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LAWYERS

7 May 2013

By email

Darrell Channing
Director, Mergers and Adjudication Group
Australian Competition & Consumer Commission
23 Marcus Clarke Street
Canberra ACT 2601

Mark Basile
Adjudication Branch
Australian Competition & Consumer Commission
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Copy to: Imogen Hartcher-O'Brien
Imogen.Hartcher-O'Brien@acc.gov.au

Public Register Version

Dear Darrell and Mark

Virgin Australia / Air New Zealand – Applications for reauthorisation of the Australasian Airline Alliance – response to 29 April 2013 ACCC Information Request

We refer to your email dated 29 April 2013 requesting additional information from Virgin Australia and Air New Zealand (the **Applicants**) in relation to the scope of their applications for reauthorisation of the Australasian Airline Alliance dated 8 March 2013.

Set out below and attached are the responses of the Applicants to each of the questions set out in that email.

We request that the agreements attached be excluded from the ACCC's Public Register on the basis that they contain information that is commercially confidential to the Applicants. The disclosure of this information would unreasonably and adversely affect the Applicants in respect of their lawful business, commercial and financial affairs.

Please contact us if you would like to discuss this letter or any of its attachments.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Luke Woodward'.

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RESPONSE TO INFORMATION REQUEST

1 Please provide copies of the FFP agreement, Lounge Sharing Agreement and the Special Prorate Agreements and any other agreements entered into by the parties under the Australasian Alliance Agreement or Code Share Agreement for which authorisation is sought.

Virgin Australia and Air New Zealand seek authorisation to make, maintain and continue to give effect to the Australasian Airline Alliance Agreement (**AAA**), an associated Code Share Agreement and related agreements which are contemplated by the AAA (together, the **Alliance**).

Please find enclosed the following confidential agreements that have been entered into by the parties under the AAA:

- Reciprocal Frequent Flyer Program Implementation Agreement between Air New Zealand Limited, Pacific Blue Airlines (Aust) Pty Ltd, Pacific Blue Airlines (NZ) Ltd, Virgin Australia Airlines Pty Ltd and Virgin Australia International Airlines Pty Ltd, and Velocity Rewards Pty Ltd as trustee for the Velocity Trust dated 1 July 2011;
- Lounge Access Agreement between Air New Zealand Limited and Virgin Australia International Airlines Pty Limited dated 31 July 2012;
- Lounge Access Agreement between Air New Zealand Limited, Virgin Australia Airlines Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd and Pacific Blue Airlines (NZ) Ltd dated 7 July 2011;
- Reciprocal Premium Customer Handling and Lounge Access Agreement between Virgin Australia Airlines Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd, Pacific Blue Airlines (NZ) Ltd, Virgin Australia International Airlines Pty Ltd, Velocity Rewards Pty Ltd and Air New Zealand Limited executed 6 July 2012;
- Special Prorate Agreement between Virgin Australia International Airlines Pty Ltd and Air New Zealand Ltd dated 1 August 2012;
- Special Prorate Agreement – Australia Domestic and Norfolk Island Sectors between Air New Zealand Limited and Virgin Australia Airlines Pty Limited dated 15 August 2012; and
- Special Prorate Agreement between Virgin International Airlines Pty Ltd, Virgin Australia Airlines Pty Ltd, Virgin Australia Airlines (SE Asia) Pty Ltd, Virgin Australia Airlines (NZ) Ltd, Virgin Samoa Ltd and Air New Zealand dated 21 December 2012.

2 Please provide a public description of the revenue sharing agreement

The revenue sharing agreement under the AAA is founded on the principle that the parties share the risk, reward and benefits of the Alliance. Another core principle is “metal neutrality”, which is given effect through revenue allocation and other mechanisms under the AAA. Metal neutrality means a state where the parties will implement programs and policies that ensure that each airline is incentivised to sell, and consumers are willing to buy, tickets on routes which comprise the Trans Tasman Sectors plus any domestic Australian or New Zealand sectors connecting to a Trans Tasman Sector as part of an international itinerary (**Network Alliance Routes**), without preference as to which parties’ aircraft a passenger travels on.

In order to make and give effect to these principles, the Alliance provides for a free sale code share on the Network Alliance Routes¹ and for the proportionate allocation of revenue from the Trans Tasman Sectors under revenue allocation arrangements founded on the principle of metal neutrality. The Applicants have agreed a form of revenue allocation arrangement as set out in the AAA.

Essentially, under the AAA, each carrier will share in the revenue generated by the Alliance on Trans Tasman Sectors regardless of which alliance carrier actually transports the passenger.

With the alignment of financial incentives, the carriers strive to grow and optimise the convenience and scope of their overall product offering such that they:

- avoid “double marginalisation” by jointly pricing a fare without separate profit mark-ups;
- agree on schedules which may involve adding flights or shifting frequencies to provide broader time of day coverage or better connections, where those changes increase passenger convenience;
- route customers between city pairs via the most efficient routing regardless of which carrier ultimately operates the flights; and
- seek to jointly introduce new routes and services that they may not be able to launch unilaterally so as to expand the scope and breadth of their joint network to the benefit of consumers.

3 Please provide a public description of all related agreements contemplated by the Australasian Airline Alliance Agreement

The AAA, refers to the following Related Agreements entered into by the Applicants pursuant to section 9 of the AAA:

- FFP Agreement;
- Lounge Sharing Agreement; and
- Special Prorate Agreements

Confidential copies of these agreements have been provided to the Commission in response to question 1 of this information request. Public descriptions of these agreements are set out in turn below.

3.1 FFP Agreement - Reciprocal Frequent Flyer Program Implementation Agreement

(a) Overview

Air New Zealand Limited (**Air NZ**), Virgin Australia Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd and Pacific Blue Airlines and Virgin Australia International Airlines (**Virgin Australia Group**) and Velocity Rewards Pty Ltd (**Velocity**) entered into the Reciprocal Frequent Flyer Program Implementation Agreement (**FFP Agreement**) on 1 July 2011 with a deemed effective date of 26 July 2011.

The FFP Agreement covers participation by the Virgin Australia Group in Air NZ's loyalty program (**Airpoints Program**) and Air NZ's participation in Virgin Australia Group's loyalty program (**Velocity Program**).

¹ See the Applicant's Submission to the ACCC of 8 March 2013 at page 6, footnote 11 in respect of the phased roll out of VA code on Air NZ's domestic network following the implementation of the SabreSonic platform by VA.

Under the FFP Agreement:

- Airpoints Members are entitled to earn Airpoints Dollars on eligible Virgin Australia Group flights in accordance with the rules of the Airpoints Program;
- Velocity members are entitled to earn Velocity points on eligible Air NZ Flights in accordance with the rules of the Velocity Program; and
- each of Air NZ and Velocity remain solely responsible for its own obligations towards members of their loyalty programs pursuant to the terms and conditions of their respective frequent flyer programs.

(b) Terms

Pursuant to the FFP Agreement:

- the parties have developed agreed business processes and procedures, service standards, rules, protocols and other requirements;
- each maintain procedures whereby Airpoints Members and Velocity Members may provide relevant details at times of check-in for all alliance flights; and
- information sharing systems between Virgin Australia Group and Air NZ were developed.

The obligations of each party under the FFP Agreement includes the following:

- each agrees to honour and accept Airpoints Awards and Velocity Awards;
- each undertakes to use reasonable efforts to advise Airpoints Members and Velocity Members of the applicable public terms and conditions of the Agreement and that they may restrict the number of seats on which Awards will be offered;
- Virgin Australia Group and Air NZ provide each other with management reports outlining redemption activity and accrual costs; and
- each party pays the other a fee on redemption of their loyalty programs on the others' flight.

3.2 Lounge Sharing Agreement

The Lounge sharing Agreement contemplated under the AAA comprises the following agreements:

- Reciprocal Premium Customer Handling and Lounge Access Agreement between Virgin Australia Airlines Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd, Pacific Blue Airlines (NZ) Ltd, Virgin Australia International Airlines Pty Ltd, Velocity Rewards Pty Ltd and Air New Zealand Limited executed 6 July 2012;
- Lounge Access Agreement between Air New Zealand Limited and Virgin Australia International Airlines Pty Limited dated 31 July 2012;
- Lounge Access Agreement between Air New Zealand Limited, Virgin Australia Airlines Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd and Pacific Blue Airlines (NZ) Ltd dated 7 July 2011.

Reciprocal Premium Customer Handling & Lounge Access Agreement executed 6 July 2012

Virgin Australia Group, Velocity and Air NZ entered into an agreement to offer premium Customer handling services and lounge access (**Premium Agreement**).

Premium customer handling services offered to certain Virgin Australia Group and Air NZ passengers under the Premium Agreement include:

- priority check-in;
- priority baggage handling;
- additional baggage allowance; and
- use of Virgin Australia Group and Air NZ Lounges.

The passengers eligible for some or all of these services under the Premium Agreement are those holding Gold Elite, Gold and Silver Airpoints cards, Koru Members, Velocity Members who are Platinum, Gold or Silver cardholders and Virgin Australia lounge members.

Under the Premium Agreement the eligible passengers are issued with membership cards. If a customer does not produce that card at an airport as a form of identification, neither party will be required to provide them with premium customer handling services.

Under the Premium Agreement:

- Air NZ will provide premium customer handling services to eligible Virgin Australia Group Passengers flying on Air NZ flights (excluding routes to and from Pacific Islands);
- the relevant member of the Virgin Australia Group shall provide the premium customer handling services to eligible Air NZ passengers flying on eligible Virgin Australia Group Flights excluding routes to and from Pacific Islands);
- access to lounges for eligible passengers shall be provided on a space available basis in accordance with agreed principles; and
- written complaints by customers will be forwarded and reviewed by the parties and if the basis for any claims or complaints is considered to be reasonable, Air NZ and Virgin Australia Group shall review their procedures to identify whether any changes to procedures are necessary.

Lounge Access Agreement between Air New Zealand Limited and Virgin Australia International Airlines Pty Limited (VA) dated 22 November 2010 (as amended and restated on 31 July 2012)

This agreement sets out the terms and conditions under which certain VA passengers are granted access to the facilities and services of the airport lounges operated by Air NZ at Sydney, Brisbane and Melbourne International Airport. Under the agreement eligible VA passengers (for example, business class passengers, Velocity Platinum, Gold and Silver Members holding VA tickets, Virgin lounge members, and their eligible guests) may use the lounges at the specified airports during the lounge opening hours. VA passengers must abide by Air NZ conditions for use of the lounges.

Lounge Access Agreement between Air New Zealand Limited, Virgin Australia Airlines Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd and Pacific Blue Airlines (NZ) Ltd dated 7 July 2011

This agreement sets out the terms and conditions under which certain passengers of Virgin Australia Airlines Pty Ltd, Pacific Blue Airlines (Aust) Pty Ltd and Pacific Blue Airlines (NZ) Ltd (collectively referred to as DJ²) can use the airport lounges operated by Air NZ at the following airports: Sydney, Brisbane, Melbourne, Auckland, Wellington Christchurch, Hamilton, Dunedin and Queenstown.

² At the time of the agreement, DJ referred to Virgin's domestic designator code.

DJ business class, DJ Premium Economy, NZ Works Deluxe, Velocity Gold members, Airpoints 'Gold Elite', Velocity Platinum members, Airpoint Gold, Koru Members and Virgin Australia Lounge members passengers holding a DJ boarding pass are permitted to use the specified lounges under the terms of the agreement. DJ passengers must abide by Air NZ conditions for use of the lounges.

3.3 Special Prorate Agreements

The AAA provides that the parties may enter into special prorate agreements to set prorates for the Network Alliance Routes. Special prorate agreements have been entered into between:

- Virgin Australia International Airlines Pty Ltd and Air New Zealand Limited;
- Virgin Australia International Airlines Pty Ltd, Virgin Australia Airlines Pty Ltd, Virgin Australia Airlines (SE Asia) Pty Ltd, Virgin Australia Airlines (NS) Ltd, Virgin Samoa Ltd and Air New Zealand; and
- Air New Zealand Limited and Virgin Australia Airlines Pty Limited in relation to Australia Domestic and Norfolk Island Sectors.

(together the **SPA Agreements**)

These agreements provide the terms and conditions under which the marketing carrier or the carrier collecting revenue for any particular flight on applicable sectors will reimburse the operating carrier. The agreed accounting arrangements and invoicing procedures are also set out in the SPA Agreements.

4 Please provide a public description of all activities contemplated by the Australasian Airline Alliance Agreement; associated Code Share Agreement, and any related agreements.

The AAA and Code Share Agreement contemplate the following activities:

- co-operation and coordination on all aspects of international services on the Trans Tasman Sectors of the Network Alliance Routes;
- code share on a free sale basis on the Network Alliance Routes;
- co-operation in relation to booking, check-in, baggage handling, frequent flyer programs, lounge access and other matters to improve the overall services offered to passengers on the Network Alliance Routes. The parties aim to align their passenger and baggage policies, implement enhancements to improve check-in and provide reciprocal baggage tracing and claims;
- working together to align customer facing products and services on the Trans Tasman Sectors of the Network Alliance Routes so that a Virgin passenger receives a more closely aligned product whether they travel on a Virgin or Air NZ operated flight, and vice versa for Air NZ passengers travelling on Virgin Australia operated flights. This includes fare inclusions, fare rules, check-in processes, baggage handling and on-board product (such as meals);
- cooperation in achieving cost saving and cost sharing and other efficiencies so as to lower operating costs. The parties aim to identify joint purchasing programs in the areas of ground handling, aircraft maintenance, real-estate and commercial leasing, information technology services, catering services and in-flight consumer products;
- developing and implementing any other information technology tools the parties agree are reasonably necessary;

- harmonising sales policies including but not limited to fares, discounting, handling of groups and contracting with corporate clients; and
- implementing reciprocal staff and duty travel arrangement between the parties.

5 Please confirm that freight services, including freighter operations and cargo belly space on scheduled flights, remain explicitly excluded from the Alliance.

Freight services, including freight operations and cargo belly space on scheduled flights remain explicitly excluded from the Alliance.

6 Please provide a submission in relation to the activities undertaken under the Alliance, or contemplated by the Alliance, in relation to ground handling, aircraft maintenance, catering, aircraft cleaning, and in-flight consumer products.

Since Authorisation, the Applicants have initiated joint operational synergies that will both reduce cost and improve customer experience. As the Alliance is still in its infancy, these initiatives are in the early stages of development and there are many more opportunities the Applicants will explore if the Alliance is reauthorised. A summary of the joint initiatives already undertaken by the Applicants and some of the future initiatives yet to be explored is set out below.

6.1 Ground Handling

As at the date of this response:

- Virgin Australia outsources its ground handling in all New Zealand ports and all Australian international ports; and
- Air NZ outsources its ground handling in all Australian ports.

Ground handling contracts typically run for long periods, and involve substantial investment in terms of training and process design. Changing ground handlers can involve significant write-off of the sunk costs associated with the old supplier, in addition to implementation costs related to the new supplier.

In 2010, Virgin Australia investigated using Air NZ as a ground handler for ports in New Zealand. Due to existing relationships with the incumbent provider in New Zealand, and differences in process and product, this was not feasible at this time. Both parties are committed to investigating opportunities for cooperation at shared airports in New Zealand.

In 2011, Virgin Australia moved its ground handling contracts for all Australian international ports to Toll Dnata in 2011. In 2012, Air NZ also moved all its ground handling contracts in Australia to Toll Dnata. While the arrangements with Toll Dnata were not tripartite or jointly tendered, the alliance parties were able to discuss and align their approach to contracting and implementation, which allowed them to enjoy significant efficiencies that would not have been possible absent the alliance.

Both Air NZ and Virgin Australia will continue to work together to explore efficiencies at Australian airports to improve customer experience and maximise efficiency including opportunities for jointly staffing customer touch points where appropriate and co-location or joint use of common use equipment.

6.2 Aircraft Maintenance

Aircraft maintenance activities involve line maintenance (checks performed after every arrival, daily checks and other line checks performed at the gate or at airport based hangars) and heavy maintenance (more substantial checks and overhauls performed in speciality hangars), together with more specialised ad hoc tasks such as livery repainting.

Airlines need to maintain a large inventory of spare parts including 'life limited parts' that are replaced and 'rotables' which are swapped in and out and overhauled prior to re-use. Maintaining these inventories can be managed in-house or through outsourced providers.

Virgin Australia has its own line maintenance provider in Australia (a wholly owned subsidiary). It outsources line maintenance in ports outside of Australia. Virgin Australia outsources all heavy maintenance. Air NZ's own teams perform line maintenance in New Zealand and also has heavy maintenance facilities in New Zealand.

Prior to the Alliance, Virgin Australia used Air NZ for various heavy maintenance functions. In 2011, Virgin Australia also moved to using Air NZ for all line maintenance at New Zealand ports.

Following its rebranding in 2011, Virgin Australia engaged Air NZ to complete the repainting of its livery for its 737 aircraft. The carriers also have a spare engine pooling agreement for 777 aircraft, an aircraft type which both carriers operate.

Both Virgin Australia and Air NZ will continue to work together to explore efficiencies in both New Zealand and Australia for line maintenance, heavy maintenance and spare parts arrangements.
[RESTRICTION OF PUBLICATION CLAIMED – CONFIDENTIAL TO APPLICANTS]

6.3 Catering and In-flight Consumer Products

Virgin Australia cater various flights (depending on aircraft type and sector) out of Australian and international ports. In New Zealand, Virgin Australia uplifts catering in Auckland, Christchurch and Wellington only – flights operating into other New Zealand ports are double catered from Australia (ie, meals are uplifted for both outbound and return journeys). Air NZ also caters various flights out of New Zealand and international ports, and on trans Tasman sectors double caters out of New Zealand.

Virgin Australia is undertaking significant product changes involving more inclusive food and beverage offerings on more sectors. Products provided on Trans-Tasman sectors are aligned with Air NZ's offering including a bundled hot meal which can be purchased at the time of ticketing, or retail food and beverage offerings.

Catering supply contracts tend to be large-scale and apply across entire countries (if not the network). For example, in 2012 Virgin Australia flew 19.5 million guests and negotiates contracts for catering within Australia on this basis.

As a result of the Alliance, Virgin Australia collaborated with Air NZ on the design and supply of included hot meals on the Tasman, which led to better product alignment and also cost reduction.

In-flight products include items such as toilet amenities (shared and also individual for premium cabins), linens, blankets and pillows (where available), earphones and other single use or reusable items. These are generally supplied through catering providers and restocking is included within catering logistic contracts.

[RESTRICTION OF PUBLICATION CLAIMED – CONFIDENTIAL TO APPLICANTS]

6.4 Aircraft Cleaning

Aircraft are cleaned after every flight. Air NZ currently employs its own aircraft cleaning crews in New Zealand and outsources this task in Australia. Virgin Australia currently engages cabin crew to clean aircraft at turn-arounds, and outsources the task of performing a complete daily clean of aircraft at tie-down.

Aircraft cleaning is an element of catering and logistics that both Virgin Australia and Air New Zealand will continue to consider when reviewing other opportunities for joint procurement under the Alliance.

6.5 Other future opportunities

The Applicants have only just begun to realise the benefits that can be derived from implementing operational synergies. Some further initiatives are in the process of being explored whilst work on others is yet to start. Joint initiatives of this nature often have long lead times and/or are bound by the timelines of external contracts already in place. If the Alliance is reauthorised, there are many future opportunities that the Applicants would like to explore and implement.

