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# TTF Australia Submission to the Qantas/Air NZ Alliance Proposal

February 14, 2003

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**Tourism Task Force**



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# 1. Introduction

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TTF Australia welcomes the opportunity to present this submission to the ACCC in response to the proposed Qantas/Air New Zealand Strategic Alliance and Equity Bid (the Alliance).

TTF Australia is the peak national industry group representing chief executives of the 200 most prestigious investors, operators and regulators in Australia's transport, infrastructure and tourism sectors.

The Alliance bid has attracted a great deal of interest from TTF Australia's broader membership. It has a direct impact on the specific business interests of TTF's 15 aviation based members and impacts on the largest single source of export income for the Australian tourism industry.

In recognition of the importance of the Alliance bid, TTF's Board of Directors have established a Review Panel - comprising three independent Directors of the Board and an independent aviation expert. The Review Panel called for submissions from TTF's aviation membership. These submissions were considered in preparing the TTF Australia submission to the ACCC.

TTF Australia examines the following areas in making its submission to the ACCC:

- Aviation Trends;
- Tourism Trends;
- The Alliance Proposal; and
- Market Impacts.

The Alliance bid documentation highlights a number of challenges facing the aviation market, governments and stakeholders. It is a fact, that under existing conditions, the current national aviation framework cannot meet future demand in a sustainable way. Without new investment, better integration and competition, the aviation framework impedes efficiency and the nation's economic and social prosperity.

It is the ACCC's role to support or reject the proposal based on an analysis of economic benefits and then to discuss and negotiate with the parties that have a direct business interest in the Alliance. We urge the ACCC to fulfil its duty within the context of the longer-term aviation market trends and consider the importance of sustainability in the aviation market and certainty in the tourism market.

## 2. Executive Summary

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TTF Australia believes there have been significant shifts in the global aviation market structure. Unprecedented levels of airline business failures globally (and the prospect of more to come), have been largely responsible for a realignment of business models for most global airlines. Global airlines are paying greater attention to sustainability and yield rather than volume.

Given the global aviation market outlook, the demand outlook for the trans-Tasman route and the concessions included with the Alliance proposal, the ACCC should support the proposal, subject to the conditions outlined within this submission. The ACCC, should progressively monitor market performance and let both the global and trans-Tasman market stabilise under Alliance operation and conduct a further review in 24 months time.

Recommendations contained within the TTF submission are repeated below.

**Recommendation 1. The ACCC's consideration of the market impacts of the Alliance cannot be made in isolation of the global aviation market trends of better yield management - reduced capacity and higher prices.**

While there has been a general shift away from direct government ownership in airlines, the uncertain global trading environment has caused Governments to provide financial support. Government assistance based on principles of national interest has been most prevalent in the New Zealand and United States markets (but is non-existent in Australia). Direct government support of airline businesses distorts market performance and delays true market signals.

**Recommendation 2. The ACCC must consider the impacts of direct Government financial support of Air New Zealand and treat such support as a price subsidy when analysing the impact on capacity and prices on the trans-Tasman route arising from the Alliance proposal.**

According to the Australian Government's Tourism Forecasting Council, over the next ten years, the growth in New Zealand's inbound tourism is expected to grow at a lower rate than it had during the last decade and will grow at a significantly lower rate than the overall inbound market. Under these demand conditions, and assuming all other things being equal, capacity on the route in the longer term would fall.

**Recommendation 3. The global and domestic aviation markets are complex. It is vitally important that the ACCC ring fences spill-over effects that relate purely to the proposal in front of it and do not confuse spill-over costs or benefits with business decisions made in competitive markets.**

The market structure is significantly more concentrated under the Alliance. This will have implications on market performance and competition in the short term (but may also be neutral in the longer term).

The original Alliance bid would be expected to put upward pressure on prices and downward pressure on capacity (all other things being equal).

**Recommendation 4.** The ACCC should consider longer-term demand trends and consequent possible capacity falls and price rises when assessing the Alliance proposal.

**Recommendation 5.** The ACCC should confine its analysis to market based solutions aimed at reducing downward pressure on capacity and upward pressure on price in the shorter term that may result from market concentration. The best way to achieve this is to reduce non-market and market barriers to entry on the route and other anti-competitive behaviour.

**Recommendation 6.** There is no evidence that market concentration will lead to anti-competitive behaviour. However, given that market concentration will double, it is important that if the proposal is approved the ACCC would monitor market conditions over a period of 24 months.

The benefits of the proposal rest heavily on the entrance of a value based airline (VBA). As part of the proposal, the Alliance would include a VBA – Freedom Air International. This arrangement has the potential to stifle rather than promote the entrance of another VBA on the route.

**Recommendation 7.** It is therefore recommended that if there is an international precedent, a condition of approval for the Alliance should be the sale of Freedom Air, to an unrelated party and also prohibitions on the Alliance establishing its own VBA or using a related VBA for a period of 24 months.

The original Alliance proposal also makes no provision for sharing (or leasing) airport facilities. The subsequent amendments rectify this non-market barrier to entry.

**Recommendation 8.** TTF is assured that the non-market barrier to entry of a VBA is satisfied under the amended concessions of the Alliance providing for sub-leasing of airport facilities.

There is potential that market concentration will lead to market exploitation in the form of capacity dumping. The original Alliance bid had no provisions prohibiting capacity dumping and market exploitation. The amended Alliance bid includes such provisions.

**Recommendation 9. TTF is satisfied that the amended Alliance includes adequate prohibitions on capacity dumping in the short term. Consistent with previous recommendations, the ACCC should monitor market conditions for 24 months if the Alliance is approved.**

Finalisation of the open skies agreement between Singapore and Australia has been suggested as an inducement to create further competition on the trans-Tasman. While there is little doubt that this agreement has the potential to add further competition to the market, the agreement is fundamentally a trade issue. If made, a condition reaching such an agreement is out of the control of the market and its participants.

**Recommendation 10. Singapore Open Skies is a trade issue first and then a market issue. It should not be a condition of approval of the Alliance. However, it could be encouraged so long as the arrangement has a national benefit to Australia.**

Long-term demand (inbound) is soft. This will have significant implications on capacity and price. It is vitally important that demand stimulatory measures be enforced as a market based response to maintaining (or at least redressing a fall in) the level of services. There are elements within the Alliance bid that cover the issue. But there are inadequate levels of investment and they may in fact, be unbalanced in favour of the New Zealand market.

**Recommendation 11. TTF recommends that a condition of approval should be an evidence of greater levels and longer-term investment in co-operative marketing to arrest the fall rates of growth in the market.**

## 3. Aviation Trends

### 3.1 Introduction

The international aviation market is undergoing massive structural change.

Since September 2001, Sabena Airlines, SwissAir and Ansett International have ceased to operate; Austrian Airlines and LaudaAir have merged; Air New Zealand required Government support and one of the world's biggest airlines, United, is operating under Chapter 11 conditions in the United States.

The world's largest aviation market, the US has its own particular problems. In 2001, American Airlines posted a loss of \$US 3bn, Delta Airlines a loss of \$US 1.2bn and United Airlines a loss of \$US 3.9bn.

There has also been transferral of profits from the traditional full service carriers (generally) towards new Value Based Airline (VBA) business models.

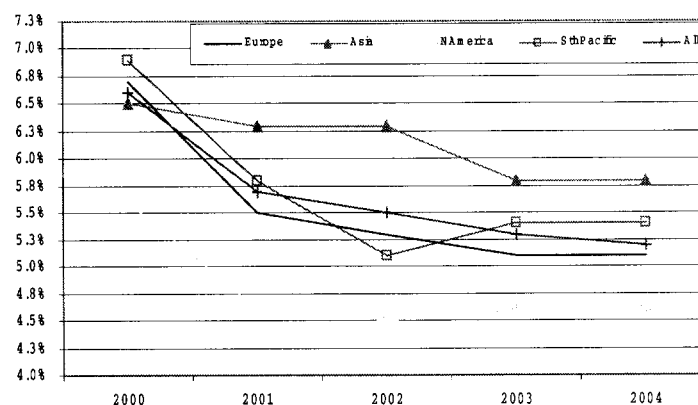
Changing market structures induce changing market outcomes. Whereas airlines once used volume to anchor their business models, VBA's have recently shown that the real secret to sustainability is managing yield. The full service airlines are openly embracing the new yield management business model.

Yield management is focussed on cutting excess capacity. With demand conditions relatively soft, both globally and domestically, airlines in the fight to survive have reduced capacity. In the face of soft demand and tighter capacity – average prices have also risen globally.

### 3.2 Capacity

Well before September 2001, there were changes forecast in the global aviation market. IATA Traffic forecast compiled in October 2000 already predicted significant drop offs in global capacity growth and this is shown below.

**Graph 1: IATA International Air Traffic Forecast**



Source: IATA forecasts October 2000.

IATA predicted growth in capacity in the South Pacific would fall by 20% and stabilise at 5.5% for 2003 and 2004. International air traffic is a crude capacity measure, but nonetheless indicates the emerging trends back in October 2000.

The reality is probably more dramatic than IATA could have predicted. Global capacity contracted by around 11% in 2000-2001. However, it then clawed back from this level to a contracted amount of 4.3% in 2001-2002. Even though new exogenous shocks may emerge in the shorter-term, capacity growth should stabilise out to 2003-04.

### 3.3 Profitability

With most structural changes in the market place there is also a transferral in income. The global aviation market is relatively inelastic, so the transfers largely stay within the market. The big shifts have been from the traditional, full service airlines towards the VBA's.

After tax profits for selected airlines are provided in Table 1 below.

**Table 1 Aviation Profitability**

<b>Airline</b>	<b>Profits (after tax) 2002</b>
Southwest	\$934M
Ryanair	\$270M
Easyjet	\$108M
Singapore Airlines	\$641M
Qantas	\$429M
British Airways	-\$403M
Air New Zealand	-\$280M
United Airlines	-\$3,921M

With soft demand internationally and the poor profit performance of the capacity boosting full service airlines it will be a major challenge for the global aviation market to maintain capacity. The key will be the ability of the full service carriers to better manage yield.

### 3.4 Yield Management

Structural shifts in the market have financially hurt aviation businesses that were slow to react or had high fixed costs. The business response has generally been targeted at improving profitability and sustainability.

There is little doubt that load factors have been on a longer term growth path representing about 70% globally, however there has been an almost inverse relationship with yields halving over the last 20 years (CSIRO Research Futures Program, Australian Inbound Tourism 2020). This is primarily due to the substantial falls in the real value of air travel over the same period (as well as exogenous shocks such as oil prices, wars and the like).



(5)

Better yield management strategies are being adopted by the full service carriers. Naturally, better yield management creates smaller levels of excess capacity and increased prices. These outcomes are not the result of anti-competitive behaviour or monopoly power; they are primarily the result of businesses responding to market signals.

TTF Australia believes there have been significant shifts in the global aviation market structure. Unprecedented levels of airline business failures globally (and the prospect of more to come), have been largely responsible for a realignment of business models for most global airlines. Global airlines are paying greater attention to sustainability and yield rather than volume.

**Recommendation 1. The ACCC's consideration of the market impacts of the Alliance cannot be made in isolation of the global aviation market trends of better yield management - reduced capacity and higher prices.**

### **3.5 Government Assistance**

The significant changes in market structures and outcomes also induced a reversal of public policy responses in home markets.

Governments around the world were actively divesting in airline businesses from 1995-2000. After the market shocks of 2001 Governments around the world have provided direct financial support to carriers on national interest grounds (not on a market failure basis).

For instance, \$US9 billion was made available by the US Government for assistance to airline carriers after September 11 and \$NZ868 million was provided by the NZ Government to bail out its national carrier Air New Zealand. The Australian Government provided no such assistance to its home market carrier Qantas.

Direct Government assistance distorts market performance; delays market signals and creates deadweight loss. In particular, NZ Government assistance on the trans-Tasman route would produce higher capacity and lower prices than would be the case under free market conditions. This is an important consideration for the ACCC, especially in the context of its analysis of the Alliance impacts.

**Recommendation 2. The ACCC must consider the impacts of direct Government financial support of Air New Zealand and treat such support as a price subsidy when analysing the impact on capacity and prices on the trans-Tasman route arising from the Alliance proposal.**

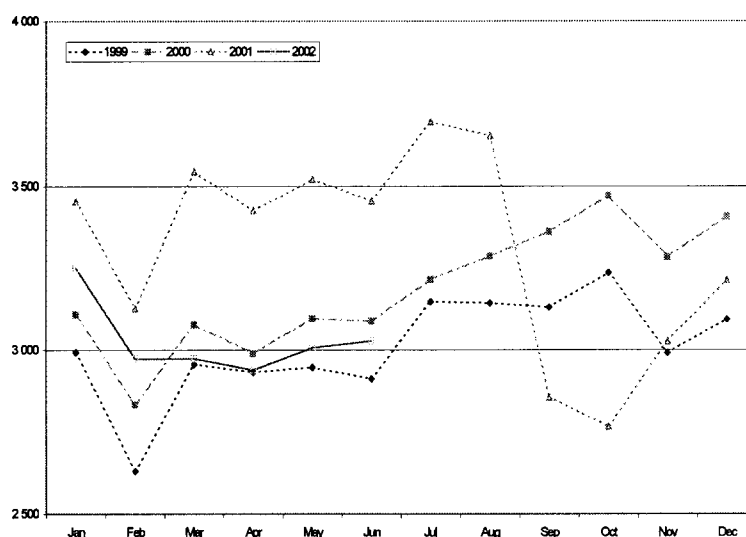
### **3.6 The Domestic Aviation Market**

Capacity has fallen in the domestic aviation markets since the peaks of 2000. It must be recognised that there were four domestic carriers in 2000 and given the

subsequent business amalgamations and failures it was clearly a competitive but unsustainable market.

While it cannot be refuted that domestic capacity in Australia has fallen since the beginning of 2001, this fall is a drop off from unsustainable capacity and market signals that were masked by the Sydney Olympics.

**Graph 2: Domestic Aviation Capacity (Available Seat Kilometres Million) 1999-2002**



Source: Department of Transport and Regional Economics, avstats.

While there have been drop offs in domestic capacity since 2001, capacity is tracking above the mid-point between 1999 and 2000. While it is hard to know, this is probably the natural market rate of capacity (given existing international aviation trends).

While nationally grouped capacity looks to be performing well – there are anecdotally problems on specific non-profitable routes. This is probably being induced by the new airline business models of yield management.

This may be a concern for the tourism industry in general, but it should not be taken into account by the ACCC in the Alliance proposal. The domestic market is a competitive market with rational regulatory regimes. There may be spill-over effects from the Alliance bid but these will be made in a competitive market and should be seen more as specific business decisions.

Therefore, it is recommended that:

**Recommendation 3.** As the global and domestic aviation markets are complex. It is vitally important that the ACCC ring fences spill-over effects that relate purely to the proposal in front of it and do not confuse spill-over costs or benefits with business decisions made in competitive markets.

## 4. Tourism Trends

### 4.1 Introduction

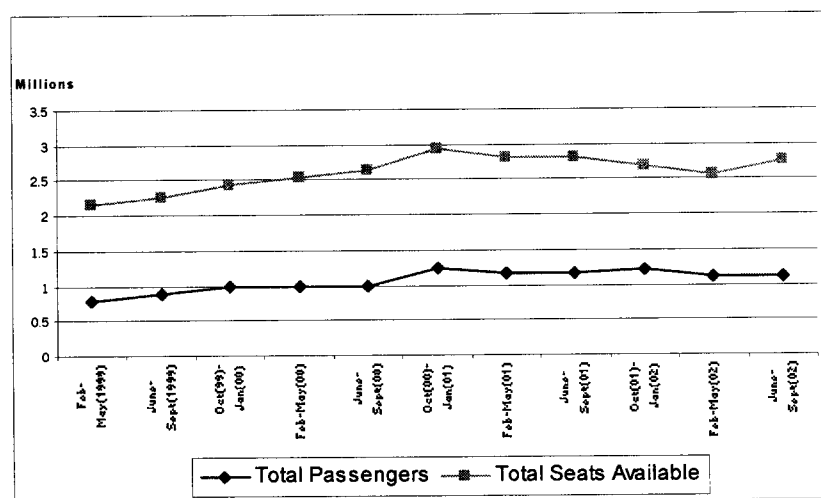
The trans-Tasman route is the most significant contributor to tourism industry exports than any other. New Zealand is Australia's largest inbound market representing some 771,700 visitors, year ended 2002 (ABS, Dec 2002).

It is also the top ranked outbound market representing some 518,200 departures, year ended November 2002 (ABS, Dec 2002).

The route is vitally important to the economic performance of the Australian tourism industry and the economy (and likewise for New Zealand).

Performance on the route in recent history has been patchy. The graph below shows that capacity and demand have fallen considerably over the last twelve months.

**Graph 3: Available Seats and Total Passengers trans-Tasman route quarterly-1999 to 2002**



Source: Bureau of Transport and Regional Economics. Department of Transport and Regional Services.

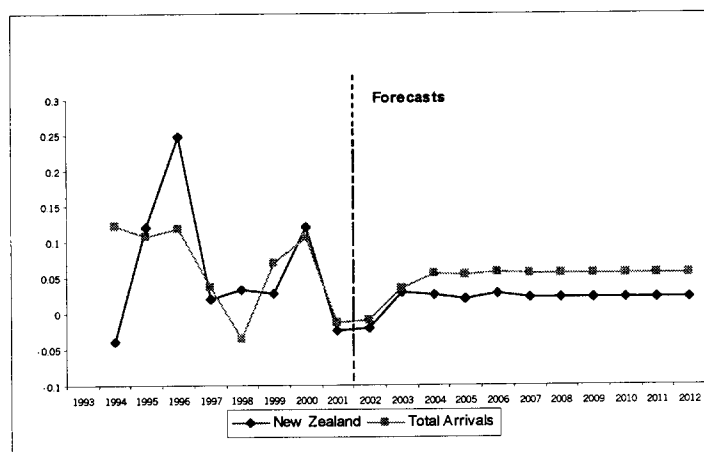
### 4.2 Capacity

Global capacity growth has slowed significantly since 2000. This trend has seemed to be masked in domestic aviation until September 2001 – when Ansett went into administration and then liquidation. This has had a similar impact on the trans-Tasman route. Market capacity has stabilised, albeit tracking mid-point between 1999 and 2000 (similar characteristics to domestic capacity).

### 4.3 Demand

The Government's own Tourism Forecasting Council highlights that inbound visitation from New Zealand over the next ten years will grow at a slower rate than it had in the previous decade and will also grow at a slower rate than total arrivals growth over the next decade. This is shown in Graph 4 below.

**Graph 4: Total International Arrivals to Australia and Total New Zealand Arrivals.**



Source: Tourism Forecasting Council, December 2002

With this soft demand outlook, it is difficult to concede that there will not be further capacity corrections in the longer term. With airlines searching for highest best use of limited resources and maximising yield, it would be expected in the face of soft demand growth, under existing conditions capacity would stabilise at best.

The ACCC should consider these longer-term trends as part of the Alliance approval process. The ACCC needs to clarify whether the Alliance is in fact neutral in the longer term, so that it can focus its policy measures on improving short-term competition in the market.

**Recommendation 4. The ACCC should consider longer-term demand trends and consequent possible capacity falls and price rises when assessing the Alliance proposal.**

# **5. The Alliance Proposal**

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## **5.1 Introduction**

On December 9, 2002 the ACCC received applications for authorisation, A30220, A30221, A30222, from Qantas and Air New Zealand. The applications have been made pursuant to sections 88(1) and 88(9) of the *Trade Practices Act, 1974* for conduct that may constitute an exclusionary provision within the meaning of the Act, conduct which may substantially lessen competition and for the acquisition of shares.

The application specifically seeks authorisation for:

1. The acquisition of Qantas for ordinary shares comprising up 22.5% voting equity interest in Air New Zealand; and
2. Collaborative arrangements between the parties.

Tourism specific details of the Alliance Proposal are included as Attachment A. However, TTF has selected the key points within the submission that will ensure the proposal delivers the stated benefits.

The key areas are listed as:

## **5.2 Competition - Value Based Airlines (VBA)**

- 4.6 (a); Notwithstanding this clause, Air NZ acknowledges, and will procure that:
  - Freedom's Sectors are to be included as a "route group" for the purposes of the Management Fee and Adjustment Payment Calculation;
  - Air NZ, Qantas (and subject to clause 4.6(a) and Freedom will co-ordinate scheduling, routings and capacity planning in relation to the JAO Networks and the Sectors operated by Freedom;
  - Air NZ, Qantas (and subject to clause 4.6(a) and Freedom will co-ordinate all aspects of the pricing of passenger and Freight services on the JAO Networks and on the Sector operated by Freedom including:
    - Setting passenger fares; the development of new fare products; and joint tendering for corporate and government accounts;

### **5.3 Non-Market Barriers to Entry**

- Air NZ and QF undertake to remove what might be seen as barriers to entry for an airline commencing trans-Tasman services, by ensuring that it has reasonable access to the following facilities at airports necessary for the provision of airline passenger services: airport gates, counter facilities, maintenance facilities and baggage handling services.
- For any airline commencing trans-Tasman services, facilities are to be provided (only if they cannot be reasonably or practicably purchased, acquired, provided or replicated by a new entrant) for a maximum 12 months at full cost to the provider plus an appropriate margin.
- These undertakings designed to facilitate and protect new entry on trans-Tasman routes is open for two years from the date of implementation of the Alliance.

### **5.4 Capacity Stability**

- The parties would be willing to undertake not to increase combined capacity beyond natural growth on an existing trans-Tasman route operated by a new entrant for a period of one year after the date on which the new entrant announces its intention to commence operating on that route.
- Capacity ceiling undertakings applies for 12 months following the new entrant's announcement of its intention to commence operating its own flights on a route.
  - Air NZ 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.
  - The undertaking will be suspended if the new entrant does not start accepting bookings within one month of the Announcement; if the new entrant ceases to operate on the route; or during periods of abnormal demand.
- The parties would undertake that they will not reduce capacity on trans-Tasman routes operated as at the date of implementation of the Alliance. These undertakings will terminate immediately upon: another airline commencing operation on the route; or two years from the date of implantation of the Alliance.

### **5.5 Demand Stimulation**

- Qantas and Air NZ would be willing to undertake to substantially increase their expenditure on advertising programs and new product offerings designed to increase tourism to Australia and New Zealand. This additional

expenditure would be undertaken in conjunction with national and state tourism bodies where that is likely to maximise tourism flow.

According to the proposal document the Alliance has significant economics benefits for Australia and New Zealand, financial benefits for the companies involved and benefits for the tourism industry. The proposal also radically alters the existing aviation market structure. The ACCC must ensure it does not throw the baby out with the bath water. In such times of general market instability, it is particularly easy to confuse responses to market based signals as anti-competitive. The ACCC should create rational regulatory regimes that promote competition and sustainability in a highly concentrated market. This will then enable the participants to respond to market signals with the knowledge that they will not be subject to separate and costly actions. Only then can consumers, the businesses involved and Australia and New Zealand realise the benefits outlined in the proposal.

**Recommendation 5. The ACCC should confine its analysis to market based solutions aimed at reducing downward pressure on capacity and upward pressure on price in the shorter term that may result from market concentration. The best way to achieve this is to reduce non-market and market barriers to entry on the route and other anti-competitive behaviour.**

## 6. Alliance Analysis

### 6.1 Introduction

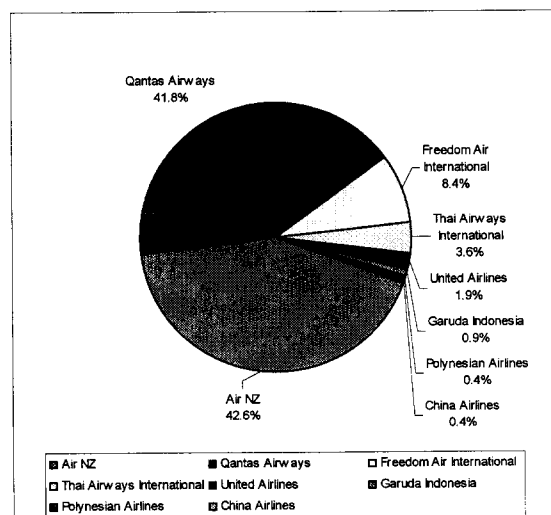
The Alliance claims to generate significant economic benefits to the Australian economy representing \$666 million and benefits to the tourism industry of \$810 million over 5 years. These figures have been generated by the NECG model and are difficult with which to argue (without an alternative model).

The analysis presented in this submission is not so concerned with economic impact or disputing any of the model's economic benefit findings. Instead, it first identifies the impact that the Alliance will have on market concentration and then addresses each of the specific elements of the Alliance proposal that were listed in the previous section.

### 6.2 Market Concentration

The composition of carriers and total passengers (Inbound and Outbound) on the market are included in Graph 5 below.

**Graph 5: Scheduled Operator Market Shares of NZ Passengers for 2001-02**



Source: Department of Transport & Regional Services, September 2002

The Alliance will therefore lead to market concentration with the Air New Zealand/Qantas operation holding 84.4% of the route market share and the next biggest operator Freedom Air International holding 8.4%. Given that Freedom Air International is also part of the Alliance, it would be reasonable to assume that the market concentration is actually 92.8% of passengers in 2002.

It is hard to deny that such levels of market concentration and market power could be used in an exploitative or anti-competitive manner (without any prohibitions).



TTF are not saying that the members of the Alliance will in fact exert their market power in this fashion – but there remains a possibility to do so.

The key issue for the ACCC is to protect consumers from the possibility of such actions, and the best way of doing this is to remove potential barriers to market entry and also ensure certain prohibitions (over ones that already exist) exist to anti-competitive behaviour. It is therefore recommended that:

**Recommendation 6. There is no evidence that market concentration will lead to anti-competitive behaviour. However, given that market concentration will double, it is important that if the proposal is approved the ACCC would monitor market conditions over a period of 24 months.**

### **6.3 Market Barriers to Entry**

Whilst it cannot be proven that market concentration will lead to price or market exploitation, the possibility exists. It is important that the ACCC considers options to remove any barriers to entry into the market. Competition will likely produce lower prices and expanded capacity – benefiting the consumer.

Even within the Alliance many of the benefits and concessions listed, arise from the entrance of a VBA. However, within the proposal the Alliance involves a VBA – Freedom Air International. The inclusion of Freedom takes concentration from 84.4% to 92.8%. While this in itself may not be an issue, there is the possibility that Freedom Air International could cross subsidise within the Alliance (see p11 of the Alliance Agreement - 5.2 Pricing and Remuneration Co-ordination), to offer lower prices, lent with checked capacity to ensure a VBA is within the market but is used as a mechanism to deflect competition from other VBA's.

On the other hand, Freedom Air International could be used as a profit generator by the Alliance and overall route capacity expanded.

On balance, but without specific evidence, there is a potential avenue for market exploitation and this should be addressed by the ACCC. It should only be addressed if there is international precedence for such action. We understand that such an arrangement has been considered by the Canadian authorities. It is recommended the ACCC consider international precedent if forcing divestment of Freedom Air International from the Alliance.

If there is clear international precedent we recommend that similar action is taken in this market i.e. divestment of Freedom Air International. Further, if there is international precedent, there should also be prohibition on the operation of related VBA's on the sector for a period of no less than 12 months.

**Recommendation 7. It is therefore recommended that if there is an international precedent, a condition of approval for the Alliance should be the sale of Freedom Air, to an unrelated party, as well as prohibitions on the Alliance establishing its own VBA or using a related VBA for a period of 24 months.**

## 6.4 Non-Market Barriers to Entry

The original Alliance also makes no provision for sharing (or leasing) airport facilities. The subsequent amendments rectify this non-market barrier to entry.

Airport facilities are vital to the opportunity for new entrants to join the market. Without access to facilities, the upfront investment required by potential entrants is a non-market based barrier to entry.

Without access, it is a probability that there would be no new entrants. Therefore, the Alliance must provide evidence that access to such facilities will be provided to entrants.

The original proposal has no such provision, but this is rectified in the amended undertakings.

This is principally an issue for NZ regulatory authorities to decide on whether facilities access meets the commercial criteria. Therefore TTF supports the undertakings by Qantas as part of the Alliance proposal.

**Recommendation 8. TTF is satisfied that the non-market barrier to entry of a VBA is satisfied under the amended Alliance providing for sub-leasing of airport facilities.**

## 6.5 Capacity Stability

With such concentration, there is potential for exercising of market power in terms of capacity dumping. Capacity dumping is where dominant market players decide to cross subsidise route services to an extent that competition is curtailed. There is no evidence that this will necessarily take place, however with over 90% of market concentration there is potential for such market power to be exerted.

This issue was a concern for TTF. But the amended Alliance gives specific guidelines for prohibition of the exercising of market power in this respect.

The Alliance proposal agrees to maintain capacity growth at its natural rate and will not reduce capacity (notwithstanding the entrance of a new competitor on the route). These undertakings provide certainty to the tourism industry and create a sustainable operating environment for the route. While these measures are supported, the ACCC should monitor capacity performance on the route to ensure the undertakings are met.

**Recommendation 9. TTF is satisfied that the amended Alliance includes adequate prohibitions on capacity dumping in the short term. Consistent with previous recommendations, the ACCC should monitor market conditions for 24 months if the Alliance is approved.**

## 6.6 Singapore Open Skies

From consultations held with the industry, it has been recommended that agreements between Australia and Singapore on Open Skies be finalised as a condition of the Alliance. This was a measure suggested to boost competition on the trans-Tasman and Pacific routes.

However, this agreement is principally a trade agreement to be struck between the Singaporean and Australian Governments.

The negotiations of such an agreement will be based on national interest considerations (not market considerations) between the Governments of both countries.

Therefore, while such an agreement should be encouraged, it should not be a condition of the Alliance as it involves negotiations between Governments and not market participants. National interest and market performance are separate issues.

**Recommendation 10. Singapore Open Skies is a trade issue first and then a market issue. It should not be a condition of approval of the Alliance. However, it could be encouraged so long as the arrangement has a national benefit to Australia.**

## 6.7 Demand

The Alliance identifies that there is a benefit of some 18,000 additional tourists to Australia if the proposal is accepted. These estimates are generated from Tourism Futures International.

However, the discussion thus far has highlighted that the market is not expected to experience the same levels of demand growth that were experienced over the last decade.

In a flat market, an additional 18,000 extra tourists per annum will provide a fillip to softening demand. This is where the Alliance delivers real benefits to the Australian economy. However, TTF are not convinced with the arguments put forward by TFI that, by Qantas Holidays selling stopover packages the propensity for joint visitation to both destinations will jump from the current 35% to 50%. There is no substantial evidence provided that supports the higher assumed rates.

Stimulating demand on the route would be the most probable way of delivering the expected number of tourists to the Australian market. By increasing demand, it is possible to increase capacity while maintaining steady yield growth.

The tourism industry has conducted extensive research into the effects of marketing to stimulate demand. The latest research conducted by Access Economics shows that for every dollar spent in international marketing a further ten dollars in export revenue is generated.

The Alliance includes a provision for additional marketing spend to stimulate demand on the route. TTF Australia supports this provision. TTF Australia would like to see a level of expenditure on demand stimulating marketing guaranteed for a period of three years. To achieve the forecast of 18,000 additional tourists to Australia and based on previous research the spend would have to be in the vicinity of \$2 million per annum for inbound marketing. Although it should not be a condition of the proposal, the Alliance should explore using the marketing spend through the Australian Tourist Commission (subject to their consent).

**Recommendation 11. TTF recommends that a condition of approval should be an evidence of greater levels and longer-term investment in co-operative marketing to arrest the fall rates of growth in the market.**

## 9. Conclusion

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In summary, TTF Australia has examined the following elements that relate to the Alliance:

- Aviation Trends;
- The Trans Tasman Route;
- The Alliance Proposal; and
- Regulatory Frameworks.

TTF Australia has found that the trans-Tasman route has a soft demand growth outlook in the longer term. Without the Alliance being approved, in all likelihood there would be contracting capacity on the route and upward price pressure in the longer term. With the Alliance being approved, and subject to the conditions outlined in this submission, there would be greater certainty and stability for consumers, Government and businesses in a market that is displaying slowing capacity growth, soft demand and upward price pressures. On balance, TTF encourages the ACCC to conditionally support the Alliance proposal.

While sustainability is important, so too is market based competition. There is a high level of market concentration associated with the proposal. Therefore, TTF Australia recommends the ACCC reviews market competition and outcomes on an annual basis for a period of 3 years.

# Attachment A. The Alliance Proposal

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In order to assess the impact of the Alliance on competition, let us first reiterate the Alliance Proposal:

1. the acquisition by Qantas of ordinary shares comprising up to a 22.5 per cent voting equity interest in Air NZ (the Equity Proposal); and
2. collaborative arrangements between the parties (the Strategic Alliance Proposal).

The ACCC must be satisfied the public benefit arising from the Alliance outweighs any anti-competitive detriment before granting authorization.

After the original application to the ACCC on the 9 December 2002 applying for exclusionary provisions from the *Trade Practices Act 1974*, QF and Air NZ have since then submitted another paper (dated 24 January 2003) which proposes to address any residual competition concerns whilst ensuring the delivery of public benefits will flow directly from their Alliance.

Below is a brief outline of the Alliance (comprised of the key points of interest to the tourism industry), including these additional undertakings, comprised of that may be to our Members.

- Under the Strategic Alliance, which will include cooperative pricing and scheduling, Air NZ and Qantas will aim to improve cost effectiveness and efficiency of services; develop new services and products; and encourage and facilitate the movement of passengers;
- Pursue opportunities where they can integrate specific activities and functions and coordinate, integrate or amalgamate areas where benefits can be derived from economies of scale and the combination of activities and functions;
- Air NZ has been appointed as the commercial manager of the commercial (as opposed to the flight operation) aspects of the JAO networks. (clause 4.4 Management Fee and Adjustment Payment Calculation)
  - Subject to the provisions of clause 4.4 Air NZ and Qantas agree to share in any benefits and bear any associated costs which might accrue in a fair and equitable manner;
  - Have regard to the long term interests and future development of Air NZ and Qantas from time to time and the profitable development of a global network;
- Qantas agrees and acknowledges that the freedom business model, is not required to be altered in any way by Air NZ's entry into this Agreement – clause 4.6 (a); Notwithstanding this clause, Air NZ acknowledges, and will procure that:
  - Freedom's Sectors are to be included as a "route group" for the purposes of the Management Fee and Adjustment Payment Calculation;

- Air NZ, Qantas (and subject to clause 4.6(a) and Freedom will co-ordinate scheduling, routings and capacity planning in relation to the JAO Networks and the Sectors operated by Freedom;
- Air NZ, Qantas (and subject to clause 4.6(a) and Freedom will co-ordinate all aspects of the pricing of passenger and Freight services on the JAO Networks and on the Sector operated by Freedom including:
  - Setting passenger fares; the development of new fare products; and joint tendering for corporate and government accounts;
- Qantas will continue to operate Australian domestic and international air services in addition to New Zealand domestic and international services. Air NZ will continue to operate New Zealand domestic and international air services;
- Air NZ and Qantas shall establish a Strategic Alliance Advisory group which shall comprise three representatives appointed by Air NZ and three representatives appointed by Qantas;
- Air NZ will codeshare on selected QF Australian domestic and international flights that connect with Air NZ services. While Qantas has the right to codeshare on any sector flown within the Air NZ network.
- Both airlines will work together in good faith and with full co-operation and transparency to successfully grow both airlines.
- Air NZ and QF undertake to remove what might be seen as barriers to entry for an airline commencing trans-Tasman services, by ensuring that it has reasonable access to the following facilities at airports necessary for the provision of airline passenger services: airport gates, counter facilities, maintenance facilities and baggage handling services.
- For any airline commencing trans-Tasman services, facilities are to be provided (only if they cannot be reasonably or practicably purchased, acquired, provided or replicated by a new entrant) for a maximum 12 months at full cost to the provider plus an appropriate margin.
- These undertakings designed to facilitate and protect new entry on trans-Tasman routes is open for two years from the date of implementation of the Alliance.
- The parties would be willing to undertake not to increase combined capacity beyond natural growth on an existing trans-Tasman route operated by a new entrant for a period of one year after the date on which the new entrant announces its intention to commence operating on that route.
- Capacity ceiling undertakings applies for 12 months following the new entrant's announcement of its intention to commence operating its own flights on a route.
  - Air NZ 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.
  - The undertaking will be suspended if the new entrant does not start accepting bookings within one month of the Announcement; if the new entrant ceases to operate on the route; or during periods of abnormal demand.
- The parties would undertake that they will not reduce capacity on trans-Tasman routes operated as at the date of implementation of the Alliance. These undertakings will terminate immediately upon: another airline commencing operation on the route; or two years from the date of implantation of the Alliance.

Qantas and Air NZ would be willing to undertake to substantially increase their expenditure on advertising programs and new product offerings designed to increase

tourism to Australia and New Zealand. This additional expenditure would be undertaken in conjunction with national and state tourism bodies where that is likely to maximise tourism flow.