Dunedin International Airport

20 August 2013

Dr Richard Chadwick
General Manager
Adjudication Branch
Australia Competition & Consumer Commission
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Dear Dr Chadwick

Virgin Australia & Air New Zealand applications for authorisation A91362 & A91363 – consultation in relation to the Applicants' proposed changes to the draft determination proposed condition

This submission is made by Dunedin International Airport Limited (DIAL) in response to the letter dated 9 August 2013 from the Australian Competition & Consumer Commission (ACCC) on the above applications by Virgin Australia and Air New Zealand (Applicants').

DIAL is the owner and operator of Dunedin International Airport which the Applicants' operate air services to and from Brisbane, Sydney and Melbourne in accordance with the "conditional" Alliance Agreement which came into effect on 7 January 2011 and expires on 31 December 2013.

DIAL has considered the Applicants' proposed changes to the condition in the draft determination dated 10 July 2013 carefully and is appreciative of the opportunity to provide a further submission.

Due to the scope of the Applicants' proposed changes and the potential for public detriment resulting from these changes, DIAL considered it necessary to take independent expert advice to review and analysis these. To enable DIAL to complete this undertaking it was necessary that an extension to the close-off of 4.00pm on 16 August 2013 for further submissions be available. DIAL is appreciative of the addition time provided.

The attached report; **"ACCC Submission for Dunedin International Airport"** dated August 2013 by CAPA Consulting is provided as DIAL's submission to the Applicants' proposed changes.

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Thank you for the opportunity to make this further submission and we remain available for any further communication required on this matter.

Yours faithfully

John McCall
Chief Executive
Dunedin International Airport Limited

ACCC Submission for Dunedin International Airport

Date: August 2013




Document Control

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CAPA Consulting provides this submission on behalf of Dunedin International Airport Ltd (DIAL) in response to a request from the Australian Competition and Consumer Commission (ACCC) for views on alternative proposals put forward by Virgin Australia and Air New Zealand (the Applicants) relating to authorisation for their alliance on the Tasman.

In its submission of 23 July 2013, DIAL noted its support for the ACCC's Draft Determination of 10 July concerning the proposed capacity conditions affecting the Dunedin-Brisbane, Dunedin-Sydney and Dunedin-Melbourne routes. This provided for minimum capacity requirements to be aggregated for the three routes and a growth factor applied.

The ACCC's Draft Determination reflected concerns that the Virgin/Air NZ Alliance was likely to give rise to a public detriment for these routes by providing a greater ability and incentive for capacity to be rationalised and fares increased.

The Applicants subsequently proposed an alternative approach (as of 24 July 2013) which would see:

(1) DIAL's major Tasman route Dunedin-Brisbane grouped with other South Island routes (Brisbane-Christchurch and Brisbane-Queenstown) for the purposes of the ACCC's capacity conditions;

(2) Conditions removed from the Dunedin-Sydney and Dunedin-Melbourne routes or, if that was unacceptable to the ACCC, these routes being bundled with Auckland-Gold Coast and Christchurch-Melbourne;

(3) Removal of the growth factor applied in relation to the capacity floors, or that this should initially be set at zero.

DIAL is not in favour of any of these proposals for reasons discussed below. These include a need for bundled routes to reflect market synergies, the characteristics of the Dunedin travel market and the prospects for competition on particular routes (or lack of them).

The recent history of Dunedin's three Tasman routes both before and under the Alliance structure indicates their vulnerability. Each is currently operated by a single carrier, Virgin Australia.

Table 1 shows the seat capacity trends on the three Dunedin routes between 2010 (the year before the Alliance introduction) and 2013. While there was a significant increase in capacity between 2010 and 2011, levels have subsequently reduced on each route during the three years of the Alliance[1].

[1] If the CAGR would show growth for each was taken from 2010 to 2013 – 6.9% per annum for Dunedin-Sydney, 24.6% for Dunedin-Melbourne and 0.9% for Dunedin-Brisbane.

Table 1: Seats Capacity to/from Dunedin, Year to December 2010-2013

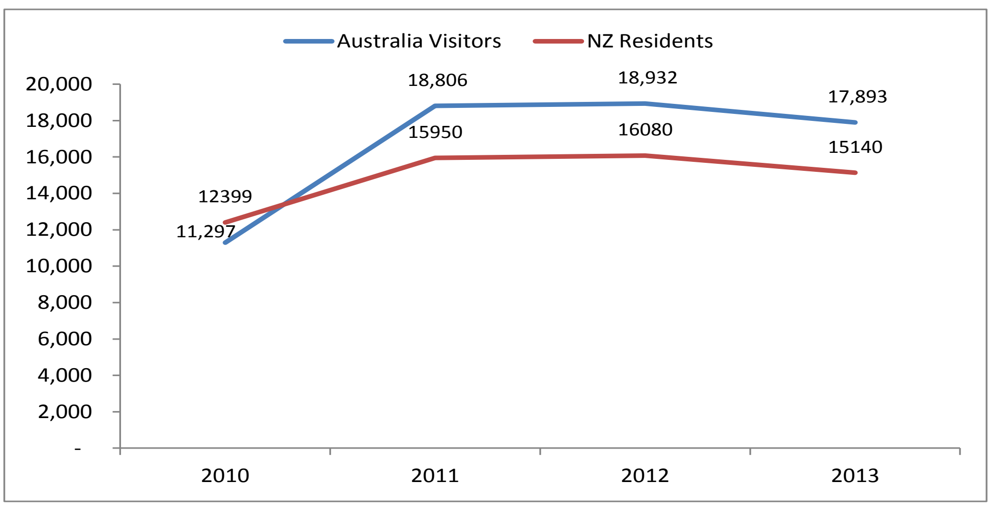
	2010	2011	2012	2013	CAGR 2011-2013
DUD-SYD	4,864	8,104	6,408	6,360	-7.8
DUD-MEL	2,432	6,888	6,048	5,864	-5.2
DUD-BNE	75,600	81,528	77,672	78,608	-1.2

Note that capacity for the calendar year 2013 is based on airline schedules.

Source: SRS Analyser

SYD-DUD and MEL-DUD have seen declines in their Compound Annual Growth Rates (CAGR) of 7.8% per annum and 5.2% per annum respectively. This reflected the transition from Air New Zealand to Virgin services which only operate seasonally over two months of each year, December and January, with Brisbane effectively serving as the hub providing connecting links for direct trans-Tasman traffic to Dunedin. On BNE-DUD the fall was 1.2%.

Figure 1: No. Australia Originating Visitors vs NZ Resident Traveller on Dunedin's Tasman Routes, FY2010-FY2013



Source: TFI, Statistics New Zealand

As **Figure 1** shows, inbound and outbound traffic levels on Dunedin's Tasman routes have largely mirrored the capacity changes between FY 2010 and FY2013, with growth in the first year offset by declines of less than 2% during the three years of the Alliance.

Interestingly, the percentage share of Australia-originating visitor traffic has increased from 47.6% in FY2010 to 54.1% in FY2013. The changing balance appears to reflect both the withdrawal of Air NZ from Dunedin's Tasman routes and the focus on Virgin as the sole supplier, supported by its Australian network.

The relatively fragile dynamics of Dunedin's Tasman system with its reliance on Virgin for non-stop services underscores the overall importance of at least maintaining capacity levels.

The South Island Grouping Proposal

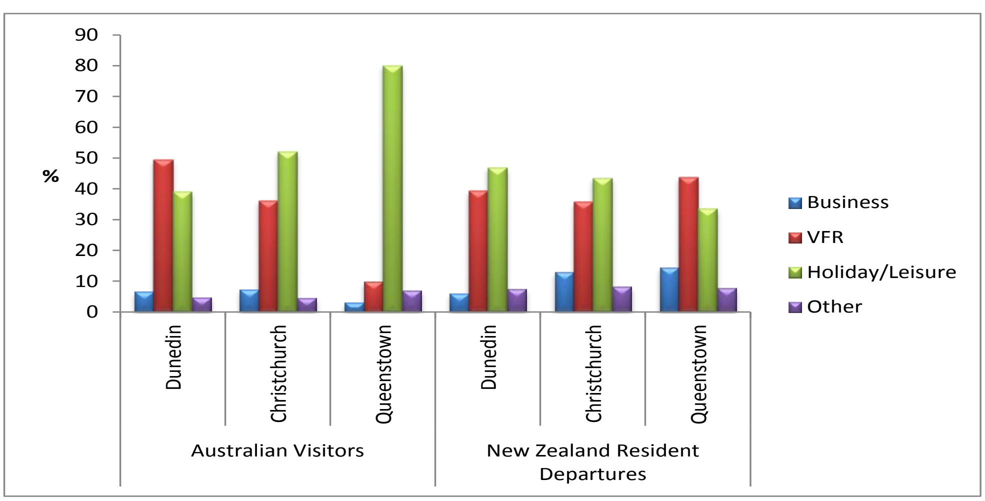
The basis for the changes proposed by the Applicants is that the three South Island destinations out of Brisbane (Dunedin, Queenstown and Christchurch) are often interchangeable and grouping them together would better reflect consumer behaviour, provide for "optimal network planning" and enable capacity to be more effectively matched to demand.

The Applicants further state that Christchurch is the major gateway to the South Island and Australian and New Zealand passengers frequently fly one leg of their journey on a direct services into or out of Dunedin and make use of a domestic connection for their return flight across the Tasman.

From a consumer perspective, DIAL takes issue with the assertion that the South Island destinations are "interchangeable". In our view, each serves a discrete travel market with its own particular characteristics:

- Dunedin is the main access point for the majority of trans-Tasman travellers from the Otago/Southland region of the South Island;
- The travel focus in the Dunedin market is on the Visiting Friends and Relatives (VFR) segment which accounts for almost half of the Australian resident traffic to Dunedin and some 40% of New Zealand resident departures;
- Australian resident travel to Christchurch and Queenstown is dominated by leisure-based traffic. In Queenstown's case, much of this is point-to-point traffic.

Figure 2: Australia Originating Visitors and New Zealand Resident Departures by Travel Purpose at South Island Airports, FY2013



Source: TFI, Statistics New Zealand

The variation in inbound and outbound travel profiles between the three airports is shown in **Figure 2** which indicates the percentage of Australian resident visitors and New Zealand resident departures for each in FY2013.

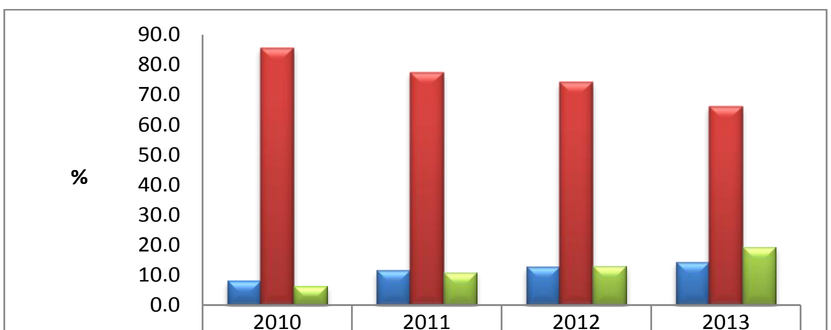
Holiday/leisure visitors make up 79.9% of visitor arrivals from Australia at Queenstown Airport and 52% of those at Christchurch Airport compared with a much smaller 39.1% for Dunedin. By contrast, VFR travel is much stronger at Dunedin, comprising 49% of visitor numbers, as opposed to 36% at Christchurch and less than 10% at Queenstown. Business-related travel is relatively small in each of the markets, accounting for around 7% at Dunedin and Christchurch and 3% at Queenstown. This proportionate mix has been relatively consistent in recent years.

Those visiting friends and relatives in Dunedin or travelling on business (some 56% of the Australia-originating visitors to the city) are more likely to access direct air services than utilise Queenstown or Christchurch which are 237kms and 365kms away and 3-5 hours by car. For these travel segments, the option of accessing alternate entry points to Dunedin is neither convenient nor practicable.

New Zealand resident departures from Dunedin also have a high proportion of VFR travellers (39% of the total departing the airport in FY2013) which slightly exceeds that of Christchurch (36%). Queenstown has a larger outbound VFR component at 44%.

Overall, Dunedin is by far the smallest of the three South Island markets for Tasman travel – and therefore the most vulnerable - with a 3% share of inbound Australian visitors to the three South Island ports and 5.6% of outbound New Zealand residents. This compares to 75.1% and 90.5% respectively for Christchurch and Queenstown's 21.9% and 3.7% (based on data for FY2013).

Figure 3: Percentage Share of Australian Resident Visitors Embarking at Brisbane to the three South Island Airports, FY2010-2013



	2010	2011	2012	2013
Dunedin	8.1	11.6	12.8	14.4
Christchurch	85.6	77.5	74.2	66.2
Queenstown	6.3	10.8	13.0	19.4

Source: TFI, Statistics New Zealand

Dunedin, however, occupies a more significant position if data is examined for Brisbane-specific routes to the South Island airports. **Figure 3** shows that Dunedin has increased its share of Australian originating visitors from 8% in FY2010 to 14% in FY2013 largely at the expense of Christchurch (the latter's share declined sharply during this period, reflecting the impact of its earthquake crises).

Dunedin's importance to the Otago/Southland market is underlined further in an analysis of New Zealand resident departures to Brisbane from the region. Of the 21,840 residents departing for Brisbane from Otago/Southland in FY2013, 60% boarded aircraft at Dunedin as against Christchurch's 21%, 14% for Auckland, 5% Wellington and 1% for Queenstown.

This demonstrates that Dunedin serves a primary role for a discrete regional market in New Zealand, as well as for a particular segment of trans-Tasman travellers originating in Australia.

DIAL acknowledges that a percentage of Dunedin's inbound and outbound travellers access the Tasman via other domestic ports (including Christchurch), but a majority prefer to utilise direct non-stop services.

The three South Island routes are also differentiated by their competitive structure, with three carriers (Virgin, Qantas and Air New Zealand) currently serving Brisbane-Queenstown and two on Brisbane-Christchurch (Virgin, Air NZ) following the withdrawal of Jetstar in March 2012.

Brisbane-Dunedin is a monopoly route and therefore requires a "safety net" through the types of capacity provisions proposed by the ACCC in relation to the Alliance.

Our view is that it would not be reasonable to group Dunedin, with its particular travel and market focus, with other South Island routes which have substantially different priorities.

The risk is that, if bundling occurs as proposed by the Alliance, the airlines will concentrate capacity and the required growth on the larger routes to the detriment of Dunedin.

While there may be operational benefits for the Applicants in taking this approach, these should not override the ACCC's concerns about the future maintenance of Dunedin's services by the Alliance in a monopoly environment.

The Options for Dunedin-Sydney and Dunedin-Melbourne

The ACCC has taken the view, which we support, that Dunedin-Sydney and Dunedin-Melbourne should be bundled with Dunedin-Brisbane to provide a "Dunedin solution" to the imposition of capacity conditions and growth.

The Applicants, in their response to the Draft Determination, argue that the introduction of conditions with a growth factor on Dunedin-Sydney and Dunedin-

Melbourne cannot be supported "in light of actual market dynamics and the counterfactual". Auckland-Gold Coast and Christchurch-Melbourne are placed in the same category. According to the Applicants, this imposes constraints on "optimal network planning" and is likely to lead to a detriment in developing alternate routes.

Virgin and Air NZ would like the conditions lifted by the ACCC or, in the absence of this, the two Dunedin routes bundled together with Auckland-Gold Coast and Christchurch-Melbourne, both of which are regarded as highly-competitive routes (Auckland-Gold Coast, for example, substitutes for the Auckland-Brisbane market).

Both of the Dunedin routes are important in the overall context of the city's trans-Tasman connections. They provide additional capacity direct to the major east coast markets of Sydney and Melbourne during the peak Christmas holiday period. As such, these routes need to be considered as supplementary to the Brisbane-Dunedin service which operates year-round and captures much of the non-stop traffic to Dunedin from other parts of Australia through the Virgin network.

For that reason DIAL believes it is logical for the three synergistic Dunedin routes to be treated together with capacity controls which still provide flexibility for operators as to the weighting of capacity applied at different times of year.

Grouping the Dunedin routes with Auckland-Gold Coast and Christchurch-Melbourne seems to make no particular sense as the market dynamics are very different.

We note with interests the acknowledgement by the Applicants that the application of a capacity condition on Dunedin-Sydney and Dunedin-Melbourne "does provide some benefit to Dunedin Airport and localised regional interests". However, DIAL does not agree that this comes "at the expense of consumers and overall competition on the Tasman".

Treatment of a Capacity Growth Factor

The Applicants propose that capacity provisions under the ACCC conditions should not be subject to a growth factor as this would give rise to market distortions, or that this growth factor should initially be set at zero.

DIAL believes that an appropriate growth factor should be applied but this should occur on a route-by-route basis depending on demand. If the ACCC agreed to bundle Brisbane-South Island routes, then any additional increase in capacity should be distributed across all of the routes within the grouping.