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Qantas – Air New Zealand Strategic Alliance Submission

I understand that the ACCC is primarily concerned with the 'big picture' issues of competitive markets, however the impact on the public is often also significant at the detail level. If this alliance is to proceed I believe that it is inevitable that there will be a reduction in competition unless there is a new entrant in the market such as Virgin Blue. It is also questionable as to how competitive the current market on trans-Tasman and trans-Pacific routes is. The trans-Tasman routes are a duopoly (except Sydney) with competition between carriers typically limited to seat availability on a given day for a particular fare level. Any promotion is almost instantly matched by the other airline. (I think it's curious how often matching promotions are launched in the media on the same day.)

Price Considerations

Where there are other carriers on routes such as Sydney – Auckland which seems to have some impact in that there are lower cost promotional fares available with Thai, Garuda etc from time to time. However this doesn't benefit travellers on other routes (eg Melbourne – Auckland). What can be seen on those other routes historically, is that prices are substantially higher than Sydney – Auckland. I suspect the airlines would argue that Auckland – Sydney is 20% shorter distance-wise and so should have substantially lower fares. But that is an argument predicated on higher costs for the greater distance flown, yet the majority of operational costs are incurred in take-off and landing, rather than cruising for an extra 30 minutes. So on the basis of cost the price differential between flying between Sydney and Auckland compared with flying between Melbourne and Auckland should be significantly less than 20% and probably less than 10%.

It is also interesting to compare trans-Tasman prices with routes of similar distance across Australia such as Melbourne – Perth. Currently there are fares to Perth advertised for $209 and less one way. If a return fare is available on that basis then the cost is $418 return. Compare that with the current Melbourne – Auckland promotional fare or $529 return, if you can find one at that level because I tried and certainly couldn't.

Thirdly, why should the one-way and return airfares be almost identically priced? I don't believe there has ever been any justification for this. As can be clearly seen from the current Australian domestic scene offers for one-way fares are now the norm. That enables the consumer to potentially find the best deal for their particular circumstances by flying different airlines on different legs of their journey. This greater freedom of choice ensures greater competition.

Trans-Tasman Not Profitable?

I have frequently read that the trans-Tasman routes don't make a profit for Qantas and Air New Zealand. It's very difficult for us to actually know because we don't have access to sufficiently detailed information. However it doesn't appear to make commercial sense to increase capacity on routes that make a loss (or just breakeven) yet that has continued to happen with some of the capacity that was taken out following September 11 being reinstated more recently. If these routes aren't profitable you would think that you would work to fly with a greater 'load factor' on the available flights rather than adding capacity and then attempting to fill seats through promotional fares which result in a lower average revenue per seat on all flights on that route.

It has often been reported historically that trans-Tasman routes have been relatively expensive to travel on. If this is correct then it also makes it difficult to understand how the airlines claim that the routes are unprofitable can be correct.

Potential Benefits

While potentially there are benefits to both consumers and businesses from this alliance, attention to the detail is critical in ensuring those benefits are achieved. One possible benefit is having flights spread more throughout the day, so that in the case of Melbourne there is a flight that leaves Auckland after 5pm (and preferably after 6pm) so that a full day's business can be done. Currently the last flight departs at 4:15pm so with check-in etc the afternoon is virtually a write-off.

Additionally, if there are such strong benefits for both Air NZ and Qantas of this alliance one would anticipate lower prices and more favourable travel terms and conditions (compared to all sorts of restrictions and advanced purchase requirements currently) on trans-Tasman travel and freight.

Reciprocity of Fares

In the last 12 months I have often seen promotions advertised. It's interesting to note that during (at least) some of these promotions the price to fly Auckland-Melbourne-Auckland is significantly lower than flying Melbourne-Auckland-Melbourne. The airlines stance is that this is due to greater demand on the route for traffic originating in one city over the other.

However I question the logic of this as in both cases there is a leg flown from Melbourne to Auckland and one flown from Auckland to Melbourne. So all we are talking about is the order in which those two legs are flown. If there is capacity and the airline is prepared to sell it on that flight at a given price (as half the return fare) it shouldn't make any difference which city the traveller originates from. With the benefit of the Internet it is possible to check out the fares offered. The following is an example of a check I ran using consecutive days for a period of about 10 days during the later half of 2002.

	Day 1	Day 2	Day 3	Day 4
Row 1	AKL – MEL	MEL – AKL	AKL - MEL	MEL -AKL
Row 2		MEL - AKL	AKL - MEL	

If I could get a fare using the day pair of Day 1 and Day 2 for Auckland – Melbourne – Auckland for a fare of NZ$X and also do this using day pair Day 3 and Day 4 again for a fare of NZ$X, then I would have thought that the fare for travel Melbourne –Auckland – Melbourne on day pair Day 2 And Day 3 would be the same price with allowance for the difference in GST rates and exchange rate. Especially as I've done this for a whole series of consecutive days which I think proves the airlines were willing to accept a price of half NZ$X for each leg on any of those days while the price to Australian residents was significantly greater.

Frequently last year the nominal price was the same (or even less in NZ$), yet there was an exchange rate differential in favour of the Aussie Dollar of over 15% most of the year. Does this mean I want to see Airfares for flights originating in New Zealand increase to match the Australian ones? – NO WAY! I want to see cheaper flights across the Tasman. I spend a small fortune on them.

Real Benefits for Customer's Irrespective of a New Entrant

Let's see some real benefits guaranteed from this alliance irrespective of whether a new entrant such as Virgin Blue enters the market. I realise this is detail stuff, however this does make a difference to the public. This could be in the area of loyalty schemes. Some ideas include:

- Points accumulated on both the Qantas Frequent Flyer and Air New Zealand Airpoints programs able to be merged into a single scheme.
- That scheme should have the most favourable aspects of both programs so that it really does benefit the travelling public. In my experience Air NZ's scheme is in many ways superior.
- That in the future points be credited to accounts on the basis of the most favourable terms of either scheme. For example Air NZ credits points based on kilometres flown whereas Qantas uses mileage, thus Air NZ provides at least an additional 12% in frequent flyer points credits per leg flown. The difference is that for a discount economy fare between Melbourne and Auckland on Qantas you get 1643 points per leg versus 1845 on Air NZ. The net effect is that on Air NZ after 8 return flights between Melbourne and Auckland plus a single New Zealand domestic leg and you have over 30,000 points (enough for a trans-Tasman award flight) whereas on you need an additional trans-Tasman flight to qualify for an award flight on Qantas (and still needed the 1000 points from a domestic flight.
- That one-way award flights continue to be available. This is currently the case with Air NZ so you can cross the Tasman in a single direction for 15,000 points which gives greater flexibility for example if you are going to live in one country or the other for an extended period. Why should Qantas be able to charge 30,000 points for a one-way or a return award flight?
- Air NZ also provides more flexibility in reward flights. For example fly Melbourne, Auckland, Christchurch, Melbourne and overnight at each city in New Zealand all for 30,000 points. Try the same on Qantas and its 30,000 points for the trans-Tasman legs and a further 20,000 points for the domestic sector (unless it's completed on the same day as one of the trans-Tasman legs.) There isn't any significant additional cost to the airline in permitting the overnight stays.
- Permanent and audit-able commitments to the availability of award seats on flights as a proportion of available seats. There probably need to be safeguards on this too so that if load factors increase above some benchmark there is a proportionate increase in award seats available over time, otherwise the potential to redeem award seats diminishes as there are less unsold seats on flights and more people potentially eligible for a reward flight.

Given there are issues of international airline alliances (One World and Star Alliance) and the likelihood that in the future flights will be flown as Air NZ/Qantas codeshare, an alternative to the above suggestions would be to allow consumers to elect whether they wish to retain their points in either the Air New Zealand Airpoints scheme or the Qantas Frequently Flyer scheme. Members could have a window of time (say 2 months) to aggregate their points in one scheme or the other if they so choose. Points would then be credited as per the member's elected scheme rules and redeemed on either airline in the same way the can now be for One World or Star Alliance partners.

ın any 'rationalisation' of loyalty programs there is significant potential for the lowest common denominator to prevail making it likely that Air NZ's Airpoints scheme will get swallowed up in the Qantas scheme. If that occurs Air New Zealand Airpoints members will be significantly disadvantaged.

Undertakings 24 January 2003

In relation to the Proposed Undertakings to the ACCC dated 24 January 2003 I would suggest that they do virtually nothing to lessen the potentially detrimental effects of this agreement. They are vague, full of out clauses and open for such short time windows that I would suggest they are of little practical commercial value in their current state.

Nothing in those undertakings addresses one of the most **strategic assets** in airline operation, take-off and landing slots particularly in peaks times at major airports such as Sydney. Without those slots a competitor can't operate flights at the times of customer peak demand during the day and are thus disadvantaged. Gaining access to these slots and (expanded) terminal facilities will be critical for any new entrant, Virgin Blue or otherwise. Qantas has taken a considerable number of those slots following the Ansett collapse. As part of this Alliance authorisation, Qantas may need to make slots available (at peak times in particular) for a new entrant to fly trans-Tasman.

Comments on specific undertakings follow:

Facilities provided for a maximum of 12 months at full cost plus a 'reasonable' margin.	How do we know what 'full cost' is? Are we talking direct costs eg salaries of staff and materials or does it include indirect costs and overheads which are invariably attributed on a relatively arbitrary basis. What's a reasonable margin? Is that 10%, 20%, or 100%. Why on for 12 months? That's not long when establishing a new carrier in the market.
Undertaking does not include facilities or services that cannot be reasonably provided by Air New Zealand or Qantas, having regard to existing schedules, operational or safety considerations, or legitimate business justifications.	So what happens if a new entrant wants check-in and baggage facilities at peak times in the way these are currently provided in Australia by Qantas for Air New Zealand or in New Zealand by Air New Zealand for Qantas. Why can't the incumbents scale up to deliver the services? There are a number of practical issues here for sure.
Capacity ceiling	One year from competitors announcement or even commencement of operations is a pretty short time commercially.
Air New Zealand and Qantas will not increase combined capacity by more than the greater of: 5% per scheduling season; one return flight per week; or 25% of the capacity operated by the new entrant on the route;	Without constraints on pricing as well this isn't that meaningful. Qantas/Air New Zealand can potentially undercut the competitor out of the market using the same force Qantas has used at times domestically in Australia and against Air New Zealand domestically in New Zealand. This is matter of public record regarding this whole strategic alliance since Air New Zealand has stated that without it Qantas can effectively run them into the ground by undercutting prices. Also an increase in capacity equivalent to 25% of the new entrant's capacity is significant. Further one additional return flight per week of a Boeing 747-400 or a new Airbus versus a new entrant flying Boeing 737's is still significant.
Capacity Floor Undertaking	Why should this undertaking terminate within 2 years of the implementation

The following undertaking is designed to prevent the Alliance carriers from restricting output and increasing prices in respect of routes on which the parties will be the sole operators as result of the Alliance. The undertaking will terminate: □ immediately upon another airline commencing operation on the route; □ two years from the date of implementation of the Alliance;	of the Alliance? All that means is that capacity could be constrained to drive up prices in two years time or at anytime thereafter at the whim of the applicants. Two years isn't a long time to wait for a potential windfall. This doesn't realistically provide protection to the public. Why should the undertaking terminate immediately a new entrant commences operation? The Alliance is protected by the 3month rolling average decline in load factor clause anyway. However we don't know what those load factors are or how they have been achieved so there are a lot of outs there for the Alliance. For example load factors will definitely decline if promotional airfares aren't offered or less seats are made available at those fares, or other activities targeted at acquiring passengers such as advertising are reduced. Measures to prevent this sort of behaviour in perpetuity are essential to protect the public.

In Closing

While the task of managing the effects on competition of this Alliance may have eased with the comments of Virgin Blue published on Wednesday 5 February stating their intention to fly trans-Tasman and domestically within New Zealand, there are still safe guards which need to be put in place. There is no certainty that Virgin Blue will continue to operate those routes. And even if they do, they may find that funding and managing the rapid growth of their business places them in vulnerable situation particularly in the current global situation with global economies slowing down, world stability in question, and the price of oil and hence Jet A1 at a substantial premium.

Qantas has shown in the past that is not averse to scurrilous commercial behaviour to ensure it's continued success. And issues such as predatory pricing have a different interpretation by regulators than that of the 'man in the street' or marketers. Qantas' current commercial success in a very difficult world aviation market is underpinned by it's success in the Australian market. That being the case and with the economies of scale and efficiencies that this Alliance will bring as documented by Qantas/Air NZ then we should be expecting commitments that trans-Tasman airfares and freight costs will both reduce in price, permanently. Let's see the Alliance put its money where its mouth is.

Yes there are variable costs and global factors to account for. However some benchmarking against global best-practise operators such as Ryanair or Easyjet (or even against Australian domestic airfares at present) may provide a way to ensure some of those financial benefits are passed on to the consumer.

Ensuring competitive pricing and availability of capacity for both passengers and freight on an ongoing basis are key challenges for the ACCC. The issues of access to take-off and landing slots, terminal facilities and all the other infrastructure and services essential to operating an airline also need to be addressed to ensure the potential viability of a new entrant on these routes.

Yours sincerely

H Melton

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