

7. **COMPETITIVENESS IN AUSTRALIA-NORTH AMERICA PASSENGER MARKET**

- 7.1 The market between Australia, New Zealand and North America is currently the subject of the United Airlines-Air NZ Alliance Expansion Agreement (the **United Alliance Agreement**), which has been granted antitrust immunity in New Zealand and the United States. Subject to receipt of necessary regulatory approvals, the United Alliance Agreement provides for price and schedule co-ordination between United Airlines and Air NZ. To date, Australian regulatory approval has not been sought for services between Australia and North America.
- 7.2 The Transactions will not apply in respect of the market between Australia and North America unless and until all or the relevant parts of the United Alliance Agreement come to an end. There will therefore be no impact on competition in this market until that time. In any event, the competitive effect in this market as a result of the Transactions is likely to be minimal predominantly for the reason that barriers to entry on routes between the two countries are low and United Airlines is the main competitor to the Parties in that market.
- 7.3 While it is likely that United Airlines will file for Chapter 11 bankruptcy protection, it is also likely that United Airlines will continue to operate in this market. Having regard to the obvious uncertainty that the Chapter 11 bankruptcy process entails, the Parties will provide further information regarding the likely competitive effects in this market shortly.

## 8. COMPETITIVENESS IN FREIGHT MARKETS

8.1 Freight services comprise both dedicated freight services and the cargo hold capacity in passenger services. As noted by the Productivity Commission:

More than 90% of Australian international air freight is carried in the bellyholds of passenger aircraft ... Less than 10% of Australia's international airfreight is carried in dedicated freighter aircraft, operated predominantly by foreign airlines.<sup>76</sup>

8.2 The impacts arising in the Freight Market are likely to be similar to those in the Passenger Air Services Market. It was on this basis that the ACCC concluded in the *SQ/AN/NZ* determination:

The majority of air freight to and from Australia is carried on passenger flights and as such the level of competition within the air freight market is dependent upon many of the same factors as within the passenger market.<sup>77</sup>

8.3 The Parties agree with the ACCC's finding in *SQ/AN/NZ*, in which the ACCC found the level of competition within the air freight market to be "relatively high".<sup>78</sup>

### **Low barriers to entry and no barriers to expansion**

8.4 Potential new entrants in the Freight Market face low barriers to entry and no barriers to expansion as many of the alleged barriers which are discussed in respect of the Passenger Air Services Market are low or non-existent in the Freight Market – for example, marketing and advertising outlays, brand loyalty and frequent flyer programmes.

8.5 Any Australian or New Zealand carrier is free to establish unlimited freighter services on the trans-Tasman and further services may be provided by the many foreign carriers which have fifth freedom freighter rights on the trans-Tasman. Australia and New Zealand have also exchanged unlimited seventh freedom cargo rights with the United States. This allows United States freight carriers to freely operate standalone services on

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<sup>76</sup> Productivity Commission, *International Air Services*, September 1998, pages 24-25.

<sup>77</sup> ACCC, *SQ/AN/NZ* determination, page 55.

<sup>78</sup> ACCC, *SQ/AN/NZ* determination, page 56.

the trans-Tasman and on other international routes to and from New Zealand and Australia.

- 8.6 Specialised freight carriers could therefore readily enter or expand and defeat any attempt to increase prices in this market.

9. **COMPETITIVENESS IN TRAVEL DISTRIBUTION SERVICES MARKET**

9.1 Airlines, wholesalers, consolidators and retail travel agents all compete in the one market for the sale of airline tickets.

9.2 There are in excess of 4,600 travel agents in Australia and an increasing number of these agents are offering their services over the Internet. The key Internet distributors include: travel.com, webjet, and zuji, as well as other retailers such as Flight Centres, UTAG, and Harvey World Travel.

9.3 The market for airline ticket sales is primarily based around the Bank Settlement Plan ('BSP')<sup>79</sup> in Australia as the majority of international business is transacted through agents and not direct with the airlines. The market has a relatively low concentration, approximate shares of the BSP via key agents in Australia being:

<b>Travel agent</b>	<b>Share</b>
Flight Centre	23%
Concorde Group	13.4%
American Express	12%
Jetset/Travelworld Group	7%
Consolidated	6.7%
Travelscene/UTAG Group	6.5%

9.4 Under the Transactions, each Party will retain its current distribution structure in the Australian market. The Parties in the foreseeable future will maintain their own yield

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<sup>79</sup> Bank Settlement Plans are run in many other countries besides Australia. Travel agents submit net payment for all the tickets they have issued regardless for which airline the ticket is for. This will be net of commission or refunds. BSP consolidates all agents' reports and settles with each airline. The airlines do not have the systems in place to deal with payment from all these agents individually.

and inventory management systems and their own sales teams. In time, there may be some movement towards using common systems and there may also be some co-location of offices.

9.5 However, the Parties will negotiate jointly with distribution channels, including wholesalers, consolidators, and retail travel agents, in relation to commissions and incentives and other agency terms.

9.6 In the *SQ/AN/NZ* determination, the ACCC indicated an interest in assessing whether the formation of an integrated alliance may impact on commissions paid to travel agents. The ACCC concluded that the *SQ/AN/NZ* alliance would not impact on commissions for a number of reasons, including:

- (a) there is a general trend towards fee for service within the travel industry which would reduce the dependence of travel agents on any one particular airline or commission level; and
- (b) competition in the sale of airline tickets is likely to increase particularly as a result of Internet ticket booking services.

All of the distribution channels supply services in the wider travel market and deal with a multitude of airlines, hotels, rental car companies and other participants in the travel industry. In the context of the Transactions, the combination of Qantas and Air NZ will not result in a material change in the relative bargaining strength of the Parties and travel distribution channels.

9.7 The constraints faced by the Parties from existing competitors will not be reduced. The Parties' retail operations will be unable to raise the prices charged for selling tickets above competitive levels because:

- (a) consumers can access different functional levels within the market;
- (b) there are a significant number of existing competitors in the market; and
- (c) market concentration is low in the market.

9.8 The ACCC has noted that competition in this market is likely to increase in the future:

“...the dynamics of the market were such, especially with the introduction of internet booking services, that competition was likely to increase in the future.”<sup>80</sup>

Overall, there is unlikely to be a material impact on competition in the Travel Distribution Services Market.

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<sup>80</sup> ACCC, *RJSA* determination, page 67.

## 10. CONCLUSION ON LESSENING OF COMPETITION

### **Passenger Air Services Markets**

- 10.1 Passenger air services on the trans-Tasman are highly contestable. Existing competition from fifth freedom carriers already exerts a significant constraint on the Parties. In addition, expansion from a VBA is inevitable.
- 10.2 United Airlines' ongoing presence in the market between Australia and North America will provide a significant constraint on the Parties. In addition, the liberal regulatory regime and low barriers to entry make the threat of potential competition from other international carriers, particularly United States carriers, an additional constraint on the Parties.
- 10.3 The Parties will also offer undertakings designed to facilitate and protect new entry on trans-Tasman routes and to ensure that the Alliance does not take unreasonable actions relating to capacity and prices on routes where the Parties will be the sole operators.

### **Freight Market**

- 10.4 The freight market is highly competitive. The presence of numerous competitors, both in the form of fifth, sixth and seventh freedom operators and dedicated freight operators, combined with low barriers to entry and no barriers to expansion, ensure that the Parties will be constrained from increasing prices or reducing capacity. There is unlikely to be any reduction in competition in the market for freight services.

### **Travel Distribution Services Market**

- 10.5 Finally, there will be no material adverse impact on competition in the Travel Distribution Services Market.

## 11. PUBLIC BENEFITS ARISING FROM THE TRANSACTIONS

### Introduction

- 11.1 This section describes the public benefits which will result directly from the Transactions. These public benefits are substantial, quantifiable and demonstrably outweigh any competitive detriment that may result from the Transactions. NECG has conducted a detailed analysis of these benefits and quantified them to the extent possible. Some substantial public benefits from the Transactions are unquantifiable, and therefore NECG's modelling results understate the total public benefits flowing from the Transactions.
- 11.2 The Parties note that NECG has prepared its modelling on a *worst case scenario*. That is, NECG has adopted a conservative approach in its modelling of benefits and their reported results represent the minimum benefits which will flow from the Transactions. Nevertheless, NECG's modelling establishes that the Transactions will result in substantial benefits to the Australian public relative to the counterfactual.
- 11.3 The primary sources of benefits from the Transactions are:
- (a) cost efficiencies;
  - (b) scheduling efficiencies;
  - (c) increased tourism to Australasia;
  - (d) improved freight operations;
  - (e) increased international competitiveness of Australia's aviation industry;
  - (f) preservation of a commercially viable full service Australasian airline and network; and
  - (g) furtherance of the national interest.

These benefits are set out in detail in the NECG Report.

- 11.4 The benefits flow from and are dependent on the Transactions. These benefits are net gains to society.



11.5 The NECG report characterises these benefits and quantifies them to the extent possible. The share of the benefits attributable to Australia is as follows:

*Summary of total annual public benefits to Australia, A\$'000 (NPV)*

	Benefits					<b>TOTAL BENEFIT</b>
	Cost Savings	Scheduling	New Direct	Tourism	Freight	
1	-\$13,844	\$2,501	\$11,299	\$33,980	\$418	34,354
2	\$58,552	\$2,360	\$10,660	\$77,082	-\$14	148,640
3	\$121,960	\$2,226	\$10,057	\$111,281	\$1,113	246,637
4	\$119,486	\$2,100	\$9,487	\$105,181	\$1,113	237,367
5	\$112,815	\$1,981	\$8,950	\$98,758	\$1,113	223,617
5yr Total	\$398,968*	\$11,168	\$50,453	\$426,283*	\$3,743	890,615

\* represents rounding error

This table excludes the following substantial public benefits which cannot be readily quantified:

- enhanced connectivity;
- increasing global competitiveness;
- preservation of a first tier full service Australasian airline with a comprehensive domestic and international network; and
- furtherance of the national interest.

**Cost Efficiencies**

11.6 Strategic alliances between competitors often result in benefits through cost rationalisation, efficiencies and/or synergies. The Transactions will produce two types of cost efficiencies:

- (a) economies of scale; and
- (b) more cost efficient aircraft usage and maintenance.

### **Economies of Scale**

- 11.7 Scale economies are likely to be derived from co-ordinating lounge maintenance, IT system maintenance and some front line functions such as baggage handling and check-in services.
- 11.8 The Alliance contemplates that the Parties may combine sales offices and marketing, purchasing and other aspects of their businesses. This integration could give rise to significant economies of scale, which NECG has not modelled in its report due to difficulties in quantifying these impacts.
- 11.9 The NECG report therefore understates the efficiencies which may be achieved by the Alliance.

### **Aircraft Usage**

- 11.10 Under the Alliance, the aircraft used will be determined by joint corporate imperatives, enabling the airlines to save costs by reducing duplication in departures and selecting the most efficient aircraft for particular flights.
- 11.11 NECG's modelling demonstrates that considerable cost savings can be achieved as compared to the counterfactual by reallocating aircraft across sectors and from aircraft rationalisation.

### **Scheduling Efficiencies**

- 11.12 The Transactions are likely to result in a significant change to the scheduling of flights on routes currently served by both Qantas and Air NZ. These changes are likely to generate several categories of public benefits, namely:
- (a) improved flight frequency;
  - (b) enhanced connectivity; and
  - (c) additional direct services.

### **Improved flight frequency**

- 11.13 Where Qantas and Air NZ have been in competition with each other on a route, each has a strong incentive to schedule flights at roughly the same times as its rival. Firstly, the airlines will seek to operate their flights at those times when there is the greatest level of high yield traffic in order to maximise their load factors and revenue. Secondly, each airline will seek to draw business away from the other. The result is that there is considerable alignment and overlap between the schedules of Qantas and Air NZ on the trans-Tasman routes.
- 11.14 Under the Alliance, the incentive to "mirror" one another's schedules no longer exists. The objective for a unified operator is to arrange the schedules such that optimum frequency is provided to consumers, minimising "spilt" traffic that cannot be served because of schedule gaps. In addition, consumers receive a greater choice of flight times – and obvious benefits will accrue to consumers who are presently unable to fly at a convenient time.
- 11.15 The Parties are likely, on some routes, to replace two overlapping flights with one flight with greater capacity and to offer an additional flight at a new time.
- 11.16 The improved scheduling under the Alliance will provide substantial benefits to the Australian public in two main ways. The consolidation of overlapping flights into one flight with greater capacity will free up both the use of an aircraft and additional landing slots at peak times. This will release a valuable resource and facilitate entry or expansion by other airlines. There is a public benefit in better and more efficient use of existing resources.

#### **Enhanced connectivity**

- 11.17 The second general type of scheduling efficiency concerns the opportunities for passengers to connect seamlessly with onward services. The Alliance will enhance connectivity in this way for passengers arriving in Australia on Air NZ and for those arriving in New Zealand on Qantas.
- 11.18 Qantas and Air NZ each possess a broad network in their own domestic and international sectors. Each will be able to codeshare on the other's flights. Therefore, the Alliance will deliver substantial benefits through enhanced connectivity.

### **Additional direct services**

- 11.19 There are significant benefits associated with the provision of the new direct services described in the NECG Report. Passengers who currently travel indirectly can complete their journeys more quickly and with significantly less effort.
- 11.20 The presence of direct services stimulates demand on that city-pair, so the number of travellers increases on the new city pairs. Also, because traffic is taken off the indirect flights, those routes will have additional capacity which the airlines will need to fill, which will lead to lower fares on those routes.

### **Tourism Benefits**

- 11.21 The Transactions will bring significant benefits to tourism in Australia and New Zealand as detailed in the NECG Report.
- 11.22 The Alliance would open up opportunities for co-operative advertising, primarily in retail sales promotion of home markets. Co-operative advertising would lead to more effective promotion as well as rationalisation of expenditure, freeing up existing expenditure for promotion in other areas. Opportunities for savings and leveraging through joint media purchasing will also be exploited by the parties, to provide increased and improved promotion of the Australasian region as a tourist destination.
- 11.23 In addition, the Parties would be able to offer a new product in the form of streamlined Australasian itineraries to offshore markets, increasing the number of dual destination travellers to the region. The Alliance will also stimulate tourism through new flights, new fares and an enhanced network.
- 11.24 Importantly, Qantas Holidays will have an incentive to market both Air NZ as a carrier and New Zealand as a destination. Absent the Alliance, Qantas Holidays would not market Air NZ as a carrier at all, and would only market those destinations in New Zealand which it serves from Australia.
- 11.25 NECG has estimated that these developments in regional tourism will lead to an additional 18,000 tourists to Australia.

### **Freight Operations**

- 11.26 The Alliance will continue to provide, and in some cases improve, freight access to major markets, to the benefit of Australian importers and exporters. Co-operation in respect of freight will create opportunities for the Parties to expand freight services.
- 11.27 NECG has calculated that the Transactions will increase freight capacity by over 5% (relative to the counterfactual) by year 3. This alone will provide a combined benefit of A\$4 million per annum.
- 11.28 The Transactions will also create (unquantifiable) benefits for freight through:
- (a) improved scheduling, which would deliver efficiency benefits, particularly for the delivery of perishable freight;
  - (b) realisation of cost savings from the use of common facilities and systems; and
  - (c) possible joint freighter services.

### **Global Competitiveness**

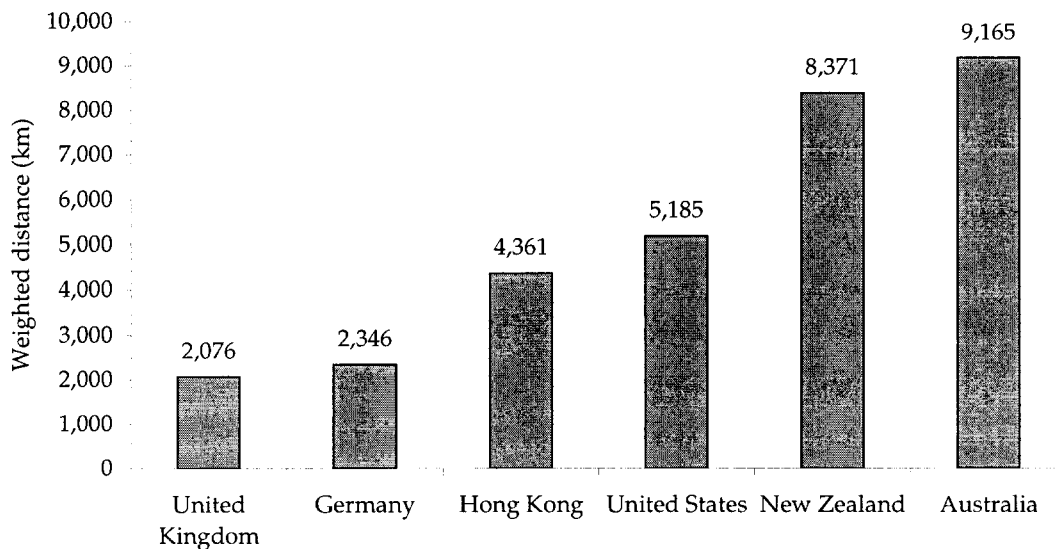
- 11.29 As discussed in section 3, one of the primary drivers for the Transactions is the Parties' need to maintain their ability to compete in the increasingly competitive and volatile global aviation market.
- 11.30 It is important for both Australia and New Zealand for this region to own a significant first tier international network airline. Many of the benefits in this section, particularly those associated with additional flying and network reach extensions, would not be available at all in the event that pressure from a large northern hemisphere or regional based carrier were to erode the viability of airlines domiciled in Australasia.
- 11.31 Pursuant to section 90(9A) of the TPA, an increase in the global competitiveness of the Australian aviation industry must be taken into account as a public benefit:
- 'In determining what amounts to a benefit to the public [and] ... without limiting the matters that may be taken into account, the Commission must take into account all other relevant matters that relate to the international competitiveness of any Australian industry.'
- 11.32 The underlying purpose for the section is described in the second reading speech in respect of section 90(9A):

There has been some concern that a more stringent merger test could impede firms' abilities to achieve the necessary scale to develop export markets or to compete effectively with imported products. To allay these concerns this Bill contains amendments to the merger authorisation provisions....<sup>81</sup>

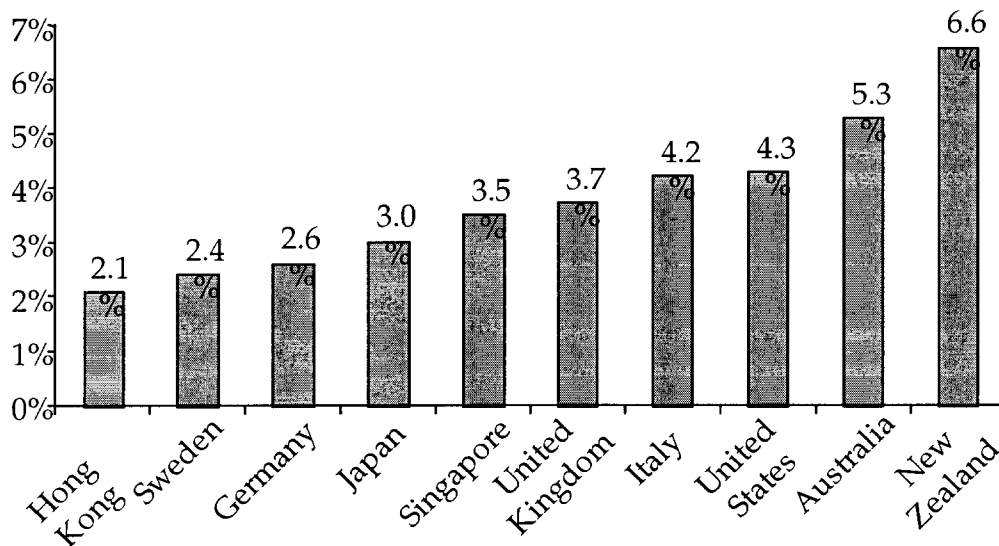
**Preservation of a First Tier Full Service Airline and Network in Australasia**

11.33 A significant, though unquantifiable, benefit associated with having a robust, first tier, FSA located in Australasia is the network that it can provide linking Australia to its trading partners and sources of inbound tourism. The charts below illustrate this.

**Weighted average distance to 10 major trading partners, 2001**



**Estimated 2002 Travel & Tourism Industry as % GDP**



<sup>81</sup> Second reading speech for *Trade Practices Legislation Amendment Bill* No 222 of 1992.

## The National Interest

11.34 The Australian Government has consistently acknowledged, in numerous contexts, the importance, not only of international aviation for Australia's trade and tourism interests, but also the importance of aviation services connecting rural and regional Australia.

11.35 On 26 November 2002, in the context of the Alliance, the Deputy Prime Minister and Minister for Transport and Regional Services, Mr John Anderson, said:

"I believe that Australia needs to think carefully about how we make certain that, as many international airlines . . . disappear over the next few years, Australia still has a flag carrier and a strong flag carrier at the end of it. ...

We have to look at the reality of the international aviation market and the enormous pressures that are emerging as rationalisation proceeds.

Frankly, when it comes to [Qantas'] place as an international carrier, an economy the size of Australia can only afford one international carrier of stature and we want to ensure that we still have one in a decade's time, when I predict there will be many fewer international carriers.

Important as the consumer interest is, what I'm worried about is that we don't only look at the consumers' interests."<sup>82</sup>

11.36 It is well established, and has been previously accepted by the ACCC, that Government policy is relevant and that furthering the national interest, as articulated by the Commonwealth Government, is a public benefit.<sup>83</sup> As this submission demonstrates, the objectives of the Parties are, and the outcome of the Alliance will be, entirely consistent with Australia Government policy and the national interest. This is a public benefit that must be taken into account by the ACCC in determining whether the Transactions satisfy the tests for authorisation.

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<sup>82</sup> Jason Koutsoukis and Jane Boyle, "Anderson pushes Qantas deal", *Australian Financial Review*, 27 November 2002.

<sup>83</sup> ACCC, *JSA determination*, page 66.

## Conclusion

11.37 The proposed Alliance will generate substantial benefits to the Australian public, including air passengers, importers and exporters, the tourism industry and the airline industry. NECG has estimated that the quantifiable benefits to Australia will be over \$A240 million per annum by year 3 of the Transactions.

### *Summary of total annual public benefits to Australia, A\$'000 (NPV)*

	Benefits					<b>TOTAL BENEFIT</b>
	Cost Savings	Scheduling	New Direct	Tourism	Freight	
1	-\$13,844	\$2,501	\$11,299	\$33,980	\$418	34,354
2	\$58,552	\$2,360	\$10,660	\$77,082	-\$14	148,640
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5	\$112,815	\$1,981	\$8,950	\$98,758	\$1,113	223,617
5yr Total	\$398,968*	\$11,168	\$50,453	\$426,283*	\$3,743	890,615

\* represents rounding error



## 12. REAUTHORISATION OF THE RJSA

- 12.1 The RJSA between Qantas and BA is described in paragraph 2.22 above. Qantas and BA will seek re-authorisation of the RJSA prior to expiration of the current RJSA authorisation in July 2003.
- 12.2 While the RJSA is expressed to cover the networks of each airline, it primarily affects the "Kangaroo route" between Australia and the United Kingdom. The RJSA has no real impact on trans-Tasman routes.
- 12.3 Similarly, while the Transactions potentially cover the Qantas and Air NZ networks, they will primarily affect trans-Tasman and New Zealand routes. The Transactions have no real impact on the Kangaroo route.

13. CONCLUSION

13.1 In conclusion, the Parties submit that the Transactions will create substantial public benefits including:

- (a) consumer benefits, particularly through expansion of services, improved availability of services and improved quality of services;
- (b) cost savings and more efficient use of resources;
- (c) increased international competitiveness of an independent Australasian network airline;
- (d) tourism benefits; and
- (e) furtherance of the national interest.

13.2 These benefits flow directly from the Transactions.

13.3 There is a low risk of anti-competitive detriment being caused by the Transactions. In any event, Qantas and Air NZ will propose various undertakings designed to facilitate and protect new entry on trans-Tasman routes and to ensure the Alliance does not take unreasonable actions relating to capacity and pricing on routes where the Parties will be the sole operators. The Transactions provide a unique opportunity to enhance the quality of competition by facilitating and initially protecting entry by a VBA or, more likely, expansion of Virgin Blue, while at the same time enabling the Alliance as full service operators to exploit synergies and efficiencies not otherwise available to the Parties separately.

13.4 The public benefits arising from the Transactions are substantial and outweigh any anti-competitive detriment.

13.5 Set out below is the quantification of the benefits and detriments from the NECG Report.

*Summary of net annual public benefits to Australia, A\$'000 (NPV)*

	Benefits					Detriments		Trade-off
	Cost Savings	Scheduling	New Direct	Tourism	Freight	Dead-weight	Net Transfer	Total Welfare Test
1	-\$13,844	\$2,501	\$11,299	\$33,980	\$418	\$7,502	-\$22,055	\$48,908
2	\$58,552	\$2,360	\$10,660	\$77,082	-\$14	\$5,048	-\$6,021	\$149,612
3	\$121,960	\$2,226	\$10,057	\$111,281	\$1,113	\$17,526	-\$11,772	\$240,883
4	\$119,486	\$2,100	\$9,487	\$105,181	\$1,113	\$16,840	-\$10,909	\$231,436
5	\$112,815	\$1,981	\$8,950	\$98,758	\$1,113	\$16,335	-\$10,410	\$217,693
5yr Total	\$398,968*	\$11,168	\$50,453	\$426,283*	\$3,743	\$63,251	-\$61,168*	\$888,532

\* represents rounding error

13.6 The Parties submit that authorisation of the Transactions should be granted.