



20 May 2024

OC240164

Hon Matt Doocey**Action required by:****Associate Minister of Transport**

Friday, 31 May 2024

AIR NEW ZEALAND AND VIRGIN AUSTRALIA CODESHARE AUTHORISATION – INITIAL ADVICE

Purpose

Air New Zealand and Virgin Australia have applied for authorisation of a codeshare arrangement. This briefing provides our initial advice on the proposal, which is that you authorise the arrangement. We are seeking your views at this stage since we would need to give the airlines an opportunity to comment if, contrary to our advice, you were to decline authorisation.

Key points

- Air New Zealand and Virgin Australia (the Applicants) are seeking authorisation to implement a unilateral Codeshare Agreement, and other related agreements (the Proposed Conduct).
- Under the arrangements, Virgin Australia could put its code on Air New Zealand operated trans-Tasman services. Air New Zealand will set the fares that Virgin Australia will charge its passengers.
- Virgin Australia wants to be able to offer a trans-Tasman product to improve its competitiveness in the Australian market, particularly for corporate customers. The codeshare would also allow Virgin Australia to offer customers a better frequent flyer points product and lounge access.
- Air New Zealand claims that this codeshare arrangement will increase passenger numbers flying on the codeshare flights via Air New Zealand and improve the efficiency and sustainability of its service.
- We consider it unlikely that Virgin Australia will re-enter the trans-Tasman market with its own aircraft in the next two or three years with or without the codeshare.
- There is a risk that if market conditions on the Tasman improve for Virgin Australia, there could be a point over the remaining period for which authorisation is sought where the codeshare could disincentivise Virgin Australia re-entering routes other than Queenstown.

- The decision is finely balanced, but we conclude there is not sufficient reason to decline authorisation. While we have identified only small benefits to New Zealand from the arrangement, we recommend you authorise for five years as requested by the applicants.
- The Australian Competition and Consumer Commission has issued a draft determination authorising the codeshare for five years. This was based on benefits they had identified in the Australian market, which do not apply to New Zealand.

Recommendations

We recommend you:

- 1 **agree** that we finalise advice to you recommending that you authorise the Air New Zealand and Virgin Australia codeshare arrangement for five years. Yes / No
or
- 2 **indicate** whether you wish to meet with officials to discuss any concerns before finalising our advice. Yes / No


 Siobhan Routledge
Acting Deputy Chief Executive, Policy
 20 May 2024

 Hon Matt Dooney
Associate Minister of Transport
 / /

- Minister's office to complete:**
- Approved Declined
 - Seen by Minister Not seen by Minister
 - Overtaken by events

Comments

Contacts

Name	Telephone	First contact
Tom Forster, Manager, Aviation and Maritime	s 9(2)(a)	✓
Sonya van de Geer, Principal Adviser, Aviation and Maritime	s 9(2)(a)	
Garrick Wood, Senior Adviser, Aviation and Maritime	s 9(2)(a)	

INITIAL BRIEFING: AIR NEW ZEALAND AND VIRGIN AUSTRALIA CODESHARE AUTHORISATION

Air New Zealand and Virgin Australia have applied for authorisation of codeshare arrangements

- 1 Air New Zealand and Virgin Australia are seeking authorisation of a codeshare arrangement pursuant to section 88 of the Civil Aviation Act 1990. The effect of authorisation is that the arrangements would be exempt from certain provisions of the Commerce Act prohibiting cartel arrangements or arrangements which substantially lessen competition.

The proposal is for a unilateral codeshare arrangement where Air New Zealand sets prices

- 2 Under the proposed arrangements, Virgin Australia would promote and sell trans-Tasman flights operated by Air New Zealand under its VA code. Key features include:
 - The fares for the services, including discounts, will be set by Air New Zealand.
 - Virgin Australia's Frequent Flyer members will gain access to Air New Zealand's lounges and can earn and redeem points on Air New Zealand trans-Tasman services.
- 3 The codeshare won't apply on routes where Virgin Australia operates its own trans-Tasman services (currently only routes to Queenstown) or any future points it serves in New Zealand.
- 4 It is a unilateral codeshare (Air New Zealand will not be putting its code on Virgin Australia services) and only applies to tickets sold in Australia for travel from Australia.

Authorisation is sought under section 88 of the Civil Aviation Act 1990

- 5 Authorisation is sought under section 88 of the Civil Aviation Act 1990. The effect of authorisation is that the arrangements are exempt from provisions of the Commerce Act 1986 that prohibit arrangements substantially lessening competition.
- 6 Section 88 sets out several statutory pre-conditions (in the form of prohibitions) that must be met.
- 7 s 9(2)(h)
[REDACTED]
- 8 Our initial view is that the Commercial Framework Agreement does not appear to breach sections 88(3) and 88(4) of the Act.

The primary commercial rationale for the arrangements relates to Virgin Australia's competitive position

- 9 New Zealand is an important destination for Australian travellers, both for business and leisure purposes.
- 10 Virgin Australia does not currently offer trans-Tasman services apart from flights to and from Queenstown. Virgin Australia's commercial rationale for the codeshare is that this reduces its ability to compete effectively in Australia particularly for higher-yield corporate and small business customers.
- 11 Air New Zealand claims that this agreement could incrementally increase passenger numbers and improve the operational efficiency and sustainability of its flight operations. It may also enable Air New Zealand access to additional distribution channels for its trans-Tasman services.

The pricing provisions of these arrangements are unusual

- 12 Under most codeshare arrangements, each airline independently determines the prices. In this case the arrangements allow Air New Zealand to establish fares which Virgin Australia will market to its Australian customers. This is because Air New Zealand would not enter into a commercial arrangement where Virgin Australia could undercut it on its own services.

Stakeholders have concerns about the proposed codeshare

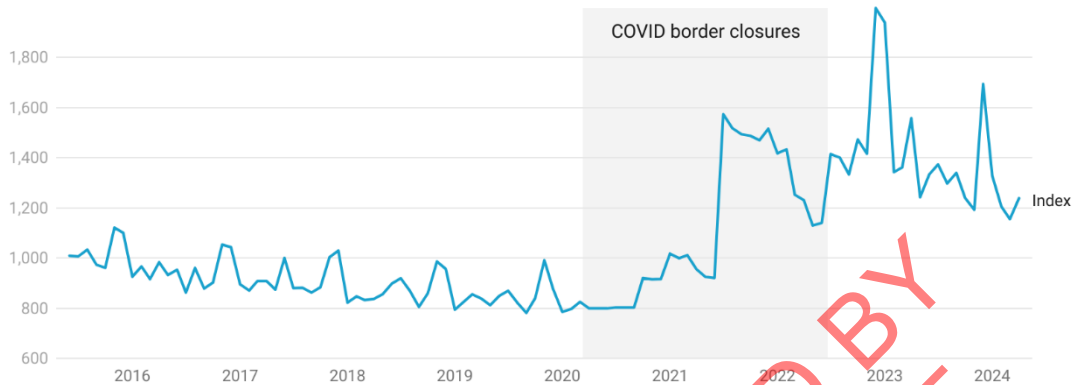
- 13 Auckland and Christchurch airports and the NZ Airports Association acknowledged that the codeshare could benefit Virgin Australia's Australian customers. However, they submitted that it could potentially reduce competition and increase airfares on trans-Tasman routes. Airports consider that the codeshare will reduce the incentives on Virgin Australia to enter trans-Tasman routes other than Queenstown. Queenstown Airport supported the authorisation of the proposed codeshare agreement on the basis that Queenstown is excluded.
- 14 Former Virgin Australia employees opposed the codeshare, expressing resentment for its handling of job losses during COVID-19 and following administration. A Virgin Australia customer identified the difficulties travellers experienced in trying to redeem credits during the COVID-19 pandemic.

The trans-Tasman market is still below pre-COVID levels but is recovering

- 15 We have reviewed the competitive landscape of the trans-Tasman market, including market share, the capacity provided by other international carriers, and the post-COVID recovery.
- 16 Data from Stats NZ shows international airfares are coming down overall, but they remain volatile and higher than pre-COVID. The selected price index for international air transport for April 2024 is 20 percent lower than April 2023 but 55 percent higher compared to April 2020.

International airfares are falling but remain higher than pre-COVID

Source: Stats NZ, Selected Price Index (SPI): International Air Transport, monthly indexes, July 2015–April 2024



Monthly data directly feeds into the CPI and uses the same data source, data treatment, and quality adjustments as the official quarterly CPI.

- 17 Historically, we have not had competition concerns on the Tasman due to the number of airlines operating to New Zealand. However, the post-COVID trans-Tasman market has duopolistic characteristics.
- 18 During the post-COVID period, Air New Zealand’s market share has decreased to 41 percent as other carriers returned to the market, with Qantas/Emirates/Jetstar at 48 percent for the first quarter of 2024. Virgin Australia’s market share is 3 percent, reflecting its return to the Queenstown route only.
- 19 While several fifth freedom carriers operate on trans-Tasman routes, they make up approximately 5 percent of the market and mainly connect long-haul passengers rather than direct point to point passengers.
- 20 Trans-Tasman capacity is increasing but it remains well below pre-COVID levels. Statistics from the Bureau of Infrastructure and Transport Research Economics (BITRE) shows capacity for January 2024 being over 112,000 fewer seats compared to January 2020. Total capacity for 2023 was approximately 1.5 million fewer seats than 2019.
- 21 Airlines are increasing capacity. In March 2024, Qantas announced from October 2024, it will add up to 260,000 additional seats across three of its trans-Tasman routes over 12 months, compared to its current schedule.
- 22 ~~[COMMERCIAL IN CONFIDENCE]~~ From April 2025, Jetstar plans to introduce daily services to Hamilton from the Gold Coast and Sydney. This could be a sign that low-cost carriers are seeing an opportunity to focus on regional airports.
- 23 Airlines are moving to fill the gap in capacity, but it is primarily shared between Air New Zealand and the Qantas Group.

The applicants assert that the codeshare will bring benefits to New Zealand

- 24 The applicants assert that the codeshare will deliver incremental tourism to New Zealand and incremental passengers on Air New Zealand services.

Increase in tourism through better marketing

- 25 The applicants state that the codeshare would see enhanced marketing of New Zealand as a destination to Virgin Australia customers (and Australian customers more generally). They expect this enhanced marketing to result in incremental traffic to New Zealand, with corresponding benefits in the form of additional tourism spend.
- 26 In considering other alliances, we have agreed that improved access to a home country's marketing network is beneficial, particularly where Air New Zealand does not have a strong existing commercial presence.
- 27 In this case, however, we only place a small weight on this. Australia is culturally a similar market to New Zealand, and Air New Zealand already has a strong stand-alone presence. It is the second biggest overseas airline in Australia and Australia is its biggest international market. It competes strongly with the Qantas Group in the trans-Tasman market. Pre-COVID, it consistently topped the most trusted brand in Australia surveys.
- 28 Some Virgin Australia passengers might also be encouraged to come to New Zealand due to the ability to use frequent flyer points. However, we do not expect this to be a large number.

Incremental passengers on Air New Zealand's services

- 29 The applicants also assert that some Virgin Australia passengers who might otherwise have travelled with Qantas will be more likely to travel via Virgin Australia code on Air New Zealand trans-Tasman services.
- 30 The applicants state that this incremental traffic will benefit Air New Zealand by improving the efficiency and sustainability of its flight operations.
- 31 We agree that the codeshare may contribute to an incremental increase in passengers. Air New Zealand has estimated this to be an additional s percent on current load factors, which equates to up to s passengers per flight for an A321neo aircraft. Virgin Australia has estimated the additional load factor could be up to s percent. Some of these passengers might be higher value customers adding more to Air New Zealand revenue than an average customer.
- 32 To the extent there are additional passengers through the codeshare, this could negatively impact existing passengers on pricing or other customer benefits, but this may happen regardless of Air New Zealand's customer growth through their own marketing efforts.
- 33 Currently, Air New Zealand load factors for the Tasman hover between s and s percent. While any additional revenue supports a service, at this load factor the services are not at risk.
- 34 From a system viewpoint we also note that many of these passengers will be transferring from Qantas and so would have a negative reciprocal effect on it.

9(2)(b)(ii)

9(2)(b)(ii)

Our key concern is the impact the codeshare might have on Virgin Australia expanding services to New Zealand...

- 35 Trans-Tasman capacity has not yet returned to pre-COVID levels, and with Virgin Australia being absent from most routes, the market has the appearance of a duopoly. Generally, increased capacity and competition lead to reduced airfares. Relatively high but declining post-COVID airfares are, in part, symptomatic of the capacity currently being operated to New Zealand. They also reflect general cost pressures.
- 36 There are some services offered by fifth freedom (third country) airlines and we are aware of additional such carriers considering operating on the Tasman. However, these only offer limited competition, and this type of carrier has a history of entry and exit.
- 37 We consider that Virgin Australia remains the airline most likely to enter the (non-Queenstown) trans-Tasman market.
- 38 In setting out their commercial rationale for the codeshare, the applicants have emphasised the importance for Virgin Australia of having a trans-Tasman offering for its frequent flyer and corporate customers. Market conditions on the Tasman for Virgin Australia on non-Queenstown routes may improve over the period for which authorisation is sought.
- 39 It is reasonable to conclude that, on the margin, by removing the need to operate itself to offer its customers a trans-Tasman product, the codeshare could count against or delay Virgin Australia's entry.
- 40 The Applicants submit that the short period in which Virgin Australia independently operated trans-Tasman services, following the dissolution of its broad Alliance with Air New Zealand, [s 9\(2\)\(b\)\(ii\)](#)
- 41 Any decision by Virgin Australia to re-commence services on non-Queenstown Tasman routes will be heavily dependent on gauging demand from New Zealand travellers, particularly leisure travellers. These passengers are not affected by the codeshare.
- 42 The codeshare arrangement could also enable Virgin Australia to better gauge whether sufficient profitable demand has emerged to make its re-entry into one or more routes viable.

...but we consider entry to be unlikely in the short term

- 43 If the codeshare was to prevent Virgin Australia from re-entering the market, this would have a cost to New Zealand that would outweigh the small benefits likely to accrue if the codeshare is authorised. We would be unable to recommend authorisation of the codeshare.
- 44 We also consider that even the threat of entry can have a beneficial impact on market behaviour. Despite what Virgin Australia has told us, New Zealand airports consider

that the codeshare does reduce the incentive for Virgin Australia to re-grow its New Zealand presence. If Air New Zealand and Qantas share this view, then authorisation could encourage duopoly behaviour to the detriment of New Zealand.

45 However, we are not able to reach a firm conclusion on if or when Virgin Australia would consider entering the market in the absence of the codeshare.

46 s 9(2)(b)(ii) [Redacted]

47 But equally operating conditions have not improved to suggest that re-entry is a realistic possibility in the short term. s 9(2)(b)(ii) [Redacted]

- s 9(2)(b)(ii) [Redacted]
- s 9(2)(b)(ii) [Redacted]
- s 9(2)(b)(ii) [Redacted]

48 s 9(2)(b)(ii) [Redacted]

49 s 9(2)(b)(ii) we are of the view that Virgin Australia's re-entry into non-Queenstown routes is very unlikely over the two to three years with or without the codeshare.

s 9(2)(b)(ii) [Redacted]

50 Both countries are experiencing economic conditions that are not conducive to increased demand for air travel. Australia is facing subdued economic growth in the short term and New Zealand is experiencing a slowdown of growth due to high inflation and reduced spending.

Length of authorisation sought

51 The applicants have applied for authorisation of the codeshare for a term of at least five years. This is consistent with similar airline co-operation agreement authorisations. The applicants argue that five years will provide certainty to customers, especially corporate and SME clients.

52 We considered authorising for three years as the uncertainty over a Virgin Australian re-entry with its own aircraft increases with time. The Act does not easily provide for setting conditions, such as length of authorisation. To do so would require the applicants to amend their application.

- 53 On balance, we do not consider that the uncertainty in years 4 and 5 to be such that a shorter authorisation period would resolve it. We also see benefits in aligning the reauthorisation timetable in New Zealand and Australia (see below).
- 54 Our analysis shows there is not sufficient reason to decline authorisation. This conclusion is reinforced by the findings of the ACCC. While a decision is finely balanced, our recommendation is to authorise for a period of five years as requested by the applicants.

Australian Competition and Consumer Commission has issued a draft determination granting authorisation

- 55 In Australia, collaborative arrangements in international air services are considered by the Australian Competition and Consumer Commission (the ACCC). Given that the codeshare agreement involves the trans-Tasman routes, decisions made by the ACCC are relevant to our assessment of the Application.
- 56 On 1 May 2024, the ACCC issued a draft determination and interim authorisation recommending to authorise the proposed conduct for a period 5 years. The ACCC is required to issue a final determination by 30 June 2024 following submissions from interest parties. We understand there has been no significant feedback that would lead the ACCC to reach a different conclusion.
- 57 Commissioners have taken the view that while the proposed conduct will result in minimal benefits to Australia, the potential detriments are smaller, and there is no reason to decline the agreement.
- 58 The benefits identified by the ACCC are:
- Increased choice and convenience for Australian point of sale trans-Tasman travellers
 - Better loyalty programme benefits for Virgin Australia customers
 - International lounge access for eligible Virgin Australia customers
- 59 These are all benefits that accrue to Australian based travellers. Given the nature of the codeshare, these benefits are not available to New Zealand customers. Therefore, we have not given weight to them, nor are we required to, in reaching our conclusions.