. In fact the evidence shows that the Alliance achieved a reduction in average fares as well as an increase in capacity from the Pre-Alliance Year to Year 1.

| | Pre-Alliance Year | | | Year 0 | | | Year 1 | | | Year 1 % variance to Pre-Alliance Year |
|---|---|---|---|---|---|---|---|---|---|---|
| | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ/VA |
| **Average fares** | [CONFIDENTIAL] | | | | | | | | | |
| **Capacity (seats)** | | | | | | | | | | **12.0%** |

For completeness, the Applicants note that Virgin Australia's increasing share on the Auckland-Brisbane route has come about in conjunction with a reduction in capacity by Air New Zealand. This was a result of the Alliance network plan and was driven by Virgin Australia position in the Brisbane market as well as aircraft flow considerations. As the current capacity level is a function of the Alliance, it does not necessarily reflect Virgin Australia's or Air New Zealand's position on the route absent the Alliance.

**(b) There has been significant capacity growth from competitors and further growth is planned**

There are five carriers currently operating on the route. Capacity has grown significantly since the commencement of the Alliance. As the Applicants have previously submitted, from the Pre-Alliance Year to Year 1, overall capacity on this route has increased by 25.1% and competitor activity has increased 40.9%.

- Over that time period, there has been strong growth by Qantas from the pre-Alliance Year to Year 1 of 15.4%. This was driven by Qantas' upgrade of the aircraft used on this route from a Boeing 737-400 to a Boeing 737-800.

- Further, there has been significant capacity added through FFCs which have the ability to deploy capacity at marginal cost. China Airlines entered the route in Jan 2011. More significantly, Emirates has announced their intention to upgrade daily Boeing 777-300ER services to daily Airbus 380-800 services on the Dubai–Brisbane–Auckland route from 1 October 2013 which will amount to an increase in seats of approximately 38%. This is on top of previous growth by Emirates of 40.5% from the pre-Alliance Year to Year 1, which was driven by their upgrade from Airbus A345 to Boeing 777-300ER.

Additionally, capacity will continue to be added to this route with the Qantas/Emirates alliance being required to maintain, and in time, grow aggregated capacity on routes including this route.

**(c) The route has been operated by other carriers in the past and the threat of re-entry acts as a constraint on the Alliance**

A number of fifth freedom carriers have operated on the route in the past and the opportunity exists for these or another FFC to enter the route. The opportunity for Jetstar to enter the route remains open.

**(d) Auckland-Gold Coast, and Auckland-Maroochydore is a substantially competitive substitute for the Auckland-Brisbane route**

There is additional competition arising from the fact that Auckland-Gold Coast, and Auckland-Maroochydore, are at least substantial viable substitute for Auckland-Brisbane.

The overwhelming majority of passengers on both of these routes are holiday or VFR travellers (approximately 88%[14]) and, as a result, this route is highly price sensitive. The service and pricing decision of the Applicants on this route are constrained by the ability of travellers to switch to Auckland-Gold Coast. Gold Coast Airport is only around 108km from Brisbane Airport and depending on the ultimate destination of the traveller they may switch to Auckland-Gold Coast instead of Auckland-Brisbane.

This constraint is made more significant by the fact that Jetstar operates services on the Auckland-Gold Coast route, and could easily deploy aircraft onto the Auckland-Brisbane route in the event that the Alliance was to anti-competitively raise fares. Jetstar provides strong competition on the route and is a proven effective competitor on such leisure routes. See further **Annexure C** which demonstrates the competitive constraint Jetstar poses on the Alliance.

**(e) The evidence shows that there has been no anticompetitive detriment on the route**

The Draft Determination considers that the effect of the Alliance on competition on this route is uncertain. However, as the Applicants have previously submitted, they have not anti-competitively increased overall fare levels or reduced the number and availability of low fares on this route. In fact, despite the Alliance's improved service offering, and the increased number of premium travellers in the fare class mix, the average fares of the Alliance on this route have decreased **[CONFIDENTIAL]** from the Pre-Alliance Year to Year 1.

**(f) Conclusion: capacity conditions clearly are not required on this route**

Consistent with the Commission's preliminary conclusions in its Draft Determination, capacity conditions are not required on this route, particularly also given that capacity conditions are already in place that apply to Qantas/Jetstar and Emirates on this route.

[14] Based on Statistics NZ MAT May 2013 data.

### Auckland-Cairns

The Draft Determination invites further comment on the likely competitive scenario on this route in the likely future without the Alliance. The ACCC takes the preliminary view that Virgin Australia may choose not to re-enter this route absent the Alliance. Balancing this against consideration of the likelihood of Jetstar constraining the Alliance, the Draft Determination forms the conclusion that the Alliance is unlikely to increase the ability and incentive of the Applicants to reduce capacity on this route.

**(a) Route performance overview under the Alliance**

The Applicants agrees with the conclusion drawn by the ACCC that the Alliance is unlikely to increase the ability and incentive of the Applicants to reduce capacity on this route. Auckland-Cairns comprises only 1.3% of total Tasman traffic.

| | Pre-Alliance Year | | | Year 0 | | | Year 1 | | | Year 1 % variance to Pre-Alliance Year |
|---|---|---|---|---|---|---|---|---|---|---|
| | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ | VA | NZ/VA | NZ/VA |
| **Average fares** | [CONFIDENTIAL] | | | | | | | | | |
| **Capacity (seats)** | | | | | | | | | | **-4.5%** |

The Applicants note that in the 2010 Determination, the ACCC considered the Auckland-Cairns route to be a minor route unlikely to raise competition concerns due to the presence of Jetstar constraining the Alliance on the route.[15]

This route has challenging market dynamics. It is a low demand route with a high proportion of leisure traffic, and is highly seasonal with summer months being very challenging. This route is a predominantly leisure route with only 6% of the traffic on this route are travelling for business purposes. As the overwhelming majority of passengers on the route are holiday or VFR passengers (approximately 85%[16]), the route is highly price sensitive.

Despite these challenging dynamics, from the Pre-Alliance to Year 1, the average fares of the Alliance on this route have decreased by **[CONFIDENTIAL]**.

ACCC noted Jetstar's entry on this route and that this entry was likely to constrain the Alliance.[17] The Applicants agree with this. Prior to October 2012, Jetstar had 27.7% of total capacity by seats flown and, as previously submitted, Jetstar operates as a strong

[15] ACCC, Final Determination re the Alliance's original authorisation application in 2010, at paragraphs 5.406 to 5.411.
[16] Based on Statistics NZ MAT May 2013 data.
[17] Draft Determination, at paragraph 508.

constraint to the Alliance, particularly for a route with such a high proportion of leisure travellers. The Applicants note that while Jetstar has not operated on this route since October 2012, Jetstar has operated on this route in the past (all year round and seasonally) and could re-enter at any time. This reflects the challenging nature of this route.

Qantas also competes on this route through connecting services and could readily commence direct services in competition with the Alliance if it were to anti-competitively raise fares.

Virgin Australia previously operated on the route. The poor performance of Virgin Australia on the route, with a **[CONFIDENTIAL]**% load factor in the base year, reducing to **[CONFIDENTIAL]**% in Year 0, highlights the challenging nature of this route. Further detail on this has been provided separately.[18]

This performance result as well as the exit of Jetstar from the route further highlights the challenging market dynamics of the route.

Despite a 4.5% decline in capacity, average fares on the route have in fact decreased by **[CONFIDENTIAL]**%.

The Alliance has also open up more options to reach Cairns from New Zealand via Brisbane, Sydney and Melbourne. This effectively provides viable alternative travel option for any material increase in price in the future.

### (b) Conclusion: capacity conditions clearly are not required on this route

Consistent with the Commission's preliminary conclusions in its Draft Determination, capacity conditions are not required on this route, particularly given the overall weakness of the route and the strong competitive position of Jetstar and Qantas, through indirect services, on the route.

---

[18] **[CONFIDENTIAL]**

# ANNEXURE C – Competitive constraint of Jetstar on the Alliance

The Draft Determination considers that Jetstar is more likely to operate as a constraint on the Alliance's leisure fares and tactical pricing decisions while Qantas is likely to provide a closer constraint on the Alliance's premium fare segment offering.[1]

However, the Draft Determination finds that Jetstar is likely to act as less of a constraint on the Alliance in the future given the changing nature of Virgin Australia's product offering under the Game Change strategy and therefore the Alliance is likely to face limited competition on the Christchurch-Melbourne route[2] and the Auckland-Gold Coast route.[3]

**(a) Overview comments**

The presence of Jetstar acts as a significant constraint to the Alliance for the following reasons:

- Jetstar has both a domestic New Zealand and domestic Australian network with high brand awareness.
- It has the advantage of its connection to the Qantas Group in terms of brand awareness, connectivity, disruption management and access to customers through the Qantas Frequent Flyer program.
- Jetstar is part of the Qantas/Emirates alliance which means it has access to the alliance's large schedule frequency and breath, and network connection advantage over all other operators.
- Jetstar faces no operational barriers to its continued entry and expansion on any particular Tasman route.
- There is no commercial reason why Jetstar would not expand further. Jetstar has the competitive advantage of the LCC business model, in particular, the influence of higher seat density and its role in substantially reducing cost per seat. LCCs have an incentive to and can profitably fill up its planes by offering more seats at lower fares than full service carriers. In fact, Jetstar has demonstrated its ability to move quickly to deploy capacity in response to any business opportunity.
- Not only is there no commercial reason why Jetstar (alone) would not expand in response to a profitable opportunity, the Qantas Group has every commercial reason to deploy Jetstar more widely. In fact, Jetstar has replaced Qantas on domestic New Zealand routes where the proportion of business passengers is significantly higher than on the Tasman. The presence of Qantas has not deterred Jetstar from entering a large number of routes. Over 80% of the 71 routes Jetstar has entered were operated by Qantas prior to Jetstar entry. Jetstar replaced Qantas on 45% of these routes and operates in tandem with Qantas on 37% of these routes.

[1] Draft Determination [352]
[2] Draft Determination [442].
[3] Draft Determination [488].

- Jetstar is an aggressive price competitor that both Applicants are forced to respond to regardless of whether or not Qantas is also present on the route.

**(b) The activity by Jetstar is monitored by the Alliance and effects price setting behaviour**

**[CONFIDENTIAL]** tactical activity is a common occurrence on the Tasman and particularly by Jetstar. The volume of tactical fares is substantial. They are a key vehicle for competitive behaviour and also act as a powerful price positioning tool. This reflects the price sensitive nature of the market. The experience of the Alliance parties is that since the commencement of the alliance:

- **[CONFIDENTIAL]**

**[CONFIDENTIAL]** the competitive responses to Jetstar's tactical sales, further illustrates the Alliance's need to respond to Jetstar and its effect on the Alliance's price setting behaviour.

**(c) Econometric evidence and ACCC analysis found Air New Zealand's and Virgin Australia's fares to be strongly constrained by Jetstar**

In support of the initial application for authorisation in 2010, the Applicants provided quantitative analysis of trans-Tasman airfares by Dr Tretheway. This analysis looked at the impact the presence of various carriers had on Air New Zealand's and on Virgin Australia's (then Virgin Blue) average airfares over the period January 2006 to December 2009.

The results are particularly relevant to the contention that given the Virgin Australia product has improved, the Alliance will not be constrained by Jetstar, as the results showed a high degree of fare response by Air New Zealand to Jetstar.

The analysis found that:

- it was not the number of carriers but the identity of those carriers which had the greatest impact on Air New Zealand's and Virgin Australia's average airfares. In particular, an increase in the number of carriers operating on a route was found to only have a small effect with an additional carrier on a route reducing Air New Zealand's average fares by an estimated **[CONFIDENTIAL]**.

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

The ACCC undertook its own analysis of Air New Zealand's and Virgin Australia's fares across trans-Tasman routes over the period July 2002 to July 2010 (a much longer series of data) and also found, relevantly, that Air New Zealand's fares were strongly constrained by Jetstar and Emirates. [4] For example, the ACCC's analysis found that Jetstar's entry:

- reduced Air New Zealand's average economy airfares by around 5% to 7% on routes where Qantas was not also operating (Auckland-Gold Coast);

---

[4] 2010 Determination, [5.284].

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

- may have reduced Air New Zealand's average economy airfares by around 10% on routes where Qantas was operating and remains on the route (Christchurch-Sydney and Auckland-Sydney).[5]

**(d) Jetstar continues to operate as a strong constraint to Air New Zealand and Virgin Australia despite their respective product changes**

As noted above, the Draft Determination finds that Jetstar is likely to act as less of a constraint on the Alliance in the future given the changing nature of Virgin Australia's product offering under the Game Change strategy.

Although there have been product changes to both Air New Zealand and Virgin Australia's offering, these product changes in fact mean that Jetstar is more competitive with the Applicants:

- Jetstar was found to strongly constrain Air New Zealand's airfares when its product offering was more targeted at the business and corporate segment.[6]

- Since then, Air New Zealand has made changes to its product to make it more competitive with the lower cost offering of Jetstar. It increased seat density by removing business class seating and increasing the number of seats on board its A320 aircraft from 152 to 168, and introduced "Seats to Suit" which unbundled the product by allowing passengers to choose one of four product bundles ranging from the unbundled "Seat Only" fare to a complete "Works Deluxe" bundle. This has made the Air New Zealand product offering more directly competitive with Jetstar.

- The conclusion that the ACCC makes that changes to Virgin Australia's product offering to target the business and corporate segment, is incongruous with the conclusion that Jetstar did constrain Air New Zealand prior to its product changes when its offering was more "full service" whilst maintaining a premium offering in the same aircraft.

Both Alliance parties are and will continue to be constrained by Jetstar on the Tasman given the high level of leisure travellers (approximately 77%) and the nature of Jetstar as a competitor. Virgin Australia's changed product offering serves not to shift away from direct competition with Jetstar, but to provide greater choice for consumers on the Tasman.

[5] 2010 Determination, [5.282].
[6] 2010 Determination, [5.284].