SUBMISSION TO THE MINISTRY OF TRANSPORT

Application for authorisation of a codeshare agreement by Virgin Australia and Air New Zealand

Introduction

1. Thank you for the opportunity to make a submission on the application by Virgin Australia (VA) and Air New Zealand (Air NZ) to the Ministry of Transport (MOT) requesting authorisation for a codeshare agreement between the two airlines on the trans-Tasman market. The agreement would allow VA to place its code on a free sale basis on Air NZ-operated trans-Tasman services (excluding Queenstown).

2. The NZ Airports' Association (NZ Airports) is the industry association for New Zealand's airports and related businesses. Its members[1] operate 46 airports across the country including the international gateways to New Zealand. This infrastructure network is essential to a well-functioning economy and enables critical transport and freight links between each region of New Zealand and between New Zealand and the world.

3. NZ Airports represents all international and regional airports in New Zealand. This gives us a keen interest in creating and maintaining a competitive aviation market for travel between Australia and New Zealand. Our members are essential components of the New Zealand tourism industry, and we have great concern at the impact of higher airfares in the vital trans-Tasman market on the broader tourism industry.

4. Since borders re-opened, the New Zealand tourism industry has been impacted by significantly higher than pre-Covid trans-Tasman airfares has a negative impact on the wider New Zealand economy, particularly on regional economies. The Australian market is a significant (51%) proportion of non-resident visitors to New Zealand, therefore any lessening of trans-Tasman airline competition resulting in higher airfares has a proportionately larger negative impact on our tourism industry. We believe this codeshare authorisation would be a missed opportunity to increase both potential competition and capacity growth on New Zealand's most important aviation market.

5. We take a 'first principles' approach regarding the issues for approving airline alliances and strongly hold to the principle that aviation as a sector, and air travel consumers in particular, are best served by having strong competition that provides those consumers with greater choice and competitive airfares. We have recently submitted to the MOT in support of reauthorising some airline agreements, because we recognised the overall consumer benefit. However, every agreement needs to be considered on its own merits.

6. NZ Airports would draw MOT's attention to a recent speech by the Australian Government's Assistant Minister for Competition, the Hon Andrew Leigh MP[2], regarding Australian domestic airline competition and the very stark competition benefits from increasing the number of airlines servicing a route.

---

[1] Our member airports: Ardmore Airport, Ashburton Airport, Auckland Airport, Bay of Islands Airport, Chatham Islands Airport, Christchurch Airport, Dunedin Airport, Gisborne Airport, Hamilton Airport, Hawkes Bay Airport, Hokitika Airport, Invercargill Airport, Kaikohe Airport, Kaitaia Airport, Kapiti Coast Airport, Marlborough Airport, Masterton Airport, Matamata Aerodrome, Motueka Airport, Nelson Airport, New Plymouth Airport, North Shore Airport, Oamaru Airport, Palmerston North Airport, Pauanui Airfield, Pukaki Airport, Queenstown Airport, Rangiora Airfield, Rotorua Airport, Takaka Airport, Taupo Airport, Tauranga Airport, Te Kowhai Airport, Thames Aerodrome, Timaru Airport, Wairoa Airport, Wanaka Airport, Wellington Airport, West Auckland Airport, Westport Airport, Whakatane Airport, Whanganui Airport, Whangarei Airport.

[2] https://ministers.treasury.gov.au/ministers/andrew-leigh-2022/speeches/address-chifley-research-centre-melbourne

When one airline services a route, airfares average 39.6 cents per kilometre. With two competing airlines, the average fare drops to 28.2 cents. With three competitors, to 19.2 cents. In other words, the price per kilometre is halved when three competitors fly a route compared with the situation when there is only a single monopoly airline. With four or five competitors, the price drops further still. (They find these results for all routes and the top 200 routes by passenger traffic.)

Initial results further indicate that the mere threat of competition in the aviation sector has, on average, helped to lower prices.

The Assistant Minister is drawing on new research by the Australian Treasury's Competition Review[3] that is looking into competition in the Australian aviation market, amongst others.

7. NZ Airports submits that the MOT should decline this application because it would limit competitive pressure on the airlines currently servicing the trans-Tasman market, resulting in less consumer choice and putting upward pressure on airfares. Crucially, approval of the application would remove the most viable potential source of increased competition for the five-year period of the codeshare.

8. We submit the negative overall impact on trans-Tasman travellers outweighs the few benefits that will accrue to the carriers themselves in terms of being able to better target high yielding travellers.

9. The key reasons this application should not be approved are:

    - The benefits are limited and accrue to a small number of VA customers, primarily business and loyalty customers, who wish to fly across the Tasman.
    - The trans-Tasman market is less competitive now than it was pre-Covid. Authorisation would remove the potential for returning to the pre-Covid market dynamics.
    - Approval would risk short and long-term negative impacts on consumers on the trans-Tasman market. In the short term, it would drive up airfares by displacing existing Air NZ passengers with higher yielding VA passengers absent Air NZ increasing capacity, which is already constrained. In the longer term it entrenches the current low level of competition on the Tasman for at least five years.

Benefits of the codeshare are limited & would accrue to a small number of consumers at the expense of the potential for stronger trans-Tasman competition.

10. The applicants outline in their proposal the key benefits of their codeshare but do not quantify these benefits for passengers. The lack of benefit quantification suggests the supposed benefits are either too small or too hard to quantify with a credible level of accuracy.

11. VA outlines that the agreement will provide their customers with various benefits including:

    - Access to VA coded trans-Tasman services on Air NZ.
    - Ability to redeem Velocity points and accrue status credits on VA coded Air NZ. services.
    - Ability to use Air NZ's seven international lounges.

    These benefits accrue solely to VA travellers who wish to fly across the Tasman, in particular their loyalty and frequent flyer customers. While we acknowledge there will be benefits for

[3] https://treasury.gov.au/review/competition-review-2023

this group, we submit that the benefits are strongly outweighed by the anti-competitive impact on the broader trans-Tasman market that will impact a much wider group of consumers. We go into further detail later in the submission on the wider trans-Tasman impact.

12. The proposal authorisation gives benefits to those of VA's premium passengers who want to fly to New Zealand but nothing for NZ travellers flying into Australia. The benefits for relatively few Australian travellers come at a not-insignificant cost in terms of reducing potential competition in the trans-Tasman market. The proposal does not include any commitment to increase overall capacity for the trans-Tasman market but instead allows pricing at agreed levels between the two applicants.

13. Air NZ states that the benefit for them of the proposed agreement would

    ‘drive increased passenger numbers (including high yield passengers such as corporates and SME customers) onto its trans-Tasman and domestic services’.

    Without offering increased capacity, additional high yielding customers accessed via the VA network would simply displace existing Air NZ customers and put upward pressure on airfares, which is not in the broader interests of consumers. We note that Air NZ already faces ongoing capacity constraints due to the required Pratt and Whitney engine rebuilds.

14. This is of particular concern in a market where Air NZ short-haul flights (Australia and Pacific) are at 84%[4] load factor, meaning there is little extra capacity on existing flights. Airfares on the Tasman are up 74%[5] on pre-COVID levels. This data indicates the market requires extra capacity, which this application does not require and will in fact act as a disincentive to being added.

15. NZ Airports notes that almost 700,000 New Zealanders live in Australia and 70,000 Australians live in New Zealand. These consumers rely on being able to fly back and forth to see family and friends at an affordable price. This agreement would see them displaced from Air NZ services by higher paying corporate and SME customers from the VA network.

16. NZ Airports submits that the New Zealand Government should focus its decision-making for this proposed authorisation on what are the purported benefits, if any, to New Zealand and to New Zealanders travelling the Tasman.

The trans-Tasman market is less competitive than it was pre-Covid

17. NZ Airports disagrees with the applicants’ characterisation of the trans-Tasman market as highly competitive.

18. The following table shows that prior to Covid around 77% of the Tasman capacity was provided by Air NZ and the Qantas Group. Over the coming 12-months, over 90% of Tasman capacity is scheduled to be operated either by Air NZ or Qantas Group and their JV partners Emirates, a significant concentration of power in a two-airline duopoly, with the residual 8% provided by airlines that provide limited competition mainly in Auckland (China Airlines, Air Asia X, LATAM Airlines, China Eastern Airlines, Batik Air.).

[4] https://www.airnewzealand.co.nz/monthly-investor-updates

[5] AirportIS

AKL/WLG/CHC Tasman Capacity				
	YEJan20	Share	YEOct24	Share
NZ	3,426,201	38%	3,176,489	42%
QF/JQ/EK	3,488,457	39%	3,813,705	50%
Other	2,077,867	23%	568,360	8%
Total	8,992,525	100%	7,558,554	100%

Source: Sabre Market Intelligence   Note EK has a Joint Venture with the Qantas Group

19. Airfares are also significantly higher, an increase of 74%, on the Tasman compared to pre-Covid, a consequence of the limited competition and capacity.

20. We note that Emirates (EK) services on the Christchurch-Sydney route is within the EK/QF joint venture, allowing coordination on capacity and pricing for Christchurch to Sydney flights. Also of note is that Air NZ and Qantas group are code-sharing on domestic AU or NZ sectors when part of trans-Tasman journeys.

21. Significantly, Air Asia X announced in December 2023 that they were pulling out of Auckland from February 2024, further reducing competition. Air Asia's forthcoming exit from the Tasman market will increase the Air NZ and Qantas Group's market share to 92%.

22. Passengers departing Wellington for Australian airports are served solely by the two airlines, Air New Zealand and the Qantas Group. Auckland and Christchurch passengers have more choice but that is only on international carriers transiting through an Australian airport. These other carriers require 5th freedom rights, and many have limited ability to operate from main gateway airports in Australia due to air rights caps or curfews.

23. Other airlines find it uneconomic due to the impact of Australian government transit visa requirements on passenger demand. Many of the 5th freedom airlines (for example, Air Asia X and Batik Air) that are operating on the Tasman do not compete directly with Air NZ or Qantas due to their non-NZ/AU customer base and lower-cost product.

24. The forthcoming exit of Air Asia X is significant as it demonstrates that sustained competition on the Tasman requires an operator for whom the Australia and New Zealand business is core to their business model. Fifth freedom carriers struggle to be viable in this market and pose little competitive check on the two domestic champions.

25. NZ Airports submits that authorisation of the codeshare agreement between VA and Air New Zealand would remove the only significant potential competitor to the duopoly on the trans-Tasman routes. VA is the only such carrier that could provide sustained competition or pose a serious competitive threat. It is notable that VA has around one-third of the Australian domestic market (33.6% in Oct 22, according to ACCC data[6]).

26. There is no other New Zealand carrier with the ability to operate on the Tasman routes. In Australia, while REX and Bonza have aircraft types within their fleets that could operate on the Tasman, their limited fleet, network and domestic market focus, means this is unlikely to occur in the foreseeable future. In our view, VA is the only Australian carrier with the aircraft and customer base to operate on the Tasman, therefore VA is the only airline that can provide genuine competition.

[6] https://www.accc.gov.au/system/files/Airline%20Competition%20in%20Australia%20-%20December%202022%20report.pdf pg. 13

The proposed agreement would have negative short and long-term impacts on trans-Tasman travellers.

27. As acknowledged by Air NZ in the application, a key benefit to Air NZ from this agreement would be to drive increased passenger numbers (including high yield passengers such as corporates and SME customers) onto its trans-Tasman and domestic services. Without offering increased services that increase overall seat capacity in the market, new high yielding customers accessed via the VA network would simply displace existing Air NZ customers and put upward pressure on airfares. This is not in the broader interests of consumers.

28. The short-term impact of the agreement would simply be to allow Air NZ to access a group of higher paying customers, rather than increasing capacity.

29. In the longer term, this agreement creates a strong disincentive for VA to resume trans-Tasman services in the next five years because it allows their customers to access a trans-Tasman service without VA having to resume a route themselves with their own aircraft. This disincentive to create new capacity on the trans-Tasman routes for five years is not in the wider interests of potential travellers. We submit that five years is very long period to entrench such an impediment to competition. Even if VA acknowledges new services on the trans-Tasman routes are not part of their current plans, granting approval to the agreement would entrench that commercial position for far too long.

30. VA argues in the application that it is merely agreeing to purchase flights and some ancillary benefits, such as redeeming air miles and access to airport lounges, from Air NZ for its existing passengers. However, if successful the application creates a strong disincentive for VA to attempt to deploy their own capacity into more Tasman markets as their customers can access NZ flights.

31. Air NZ benefits by reducing the potential for direct competition, and the potentially greater overall capacity, from the only carrier (VA) that could meaningfully compete on the trans-Tasman routes. It is worthwhile repeating the part of the Minister's quote above in regard to the effect of potential competition:

> *"Initial results further indicate that the mere threat of competition in the aviation sector has, on average, helped to lower prices."*

Approval of this agreement risks maintaining or worsening the current low levels of competition in the Tasman aviation market

32. Approval of this application immediately reduces the potential future competition that VA presents to Air NZ and Qantas Group. To quote the ACCC's submission[7] on the terms of reference for the Australian Government's Aviation White Paper:

> *"A competitive airline sector is vital to meet the needs of consumers and the economy more broadly, ….. Rivalry between airlines can deliver more routes, a greater choice of products, cheaper airfares, more reliable services and better customer service."*

33. Referring again to the ACCC's White Paper submission, NZ Airports' notes that Rex's presence as a third airline on some domestic routes between major Australian cities has

[7] https://www.accc.gov.au/system/files/ACCC%20submission%20in%20response%20to%20the%20Aviation%20White%20Paper%20terms%20of%20reference%20-%20March%202023.pdf

had the effect of immediately and substantially lowering the combined revenue per passenger for Jetstar, Qantas, VA and Rex. The ACCC noted in that case:

> *"Competition between more airline groups will generally result in better services and more attractive pricing."*

34. The potential for competition from VA (being a well-regarded Australian domestic airline with meaningful sales and distribution strength) entering the Tasman market is a stronger pro-competition factor than any other third airline entering the Tasman market. To state this factor another way, removing the potential competition by VA would have the greatest possible anti-competitive effect on what is already very significant market power held by Qantas Group and Air NZ.

35. The applicants highlight the importance of New Zealand to outbound Australians (second largest market), and the difficulty VA has competing domestically in Australia for certain market segments (for example, high value corporate customers) without its customers having access to connectivity, lounges and loyalty benefits on trans-Tasman routes beyond Queenstown (ZQN).

36. While the proposed codeshare arrangement gives VA access to New Zealand on Air NZ aircraft, the counterfactual is that declining the authorisation will place more pressure on VA to reinstate their own services that they operated prior to Covid. Not having a codeshare agreement provides an incentive for VA at some point to provide more competition in the trans-Tasman market to Air NZ and the Qantas Group.

The Applicants' previous relationship sought to reduce competition and capacity.

37. In general, the history of airline joint ventures has been to limit competition and reduce capacity rather than enhance markets and grow. That can be justified when there are strong consumer benefits, but in this instance the apparent benefits do not outweigh the risks.

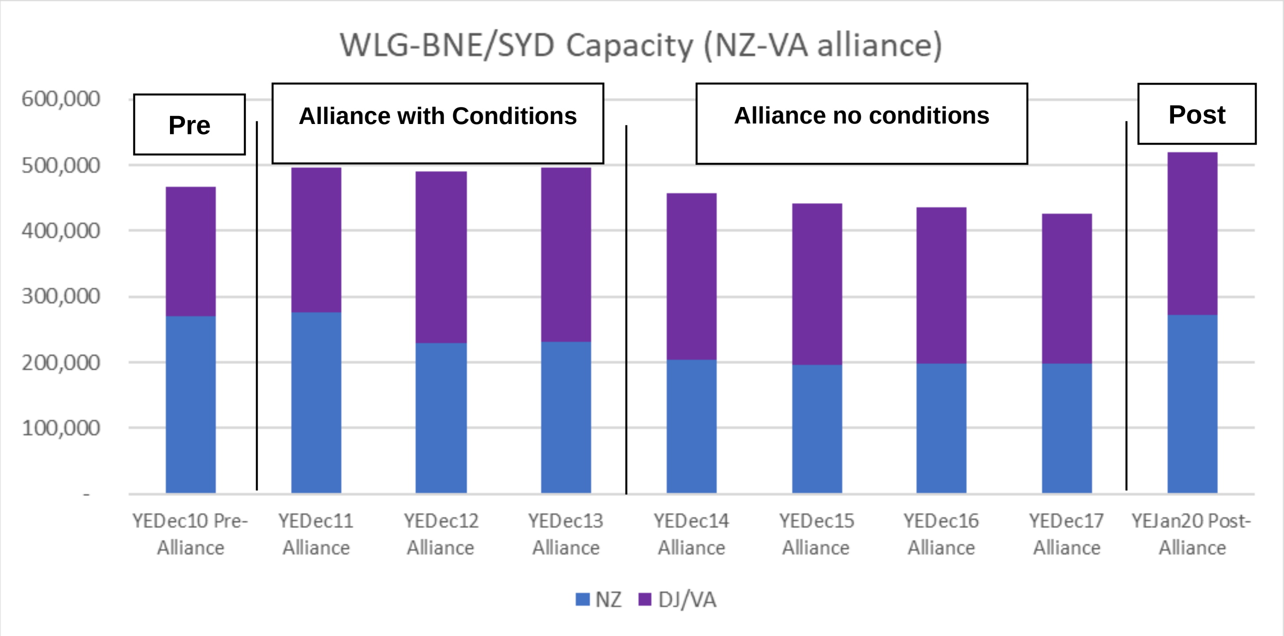
38. Competition, and hence better deals for travellers, is far stronger in markets with a minimum of three financially strong carriers having a viable potential to service the routes. The proposed authorisation would significantly reduce the risks to Qantas Group and Air NZ that VA could easily re-enter the trans-Tasman market and so pose a competitive threat to the existing duopoly.

39. Total capacity on the trans-Tasman market has reduced markedly since VA's exit in 2018, which has delivered highly favourable market conditions for Air NZ and the Qantas Group. NZ Airports would note to the MOT that competition in the trans-Tasman market is already far from adequate. The market share held currently (early 2024) in the duopoly of the Qantas Group and Air NZ is extremely high at 91%.

40. For example, since 2019 passengers departing Christchurch Airport have had fewer choices of routes, fewer participating airlines and 15% lower overall capacity on trans-Tasman routes.

41. A previous agreement between VA and Air NZ that operated between 2010 and 2018 reduced competition. There is no reason this agreement would not have the same impact. Prior to the alliance between Air NZ and Virgin Blue (as VA were known at the time), the two airlines in competition operated around 467k annual seats between Wellington and Brisbane/Sydney. The alliance initially grew capacity (due to ACCC conditions) to reach 496k seats. However, when these conditions were removed in 2013 the airlines gradually reduced capacity to below pre-alliance levels, reaching 426k in 2017.

42. In October 2018, the alliance broke up at Air NZ's request into two independent competing airlines. The two competing airlines' capacity on the routes between Wellington and Brisbane/Sydney grew again, to reach 520k seats, which was greater capacity than both airlines in the pre-Alliance and peak-Alliance periods.

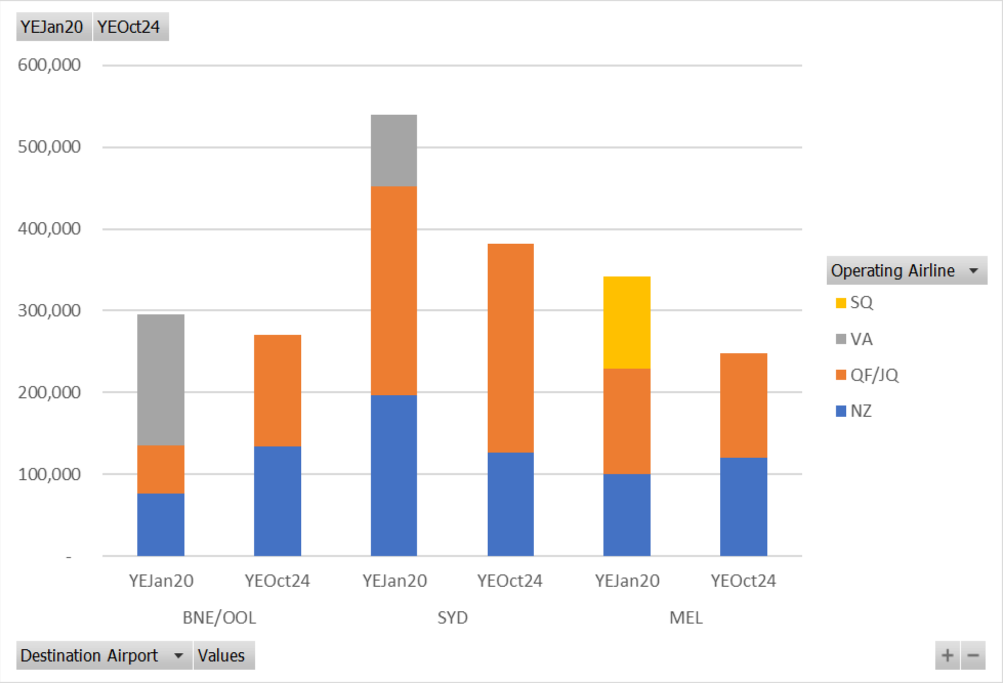


Source: Sabre Market Intelligence

43. Using Wellington Airport as a further example, it has become a duopoly on all Tasman sectors where it used to be fully competitive.

44. Prior to the Covid pandemic, Wellington Airport's trans-Tasman sectors were served by three independent airlines. Brisbane/Gold Coast was served by Air NZ/Virgin/Jetstar, Sydney by Air NZ/Virgin/Qantas, and Melbourne by Air NZ/Qantas/Singapore Airlines. Currently in the absence of Virgin/Singapore Airlines, all three sectors fall under the Air NZ/Qantas duopoly. WLG-Tasman capacity will be -23% lower YEOct24 than pre-Covid (YEJan20). BNE/OOL (grouped together due to overlapping markets) -8% (3 airlines drop to 2), SYD -29% (3 to 2), MEL -27% (3 to 2). Virgin flew 21% of WLG's Tasman capacity which has not returned.

Trans-Tasman airline capacity to/from Wellington for the 2020 and 2024 years



Source: Sabre Market Intelligence

Summary

45. NZ Airports sees little justification for authorisation of this codeshare application. The potential benefits for a small part of the travelling public are exceedingly small in comparison to the overall dis-benefits done to the broader trans-Tasman market.

46. If authorised, the agreement would significantly reduce the potential competitive threat to the Qantas Group and Air NZ duopoly that is posed by VA re-entering the market using its own aircraft. This reduced competition impact would be at least for the short- to medium term or until one of the alliances (Qantas group or VA/Air NZ) decides to break apart.

47. Authorisation would create the situation where a capacity-constrained Air NZ carries premium and Velocity passengers originating from its single remaining potential competitor holding significant market share in the NZ/AU market. Reducing the commercial reasons for VA to restart its own services on trans-Tasman routes, and thereby competing directly with Air NZ, is a significant benefit for Air NZ but at great cost to the wider travelling public.

48. The counter-factual if the application is declined is that VA instead responds to the acute commercial pressures from the demands of its large domestic customer base by expanding its services beyond just Queenstown and re-starting its own service on more routes to more New Zealand airports.

49. Air NZ will have substantial difficulty delivering adequate capacity while its Pratt and Whitney engine rebuilds are underway. VA in contrast has placed orders for a further 39 Boeing 737 Max 8/10 aircraft[8] (as of December 2023). These additional aircraft will greatly increase VA's fleet capacity and give VA the capability to re-start its own trans-Tasman service if commercial conditions allow. The codeshare agreement reduces VA's reasons

[8] https://newsroom.virginaustralia.com/release/virgin-australia-increases-737-max-8-aircraft-order

for re-starting its trans-Tasman services and thereby growing overall capacity in the trans-Tasman market.

50. NZ Airports recognises the challenges that airlines have faced during the COVID pandemic, and that airlines have faced capacity constraints during a difficult rebuilding period. However, we consider that the airline sector has now largely recovered. If the MOT believes that ongoing trans-Tasman capacity constraints justify authorising the codeshare agreement, then a two-year authorisation period would be better than the requested five-year authorisation because the overall capacity is rapidly rebuilding.

51. NZ Airports acknowledges that arrangements between airlines are sometimes necessary and in the interests of consumers. We have previously made submissions to the MOT in support of reauthorising particular airline agreements. However, each agreement should be considered carefully for its impact on all consumers, not only certain groups of potential travellers.

52. In this instance, granting approval would substantially move the trans-Tasman market toward becoming a fully authorised duopoly. NZ Airports notes that 5th freedom carriers struggle to be viable in this market (note the upcoming exit of Air Asia X, after its third attempt at the Tasman market) and pose little competitive check on the two national champions.

53. The MOT should consider what would be the ideal market conditions that deliver adequate competition in the Tasman market and hence better prices and services for travellers, and if an authorisation enhances or retards those market conditions.

54. If the NZ Government does approve this application, then the MOT needs to consider what policy changes and other initiatives could be made to increase competitiveness in the trans-Tasman market and provide greater overall transparency to external parties. These policy changes could include using the new information disclosure powers under the Civil Aviation Act 2023 to ensure and demonstrate that any conditions and purported benefits that are part of the approval are actually delivered by the applicants.

Contact:

Steve Riden
Policy Director
New Zealand Airports Association

Address for Service:
Steve Riden
New Zealand Airports Association Inc.
P O Box 11 369
Manners Street,
WELLINGTON 6142

Telephone: (04) 384 3217
Email: steve.riden@nzairports.co.nz
Date: 7 February 2024