



Australian Government

Department of Infrastructure and Regional Development

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Dr Richard Chadwick
General Manager
Adjudication Branch
Australian Competition and Consumer Commission

Dear Dr Chadwick

Subject: Capacity Growth Rates on trans-Tasman airline alliances

Thank you for your letter of 16 October 2015. The Department of Infrastructure and Regional Development (the Department) welcomes the opportunity to provide a submission to the ACCC on the review of conditions of authorisation for the two trans-Tasman airline alliances – the first between Qantas Airways Ltd and Emirates Airline and the second between Virgin Australia and Air New Zealand. The Department continues to support authorisation for the alliances and considers the alliances continue to deliver benefit for consumers.

Market activity – trans-Tasman

The trans-Tasman remains Australia's largest international market. Since the Virgin Australia-Air New Zealand alliance was reauthorised in 2013, passenger numbers have continued to grow at a significant rate – 5.1 per cent in 2013-14 and 6.1 per cent in 2014-15. Available capacity increased 4.3 per cent in 2013-14 and 2.2 per cent in 2014-15, resulting in higher aircraft utilisation (load factor of 80.9 per cent in 2014-15 calculated using Traffic on Board figures). These levels are now comparable with other international markets, suggesting an element of excess capacity in previous years.

Market activity – routes of concern

The Department notes the ACCC's authorisations of the airline alliances include conditions stipulating a base level of capacity to be provided by the alliances on particular trans-Tasman services – the 'routes of concern'.

Data from the Bureau of Infrastructure, Transport and Regional Economics (BITRE) suggests a degree of variability in the amount of capacity across the routes of concern in northern summer 2014 and northern winter 2014 (full data for northern summer 2015 is currently unavailable).

In most cases, capacity levels on the routes of concern over the two scheduling seasons have remained above the levels set by the ACCC. In the few cases where capacity has fallen below these levels, the margin has generally been less than 5 per cent and likely reflects operational considerations, including the type of aircraft available.

Forecasts

The trans-Tasman is a reasonably mature market. Future growth in this market will largely reflect economic growth but there are other factors which may also affect the amount of capacity.

The Australian resources industry's transition from an investment phase to a production phase has led to a reduction in demand for fly-in, fly-out services and the number of aircraft needed to service this sector. The increased number of available aircraft means Australian airlines have greater flexibility to exploit other commercial opportunities where they arise. To date, this has seen additional capacity deployed on routes supporting the tourism industry. For example, in July 2015, passenger traffic on the Sunshine Coast was 11.7 per cent greater than the corresponding period in 2014; the Darwin-Perth route was up by 9.7 per cent; the Broome-Perth route was up by 8.5 per cent; and the growth in passenger movements at Proserpine Airport in the Whitsundays was 27.8 per cent.

For the trans-Tasman market, we would expect this to contribute to continued or above-average growth over the next few years. It may also mean it is more commercially viable for airlines to add more capacity on more marginal routes or "thinner routes", which could include some of the routes of concern.

There is also greater potential for some smaller Australian airlines which have previously exclusively served mining routes to diversify their business, potentially adding to the competitive pressure on the trans-Tasman. The Department notes Alliance Airlines (an Australian charter operator specialising in operations on behalf of the resource industry) has recently expanded its operations to service the New Zealand domestic tourist market.

Regulatory considerations

As noted in our previous submissions on the trans-Tasman airline alliances, the Australia/New Zealand air services market is one of the most open in the world. The *Agreement between the Government of Australia and the Government of New Zealand relating to Air Services*, done at Auckland on 8 August 2002, [2003] ATS 18 (the Agreement) has no restrictions on capacity, frequency or routes that airlines of either country can operate to, within or beyond the two countries.

The Agreement provides for eligible airlines to be authorised as Single Aviation Market (SAM) airlines. A SAM airline is required by Article 2 (4) to be at least 50 per cent owned and effectively controlled by either Australian or New Zealand nationals or both; at least two-thirds of the board are required to be Australian or New Zealand nationals, including the Chairperson; and its head office and operational base must be in either Australia or New Zealand.

Australian and New Zealand airlines can also continue to be designated under the Agreement using the incorporation and principal place of business criteria. This is consistent with both Australia's usual approach toward designation criteria when negotiating air services arrangements, and broader global moves towards greater liberalisation of airline ownership restrictions.

In conjunction with SAM arrangements the mutual recognition of safety and operational regulatory approvals streamlines airlines' flying within the SAM.

Section 2 of the Annex to the Agreement provides for ninth-freedom rights to airlines that are authorised as SAM airlines, and allows them to operate both international services between, and domestic services within either country with full traffic rights.

Article 2 (3) specifies that there is no limit on the number of SAM airlines of either country that can operate services linking any city pair combinations within and directly between the two countries. Airlines are able to operate passenger and/or freight services as they decide.

The deregulated nature of the SAM means there are no economic regulatory barriers for new market entrants from either Australia or New Zealand. There are similarly no barriers for existing market participants to add or change services; airlines can make air services decisions based solely on commercial considerations. The SAM has also provided New Zealand airlines with the ability to operate services in the Australian domestic market, subject to safety considerations.

In addition to the access afforded to New Zealand carriers, the airlines of over 50 economies currently have rights to commence direct Australia-New Zealand services under bilateral air services arrangements between Australia and the respective economies; albeit with the restriction that the flight must either originate or terminate in its home country. Their entitlements under agreements with New Zealand may impact on their respective ability to exercise these rights.

Details of third party access to the Australia-New Zealand market have been provided in a confidential document at Attachment A.

Capacity conditions

The Department does not support the retention of the current conditions placed on the trans-Tasman cooperation agreement. In our view they are unnecessary and do not sit comfortably with the highly liberal SAM arrangements.

Competition in a market is not necessarily enhanced by a condition requiring existing operators to maintain a level of capacity. Such regulation can reduce the number of competitors, creating barriers to entry by artificially setting supply.

The trans-Tasman alliances will continue to act as strong competitive counterweights to each other on trans-Tasman routes, including the routes the alliances currently serve in their own right. Market observations to date continue to support this position.

There is also significant competitive constraint offered by third country airlines outside of the alliances. Because of the deregulated nature of the trans-Tasman market, other airlines have the capability to quickly reassess their operations. A number of third country airlines either currently or have previously operated services in the trans-Tasman market, including LAN Airlines, Aerolinaes Argentina, China Airlines and Royal Brunei Airlines. There are no regulatory barriers preventing these airlines from expanding or resuming services if the commercial opportunity arose.

We consider the barriers to entry are sufficiently low that if the market is left to operate naturally and competition between existing airlines was to wane, additional competitors are likely to enter the market, causing the market to reach a natural balance point.

If the ACCC is inclined to retain the capacity constraints for the trans-Tasman alliances, the Department would not support the application of any growth rate to these restrictions.

Thank you again for inviting the Department to provide a submission. I can be contacted on (02) 6274 7739 should you wish to discuss this matter further or require any additional information.

Yours sincerely



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