Friday, 26 April 2013

Dr Richard Chadwick
General Manager – Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2061

Dear Dr Chadwick,

Virgin Australia & Air New Zealand applications for authorisation A91362 & A91363 – interested party consultation

Thank you for the opportunity to make a submission regarding the above application.

Please find attached a shared submission expressing the combined views of a group of Wellington based organisations deeply interested in the market for trans-Tasman air services. Our group comprises the following organisations (in alphabetical order):

- ***Greater Wellington Regional Council***: Greater Wellington Regional Council is the regional authority for the Greater Wellington area.
- ***Grow Wellington***: Grow Wellington is the regional economic development agency charged with the delivery of the economic aspects of the Wellington Regional Strategy.
- ***Positively Wellington Tourism***: Positively Wellington Tourism is the Regional Tourism Organisation responsible for marketing and promoting Wellington.
- ***Wellington City Council***: Wellington City Council is the local territorial authority for Wellington city.
- ***Wellington Employers' Chamber of Commerce***: Wellington Employers' Chambers of Commerce has a membership of over 1,600 businesses in Wellington city and represents a regional hub of Chambers of Commerce.
- ***Wellington International Airport Limited***: WIAL is the owner and operator of Wellington International Airport.

All of these organisations have contributed to, reviewed and approved the draft of the attached submission. We would be pleased to discuss any aspect of the submission with the ACCC upon request. The contact person for the Key Wellington Stakeholders Group is Fran Wilde, Chair, Greater Wellington Regional Council.

Ms Wilde can be reached at:
fran.wilde@gw.govt.nz

c/o PO BOX 11646
WELLINGTON 6142

Yours sincerely,

Fran Wilde
Chair
Greater Wellington Regional Council

Paul Merci
Chair
Grow Wellington

David Perks
Chief Executive
Positively Wellington Tourism

Ceilia Wade-Brown
Mayor
Wellington City Council

Raewyn Bleakley
Chief Executive
Wellington Employers' Chamber of Commerce

Steven Sanderson
Chief Executive
Wellington International Airport

Submission to the Australian Competition and Consumer Commission on the application for re-authorisation of an alliance between Virgin Australia and Air New Zealand

Key Wellington Stakeholders

26 April 2013

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Introduction

1 This submission is presented by Key Wellington Stakeholders, a group of business, local government and tourism organisations from the Wellington region. Key Wellington Stakeholders include the following organisations (in alphabetical order):

- Greater Wellington Regional Council
- Grow Wellington
- Positively Wellington Tourism
- Wellington Employers' Chamber of Commerce
- Wellington City Council
- Wellington International Airport Limited

2 Collectively, we represent the region's local government, businesses and tourism industry of Wellington and the surrounding region.

3 We support re-authorisation of the Alliance but *only for a further term of three years* and *only with continued appropriate capacity conditions*. We acknowledge that the Alliance has resulted in some public benefits, but the outweighing public detriments that would arise from the Alliance remain very real if there do not continue to be appropriate capacity conditions to ensure that public benefits from the Alliance continue to be realised.

4 We are concerned that the application by the Applicants, Virgin Australia and Air New Zealand, to have their Alliance re-authorised *without continuation of capacity conditions* will have the effect of substantially lessening competition in the trans-Tasman air passenger services market between Wellington and Australia, without providing sufficient countervailing public benefits.

5 We consider that this detrimental effect would be adequately mitigated if re-authorisation is granted only for a further three-year period and is made subject to continuing appropriate capacity conditions that require the Applicants to maintain and continue to grow capacity on Wellington (and other) trans-Tasman routes. The Key Wellington Stakeholders would support re-authorisation of the Alliance for a further three years if appropriate capacity conditions were continued.

Reauthorisation of the Alliance must be subject to appropriate conditions

6 The Applicants seek to have the Alliance re-authorised without the existing conditions because they contend that "the competitive response to the Alliance and the experience of the Alliance's implementation to date demonstrate that there is no ongoing requirement for the Conditions".[1] The Key Wellington Stakeholders disagree entirely.

[1] The Applicants' submission to the ACCC dated 8 March 2013, at [5.6].

7 We consider that, if the Alliance is to be re-authorised, continuation of conditions requiring the Applicants to maintain and grow capacity in the trans-Tasman air passenger services market between Wellington and Australia remains as essential now as it was in 2010. The conditions are needed to avoid the obvious detriment to the public that would otherwise flow from the reduced competitive dynamics inherent in any alliance of this nature.

8 The Applicants say that the "core rationale" for the Alliance is "to increase the number of passengers travelling on the Applicants' combined services through the development of a second integrated Australasian network offering enhanced products and services including a greater choice of flights, better online connections, better schedule options and enhanced loyalty programs and lounge benefits".[2] Conditions requiring the Applicants to maintain and grow capacity *support* this goal of increased passenger numbers, as more capacity enables the Applicants to carry more passengers across the Tasman.

9 Yet, the Applicants say that they want re-authorisation with these conditions removed. It is difficult to see why the Applicants would want the conditions removed unless it was to enable them to reduce capacity, particularly in respect of routes with no or minimal competitive constraint. Nor did these conditions seem to trouble the Applicants at the time that the authorisation was granted, as it was the Applicants themselves who proposed them.

10 It is imperative that any re-authorisation of the Alliance is made subject to continued and appropriate conditions requiring the Applicants to maintain and grow capacity. Otherwise, there is a very real incentive on the Applicants (and certainly no disincentive) to reduce capacity and to increase fares.

Nothing has relevantly changed since the ACCC's 2010 final decision

11 In essence, the view of the ACCC in its final decision granting authorisation of the Alliance in December 2010 was that, absent imposition of the conditions, the likely benefits to the public from the Alliance would be outweighed by the likely detriment to the public in authorising the Alliance. In particular, the ACCC concluded that, if the Alliance were authorised without conditions, there was likely to be detriment to the public in respect of various trans-Tasman routes, including all the routes to and from Wellington. The conditions were imposed to ensure that this detriment would be avoided.

12 The ACCC's conclusion was reached after a careful analysis of the relevant markets and the competitive situation then existing on the trans-Tasman routes, including those to and from Wellington. Obviously, the key change in the market since the ACCC's 2010 decision has been the ACCC authorisation of the Qantas/Emirates alliance. That development is one factor that the ACCC will need to take into account when considering the present Application.

13 But it is *not* a factor that bears particularly on the competitive situation existing on the Wellington trans-Tasman routes. Emirates has never flown into and out of Wellington, noting two significant hurdles to doing so in their submission in support

[2] The Applicants' submission to the ACCC dated 8 March 2013, at 3 and [4.4].

of the Qantas/Emirates Alliance.[3] It is not and never was a competitive restraint on the existing operators flying into and out of Wellington in respect of the Wellington trans-Tasman routes.

14 As far as the Wellington trans-Tasman routes are concerned, nothing in the market is relevantly different today from how it was when the ACCC issued its final decision in 2010 (except, of course, that the Applicants' Alliance is now in operation). Wellington's three trans-Tasman routes are characterised by high levels of market concentration with a monopoly Alliance position on the Brisbane route and duopolies supplying the Melbourne and Sydney routes.

15 These levels of market concentration have the clear potential to deliver detrimental competitive outcomes and are materially influenced by the authorisation of the Alliance. The ACCC's conclusion that appropriate capacity conditions must be imposed on the authorisation of the Alliance remains valid, essentially for the reasons given by the ACCC in 2010. Re-authorisation of the Alliance must be subject to appropriate capacity conditions continuing.

Enhanced competition before 2010 – and, since 2010, the capacity conditions – have led to increased passenger numbers

16 Our common concern is to maintain and increase the growing number of passengers travelling between Wellington and Australia. That outcome was what we experienced before the Alliance was authorised when full competition prevailed among Air New Zealand, Qantas/Jetstar and Virgin Australia. Now that authorisation of the Alliance has reduced the previous level of competition, appropriate steps must continue to be taken to ensure that passenger growth continues, which is the outcome we would expect to occur in a competitive market.

17 In effect, the conditions have served as a regulatory proxy for the competitive dynamics that would otherwise have delivered this growth. Unless the Applicants intend to abandon their Alliance and resume full competition with each other (and with Qantas/Jetstar), continued imposition of appropriate capacity conditions is a necessary regulatory response to ensure that the outcomes that would be expected in a competitive market are promoted and achieved.

18 Affordable travel remains critical to the Wellington regional economy. Tourism is a vital industry, and each visitor to Wellington contributes around $621 to the economy in the form of direct spend. The tourism industry employs approximately 16,000 people in the region. Increased passenger numbers are critical for sustaining and growing this industry.

19 Many businesses and organisations, including Government, also rely on convenient and affordable international travel to operate efficiently. It is essential that businesses in the Wellington region have sufficient choice and access to cost-effective international air travel. The region's ability to attract new businesses and grow its economy is also directly affected by the availability of direct international flights. This is recognised as a key issue in the Wellington Regional Strategy and the Wellington City Council's Economic Development Strategy including the Destination Wellington work programme.

[3] Emirates' submission to the ACCC dated 3 December 2012 at page 2. Emirates notes infrastructure constraints and lack of regulatory approval as barriers to entry.

20 In the absence of the previous level of competition on the trans-Tasman routes, the conditions have served to promote and ensure continued capacity growth for the benefit of the public. Their continuation is ultimately in the best interests of airlines, of the Wellington region and of the public on both sides of the Tasman.

Specific concerns

21 The Applicants point in Section 3 of their submission to various benefits that they say have resulted from the Alliance. We accept that the Alliance has brought some of the benefits that have been claimed, such as better schedule spread, reduced wingtip flying and reciprocity for frequent flyer programmes and lounge access.

22 But these benefits essentially arise in non-price competition areas, which are less valued by most customers. The key competitive benefits that most customers focus on are availability of seats on their desired route and price. These benefits are a function of available capacity, and increased capacity on the trans-Tasman routes was inevitable – to some degree – given the ACCC's imposition of conditions requiring the Applicants to increase capacity.

23 It is not clear that the market growth witnessed over the initial term of the Alliance has been driven by the "benefits" pointed to by the Applicants, the imposition of the capacity conditions themselves, or other market dynamics affecting the various routes. The Applicants note that the Alliance has only been in genuine effect for around 18 months,[4] and that this period has seen a number of rare and significant external shocks, both positive and negative. There is no reason to assume that any growth attributed by the Applicants to the demand for the Alliance's newly introduced services and benefits over this period will continue into the future.

24 The Alliance currently finds itself in a position of significant market power and, if permitted to use this power unencumbered, it has the potential to, and could be rationally expected to act to, restrict capacity and enhance its profitability at the expense of the travelling public.

25 The Wellington-Brisbane route is an example of a route which would be directly, and negatively, affected by the removal of capacity conditions. We note that, since the authorisation was granted, there has been minimal if any passenger growth on the (monopoly) Wellington-Brisbane route that the Applicants service beyond that required by the conditions. It is difficult to see that the Applicants would be incentivised to maintain and grow this route in particular, if the conditions did not remain in place. Indeed, Air New Zealand has confirmed – in a meeting with Wellington International Airport Limited – that if the capacity conditions are removed the Alliance *will* reduce capacity on the Wellington-Brisbane route.

26 The removal of capacity conditions may reasonably be expected to reverse a proportion of the growth experienced on Wellington routes and promote the inefficient outcomes inherent in a restricted supply market. If the conditions were removed, we consider that capacity reduction would be most severe on those trans-Tasman routes that the ACCC has already identified as being subject to minimal competitive constraint, including the Wellington trans-Tasman routes. The effects of this change would be felt across all of the Wellington trans-Tasman routes, as the

[4] The Applicants' submission to the ACCC dated 8 March 2013, at [1.2].

Alliance grants the Applicants a level of market power substantially greater than that which existed before the Alliance came into effect.

27 The Applicants claim that the conditions have caused "rigidity" and "inefficiencies".[5] These concerns are overstated and are, in any event, immaterial. Some regulatory oversight is the price that the Applicants must expect to pay for being exempted from the usual application of competition law. Compliance with the conditions cannot be too onerous for the Applicants; it was they who proposed the conditions. The natural disaster situations to which the Applicants point were exceptional occurrences and have already been addressed by the ACCC in the three variations granted to date. Their occurrence in no way justifies removal of the conditions for the future.

28 It is appropriate to make one further point. As with the last time that the Applicants applied to the ACCC for authorisation of their Alliance, their submission to the ACCC this time round contains significant passages in respect of which confidentiality has been claimed. Three years after the original authorisation was granted, there remains very little information about the Alliance forthcoming from the Applicants. The unwillingness to share information remains concerning, particularly given the obvious reduction in the competitive dynamics that flow from any alliance of this nature.

29 It is not possible for the Key Wellington Stakeholders (or other members of the public) to provide comprehensive analysis and comment on the Application in the absence of this information. We are therefore particularly reliant on the ACCC, which does have the confidential information, to ensure that the merits (or otherwise) of the arguments put forward by the Applicants are carefully scrutinised and tested.

Recommendations

30 We recommend that:

30.1 The Application for re-authorisation of the Alliance is granted but only for a further three years and only subject to continuation of appropriate capacity conditions; and

30.2 If the Applicants are unwilling to accept re-authorisation on this basis, the Application should be declined.

31 Thank you for the opportunity to make this submission. We are happy to elaborate further on any issue raised with the ACCC. To that end, please feel free to contact Fran Wilde, Chair, Greater Wellington Regional Council at fran.wilde@gw.govt.nz.

[5] The Applicants' submission to the ACCC dated 8 March 2013, at [5.12] and [5.13].

INTRODUCTION TO THE DETAILED SUBMISSION

32 This submission relates to applications dated 8 March 2013 (together, referred to simply as "the **Application**") lodged with the Australian Competition and Consumer Commission by Virgin Australia Airlines Pty Ltd, Virgin Australia Airlines (NZ) Ltd, Virgin Australia Airlines (SE Asia) Pty Ltd, Virgin Australia International Airlines Pty Ltd and Air New Zealand Limited (together, the **Applicants**). We will refer in this submission to the three applicants from the Virgin Australia group as "**Virgin Australia**".

33 In the Application, the Applicants seek re-authorisation pursuant to the Competition and Consumer Act 2010 of the alliance regarding the Applicants' trans-Tasman services (the **Alliance**). The Alliance comprises a number of different agreements: an Alliance Agreement, a Code Share Agreement and various related agreements contemplated in the Alliance Agreement.

34 The Applicants seek re-authorisation of the Alliance for at least five more years (if not, indeed, for the remaining term of the Alliance) without continuation of the existing conditions. The ACCC should refuse to entertain that course in our view. The ACCC should ensure that any re-authorisation is subject to conditions that continue to require the Applicants to maintain and grow capacity. Otherwise, an Alliance authorised without such conditions will substantially lessen competition in the trans-Tasman air passenger services market, without providing sufficient countervailing public benefits.

35 At the outset, we note that we still have not seen, and are therefore unable to address in any detail, the particular provisions of the Alliance, because the Applicants have claimed confidentiality over the relevant agreements. We will therefore comment only on the main features of the Alliance as appear to be disclosed in general terms in the Application.

WHO IS MAKING THIS SUBMISSION

36 Our group comprises the following organisations (in alphabetical order):

- ***Greater Wellington Regional Council***: Greater Wellington Regional Council is the regional authority for the Greater Wellington area.
- ***Grow Wellington***: Grow Wellington is the regional economic development agency charged with the delivery of the economic aspects of the Wellington Regional Strategy.
- ***Positively Wellington Tourism***: Positively Wellington Tourism is the Regional Tourism Organisation responsible for marketing and promoting Wellington.
- ***Wellington City Council***: Wellington City Council is the local territorial authority for Wellington city.
- ***Wellington Employers' Chamber of Commerce***: Wellington Employers' Chambers of Commerce has a membership of over 1,600 businesses in Wellington city and represents a regional hub of Chambers of Commerce. The

Chamber promotes policies that reflect the interests of the region's business community and the development of the Wellington economy.

- ***Wellington International Airport Limited***: WIAL is the owner and operator of Wellington International Airport.

All these organisations have contributed to, reviewed and approved the draft of this submission.

SOME BACKGROUND TO THIS SUBMISSION

Previous failed attempts to reduce trans-Tasman competition

37 What follows repeats to some extent submissions previously made by the Key Wellington Stakeholders when we submitted on the Applicants' 2010 application for authorisation of the Alliance. We view this background as important.

38 The key message is that having full competition on these routes delivered good competitive outcomes for consumers. With the authorisation of the Alliance removing the level (and vigour) of competition that previously prevailed, the conditions (and their continuation) are an essential regulatory mechanism for delivering for consumers (as a proxy to real competition) the type of market outcomes that would be expected in a competitive market.

39 Since 2000 and before the Alliance was authorised in 2010, two previous attempts had been made by competing airlines servicing the Tasman to combine their trans-Tasman operations and reduce the competition and choice that would otherwise be available to passengers travelling across the Tasman. Both of those attempts involved Air New Zealand and Qantas, and both attempts failed.

40 Those attempts failed because the two airlines seeking to combine were, at the relevant time, the only main players on the Tasman. They were effectively a duopoly, and they faced little real or meaningful competition.

41 A real competitive constraint on the Qantas/Jetstar Group and on Air New Zealand emerged, in the form of Pacific Blue, now Virgin Australia. With three major players servicing the trans-Tasman routes, trans-Tasman passengers began to enjoy the benefits of the competition that a third operator brought on some routes.

42 Over the decade from 2000 to 2010, the 44% growth on Wellington trans-Tasman routes stemmed virtually exclusively from the presence of a third operator. Over the same period, Air New Zealand reduced services by 12% and Qantas traffic grew by 1% per annum.

The 2010 application and the ACCC's conditional authorisation

43 The Applicants then sought authorisation of a proposed alliance that would have had the effect of substantially lessening the vigorous competition that had developed on the Tasman during the 2000s. The Key Wellington Stakeholders opposed that outcome because of the obvious competition law concerns posed by the proposed alliance. The ACCC's draft decision on the application for authorisation was to decline the authorisation, because of the anti-competitive effects and the net public detriment that the proposed alliance would be likely to produce.

44 Following the ACCC's draft decision, the Applicants proposed that authorisation of their proposed alliance should be granted subject to conditions. In its final authorisation decision, the ACCC granted the authorisation on a conditional basis. The Key Wellington Stakeholders were content for the authorisation to be granted on this basis, because the conditional authorisation addressed the key competition law problems that would have arisen had an unconditional authorisation been granted.

45 The gist of the ACCC's final decision approving a conditional authorisation is worth noting. The ACCC accepted the view that the benefits and detriments of the Alliance (without conditions) were finely balanced in respect of the trans-Tasman market as a whole. But the ACCC also accepted that, in respect of particular routes (including all trans-Tasman routes to and from Wellington), any benefits from the Alliance would be outweighed by the detriments that would be likely to arise from the Alliance.

46 Accordingly, the ACCC authorised the Alliance conditionally. While some of the conditions related generally to capacity on the trans-Tasman routes as a whole, specific capacity conditions attached to the three Wellington trans-Tasman routes (and a number of other routes). The ACCC accepted that the benefits of the Alliance would outweigh its detriments in respect of these routes only if the capacity conditions were imposed.

HOW HAS THE MARKET CHANGED SINCE 2010?

47 The ACCC undertook a considered and detailed analysis of the benefits and detriments of the Alliance as part of its final decision in December 2010 granting conditional authorisation. In the view of the Key Wellington Stakeholders, it is appropriate to use that analysis as a starting point for the present Application and to ask: How has the market changed since 2010?

The Qantas/Emirates Alliance is a change: but not at Wellington

48 The ACCC's 2010 conclusion was reached after a careful analysis of the relevant markets and the competitive situation then existing on the trans-Tasman routes, including those to and from Wellington. Obviously, the key change in the market since the ACCC's 2010 decision has been the authorisation of the Qantas/Emirates Alliance. That development is one factor that the ACCC will need to take into account when considering the present Application.

49 But it is *not* a factor that bears particularly on the competitive situation existing on the Wellington trans-Tasman routes. Emirates has never flown into and out of Wellington. In its application for its own alliance with Qantas, Emirates cited both air service rights and infrastructure as two reasons preventing entry into the Wellington market.[6] Emirates is not and never was a competitive restraint on the existing operators flying into and out of Wellington in respect of the Wellington trans-Tasman routes.

Duopoly or monopoly on Wellington trans-Tasman routes now in place

50 As far as the Wellington trans-Tasman routes are concerned, nothing in the market is relevantly different today from how it was when the ACCC issued its final decision in 2010 (except, of course, that the Applicants' Alliance is now in operation). The

[6] Emirates' submission to the ACCC dated 3 December 2012, at page 2.

operation of the Alliance now means that the Wellington-Brisbane route is a monopoly, and that there is (again) only a duopoly for Wellington-Sydney and Wellington-Melbourne.

51 The below table illustrates the market concentration on Wellington routes pre-Alliance, as at 31 March 2013 and estimated for March 2014.

Route	Pre Alliance		March 2013		March 2014*	
	No. of Competitors	HHI	No. of Competitors	HHI	No. of Competitors	HHI
WLG-BNE	2	5,060	1	10,000	1	10,000
WLG-MEL	2	5,008	2	5,000	2	5,003
WLG-SYD	3	3,934	2	5,009	2	5,022
Total Trans-Tasman	6	2,626	5	3,695	4	4,585

Note *: Subject to the QF/EK partnership regulatory approval

Pre Alliance competitiors on the Tasman were: LAN, Virgin Australia (Pacific Blue), Air New Zealand, Emirates, the Qantas Group and Aerolineas Argentinas. March 2013 includes China Airlines but excludes Aerolineas Argentinas from the previous list of competitors.

52 Since the commencement of the Alliance in January 2011, the level of competition as measured by the Herfindahl–Hirschman Index has reduced on Wellington routes with Wellington-Brisbane becoming a monopoly and Wellington-Sydney a duopoly. The level of competition across the trans-Tasman has also significantly reduced and (subject to approval) is forecast to reduce further with the commencement of the QF/EK partnership.

53 Out of the 3 largest New Zealand international airports, Wellington has the highest number and proportion of passengers having to travel indirectly via other New Zealand ports, and so an overall reduction in trans-Tasman competition as part of the QF/EK partnership will have a significant impact on Wellington residents.

54 It is clear from this analysis that from an airline competition perspective nothing has materially changed on the Wellington trans-Tasman routes.

The Wellington-Brisbane monopoly route

55 The largest in terms of passenger volume of the three Wellington trans-Tasman routes is Wellington-Brisbane. That route is now an effective monopoly, because it is flown only by the Applicants and it is operated pursuant to their Alliance. While Qantas and Jetstar operate at both Wellington and Brisbane airports, they do not currently fly the Wellington-Brisbane route and have not done so for some years. We have no reason to think that Qantas or Jetstar are about to start Wellington-Brisbane operations at any time in the foreseeable future. The threat of entry by them can provide only limited competitive constraint on this route at best. The reality is that the Applicants – without the conditions to constrain them – would have no incentive to maintain and grow capacity or to work to reduce fares on this route.

The Wellington-Sydney and Wellington-Melbourne duopoly routes

56 These routes are duopolies, with Qantas/Jetstar operating services on them as well as the Virgin Australia/Air New Zealand Alliance. The players operating on these routes are the same as in 2010 and there is no realistic prospect that any other operator would begin to fly these routes.

57 The market conditions in respect of these routes are not materially different today from the market conditions that the ACCC characterised in 2010 as providing for limited competition on these routes.

58 Alliance capacity on the Wellington-Sydney route has grown. But, as the applicants themselves note, the combined Alliance average fare on the Sydney-Wellington route has increased, which the applicants say was due to "exceptionally high demand from the Rugby World Cup 2011".[7]

THE BENEFITS: AS A RESULT OF THE ALLIANCE, AS A RESULT OF THE CONDITIONS OR AS A RESULT OF MARKET DYNAMICS?

Introduction

59 In their submissions, the Applicants point to various benefits that they say the Alliance has brought. They appear to rely on the existence of these benefits to argue that continuation of the conditions is unnecessary because the Alliance is delivering the very benefits that they said it would.

60 The Key Wellington Stakeholders disagree. Many of the benefits stated (such as access to airline lounges) relate to areas of non-price competition which are relatively minor in the overall scheme. The key benefits arise from capacity growth on the Tasman. But it is unclear whether the market growth witnessed over the initial term of the Alliance has been driven by the "benefits" pointed to by the Applicants, by the imposition of the capacity conditions themselves, or by other market dynamics affecting the various routes. There is no reason to suppose that this growth will continue on all routes (and particularly on routes, such as the Wellington trans-Tasman routes, that are not subject to strong competitive pressures) unless the conditions are maintained in place.

61 The applicants note that the Alliance has been in genuine effect for only around 18 months.[8] It is important to note that, over the course of this brief period, a range of significant external shocks, both positive and negative, have also been felt by the market, most notably the Rugby World Cup and the ongoing impact of the Canterbury Earthquakes.

Some benefits have been delivered – but minor in the overall scheme

62 Section 3 of the Applicants' submission outlines a range of benefits that they say are derived from the Alliance. The main benefits that they identify are:

62.1 Increased access to existing frequencies and increased online connection options;[9]

[7] The Applicants' submission to the ACCC dated 8 March 2013, at [5.9].

[8] The Applicants' submission to the ACCC dated 8 March 2013, at [1.2].

[9] The Applicants' submission to the ACCC dated 8 March 2013, at [3.3] to [3.10].

62.2 Better schedule spread, resulting in significant reductions of wingtip flying and removal of some day of week or time of day clashes;[10]

62.3 Enhanced value added services, such as frequent flyer reciprocity and lounge access reciprocity;[11] and

62.4 Costs savings and other efficiencies, such as higher load factors resulting in a lower cost per seat sold.[12]

63 The Key Wellington Stakeholders accept and have recognised that the Alliance has delivered some benefits in these areas, such as enhanced schedules, sharing of lounges, frequent flyer programmes, access to domestic networks and other features, which have likely made it easier for capacity to be filled and grown on the trans-Tasman routes. We also recognise the benefits of the Alliance to the carriers and acknowledge that, where sufficient competitive constraint exists, these benefits can potentially be passed on to consumers in the form of enhanced schedules, service offerings and lower fares.

64 However, and as accepted in the ACCC final determination in 2010, the competitive impacts of the Alliance must be considered on a route-by-route basis in order to anticipate the effects in each market, noting the different competitive dynamics at play in each. Sufficient competitive constraint does not exist on the Wellington trans-Tasman routes, the Wellington-Brisbane route being a monopoly (with no indication that Qantas/Jetstar has any intention of entering that market) and the Wellington-Sydney and Wellington-Melbourne routes being duopolies.

65 On routes where the Alliance is set to face limited or no competition (such as the Wellington trans-Tasman routes), it is clear that the incentives faced by the Applicants will lead them to "bank" any surplus generated by the efficiencies of their Alliance in order to maximise their financial performance. This activity would come at the expense of consumers and should be protected against.

66 In any event, the benefits discussed in Section 3 of the Applicants' submission – increased online connection options, reciprocity in airline lounge access, reciprocity in frequent flyer programs – mainly relate to areas of non-price competition. These benefits are less valued by most customers than the key competitive benefits that most customers focus on – availability of seats on their desired route and price. Accordingly, the ACCC should be astute not to accord too much significance to these benefits when assessing the public benefits derived from the Alliance.

But it remains unclear whether the key benefit – increased capacity – is a result of the Alliance, of the ACCC's conditions or of market dynamics

67 The benefits just mentioned essentially arise in non-price competition areas, which are less valued by most customers. The key competitive benefits that most customers focus on are availability of seats on their desired route and price. These benefits are a function of available capacity, and increased capacity on the trans-

[10] The Applicants' submission to the ACCC dated 8 March 2013, at [3.11] to [3.23].

[11] The Applicants' submission to the ACCC dated 8 March 2013, at [3.24] to [3.35].

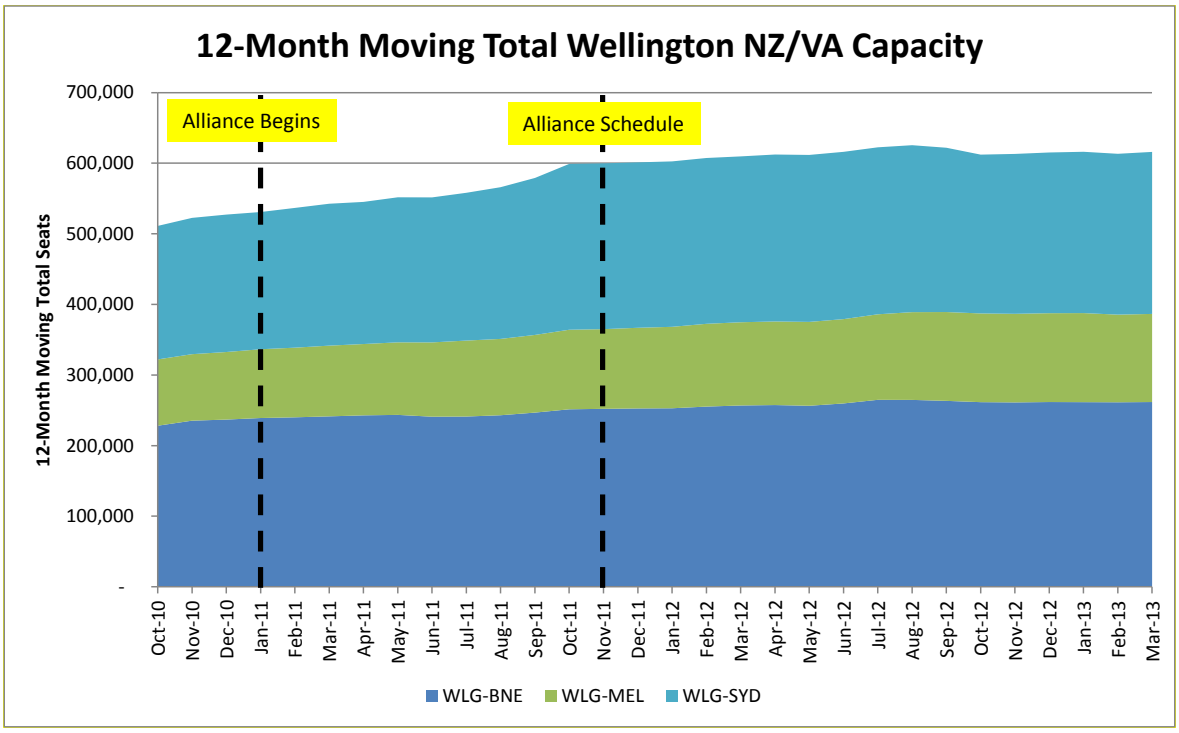
[12] The Applicants' submission to the ACCC dated 8 March 2013, at [3.44] to [3.52].

Tasman routes was inevitable – to some degree – given the ACCC's imposition of conditions requiring the Applicants to increase capacity.

68 It is not clear that the market growth witnessed over the initial term of the Alliance has been driven by the "benefits" pointed to by the Applicants. That growth could also be the effect of the imposition of the capacity conditions themselves or other market dynamics affecting the various routes. The Applicants note that the Alliance has only been in genuine effect for around 18 months,[13] and that this period has seen a number of rare and significant external shocks, both positive and negative. There is no reason to assume that any growth attributed by the Applicants to the demand for the Alliance's newly introduced services and benefits over this period will continue into the future.

69 The Alliance currently finds itself in a position of significant market power and, if permitted to use this power unencumbered, it has the potential to, and could be rationally expected to act to, restrict capacity and enhance its profitability at the expense of the travelling public. Our recent experience is that the Alliance has in fact reduced capacity from an annualised peak in August 2012.

70 A degree of capacity reduction is to be expected following a strong year for trans-Tasman travel driven by an influx of visitors to New Zealand during the Rugby World Cup.[14] But, in recent months (and, thus, well after the effects of the Rugby World Cup should have dissipated), we have observed a reduction in capacity by the Alliance on Wellington routes versus the prior year.



[13] The Applicants' submission to the ACCC dated 8 March 2013, at [1.2].

[14] The Applicants' submission to the ACCC dated 8 March 2013, at 37, footnote 62, refers to the exceptionally high demand from the Rugby World Cup 2011.

71 In our view, a more considered and sensible approach than a reliance on the "benefits" of the Alliance to deliver a positive outcome would be to look at the dynamics of the various markets, to consider any relevant changes over the period and to make an assessment of the commercial incentives faced by the Applicants in each of those markets.

72 The information in the table at paragraph, 51, above scores the Wellington markets on the basis of market concentration. The Herfindahl-Hirschman Index (HHI) is a commonly accepted measure of market concentration, and is calculated by summing the squares of the market shares of each firm within a competing market to provide an index. For a market with only one firm the index is 10,000 (100^2), for 2 firms of equal size it is 5,000 (50^2+50^2) and for 10 firms of equal size 1,000 (10 times 10^2). The United States Department of Justice (USDOJ) uses the HHI as an indicator, and based on their experience generally classify markets into 3 types based on the level of market concentration:

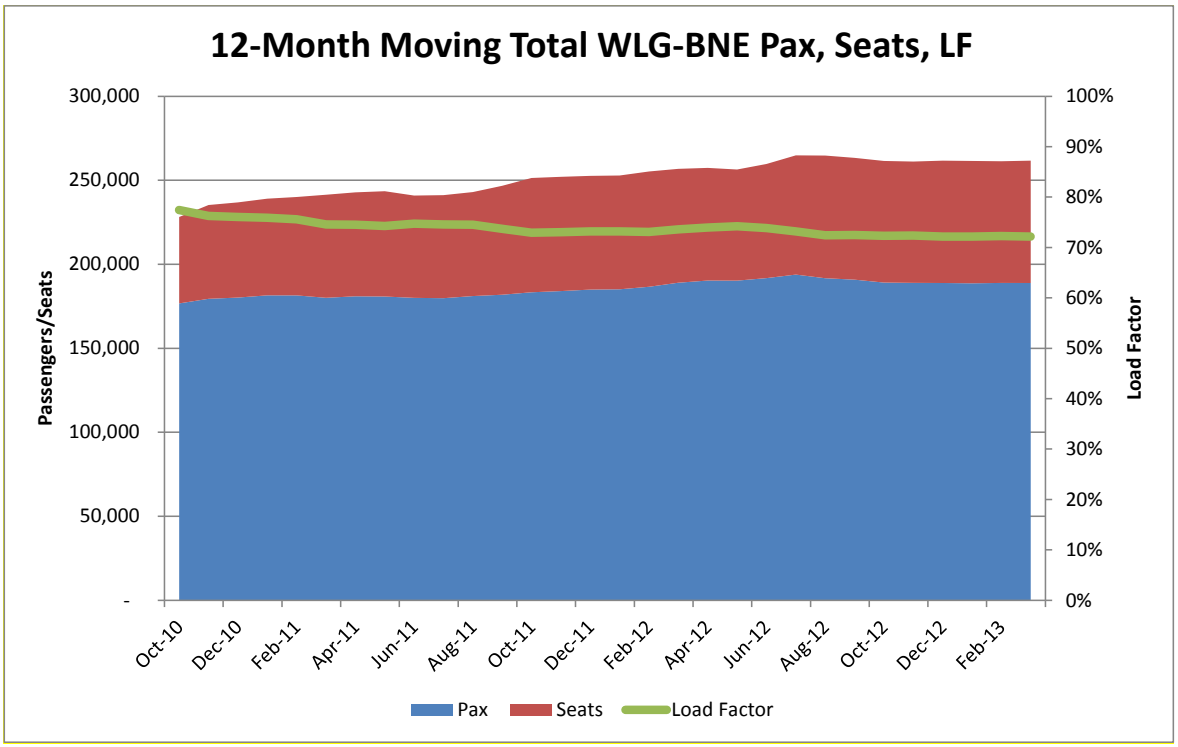
- Unconcentrated markets: HHI below 1,500
- Moderately concentrated markets: HHI between 1,500 and 2,500
- Highly concentrated markets: HHI above 2,500

73 The USDOJ also provides standards where competitive concerns are raised around the market types they have defined. For highly concentrated markets the standard they have provided is:

"Highly Concentrated Markets: Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power."

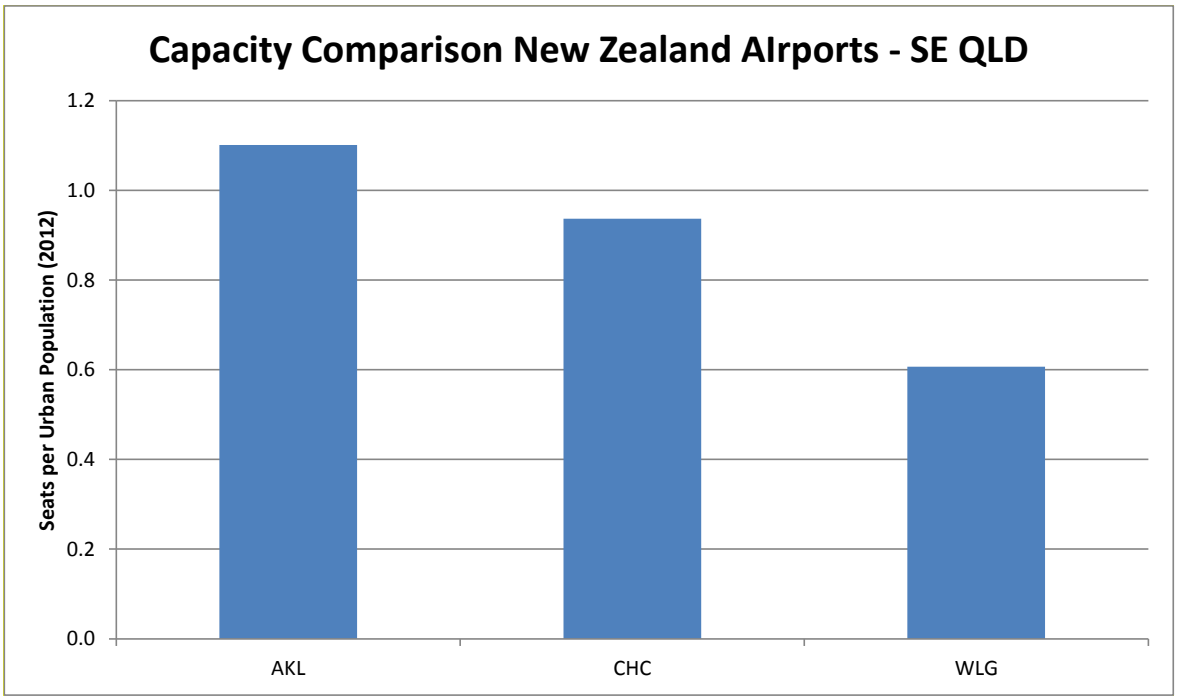
74 Given that on the Wellington routes (along with several other affected routes on the Tasman) the Alliance currently finds itself in a position of significant market power in highly concentrated markets, it would be expected to behave in a rational profit-maximising manner. As recognised by the ACCC in its final determination, this could mean withholding capacity to optimise profitability in the absence of competitive constraint. This activity would be expected of the Alliance if re-authorisation were to be granted unconditionally as requested.

75 The Wellington-Brisbane route is an example of a route which would be directly affected by the removal of capacity conditions. The route is served only by the Alliance and is operated with double daily services and additional frequencies during peak demand periods. The chart below illustrates the changes in the market in the year before the Alliance up to the end of March 2013.



76 Load factors have reduced slightly and fare monitoring suggests that airfares have increased, indicating that the capacity growth has been short of the growth in underlying demand over the period and that demand is being suppressed by fares. Details regarding the fare monitoring are provided in the confidential appendix to this submission.

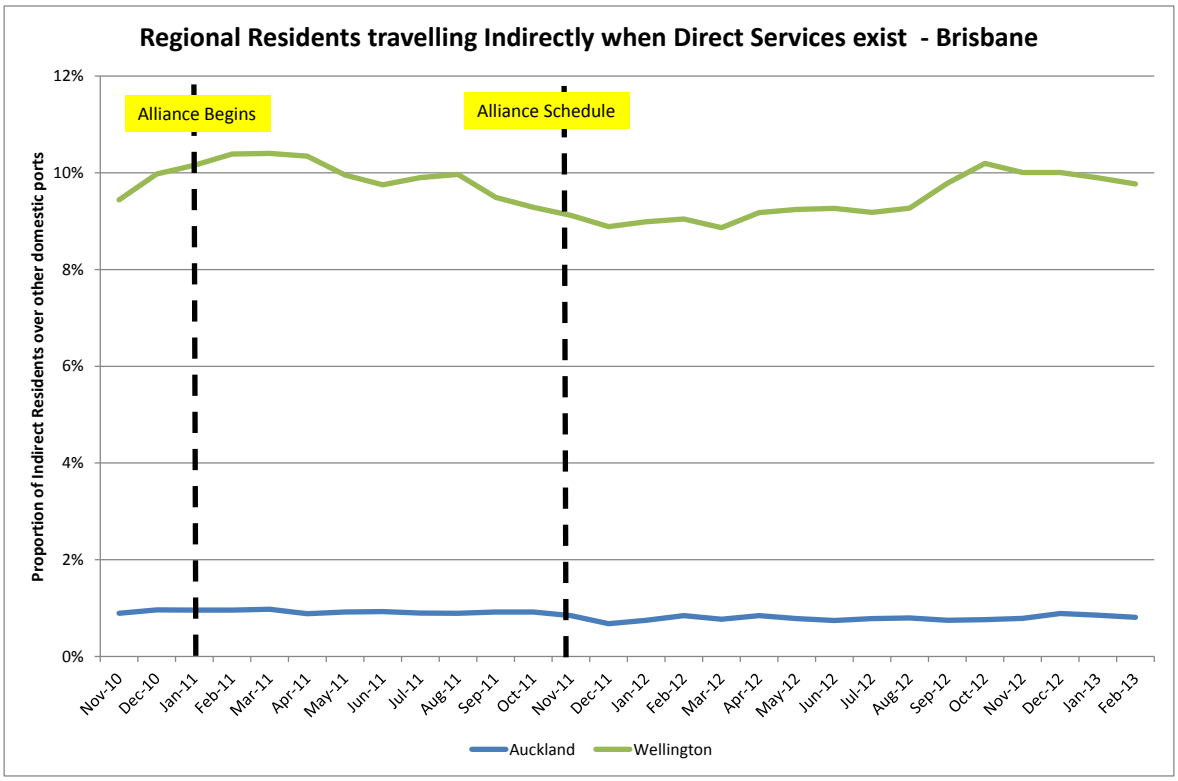
77 Further evidence that the Wellington-Brisbane market is not in a state of over capacity appears in the chart below illustrating the level of capacity on the Brisbane routes to Wellington, Auckland and Christchurch corrected for population at either end of the routes.



Source: Sabre and Statistics New Zealand

78 This shows that the level of capacity on the Wellington-Brisbane route is clearly not inefficiently high, as suggested by the Applicants by their application to remove the capacity conditions. Indeed, Statistics NZ departure data show that Wellington has the highest percentage of Brisbane passengers flying via other ports (10% compared to less than 1% for Auckland), indicating that the level of capacity and or price is not presently satisfying the existing level of market demand.

79 Since Virgin became the sole operator on the sector the proportion of Wellington resident passengers flying via other ports has increased, highlighting the reduced product choice for consumers as Virgin works to become metal neutral with Air New Zealand.



Source: Statistics NZ Immigration data

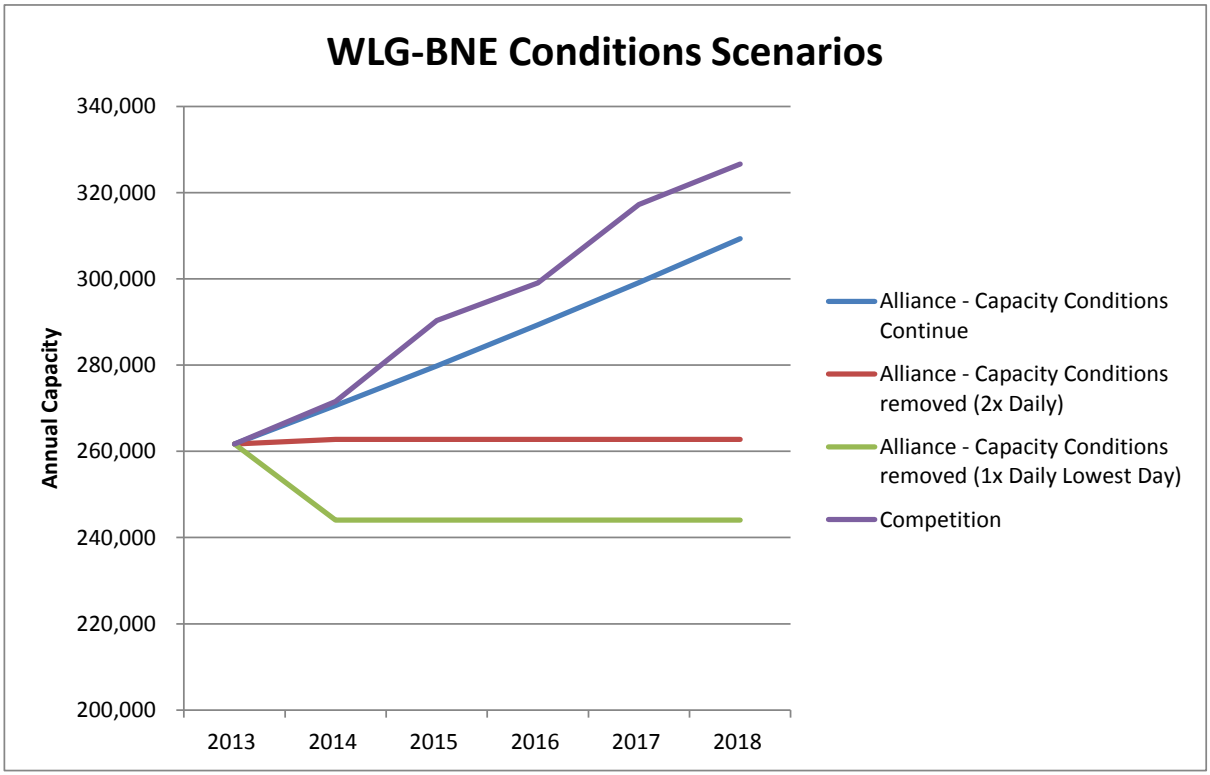
80 It is significant that the capacity increase over the period of the Alliance has been barely sufficient to meet the capacity condition required of the Applicants on the Wellington-Brisbane route. In the absence of the capacity condition, given the degree of market power wielded by the Alliance, there would have been no incentive for it to maintain capacity growth in line with demand increases. A more profitable course would have been to maintain a double daily service on days of high demand, dropping below this level on days with lower levels of demand to further reduce operating costs. On the 16th of April a meeting was held at Wellington Airport with representatives from the Airport and Air New Zealand present to discuss the Alliance reauthorisation process. During that meeting, John Whittaker, Group General Manager Airports for Air New Zealand confirmed that, in the event that the capacity conditions are lifted, the Alliance *will* reduce capacity on the Wellington – Brisbane route.

81 The chart at paragraph 83, below, illustrates a counterfactual scenario of the Wellington-Brisbane route absent the capacity condition, with the Alliance carriers operating a maximum of double daily services over the period pre- and post-Alliance. Another scenario is also included illustrating the further impact which would be expected from a decision taken to reduce capacity to one daily service on the day of lowest demand (Tuesday). In each of these scenarios, capacity growth would have been materially less than was experienced with the capacity condition. Given the link between capacity and price established in the original Authorisation process, it is irrefutable that either of these outcomes would have delivered material consumer detriment in spite of the claimed consumer benefits of the Alliance.

82 These scenarios may be compared to the genuine counterfactual of the two carriers operating competitively at this point in time. It would be expected that one of the

carriers would take the decision to operate double daily frequency on days of peak demand as load factors exceed 90% for more than 10% of all flights operated. This scenario shown at paragraph 83 below would have delivered substantially higher levels of growth over the period, consistent with the market average growth over that time.

83 In our view, the capacity conditions are working as they were designed to work – that is, to preserve the consumer outcome to the minimum level which could be expected from a continuation of the competitive environment. This has had the result of maintaining fares at levels consistent with those seen before the advent of the Alliance and ensuring that an efficient schedule has remained available for consumers.



84 The following table provides total seats for the 2013-2018 period in these different scenarios:

	Current Conditions	Alliance – No Conditions (2x Daily)	Alliance – No Conditions (1x Daily Lowest Day)	Competition
Total Seats (2013-2018)	1,709,848	1,575,696	1,481,839	1,766,539
Diff with Current		-134,152	-228,009	56,691
% Diff		-7.8%	-13.3%	3.3%

85 The removal of capacity conditions would be expected to reverse a proportion of the growth experienced on Wellington routes and promote the inefficient outcomes inherent in a restricted supply market. It is important to note that, while the impacts of a monopoly supplier scenario are more easily analysed, the impact of a duopoly supply situation is also significant when contrasted with a market with three or more suppliers.[15] This feature was recognised by the ACCC in its final determination and these features remain evident in the various markets today, affirming the importance of capacity conditions on all of the affected routes identified in 2010.

THE DETRIMENTS: WHY ANY RE-AUTHORISATION MUST BE SUBJECT TO CONDITIONS

The anti-competitive effects from an Alliance without conditions

86 The Applicants submit that there is "unlikely to be any adverse competitive effects on any trans Tasman route" and rely on their "experience to date under the Alliance" in support of this argument.[16] In the view of the Key Wellington Stakeholders, the limited experience to date does not support this argument at all.

87 Most of the developments to which the Applicants point in Section 5 of their submission do not bear on the situation at Wellington at all.[17] There are no (and it cannot reasonably be expected in future that there will be any) fifth freedom carriers operating at Wellington airport. On the Wellington-Brisbane route, there has been no competition from Qantas/Jetstar for some years. And on the Wellington-Sydney route, the Applicants openly state that the combined Alliance average fare has increased (as a result, it is said, of "exceptionally high demand" from the Rugby World Cup 2011).[18]

88 The experience of the Alliance to date forms no basis on which to conclude that the conditions can safely be removed without consequences. The ACCC accepted in its Final Authorisation that the Alliance would be likely to result in anti-competitive detriment on routes to and from Wellington.[19] The ACCC therefore accepted the conditions proposed by the Applicants on the basis that the combination of public benefits and conditions were likely to be sufficient to outweigh any anti-competitive detriment on the identified routes or on the Tasman as a whole.

89 That analysis holds good today. There has been no particular change in market conditions on the Wellington trans-Tasman routes that leads to any different conclusion when considering the competitive state of those markets today. Competition remains limited on all three Wellington trans-Tasman routes and the prospect of new entry remains as limited as it was three years ago.

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[15] Airport Strategy and Marketing Limited *Impact of Proposed Virgin Blue Airlines/Air New Zealand trans-Tasman Alliance* 2010 (available at: http://www.transport.govt.nz/ourwork/air/Documents/Key%20Wellington%20Stakeholders%20-%2002.07.10%20(attachment%201).pdf).

[16] The Applicants' submission to the ACCC dated 8 March 2013, at [5.10].

[17] See particularly the Applicants' submission to the ACCC dated 8 March 2013, at [5.9].

[18] The Applicants' submission to the ACCC dated 8 March 2013, at [5.9].

[19] As acknowledged in the Applicants' submission to the ACCC dated 8 March 2013, at [5.5].

Conditions are essential to satisfy net public benefits test

90 As determined by the ACCC when considering the initial application in 2010, the most appropriate way to protect against the Applicants taking advantage of their authorised position of market dominance is to require appropriate levels of capacity to be maintained.

91 In the initial authorisation, the ACCC recognised that the threat of competitor entry into a market is not sufficient in itself to provide sufficient competitive constraint against abuse of market power. Barriers to entry involving physical constraints such as runway requirements for wide-body aircraft types, operational constraints such as fleet utilisation/aircraft base locations and regulatory constraints limiting trans-Tasman operations flown by foreign carriers can make competitor entry difficult, expensive or technically impossible thereby rendering any threat meaningless in effect.[20]

92 For this reason, capacity conditions are essential to preserve the level of capacity that may reasonably be expected to be delivered in the most likely counterfactual scenario, of the Applicants (each being strong participants in the Australasian market) actively competing with each other and others for market share by seeking to deliver competitive fares, frequencies, product offers and routes to the market.

93 Our common concern is to maintain and increase the growing number of passengers coming into Wellington from Australia. In the decade before the Alliance between Virgin Australia and Air New Zealand was authorised, growth on the Wellington trans-Tasman routes was 44%, and it stemmed almost exclusively from the presence of a third operator, Pacific Blue, to challenge the Air New Zealand-Qantas duopoly.

94 That competition brought increased capacity on Wellington trans-Tasman routes and lower average fares on these routes for consumers. Authorisation of the Alliance effectively removed the third operator from the Wellington trans-Tasman routes. In the absence of the competitive dynamics and forces that would otherwise be at play, some mechanism was essential to ensure that the competitive outcomes that would otherwise obtain on these routes were obtained.

95 That mechanism was the imposition and enforcement of the conditions to the alliance authorisation. By requiring the Applicants to maintain and grow capacity in a situation of substantially reduced competition, the ACCC (rightly) has created a proxy mechanism for producing the competitive outcomes that would otherwise obtain if the trans-Tasman market were left to competition.

WHAT ARE THE CONDITIONS THAT SHOULD BE IMPOSED?

Introduction

96 We support the re-authorisation only for a period of a further three years and only on the basis that appropriate conditions are imposed requiring the applicants to maintain, and grow, a base level of capacity.

97 The re-authorisation must:

[20] Emirates' submission to the ACCC dated 3 December 2012 at page 2. Emirates notes infrastructure constraints and lack of regulatory approval as barriers to entry.

97.1 preserve the base level capacity condition on the Wellington routes; and

97.2 keep the requirement to grow capacity in line with an appropriate measure of market growth; and

97.3 last for no more than three years (until, say, 31 December 2016).

Nature of conditions

98 The conditions we seek are the same as those currently in place. They should take as their starting point for capacity the position reached under those conditions as at 31 December 2013, and then continue (as currently) for a further three years.

Term of the re-authorisation

99 The Applicants seek re-authorisation of their Alliance for "at least five years" and, it would seem, they would prefer re-authorisation to be for the life of the Alliance (which has never been publicly identified, to the best of our knowledge).

100 The suggestion that the Applicants' Alliance should be re-authorised for the rest of its term is entirely unacceptable. There are obvious and substantial detriments that flow from collusive conduct. Allowing it to continue indefinitely and unchecked is inappropriate.

101 The approach that the ACCC took last time – authorisation with conditions and for three years only – is the right approach. Three years will give the Applicants time to derive further benefits from the Alliance, and it will also allow the ACCC and all parties to benefit from a review of the Alliance and the conditions (and the benefits and detriments that have flowed from the Alliance) after that period.

WHY THE APPLICANTS' ARGUMENTS FOR RE-AUTHORISATION WITHOUT CONDITIONS ARE UNPERSUASIVE

Introduction

102 The Applicants seek re-authorisation without conditions, arguing that ongoing conditions are not necessary for the benefits of the Alliance to be obtained and that the conditions in fact lead to distortions and inefficiencies.[21]

103 The ACCC should treat this argument with extreme caution. There is a real disconnect between the stated "core rationale" for the Alliance ("to increase the number of passengers travelling on the Applicants' combined services") and the Applicants' request for the Alliance to be re-authorised without the present conditions (the effect of the conditions being to increase capacity so that the Applicants do carry an increasing number of passengers in line with market growth and/or economic growth).

104 In the view of the Key Wellington Stakeholders, and as addressed above, the conditions were (and remain) pivotal to creating increased capacity, from which flow the key benefits for consumers—greater seat availability and better prices. But, more fundamentally, a regulatory response of this nature is necessary and appropriate in circumstances where the Applicants are asking for permission to

[21] See, generally, Section 5 of the Applicants' submission to the ACCC.

engage in conduct that is itself artificial and distortive: namely, collusive behaviour on price and capacity on the trans-Tasman routes.

The conditions and the "core rationale"

105 The stated "core rationale" for the Alliance is "to increase the number of passengers travelling on the Applicants' combined services through the development of a second integrated Australasian network offering enhanced products and services including a greater choice of flights, better online connections, better schedule options and enhanced loyalty programs and lounge benefits".[22] We see the conditions as supporting this rationale, not detracting from it.

106 Conditions requiring the Applicants to maintain and grow capacity *support* this goal of increased passenger numbers, as more capacity enables the Applicants to carry more passengers across the Tasman. With this being clearly the case, a capacity condition requiring the Applicants to simply maintain capacity at a constant level relative to general market growth should not be viewed as an onerous obligation. Indeed, it was the Applicants themselves who proposed the conditions in order to secure authorisation in 2010.

107 Yet, the Applicants say that they want reauthorisation with these conditions removed. It is difficult to see why the Applicants would want the conditions removed unless it was to enable them to reduce capacity, particularly in respect of routes with no or minimal competitive constraint.

108 It is imperative that any re-authorisation of the Alliance is made subject to continued and appropriate conditions requiring the Applicants to maintain and grow capacity. Otherwise, there is a very real incentive on the Applicant (and certainly no disincentive) to reduce capacity and increase fares.

The conditions are not "distortive"

109 The Applicants voice a concern that the conditions "have the potential to create significant distortions and inefficiencies in the provision of Trans Tasman air passenger services" and that these "may not only result in compliance costs for the Applicants but in fact be to the detriment of consumers".[23]

110 This is no reason not to maintain the conditions. What is "distortive" of the market is the very fact of having two competitors suppressing competition between them and operating as a single venture. When competition is eliminated in this way, a regulatory response in the form of monitored conditions to preserve the outcomes that may be expected in a competitive market is entirely appropriate.

111 The Applicants also complain that the conditions reduce their ability to "respond flexibly to adjust supply".[24] The examples they go on to give are two applications they made for variations to the conditions following the Canterbury earthquakes and a third application for variations to the conditions made as a result of Chilean volcanic ash cloud activity.

[22] The Applicants' submission to the ACCC dated 8 March 2013, at 3 and [4.4].

[23] The Applicants' submission to the ACCC dated 8 March 2013, at [5.12].

[24] The Applicants' submission to the ACCC dated 8 March 2013, at [5.13].

112 The Canterbury earthquakes were obviously an exceptional occurrence, and decades can be expected to pass between natural disasters of this magnitude. The last major earthquake to devastate a New Zealand city was the Napier earthquake in 1931, some 80 years before the 22 February 2011 Christchurch earthquake. There is no reason to suppose that it is likely that the applicants will again have need to respond "flexibly" during the next five years to an event of this nature.

113 In any event, the conditions were fashioned with force majeure provisions to allow variations to be sought and granted in precisely this situation. If the applicants find that they needed to spend time and resources in applying for variations of the conditions, that is simply the cost that they must accept as part of the privilege of being authorised to engage in otherwise anti-competitive conduct.

114 Disruptions to flight patterns from volcanic ash could be expected to occur with some greater frequency than massive earthquakes. But disruptions from volcanic ash are usually ephemeral. And, again, the conditions imposed contain force majeure provisions to address these situations.

115 Similarly, the weather-related difficulties on the Wellington-Brisbane route to which the Applicants point at [5.17] of their submissions are trifling in the overall scale of conditions that operate on a season-by-season basis. Any operator – in an alliance or not – has to contend with these sorts of difficulties in its business. Their presence in way no justifies any argument that the conditions are unnecessary or lead to "inefficiencies" of a magnitude sufficient to offset the consumer protection afforded by the capacity conditions.

116 The Applicants describe the conditions are involving "rigidity and artificial distortion to the dynamic air passenger services market".[25] Of course, the "artificial distortion" to a dynamic market is the Alliance itself, because it removes a significant level of competition that would otherwise obtain. The conditions are the regulatory response necessary to ensure that the detriment that would otherwise flow from this artificial combination does not arise.

117 It is also noteworthy, of course, that it was the Applicants who proposed conditions in order to obtain authorisation of their Alliance. It is reasonable to presume that any cost or inefficiency that the conditions might generate is more than outweighed by the benefits that the Applicants derive from the Alliance. Otherwise, they would not choose to give effect to the Alliance and revert to competing separately.

CONCLUSION

118 In summary, any re-authorisation of the Alliance must remain subject to appropriate conditions relating to capacity maintenance and growth in the trans-Tasman and should be permitted only for a further three-year period.

[25] The Applicants' submission to the ACCC dated 8 March 2013, at [5.13].