PUBLIC VERSION

Application to the Minister of Transport pursuant to Part 9 of the Civil Aviation Act 1990 for Reauthorisation of the Air New Zealand and Virgin Australia Group Australasian Airline Alliance

8 March 2013

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Executive summary

Application for reauthorisation

On 21 December 2010, the Minister of Transport (**Minister**) granted Air New Zealand and Virgin Australia (the **Applicants**) authorisation pursuant to s.88 of the Civil Aviation Act 1990 (the **CAA**) to make and give effect to the Australasian Airline Alliance Agreement (the **AAA**), the Code Share Agreement and proposed related agreements contemplated in the AAA (together the **Alliance**).[1] The Minister separately granted the Applicants authorisation to make and give effect to the Alliance Capacity Implementation Agreement dated 21 December 2010 in respect of certain capacity conditions (the **Conditions**).

Copies of the executed AAA and Code Share Agreement (as amended on 15 June 2012)[2] are set out in **Confidential Annexure A**. Further information on Air New Zealand and Virgin Australia is set out in **Annexure B** and **Annexure C**.

Authorisation of the Alliance by the Ministry of Transport (**MOT**) came into effect on 1 January 2011 and authorisation of the Alliance by the Australian Competition and Consumer Commission (**ACCC**) came into effect on 7 January 2011. Under the Alliance Capacity Implementation Agreement, the Applicants agreed to cease giving effect to the Alliance, unless reauthorised, by 31 December 2013. The ACCC's authorisation of the Alliance also expires on 31 December 2013.

This Application is lodged by Air New Zealand and Virgin Australia for reauthorisation of the Alliance pursuant to s.88 of the CAA whereby, the Applicants will give effect to the Alliance:

- until a date at least five years from 31 December 2013; and
- without the renewal of the capacity commitments contained in the Alliance Capacity Implementation Agreement beyond 31 December 2013 or the implementation of any other capacity commitments.

The Applicants submit that the Minister should exercise his discretion to reauthorise the Alliance because:

- the Alliance is capable of authorisation by the Minister under section 88 of the CAA;
- the Alliance has, and will continue to result in significant and substantiated public benefits to New Zealand;
- there has not been, and will not be, any adverse impact on consumers from the Alliance;
- the Alliance has, and will continue to have, pro-competitive effects and

[1] Other related agreements include the frequent flyer program (**FFP**), Premium Customer Handling and a special prorate agreement (**SPA**). For further information see: MOT, Analysis of Air New Zealand/Virgin Blue application for authorisation of a Trans Tasman alliance http://www.transport.govt.nz/ourwork/air/airnz-virginbluealllianceapplication/ (**MOT Determination**). On 16 December 2010, the ACCC similarly authorised the Alliance. For further information see: ACCC, Determination: Applications for authorisation lodged by Virgin Blue Airlines Pty Ltd and Others in respect of an airline alliance between the applicants, 16 December 2010 (**ACCC Final Determination**).

[2] On 15 June 2012, the Applicants made some minor amendments to the AAA and Codeshare Agreement. These amendments were within the scope of the existing authorisation and were necessary for the practical operation of the Alliance. The MOT was provided with copies of the amended agreements on 15 June 2012.

benefits for consumers; and

- the Alliance does not breach any of the specific provisions in section 88(4)(a)-(f) of the CAA.

The Alliance

The Alliance covers cooperation between the Applicants across:

- **Trans Tasman Sectors**, which are any sectors between a point in Australia and a point in New Zealand, including when the ultimate destination of the service is another point in Australia, New Zealand or another country; and

- **Network Alliance 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.

Under the Alliance, the Applicants aim to:

- fully cooperate and coordinate on all aspects of their international services on the Trans Tasman Sectors;

- code share on the Network Alliance Routes (on a free sale basis);

- work together to align their Customer Facing Products and Systems on the Trans Tasman Sectors to:

    - achieve "Metal Neutrality"[3]; and

    - provide passengers with a harmonised and integrated product with consistent service and seamless check-in, transfers, baggage and other services;

- cooperate in relation to frequent flyer programs and lounge access on the Network Alliance Routes;

- cooperate in achieving cost savings, cost sharing and other efficiencies;

- work together to optimise their operations on the Trans Tasman Sectors by developing a network that matches aircraft type to route and focuses each Operating Carrier on its market strengths and primary operating hubs; and

- cooperate to develop new Tasman products that customers value.

A core principle of the Alliance is that the Applicants share the risks and rewards generated by the Alliance. Another core principle is Metal Neutrality, which is given effect through revenue allocation and other mechanisms under the Alliance. Metal Neutrality ensures that the Applicants' commercial interests are aligned so they can maximise passenger numbers and Alliance revenue.[4]

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[3] Metal Neutrality means a state of events where each Applicant will implement programs and policies that ensure the Applicants are incentivised to sell, and consumers are willing to buy, tickets on Network Alliance Routes without preference as to which Applicant is the Operating Carrier.

[4] The ACCC recently noted that the realisation of potential public benefits from airlines alliances depends on:

- how complementary the product and services offerings of the airlines concerned are; and

- how strongly the alliance aligns the incentives of the parties so that they are driven to act in the interests of the alliance as a whole, rather than themselves. In alliances where the parties' incentives are fully aligned – to a point where each carrier is not concerned with making sure that a passenger flies on their airline (a situation described in

Core rationale

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.

The enhanced product and service offering under the Alliance allows the Applicants to achieve a better competitive position on the Tasman and more generally within Australasia against the Qantas-Jetstar Group and Emirates.

For Air New Zealand, the Alliance addresses limitations to its stand-alone competitive offering such as:

- a lack of access to onward connections within Australia;
- a lack of an effective marketing presence within Australia; and
- a lack of effective Australian distribution channels.

For Virgin Australia, the Alliance is key to its Game Change Program:

- the Tasman is a key market for corporate contracts; and
- without the Alliance, Virgin Australia cannot match Qantas' Tasman product in terms of frequency and schedule or frequent flyer and lounge benefits.

Evidence of substantial Alliance driven public benefits

In its short operation, the Alliance has already delivered on the core rationale for the Alliance, and resulted in substantial public benefits.[5] Reauthorisation will result in further and deeper benefits as the Alliance matures.

Some of the key outcomes generated by the Alliance so far include:

- **enhanced products and services** and the associated increase in consumer choice (including increased access to existing frequencies, increased online connection options, better schedule spread, enhanced value added services and new frequencies). For example:
  - o the availability of an additional 576 online connection options for Alliance passengers. This will increase to 628 from May 2013;[6] ;
  - o additional frequencies on Auckland-Adelaide, Auckland-Brisbane, Auckland-Perth, Brisbane-Wellington, Melbourne-Wellington and the addition of some peak period frequencies on Sydney-Wellington;

the literature as "metal neutrality") – they tend to be very focused on synchronising their operations and activities and sharing the financial rewards and risks so as to make their products and services as appealing as possible to passengers. See ACCC, Draft Determination, Applications for authorisation lodged by Qantas Airways Limited and Emirates in respect of a Master Coordination Agreement to coordinate the operations of the applicants Authorisation numbers A91332 & A91333 dated 20 December 2012 (**QF/EK Draft Determination**) para 122 at pp30-31.

[5] To enable an analysis of the Alliance's impact since implementation the Applicants have compared actual data during the period 1 November 2011 to 31 October 2012 (the first full year of data reflecting the network changes made to optimise schedules, the codeshare sales that were commenced on certain sectors and other cooperative activities. (**Year 1**) with actual data during the period 1 November 2009 to 31 October 2010 (the year prior to the Alliance being authorised) (**Pre-Alliance Year**). The Pre-Alliance Year is used throughout this Application as a 'without authorisation' or 'without the Alliance' reference point for comparison. During 1 November 2010 to 31 October 2011 (**Year 0**), authorisation of the Alliance came into effect. Some cooperative activities also commenced at different points throughout Year 0.

[6] This is in excess of the 420 additional online connection options anticipated by the Applicants in their initial application for authorisation.

- a significant reduction of wingtip flying including, in some cases the removal of wingtip flights in a particular schedule, providing customers with a greater choice of departure and arrival times on a number of high frequency sectors;

- a removal of day of week clashes on low frequency sectors Brisbane-Queenstown and Queenstown-Sydney to provide consumers with a better offering including the ability to have different length stays;

- the ability to earn and burn frequent flyer points across the entire Air New Zealand and Virgin Australia networks including the Trans Tasman, domestic Australia, domestic New Zealand and long haul sectors (excluding sectors to/from the Pacific Islands);

- the ability for Air New Zealand passengers to access Virgin Australia's eight domestic Australia lounges and Virgin Australia passengers to access Air New Zealand's six international air-side lounges on the Tasman and Air New Zealand's 12 domestic lounges;

- Air New Zealand upgauged its daily Auckland-Perth service from a Boeing 767 to a 777 on 3 September 2012. This upgauge will result in approximately **[CONFIDENTIAL]** additional seats (for Year 2[7] compared with the Pre-Alliance Year); and

- the commencement of new seasonal Auckland-Sunshine Coast services.

- **stimulation of passengers on Alliance services and the Tasman overall** showing that passengers value the improved product offering under the Alliance. From the Pre-Alliance Year to Year 1, the total number of passengers travelling on the Tasman across all carriers increased by 4.0%. Over the same period the number of Trans Tasman Alliance passengers increased by **[CONFIDENTIAL]** on non-Christchurch routes[8]);

- **lower average fares** as a result of cost savings and efficiency improvements through removal of double marginalisation and higher load factors;

- **promotion of competition,** particularly in the business traveller segment of the Trans Tasman market; and

- **stimulation of tourism** through the Alliance's improved product offering, the creation of a second comprehensive Australasian network in competition with the Qantas-Jetstar Group, synergies from joint promotion of Alliance services and Alliance destinations and improved distribution channels.

No anti-competitive detriment

The Alliance has delivered, and with reauthorisation will continue to deliver, substantial public benefits without any anti-competitive detriment on the Tasman or on any individual route.

[7] Year 2 means the period from 1 November 2012 to 31 October 2013. It includes forecasted data.

[8] In light of the impact of the Christchurch earthquake on services to/from Christchurch, in this Application data is provided for non-Christchurch routes as well as the Tasman generally.

The Alliance provides an improved service offering that consumers value. The Alliance has led to a decrease in the combined average fares of the Applicants[9] and has not resulted in an anti-competitive withholding of capacity on the Trans Tasman generally or on any individual route. In fact, from the Pre-Alliance Year to Year 1:

- the volume and proportion of lead-in and sales fares sold on flights operated by Air New Zealand and Virgin Australia has increased;
- the combined average fare for the Alliance has decreased by **[CONFIDENTIAL]**; and
- Alliance capacity on the Tasman has increased 5% (10.1% on non-Christchurch routes).[10]

The Tasman is a highly competitive market characterised by substantial capacity and strong fare competition. The Alliance faces strong competition on the Tasman in the form of new entry and expansion and the expansion of existing carriers, including on the individual routes subject to the capacity conditions (e.g., the entry of Jetstar on Queenstown-Sydney and the entry of China Airlines on Auckland-Brisbane).

Under the Alliance, consumers also benefit from the fact that the Alliance provides a more effective competitive offering than either of the Applicants could provide independently.

The Alliance is in the public interest without any need for Conditions

The Alliance was granted subject to the Alliance Capacity Implementation Agreement which was proposed by the Applicants and which effectively required the Applicants to meet certain capacity conditions (the **Conditions**). The Conditions are not necessary to satisfy the public benefit test as the public benefits derived from the Alliance are sufficient in and of themselves to outweigh any risk of an anti-competitive detriment on the Tasman.

Capacity Conditions, by their very nature, create a measure of inflexibility, and (to the extent they hamper otherwise efficient resource allocation) a measure of inefficiency. Notwithstanding, where the net public benefit position is finely balanced such capacity conditions are appropriate so as to ensure the delivery of the overall net public benefit.

This is particularly true where there is already substantial capacity in the market, and in the potential situation of simultaneous capacity conditions on the overlapping routes of Qantas and Emirates (if the Qantas-Emirates Alliance is approved).

Consumers would be worse off without reauthorisation

If reauthorisation were not granted, the Applicants would immediately take steps to unwind the Alliance. In particular, each Applicant would:

- remove its code from the other's services and terminate or renegotiate the interline pricing for access to its domestic network;
- review its network with a view to adjusting capacity where necessary to reflect the likely reduced demand due to the loss of connectivity and

[9] Average fare means the average base fare on a given sector in AUD. Calculated as Average Fare = Net Passenger Revenue/No. Passengers.

[10] In order for like for like comparisons to be made between the Pre-Alliance Year and Year 1 for average fares, passenger numbers, industry capacity and Alliance capacity, all capacity analysis in this Application refers to the actual change in capacity over the relevant time period. This includes the change in capacity from the reconfiguration of Air New Zealand's A320 fleet from 152 to 168 seats. The Applicants have provided a breakdown of Alliance capacity by route at Annexure E. In Annexure E, capacity data is provided including the A320 reconfiguration and excluding the A320 reconfiguration.

distribution provided by their former Alliance partner;

- retime services to maximise load factors on its own services even though that may result in wingtip flying with their former Alliance partner;
- take steps to secure access to slots that were surrendered during the term of the Alliance;
- terminate their former Alliance partner's access to its lounges; and
- renegotiate access to reciprocal frequent flyer benefits with their former Alliance partner. This would involve less favourable commercial terms which would impact the overall benefit to consumers.

This would leave consumers with less choice and a reduced product and service offering. It would also remove a competitive alternative to the Qantas-Jetstar Group or the Qantas-Emirates Alliance (if that alliance is approved).

Confidential Information

The Applicants claim confidentiality over the information redacted from this Application and identified as confidential by square brackets and the words "**CONFIDENTIAL**" (the **Confidential Information**).

Confidentiality is sought pursuant to section 9(2)(b) of the *Official Information Act 1982* on the grounds that:

- the Confidential Information is commercially sensitive and valuable information which is confidential to the Applicants (vis-a-vis the public and also in some respects vis-a-vis each other); and
- disclosure of the Confidential Information would be likely to unreasonably prejudice the commercial position of one, or both, of the Applicants.

The Applicants request they be notified of any request made under the Official Information Act for release of or access to the Confidential Information, and that the Minister seeks the Applicant's views as to whether the Confidential Information remains confidential and commercially sensitive at the time responses to such requests are being considered.

This request for confidentiality is not intended to constrain the Minister or the MOT from disclosing information to other Government departments for the purpose of seeking relevant expert advice. However, the Applicants request that the Minister ensure any such departments maintain the same full confidentiality as requested above.

The above applies in respect of any additional information provided to the MOT that is expressed to be "confidential".

1. Implementation of the Alliance

Key aspects of the Alliance have been implemented

1.1. Authorisation of the Alliance by the MOT came into effect on 1 January 2011 and authorisation of the Alliance by the ACCC came into effect on 7 January 2011. In the 2 years since then, the Applicants have:

- commenced code share sales on Network Alliance Routes;[11]
- implemented joint pricing on code share routes for travel from 26 July 2011;
- commenced lounge and frequent flyer reciprocity from 26 July 2011;
- begun aligning product offerings, including: meal specifications on Trans Tasman flights, the alignment of child and infant fares, age policies, check-in policies and baggage policies and fees;[12]
- implemented a revenue share model from 1 August 2011;
- commenced joint scheduling from April 2011 with comprehensive network changes starting on 30 October 2011;
- commenced joint promotion of the Alliance and its destinations through the Joint Sales Team; and
- complied with the Conditions set out in the Alliance Capacity Implementation Agreement.[13]

Reauthorisation is required to more fully implement the Alliance and deliver continued and expanded public benefits

1.2. Implementing alliance agreements and integrating business systems takes time. Authorisation of the Alliance has only been in effect for 2 years and the Alliance has only been operational for 18 months. Whilst key aspects of the Alliance have been implemented, reauthorisation will allow the Applicants to:

- continue the delivery of public benefits that have been realised to date such as, increased coded frequencies and the public benefits flowing from lounge and frequent flyer reciprocity; and
- enhance and expand the public benefits achievable as a result of the Alliance.

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[11] Codeshare sales on Trans Tasman Sectors and domestic Australia sectors connecting to a Trans Tasman Sector as part of an international itinerary started from 4 July 2011 for travel from 26 July 2011. Codeshare sales on domestic New Zealand sectors connecting to a Trans Tasman Sector as part of an international itinerary were gradually introduced due to Virgin Australia's migration to the SabreSonic platform. From 4 July 2011 (for travel from 26 July 2011), Virgin Australia commenced codesharing from 9 destinations via 13 city pairs. This was increased to 26 destinations via 37 city pairs on 23 October 2012 (for travel from 31 October 2011).

[12] The onboard experience of passengers has, and will continue to be, improved under the Alliance. For example, Air New Zealand guests on Virgin Australia services have indicated increased satisfaction in relation to catering under the Alliance. Significant steps have already been made by the Applicants to harmonise the onboard experience for passengers. This is an ongoing project and further improvements will made over time. **[CONFIDENTIAL].** Currently, Air New Zealand offers some seat back IFE to all guests and full content to guests with an IFE inclusive fare whereas Virgin Australia offers hand held DigiPlayers to those guests with an IFE inclusive fare. Virgin Australia is currently testing a new WiFi system, which will enable both airline-provided and user-provided devices to access the onboard WiFi while in the air.

[13] Under the authorisation, the Conditions have applied for each scheduling season since 1 April 2011. From that date there have been three decisions by the MOT and ACCC to vary the requirement to comply fully with the Conditions due to exceptional circumstances including the Christchurch earthquakes and the Chilean volcanic ash cloud.

1.3. The Applicants would not offer lounge and frequent flyer reciprocity or codeshare sales across the full extent of each other's networks without the Alliance. Nor, could they independently deliver the public benefits and efficiencies derived from optimisation of the Applicants' shared networks, products and costs.

1.4. Examples of the public benefits which will be enhanced or expanded with continued authorisation are:

- Cost savings achieved by taking advantage of future opportunities for joint contracting.
- Cost savings delivered over time from the operational changes made to deliver the Alliance product offering.
- An enhanced product offering through further alignment of the Applicants' products and services and the continued ability to optimise scheduling across the total Alliance network.

1.5. Now that Virgin Australia has upgraded its reservations system even greater public benefits can be realised if the Alliance is reauthorised. In January 2013, Virgin Australia migrated to a single SabreSonic reservation platform from the dual platforms of Amadeus (used for the long haul network) and Navitaire (used for the domestic and short haul networks). Due to the difficulty in interfacing Air New Zealand's IT infrastructure with Virgin Australia's previous platforms, implementation of certain aspects of the Alliance was put on hold until Virgin Australia had migrated to SabreSonic. This allowed the Applicants to avoid doubling up on the time and costs associated with interfacing their systems. The recent migration to SabreSonic will allow a greater level of compatibility and integration between the Applicant's IT infrastructures and enable:

- improved flexibility and functionality in pricing which allows the Applicants to put improved fare and product offerings to market;
- the potential expansion of interline cooperation beyond the Tasman to drive dual-destination traffic and tourism into New Zealand and Australia from global points of sale;
- improved messaging between the two airlines, ultimately allowing better design and delivery of joint fare product innovations and a more seamless reservations process;
- an improved customer experience at the airport, with better recognition of high value guests, and guests with special needs;
- an improved capability to through check guests from the Virgin Australia network;
- a more flexible combination of segments to build journeys when selling connecting flights, allowing maximum origin/destination combinations; and
- **[CONFIDENTIAL]**.

1.6. Reauthorisation will enable the Applicants to continue to work together and achieve ever improving levels of integration and efficiency. Thus, expanding the public benefits achievable under the Alliance.

The Alliance's impact since implementation

Measurement of the Alliance's impact since implementation

1.7. To enable an analysis of the Alliance's impact since implementation, the Applicants have provided, where appropriate, three years of actual data starting at 1 November 2009.[14] This includes data for the following periods:

- 1 November 2009 to 31 October 2010 (**Pre-Alliance Year**);
- 1 November 2010 to 31 October 2011 (**Year 0**); and
- 1 November 2011 to 31 October 2012 (**Year 1**).

1.8. The Pre-Alliance Year is the year prior to the Alliance being authorised. It is used throughout this Application as a 'without authorisation' or 'without the Alliance' reference point for comparison. During Year 0, authorisation of the Alliance came into effect. Cooperative activities commenced at different points throughout Year 0. Due to the lead times of various initiatives and booking patterns Alliance benefits were limited in Year 0. Year 0 was also marked by exceptional circumstances such as continued earthquakes in Christchurch and the Canterbury region, the Queensland floods, and the Chilean volcanic eruption. Year 1 is the first full year of data reflecting the network changes made to optimise schedules, the codeshare sales that were commenced on certain sectors and other cooperative activities. For this reason, comparisons between the Pre-Alliance Year and Year 1 are used in this Application to provide an overview of the Alliance's impact since implementation.[15]

1.9. In the initial application for authorisation, Air New Zealand noted that it was planning to reconfigure the A320 shorthaul fleet from 152 seats to 171 seats. The Conditions placed on the Applicants assumed this proposed increase to have taken place. However, following customer feedback on the proposed changes Air New Zealand chose to reconfigure the A320 shorthaul fleet to 168 seats instead of 171 seats. These changes in capacity took place after authorisation.

1.10. Since authorisation, Tasman air services have been affected by challenging market conditions and in particular, natural disasters. These included the series of high magnitude earthquakes in Christchurch and the Canterbury region, the Queensland floods and the Chilean volcanic ash cloud plume. Further information on these natural disasters is provided at section 2.19-2.25.

1.11. In light of these conditions, this Application separately provides, where appropriate, data for non-Christchurch routes in addition to similar data for the Tasman overall.

Conclusion

1.12. Despite the Alliance only being in operation since July 2011 and the Alliance's performance taking place in the context of difficult conditions, the data reflects the fact that the Alliance has:

- delivered substantial public benefits without any adverse impact on overall fare levels or the number and availability of low fares.

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[14] The years begin at 1 November so that they reflect two complete scheduling seasons. 1 November is the start date of the northern winter scheduling season.

[15] In order for like for like comparisons to be made between the Pre-Alliance Year and Year 1 for average fares, passenger numbers, industry capacity and Alliance capacity, all capacity analysis in this Application refers to the actual change in capacity over the relevant time period. This includes the change in capacity from the reconfiguration of Air New Zealand's A320 fleet from 152 to 168 seats. The Applicants have provided a breakdown of Alliance capacity by route at Annexure E. In Annexure E, capacity data is provided including the A320 reconfiguration and excluding the A320 reconfiguration.

- delivered on its core rationale, including:
  - combining to build a better network and product on the Tasman with increased frequencies, better connections and access to passengers for new and increased online flights;
  - increasing passenger traffic on Alliance services through the provision of an improved service offering which customers value, including higher yield passengers who value additional frequencies and connections;
  - achieving a better competitive position against the Qantas-Jetstar Group and Emirates than would be possible without the Alliance; and
  - capitalising on each Applicant's distribution and sales strength to make the Alliance product more readily accessible and easier to purchase for the public.

1.13. With reauthorisation, the public benefits resulting from the Alliance will continue and expand as the Alliance matures and greater levels of integration and cooperation take place.

2. Overview of market conditions

The Alliance operates within the context of the broader Australasian aviation market

2.1. The Alliance operates in the market for Trans Tasman air passenger services which is part of the broader Australasian and global aviation markets.

2.2. Trans Tasman air services include services between any point in Australia and any point in New Zealand.

2.3. There is strong demand for Trans Tasman air services. This includes Trans Tasman travel that originates in New Zealand or Australia and travel between New Zealand and Australia as part of travel from Asia, Europe, the Middle East or North or South America.

2.4. Each of the main airlines operating on the Tasman has operations across or into Asia. Asian and Middle-Eastern based carriers have shown an increasing interest in establishing services to Australia, New Zealand and also across the Tasman to address the demand for Trans Tasman air services. For example, China Airlines began operating a Taipei-Brisbane-Auckland service in 2011 and has expanded its Tasman offering by adding Taipei-Sydney-Auckland services in October 2012.

2.5. The Tasman market reflects the dynamics and trends of the global and regional aviation industry generally, including:

- the continued deregulation and liberalisation of airline markets around the world, with New Zealand and Australia at the forefront of this trend;
- the sustained pressure on airlines to drive cost reductions and efficiencies and innovate;
- the risk associated with exposure to unpredictable demand shocks; and
- the formation of alliances as a principal means by which airlines can offer passengers services to destinations that the airline does not individually offer , or offer more services to destinations than it could individually offer.

Overview of Trans Tasman air passenger services

2.6. The Tasman is a well served, highly competitive market, with seven carriers providing a range of product offerings including the:

- high frequency, high service offering of full service airline (**FSA**) Qantas;
- high frequency, highly connected, comprehensive Alliance product offering of Air New Zealand and Virgin Australia;
- full service offering, by fifth freedom carriers (**FFC**s)[16] (e.g., Emirates, LAN Airlines and China Airlines); and
- low cost carrier (**LCC**) offering of Jetstar.

2.7. Further detail on each of these carriers is provided in **Annexure D**.

2.8. The supply of Trans Tasman air passenger services is characterised by low barriers to entry and expansion. The Tasman is one of the most open international airline markets in the world. Any international designated airline can operate a connecting fifth freedom service between the two countries without restriction[17] and any foreign-owned carrier can operate domestic services through an Australian subsidiary.

2.9. Given connections between New Zealand and Australia for onward international travel and the liberal aviation policies of each country, Trans Tasman routes can be served by international operators using fifth freedom rights at marginal cost. As a result, a Trans Tasman route does not need to be profitable on a stand-alone fully costed basis for a FFC. FFCs are an established feature of the Tasman market with many FFC operators having offered Trans Tasman services at different points in time such as Malaysia Airlines, Thai Airways, Royal Brunei and Aerolineas Argentinas. Emirates, in particular, has positioned itself as a long term fixture in the market and has been able to achieve rapid and significant growth in passenger share. The competitive presence and threat of entry from FFCs is characteristic of the Tasman market and from the Pre-Alliance Year to the end of Year 1, the proportion of FFC flying increased from around 16% of Tasman capacity to 18%.

2.10. The majority of Tasman traffic is carried on a few main routes, enabling carriers (such as FFCs) to establish their Tasman presence and support a substantial proportion of the overall market without having to operate on all routes. For example, in April 2010, the three routes from Auckland to Sydney, Melbourne and Brisbane alone accounted for around 54% of total Trans Tasman traffic.[18] Entry and expansion on the Tasman since the Alliance has included the entry of China Airlines onto Auckland-Brisbane in 2011 and its expansion onto Auckland-Sydney in October 2012. Jetstar and Emirates have also expanded their Tasman operations. There have been substantial increases in capacity by Emirates (13.3%), Jetstar (5.2%), LAN Airlines (4.2%) and Qantas (2.1%) on the Tasman from the Pre-Alliance Year to Year 1. Since November 2012, Jetstar has increased capacity further with an additional aircraft in its New Zealand based fleet.

2.11. Demand for Trans Tasman air passenger services is characterised by highly price responsive passengers (a so called tactical market). This is reflected in the success of online internet bookings, cheap fares and the continued discount fare offerings available on the Tasman. According to data provided by the Department of Immigration and Citizenship (**DIAC**), in the year ended 30 June 2012, 73% of Trans Tasman origin/destination passengers travelled for

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[16] Fifth freedom rights are the rights of an airline of one country to carry traffic between two foreign countries as long as the flight originates and terminates in its own country.

[17] Any constraint is at the level of access to either the Australian or New Zealand market under the various bilateral Air Service Agreements between each of New Zealand and Australia and other jurisdictions.

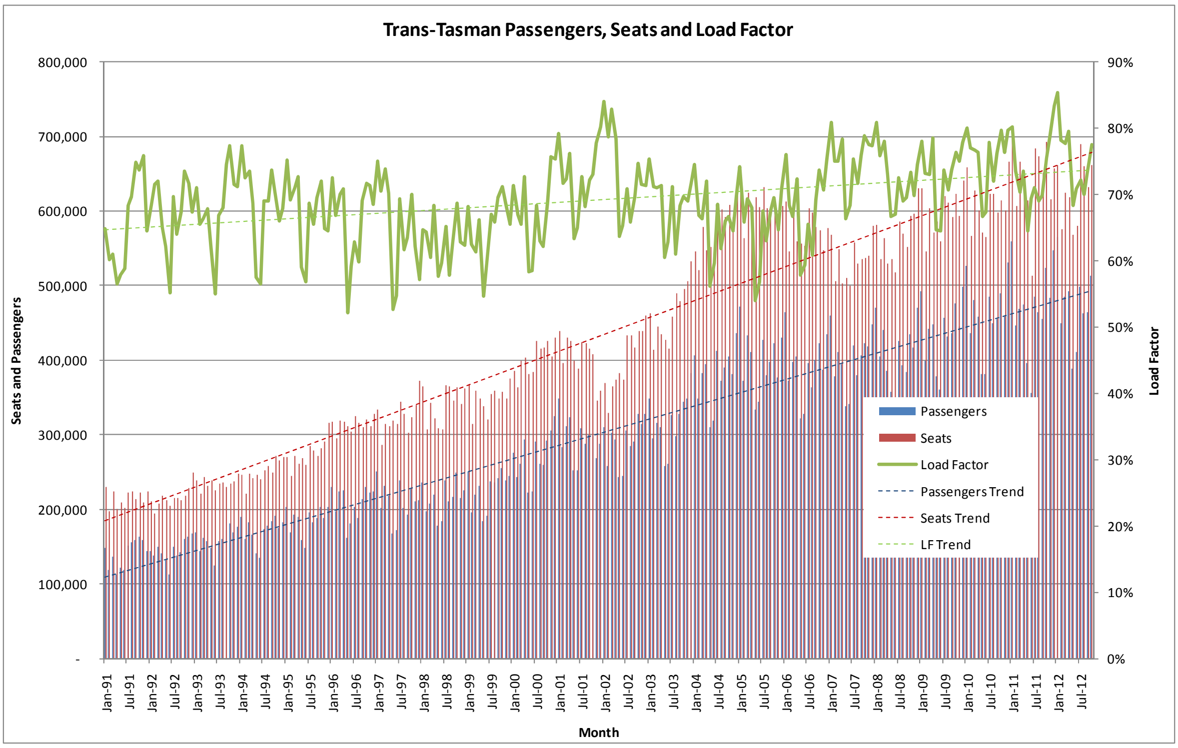
[18] AKL-SYD accounted for around 26%, AKL-MEL accounted for around 15% and AKL-BNE accounted for 13%. See ACCC Final Determination at 5.324, 5.332 and 5.340.

leisure and 12% travelled for business.[19] The overall leisure nature of the Tasman intensifies Tasman fare competition and provides a strong incentive for operators to seek to also attract the high yielding business travellers. The result is that there is strong fare competition in both the business and leisure segments of the Tasman.

2.12. The strong fare competition on the Tasman is also a reflection of available capacity. Structurally, the Tasman has not been capacity constrained but instead demand for Trans Tasman air passenger services has been consistently supported by substantial capacity growth. This has continued to be the case during the operation of the Alliance with excess capacity across Trans Tasman routes.

2.13. Figure 1 below shows the number of seats, passengers and the overall load factor for the Tasman from January 1991 to October 2012.

Figure 1: Passenger numbers, seats and load factor from January 1991 to October 2012



Source: BITRE

2.14. As shown in Figure 1, the Tasman has seen consistent growth in passengers and capacity over the 21 year period and there is excess capacity available on the Tasman.[20]

2.15. Since implementation of the Alliance, the Tasman has continued to be characterised by high capacity levels relative to overall passenger numbers as well as strong fare competition. Figure 2 below provides a summary of Trans Tasman passengers before and during the Alliance.

Figure 2: Summary of Trans Tasman Passengers before and during the Alliance

[CONFIDENTIAL]

2.16. Figure 3 below gives a summary of Trans Tasman capacity before and during the Alliance.

[19] QF/EK ACCC Draft Determination at para 356, p76.

[20] The passenger numbers in Figure 1 are O & D passengers. They include passengers that originate their journey in New Zealand with Australia as their final destination (and vice versa) regardless of the particular flight itinerary or the behind/beyond connections that make up the journey.

Figure 3: Summary of Trans Tasman capacity before and during the Alliance

Summary of Trans Tasman Capacity					
Airline	**Pre-Alliance Year**	**Year 0**	**% Var to Pre-Alliance Year**	**Year 1**	**% Var to Pre-Alliance Year**
Virgin Australia	1,301,040	1,220,316	-6.2%	1,244,088	-4.4%
Air New Zealand	2,605,631	2,885,221	10.7%	2,857,495	9.7%
Alliance	*3,906,671*	*4,105,537*	*5.1%*	*4,101,583*	*5.0%*
Qantas	1,705,737	1,690,290	-0.9%	1,742,134	2.1%
Jetstar	725,773	846,927	16.7%	763,455	5.2%
Emirates	1,004,897	1,114,066	10.9%	1,139,022	13.3%
Royal Brunei Airlines	30,355	-	-100.0%	-	-100.0%
Aerolineas Argentinas	95,907	82,004	-14.5%	49,894	-48.0%
Lan Airlines	153,276	155,654	1.6%	159,768	4.2%
China Airlines	-	70,970		95,784	
Total Competitors	***3,715,944***	***3,959,911***	***6.6%***	***3,950,057***	***6.3%***
Total Trans Tasman	**7,622,615**	**8,065,448**	**5.8%**	**8,051,640**	**5.6%**

Note: Alliance capacity fell slightly between Year 0 and Year 1 due to the impact of the Christchurch earthquakes. Christchurch routes form a substantial proportion of routes flown by the Alliance. This proportion is considerably higher than it is for the Alliance's competitors as a whole. As a result, the Alliance has been relatively more effected by the earthquake than competing airlines.

2.17. As shown in Figures 2 and 3, Trans Tasman capacity increased by 5.6% whilst passengers increased by 4.0% from the Pre-Alliance Year to Year 1. The Applicants increased capacity by 5% from the Pre-Alliance Year to Year 1. Figure 3 shows that in addition to the capacity increases of the Applicants there were significant capacity increases by Emirates and Jetstar following the implementation of the Alliance. Emirates increased capacity by 13.3% and Jetstar increased capacity by 5.2% from the Pre-Alliance Year to Year 1. It also demonstrates the ability for airlines such as Jetstar to rapidly deploy capacity in response to market opportunities. In the year between Year 0 and the Pre-Alliance Year, Jetstar was able to increase its capacity by 16.7%.

2.18. Further information on Alliance passengers, capacity and load factors is provided at **Confidential Annexure E** on a route by route basis.

Natural disasters impacting Trans Tasman air services since authorisation

2.19. Since authorisation of the Alliance, there have been a number of significant natural disasters that have affected the demand and supply of Trans Tasman air passenger services and consequently the performance of the Alliance. For example:

- the series of high magnitude earthquakes in Christchurch and the Canterbury region from September 2010 through to January 2012;
- the ash cloud activity over New Zealand and Australia from the eruption of the Puyehue-Cordon Caulle volcano in South-Central Chile in June 2011; and

- the series of Australian floods beginning in December 2010 primarily in Queensland.

2.20. In February 2011, an earthquake of magnitude 6.3 struck the centre of Christchurch, killing over 180 people and causing severe destruction of homes, businesses, essential infrastructure and iconic landmarks and tourist attractions such as the Christchurch Cathedral. Following the February 2011 earthquake, Christchurch continued to experience aftershocks and a series of high magnitude earthquakes slowing rebuilding efforts and recovery. The Canterbury region has been struck with more than 40 earthquakes of magnitude 5.0 or over since September 2010.[21]

2.21. As a result of the earthquakes there has been a significant reduction in demand for Trans Tasman flights to Christchurch. Australian visitors to Christchurch for holiday purposes have declined by more than 85,000 or 40% for the year ending June 2010 to June 2012.[22]

2.22. On 4 June 2011, the Puyehue-Cordon Caulle volcano in South-Central Chile erupted sending an ash plume over 15 kilometres into the air. Winds blew the ash plume eastwards across the Atlantic Ocean, under southern Africa and across the Southern Ocean towards southern New Zealand and Australia.

2.23. On 12 June 2011, ash clouds moved into the air space above New Zealand and Australia creating conditions which were potentially dangerous for flying and resulting in the cancellation of significant numbers of domestic and international services by all Australian airlines and many international airlines. As a direct consequence of the volcanic ash, Virgin Australia cancelled over 150 Trans Tasman flights (net of additional services deployed to transport inconvenienced passengers) over a period of 16 days.

2.24. Air New Zealand was able to safely continue operating the majority of its services by making flight path adjustments. As a consequence, it cancelled two Trans Tasman flights and, where aircraft were available, deployed larger aircraft on services in order to uplift some of the passengers who were disrupted by cancellations.

2.25. The series of Australian floods beginning in December 2010 forced the evacuation of thousands of people from towns and cities, mostly in Queensland. At least 70 towns and over 200,000 people were affected. Damage was initially estimated at around AU$1 billion with three-quarters of the state of Queensland declared a disaster zone. Inbound demand from New Zealand was negatively affected by the floods due to limited access to key tourist destinations within Queensland as well as the negative publicity generated during and after the floods.

3. Public benefits derived from the Alliance

The MOT concluded that the Alliance will result in public benefits

3.1. The MOT Determination considered that the Alliance would provide benefits in the following forms:[23]

- improved service levels;
- increased frequencies on each airlines' code;
- improved online connections;
- improved schedule spread;

[21] Reserve Bank of New Zealand – "The economic impact of the Canterbury earthquakes" at http://www.rbnz.govt.nz/research/bulletin/2012_2016/2012sep75_3parkersteenkamp.pdf.
[22] Statistics New Zealand *International Travel and Migration Statistics* at www.stats.gov.nz.
[23] MOT Determination paragraph 7.

- increased frequencies;
- possible additional routes;
- improved access to frequent flyer benefits; and
- improved access to lounge facilities.

3.2. The MOT also considered that the Alliance would provide opportunities for the Applicants to make cost savings by increasing load factors and reducing costs per seat sold.[24]

3.3. The MOT Determination considered that the magnitude of the above benefits was uncertain. However, even in the short time the Alliance has been in operation, the Alliance has proven its ability to generate substantial public benefits. The Applicants have set out below an analysis of each of the benefits arising from the Alliance, under the following headings:

- **enhanced products and services** and associated increased consumer choice (including increased access to existing frequencies, increased online connection options, better schedule spread, enhanced value added services and new frequencies);
- **potential for lower fares as a result of cost savings and efficiency improvements** through removal of double marginalisation and higher load factors;
- **promotion of competition**, particularly in the business traveller segment of the Trans Tasman market; and
- **stimulation of tourism**.[25]

Enhanced products and services

Enhanced products and services – Improved access to existing frequencies and increased online connection options

3.4. The implementation of codeshare sales on Network Alliance Routes has allowed each of the Applicants to now offer a full range of high frequency flights between 26 points in New Zealand and 34 points in Australia. This represents an Alliance product offering with:

- Improved service levels that customers value.
- significantly increased frequency of service for both Air New Zealand and Virgin Australia passengers; and
- substantially increased connectivity in terms of available city pairs. The Alliance offers city pair connectivity between all ports in Australia and all ports in New Zealand. An equivalent Trans Tasman connectivity offering has not previously been achieved by any airline or alliance.

3.5. Under the Alliance, an additional 576 online connection options have become available to Alliance passengers. In addition, Virgin Australia announced on 26 February, the introduction of two new domestic destinations, Bundaberg and Moranbah. This creates an additional 52 online connections between New Zealand and Australia bringing the total Alliance connections to 628 from May 2013. This is in excess of the 420 additional online connection options anticipated by the Applicants in their initial application for authorisation.

[24] MOT Determination paragraph 8.

[25] ACCC Final Determination at 5.243. The ACCC Final Determination considered that the Alliance would likely result in material public benefits in the form of these headline benefits.

3.6. For a Virgin Australia customer, online options across the Tasman have increased from 168 to 884 (including access to Air New Zealand's 26 New Zealand destinations via 37 city pairs). For an Air New Zealand customer, online options across the Tasman have increased from 182 to 884 (including access to Virgin Australia's 34 Australian destinations via 65 city pairs). The benefits described above could not have been achieved without the Alliance. Unlike a standalone code share agreement, the Alliance's metal neutral revenue allocation model incentivises the carriers to focus on improving revenue across both carriers' Tasman flights without preference to their own operated services.[26] For example, prior to the Alliance, Air New Zealand would have sold a passenger travelling during the off-peak season from Dunedin to Brisbane, a ticket going via Christchurch or Auckland as Air New Zealand does not fly direct from Dunedin to Brisbane during the off-peak season. Under the Alliance, because there is no revenue impact, Air New Zealand would offer the same passenger a direct flight on Virgin Australia metal. Further under the Alliance, Air New Zealand is now able to offer double the frequency on this sector during the peak season.

3.7. The Alliance has increased the choice of online journey options for passengers providing them with:

- access to better connections and a broader schedule at competitive fare levels;
- the convenience of not having to collect and bear baggage mid journey;
- time savings associated with through check; and
- removal of the risk of forfeiting non-refundable fares if the first flight in a multiple flight journey is delayed.

3.8. The MOT Determination noted that benefits would arise as a result of the following:[27]

- Ease of website booking. Under the Alliance, the Air New Zealand site now allows customers to view and book all direct and indirect Air New Zealand and Virgin Australia operated Trans Tasman options rather than only being able to view and book Air New Zealand operated flights;
- Streamlined baggage transfers between domestic and international terminals. With interline baggage arrangements in place, bags are now checked through rather than being off-loaded and re-checked by transfer passengers. In addition, from June 2012, the Applicants implemented IATCI so that connecting passengers are checked through for their entire journey;
- Shorter connection times. System and process enhancements that have taken place since authorisation, including those delivered by Virgin Australia's migration to the Sabre Sonic reservation platform on 13 January 2013, will enable the Applicants to review minimum connection times. This review is ongoing and operational capability must be confirmed before reductions are effected to ensure guest experience is not impacted. Reduced minimum connection times benefit consumers by allowing more flight combinations to be sold as connections, increasing frequency of available services between origin and destination points.

3.9. If reauthorised, consumers will continue to receive these benefits.

Enhanced products and services – Better schedule spread

3.10. In their initial application for authorisation, the Applicants submitted that the Alliance would provide them with the ability and the incentive to undertake significant schedule changes

[26] ACCC Final Determination at 5.215.

[27] MOT Determination paragraph 181.

which would optimise the network and benefit all travellers. The MOT acknowledged this as a public benefit.[28]

3.11. A better schedule spread is a benefit. All passengers, whether they are travelling for business or leisure, are likely to value increased schedule spread to the extent that it improves connectivity with other transport options, allows passengers to avoid overnight accommodation costs, provides greater flexibility for coordination with friends and relatives' schedules and allows access to cheaper fares.[29]

3.12. Under the Alliance, the Applicants have been able to work together to maximise their total network offering. There have been a number of key changes to the Alliance's network and schedule spread which have provided, and will continue to provide, public benefits, namely:

- a significant reduction of wingtip flying including, in some cases the removal of wingtip flights, providing customers with a greater choice of departure and arrival times on a number of high frequency sectors; and,

- a removal of day of week clashes on low frequency sectors Brisbane-Queenstown and Queenstown-Sydney to provide consumers with a better offering including the ability to have different length stays.

3.13. The Alliance has also allowed for better management of flight disruptions or cancellations and better outcomes for customers in those situations. For example, prior to the Alliance, if there was a cancellation of a Virgin Australia Auckland-Coolangatta service, passengers were re-accommodated onto a flight to Brisbane and an onwards bus service. Under the Alliance two Auckland-Coolangatta services are operated a day, so passengers can be re-accommodated onto the next flight.

Enhanced products and services – Reduction in wingtip flying

3.14. As shown in Figure 4 below, from the Pre-Alliance Year to Year 1 the Alliance has:

- removed northern winter wingtip flying on Auckland-Brisbane, Auckland-Gold Coast, Auckland-Melbourne, Brisbane-Wellington and Sydney-Wellington;

- removed northern summer wingtip flying on Sydney-Wellington;

- significantly reduced the number of northern winter wingtip flights on Auckland-Sydney, Brisbane-Christchurch, Christchurch-Melbourne and Christchurch-Sydney; and

- significantly reduced the number of northern summer wingtip flights on Auckland-Brisbane, Auckland-Gold Coast, Auckland-Melbourne, Auckland-Sydney, Brisbane-Wellington, Christchurch-Melbourne and Christchurch-Sydney.

[28] MOT Determination paragraph 169.

[29] ACCC Final Determination at 5.96.

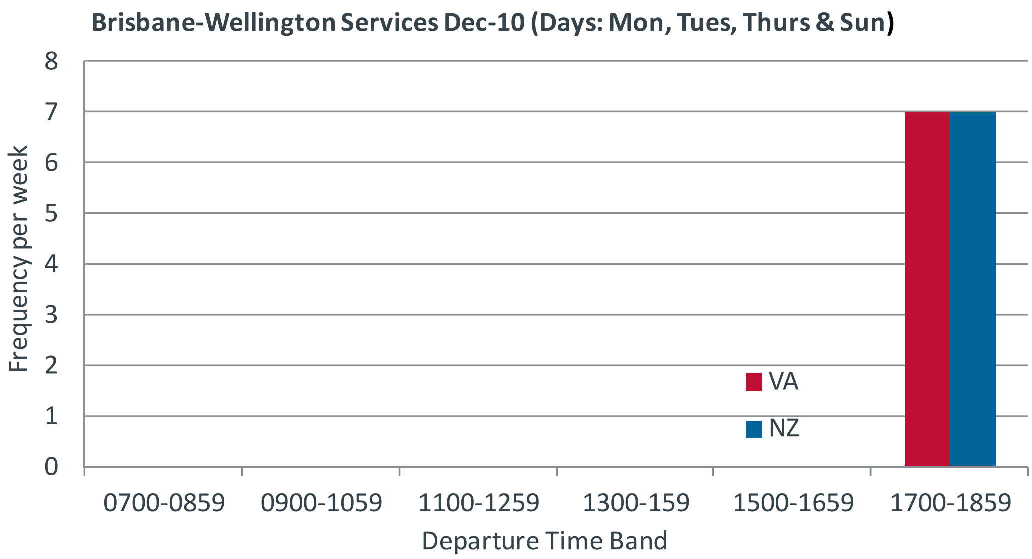
Figure 4: Wingtip Flying from the Pre-Alliance Year to Year 1[30]

	Pre-Alliance Year						Year 0						Year 1					
	Northern Winter			Northern Summer			Northern Winter			Northern Summer			Northern Winter			Northern Summer		
	Sectors per season	No. of wingtip Flights	Wingtip %	Sectors per season	No. of wingtip Flights	Wingtip %	Sectors per season	No. of wingtip Flights	Wingtip %	Sectors per season	No. of wingtip Flights	Wingtip %	Sectors per season	No. of wingtip Flights	Wingtip %	Sectors per season	No. of wingtip Flights	Wingtip %
AKLBNE	952	161	17%	1514	267	18%	944	160	17%	1504	102	7%	946	0	0%	1598	174	11%
AKLOOL	456	52	11%	736	175	24%	476	0	0%	728	116	16%	478	0	0%	696	4	1%
AKLMEL	1051	30	3%	1362	205	15%	1008	83	8%	1394	206	15%	106	4	0%	1422	49	3%
AKLSYD	1885	268	14%	2340	415	18%	1704	295	17%	2368	420	18%	1712	92	5%	2334	49	2%
BNECHC	643	148	23%	1106	262	24%	710	49	7%	950	222	23%	578	36	6%	992	302	30%
BNEWLG	600	164	27%	848	243	29%	574	141	25%	886	271	31%	588	0	0%	866	28	3%
CHCMEL	742	192	26%	738	149	20%	706	2	0%	650	94	14%	534	29	5%	586	26	4%
CHCSYD	784	117	15%	900	200	22%	714	88	12%	756	158	21%	536	24	4%	668	67	10%
SYDWLG	594	110	19%	676	167	25%	536	88	16%	802	76	9%	586	0	0%	756	0	0%

3.15. The improved schedule spread and reduction in wingtip flying achieved under the Alliance, has resulted in greater customer choice, convenience and flexibility. Airline schedules including the schedule of the Alliance vary season by season and month by month. However, the examples provided below show a point in time illustration of the schedule improvements made possible under the Alliance.

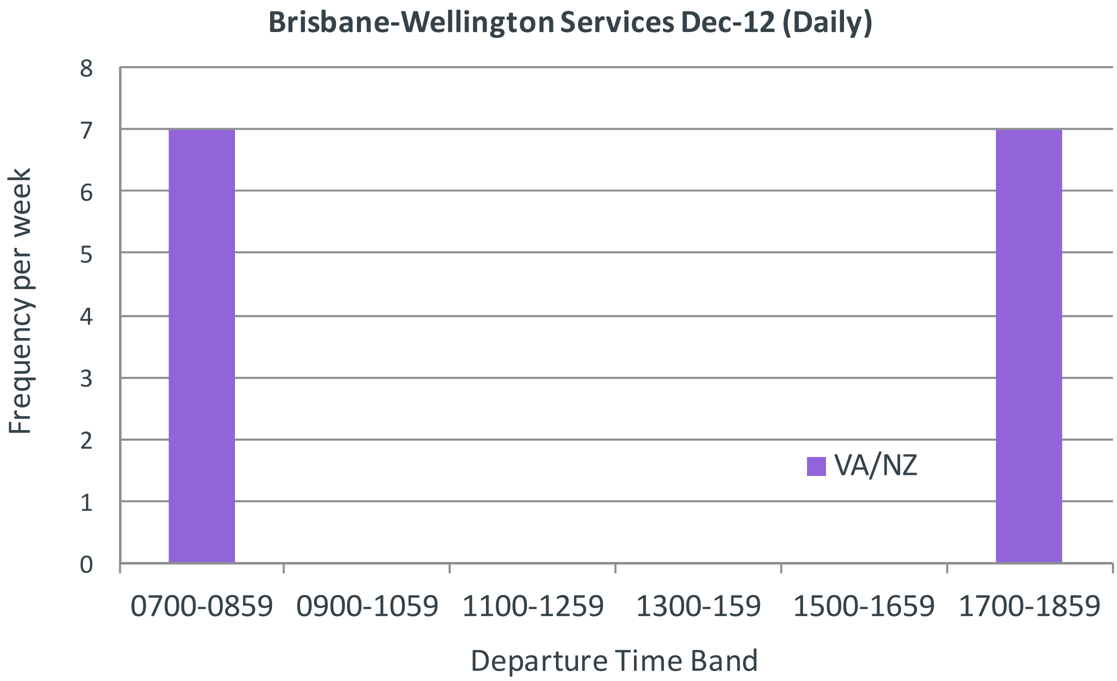
(i) Removal of time of day clashes

3.16. In December 2010, both Air New Zealand and Virgin Australia had similar evening departures from Brisbane on four days of the week. These services departed as little as 25 minutes apart. This meant that people flying from Brisbane to Wellington were 'forced' to travel on an evening service four days of the week, arriving in Wellington around midnight, necessitating an overnight stay and preventing any onward connections.



30 The relatively high wingtip percentage for Northern Summer on BNE-CHC reflects operational changes required to meet capacity commitments under the Conditions and account for growth on BNE-DUD and BNE-ZQN. Flights to BNE-DUD and BNE-ZQN effect the departure and arrival time possibilities for BNE-CHC flights.

3.17. Under the Alliance, the Applicants have been able to provide a better spread of schedules, as illustrated below.

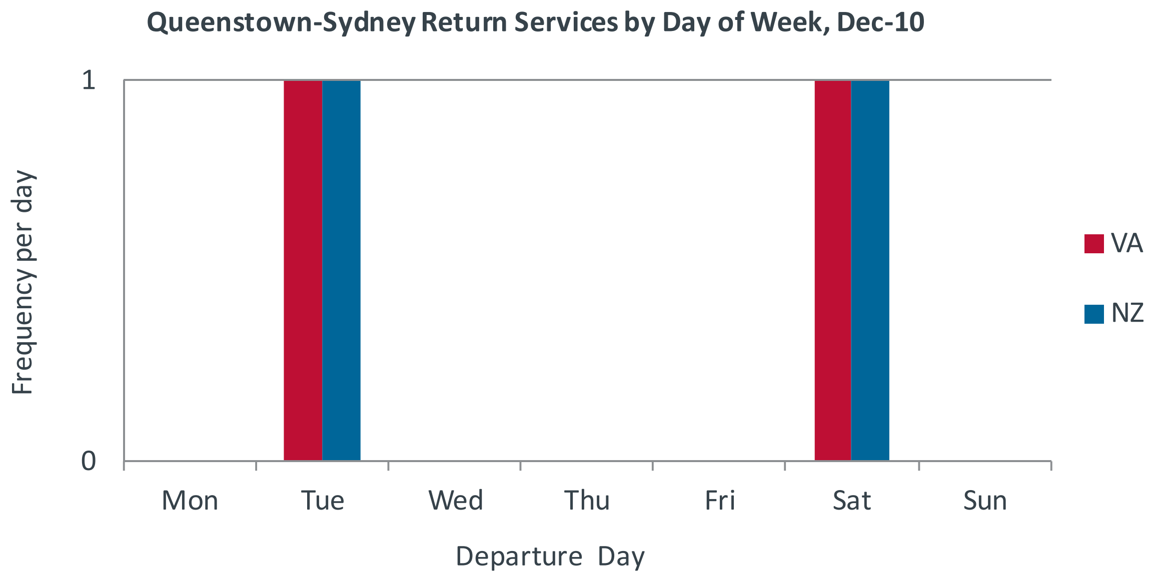


3.18. As these graphs show, prior to the Alliance, on four days of the week, customers could only travel Brisbane-Wellington on an evening service. Under the Alliance, the Applicants have been able to fly this route twice daily, with one arrival/departure time in the morning, and one in the evening, enhancing choice and convenience.

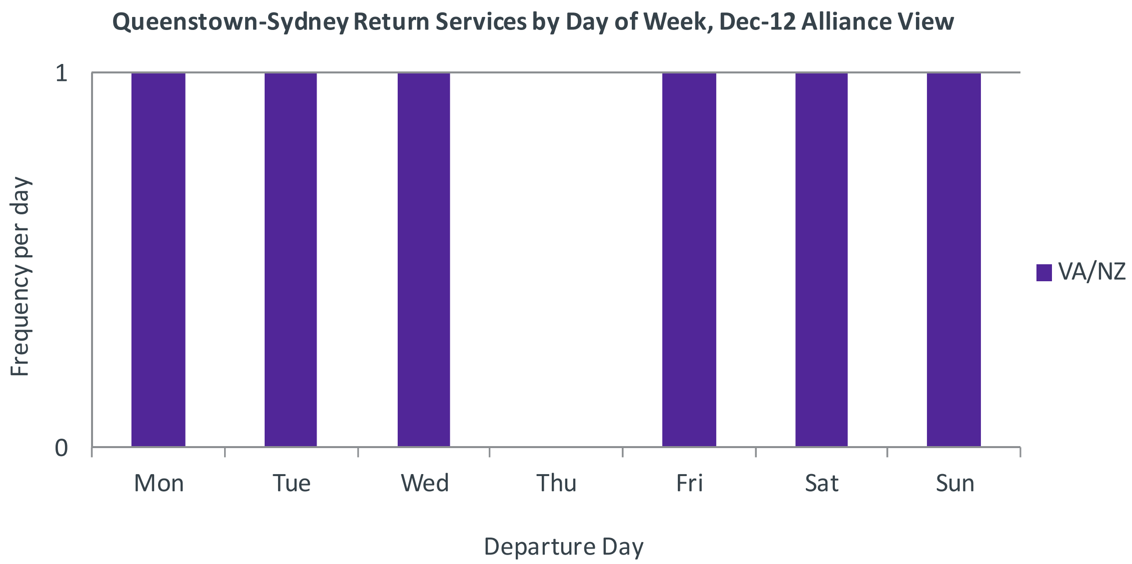
(ii) Removal of day of week clashes

3.19. This specific example of changes made to the Queenstown-Sydney schedule since December 2010 is used below to illustrate the greater customer choice, convenience and flexibility of the improved schedule changes made to remove day of the week clashes under the Alliance.

3.20. In December 2010, each of Air New Zealand and Virgin Australia operated two services a week. Both airlines operated these services on a Tuesday and a Saturday departing within 30 minutes of each other. This day of the week clash and wingtip flying did not reflect higher demand at this time but was due to each airline optimising its schedule operation in isolation. As a consequence, a person wishing to travel on a direct service from Sydney to Queenstown could only fly with Virgin Australia or Air New Zealand on a Tuesday or Saturday, enabling a 3, 4 or 7 night stay, as illustrated below.



3.21. Under the Alliance, the Applicants have been able to optimise their schedule to remove the day of week clashes, reduce wingtip flying when there is more than one service per day and grow frequency as illustrated below.



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3.22. As the above graphs illustrate, prior to the Alliance, the Applicant's customers could only fly from Sydney to Queenstown on either a Tuesday or a Saturday. Under the Alliance, the Applicants were able to make schedule changes so that customers have the flexibility of choosing one of six potential departure or arrival days, enabling a 1, 2, 3, 4, 5, 6 or 7 night stay, including over a weekend.

Enhanced products and services – Frequent flyer reciprocity

3.23. In the MOT Determination, the MOT accepted that reciprocal earning and burning of frequent flyer points had the potential to drive travel and tourism and could particularly benefit regions of New Zealand that are not serviced directly by Trans Tasman services.[31]

3.24. Since 26 July 2011, the Applicants have offered guests frequent flyer reciprocity on their respective networks. The reciprocal loyalty program access negotiated as a result of the Alliance includes earning and redeeming points across the entire Air New Zealand and Virgin Australia networks including the Trans Tasman, domestic Australia, domestic New Zealand and long haul sectors excluding sectors to/from the Pacific Islands. Such access would not have been agreed without the Alliance.

3.25. The frequent flyer reciprocity under the Alliance translates to the ability for passengers to earn and burn on over 160,000 more one way services per year. In Year 1, Virgin Australia passengers gained access to frequent flyer benefits on an additional 190,000 Air New Zealand services and Air New Zealand passengers gained access to frequent flyer benefits on an additional 161,000 services compared to the Pre-Alliance Year.

3.26. Members of Velocity or Airpoints also receive reciprocal benefits including (depending on the membership tier and the fare purchased) lounge access, priority check-in, priority baggage handling, additional checked baggage, priority seating and priority boarding on both Alliance and non-Alliance flights (excluding the Pacific Islands).

3.27. There has been a substantial increase in Velocity frequent flyer membership since the implementation of the Alliance. As at 31 October 2009, the beginning of the Pre-Alliance Year, Velocity had **[CONFIDENTIAL]** members. As at 31 October 2012, membership increased to **[CONFIDENTIAL]** members. Airpoints membership has also increased since the implementation of the Alliance from **[CONFIDENTIAL]** members as at 31 October 2009 to **[CONFIDENTIAL]** as at 31 October 2012. This means that even more members of the public now have access to the frequent flyer benefits provided under the Alliance. As part of assessing the potential tourist increase under the Alliance, the MOT calculated the increase in tourists which would result from an increase of only 1% in the number of Velocity members travelling to New Zealand.[32] The Velocity membership has grown substantially (by approximately **[CONFIDENTIAL]**) since the date of the original authorisation, meaning that a 1% increase in Velocity members travelling to New Zealand would result in a substantially higher tourism uplift than it would have at the time of the original authorisation.

3.28. The public benefits delivered from frequent flyer reciprocity under the Alliance will continue and increase in magnitude with increases in passenger traffic, frequent flyer memberships and increases in network services and coverage. Without reauthorisation frequent flyer reciprocity would be renegotiated.

Enhanced products and services – Lounge access reciprocity

3.29. The MOT acknowledged that the Alliance would result in improved lounge access compared to the status quo.[33]

3.30. Prior to the Alliance, Virgin Australia customers had no international lounge access in Australia or New Zealand and no domestic lounge access in New Zealand. Similarly, prior to the Alliance, Air New Zealand customers travelling on domestic Australia services had no lounge access.

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[31] MOT Determination paragraph 182, and 184

[32] MOT Determination paragraph 184

[33] MOT Determination paragraph 191.

3.31. The reciprocal access to the Applicant's respective loyalty programs in relation to Alliance and non-Alliance journeys (excluding Pacific Islands) negotiated under the Alliance, has (depending on frequent flyer membership tier[34] and / or the fare purchased) allowed:

- Virgin Australia passengers to access Air New Zealand's six international air-side lounges on the Tasman and Air New Zealand's 12 domestic lounges; and
- Air New Zealand passengers to access Virgin Australia's eight domestic Australia lounges.

3.32. Figure 5 below sets out the various Air New Zealand and Virgin Australia lounges which have permitted reciprocal access since 26 July 2011 as a result of the Alliance.

Figure 5: Lounge access permitted under the Alliance since 26 July 2011

Air New Zealand Lounges	Virgin Australia Lounges
Auckland (Intl and Dom)	Adelaide
Brisbane International	Brisbane Domestic
Christchurch (Intl and Dom)	Canberra
Dunedin	Gold Coast
Hamilton	Mackay
Invercargill	Melbourne Domestic
Melbourne International	Perth
Napier	Sydney Domestic
Nelson	
New Plymouth	
Palmerston North	
Sydney International	
Tauranga	
Wellington (Intl and Dom)	
Queenstown	

3.33. Lounge access is a significant benefit, particularly for those travellers with onward connections. If the Alliance is reauthorised, reciprocal lounge access will continue to be available and provide valued benefits to customers.

3.34. The table below shows that reciprocal access under the Alliance is being utilised by customers and that there has been considerable growth in lounge entries by Alliance customers on Alliance and non-Alliance journeys since implementation. The Applicants expect further growth over time.

Figure 6: Reciprocal Lounge Access Usage

[CONFIDENTIAL]

[34] Air New Zealand's Koruclub paid lounge membership allows such members to access Virgin Australia's various lounges.

Enhanced products and services – Expected new frequencies under the Alliance

3.35. In their initial application for authorisation, the Applicants stated that the Alliance would enable them to increase frequencies by an additional 326 frequencies per annum comprising additional frequencies on Auckland-Coolangatta, Auckland-Perth, Brisbane-Wellington, Melbourne-Wellington and Sydney-Wellington.

3.36. In the Alliance's short operation, the Applicants have realised the additional frequencies proposed on Auckland-Adelaide, Auckland-Perth, Brisbane-Wellington and Melbourne-Wellington. Frequencies have increased under the Alliance by an additional 310 return trips per year on non-Christchurch routes. However, due to a drop in demand following the Christchurch earthquakes there has been a reduction of 465 return trips on Christchurch routes. As expected, the Applicants were also able to implement some additional frequencies in peak periods on Sydney-Wellington. However, there was not the demand for these to be sustained year round.

3.37. Instead of increasing frequency on Auckland-Perth, Air New Zealand upgauged its daily Auckland-Perth service from a Boeing 767 to a 777 on 3 September 2012. This will result in approximately **[CONFIDENTIAL]** additional seats (for Year 2 compared with the Pre-Alliance Year). This has also resulted in an improved product being provided to customers with lie flat business class seats, and a premium economy offering.

3.38. The Applicants proposed double daily services from July through September and 12 services weekly from October through June on the Auckland-Coolangatta sector.[35] Both Applicants operate on this route and the Applicants have maintained a strong schedule with improved spread as well as up to 13 services per week in peak months of July, December and January. While the Alliance has not yet reached the anticipated level of services for all months of the year, some of the anticipated demand for these services will have formed part of the growth on related routes such as Christchurch-Coolangatta, Auckland-Brisbane and the new Auckland-Sunshine Coast services.

3.39. The Applicants started the new seasonal services from Auckland to Sunshine Coast twice a week between July and September 2012. This new route was made possible by **[CONFIDENTIAL]** the strength of the Alliance. The Applicants intend to operate these services again in the northern summer 2013 season.

3.40. In addition to the new routes and new frequencies that have already been implemented by the Alliance, the Applicants are actively engaged in exploring new opportunities. **[CONFIDENTIAL].**

3.41. Further details of the Alliance's improved network changes and increased frequencies by sector are set out at **Confidential Annexure F**.

Cost savings and other efficiencies

3.42. The MOT acknowledged that the Alliance would provide opportunities for the Applicants to make cost savings by increasing load factors and reducing cost per seat sold.[36]

3.43. In their initial application for authorisation, the Applicants envisaged that the Alliance would result in cost savings and efficiencies in the following areas:

- higher load factors resulting in a lower cost per seat sold;
- joint procurement;

[35] Applicants', Submission in response to the ACCC Draft Determination, 11 October 2010 at 28.

[36] MOT Determination at 8, and 198 - 215.

- collocation of certain functions and utilisation of common resources;
- operational optimisation; and
- removal of double marginalisation.

3.44. Examples of the cost savings and efficiencies that have been achieved to date are set out below. Many of the cost savings achievable under the Alliance could not be fully realised in the first 18 months of implementation and are still to come. These include, cost savings that will be delivered over time from better fleet planning and operational changes and cost savings from improved or more efficient contractual arrangements with suppliers.

Higher load factors resulting in a lower cost per seat sold

3.45. The Applicants originally submitted that increased load factors under the Alliance will result in public benefit either directly through greater efficiency (i.e., lower cost per seat sold) or indirectly by supporting greater total output (i.e., increased capacity) and that the overall increase in passenger numbers under the Alliance is likely to have a combination of these effects.

3.46. A plane has a set number of available seats and if the plane leaves the gate with empty seats, this inventory cannot be stored and is lost. That is, the overall costs of operating the flight are fixed, hence the greater the number of passengers on that flight the more efficient the use of the plane's "perishable" inventory, which is reflected in a lower average cost per seat sold.

3.47. In the Draft Determination, the ACCC accepted that increased load factors, to the extent that they are realised under the Alliance, represent a source of efficiency improvement through lowering of cost per seat sold.

3.48. In its Final Determination, the ACCC noted that, the Alliance would be likely to have an overall stimulatory effect on Trans Tasman traffic and on that basis concluded that the Alliance would likely generate public benefits through increased load factors.[37]

3.49. As anticipated, the Alliance has resulted in higher load factors. The load factor on the Tasman increased from **[CONFIDENTIAL]** in the Pre-Alliance Year to **[CONFIDENTIAL]** in Year 1, at the same time as overall capacity has increased. The increased load factor achieved under the Alliance has resulted in a lower overall average cost per seat sold. In addition, as anticipated, travellers have also benefited indirectly from increased load factors supporting greater total output in the form of new routes and additional frequencies and capacity on existing routes as discussed above.

3.50. Further information on the Alliance's load factors by sector can be found at **Confidential Annexure E**.

Joint procurement

3.51. The Applicants have and will continue to review opportunities for cost savings from joint procurement activities.

3.52. In November 2012, Air New Zealand announced that from early 2013 it would be moving its Australian Ground Handling contract to Toll Dnata, who also supply ground handling services for Virgin Australia. This move is largely attributable to the Alliance and Air New Zealand

[37] ACCC Final Determination at 5.192.

expects to realise cost savings of approximately **[CONFIDENTIAL]** per annum in the first year, increasing to **[CONFIDENTIAL]** per annum as a result of this change.

3.53. Large scale procurement such as fuel and ground handling are generally contracted for a number of years in advance. As these arrangements expire the Applicants expect to be able to capitalise on further cost saving opportunities.

Collocation of certain functions and utilisation of common resources

3.54. The Applicants have also been able to achieve savings in operational areas. For example, Air New Zealand and Virgin Australia entered into an engine access agreement in December 2011 which enables the parties to pool their spare B777 engines and reduce the overall number of spares required to be held by each party. This represents a substantial saving of up to **[CONFIDENTIAL]** for each party.

3.55. Air New Zealand and Virgin Australia are actively engaged in discussions about further cost savings opportunities. For example:

- the Applicants are exploring further opportunities to realise improvements and cost savings for other engine types. The opportunities being developed currently include sharing of knowledge, systems, personnel and joint training.
- Air New Zealand uses kiosk check in for international flights out of New Zealand and Sydney. **[CONFIDENTIAL].**

Operational optimisation

3.56. The optimisation of the Applicant's combined Tasman network offering under the Alliance has allowed them to achieve cost savings by utilising their fleet in a more cost efficient way. This has created a more efficient network and schedule offering without the associated increase in fixed costs that would be incurred by the Applicants acting independently. For example:

3.57. Virgin Australia is operating the seasonal Dunedin-Sydney and Dunedin-Melbourne services previously operated by Air New Zealand which complements the existing Virgin Australia schedule on Brisbane-Dunedin.

3.58. Air New Zealand becoming the Alliance carrier on the Sydney-Wellington route utilises the market presence of Air New Zealand on this sector, while Virgin Australia has been able to utilise the advantages of its home hub in Brisbane by becoming the Alliance carrier on the Brisbane-Wellington route.

3.59. Air New Zealand's operation of the Auckland-Cairns services allows the Alliance to take advantage of the Air New Zealand's sales strength on a sector which is largely a New Zealand point of sale sector.[38]

3.60. The Alliance has enabled more effective handling of flight disruptions including utilising each other's aircraft (both scheduled and non-scheduled flights) to re-accommodate passengers in a disrupt situation. Such assistance also saves costs.

3.61. Potential opportunities currently under review include the sharing of systems, personnel and resources and joint purchasing initiatives that leverage on combined buying power.

3.62. In particular, at the expiration of the existing contracts, the Applicants intend to review the following operations in order to derive future cost savings:

[38] This move has also provided passengers with additional benefits on the sector such as IFE for all passengers, irrespective of fare type and a daytime flight schedule with the removal of overnight flying.

- **[CONFIDENTIAL].**
- **[CONFIDENTIAL].**
- **[CONFIDENTIAL].**
- **[CONFIDENTIAL].**
- **[CONFIDENTIAL].**

Reduced pro-rate costs and removal of double marginalisation

3.63. In their initial application for authorisation, the Applicants stated that the Alliance would create the opportunity for reduced costs for connecting services. In particular it would facilitate more low cost code share inventory, which would enable the parties to offer a more competitive combined fare for connecting services than was possible under an arms-length arrangement. As the MOT noted,[39] the ACCC questioned whether in practice these benefits would be widespread across the Tasman[40] and also questioned the proportion of total Trans Tasman passengers under that Alliance that would purchase onward (complementary) flights beyond current destination points in Australia.

3.64. In their response, the Applicants were able to provide substantive evidence of the large number of connecting fares that would benefit from the Applicants sharing low cost code share inventory with each other. The Applicants submit that the removal of double marginalisation under the Alliance is a direct benefit to Trans Tasman passengers who prefer to travel with one of the Applicants post-Alliance and utilise connections in both New Zealand and Australia beyond the Trans Tasman gateway destinations. Further, the revenue sharing arrangements on the Trans Tasman Sector provides the Applicants with the incentive to offer cheaper fares on connecting flights than would otherwise be the case (e.g., between Air New Zealand and Qantas)[41] to encourage greater revenue on the Trans Tasman Sector.

3.65. Ultimately, the MOT concluded that "it provides scope for the applicants to offer consumers a lower fare on journeys involving connections on each other's services."[42]

3.66. Indeed, as a result of the removal of double marginalisation, the Applicants have been able to pass through these lower costs on connecting services to consumers via lower fares. For example, between the Pre-Alliance Year and Year 1, Air New Zealand sold journeys that included a domestic Australian sector at **[CONFIDENTIAL]** lower fares than in the Pre-Alliance Year. In relation to Virgin Australia, New Zealand connectors are not as significant due to the large number of direct flights to key New Zealand ports. Virgin Australia also did not have an interline arrangement with another competitor prior to the Alliance to compare the pro-rates.

3.67. The wide spread benefit of these lower fares to consumers is reflected in the fact that, between the Pre-Alliance Year and Year 1, Air New Zealand sold an additional **[CONFIDENTIAL]** journeys that included a domestic Australian sector. This also reflects increased connecting fare competition as a result of the Alliance.

3.68. Further information on rates charged to Air New Zealand under the Qantas interline agreement versus the rates charged by Virgin Australia under the Alliance and the impact on fare levels is provided at **Air New Zealand Confidential Annexure J.**

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[39] MOT Determination paragraph 213.

[40] ACCC Draft Determination at 5.155.

[41] ACCC Final Determination at 5.170.

[42] MOT Determination at paragraph 215.

Promotion of competition

3.69. The essence of competition is seeking to win customers away from competitors by providing a service-price offering that the customer prefers to the service-price offering of other competitors. In short, competition is about offering customers a choice.

3.70. Under the Alliance, the Applicants' have been able to achieve this. Customers now have the choice to access an Alliance product with better frequencies, pricing, frequent flyer value and a more integrated network than either airline could have offered alone. This has allowed the Applicants to compete more effectively with the Qantas-Jetstar Group for both leisure and business passengers on the Tasman and throughout Australasia.

3.1 In response to the Applicant's submissions, the ACCC concluded that the Alliance had the potential to confer material public benefits by stimulating competition.[43] The ACCC noted that the Alliance was likely to enhance the Applicants' product and service offering and could lead to lower fares to the extent that cost savings and efficiency gains are passed through to consumers. The ACCC considered that this had the potential to trigger a competitive reaction from the Qantas-Jetstar Group which could lead to better price and service offerings and potentially lower fares for Qantas-Jetstar Group passengers. In turn, the Qantas-Jetstar Group's reaction to the Alliance could stimulate a second round competitive response from the Alliance.[44]

3.71. Since the authorisation of the Alliance the Trans Tasman market has seen frequent and aggressive tactical pricing activity and carrier entry and expansion.

3.72. For example, from January to August 2010 to the same period in 2012, there has been an increase in the total frequency of tactical sales activity on the Auckland-Sydney route. In particular, Qantas, Jetstar and Emirates increased their sales activity over that period. The Auckland–Sydney route is representative of the increased tactical sales activity across other Trans Tasman Sectors due to each airline generally releasing network wide sales.

3.73. Entry and expansion on the Tasman since the Alliance has included the entry of China Airlines onto Auckland-Brisbane in 2011 and its expansion onto Auckland-Sydney in October 2012. Jetstar and Emirates have also expanded their Tasman operations. There have been substantial increases in capacity by Emirates (13.3%), Jetstar (5.2%), LAN Airlines (4.2%) and Qantas (2.1%) on the Tasman from the Pre-Alliance Year to Year 1. Since November 2012, Jetstar has increased capacity further with an additional aircraft to its New Zealand based fleet.

3.74. Qantas and Emirates have also proposed entry into an alliance for broad cooperation across their global networks including the Tasman. The ACCC has issued a draft determination approving this alliance, and the Applicants understand a decision is expected late March 2013. The MOT is still considering its position.

3.2 The ACCC considered that the Alliance would be likely to strengthen Virgin Australia's capacity to contest the business traveller segment of the Trans Tasman market (a key rationale for the Alliance) and enhance the Applicants' prospects of attracting additional corporate and government customers who might otherwise have signed with Qantas. It was further accepted that increased competitive pressure on Qantas in the market for business passengers could benefit Qantas passengers as well.[45]

3.75. The Alliance has enabled Virgin Australia to access more of the corporate market than would otherwise be the case. The Applicants have seen significant growth in corporate revenue as

[43] ACCC Final Determination at 5.213.

[44] ACCC Final Determination at 5.203.

[45] ACCC Final Determination at 5.210 and 5.212-5.213.

a result of the Alliance. Trans Tasman revenue on Air New Zealand code through contracted **[CONFIDENTIAL].**

3.76. The Alliance has enabled the Applicants to retain significant corporate contracts and attract new corporate contracts which might previously have been signed with Qantas. This is due to the greater scope of benefits available to consumers under the Alliance than could be offered by the Applicants on their own.

3.77. Examples of the Alliance's corporate contracts include:

- **[CONFIDENTIAL].**
- **[CONFIDENTIAL].**
- **[CONFIDENTIAL].**
- **[CONFIDENTIAL].**
- **[CONFIDENTIAL].**

3.78. The Alliance has allowed Virgin Australia to quickly and efficiently provide customers with a stronger product offering in competition with the Qantas-Jetstar Group promoting competition for air travel within and to/from Australia and giving Australian travellers the choice of a second international Australian based airline.

3.79. In light of the recent draft approval of the Qantas / Emirates alliance there is an even greater need for reauthorisation of the Alliance so that the Applicants can continue to provide consumers with an alternative competitive offering and continue to exert service and price pressure on Qantas and Emirates.

Stimulation of tourism

3.80. As the Applicants stated in their original application to the MOT, tourism is one of New Zealand's most significant industries, and its success is a matter of national importance for New Zealand. Improved airline services, including through better connections, higher value services and the ability to use frequent flyer points, all available under the Alliance, can increase the attractiveness of New Zealand for Australians when choosing a travel destination.[46]

3.81. Australia continues to be New Zealand's largest source of inbound tourists. For the year to December 2012, 1.117 million travellers to New Zealand, or 45% (up from 44% in the year to Dec 2010) of all international tourists, were Australian. Their spend is accordingly an important source of inbound investment: Australians spent approximately NZ$1.66 billion (down from NZ$1.78bn year to Dec 2010) at an average of NZ$1,500 per trip or NZ$144 per day.[47]

3.82. New Zealand, however, continues to compete against rival destinations. In the year to December 2012 Australian outbound tourists rose by 5.4% whereas Australian tourists travelling to New Zealand only increased by 0.2%.[48] Whilst the Christchurch earthquake had a major impact, the figures nevertheless reinforce the importance of offering Australian outbound tourists a compelling travel proposition, given their willingness to substitute between New Zealand and competing destinations.

[46] MOT Application paragraph 4.5(a).

[47] Ministry of Tourism *Key Tourism Statistics*, Year Ending Sept 2012.

[48] Australian Bureau of Statistics – Overseas Arrivals and Departures Dec 2012. Table 9 Short Term Movement, Resident Departures – Main Destinations: Original.

3.83. This is why the greater online connectivity under the Alliance is so important.

Stimulation of tourism through an enhanced product and service offering and increased passenger traffic

3.84. As previously discussed, the Alliance has resulted in increased passenger traffic on Alliance services and increased online connections.

3.85. The Alliance has and will continue to allow for increased short haul tourism and long haul dual destination tourism.

3.86. An important characteristic of long haul international tourists to Australia is their propensity to take the opportunity to visit other destinations at the same time. In order to attract dual destination travel it is important to be able to offer extensive domestic Australian and New Zealand networks.

3.87. The Alliance has these characteristics and both partners are committed to development of fare products which support these objectives. Such products are technically possible following Virgin Australia's migration to SabreSonic and the Rivera revenue accounting platform. Prior to migration, Virgin Australia did not have the ability to support settlement of such itineraries and the development of these products was challenging, due to IT incompatibilities.

Joint marketing

3.88. Both Applicants have relationships with Tourism New Zealand (**TNZ**) and regional New Zealand tourism organisations. Together they support the Alliance network by ensuring that both airlines maximise airtime within TNZ activity.

3.89. Each financial year the Alliance undertakes joint promotional activity in New Zealand and Australia. Examples of these marketing initiatives are provided at **Annexure G**.

3.90. The Alliance's ability to jointly host familiarisation groups[49] and media has expanded these marketing arrangements so that new, non-gateway destinations can now be showcased to the consumer. For example, in September 2012 the Alliance undertook a joint marketing venture with Tourism Western Australia for Broome. Air New Zealand transported a familiarisation group to Perth while Virgin Australia carried them from Perth to Broome.

3.91. Another example of a joint marketing endeavour made possible under the Alliance was the Seniors Card promotion with AAT Kings & Tourism Tasmania. The prize-winners were awarded a ticket from New Zealand to Hobart; Air New Zealand carried passengers across the Tasman while Virgin Australia carried passengers to Hobart.

3.92. The Alliance has also enabled the Applicants to more efficiently use their marketing spend and increase their scope of destination promoting activity. Further details of New Zealand and Australia point of sale promotions are set out at Confidential Annexure G.

3.93. Examples of marketing investment by the Applicants are the "Just 3 hours away" winter campaigns in 2011 and 2012 and "The Kiwi Sceptics" campaigns in 2012. The work has gained considerable attention in Australia, with Kiwi Sceptics recognised globally in creative awards, and indications that consideration of New Zealand, Air New Zealand and Virgin Australia has grown as a result.

3.94. The Alliance actively works with TNZ to promote and stimulate tourism to New Zealand. The Alliance advises TNZ of all planned sales so that it is easy for TNZ to leverage off the tactical

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[49] The purpose of a familiarisation group is to take trade agents, product/marketing managers away to experience new destinations.

fares the Alliance has on offer and promote New Zealand to the travelling public. As an Alliance Air New Zealand and Virgin Australia are able to provide TNZ with greater opportunity to promote New Zealand due to the strength and reach of the combined Alliance network.

3.95. Since the implementation of the Alliance, the Applicants have been able to utilise their marketing spend for the Trans Tasman more efficiently than was possible prior to the Alliance.

Joint promotion of the Alliance

3.96. Through the Joint Sales Team, the Applicants have conducted regular coordinated marketing campaigns to stimulate travel on the Trans Tasman and educate the public about the Alliance. Specific Joint awareness campaigns which have been undertaken in 2011 and 2012 are set out at **Annexure G**.

3.97. In addition to the joint awareness activity, the Alliance has been to market 3 times with specific Alliance retail campaigns. The “Bromance Sale” was in market in 2 bursts in 2011 to celebrate the launch of the Alliance and the “Friends with benefits” sale in 2012 to leverage the 1 year anniversary of the partnership. The campaigns included a tactical offer and key messaging reinforced the consumer benefits of better flight times and reciprocal loyalty rewards.

3.98. In relation to general retail marketing, since authorisation the Applicants have conducted a minimum of 1 proactive retail marketing campaign per month. For the second half of the 2012 financial year there were up to 2 proactive retail campaigns per month. These campaigns have been promoted on television, press, online and electronic mail.

3.99. A sample of the campaigns is set out in **Annexure G**.

3.100. In addition to the specific Trans Tasman campaigns, the Alliance is also involved in regular retail campaigns. This includes Alliance awareness messaging. For example, in electronic mail outs to loyalty program members, Alliance messaging is included. The Alliance has also produced an “Alliance brochure” to assist the travel agent trade to sell the Alliance and identify the product offerings of each airline.

Improved distribution channels

3.101. The implementation of codesharing across each other’s Network Alliance Routes has greatly expanded the availability of inventory through various distribution channels. Before implementing the Alliance, Air New Zealand and Virgin Australia both had distribution strength in differing channels. Air New Zealand had a strong presence across indirect channels (particularly through GDS channels) as well as in the online space, with a stronger presence in New Zealand regions. Conversely, Virgin Australia had a stronger presence within Australia, and a strong presence through direct channels and non-GDS direct channels using bespoke business interfaces (such as API). Such interfaces are preferred by many large travel retailers within Australia, and are favoured due to lower transaction costs.

3.102. The recent Virgin Australia migration to the SabreSonic and Rivera revenue accounting platform has removed the reporting limitations that were inherent in Virgin Australia’s previous reservation platform and will allow for greater and easier alignment of reporting enhancing the ability of the Alliance parties to more effectively cooperate in sales and distribution.

4. No Adverse Price Impact on Consumers

4.1. The Applicants consider that the Alliance has not given rise to adverse price or quality impacts on consumers. The Alliance has promoted competition, and will continue to do so.

MOT assessment

4.2. The MOT assessed that:

- The Alliance would provide Air NZ a domestic presence in Australia, and would provide Virgin Australia with an increased presence on Trans Tasman routes, and a renewed presence in domestic New Zealand, which would enable the Applicants to more effectively compete with the Qantas Group.[50]

- There was potential for additional capacity / frequency by existing operators, particularly Qantas / Jetstar and Emirates.[51]

Impact of the Alliance on competition

More effective competitor as an Alliance than Applicants would be independently

4.3. The Alliance has not and will not (following reauthorisation) result in any adverse impact on consumers on the Trans Tasman air passenger market or on any individual route. The Alliance has enabled the Applicants to become a more effective competitor than the Applicants could by acting independently. Rather than decreasing the quality of its service offering, the Alliance has provided an improved service offering that consumers value. This improved service offering would not have been achievable without the authorisation and has increased passenger traffic onto Alliance services. The Alliance has led to a reduction in the combined average fares of the Applicants and, the Applicants have not reduced or withheld capacity in an anti-competitive way on the Tasman or any individual Trans Tasman route. Nor do the structure or commercial objectives of the Alliance provide the incentives to do this in the future.

4.4. The core rationale of the Alliance was always to increase the number of passengers travelling on the Applicants' combined services through the development of a second integrated Australasian network with enhanced services. The Alliance was designed to ensure that each Applicant has the incentive to achieve this commercial objective for the Alliance as a whole and as a result there has not been an incentive to remove capacity or increase prices in an anti-competitive way. In fact, as a result of the increased passenger numbers generated by the Alliance, the Applicants have been incentivised to increase capacity and fill that capacity by continuing to compete strongly on product and price.

Alliance capacity

4.5. Trans Tasman Alliance capacity has grown by 5% from the Pre-Alliance Year to Year 1. On non-Christchurch routes Alliance capacity grew by 10.1% over the same time period. With the exception of the Christchurch routes, which suffered depressed demand as a result of the earthquake and aftershocks, and the Hamilton routes, from which unprofitable services were withdrawn, Alliance capacity increased on all routes over this time period. An analysis of capacity growth on Alliance services is provided at **Confidential Annexure E**.

4.6. In addition to the 5% additional capacity added by the Alliance, the Applicants also had access to the excess capacity Virgin Australia had in the market prior to authorisation. From Pre-Alliance Year to Year 1 Virgin Australia's average load factor has grown from **[CONFIDENTIAL]** to **[CONFIDENTIAL].**

Alliance fares

4.7. Across Trans Tasman routes, combined Alliance average fares have decreased overall by **[CONFIDENTIAL]** from the Pre-Alliance Year to Year 1. Average fares are nominal figures (in that they are not adjusted for CPI / inflation) consequently the real decrease would be

[50] MOT Determination paragraph 18.

[51] Mot Determination paragraph 241.

even more significant. An analysis of average fares under the Alliance is provided at **Confidential Annexure H**.

4.8. The metal neutral nature of the Alliance has resulted in differential fare changes for Virgin Australia and Air New Zealand, as the average fare levels of each carrier move to alignment to coincide with the alignment of products and sales.

4.9. As a result of the Alliance, Virgin Australia has been able to provide an improved product and network offering. This has allowed Virgin Australia to attract higher yielding passengers which was one of commercial objectives behind the Alliance. Consequently, Virgin Australia's fare class mix has been altered and since the implementation of the Alliance, the overall Tasman average fare of Virgin Australia has increased. At the same time, under the Alliance, the average fare for Air New Zealand over Trans Tasman routes fell by **[CONFIDENTIAL].**

4.10. Virgin Australia's ability to achieve an increase in average fares on the Tasman and on certain routes is also a function of other factors which are dealt with in more detail below, including:

- network changes or the operation of a different schedule under the Alliance;
- the sale of the full range of Air New Zealand's product types on flights operated by Virgin Australia;
- fuel cost increases; and
- the ability to sell higher fare inventory, where increased demand (as reflected in higher load ratios) has allowed Virgin Australia to sell additional seats at fares that it would not otherwise have sold.

4.11. To optimise the total network offering under the Alliance, Virgin Australia's network schedule has changed. Virgin Australia has rebalanced the services it operates (resulting in operational efficiencies). The rebalance of Virgin Australia's services has resulted in increased Virgin Australia capacity on routes which tend to have higher fares due to the particular route characteristics such as the thin seasonal route of Brisbane-Queenstown and decreased Virgin Australia capacity (but not total Alliance capacity) on routes which tend to have lower fare levels such as Auckland-Sydney. The Applicants estimate that this factor is responsible for around half of the increase in Virgin Australia's total average fare.

4.12. Prior to the Alliance, Virgin Australia only sold saver fares, and not an all inclusive fare. Under the Alliance, Air New Zealand has been able to offer the full range of product types on Virgin Australia operated flights. This has meant that Virgin Australia have carried more full service customers who pay higher fares for the additional service inclusions. In Year 1, Air New Zealand sold **[CONFIDENTIAL]** Works customers out of Virgin Australia's total of **[CONFIDENTIAL]** customers. This equates to around a quarter of the increase in the Tasman average fare for Virgin Australia.

4.13. Auckland-Coolangatta and Auckland-Melbourne, as with other routes, were affected by fuel cost increases. Although Virgin Australia's average fare increased on these sectors, Virgin Australia's relative average fare is now in-line with the Tasman average, whilst in the Pre-Alliance Year their average fares on these sectors were below the average.

4.14. However, as previously discussed, the Alliance has also enabled opportunities for lower fare levels. For example, reduced pro-rate costs and the cost reduction from the removal of double marginalisation have been passed through to consumers on connecting services in the form of lower fare levels. In Year 1, Air New Zealand sold journeys that included a domestic Australian sector at **[CONFIDENTIAL]** lower fares than in the Pre-Alliance Year.

4.15. Under the Alliance, there has been no anti-competitive adverse impact on overall fare levels or the availability of fares in lower classes. In fact, as demonstrated in Figure 7 below, the volumes of lead-in and sale fares sold on Virgin Australia operated flights have increased between the Pre-Alliance Year and Year 1 by **[CONFIDENTIAL]**. As a proportion of Virgin Australia's total customers, this represents an increase from **[CONFIDENTIAL]** to **[CONFIDENTIAL]**.

Figure 7 Lead-in and sales fare volumes on Virgin Australia operated flights

[CONFIDENTIAL]

4.16. As shown in Figure 8 below, between the Pre-Alliance Year and Year 1, Trans Tasman flights operated by Air New Zealand carried **[CONFIDENTIAL]** more customers paying lead-in or sales fares. As a proportion of Air New Zealand's total customers, this has reduced but not in a material way.

Figure 8 Lead-in and sales fare volumes on Air New Zealand operated flights

[CONFIDENTIAL]

Competitive constraint imposed by other carriers

4.17. The Tasman is a highly competitive market characterised by substantial capacity and strong fare competition. The Alliance faces, and will continue to face, strong competition on the Tasman in the form of new entry and expansion as well as the expansion of existing carriers, including on the individual routes subject to the Conditions. Since the implementation of the Alliance, there has been entry and expansion on both the Auckland-Brisbane route (by China Airlines) and the Queenstown-Sydney route (by Jetstar). There have also been substantial increases in capacity by Emirates (13.3%), Jetstar (5.2%), LAN Airlines (4.2%) and Qantas (2.1%) on the Tasman from the Pre-Alliance Year to Year 1.

4.18. Further information on the competitive constraint imposed by other carriers on a route by route basis is provided at **Annexure I**.

No adverse impact on the Tasman or any city pair

4.19. As discussed in detail above, the Alliance has not, and if reauthorised will not, result in any adverse impact on the Tasman as a whole or any individual route. Competitive constraints are such that this will continue to be the case.

4.20. A route by route break down of Alliance average fares has been provided in **Confidential Annexure H** and an analysis of the competitive dynamics on specific routes is provided in **Annexure I**.

5. Operation of the capacity conditions

Background to the capacity conditions

5.1. The Capacity Implementation Agreement dated 21 December 2010 between the Applicants in relation to the Conditions, was authorised by the Minister under s88.

5.2. Broadly speaking, the Conditions require the Applicants to maintain a base level of capacity on the Trans Tasman as a whole and grow seasonally on individually identified routes (service to/from Wellington, Queenstown-Sydney, and Brisbane-Dunedin) in line with the greater of the most recent economic growth or growth in Trans Tasman passenger demand for the term of the authorisation.

5.3. There is also a requirement that the Applicants provide to the MOT:

- a report on total seat capacity made available on each Trans Tasman sector for each scheduling season and each annual period; and
- an independently audited report confirming their compliance with the Conditions as applied by the ACCC within 25 business days of the end of each scheduling season.

5.4. The Applicants considered that the Alliance would result in compelling public benefits. Although the Applicants were confident that the Alliance would lead to passenger stimulation and strong price and service competition on the Tasman such that the Applicants would not have the ability or the incentive to unilaterally raise prices or reduce capacity on the Tasman, or on any individual route, the Applicants proposed the capacity conditions to the ACCC in order to address any concerns, and entered into the Alliance Capacity Implementation Agreement, which the MOT authorised separately.

5.5. The MOT stated that the Alliance Capacity Implementation Agreement increased its confidence that the benefits put forward would be realised.[52] The ACCC accepted the Conditions 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. (It should be noted that the MOT did not share the ACCC's concerns in relation to Auckland-Brisbane, with that route only forming part of the Alliance Capacity Implementation Agreement by reference to any conditions imposed by the ACCC.)

5.6. The Alliance has now been operational for approximately 18 months. Even in this short period of time, it is clear that the Alliance has resulted in compelling public benefits and that there have been strong competitive responses to the Alliance and new entry and expansion, including on the individual routes subject to the Conditions. The competitive response to the Alliance and the experience of the Alliance's implementation to date demonstrate that there is no ongoing requirement for capacity conditions. As such, the Applicants submit that the Alliance should be reauthorized without any capacity conditions.

The Alliance has not and will not result in any route-specific anti-competitive effects

5.7. In the Applicants original submission, and in the subsequent submissions made to the MOT and ACCC following the ACCC Draft Determination, the Applicants provided a detailed analysis of the competitive conditions on specific Trans Tasman routes. In its Draft Determination, the ACCC expressed concern, to varying degrees, in respect of specific identified routes. These routes were subsequently the subject of the Conditions. The responding submission addressed in detail the route specific competitive dynamics on the Condition routes, Auckland-Brisbane, Brisbane-Dunedin, Brisbane-Wellington, Melbourne-Wellington, Sydney-Wellington and Sydney-Queenstown. The analysis of route specific competitive conditions has been updated at **Annexure I**.

5.8. In addition to the presence of FFCs, the Applicant's responding submission to the ACCC Draft Determination identified the presence of Jetstar and Qantas on the Condition routes, or at least as operating into each of the airports on the Condition routes, and the lack of constraint on their ability to switch or expand capacity onto the identified routes as enough, in and of itself, to provide sufficient constraint on the Applicants. It was anticipated that Jetstar in particular would respond to the competitive threat represented by the Alliance through increased capacity. Since the implementation of the Alliance, there has been entry, expansion and exit of FFCs on the Trans Tasman and Jetstar and Qantas have expanded capacity by 5.2% and 2.1% respectively, notwithstanding the difficult market conditions.

5.9. In particular, the Applicants note that:

[52] MOT Determination, paragraph 327.

- China Airlines have commenced services on Auckland-Brisbane and there is potential for further FFC entry on this and other Trans Tasman routes;
- total and competitor capacity on Auckland-Brisbane has increased substantially between the Pre-Alliance Year and Year 1;
- Auckland-Coolangatta is a substitutable route should the Applicants increase prices or decrease capacity on Auckland-Brisbane;
- Jetstar has demonstrated its ability to move quickly to deploy capacity in response to market opportunities. In the one year period from the Pre-Alliance Year to Year 0, Jetstar increased capacity by 16.7%. As a result, any anti-competitive behaviour by the Alliance would only encourage Jetstar's entry;
- Jetstar has commenced services on Queenstown-Sydney since authorisation;
- Jetstar also boosted flights from Australia to Queenstown including Queenstown-Sydney when it increased its New Zealand based fleet from 8 to 9 Airbus 320 aircraft from 15 November 2012;[53] and
- on each of the Condition routes, there has been a reduction in the combined Alliance average fare (with the exception of Sydney-Wellington where the average fare increased by **[CONFIDENTIAL]**)[54] from the end of the Pre-Alliance Year to the end of Year 1.

5.10. The experience to date under the Alliance supports the Applicants' submission that there is unlikely to be any adverse competitive effects on any Trans Tasman routes.

The Conditions are distortive and costly to both the Applicants and consumers

5.11. Since the authorisation came into effect, the Applicants have complied diligently with the Conditions. This compliance has been confirmed by the independent compliance audit reports that have been provided to the ACCC. The external audit services to monitor compliance with the Conditions are currently costing the Alliance in excess of **[CONFIDENTIAL]** per annum.

5.12. The Conditions effectively set an output floor for the Alliance on the Trans Tasman as a whole and on an escalating basis for particular routes. As such, the Applicants are concerned that the Conditions have the potential to create significant distortions and inefficiencies in the provision of Trans Tasman air passenger services which may not only result in compliance costs for the Applicants but in fact be to the detriment of consumers.

5.13. The Conditions reduce the ability of the Applicants to respond flexibly to adjust supply (i.e. capacity) to demand because the Conditions artificially allocate capacity on the basis of a rigid formula that was determined in December 2010. This rigidity and artificial distortion to the dynamic air passenger services market comes at a cost.

5.14. For example, as a result of the February 2011 Christchurch earthquake, the Applicants experienced a material fall in demand for travel to/from Christchurch. Due to the Conditions the Applicants were unable to fully react to this change in market conditions until a variation to compliance with the Conditions was granted by the ACCC on 27 July 2011 and by the MOT on 2 August 2011. This approval was obtained almost 6 months after the Christchurch earthquake. The long booking curve (up to 12 months) on the Tasman meant that even after the Conditions were varied it was difficult to adjust capacity as required. This lack of flexibility resulted in the Applicants operating sub-optimal capacity over this period and additional

[53] "Jetstar spreads its wings in New Zealand" available at: http://www.jetstar.com/mediacentre/latest-announcements/detail?Id=dda88062-1400-4919-a992-260fc926dc5b&language=en

[54] The increased average fare on this route was due to the exceptionally high demand from the Rugby World Cup 2011.

passenger disruption as adjustments to capacity were made later in the booking curve than desired.

5.15. During the short operation of the Alliance, the Applicants have had to apply to the MOT and ACCC three times for variation to the Conditions in response to exceptional circumstances:

- The application to the MOT on 7 June 2011 to vary compliance with the Conditions as a result of the February 2011 earthquakes in Christchurch, New Zealand for NS11, and NW11 scheduling seasons. The ACCC made the corresponding variation on 27 July 2011.

- The application on 1 July 2011 to further vary compliance with the Conditions as a result of the June 2011 Chilean volcanic ash cloud activity over New Zealand and Australia. The ACCC made the corresponding variation on 4 August 2011.

- The application on 18 May 2012 to vary compliance with the Conditions as a result of the continued impact of the February 2011 Christchurch earthquakes and aftershocks. The ACCC made the corresponding variation on 31 May 2012.

5.16. Considerable management time and external legal fees were also required to prepare and submit these requests for variation, and no doubt significant cost and resources were also invested by the MOT and ACCC to consider and promptly respond to these requests.

5.17. There have been several other examples of market distortions caused by the application of the Conditions. For instance, during the NS11 season the Applicants experienced a higher level of operational (e.g. weather, engineering) cancellations than expected on the Brisbane-Wellington and Sydney-Wellington routes. As a consequence, the Applicants were obliged to add last minute capacity on these sectors to meet the Conditions. While the Applicants did everything possible to ensure the additional capacity was added at attractive timings for the public, the last minute nature of this capacity meant that the flights were added at times when additional capacity was not needed. The short lead time meant the flights took off with low seat factors. When combined with lower than average fare levels the revenue for these flights was insufficient to cover costs.

5.18. **[CONFIDENTIAL]**.

5.19. **[CONFIDENTIAL]**.

5.20. The Conditions also constrain the Applicants' ability to make efficient fleet and network planning decisions. For example, when considering the new route of Auckland-Sunshine Coast the Applicants were very mindful that this service would attract passengers who would otherwise fly to Brisbane and drive to the Sunshine Coast. With this traffic likely to divert from the Brisbane service to the Sunshine Coast service, the network planning teams would ordinarily look to whether some capacity should be redeployed from Brisbane to service the Sunshine Coast route. The net result in terms of matching capacity to demand would be neutral, but the Sunshine Coast bound passengers would be better off as they would be offered a direct service to their destination rather than having to drive to the Sunshine Coast from Brisbane and the new service would stimulate tourism. Despite these clear consumer benefits, compliance with the Conditions on the Auckland-Brisbane route meant that the Applicants were constrained by the Conditions which could have prevented the Applicants from choosing the best outcome for the market and the customer. Further, if it were not for **[CONFIDENTIAL]** which offset this effect, the Applicants would not have launched this new service.

5.21. **[CONFIDENTIAL]**.

5.22. Furthermore, the Conditions could also have the unintended consequence of making entry or expansion more difficult. The Tasman air passenger services market is characterised by a history of substantial capacity relative to passenger numbers. Under the Conditions, the Alliance cannot reduce its capacity (and must grow capacity over time) regardless of whether there is excess capacity on condition routes. This regulated capacity is likely to discourage new entrants and make new entry more difficult. The ACCC acknowledged this in its recent draft determination on the proposed Qantas/ Emirates alliance.[55] This distortion would be exacerbated if the Qantas-Emirates alliance is approved and conditions are placed on approximately 95% of Tasman routes.

5.23. Further distortive effects are likely to be caused by competitor and supplier knowledge of the Applicants' obligation to operate according to a rigid, formula-driven, capacity floor per scheduling season. Specifically, the Conditions will influence the capacity deployment and pricing decisions of competitors as well as negotiations surrounding supplier charges (e.g., airport aeronautical charges). The Conditions create an environment where suppliers, including airports can raise prices, knowing that the relevant airlines are unable to adjust capacity.

5.24. The issue described above are ultimately is detrimental to consumers as it forces the Applicants to either pass on these additional costs or absorb them into their cost base. If costs are passed on the price of air travel rises and demand decreases. If the costs are absorbed without reducing capacity, either returns are lower or the Applicants must raise prices in other markets to compensate.

The Alliance is in the public interest without any need for Conditions

5.25. The MOT and the ACCC have now had the opportunity to observe the effect of the Alliance and the impact of the Conditions. The Conditions were introduced to address any concern at the time of authorisation that the detriments/benefits might be finely balanced.

5.26. Short term or initial capacity conditions may be justifiable in cases which are finely balanced. However, the Alliance has clearly demonstrated that it has resulted in net public benefits and as discussed above, reauthorisation will result in further and deeper benefits from the Alliance without any material public detriment, including on any individual route. It cannot be considered that the public benefits and detriments from the Alliance are finely balanced. It is submitted that the Alliance experience of the past two years should address any concerns which existed at the time of the initial authorisation.

5.27. The core rationale of the Alliance is to stimulate passengers on Alliance services. It has been structured in a way to incentivise capacity growth, not capacity reduction, and the Alliance has triggered significant increases in passenger numbers on Alliance services through its enhanced product offering. The combined Alliance average fares have decreased and there has been no anti-competitive reduction in capacity on any Trans Tasman route. In particular, the competitive dynamics on the Condition routes are such as to remove any need for the Conditions.

5.28. The Applicants submit that the Conditions are no longer justified because they are unnecessary to satisfy any concern as to adverse consumer impact, and, they also create market distortions, inflexibility, inefficiency in allocation of resources and therefore result in unnecessary costs being incurred by the Applicants, the regulators and consumers.

6. The Authorisation sought and no legal reasons for the Minister refusing to authorise the Alliance

The Authorisation Sought

6.1. The Minister's discretion to authorise the Alliance is provided for in section 88(2) of the CAA. The Applicants believe the Alliance meets the test for authorisation and the Minister should

[55] QF/Emirates Determination at para 478, p100.

exercise his discretion to reauthorise the Alliance pursuant to s.88 of the CAA whereby, the Applicants will give effect to the Alliance:

- until a date at least five years from 31 December 2013; and
- without the renewal of the capacity commitments contained in the Alliance Capacity Implementation Agreement beyond 31 December 2013, or the implementation of any other capacity commitments.

No Legal Reasons for the Minister Refusing to Authorise the Alliance

6.2. Sections 88(3) and (4) of the CAA provide specific reasons for the Minister to decline to authorise, although they are subject to an override in section 88(5) if the Minister believes that to decline authorisation would have an undesirable effect on international comity. For the reasons discussed below:

- none of the reasons set out in sections 88(3) and (4) apply in respect of the Alliance; and
- furthermore, declining authorisation would have an undesirable effect on international comity between New Zealand and Australia and accordingly, section 88(5) provides a distinct reason for the Minister to exercise his discretion in favour of authorising the Alliance.

6.3. The MOT Determination accepted that "the agreements do not fall foul of any of the prohibitions set out in sections 88(3) and 88(4) of the CAA. Thus the agreements are capable of authorisation under the Civil Aviation Act."

No infringement of section 88(3)

6.4. Nothing has occurred in the period since authorisation which should cause the MOT to depart from its earlier view that "Authorisation will not prejudice compliance with any relevant international convention, agreement, or arrangement to which the Government of New Zealand is a party."[56]

No infringement of section 88(4)

No infringement of section 88(4)(a)

6.5. As noted in paragraph 110 of the MOT Determination, the "Agreements do not contain any provisions that provide for enforcement through fines or market pressures." This remains the case.

No infringement of section 88(4)(b)

6.6. The Applicants understand it remains the case that the only commission regimes issued by the Minister which are currently in force under section 89 of the CAA are the Civil Aviation (Passenger Agents' Commission Regime) Notice 1983 and the Civil Aviation (Cargo Agents' Commission Regime) Notice 1983. In addition, it remains the case that the Alliance provides increased opportunities to sell New Zealand code-share flights across the Virgin Australia network. Accordingly, the MOT's earlier conclusion that there is no breach of s88(4)(b) remains correct.

[56] MOT Determination, paragraph 109.

No infringement of section 88(4)(c)

6.7. As noted in the MOT Determination (at paragraph 114), “The Agreements do not contain any provisions that unjustifiably discriminate between consumers in terms of this paragraph.” This remains the case.

6.8. More generally, the Alliance is likely to enhance the availability of competitive fares on the Tasman. For reasons set out in Section 3 above, the Alliance has, and will continue to improve outcomes for consumers of international air services as it has and will continue to provide:

- enhanced products and services, including improved network connections and frequency of online services (and is also expected to result in additional physical frequencies to some destinations);
- lower cost inventory, through the provision of attractive rates on connecting domestic sectors in New Zealand and Australia and higher load factors, with lower cost per seat sold;
- increased efficiencies;
- additional frequency and capacity; and
- promotion of competition on the Tasman and in Australasia more generally.

6.9. At present, consumers have wide access to competitive fares from Air New Zealand, Virgin Australia, Qantas, Jetstar, Emirates and the other competitors on the Tasman. In that context, neither Applicant can be said to unjustifiably discriminate between consumers of international air services in the access they have to competitive tariffs:

- today, the Applicants set fares having regard to existing and potential competition from other carriers on all routes on which they operate, i.e., they set “competitive fares”; and
- each Applicant makes those fares widely available – distribution strategies are determined having regard to existing and potential competition, and the costs and benefits of various distribution channels.

6.10. While the Alliance removes competition between Air New Zealand and Virgin, they will continue to face competitive pressure from other competitors and destinations, and hence will continue to offer competitive fares. The Applicants will have no greater ability (or incentive) to discriminate between consumers in the access those consumers have to competitive tariffs. To the contrary, consumers are more likely to have greater access under the Alliance:

- the Applicants will continue to set fares having regard to existing and potential competition from other carriers on all routes on which they operate;
- the Applicants will continue to make those fares widely available – their distribution strategy will be determined having regard to existing and potential competition, and the costs and benefits of various distribution channels. Indeed, rather than restricting access, the Alliance have and will continue to enhance the availability of fares for travel on the Tasman as the Applicants will continue to coordinate their marketing and sales activities on the Trans Tasman Sectors;
- a larger inventory of seats in the lower booking classes has and will continue to make available under the Alliance; and
- accordingly, neither the Alliance viewed as a whole nor any other provision of the Alliance will undermine consumers’ wide access to competitive fares either from the Applicants or their competitors on the Tasman. Indeed, the opposite is the case.

No infringement of section 88(4)(d)

6.11. Nothing has occurred in the period since authorisation which should cause the MOT to depart from its earlier view that "The Agreements do not impact on the right or ability of any other operating carrier, or code-share partner of another operating carrier, to enter and put tariffs in the market"[57] and that, "in relation to tariffs, the Agreements do not have the effect of excluding any supplier of international carriage by air from participating in the market to which they relate."[58]

No infringement of section 88(4)(e)

6.12. Again, nothing has occurred in the period since authorisation which should cause the MOT to depart from its view that the agreements do not contain any provision which has the purpose or effect of preventing any party from seeking approval, in terms of section 90 of this Act, for the purpose of selling international carriage by air at any other tariff so approved."

No infringement of section 88(4)(f)

6.13. The MOT Determination noted that the "The Agreements do not contain any provisions that prevent any party from withdrawing without penalty on reasonable notice from the contract, arrangement, or understanding",[59] noting, among other factors, the integrated nature of the alliance. The Applicants believe this conclusion remains correct and thus s88(4)(e) does not give rise to a reason for declining authorisation.

International comity

6.14. The Applicants note the MOT's conclusion in relation to whether declining authorisation would have an undesirable effect on international comity at paragraph 148, although they respectfully disagree. The Applicants remain of the view that declining authorisation would have an undesirable effect on international comity between New Zealand and Australia and as a result, international comity provides a distinct reason for the Minister to exercise his discretion in favour of authorising the Alliance.

7. Period during which to give effect to the Alliance

7.1. An initial expiry date of 31 December 2013 was put in place by the ACCC, and the Alliance Capacity Implementation Agreement records the Applicants' agreement that they will cease to give effect to the Alliance beyond 31 December 2013. This allowed the opportunity for early review of Alliance outcomes.

7.2. As set out above, in the two years since the authorisation came into effect, the Alliance has delivered substantial public benefits and has not resulted in any adverse consumer impact on the Tasman as a whole or on any individual route. These public benefits will continue to increase in scope and substance, and it is likely that additional public benefits will become available, if the Alliance is reauthorised.

7.3. As a result, the Applicants are seeking authorisation to give effect to the Alliance until a date at least five years from 31 December 2013.

Implementation costs

7.4. In addition, the Applicants have incurred substantial costs in establishing and implementing the Alliance. Reauthorisation is not only required to continue the expansion of public benefits but also to realise the financial benefits of this investment. The combined costs of

[57] MOT Determination, paragraph 119.

[58] MOT Determination, paragraph 121.

[59] MOT Determination, paragraph 139.

establishing the Alliance, including the costs of negotiating and documenting the Alliance and of obtaining authorisation in New Zealand and Australia, have already amounted to over **[CONFIDENTIAL]**. This does not include the considerable internal resources dedicated to drafting the submissions required for the authorisation process and compliance process and the Alliance agreements. To complete those tasks, internal resources have been engaged over a period of more than 12 months.

7.5. Since the implementation of the Alliance, each of Air New Zealand and Virgin Australia has incurred substantial capital and operational costs in moving to fully establish the Alliance. This has included process design, training, and issue resolution across all areas of each operation in order to establish business as usual processes. Affected operational areas include web site teams, contact centres, trade support teams, airport teams, cabin crew, guest relation, revenue and network management, sales and finance.

7.6. Air New Zealand has spent **[CONFIDENTIAL]** implementing the Alliance and has recently spent a further **[CONFIDENTIAL]** on system changes in connection with Virgin Australia's move to SabreSonic. The **[CONFIDENTIAL]** comprises of capital expenditure on IT systems for Loyalty **[CONFIDENTIAL]** (**[CONFIDENTIAL]**), reservation system integration (**[CONFIDENTIAL]**), sales and distribution channels (**[CONFIDENTIAL]**), airports (**[CONFIDENTIAL]**) and approximately **[CONFIDENTIAL]** on additional set up costs.

7.7. Virgin Australia's capitalised information technology costs in implementing the Alliance to date are approximately **[CONFIDENTIAL]**. Virgin Australia would not have incurred these costs absent the Alliance. In addition, Virgin Australia has incurred internal resourcing costs involving design and implementation of new Alliance processes of **[CONFIDENTIAL]** as well as other Alliance implementation costs.

8. Counterfactual

8.1. The Applicants require reauthorisation in order to continue to realise and expand on the public benefits set out above.

8.2. If reauthorisation were not granted, the Applicants would immediately take steps to unwind the Alliance. In particular, each Applicant would:

- remove its code from the other's services and terminate or renegotiate the interline pricing for access to its domestic network;
- review its network with a view to adjusting capacity where necessary to reflect the likely reduced demand due to the loss of connectivity and distribution provided by their former Alliance partner;
- retime services to maximise load factors on its own services even though that may result in wingtip flying with their former Alliance partner;
- take steps to secure access to slots that were surrendered during the term of the Alliance;
- terminate their former Alliance partner's access to its lounges; and
- renegotiate access to reciprocal frequent flyer benefits with their former Alliance partner. This would involve less favourable commercial terms which would impact the overall benefit to consumers.

8.3. While there may be opportunities for limited cooperation to continue (such as limited interline and disrupt arrangements) the incentive to cooperate in any significant way would be lost as each party reverts to protecting the financial performance of its own Tasman services.

Consequently the pro-rate pricing, access to inventory and terms of any such co-operation without the Alliance would be much less favourable than under the Alliance.

8.4. Air New Zealand passengers would immediately lose codeshare connectivity to domestic Australia and accordingly would remain at a competitive disadvantage to the Qantas-Jetstar Group in competing for passengers requiring access to or from points behind the main Australian gateways. Virgin Australia passengers would immediately lose access to the frequencies and choice on the Tasman that they enjoyed through the Alliance as well as codeshare connectivity to domestic New Zealand. Passengers from both airlines would suffer a reduction in their lounge and frequent flyer benefits.

8.5. The termination of the Alliance would make it significantly more difficult for Virgin Australia to compete with the Qantas-Jetstar Group for corporate and government accounts, as high frequencies on the Trans Tasman along with lounge networks and the ability to earn and burn frequent flyer points over a broad network is important to Australian and New Zealand business travellers. Under this scenario, the Qantas-Jetstar Group would revert to being the only market participant able to offer a comprehensive Australian and Tasman network which serves both the high yield or corporate passengers as well as the low cost leisure traveller. If the Qantas alliance with Emirates is also given final approval in relation to the Tasman this situation will become even worse for the Applicants.

8.6. In addition each airline would also face significant write-off of capital expenditure, due to the large investment made by each airline in implementing the Alliance.

9. Conclusion

9.1 For the reasons set out in this Application, the Applicants submit that the Minister should exercise his discretion to re-authorise the Alliance on terms set out at paragraph 6.1 above, because:

- the Alliance is capable of authorisation by the Minister under section 88 of the CAA;
- the Alliance has resulted in, and will continue to result in significant and substantiated public benefits to New Zealand;
- there has been and will continue to be no adverse impact on consumers from the removal of direct competition between Air New Zealand and Virgin Australia on the Tasman – indeed, on the contrary, the Alliance will have pro-competitive effects and will be beneficial for consumers; and
- the Alliance does not breach any of the provisions in section 88 of the CAA which limit the Minister's discretion to grant an authorisation.

Glossary

ACCC Final Determination	means the ACCC's report in respect of its authorisation of the Alliance dated 16 December 2010
ACCC Draft Determination	means the ACCC's draft report in respect of its authorisation of the Alliance dated 10 September 2010
ADL	means Adelaide Airport
AKL	means Auckland Airport
Applicants	means Air New Zealand and Virgin Australia
BITRE	means Bureau of Infrastructure, Transport and Regional Economics
BNE	means Brisbane Airport
CHC	means Christchurch International Airport
City pair	means two cities connected by a direct flight or connecting flights.
CNS	means Cairns Airport
Code sharing	means a special kind of interline arrangement whereby one airline's designator code is assigned to a flight operated by another airline
Customer Facing Products and Systems	include, but are not limited to: conditions of carriage, fare names, fare inclusions, fare rules (e.g., cancellations and refunds), non airfare charges (e.g., card payment fees), check-in processes, baggage handling processes, on board announcements, on board products, on board food and beverage, in-flight entertainment, high value customer benefits and any other products and systems deemed to be such by the Alliance Revenue Team from time to time
Day of the week clash	refers to sectors where both Air New Zealand and Virgin Australia operated less than 7 trips per week each. A day of week clash is where both carriers operate on the same day and leave another day with zero services
DIAC	means The Department of Immigration and Citizenship
DUD	means Dunedin International Airport
EK	means Emirates
FFP	means frequent flyer points
Fifth Freedom	means the right of an airline of one country to carry traffic between 2 foreign countries as long as the flight originates or terminates in its own country
FFC	refers to a carrier utilising Fifth Freedom rights
Free sale (code share)	means a direct sale of seats on the other carrier's aircraft, with no obligation to pre-purchase any volume of seats
FSA	means full service airline

HLZ	means Hamilton International Airport
IATCI	means InterAirline Through Check-In, which enables airlines to provide passengers with boarding passes for their onward connections
Interline arrangements, agreements or partnerships	means arrangements, agreements or partnerships relating to the carriage of passengers and/or freight between two points using more than one airline under an arrangement which typically involves baggage check through and the honouring of tickets between airlines with a rate agreed by each carrier payable by the other carrier for such carriage
JQ	means Jetstar Airways
LA	means LAN Airlines
LCC	means low cost carrier
Load factor	means % of seats sold.
MEL	means Melbourne Airport
Metal Neutrality	means a state of events in which each Party will be incentivised to treat all flying, regardless of carrier, within the scope of any of the provisions of this Agreement as flying on its own network and in which customers also will become neutral as to the choice among the Parties as carriers and among itineraries on any given route
MOT Determination	means the Ministry of Transport's Report in respect of the AAA, the Codeshare Agreement, and the Alliance Capacity Implementation Agreement dated 21 December 2010.
Net Passenger Revenue	comprises of the following: Tasman passenger revenue (including revenue from FFP and OAL and revenue from any baggage and product upgrades). Note for Air New Zealand this excludes staff and duty travel. *Plus:* YQ Collections (fuel surcharges) *Less:* Standard commissions paid (commissions retained at the point of sale by the selling agent/ retailer)
Network Alliance Route	means any Trans Tasman Sector plus any domestic Australian or New Zealand sectors connecting to a Trans Tasman Sector as part of an international itinerary
NS	means the scheduling season for Northern Summer from 1 April to 31 October of any year
NW	means the scheduling season for Northern Winter from 1 November to 31 March of any year
NZ	means Air New Zealand
OOL	means Gold Coast Airport

Operating Carrier	means the party to a code share operating a code share flight with its own or leased aircraft
PER	means Perth International Airport
Pre-Alliance Year	means the period from 1 November 2009 to 31 October 2010. It is the year prior to the authorisation of the Alliance and is used throughout this Application as a reference point for comparison
QF	means Qantas Airways
ROT	means Rotorua Airport
Seat capacity	means the number of seats operated. Air New Zealand uses marketing seats (seats available for sale) Virgin Australia uses actual capacity (i.e., the number of seats physically on the aircraft). This aligns with the data provided in the original application
Sector	means a non-stop flight leg between 2 points
SYD	means Sydney Airport
Trans Tasman Sectors	means any sectors between a point in Australia and a point in New Zealand, including when the ultimate destination of the service is another point in Australia, New Zealand or another country
Velocity	means Virgin Australia's loyalty program
VFR	means visiting friends and relatives
Wingtip flying	refers to when there are 2 flights, on the same sector, and they both depart in the same morning or afternoon or less than 3 hours apart. When there are more than two flights per day on a given sector, wingtip flying is defined as any flights that depart within 1 hour of each other
WLG	means Wellington International Airport
Year 0	means the period from 1 November 2010 to 31 October 2011. During Year 0, authorisation of the Alliance came into effect and some cooperative activities also commenced at different points throughout year.
Year 1	means the period from 1 November 2011 to 31 October 2012, being the first full year of data available with optimised schedules, the application of codeshare sales on certain sectors and certain other cooperative activities in place. It is used throughout this Application in comparison with Pre-Alliance Year data to provide some analysis of the impact of the Alliance since implementation
Year 2	means the period from 1 November 2012 to 31 October 2013
ZQN	means Queenstown Airport