

12 November 2015

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Dear Mr. Chadwick

**CONSULTATION IN RELATION TO THE REVIEW REGARDING WHETHER TO  
IMPOSE CAPACITY GROWTH RATES ON TRANS-TASMAN AIRLINE  
ALLIANCES – INTERESTED PARTY CONSULTATION**

**RE: AUTHORISATIONS A91362 & A91363 –**

This submission is made by Dunedin International Airport Limited (DIAL) in response to the letter dated 16 October 2015 from the Australian Competition & Consumer Commission (ACCC) on the above review.

DIAL is the owner and operator of Dunedin Airport which the Applicants' operate air services to and from Brisbane.

To enable DIAL to complete this undertaking it was necessary that an extension to the close-off of COB on 6 November 2015 for further submissions be available. DIAL is appreciative of the additional time provided.

The attached report; "Submission to the ACCC Review of Trans-Tasman Airline Alliances" dated August 2013 by 3 Consulting is provided as DIAL's submission to the review.

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

Yours faithfully



Richard Roberts

CEO

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# **dunedin** **AIRPORT**

**Submission to the  
Australian Competition and Consumer  
Commission's  
Review of Trans-Tasman Airline Alliances**

**12 November 2015**

prepared by   
**three**  
CONSULTING

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## 1 INTRODUCTION

During the course of 2013 the Australian Competition and Consumer Commission (ACCC) granted re-authorisations to both the Qantas / Emirates (QF/EK) and Virgin Australia / Air New Zealand (VA/NZ) trans-Tasman alliances. The conditions of both authorisations required each alliance to maintain at least their pre-alliance aggregated capacity on "routes of concern", defined as Sydney-Auckland, Melbourne-Auckland, Brisbane-Auckland, and Sydney-Christchurch for the QF/EK alliance and Wellington-Brisbane, Queenstown-Brisbane, Auckland-Gold Coast, Christchurch-Brisbane, Christchurch-Melbourne, and Dunedin-Brisbane for the VA/NZ alliance. The conditions also call for the ACCC to undertake a review, commencing in September 2015, to determine whether to require either alliance to increase capacity flown on any of the routes of concern.

In its request for submission, the ACCC invites interested parties to comment on matters relevant to the ACCC's reviews, including current market conditions, current and planned future capacity growth on the routes of concern, including potential new entry; available forecasts of passenger demand on the routes of concern; the size and type of aircraft operated by airlines on the routes of concern; regulatory constraints on airlines' abilities to operate on the routes of concern; and the impact of the variation on route profitability on the routes of concern.

Dunedin International Airport Limited (DIAL), the operator of Dunedin Airport (DUD) welcomes this opportunity to discuss developments on trans-Tasman markets, especially since the ACCC's September 2013 authorisation of the VA/NZ alliance.

## 2 ACCC AUTHORISATIONS

### 2.1 December 2010 (VA/NZ)

In its determination dated 16 December 2010 the ACCC labelled Dunedin – Brisbane a minor Trans-tasman route that may raise competition concerns. Whilst VA/NZ argued that there is nothing to stop Jetstar (JQ) from entering the route and that the experience in domestic New Zealand suggests that were VA/NZ to reduce capacity on the route, JQ would be likely to respond by entering the market, the ACCC concluded that the alliance partners faced limited competitive constraints on this route and, as a result, would have the incentive and ability to raise fares, reduce capacity or otherwise reduce their service offering.

The authority was granted under the condition to maintain and increase capacity (by a formula that has been made part of the authorisation) over time on a set of six routes, Dunedin – Brisbane being one of them.

Interestingly, even though BITRE data shows that both Freedom Air and Air New Zealand offered services on both Dunedin – Sydney and Dunedin – Melbourne during the five years before the 2010 authorisation, these two routes are not discussed or mentioned in the ACCC's determination.

## 2.2 September 2013 (VA/NZ)

In its submission to the September 2013 determination, DIAL supported a continuation of the 2010 conditions for the Dunedin-Brisbane route and asked for additional conditions requiring maintenance of capacity on the Dunedin – Sydney and Dunedin – Melbourne routes. DIAL submitted that both the Dunedin – Sydney and Dunedin – Melbourne routes experienced a reduction of services with Dunedin passengers having no alternative but to use other New Zealand airports for their travel and thereby incurring additional time and cost. To ensure that the market is not disadvantaged, both routes should be made subject to a specific capacity condition that ensures that the level of capacity and frequency is no less (but subject to the growth factor) than that at the commencement of the 2010 alliance agreement.

The applicants reasoned that due to the extremely thin nature of both the Dunedin – Sydney and Dunedin – Melbourne markets they have always been single operator routes and the alliance would have no competitive detriment on either. This was evidenced by the fact that over the years, three different carriers had operated these routes as sole operators and all had struggled to make them viable, despite the absence of any competitor.

In its determination dated 3 September 2013, the ACCC acknowledged the thinness, and in some instances the seasonal nature, of the Dunedin routes and considered that the applicants face limited competitive constraints on these routes. Absent the alliance, the ACCC considered that there is little likelihood of entry by another operator given the thinness of the Dunedin – Sydney and Dunedin – Melbourne routes and reasoned that it is unlikely that more than one airline would operate on these routes at any given time. However, the ACCC noted that Air New Zealand also operated on the Dunedin – Brisbane route prior to the alliance and that, absent the alliance, Air New Zealand may consider re-entering the Dunedin – Brisbane route. For this reason the ACCC considered that the alliance is likely to result in detriment on the Dunedin – Brisbane route. The ACCC considered that the alliance is likely to have the incentive and ability to raise fares, reduce capacity or otherwise reduce their service offering on the Dunedin – Brisbane route, and that it is not clear that the alliance would face competition from entry by Jetstar or Qantas. However, on the Dunedin – Sydney and Dunedin – Melbourne routes, the ACCC considered that in light of the size of these routes and the fact that historically they have been monopoly routes, the alliance is unlikely to change the level of competition on these two routes

In summary, the ACCC considered that it is likely that the alliance will result in detriments on the following six routes, and therefore has made them subject to capacity conditions:

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

Very importantly, and “having regard to confidential information provided by the applicants after the draft determination”, the ACCC imposed conditions of authorisation which require the applicants to maintain an **aggregate base level of capacity across all six routes of concern** in order to provide the applicants with additional flexibility and mitigate some of the risk of the inefficient allocation of capacity. And finally, rather than prescribing a minimum growth factor for the bundle, the ACCC considered it appropriate to review the applicants’ capacity additions in light of actual demand growth over the next two years which will enable it to consider whether increases in the minimum required capacity are warranted.

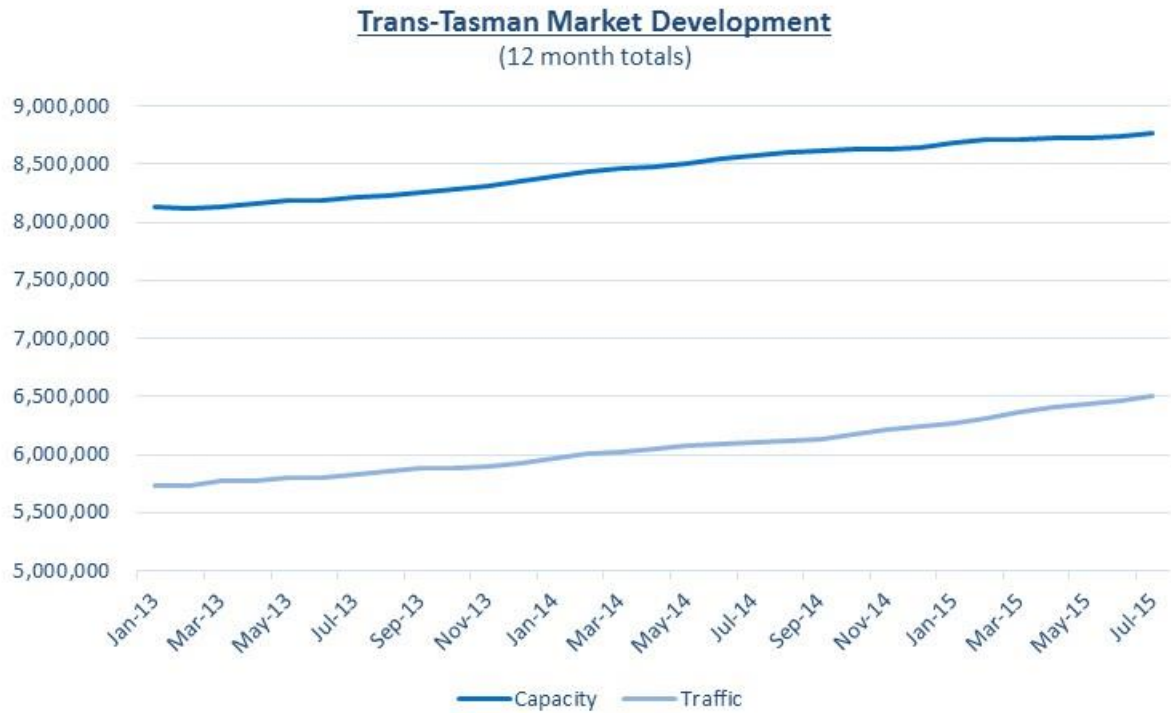
### 3 TRANS TASMAN AVIATION MARKET DEVELOPMENT

The Australia – New Zealand aviation market represents the largest international capacity and traffic generator on both sides of the Tasman. Naturally, growth rates vary and are influenced by general economic conditions, exchange rate movements, availability of attractive air fares, where these factors are not necessarily confined to the Australia – New Zealand market but do include other markets where these compete for traffic on the Tasman.

Over the last decade negative traffic growth followed capacity reductions leading into the Global Financial Crisis between late 2007 and mid 2009. Traffic growth started to pick up reaching around 5% on a 12 month total basis in the lead up to the first VA/NZ alliance authorisation. The 2011 Canterbury Earthquakes had a severe impact on overall traffic development between 2011 and 2013 with 12 month growth rates during that time averaging below 2%. These events also – so to speak - polarised market developments around New Zealand: whilst Christchurch Trans-tasman capacity reduced by around 250,000 seats (ca. 15%) within these two years, Queenstown capacity increased by around 50%. Importantly, during the 12 months leading up to the ACCC’s September 2013 determination, trans-Tasman capacity growth rates averaged just 0.9% and traffic grew by an average 1.6%.

With airlines re-introducing Christchurch trans-Tasman capacity from late 2013, the Australian Dollar losing strength against third countries increasing Australian leisure travel to New Zealand and an ever increasing number of Asian and, in particular, Chinese leisure travellers on dual country (Australia and New Zealand) holidays, traffic growth on trans-Tasman routes is now at its strongest for the past decade. And, as shown in Chart 1, capacity development is not keeping track with traffic growth. Between January 2013 and July 2015, total trans-Tasman uplift-discharge traffic improved by 13% whilst capacity increased by just 8%.

**Chart 1: Trans-Tasman Market Development (Absolute, January 2013 – July 2015)**

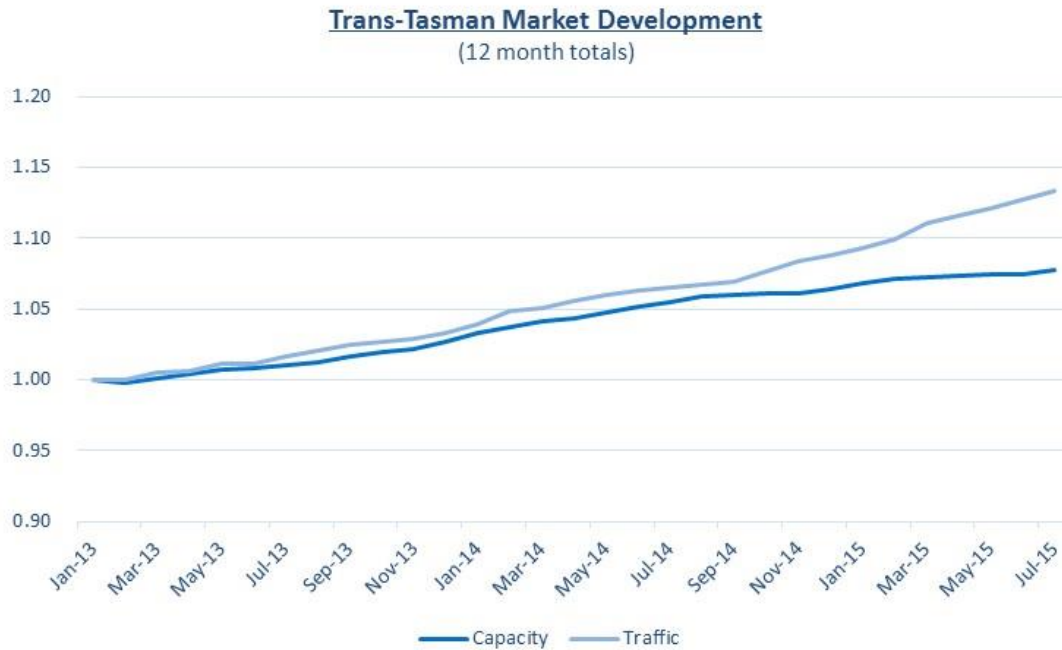


Source: BITRE

Chart 2 shows traffic and capacity growth on a normalised basis clearly visualising the relative tightening of capacity against healthy traffic development. Our calculations show that for the 12 months ending July 2015, the average Trans-tasman uplift-discharge load factor stands at 74.2%, the highest such value during the past decade.



**Chart 2: Trans-Tasman Market Development (Normalised, January 2013 – July 2015)**



Source: BITRE

## 4 THE SIX ROUTES UNDERCAPACITY CONDITIONS

Whilst the trans-Tasman market overall has been tracking well since the ACCC's September 2013 determination, this can't be said for all of its individual components. Of particular interest, and the subject of the ACCC's current review, is to create an understanding of how the six routes under capacity conditions performed over the last two years or, to quote the ACCC in its September 2013 determination, "to review the applicants' capacity additions in light of actual demand growth over the next two years".

Whilst BITRE data does not accommodate the investigation of route specific traffic flows, we have collected market and route specific capacity information. Our findings are summarised in Table 1, comparing route specific, aggregate 6 routes as well as total trans-Tasman capacity for FY13, FY14 and FY15 and calculating respective compound annual growth rates (CAGR):

**Table 1: Comparison of Capacity Growth on Select trans-Tasman Markets**

| Market                    |     | Alliance | Competition | FY13           | FY14           | FY15           | CAGR          |
|---------------------------|-----|----------|-------------|----------------|----------------|----------------|---------------|
| ZQN                       | BNE | VA/NZ    | QF          | 48,203         | 76,688         | 91,166         | 37.5%         |
| CHC                       | MEL | VA/NZ    | JQ          | 312,831        | 322,222        | 341,898        | 4.5%          |
| AKL                       | OOL | VA/NZ    | JQ          | 323,121        | 342,350        | 344,761        | 3.3%          |
| CHC                       | BNE | VA/NZ    |             | <b>272,841</b> | <b>246,373</b> | <b>261,042</b> | <b>-2.2%</b>  |
| WLG                       | BNE | VA       |             | <b>268,592</b> | <b>261,402</b> | <b>244,232</b> | <b>-4.6%</b>  |
| DUD                       | BNE | VA       |             | <b>80,640</b>  | <b>76,312</b>  | <b>64,716</b>  | <b>-10.4%</b> |
| <b>Aggregate 6 Routes</b> |     |          |             | 1,306,228      | 1,325,347      | 1,347,815      | 1.6%          |
| <b>Total trans-Tasman</b> |     |          |             | 8,193,619      | 8,545,238      | 8,733,739      | 3.2%          |

Source: BITRE

The first key insight is that the six critical routes grew at only one half of the overall market's capacity increases. The second insight is that competitive markets (Queenstown – Brisbane, Christchurch – Melbourne as well as Auckland – Gold Coast) recorded above average trans-Tasman capacity growth, whilst non-competitive markets (Christchurch – Brisbane, Wellington – Brisbane and in particular Dunedin – Brisbane) recorded negative capacity growth rates, in stark contrast to developments on the trans-Tasman as a whole.

It seems fair to note that route specific capacity decisions by the VA/NZ alliance are influenced by the presence of competition and that capacity development with regards to the three single operator routes (within the portfolio of six routes under capacity conditions) served by the alliance appears inadequate.

## 5 IMPACT ON DUNEDIN AVIATION MARKET

Whilst there have been other New Zealand airports benefitting from trans-Tasman services over the past decade (notably Hamilton, Rotorua and Palmerston North), there is – in fact – a core market of 5 trans-Tasman gateways: Auckland, Christchurch, Wellington, Queenstown as well as Dunedin.

Aggregating trans-Tasman capacity on gateway level and comparing growth among the 5 gateways highlights the devastating impact recent capacity development decisions had on the Dunedin aviation market (Table 2). Between FY13 and FY15, Queenstown recorded compound growth rates in excess of 28% and Christchurch as well as Auckland came in just around the trans-Tasman average of 3.2%. Whilst Wellington shows a CAGR of -0.6%, recent growth by Jetstar on both the Wellington – Gold Coast and Wellington – Melbourne markets have corrected for sluggish capacity growth at that port.

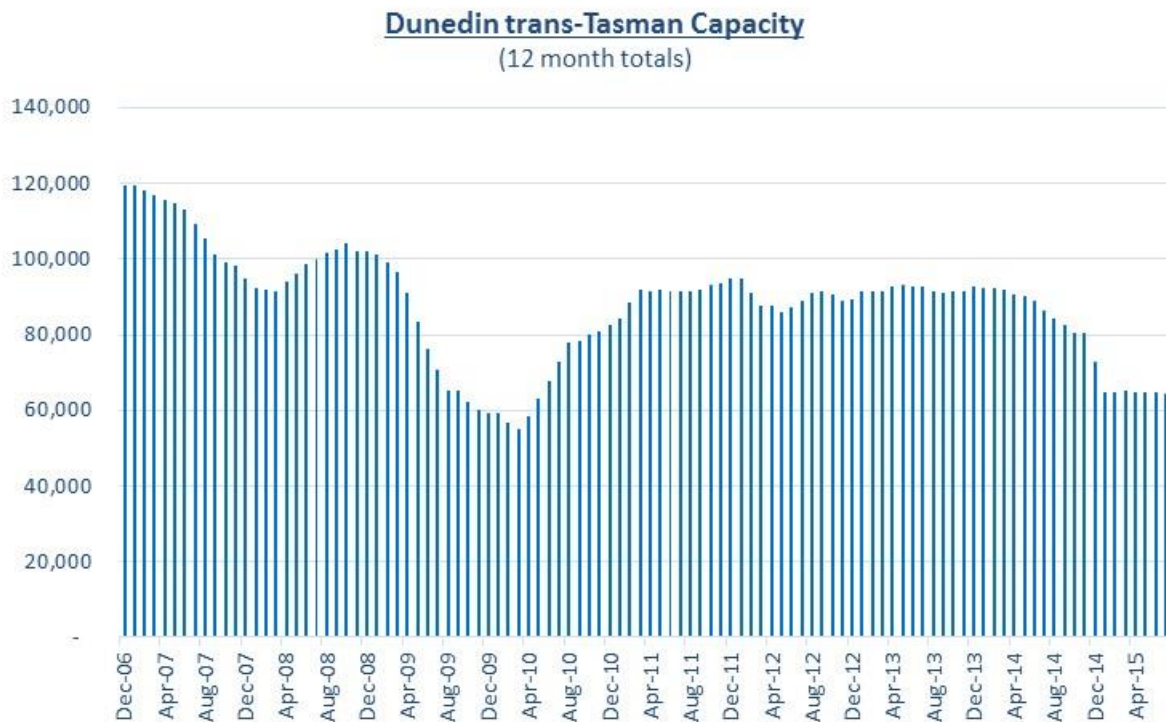
Having lost two markets (Dunedin – Sydney and Dunedin – Melbourne) and FY15 capacity 31% below the levels reached 2 years earlier leaves Dunedin as the single most impacted New Zealand trans-Tasman gateway since the September 2013 determination.

**Table 2: Comparison of Capacity Growth on 5 New Zealand trans-Tasman Gateways**

|                     | <b>FY13</b>   | <b>FY14</b>   | <b>FY15</b>   | <b>CAGR</b>   |
|---------------------|---------------|---------------|---------------|---------------|
| <b>Queenstown</b>   | 328,952       | 414,449       | 542,234       | 28.4%         |
| <b>Christchurch</b> | 1,363,017     | 1,388,660     | 1,461,876     | 3.6%          |
| <b>Auckland</b>     | 5,386,354     | 5,661,819     | 5,680,358     | 2.7%          |
| <b>Wellington</b>   | 972,842       | 964,528       | 962,091       | -0.6%         |
| <b>Dunedin</b>      | <b>92,880</b> | <b>89,080</b> | <b>64,716</b> | <b>-16.5%</b> |
| <b>Trans-tasman</b> | 8,193,619     | 8,545,238     | 8,733,739     | 3.2%          |

Source: BITRE

Chart 3 plots Dunedin trans-Tasman capacity for the past ten years, which peaked at around 120,000 seats per annum at the beginning of the observation period. Whilst the market dipped to a low in early 2010, it has maintained an average of around 90,000 seats for most periods since then. With the alliance discontinuing both Dunedin – Sydney and Dunedin – Melbourne after the Northern Winter 2013/14 scheduling period with no increase of Dunedin – Brisbane capacity, Dunedin's trans-Tasman capacity has stalled at around 65,000 seats per annum. This represents 48% less than for the 12 months ending in December 2006, while, between that time and today, overall trans-Tasman capacity has grown by 15% and traffic by 32%.

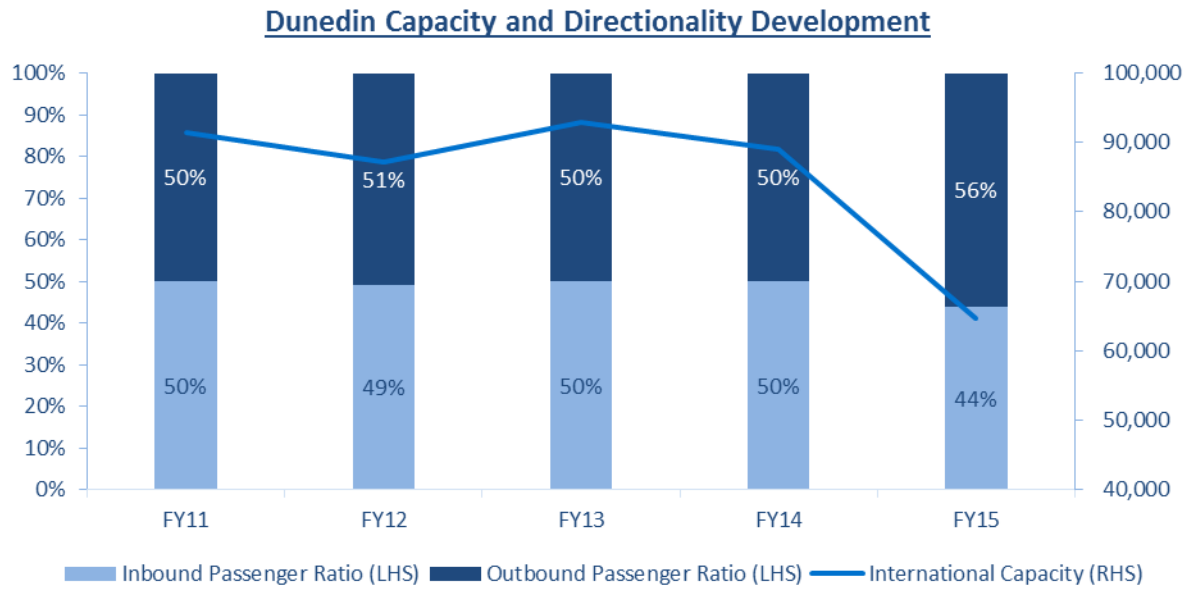
**Chart 3: Dunedin trans-Tasman Capacity Development (2006 - 2015)**

Source: BITRE

Chart 4 highlights that Dunedin Airport's international services have a history of almost perfectly balanced directionality; between FY11 and FY14, with an annual seat production of around 90,000, 50% of passengers on international (trans-Tasman) flights were Otago residents whereas the other 50% were international visitors. As capacity dropped by around 30% to the current 65,000 seats per annum, inbound visitation on international capacity has declined to just 44%, the lowest level observed during the past 5 years. Whilst the trans-Tasman passenger market is almost perfectly split between Australian and New Zealand residents (38% Australians, 39% New Zealander, 23% Other Nationalities) it appears that the alliance prefers the New Zealand point of sale for Dunedin's remaining trans-Tasman capacity. Given the relative lack of trans-Tasman capacity compared to Dunedin's population base, this might well be due to a mismatch of supply and demand and improving average fares paid by outbound resident travellers.

This recent skew towards outbound directionality may be one of the reasons for what appear to be declining international visitor nights in the Otago Regional Tourism Organisation. Chart 5 compares international visitor night growth for the Otago RTO in comparison with New Zealand overall. Otago seems to be mostly following New Zealand overall, especially since the country's inbound tourism numbers improved markedly from 2013. Whilst New Zealand overall keeps recording international visitor night growth averaging 6.4% for the past two years, Dunedin's growth came to a halt at around the time when trans-Tasman capacity was reduced and the international passenger ratio changed in favour of outbound travel.

**Chart 4: Dunedin trans-Tasman Capacity and Directionality Development (FY11 – FY15)**



Source: BITRE and Statistics NZ

**Chart 5: Dunedin RTO and Total New Zealand International Visitor Nights (2009 – 2015)**



Source: Statistics NZ

## 6 CONCLUSION

In summary, the above suggests that Dunedin Airport's international traffic development and, as a consequence, Dunedin's international tourism growth have suffered following capacity development decisions by VA/NZ. Whilst we believe that VA/NZ's decisions have been reached with overall alliance profitability in mind, they have been facilitated by a change in the conditions of authorisation between the December 2010 and the September 2013 determinations.

Whilst DIAL is in ongoing discussions with all of our current air capacity providers and we do believe we have created interest to improve what are obvious capacity shortages on our trans-Tasman network, the lack of competitive pressure means that Dunedin is not a priority for the alliance's network development teams. Given VA/NZ do not only control 100% of Dunedin Airport's international capacity but also around 87% of domestic capacity, the alliance can be reasonably safe in assuming that international traffic will flow on VA/NZ metal, regardless of whether it is accommodated non-stop or via hubs at Christchurch, Auckland or Wellington.

We do agree with the ACCC's assessment that, outside an alliance agreement, VA and NZ would not operate Dunedin – Sydney and Dunedin – Melbourne in direct competition. It is correct that, for the time being, the respective markets are too thin to sustain two carriers. However, we do not agree with the notion that Jetstar, or any other airline for that matter, institutes competitive control by being likely to enter either the Dunedin – Sydney and / or Dunedin – Melbourne markets in case VA/NZ discontinue services. By the end of the current scheduling season it will be two years that these two markets have been left vacant by VA/NZ and – to date – we have not been able to fill this hole in our network. It stands to reason that the overall Dunedin – trans-Tasman market is too thin to produce sustainable levels of profits for two airlines. Seen from another angle, it is much more likely for a current operator on Dunedin – Brisbane to also operate Dunedin – Melbourne as the two services, ideally flown on different days of the week, are able to complement each other. A passenger going non-stop to Brisbane could then come back on the reverse routing or, alternatively, be flown back on a one-stop itinerary via Melbourne. These benefits of network density can only be achieved by the same airline or within the same carrier grouping.

As far as this review is concerned, DIAL maintains its view from around two years ago and believes that the Dunedin market, both in- and out-bound would be best served by re-introducing route based growth conditions, establishing 2013 as the base year, and by extending these conditions to all trans-Tasman routes operated at the time of the September 2013 determination.

## 6.1 Disclaimer:

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