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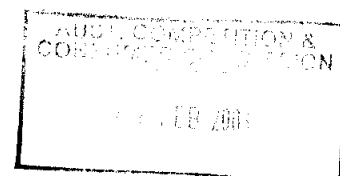
Dear Mr Grimwade,

I refer to the several items of correspondence from the Australian Competition and Consumer Commission (ACCC) sent in December, January and February inviting comments from the NSW Government on the application for authorisation of proposed arrangements by Qantas Airways Ltd and Air New Zealand (A30220, A30221, A30222). Thank you for the opportunity to comment on the proposed alliance.

On the basis of the information available the proposed authorisation sought is supported in principle. However, the NSW Government has a number of concerns which could be addressed through conditions that the ACCC may impose on the authorisation in relation to the impact on regional aviation transport in the State, through risks to local employment and potential damage to tourism. These concerns are detailed below.

As a matter of policy, the NSW Government is clearly committed to encouraging competition as a means of achieving sustainable and efficient economic performance and suitable standards and quality of services. This policy position applies equally to the aviation industry. It is acknowledged, however, that the global situation of the aviation industry is facing critical challenges and the proposed alliance between Qantas Airways Ltd and Air New Zealand is seen by the proponents as a means of addressing the viability and sustainability of a full service Australasian air service.

The future of the local aviation industry, both in its domestic and international dimensions, appears to be highly sensitive to external factors, particularly international. The failure in recent years of a number of large international industry players and the poor profit performance of the industry generally provides support to this argument.



The proposed alliance could reduce competition on the trans-Tasman route. The argument used to support the alliance is one of public benefit. According to Qantas the benefits from the proposed alliance would be:

- improved cost and scheduling efficiencies;
- increased tourism into Australia and New Zealand;
- improved freight operations;
- increased international competitiveness of Qantas and Air New Zealand;
- the preservation of a viable full service Australasian airline; and
- the furtherance of the national interest.

If these arguments are accepted there are several issues which are of concern to NSW.

The intrastate aviation market has deteriorated in recent years due to a number of factors. The strategy that is adopted by Qantas in relation to its intrastate operations has the potential to have a significant affect on regional and rural areas (see below).

As a dominant player in the domestic aviation industry and as a major employer, particularly in NSW, operational decisions made through the alliance in relation to ground based support to the aviation activities may similarly have adverse affects that would not be in the public benefit.

The trans-Tasman tourism market is an important element in the NSW tourism market. The proposal suggests a potential for growth in tourism as a result of the alliance. However, this is dependent on decisions made through the alliance and conditions of approval may need to be applied to ensure the greatest opportunity to achieve this outcome.

### **Impact on regional aviation in NSW**

At 4 February 2003, 33 NSW rural and regional centres have air links to Sydney. 14 other towns lost their air links to Sydney during 2001, with no losses occurring in 2002.

There is a concern that a number of the air services in NSW are operating unprofitably, giving rise to uncertainty and further potential for instability in the industry. This matter was raised in the NSW Government's submission of August 2002 to the Federal Inquiry into Commercial Regional Aviation Services in Australia.

Some recent developments increase this concern:

- Qantas support for air services to Inverell and Glen Innes was withdrawn as of 14 February 2003 and is likely to cause those services to cease.
- Qantas withdrew from Taree and Cooma in August 2002. In these cases, Horizon Airlines took up the services. Horizon also entered the Sydney – Williamtown route where it is competing with Qantas.
- Queensland operator Macair Airlines, which replaced Qantas on the Brisbane to Armidale and Tamworth route in July 2002, ceased these services in January 2003 citing lack of commercial viability as the determining factor.
- Overall the Qantas withdrawals have had a significant destabilising effect within rural and regional NSW.
- Regional Express Airlines (Rex) (which acquired Hazelton and Kendell Airlines) continues its endeavours to build a sustainable operation.

- Rex has only a small share of the NSW market and faces extensive competition from Qantas and Virgin Blue's entry into Coffs Harbour.

There has been a fall in total demand for NSW intrastate air services to and from Sydney from 1.4 million passengers in the 2000/01 financial year to 1.0 million in 2001/02. This represents a reduction of 28% and is well in excess of the downturn indicated for international and interstate air travel in the same period.

Qantas, through its regional carrier QantasLink, provides employment opportunities for a range of people directly involved with the airline and related services. (QantasLink became the common brand in May 2001 for the five Qantas regional airlines: Qantas Airlink, Eastern Australia Airlines, Impulse Airlines, Southern Australia Airlines and Sunstate Airlines.)

The NSW Government is concerned about what strategy Qantas might pursue in relation to its intrastate operations. Further to the information outlined above, it might be expected that, whether or not the Air New Zealand proposal proceeds, Qantas may withdraw further services from less viable intrastate routes while continuing to dominate smaller competitors in the more profitable intrastate markets.

The NSW Government will continue to monitor this situation and is concerned at the prospect of an increasing number of monopolies developing in NSW intrastate air markets.

It is understood that Regional Express is opposed to the Qantas/Air New Zealand alliance proposal mainly because it will negate an agreement to book Air New Zealand passengers on Rex services. In this instance, the ACCC should examine whether or not there is any specific remedy, such as a condition of approval, which would uphold the agreement referred to by Rex.

### **Competition issues and impact on employment**

Any negative impact from the Alliance for NSW, if approved, would be on Qantas' existing operations and facilities in Sydney and the effect on the general public from a loss of competition particularly on trans-Tasman services.

In its arguments in support of the proposal, Qantas has not dealt in any significant detail with the potential impact on employees and its facilities in NSW. It maintains that Qantas and Air New Zealand Head Offices would not change. It does suggest that Air New Zealand might attract more of the engineering work Qantas currently out sources to airlines such as Singapore Airlines.

Qantas does, however, in general terms, refer to the potential for achieving savings from economies of scale in the areas of lounge maintenance, IT systems, baggage handling and check-in services. The precise impact cannot be ascertained at this stage.

In terms of competition, the main impact will be on trans-Tasman services. However, Qantas argues that, while there is the potential for the alliance to lessen competition in the relevant markets, the overall net benefits from the proposals (referred to above) should outweigh these concerns. Moreover, the trans-Tasman market is unprofitable for Air New Zealand and only just breakeven for Qantas, suggesting that the existing competition between the two airlines may not last in any case.

Competition concerns are largely offset by the timely emergence of Virgin Blue, which not only seeks to further consolidate its Australian domestic operations but has shown clear interest in the trans-Tasman and New Zealand domestic market. In other words, it is feasible that any concerns over the loss of competition between Qantas and Air New Zealand may be offset by the emergence of Virgin Blue, on

the assumption that this value based service actually occurs. In this context it may be noted that Virgin Blue has sought a strengthening of the undertakings by the proposed Alliance.

However, it should be noted that the recent withdrawal of Air New Zealand from its direct Australia-United States flights and the uncertainty regarding the future of United Airlines makes a loss of competition of the Pacific route to the United States of concern. It is suggested therefore, that in conjunction with any authorisation granted that the Commonwealth Government amend its aviation policy to open access to the trans-Pacific route to a wider range of competition.

Also, consideration should be given to continuing the encouragement of fifth freedom carriers, ie, carriers that fly into Australia and can utilise their otherwise idle aircraft on the Tasman before returning to their home port. They can have the capacity to act as a countervailing competitive force on the trans-Tasman route.

### **Impact on Tourism**

The main concerns from a tourism perspective relate to pricing and scheduling arrangements should the merger proceed. Tourism from New Zealand is important for the NSW economy and capacity, and therefore adverse pricing decisions, could disrupt this market. While recognising the fact that Air New Zealand's ongoing losses on the Tasman service cannot be sustained, an alliance is preferable to a monopoly, which would be the result should Air New Zealand collapse or wind back its loss making services.

As I indicated at the outset, the NSW Government supports in principle the proposed Alliance. However, concerns over its impact suggest that undertakings given to support the Alliance will need to be factored in as conditions of any authorisation to ensure that the public benefits derived through the reduced competition are shared rather than diverted into benefits to monopoly activities.

The NSW Government would be grateful for the opportunity to comment on any conditions which may be proposed should the ACCC determine that it will grant the authorisation sought by Qantas Airways Ltd and Air New Zealand.

If you would like to discuss this issue further, please do not hesitate to contact John Scott, Director, Strategic Projects on ph 9228 4989, email [john.scott@premiers.nsw.gov.au](mailto:john.scott@premiers.nsw.gov.au) or fax 9228 4096.

Yours sincerely



C Gellatly  
Director General