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05 February 2002

Reference: Legal

Ross Jones
Merger Commissioner
Australian Competition and Consumer Commission
P O Box 1199
Dickson ACT
Australia

FILE No:	
DOC:	D03/5580
MARS/PRISM:	

Dear Mr Jones,

Subject: **PROPOSED MERGER - QANTAS AND AIR NEW ZEALAND**

Please find enclosed a copy of the submission on the above topic that was recently presented to the New Zealand Commerce Commission. We feel that a copy of the submission to the ACCC may be valuable under the circumstances of dual assessment concerning the proposed merger.

Jumpjet is a New Zealand incorporated company and the submission is orientated for this formality. Naturally the company may also be dependent on the outcome of the ACCC deliberations on the proposed merger.

We extend best wishes for a successful outcome following investigations into this difficult topic.

Respectfully yours,

Nick Kile
Managing Director

Enclosures (1)

Registered Office: Level 1, Stewart Dawson Building, 2 Willis Street, Wellington, New Zealand

PROPOSED

QANTAS AND AIR NEW ZEALAND MERGER

COMMERCE COMMISSION SUBMISSION

February 2003

JUMPJET AIRLINES LIMITED
P O BOX 30031
LOWER HUTT 6315
NEW ZEALAND

Copy: Australian Competition and Consumer Commission

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Copy: Australian Competition and Consumer Commission

Executive Summary

Jumpjet Airlines Limited® recognises the consequences of decision making by the Commerce Commission and the Australian Competition and Consumer Commission in response to the proposed integrated merger via equity shareholding between Qantas Airlines and Air New Zealand. The following is aimed at providing information and analogy in relation to the alliance strategies in motion by major players in the Australasian aviation industry.

The Virgin Blue company publicly exhibits the perception that is a "Competitor" in the market. Public information available indicates that the authentic situation is the converse. The subsidiary of the Virgin Group and Patrick Corporation is a "Player" in the game of market control that is developing within the region.

Such equity alliance activity could easily be classified as a "Market Lockup" strategy. The major players are the Virgin Group/Patrick Corporation, Singapore Airlines, Qantas, Air New Zealand and their subsidiaries. The premium for Virgin is the discount market in Australia across the Tasman and possibly within New Zealand.

It is commonly known that the Qantas Board strategy is to create a grand "Monopoly" of alliances in the region through shareholder equity. The current ownership tree includes Singapore Airlines owning 49% of the Virgin Group's company, Virgin Atlantic. {One of billionaire Richard Branson's 120 odd companies that span 25 countries with a collective estimated turnover of $NZD 9 Billion per annum}

The Virgin Group also jointly owns the duopoly Australian carrier Virgin Blue with Patrick Corporation and management owning the remainder. Singapore Airlines also continues to own a 5% stake in Air New Zealand. Air New Zealand intends to pass a 22.5% ownership to Qantas Airlines and it fully owns Freedom Air International.

Information available indicates that Patrick Corporation has approached Singapore Airlines and offered that company a consequential equity share in the subsidiary, Virgin Blue. A similar shareholding could be taken up by Singapore Airlines through a possible public offering planned in 2003.

Similar research indicates that Qantas has also invited Singapore Airlines to purchase the British Airways 22% shareholding in Qantas. It is possible that Singapore Airlines could purchase either or both shareholdings to satisfy its drive into the region (Australia in particular) in 2003.

When complete, the resultant "Monopoly" of alliances would effectively: -

- ✈Control the southern Australasian full service market including the Trans Tasman
- ✈Lockup the regional discount market including the Trans Tasman
- ✈Enable Price Control to be effectively introduced by all alliance players

✈Dominate the market in a predatory sense preventing fair competition emerging

Jumpjet Airlines Limited® has a major concern due to the slimness of the niche Trans Tasman market that we intend to develop and operate within. If Virgin Blue succeeds in gaining entrance to the Trans Tasman the Jumpjet introduction could be placed in jeopardy. Anticipated predatory capacity introduced by Virgin would effectively reduce the size of our potential market.

It is conceivable that these alliance players are fully aware of the Jumpjet development and part of their current strategy is to prevent the company independently entering the market. The Trans Tasman Commerce Commissions are in a position to assist the preservation of fair competition and fair play by legal policy determination that preserves an opportunity for Jumpjet Airlines Limited® as an entrant carrier.

PUBLIC OPINION

The first media poll undertaken following the announcement of the Qantas Air New Zealand proposed merger strategy revealed a public disfavour in excess of 80%. Such a result did not indicate any nationalistic or racial view but rather a consumer concern. As consumers, the vast majority of people believed that such a merger would result in the substantial lessening of competition in the market.

The Commerce Act 1986 was introduced and amended as much to protect the consumer as it was to regulate predatory commercialism levelled by powerful corporate bodies against independent new entrants entering into any industry.

Following extensive campaigning through media programs, high level political lobbying and advertising by Qantas and Air New Zealand the public rejection of the merger remains in the mid fifties.

EFFECTS OF COMMERCE LAW

Research into the existing equity and marketing alliances reveals a strong government equity ownership of airlines within the region. The obvious public awareness over the Qantas and Air New Zealand proposed merger and related issues in Australia and New Zealand ought to capture the attention of parliaments on both sides of the Tasman.

Of particular interest is the operating independence of the Australian Consumer and Competition Commission and the Commerce Commission in New Zealand. The pressure on these bodies could become extensive as governments, being majority shareholders or controllers of national airlines, are also protectors of consumer interests.

Whilst the proposed entrance of the Virgin Group and Patrick Corporation airline Virgin Blue into the Trans Tasman appears to be the possible introduction of independent competition closer examination discloses otherwise.

FAIR COMPETITION

Traditional competitive entrance into the airline industry by new airlines has in the past been as predatory as the retaliation levelled on such an entrant. The universal strategy being to drive the competitor from the market at all costs. The entrant carrier enters the market and commences an airfare war with established carriers using airfare structures that are unable to gain sufficient revenue for the business to be viable.

To continue trading in a legal sense one or both competitors rely on debt or equity capital to continue the fare war until one consumes all capital and ceases trading. The most pronounced loss of capital occurs when predatory capacity {increased services} is deliberately introduced to capture the available market. The market is then flooded with unsustainable airfares. Revenue decreases due to low load factors { ie. Reduced passenger numbers uplifted per flight} and unrealistic airfares.

Up to date, traditional competitive entrances have been unable to successfully provide for fair competition to be introduced into the industry and exist for any length of time. In Australia the industry has now been driven back to where it was decades ago with a duopoly that is less competitive. Less competitive because of the distribution of different sale products between the remaining carriers and the bonding of equity and marketing alliances that currently or predicably exist.

Modernisation and control of commercial behaviour concerning high level corporate strategies that occur in the comfort of secrecy and are aimed at market dominance is acutely needed if the industry is to prosper within the bounds of fair competition.

PREDATORY COMMERCIALISM

The proposed Qantas and Air New Zealand integrated merger combines the majority of regional airlines into a complex alliance structure that also incorporates two major global alliances and epitomises consumer fears. The merger is the very reason for the necessity and existence of anti-trust, anti-monopoly and other protective legislation that preserves business ethics and promotes fair competition.

A major contributing factor in the collapse of Ansett Australia was the predatory airfare war being waged between carriers at that time. The traditional entrance and commercial strategies exercised by the Virgin Group,Page5 Ansett Australia Collapse through its subsidiary Virgin Blue played a major role in the failure of local jet operator Impulse Airlines and the largest corporate collapse in Australia's history. That is, the desolation of Ansett Australia.

As a result, Ansett was denied the opportunity to adjust corporately and financially. The company was also not able to gain similar commercial protection that Chapter 11 regulations in the USA provides its carriers. An example of the ability to commercially adjust is the success being achieved by United Airlines, which has been able to dramatically reduce its operating costs in recent times.

Media reports, since the arrival of the Virgin machine in Australia, identify the company as financially powerful, political and clever. The airline is influential through extraordinary media sway.

In relation to the proposed merger, both Qantas and Air New Zealand publicly admit to the lessening of competition the merger will deliver the consumer, but declare the overall result will serve their best economic interests from a nationalistic political point of view.

Reports also indicate that the merger application has enabled Virgin to pursue favour with the New Zealand public in the interests of bridging "perceived" airfare exploitation by existing carriers across the Tasman. Plus, publicly reported attempts indicate the seeking of commercial and political favouritism[1] through various tenders and approaches. Although media coverage has revealed notable equity offers in relation to the foundation stones of an impending alliance, public awareness of industry strategies remains low.

The publicly reported demand from senior executives of Virgin Blue for the sale of Freedom Air International [2], the wholly owned subsidiary of Air New Zealand, would enable a competition barrier to be removed and the provision of the discount product to be passed into the hands of Virgin Blue. Media reported offers of support services {eg. terminal facilities, ramp services, loaders and packers etc.} are all services that would normally be provided to an alliance partner. Not a competitor.

Such strategies would enable Virgin to transform from historic predator[Page 5] to protector and secure the merger of alliances from future competition - either within Australia, New Zealand or across the Tasman. The Virgin Group/Patrick Corporation, Singapore Airlines, Qantas and Air New Zealand combined would exhibit extensive and substantial power in the market and virtually prevent any new entrant from gaining funding support to enter and introduce fair competition.

MARKET LOCKUP STRATEGIES

Publicly reported efforts of senior Qantas executives and the Board of Directors to build an impending Grand Regional Alliance, that is designed to protect major regional {Alliance} airlines from international {or any} competition, are both equity and marketing based. Currently, in terms of the Trans Tasman, only one jet airline {Garuda Indonesia} is not part of the "web" of alliances that currently exist between carriers. That is, either directly through ownership equity or marketing agreements with the global alliances of Star and One World. Although that airline, Garuda Indonesia, does have a marketing alliance with Malaysia Airlines.

A merger between Qantas and Air New Zealand would integrate two separate groups each with a substantial degree of power in the market into one powerful market force.[3] The merger would override democratic economic principles within and between Australia and New Zealand. Such principles provide the right of consumers to fair competition, freedom of choice and competitive airfares - a factor that must override other economic considerations.

Such a merger would also effectively lockup the market from an investment point of view. The resultant monopoly of alliances would effectively drive the stock market share values of alliance members upward and secure high profits from operations and investment. The primary beneficiaries would be the alliance shareholders of which some government ownership features prominently. Consequently, it is understandable that consultative advice to government favours the merger.

ANSETT AUSTRALIA COLLAPSE

Whilst a number of major factors served to guarantee the collapse of Ansett Australia the concentration of this submission is directed towards predatory commercialism and the mess of the aftermath. Common sense, mathematical analogies and examination of the Australian domestic East Coast market concludes that insufficient market existed to support the increased seat capacity introduced into the route structures during an airfare war waged between Ansett Australia, Impulse Airlines, Virgin Blue and Qantas.

Virgin Blue commenced operations shortly after Impulse Airlines and rapidly increased services into the market. The company marketed a barrage of discount tickets at ignoble values that resulted in a crucial reduction in revenue income {Estimated to be 15%} for Ansett.[4] Few airlines, if any, could withstand such a dramatic reduction in revenue income even in buoyant circumstances.

This marketing technique was made possible for the Virgin subsidiary by its advertised ability to gain dramatic funding support from the parent company [5] (Virgin Group) that enabled the Australian based subsidiary to discount trade in the market below the airline's own operating costs. Thus, remaining within commercial law, the Fare War was then continued. Such commercialism assisted the promotion of Ansett's slide into a financial crisis that ultimately led to bankruptcy.[6]

Such a strategy is considered traditional within the aviation industry. In the Virgin Group case it appeared to be premeditated and elementary. This immense group of companies, virtually owned by a billionaire, spans a multitude of countries and consists of a vast number of companies. Whilst difficult for economists to discover, due to the reported vast array of trusts and accounts in countries or states {some offering tax relief}, the annual revenue income of the group is reported to be many billions of dollars per year. Under these circumstances any of the groups subsidiaries must surely possess substantial financial and economic power in the market.

The Virgin strategy was aided by Patrick Corporation in the taking up of a joint shareholding in Virgin Blue for $NZD 290 Million. Its key strategy was to ensure Virgin Blue formed a duopoly and Ansett failed.[7]

The price of the Ansett collapse and its failed struggle to resurrect prompts an alert as to the damming effects of predatory strategies from industry participants. Some of the facts that identify this corporate loss as probably the worst in Australia's history are frightening to say the least.

Some 3.6 million creditors, many bankrupted by the events, are owed $NZD 3.0 Billion dollars. The loss of jobs to the permanent staff of Ansett numbered in excess of 15,000 with thousands having given in excess of 20 years service to the company. The five staff superannuation funds are unlikely to remain functional and are liable to endure substantial devaluation. {Total loss still remains a possibility}

An estimated 5,000 jobs were lost in the states of Victoria, New South Wales and Queensland in the tourism industry. The tourist industry in the prime Tourist State of Queensland is not expected to recover for a year and a half. The collapse has also left the state of the airline industry less competitive than it was prior to the arrival of the Virgin machine.

To wind-up the Ansett Group Administrators must dispose of 133 aircraft worth $NZD 2.3 Billion dollars in six airlines. They must vacate substantial interest or leases on 350 buildings and close investment in many peripheral companies. The airline group operated into 130 destinations with 900 flights per week. The full disposal may take years to conclude.[8]

References:

1. *The Dominion Post - January 18, 2003*
2. *The New Zealand Herald Website - December 11, 2002*
3. *Attachment ii - Marketing Alliance Flow Chart*
4. *The Book: Geoff Easdown & Peter Wilms - ANSETT: THE COLLAPSE; Page 115*
5. *The Dominion newspaper - April 18, 2002; The Evening Post newspaper - April 16, 2002*
6. *The Book: Geoff Easdown & Peter Wilms - ANSETT: THE COLLAPSE; Chapter 11 to 19 & The Aftermath*
7. *The Book: Stewart Wilson - Ansett - The story of the rise and fall of Ansett 1936 - 2002 - Page 171*
8. *The Book: Geoff Easdown & Peter Wilms - ANSETT: THE COLLAPSE*

PART 1: Monopoly Alliance Development - Trans Tasman

1. It is the intention of this submission to identify the consequences of the proposed integrated merger between Qantas and Air New Zealand in a practical sense from the perspective of the strategies involved. Including their effect on the future availability of opportunities to provide fair competition in the future for a new entrant carrier. Obviously, if fair competition is denied in the industry, airfares will rise to levels that will be utopian for major shareholders and investors and predatory for the consumer.

2. Complex analogies of industry behavioural patterns and academic assessments concerning the success or failure of subsidiaries, companies, groups of companies or alliances in the industry and the reasons behind such events dodge a simple reality. Fair competition is the primary criteria that determines the well being of any industry. It introduces continuing choice for the consumer, promotes new ideas and marketing techniques that give rise to a vibrant industry.

3. Any relaxation by regulators that permits industry participants to control the aviation industry outside of ethical grounds will ultimately result in substantially lessening competition in the market. Should subsidiaries, companies, groups of companies or alliances succeed in controlling the market, advantage will be taken of market power - Preventing or restricting new entrants from competing and effectively lessening existing competition in the market.

4. The Qantas/Air New Zealand proposed merger portrays the distinct possibility that a structure of alliances could, with little undertaking, achieve a regional Market Lockup through Monopoly Alliance status.

   For the purpose of this submission the definition of Monopoly status is: -

   > Monopoly - *exclusive control of a commodity or service in a particular market, or a control that makes possible the manipulation of prices.*[1]

5. The proposed Qantas/Air New Zealand merger is planned to expand from a current 4.99% Equity Alliance to an Integrated Alliance status of 22.5%.

   For the purpose of this submission the definition of an Equity Alliance is: -

   > Equity Alliance - *A degree of ownership that exists between two or more subsidiaries, companies or groups of companies that is established by formal investment agreement to cooperate for specific purposes. Integrated ownership occurs when the degree of ownership reaches a level that includes the mutual determination of airfares, schedules, capacity, yield sharing (Revenue Income), the provision of services and the purchase of goods and services.*

6. The proposed Qantas/Air New Zealand merger regionally integrates the two global alliances of Star and One World and includes the merging of additional airlines. Some of these airlines hold separate Marketing Alliances with other airline groupings.

For the purpose of this submission the definition of a Marketing Alliance is: -

> Marketing *Alliance* - *A degree of cooperation between airlines providing seamless travel and mutual frequent flyer programs. Many alliances use code sharing* and other mechanisms to reduce competition over specified routes. Very few, if any, are competitive. The global alliances of Star and One World are complex marketing alliances.*
>
> *(*) Code Sharing agreements are services operated by one carrier on behalf of another. Thus enabling the elimination of competition between the two operators.*

7. We put it to the Commission that an Equity Alliance, a Marketing Alliance or groups of these alliances, constitutes *"a person that includes 2 or more persons that are interconnected or associated"* under Section 47 {Certain Acquisitions Prohibited} of the Commerce Act 1986. Subsequently the integrated proposed merger of Qantas and Air New Zealand substantially increases such associations - Both currently and in a projected manner.

Reference:

1. The Concise Macquarie Dictionary

CURRENT CORPORATE EQUITY STRUCTURING - SCHEDULED AIRLINES

8. A significant number of national carriers operating in the Trans Tasman region are substantially government owned and controlled by shareholding or statute. Governments involved with Equity are New Zealand (75%), Australia (Minority Shareholding), Singapore (100% - includes investment arms and minority airline shareholdings), Indonesia (100%), Fiji and other Pacific Island governments (52%), Thai Government (93%), Government of Tonga (100%) and the Government of Argentina (52%). {Figures are approximate}[1]

9. Existing corporate shareholder ownership {Including airline ownership} of airlines operating in the Trans Tasman region is: Qantas (70%), Air New Zealand (10%), Thai International (7%), Lan Chile (100%), Aerolineas Argentinas (39%), Regional Express (100%), Virgin Blue (49%) and Origin Pacific (100% - Private). {Figures are approximate}[2]

10. Existing public ownership of airlines in the Trans Tasman region is: Air New Zealand (13%) and Qantas (30%). {Figures are approximate}[2]

11. We put it to the Commission that the Equity Alliances as described in Table 1 - International Alliances - Trans Tasman, constitutes *"a person that includes 2 or more persons that are interconnected or associated"* under Section 47 {Certain Acquisitions Prohibited} of the Commerce Act 1986. Subsequently the integrated proposed merger of Qantas and Air New Zealand substantially increases such associations - Both currently and in a projected manner.

Reference:

1. *Table 1 - International Alliances - Trans Tasman*

2. *Table 1 - International Alliances - Trans Tasman & Flight International Airline Directory 2000, 2001, 2002*

FUTURE CORPORATE EQUITY STRUCTURING - SCHEDULED AIRLINES

12. The projected corporate equity structures, whilst speculative in terms of {Publicly reported} offers portrayed in Attachment i - Market Lockup Flow Chart, provides a valuable insight into current strategies being emulated by Trans Tasman airlines presently in duopoly or aligned trading situations.

13. During 2002 Qantas has offered Singapore Airlines the British Airways shareholding in Qantas (22%) as depicted via the following newspaper report quote:[1]

    "Qantas: ...vision is to build an antipodean airline alliance, including, preferably, Singapore Airlines. People close to the airlines said Qantas and Singapore had held regular discussions." {ie. Related to the British Airways 22% shareholding in Qantas}

14. During 2002 Patrick Corporation has offered Singapore Airlines a shareholding in Virgin Blue as depicted via the following newspaper report quote:[2]

    "Singapore already has ties with Richard Branson through its partnership in Virgin Atlantic. Patrick Corporation ...is also interested in getting Singapore involved in Virgin Blue." {Historically Singapore Airlines invests in joint ownership or at least a high percentage. A figure of approximately 25% is highly likely}

15. It is common knowledge that Singapore Airlines has the ambition to gain a stronger presence in the region. The present regulatory environment would permit the carrier to enter in its own right. However, it is highly likely that its current Joint Venture alliance with the Virgin Group would prevent direct competition with Virgin Blue in the domestic Australian market.

16. The current Virgin Blue strategy to use the Qantas/Air New Zealand merger as a means to assist the acquisition of Freedom Air International is depicted by the following newspaper report quote.[4] {As depicted by the Attachment i - Market Lockup Flow Chart such a scenario is all that is needed for the Virgin Group/Patrick Corporation subsidiary to gain a substantial degree of power in the discount market. Such power and existing alliances would restrict the entry of a new entrant into the market.}

    "Virgin Blue...said structural changes to the market were needed before any Qantas/Air New Zealand deal went ahead...Disposal of Freedom Air should be another condition."

17. An earlier report reinforces the Virgin Blue strategy of piggybacking on the merger to overshadow any recognition of alliance developments in motion.[5]

"Observers have speculated that Virgin Blue could be given concessions such as slots and assistance to accelerate its entry on the Tasman as a trade-off. The discount carrier is also interested in Air NZ's no-frills offshoot Freedom Air and has previously raised the idea of Air NZ being forced to divest the subsidiary operation..."

Reference:

1. *The Weekend Australian Financial Review - November 30, 2002*
2. *The Weekend Australian Financial Review - November 30, 2002*
3. *Attachment i - Market Lockup Flow Chart*
4. *The New Zealand Herald Website - December 11, 2002*
5. *The Australian Financial Review - October 10, 2002*

SUPPORT SERVICES: ALLIANCE MECHANISM

21. As previously defined Marketing Alliances are entered into to provide contractual support services in the commercial or marketing areas of airline operation to participating airlines. Obviously, a genuine competitor will not be supported to compete with the service-providing airline over the same routes. {Note: Engineering services are generally available to any carrier from separate autonomous engineering divisions} The aim of a Marketing Alliance is to reduce competition in a primary sense. The following newspaper report further identifies an overshadowing alliance development with Virgin Blue.[1]

> *"Air New Zealand...said this week that terminal access and ground services would be readily given to new rivals {Virgin Blue} under enforceable {Marketing?} agreements which would include promises not to use predatory pricing to shut out competition."*

{Logic Question: ***Would you allow a genuine competitor to provide customer services to your valued clients?}***

Reference:

1. *The New Zealand Herald Website - December 11, 2002*