AIRLINE COMPETITION

-- Note by New Zealand --

18-19 June 2014

This note is submitted by New Zealand to the Competition Committee FOR DISCUSSION under Item IX of the agenda at its forthcoming meeting to be held on 18-19 June 2014.
Key points

- A number of market driven structural and behavioural changes in the last ten years have changed the way airlines compete in New Zealand’s domestic and international markets.

- The New Zealand Commerce Commission (the Commission) has relatively limited experience in terms of competition analysis of airline markets.

- The Commission approach to market definition in its limited dealings with airline competition has been to aggregate city pair markets on the basis of the same or similar competitive conditions. However, this has been dependent on the facts of the case. The Commission has also recognised the existence of non-passenger markets, including air travel services and travel distribution services.

1. Introduction
   1. The paper follows the first two OECD suggested topic headings, namely:
      2. The structure and functioning of the airline sector; and
      3. Competition issues in the airline sector.

2. The structure and functioning of the airline sector

2.1 Boundaries of the airline sector

2.1.1 The domestic airline sector

2. There are close to 30 domestic airports located across New Zealand.\(^1\)\(^2\) New Zealand’s three main airports are Auckland, Christchurch and Wellington, and flights between these centres make up the ‘domestic main trunk’.

3. New Zealand currently has two airlines operating on the domestic main trunk routes, Air New Zealand and Jetstar Airways (a subsidiary of Qantas Airlines). However, Air New Zealand is the only airline operating in the majority of provincial routes.

4. New Zealand’s domestic airline markets (passenger, freight and travel distribution services\(^3\)) are reasonably liberalised. Foreign owned airlines (including 100% foreign owned airlines) are permitted to

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1 All airports are independently owned and operated from airlines. Most airports are wholly owned by local and central Government, but the larger airports are also partly owned by private investors.

2 The companies operating at Auckland, Christchurch and Wellington airports are subject to information disclosure regulation (subpart 11 of Part 4 of the Commerce Act). This requires them to disclose to the Commission information relevant to their performance (such as financial statements, prices and quality performance measures), including forward-looking information (such as forecasts and asset management plans). The purpose of this form of regulation is to ensure that sufficient information is readily available to interested persons, including airlines, to assess whether the purpose of Part 4 is being met. The purpose of Part 4 is to get the right balance between providing incentives for regulated businesses to invest, and ensuring that household and business consumers are charged prices that align with the cost of the goods or services they receive.
operate domestic air services in New Zealand. The only requirements are that airlines meet licensing conditions and on-going compliance with competition laws and industry regulation covering safety, security and liability.

2.1.2 The international airline sector

5. New Zealand’s international airline markets are currently subject to a higher degree of control than domestic markets. Inter-Government Air Service Agreements (ASAs) must be in place before international airlines can operate scheduled air services. New Zealand currently has ASAs with more than 60 partner jurisdictions.4

6. ASAs typically include: negotiated rights that relate to routes that can be flown; capacity (frequency and aircraft types) that may be offered; and how many airlines may operate and the regulation of tariffs.5 The Ministry of Transport is responsible for negotiating New Zealand’s ASAs. New Zealand seeks to negotiate ‘Open Skies’ ASAs in the first instance. Examples include New Zealand’s bilateral ASA with Australia (2002) and a multilateral ASA signed by Brunei, Chile, New Zealand, Singapore and the United States of America (2001).6 New Zealand only introduces restrictions (eg, capacity or carrier restrictions) when compelled to do so by the other country.

7. International air services are operated from a smaller number of airports than domestic air services. Auckland is the major international airport through which most long-haul services (eg, services to Asia and the Americas) operate, although, a few airlines also operate long-haul services from Christchurch. Auckland, Christchurch and Wellington are the main airports through which short-haul international services (to Australia and the Pacific Islands) operate. Some international flights to Australia are operated at times through other airports. For example, there are currently regular scheduled services from Dunedin, Rotorua and Queenstown, with the number of direct flights to Queenstown continuing to grow.

8. Close to twenty airlines operate international air services to/from New Zealand using their own aircraft. A further twenty or so airlines offer international air services to/from New Zealand on a code-share only basis.7

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3 Travel distribution services consist of firms such as: travel wholesalers, travel agencies, travel management companies (TMCs), consolidators (who purchase air tickets from airlines that are not available to travel agencies and TMCs and sell them to travel agencies), and airlines who sell tickets to consolidators, travel wholesalers and directly to the public.


5 Ibid.

6 Ibid.

7 The exact number of airlines providing international air services to/from New Zealand varies depending on a number of factors. International airline schedules also change, impacting on the frequency of flights and whether airlines flight to an overseas destination direct from New Zealand or via Australia. For an up to date list of airlines providing international air services to/from New Zealand, see: http://www.transport.govt.nz/ourwork/air/internationalairservices/internationalairlinelicensing/international airlinesservingnewzealand/

For analysis on international airline entry and exit, see:
2.2 Structural disequilibrium

2.2.1 Recent changes to the airline sector in New Zealand

9. A number of market-driven structural and behavioural changes in the last ten years have affected the way that airlines compete in New Zealand’s domestic and international markets. Key developments include the following.

a) As has been the case around the world, the low cost carrier (LCC) model has developed in this region.

- Air New Zealand has changed a portion of its domestic and short-haul international services to more closely resemble that of a LCC model. Despite this, it still retains some elements of a full service airline (FSA) given the extensive range of optional services available to passengers.

- Qantas continues to operate as a full service airline, but also as a LCC through its subsidiary Jetstar, which entered in 2009.

- Virgin Australia (then called Pacific Blue) entered New Zealand in 2004 as a LCC.

a) A moderate level of recent code sharing and coordination activity has occurred, specifically the:\(^8\)

- Qantas and Emirates Coordination agreement 2013;

- Air New Zealand and Cathay Pacific alliance agreement 2013;

- Air New Zealand and Virgin Blue Group Australasian Airline alliance 2010 (re-authorised in 2013); and

- Air New Zealand and Singapore Airlines applied to the Ministry of Transport for the approval of an alliance in early 2014.

2.2.2 New Zealand agencies responsible for maintaining competition in airline markets

10. The two agencies primarily responsible for regulating airline competition in New Zealand are the Commerce Commission and the Ministry of Transport.

11. The Minister of Transport can authorise under the Civil Aviation Act 1990 contracts, arrangements and understandings relating to international travel by air that relate to the fixing and/or application of tariffs and/or the fixing of capacity. In practice this covers alliances and code sharing agreements among international carriers in relation to both passengers and freight. If authorised, the price fixing or cartel rules within the Commerce Act do not apply to any such authorised agreement.

12. The Commerce Commission enforces New Zealand’s competition, fair trading and credit laws. The Commerce Act 1986 is New Zealand’s generic competition law statute. The Commission has an enforcement and adjudication role with respect to airline competition. Our enforcement role can include a

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range of actions. This might include educating a business about how to comply with the Act or issuing a warning, or we can prosecute a business or person in the High Court. The adjudication decisions of the Commission, an independent statutory authority, are subject to appeal to the New Zealand Courts and judicial review. The Commission is empowered to:

a) remedy and deter anti-competitive behaviour that substantially lessens competition;
b) remedy and deter the misuse of market power;
c) remedy and deter cartel conduct;
d) approve mergers and acquisitions except where they have the effect or would be likely to have the effect of substantially lessening competition in a market; and
e) authorise arrangements or mergers where they confer net public benefits.

13. A specific authorisation regime exists in the Civil Aviation Act for agreements relating to international civil aviation. Consequently, the prohibitions against anticompetitive agreements in the Commerce Act do not apply to conduct that is authorised under the Civil Aviation Act. Otherwise the Commerce Act and Fair Trading Act apply to domestic and international civil aviation.

14. In its 2012 report into International Freight Transport Services the New Zealand Productivity Commission considered whether to adopt, retain or amend this dual regime, or move to a Commerce Act only approach. The Productivity Commission is an independent Crown entity that provides advice to Government on improving productivity, and its reports are not government policy.

15. The Productivity Commission recommended that the responsibilities of the Ministry of Transport relating to international alliances and code sharing agreements be moved to the Commerce Commission. In response to the report, the Government has directed that the upcoming review of the Civil Aviation Act should consider how to strengthen the competition regime for international civil aviation services.

16. The Productivity Commission formed the view that the most important factor to ensure is that the authorisation process is based on a comprehensive analysis of the costs and benefits of the trade practices. Drawing on recent OECD guidance, the Productivity Commission indicated that a comprehensive analysis would include:

a) gathering sufficient information to assess and, if practicable, quantify the costs and benefits of trade practices;
b) coordinating with other overseas authorities in the review of international trade practices;

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c) providing transparent and publicly available rules, policies, practices and procedures for the authorisation process; and

d) evaluating previous decisions to improve authorisation processes and decision-making over time.

17. A Commerce Act-only regime for international alliances and code-sharing agreements was seen by the Productivity Commission as:

a) likely to provide a more comprehensive assessment of the costs and benefits of the trade practices that are proposed for authorisation;

b) more transparent than the current Civil Aviation Act regime; and

c) in line with current Australian practice.

18. On the other hand, the Productivity Commission pointed out that a Commerce Act-only regime does not require the decision-maker to consider New Zealand’s international obligations and international comity as the Civil Aviation Act currently does. The Productivity Commission also believes that the comprehensiveness of the analysis needs to be balanced against the need to avoid unnecessary costs and burdens on affected parties and third parties.

19. International passenger services were outside the scope of the Productivity Commission’s inquiry, which was focused on international freight services. The Productivity Commission noted that the Government should separately review the impact on passenger services before making any decision to adopt a Commerce Act-only regime.

20. If the Government were to retain the current competition regime, the Productivity Commission recommended that the Government should make changes to Part 9 of the Civil Aviation Act to improve the assessment of the benefits and costs of proposals to authorise certain trade practices.

3. **Competition issues in the airline sector**

3.1 **Our recent experience**

21. In the last ten years, the Commission’s assessment of competition issues in the airline sector has involved three main cases.

a) An application from Air New Zealand and Qantas for authorisation of a strategic alliance arrangement and for Qantas’ acquisition of shares in Air New Zealand. The Commission declined to grant authorisation in late 2003\(^{12}\) and this decision was upheld by the High Court on appeal in late 2004.\(^{13}\) *Air New Zealand and Qantas* is the only merger or acquisition in the airline sector that we have considered in the last eleven years.

b) Investigation of alleged unilateral abuse of market power by Air New Zealand in regard to a domestic provincial competitor’s (Origin Pacific) ability to compete. The Commission investigated the allegations but concluded that Air New Zealand had not taken advantage of its market power.

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\(^{12}\) Air New Zealand Limited and Qantas Airways Limited (Commerce Commission Decision 511, 23 October 2003).

\(^{13}\) *Air New Zealand & Ors v Commerce Commission & Ors* (2004) 11 TCLR 347.
c) Investigation into collusion in respect of surcharges imposed by airlines on international air cargo services (Air Cargo case). In 2008, the Commission filed proceedings against thirteen airlines for alleged collusion on fuel and security surcharges imposed on air cargo services to and from New Zealand. We reached settlements with eleven defendants, with Court-ordered penalties totalling $42.5m, and withdrew our proceedings against two other defendants.

22. These cases are discussed further below in the context of the OECD’s questions on market definition, horizontal agreements, mergers and abuse of dominance cases, and barriers to entry/expansion.

23. The Ministry of Transport has also been active in analysing competition issues in the last ten years, making a number of key decisions.14

a) Considering the Air New Zealand and Qantas Tasman Networks Agreement (TNA) before the application was withdrawn in April 2006.

b) Authorising the Air New Zealand and Virgin Blue group Australasian Airline Alliance in May 2010.

c) Authorising the Air New Zealand and Cathay Pacific Alliance in April 2013.

d) Authorising the Qantas and Emirates Coordination Agreement in May 2013.

e) Reauthorising the Air New Zealand and Virgin Australia Group Alliance in September 2013.

3.2 Market definition

24. New Zealand courts have reiterated that market definition is a tool to aid in competition analysis, rather than an end in itself. The Commission has moved away from defining markets as a first step in the analysis and recognise that relevant markets need not always be defined precisely.

25. In the case of airline markets the Commission did define the relevant markets as part of our assessment of the effects of acquisitions and anti-competitive conduct on competition.

26. Our experience shows that what markets are relevant varies depending on the acquisition or conduct at issue. The Air New Zealand and Qantas authorisation application (which related to both domestic and international air services) considered markets for air passenger services, air cargo, and travel distribution services. The Origin Pacific investigation only considered markets for domestic air passenger services. The Air Cargo case naturally focussed on markets for air cargo (or freight).

27. The Commission generally has regard to relative prices, quality and performance when assessing whether alternative products are, in fact, close substitutes in the eyes of buyers. The Commission agrees that in relation to the airline sector schedules, timeliness, interlining options, customisation, ancillary services, and airport location may also be relevant to market definition.

28. Due to New Zealand’s geographical isolation from other countries, alternative modes of transport are only potential substitutes for domestic flights, but even then are unlikely to be sufficiently close substitutes to bring them within the same market. For example, the Commission considered in Air New Zealand and Qantas that for some very short haul routes some substitution to other forms of transportation

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14 Please visit the following website for more information on each of these decisions: http://www.transport.govt.nz/ourwork/air/internationalairservices/internationalaircarrigecompetition/
may occur on domestic routes, eg, Blenheim to Wellington. However, the Commission considered that such substitution would not constrain the profitable imposition of a small but significant and non-transitory increase in price (SSNIP) by a hypothetical monopolist and therefore alternative modes of transport did not form part of the same relevant market.

3.3 Aggregation of city pair routes

29. Individual origin-destination (city pair) markets were identified in Air New Zealand and Qantas. This is because passengers are generally seen as ‘captive’ to particular routes in the sense that their travel plans are city pair specific. The city pair routes were then aggregated into geographic groups. This aggregation of city pair routes was done because the various city pair routes all faced the same or similar competitive constraints, not because they were considered substitutes.

30. The Commission found support for the city pair aggregation approach in the testimony of economic expert Professor Robert D. Willig. Professor Willig stated at the Commission’s six day conference\(^\text{15}\) in the Air New Zealand/Qantas matter that “if the routes are… pretty much the same in terms of the elements that should go into the competition analysis, then it is valid to analyse them together”\(^\text{16}\).

31. Supply-side substitution could support the adoption of wider market boundaries, such as a general international market, given the potential for airlines to divert aircraft to new routes. However, the airline would have to be able to ‘easily, profitably and quickly (generally within one year) switch production or locations in question without significant cost’.\(^\text{17}\) Given this, possible ‘near competitors’ are often better considered under barriers to entry/expansion.

32. We note that city pairs may not be the correct market in the case of certain holiday destinations. For example, in the case of flights from New Zealand to certain south Pacific islands, a segment of buyers may be indifferent between various island destinations.

3.4 Passenger air services market

33. In Air New Zealand and Qantas, within the passenger air services market we identified the following geographic markets:

a) domestic main trunk (routes between Auckland, Wellington and Christchurch) and domestic provincial markets (all other New Zealand domestic routes); and

b) international markets, made up of both direct and indirect flights across the Tasman, New Zealand to Asia, New Zealand to the Pacific Islands, New Zealand to the United States, and a market for other international locations.

34. The Commission found that the distinction between main trunk and provincial routes was readily apparent. Each had differing characteristics in terms of the number of passengers carried, and the size and type of aircraft used to maintain sufficient service frequency. Different participants operated in the main trunk and provincial routes, with a number of small operators operating only in the provincial market. The

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15 A conference is a process whereby parties can present their submissions on the draft determinations orally, and the Commission can ask questions based on those submissions.

16 Air New Zealand Limited and Qantas Airways Limited, above n 12, at [240].

The presence of these different market participants meant the markets could not be aggregated together to form a national market.

35. The Commission has used the city pair market definition in other cases, such as our Origin Pacific investigation. The Origin Pacific investigation is the only case in New Zealand’s airline sector concerning the alleged unilateral abuse of market power. The allegation came about after Origin Pacific, a small primarily provincial player, announced new non-stop flights between Christchurch and Hamilton on 1 September 2003. Before that announcement there were no non-stop flights between the cities. On 9 September 2003 Air New Zealand announced its own new non-stop flights between Christchurch and Hamilton. Origin Pacific then cancelled its plans to operate the service because it considered it could not viably fly the route in competition with Air New Zealand. The investigation only considered markets for domestic air passenger services.

36. Origin Pacific alleged that Air New Zealand’s behaviour was an abuse of market power and therefore a breach of section 36 of the Commerce Act.

37. The Commission concluded that, by introducing its own direct flights between Christchurch and Hamilton, Air New Zealand was exhibiting a competitive response to a rival in the marketplace. Air New Zealand’s behaviour is unlikely to have been materially different from what might have occurred in a competitive market.

38. In that case it was necessary to look at the individual city pair market as well as the indirect city pair market and the wider provincial market. The indirect city pair market and the wider provincial market were relevant to the consideration of whether or not Air New Zealand had a substantial degree of market power in those markets and whether it had taken advantage of that market power for an anticompetitive purpose.

3.5 Air freight market

3.5.1 Air cargo cartel case

39. In the Air Cargo case, the Commission had to establish that inbound cargo services were supplied in a ‘market in New Zealand.’ A number of parties argued that the air cargo service to New Zealand ended after take-off at the point of origin which meant their conduct did not form part of a New Zealand market.

40. At the first-stage hearing in 2011 the Commerce Commission succeeded on the issue of whether there was a ‘market in New Zealand’ for air cargo services from overseas countries to New Zealand. The Court held that it was sufficient that part of the market is situated in New Zealand, noting that it “[saw] the fact that part of the service takes place in New Zealand as an important facet of the reality that part of the market is in New Zealand”. In this case, the arrival and handling of cargo in New Zealand, and the demand for cargo shipments from New Zealand importers, were key factors in the Court’s finding that a market exists here for inbound cargo services.

41. The airlines had argued that these were markets in the overseas countries and were therefore subject to the relevant overseas laws and not to the New Zealand Commerce Act. The Court rejected the airlines’ argument that competition between the airlines stopped at the moment the cargo contracts were

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18 Commerce Commission v Air New Zealand and Ors, HC Auckland, CIV-2008-404-008352, 24 August 2011.
entered into at ports of origin, and found that such a narrow analysis “does not seem ... in accord with the facts and common sense”.19

3.5.2 Air New Zealand and Qantas authorisation

42. The air freight market in Air New Zealand and Qantas was divided into three geographic markets – New Zealand domestic, Tasman and international. Tasman and international air freight markets were limited to belly-hold freight.

43. The reason that the Tasman and international freight markets were limited to only belly-hold freight was largely due to the differing level of substitutability between belly-hold freight services and dedicated freight services. The Commission was of the view that substitutability was weak on both the supply and demand sides. Therefore, the Commission considered that the freight services supplied on passenger flights served a market distinct from that supplied by dedicated freighters.

44. The argument was made that dedicated freight services were not substitutable for passenger service belly-hold freight services for various reasons. These reasons included differences in price, route network, and frequency of flights such that the type of cargo and customer base tended to be different between the two types of services.

45. The Commission considered that the substitutability between belly-hold and dedicated freight may increase with flight distance. However, it was of the view that the imposition of a SSNIP by a hypothetical monopolist of belly-hold freight services on the international routes would be profitable. Dedicated freighters do not have the necessary frequency of service or comprehensive route network of belly-hold freight services to enable them to act as significant competitors.

46. The Commission was of the view that the Tasman market was differentiated from other international markets because of route density and possible backhauling.

3.6 Travel distribution services market

47. In Air New Zealand and Qantas the Commission was of the view that there was a national wholesale travel distribution services market. Travel distribution services consist of firms such as travel wholesalers, travel agencies, travel management companies (TMCs), consolidators (who purchase air tickets from airlines that are not available to travel agencies and TMCs and sell them to travel agencies), and airlines who sell tickets to consolidators, travel wholesalers and directly to the public.

48. The Commission considered that it was the relationship between the airlines and the travel wholesalers that was relevant, rather than the downstream purchase by the end consumer (the retail market).

3.7 Direct and indirect flights

49. The Commission is of the view that where fares on a direct route are likely to be constrained by fares on an indirect route, those indirect routes are relevant to competition analysis. This will depend on the facts and it is likely that such indirect routes will need to result in relatively little extra expenditure or time to passengers.

19 Ibid.
50. For routes that involve long haul flights, indirect flights are likely to be substitutable because the time delay as a result of a stopover is likely short relative to the length of the entire flight. This is not the case for short-haul flights. That said, the indirect city pair route of Hamilton to Christchurch via Wellington was considered relevant in the Origin Pacific investigation, despite it being a relatively short flight, demonstrating how each case is fact dependent.

51. The Commission considered indirect flights on international routes to act as competitive constraints to direct routes in Air New Zealand and Qantas. The ability for these indirect flights to stopover in another country (such as Australia on the way to or from Asia) depends entirely on the ASA that is signed between countries and the freedom rights that are agreed to. Fifth freedom rights (as well as the variations of these rights found in the sixth and seventh freedom rights) allow an airline to carry revenue traffic between foreign countries as part of a service connecting the airline's own country. From that perspective, fifth freedom rights are an important factor in maintaining competition in international markets.

3.8 **Hub and spoke business model**

52. It does not appear likely that any hub and spoke model would have the result in changing the definition of a relevant market in New Zealand. It is likely that New Zealand is too small to support a hub and spoke business model and market definition is likely to continue to focus on city pairs, which may be aggregated where appropriate.

53. The hub and spoke model is unlikely to apply to the Tasman market as it was defined in Air New Zealand and Qantas. This is because of the diverse nature of the traffic between all of New Zealand and Australia’s main airports (Auckland, Christchurch, Wellington, Sydney, Brisbane and Melbourne) as well as some of the smaller airports in both countries.

54. Arguably the hub and spoke model may be more appropriate in selected international markets, including Asia and the Pacific Islands. However, this is only likely to mean that indirect flights become more relevant to market definition as they provide a stronger competitive constraint on those routes.

55. The Commission has not specifically considered whether a hub and spoke situation exists in any particular market, but rather focused on the competitive constraints that exist on the relevant routes.

3.9 **Business and leisure passenger distinction**

56. In Air New Zealand and Qantas, the Commission considered whether to further disaggregate the air passenger services market into two distinct markets: the market for business and the market for leisure passenger air services.20

57. The Commission considered in that case that there is differentiation between business and leisure passengers, particularly in regard to price and flight frequency, and this is further emphasised by the ability of airlines to successfully price discriminate between the two segments.

58. The Commission considered that business fares were unlikely to act as a disciplining factor on leisure fares as leisure passengers generally had a greater flexibility with respect to time and a greater discretion over the necessity to travel. Leisure fares may in some circumstances act as a disciplining factor

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20 In another decision, Air New Zealand / Ansett Holdings / Bodas Pty Ltd, (Commerce Commission Decision 278, 3 April 1996), leisure passengers were further disaggregated into ‘Visiting friends and relatives’ (VFR) and leisure passengers markets.
on business fares, but such an influence would be dependent on the levels of service and frequency being comparable. As a result the Commission concluded that from a demand-side substitutability perspective business and leisure passenger products did exhibit a significant degree of differentiation and did appear to fall into different markets. However, for the purposes of considering the competition effects of the proposed alliance in \textit{Air New Zealand and Qantas}, the Commission decided that they would be considered as two segments of a differentiated product market, rather than as separate markets.

59. The fact that business passengers have less elastic demand and leisure passengers more elastic demand is only relevant where that affects the number of substitutes available to them. However, in this case due to the nature of the market participants being considered, the main influence that this differing elasticity had on the passengers’ decision was as to time or price, not a switching away to other competitors.\footnote{The LCC model was far less prevalent in the New Zealand market at the time of this case.}

60. As a general point, there is difficulty in meaningfully separating the two segments for the purposes of competition analysis. The lack of availability of discrete data, particularly for New Zealand domestic travel, makes it difficult to draw such a distinction. Since \textit{Air New Zealand and Qantas} the boundaries of the differentiation gap have also become less clear with the recent emergence of added value services from low cost carriers on a user pays basis and the elimination of first class seating in some markets. These factors ultimately make the meaningful application of a SSNIP difficult on both a theoretical and practical basis.

\subsection*{3.10 Co-operation, horizontal and cartel agreements}

61. We have only had one cartel in the airline sector, the air cargo cartel, as well as a cartel in the closely related freight forwarding industry. Detecting, investigating and prosecuting cartel conduct is always a high priority for the Commission.

62. The Commission believes that the increased consolidation of the sector in recent years, with a number of alliances taking place, does raise the risk of coordinated conduct. The recent Air Cargo case shows that coordinated conduct is possible in the airline sector.

\subsection*{3.11 Mergers and abuse of dominance cases}

63. There have been no merger applications made to the Commission in the past ten years other than the application for authorisation by Air New Zealand and Qantas. As discussed, there has also only been one case of alleged unilateral conduct.

\subsection*{3.12 Barriers to entry and expansion}

64. The Commission uses the LET test (likelihood of entry, extent of entry and timeliness of entry) to ensure that entry or expansion is likely to have a tangible effect on the relevant market.

65. The Commission considered barriers to entry and expansion in some detail in \textit{Air New Zealand and Qantas}. The barriers were mainly examined in relation to the Tasman and domestic markets.\footnote{Within the international market, the focus was on existing competition and what routes constrain others, considering both direct and indirect flights.} The Commission considered that the following conditions of entry and expansion may have been important determinants of the ability of an airline to enter and expand in the main trunk market and so required further analysis:
1) scale and scope of entry;
2) sunk costs, including the acquisition of a reservation system, terminal facilities, engineering facilities, advertising for brand recognition, aircraft painting, pilot training, and manuals;
3) access to feeder services (air services that feed passengers into the main airports);
4) access to travel distribution services;
5) brand awareness;
6) size of the market;
7) capital requirements;
8) the potential response of the incumbent market participants;
9) loyalty schemes operated by the incumbent market participants; and
10) access to airport facilities in New Zealand.23

66. We discuss loyalty schemes and slots below. The other conditions of entry and expansion are arguably more fact dependent.

3.13 Loyalty schemes

67. The Commission has considered pricing and loyalty schemes. In Air New Zealand and Qantas the Commission considered that loyalty schemes and corporate contracts could and did act as barriers to targeting the business customer. This was particularly true for new entrants and for those that do not have the frequency of flights necessary to provide a comparable alternative for the business traveller. This was only applicable to the Tasman and domestic main trunk markets in this case.

68. However, the Commission also recognises that loyalty schemes could be a form of competition and would always take a fact dependent view of the competition effects of loyalty schemes.

69. The High Court took a different view, stating that there was:

…no necessity for a new entrant to introduce an equivalent scheme or to incur any other costs in order to attract new business. It disadvantaged only in its ability to appeal to that class of potential customers who are members of a loyalty scheme and who face some disincentive to switch to another airline. That may be granted as a barrier to expansion in the sense that the new entrant faces a limitation not shared by incumbents, but it is not, in our view, a barrier to entry. 24

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23 Airport facilities included slots, gates, counter facilities, maintenance and ground handling services on reasonable terms and timings. The argument was made by Virgin Blue in Air New Zealand and Qantas that a barrier to entry may be access to the Auckland domestic terminal. There, where there was no formal slot allocation process, the issue was said to be one of facilities such as counter facilities, as opposed to availability of slots.

24 Air New Zealand & Ors v Commerce Commission & Ors, above n 13, at [103].
3.14 Slots

70. No real shortage of slots exists at this time in New Zealand because of the relatively low number of airline competitors wanting access to airports, and the relatively low number of flights.

71. ACL International has been appointed as the slot coordinator for Auckland, Wellington, Christchurch and Queenstown international airports. 25 Auckland, Wellington and Christchurch international airports have their slots managed at level three, where ACL International:

a) manage excess demand through mandatory slot allocation;

b) maintain desired standards of service, eg, queuing, delay;

c) slot monitoring to ensure compliance; and

d) capacity governance to international best practice standards.

72. Queenstown International airport have their slots managed at level two, where ACL International is tasked to:

a) smooth peaks in demand through voluntary adjustments;

b) make best use of existing facilities and resources;

c) ensure profitable investment in new capacity; and

d) benefit from ACL’s experience optimising capacity utilisation.

25 ACL International “Slot Coordination” (2014) ACL-UK