

Commission assessment of undertakings proposed

- 14.82. Subsequent to submissions being received in response to the Draft Determination, Virgin Blue has received approval from the IASC to enter the trans-Tasman, Fiji and Vanuatu markets and has committed to enter the trans-Tasman market regardless of whether the Proposed Arrangements proceed or not. Virgin Blue has also made verbal representations to the Commission which will be addressed where relevant in its assessment of the undertakings.
- 14.83. The Commission's assessment of the extent to which the proposed undertakings alter the balance between anti-competitive detriment and public benefit is taken into account in the Commission's assessment at Part 15 of this Determination. The paragraphs below assess the weight likely to be given to the proposed undertakings.
- 14.84. Each of the undertakings is discussed below.

Facilities

- 14.85. The Applicants offer to make certain airport and ground handling services available to new entrants for five years or the period of authorisation of the Strategic Alliance. The Commission considers this period more realistic than the twelve months originally offered.
- 14.86. The Commission accepts that access to airport and ground handling facilities can constitute a barrier to new entry. Undertakings which guaranteed effective access would therefore reduce the anti-competitive effect of the Proposed Arrangements.
- 14.87. The proposed undertakings include a number of qualifications which have the potential to frustrate the provision of access to new entrants. For example, the proposed undertakings do not extend to facilities for new entrant schedules which do not match those provided by the Applicants. This caveat would have the impact of restricting the ability of a new entrant to allocate aircraft to maximise yield, especially at the early stages of market entry when a limited number of aircraft are involved.
- 14.88. The undertaking also does not extend to schedules which would require the Applicants to "alter" more than 25 per cent of their schedules. There is a vagueness about the word "alter" which would give the Applicants significant flexibility in providing facility access depending on the circumstances of the day.
- 14.89. Virgin Blue has stated that it is definitely entering the trans-Tasman market regardless of the Proposed Arrangements. Delays in obtaining suitable access can have a significant impact on the growth of its business, as happened at Sydney. Virgin Blue stated that it cannot make money without peak time airport access.
- 14.90. While the rationale behind the proposed undertakings in relation to facilities is understood, the Commission is of the view that they still give the

Applicants a degree of control over access by any new entrant that could impact on its financial performance and rate of growth.

- 14.91. The Commission acknowledges that the undertakings do address an important competition issue in the form of access to facilities and do facilitate entry relative to a scenario absent the undertakings. That said, the Commission notes that the form of the undertakings still provides the Applicants with a measure of control over access to facilities to the extent that the rate of entry and performance of a new entrant could be affected.

Capacity Ceiling

- 14.92. The Applicants have proposed to undertake not to increase combined capacity on certain trans-Tasman routes operated by a new entrant for a period of eighteen months after the date on which the new entrant announces its intention to commence operating on that route. This represents a six month increase on the Applicants' earlier offer.
- 14.93. The Commission believes that undertakings which effectively limit the ability of incumbent airlines to increase capacity on routes subject to new entrant competition for the purpose or with the effect of damaging the new entrant would address a key issue of competitive concern.
- 14.94. The Commission believes the undertaking proposed does, to some extent, limit the anti-competitive effect of the Strategic Alliance. The weight which the Commission is prepared to attribute to the proposed undertaking is, however, limited by the matters discussed below.
- 14.95. The qualifications in relation to the undertaking would seem to reduce their effectiveness:
- The undertaking only applies to city pairs routes on which either or both of the Applicants, but no other carriers (excepting Origin Pacific) operate. This means that the undertaking would not apply on key trans-Tasman routes with a fifth freedom carrier presence such as between Melbourne and Auckland, regardless of the extent of the fifth freedom competition. The Commission is of the view that the failure to provide new entrant protection on these key routes significantly reduces the effectiveness of the proposed undertakings.
 - The undertaking does not apply to new routes which may be developed by a new entrant such as, say, Newcastle-Auckland.
 - For Air NZ the replacement of B737 aircraft with an equivalent number of A320 aircraft would not be regarded as an increase in capacity, despite it resulting (on NECG's figures) in an increase of up to 20 per cent in available seats.
 - For both of the Applicants a move from B737-300 aircraft to B737-800 aircraft would not be regarded as an increase in capacity. On NECG's figures such moves would result in an increase of up to 20 per cent for Air NZ and up to 33 per cent for Qantas. NECG assumes

seating for 154 persons on a B737-800 compared to the 168 on Qantas' web-site. If the Qantas figures are chosen an increase of up to 45 per cent is possible.

- 14.96. As discussed above, the Commission is of the general view that behavioural undertakings in relation to capacity are susceptible to monitoring and enforcement limitations.
- 14.97. While acknowledging that an undertaking to restrict increases in capacity can assist market entry, the Commission is of the view that the particular undertakings proposed by the Applicants still give them scope to utilise increases in capacity against the interests of a new entrant.

Freedom

- 14.98. While resisting suggestions from interested parties that the undertakings should include the divestment of the Air NZ subsidiary Freedom, the Applicants have offered an undertaking that constrains Freedom's operations against a new entrant airline. These constraints would effectively preclude Freedom being used on trunk routes against Virgin Blue.
- 14.99. The Commission sees little value from such constraints as the Applicants could still utilise other low cost carrier strategies, for example deploying Australian Airlines, Jet Connect or Impulse on those trunk routes. Virgin Blue has acknowledged this range of options by stating that the divestment of Freedom is no longer essential.
- 14.100. The undertaking also proposes that Freedom would not grow its trans-Tasman schedules by more than one aircraft each calendar year. Given that Freedom has a fleet of four aircraft, such growth represents a 75 per cent increase in capacity for that airline over three years.
- 14.101. Absent the divestment of Freedom the Applicants have offered an undertaking to wet lease up to four B737-300 aircraft for up to three years to a new entrant. The Commission notes that Virgin Blue has aircraft on order and has satisfied the IASC that it is capable of operating on the trans-Tasman.
- 14.102. For the reasons described above the Commission considers that it can attach no weight to undertakings relating to Freedom or the proposition of leasing aircraft to a new entrant.

Capacity Floor and Tasman Price Cap

- 14.103. The Applicants propose undertakings that limit their ability to reduce capacity on routes after commencing any Strategic Alliance. The undertakings are couched in terms of providing consumer protection by maintaining a certain level of services.
- 14.104. The undertakings propose that the capacity floor on a city pair would cease if another airline achieves a 20 per cent market share on the route. The Applicants could also reduce capacity if over a three month period seat

factors decline to less than 70 per cent or yield declines by more than five per cent.

- 14.105. Undertakings as to the maintenance of current service levels are likely to limit the possible anti-competitive detriment associated with the Strategic Alliance (that is, the possible reduction in quality of service associated with a reduction in competition). However, such an undertaking is limited in effect if it focuses on only one area of consumer choice and provides, for example, no assurance as to pricing levels.
- 14.106. In recognition of comments made by the Commission along these lines in the Draft Determination, the Applicants have subsequently offered an undertaking capping trans-Tasman prices in line with airlines' cost base increases. The capping would cease on any city pair on entry by another airline.
- 14.107. The Commission does not see value in the price cap undertaking proposed by the Applicants. Airlines can increase yield and average prices paid by varying seat availability in the various fare classes even in an environment where prices for each fare class are held constant.
- 14.108. A capacity floor could be of value if accompanied by effective price control. While a capacity floor restricts the ability to reduce supply to enable increased prices, where there is reduced competition as a result of the Proposed Arrangements there is still an opportunity even with the proposed price cap undertaking to effectively increase prices, especially as natural growth in markets leads to demand/supply imbalances.
- 14.109. For the above reasons, the Commission is of the view that the proposed undertakings as to a capacity floor and a price cap should be given little weight as a means of reducing the anti-competitive detriment associated with the Proposed Arrangements.

New services, tourism and freight

- 14.110. The Applicants have proposed undertakings which they submit are relevant to the public benefits of the Proposed Arrangements. The undertakings include:
- the commencement of new direct services between specified city pairs;
 - a commitment to substantially increase their expenditure on advertising programs and new product offerings designed to increase tourism to Australia and New Zealand; and
 - undertakings relating to maintenance of freight capacity on trans-Tasman routes by the addition of a minimum of four weekly return trans-Tasman wide bodied "back-of-the-clock" services specifically for freight.
- 14.111. To the extent that undertakings enhance or ensure delivery of public benefits flowing from the proposed conduct or arrangements, the Commission may give such undertakings some weight.

- 14.112. Having regard to the undertakings proposed by the Applicants however, it is also apparent that the Applicants have included these purported outcomes in their supporting submissions as flowing from the Proposed Arrangements. It is further understood that the Applicants have taken these purported outcomes into account in preparing its modelling of benefits and detriments. Therefore, the Commission has taken them into account in its assessment of benefits and detriments directly. To give any further weight to the undertakings would most likely result in double counting.
- 14.113. For further discussion regarding undertakings associated with new services, tourism and freight, see Part 13 above.

Other aspects of the undertakings proposed by the Applicants

- 14.114. Having regard to the above, the Commission considers that the ability of undertakings to control behaviour such as that under the Proposed Arrangements is severely limited. The Commission is also of the view that there are practical difficulties associated with attempting to implement and enforce effective behavioural undertakings.
- 14.115. The Applicants have proposed the use of monitoring and independent third parties as a means of ensuring compliance with the undertakings. The adoption of such an approach combined with the extensive range of undertakings proposed would result in a prima facie regulated market. The Commission is of the view that most markets work optimally for consumers when intervention is minimised and competitive forces are allowed to drive outcomes.

Commission assessment of undertakings proposed by interested parties

- 14.116. As indicated earlier, the Commission has received various submissions as to possible undertakings that might address competition concerns. The Commission does not intend to assess in detail those proposals. Ultimately it is a matter for the Applicants to decide the nature of undertakings it might be prepared to offer.
- 14.117. With respect to submissions from interested parties, many of the proposals appear to address individual or narrow interests and/or are outside the Commission's or the Applicants' control. While these may well reduce the anti-competitive effect or enhance the benefit of any proposal in specific areas, they are unlikely, by themselves, to have significant impact on the Commission's overall assessment.
- 14.118. Proposals which were likely to have a wider impact included proposals for Air NZ to divest itself of Freedom Air. While such a proposal would have a wider impact, this is not to say that the Commission would necessarily be satisfied such a divestiture would significantly reduce the detriment or increase the benefit associated with the Proposed Arrangements.

15. Commission assessment – whether public benefits outweigh anti-competitive effects

Anti-competitive detriment

- 15.1. Following its assessment of the anti-competitive detriment flowing from the Proposed Arrangements, the Commission concluded that the arrangements were highly anti-competitive and resulted in a high level of anti-competitive detriment. In forming this view, the Commission concluded that the Proposed Arrangements would result in:
- high anti-competitive detriment in relation to trans-Tasman routes as a result of a substantial lessening of competition and a substantial increase in the market power of the Applicants;
 - anti-competitive detriment in relation to passenger air services between Australia and North American;
 - little anti-competitive detriment in relation to passenger air services between Australia and the Pacific Islands albeit with the potential for the Proposed Arrangements to be anti-competitive;
 - significant anti-competitive detriment in relevant air freight markets leading to increased prices and reduced capacity;
 - substantial anti-competitive detriment in the Australian domestic air passenger market; and
 - some anti-competitive detriment in the relevant markets for the sale of air travel.
- 15.2. On the Applicant's view of how markets would develop absent the Proposed Arrangements, the Proposed Arrangements would see a loss of around five years' competition between Qantas and Air NZ in markets where they currently compete.
- 15.3. In considering the anti-competitive effects of the Proposed Arrangements, the Commission formed the view that the markets most likely affected by the Proposed Arrangements (from an Australian perspective) were the trans-Tasman passenger air services and trans-Tasman freight services. It follows therefore that the anti-competitive effect in those markets should be given greater weight.
- 15.4. Having regard to the foregoing, the Commission is of the view that the anti-competitive nature of the Proposed Arrangements would lead to increased fares and decreases in capacity and quality of service on routes which involve Australia.

Public Benefits

- 15.5. The Commission's overall assessment was that the Proposed Arrangements did not give rise to public benefits of significance to which a reasonable degree of certainty of realisation could be attached. The Commission's assessment was that:
- there exists substantial doubt as to whether the claimed significant cost efficiencies would flow from the Proposed Arrangements;
 - any benefits that might accrue from scheduling efficiencies are not significant in the context of the overall arrangement and there is a risk of capacity reduction associated with scheduling efficiencies;
 - new direct services were not necessarily sustainable and any benefits for passengers were not significant;
 - it was not convinced that claimed tourism increases or associated public benefits would occur;
 - it was not satisfied that claimed freight capacity initiatives were sustainable and that associated public benefits would occur; and
 - the Proposed Arrangements add only marginally to the global competitiveness of Qantas and are not necessarily in the national interest.

Balance of anti-competitive detriments and public benefits

- 15.6. Having regard to the foregoing and having applied the "with-and-without test" previously discussed, the Commission is of the view that the highly anti-competitive effects of the Proposed Arrangements identified by the Commission would, for the foreseeable future, significantly outweigh the low public benefits flowing from the Proposed Arrangements accepted by the Commission.
- 15.7. The Commission is of the view that the gap between the anti-competitive detriments and public benefits likely to flow from the Proposed Arrangements, in comparison with the situation likely to arise without the Proposed Arrangements, is substantial.

Potential for undertakings to redress the imbalance

- 15.8. The Commission has earlier indicated that it considers the ability of undertakings to control behaviour such as that proposed by the Applicants is limited.
- 15.9. In the context of the Applicants' Applications, the Commission does not believe that undertakings have the potential to significantly reduce the high level of anti-competitive detriment arising from the Proposed Arrangements.

- 15.10. Some of the proposed undertakings, such as those involving access to facilities and capacity ceilings are intended to facilitate the entry of a new carrier into the market. Given, however, that Virgin Blue has committed to entering the trans-Tasman market, regardless of whether the Proposed Arrangements proceed, the impact of the undertakings would seem directed more to the rate of entry of Virgin Blue than the possibility of entry. From that perspective, the Commission needs to consider the extent to which the anti-competitive detriment assessed as arising from the Proposed Arrangements could be reduced by the undertakings if they allow faster entry and expansion by Virgin Blue.
- 15.11. The Commission considers that the scale of anti-competitive detriment associated with the Proposed Arrangements is such that the detriment would not be significantly reduced by a faster rate of entry by Virgin Blue if that faster rate of entry was achieved as a result of the proposed undertakings, even without taking into account the limitations of the undertakings as identified by the Commission.
- 15.12. Other undertakings are intended to reduce anti-competitive detriment associated with reduced competition by using capacity ceilings and price caps to protect consumers from higher prices. The Commission considers that such undertakings are ineffective and do not reduce detriment.
- 15.13. The Commission also recognises that undertakings can be used to ensure public benefits are realised. In this matter, any uncertainty with public benefit is mainly associated with the size of the benefit rather than realisation, for example, as with claimed tourism benefits. The proposed undertakings have already been taken into account when assessing public benefit associated with the Proposed Arrangements. There is accordingly no scope for further consideration of the potential for undertakings to increase the level of public benefit arising from the Proposed Arrangements.
- 15.14. In summary, the Commission considers there to be limited potential for the foreseeable future for the giving of undertakings by the Applicants to change the balance of detriment and benefit associated with the Proposed Arrangements to the extent that a position of net public benefit would be achieved.

16. Determination

The Applications

- 16.1. On 9 December 2002 Qantas and Air NZ lodged applications for authorisation (numbers A30220, A30221 and A30222) with the Commission.
- 16.2. On 20 December 2002 Qantas and Air NZ lodged applications for authorisation (numbers A90862 and A90863) with the Commission.

Applications A30220 and A30221

- 16.3. Applications A30220 and A30221 were made under section 88(1) of the Act for authorisation under that subsection:
 - to make a contract or arrangement, or arrive at an understanding, where a provision of the proposed contract, arrangement or understanding would be, or might be, an exclusionary provisions within the meaning of section 45 of the Act and to give effect to those provisions (A30220); and
 - to make a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the TPA and to give effect to those provisions (A30221).
- 16.4. Applications A30220 and A30221 essentially sought authorisation for Qantas and Air NZ to enter collaborative arrangements on passenger and freight services (the Strategic Alliance) whereby the airlines would, among other things, coordinate fares and schedules of all Air NZ flights and Qantas flights into, within and departing from New Zealand and agree not to compete with each other on other routes departing from or arriving at Australia or New Zealand.

Application A30222

- 16.5. Application A30222 was made under subsection 88(9) of the Act and sought authorisation for the acquisition by Qantas of ordinary shares comprising up to a 22.5 per cent voting equity interest in Air NZ (the Equity Proposal).

Applications A90862 and A90863

- 16.6. Applications A90862 and A90863 were made under section 88(1) of the Act for authorisation under that subsection:
 - to make a contract or arrangement, or arrive at an understanding, where a provision of the proposed contract, arrangement or understanding would be, or might be, an exclusionary provisions within the meaning of section 45 of the Act and to give effect to those provisions (A90862); and

- to make a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the TPA and to give effect to those provisions (A90863).
- 16.7. Applications A90862 and A90863 essentially sought authorisation for Qantas and Air NZ (with Air Pacific) to enter into an agreement (the Cooperation Agreement) ancillary to the Strategic Alliance which allows the Applicants to cooperate with respect to aspects of passenger and freight services.

The Statutory Test

Applications A30221 and A90863

- 16.8. For the reasons outlined in Part 15 of this Determination, the Commission is not satisfied that in all the circumstances the making of the arrangements and the giving effect to the provisions of the arrangements that might have the purpose or effect of substantially lessening competition and for which authorisation is sought under subsection 88 (1) of the Act:
- would be likely to result in a benefit to the public; and
 - that benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result from the arrangements.

Applications A30220 and A90862

- 16.9. For the reasons outlined in Part 15 of this Determination, the Commission is also not satisfied that, in all the circumstances, the arrangements for which authorisation is sought under subsection 88 (1) of the Act in respect of provisions which may be exclusionary provisions would be likely to result in such a benefit to the public that it should be allowed to be made and given effect to.

Application A30222

- 16.10. For the reasons outlined in Part 15 of this Determination, the Commission is also not satisfied that, in all the circumstances, the proposed acquisition in shares for which authorisation is sought under subsection 88 (9) of the Act would be likely to result in such a benefit to the public that it should be allowed to be made and given effect to.

Determination

- 16.11. The Commission therefore denies authorisation to applications A30220, A30221, A30222, A90862 and A90863.
- 16.12. This Determination is made on 9 September 2003.

- 16.13. Pursuant to section 101 of the Act, a person dissatisfied with the above Determination may apply to the Australian Competition Tribunal for a review of the Determination.
- 16.14. Any application for review must be made within 21 days of the date of the Determination.

APPENDIX A

Summary of other submissions on the Application prior to the Draft Determination

Anonymous submissions

The two anonymous submissions to the Commission (hereafter referred to as “Party A” and “Party B”) are outlined below.

Party A submitted that Qantas’ market share is so large that it effectively operates with monopolistic power and that, in an environment where larger carriers are struggling to survive, Air NZ and Qantas are performing well. Party A submitted that there is no guarantee that there will be competition on the trans-Tasman sector and that this will result in higher fares.

Party A submitted that if the Proposed Arrangements were authorised, this may also lead to misleading conduct as the public is likely to believe that the aligned airlines – each with distinctive branding – are competitors, when this is actually not the case. Party A also submitted that the barriers to entry for new carriers would be prohibitive under the arrangement.

Party A submitted that there may be an impact on smaller travel agents as airlines stop paying them (by commission) to distribute products and that the public may have less choice and airfares will effectively increase as agents introduce booking fees to compensate for the removal of commission.

Party A noted that studies show that greater competition reduces airfares and increases the frequency, variety and quality of services, to the benefit of consumers. Party A cites low fares on Australia-Hong Kong routes (as a result of competition from Ansett) as evidence of this. Party A submitted that higher airfares are likely to have an impact on tourism in two ways. First, they will reduce the number of inbound foreign tourists and, second, they will reduce the level of expenditure of those tourists who do visit.

Party A submitted that the Proposed Arrangements may, in fact, be costly and time consuming to manage and that there are other viable alternatives that allow for the capturing of cost efficiencies without an alliance arrangement and the associated lower flight frequency.

In relation to the enforceable undertakings proposed by the Applicants in relation to price and barriers to entry, Party A submitted that these are likely to be difficult to monitor.

Party A submitted that the Commission should not authorise the Proposed Arrangements. If the Commission does authorise the Proposed Arrangements, Party A submitted that it should be on condition that the Applicants agree to:

- guarantee commission to travel agents at levels no less favourable than prior to the merger occurring;

- measures that would allow agents fair and equitable access to all airline products; and
- future entrant protection and measures that would prevent Qantas and Air NZ from handicapping such entrants.

Party B submitted that the Proposed Arrangements may result in direct services from the west coast of Australia to New Zealand will be cancelled. In this regard, Party B noted that following the Qantas/BA JSA, BA cancelled its Perth-Auckland service and the extension of the JSA resulted in the cancellation of the BA Perth-London service. Party B submitted that a decision to cancel the Qantas Perth-Auckland route would disadvantage consumers in three ways:

- it would lead to longer (and interrupted) travelling time as a result of a change of flights on the east coast before moving on to New Zealand;
- reduced cabin baggage allowances on the domestic leg of the journey; and
- no competition on the Perth-Auckland route.

Air Freight Council of Queensland

The Air Freight Council of Queensland (“AFCQ”) made two submissions to the Commission in relation to this matter. An outline of the issues raised in the submissions follows.

AFCQ submitted that, in order to provide an objective submission, more detail in relation to the Proposed Arrangements is required.

AFCQ provided the Commission with background in relation to current freight capacity and submitted that most freight is carried on the lower deck of wide-bodied passenger aircraft. AFCQ submitted that it is vital to the development of air cargo and trans-Tasman trade that the industry is provided with regular wide-bodied passenger services on which to transport freight and noted that the operation of dedicated freighter aircraft is generally not considered economically viable.

AFCQ submitted that, should the Commission authorise the Proposed Arrangements, both the Australian and New Zealand Governments should provide foreign flag carriers full traffic rights (passenger and cargo) without restriction to operate trans-Tasman services in either or both directions.

In relation to the undertakings proposed by the Applicants, AFCQ submitted that the time frame in relation to the “entry facilitation and protection” undertaking is too short and that the “capacity floor” undertaking is not specific enough and should be stated in terms of a city-pair basis for the carriage of freight.

Australia Pacific Airports (Melbourne) Pty Ltd

Australia Pacific Airports (Melbourne) Pty Ltd (“Melbourne Airport”) submitted that long term stability and viability in the aviation industry would, by necessity, involve consolidation of airline operators either by way of alliances, acquisition or exit by

some carriers from the industry. However, Melbourne Airport submitted that the Proposed Arrangements is not essential for the long term viability of Qantas.

Melbourne Airport submitted that relatively little benefit flows to consumers directly and consolidation of capacity by Qantas and Air NZ could be seen as a reduction in supply which is not in the interests of consumers.

Melbourne Airport submitted that competition and consumer interests would be improved by further reform and further liberalisation of the Australian international air services policy. Melbourne Airport submitted that it may be appropriate for the Commission to request the Commonwealth Government to review its air services policy prior to the Commission authorising the Proposed Arrangements.

Melbourne Airport submitted that the Commission should require specific undertakings, particularly in relation to capacity dumping.

Australasian Business Travel Association

The Australasian Business Travel Association (“ABTA”) submitted that the potential for rationalisation of the trans-Tasman and other routes will mean less services and higher prices and that any withdrawal by Air NZ from the Star Alliance would adversely affect ABTA members with points in this loyalty program. ABTA also submitted that international routes may be dominated by the Proposed Arrangements and that this may lead to collusion on airfares, little product differentiation and tightly controlled capacity.

ABTA further submitted that controlled capacity as a result of the Proposed Arrangements will mean less choice, less seats and less availability of discount fares. Additionally, ABTA submitted that the Proposed Arrangements will increase the cost of cargo and reduce the available space for cargo.

ABTA submitted that its members were of the view that business activity will be more difficult as a result of the Proposed Arrangements.

ABTA submitted that it may be appropriate for financial concessions and protection to be provided to new entrants as this will allow them to compete on a level footing and avoid subjection to anticompetitive behaviour.

Australian Airports Associated Limited

The Australian Airports Association Limited (“AAA”) submitted that, while there is a need for industry stability within the region, Government should actively encourage another operator to commence scheduled services on the trans-Tasman and trans-Pacific routes. AAA submitted that it is in the public interest to have a more competitive market.

In relation to the undertakings proposed by the Applicants, AAA submitted that in their current form they do not sufficiently demonstrate a public benefit. Further, AAA submitted that it can take years for a new entrant to be in a position to compete and undertakings in place for two years (as proposed by the Applicants’) do not give any new entrant sufficient time to commence operations and establish the integrity of their

schedules. AAA submitted that, should the Proposed Arrangements be authorised by the Commission, there should be a regulatory review at the conclusion of the first three years of the Proposed Arrangements and that there should be no rationalisation of existing capacity.

AAA noted that in many instances international airline alliances have not resulted in a public benefit and cited Qantas' relationships with JAL, BA and South African Airways, and Air NZ's relationship with Ansett as examples.

AAA submitted that the Proposed Arrangements should only be authorised if the Commonwealth Government adopts an international "open skies" policy, effective from the commencement of the Proposed Arrangements. AAA submitted that any international airlines should be allowed to operate passenger and cargo services between any Australian airport and any airport outside Australia.

Australian Consumers Association

The Australian Consumers Association ("ACA") submitted that the Proposed Arrangements are likely to result in a substantial lessening of competition in regional air services that will not provide sufficient, if any, consumer benefit.

ACA submitted that Australian routes to Wellington and Christchurch currently exhibit no competition and price gouging. ACA submitted that Air NZ and Qantas schedule flights in parallel, and charge almost identical fares with identical conditions.

In relation to the public benefits claimed by the Applicants, ACA submitted that cost efficiencies will accrue to the benefit of the Applicants alone and that there is no suggestion that the public will benefit from lower fares and freight charges. ACA submitted that if scheduling efficiencies were to produce greater diversity of flights, then this should be considered a public benefit, though probably a minor one.

In terms of improved freight services, ACA submitted that, if all of the benefits associated with improved services accrue to the Applicants, then there is no real public benefit. In relation to the claim that the Proposed Arrangements will increase the international competitiveness of the Applicants, ACA submitted that the conduct is more likely to "shore up" Qantas' position by blocking competitors' access to the markets.

ACA submitted that there is no consumer benefit in authorising the Proposed Arrangements.

Australian Council of Trade Unions

The Australian Council of Trade Unions ("ACTU") submitted that a measure of the public interest should include an analysis of the impact of employment levels and safety. ACTU recognised that there may be efficiencies achieved through a closer working relationship between Qantas and Air NZ that do not involve reductions in employment and that these efficiencies may be categorised as a benefit – through whether it is a *public* benefit will be a function of the distribution of the benefits.

ACTU submitted that the Proposed Arrangements will result in a loss of jobs and/or a reduction in Australia's aviation skills base.

ACTU noted that employment growth elsewhere within the Qantas group may in part compensate for a reduction in employment levels but that there would still be an impact on jobs as a result of the arrangements. ACTU submitted that job losses and a reduction in the existing skills base within the industry would not be in the public benefit. ACTU also submitted that the Proposed Arrangements could result in a "race to the bottom" in relation to operating procedures, staffing and safety considerations.

In relation to the counterfactual proposed by the Applicants, ACTU submitted that the continuance of Qantas as a profitable operator, and Air NZ as a national flag carrier, is not dependent on approval of the application. In terms of the public benefit claims made by the Applicants', ACTU submitted that the Applicants' have proffered little evidence that the Proposed Arrangements (if authorised) will advance each country's tourism and exports.

ACTU recognised that the Proposed Arrangements would provide a necessary capital injection in Air NZ and would avoid the costs associated with competition while producing savings in terms of joint operations.

ACTU submitted that enforceable undertakings regarding scheduling of existing and new passenger and freight services, pricing and employment are appropriate.

Australian Federation of International Forwarders Ltd

The Australian Federation of International Forwarders Ltd ("AFIF") submitted that the international air transport industry has suffered financial hardship in recent years and has seen reduced demand and oversupply of capacity. AFIF noted that most of the market instability in both passenger and freight markets has occurred in North America and Europe and that fluctuations in market demand in Australia and New Zealand and on the trans-Tasman route have been much less than most other areas. AFIF submitted that Qantas, Air NZ and Air Pacific have all achieved good profit results over the last three years.

In relation to the impact of the Proposed Arrangements on freight, AFIF submitted that the effect of the Applicants' move to narrow-bodied aircraft will be to:

- reduce overall freight capacity; and
- eliminate the use of unit load devices such as pallets and bins and enable only "loose" freight to be carried.

AFIF submitted that the above will have a detrimental effect on freight operations and that the Proposed Arrangements will not "improve freight operations".

AFIF also submitted that the loss of competition on the trans-Tasman route will result in a substantial price increase.

AFIF submitted that, should the Commission authorise the Proposed Arrangements, it should consider limiting the scope of the Conduct to include only operational matters such as aircraft operations, scheduling, terminal operations and purchasing, and

prohibit commercial cooperation on aspects such as pricing, space allocation, reservation and bookings.

Australian and International Pilots Association

The Australian and International Pilots Association (“AIPA”) submitted that there are very significant public detriments association with the reduction of competition and the creation of one dominant airline in the trans-Tasman market.

AIPA submitted that the Proposed Arrangements (if authorised) would result in a restriction of employment in the aviation industry and that Australia will suffer significant long-term detriment as a result of the conduct. AIPA submitted that this detriment specifically arises from contraction of employment (and increasing unemployment); restriction of competition in the trans-Tasman market; exporting employment opportunities; restriction of economic development; increased industrial disputation and industrial disharmony; decline in the quality and safety of goods and services; a contraction of consumer choice; and avoidance of Australian industrial legislation.

In relation to the undertakings lodged by the Applicants, AIPA submitted that it may be possible to relieve, or minimise, many of the detriments association with the Proposed Arrangements.

AIPA submitted that, should the Applicants make enforceable undertakings in relation to the security of Australian jobs and equitable distribution of any employment growth generated by the Proposed Arrangements (if authorised), they would be likely to support the Proposal.

Australian Manufacturing Workers’ Union

The Australian Manufacturing Workers’ Union (“AMWU”) submitted that the Proposed Arrangements (if authorised) will result in public detriment in terms of the social and economic impacts of the Proposals on maintenance and engineering services, employment, safety, skill availability and civil and defence services capability.

AMWU submitted that the Applicants’ proposal to increase sub-contracted heavy maintenance work to New Zealand by almost 40 per cent will have a negative sustainability impact on Australian services. Similarly, AMWU submitted that the contracting out of civil and defence services is not a public benefit. AMWU noted NECG’s submission that the increase in sub-contracted work to Air NZ is not cost effective and raises issues in terms of public benefit and detriment. AMWU noted that NECG conceded that the Proposed Arrangements “would remove competing providers of engineering and maintenance services from which an entering or expanding airline could potentially obtain services”.

AMWU also submitted that Qantas has social responsibilities as it received public funds for almost 50 years. AMWU submitted that any contraction in Qantas’ ability to perform its civic role is a public detriment.

The AMWU recommended that the Proposed Arrangements should only be considered when it contains enforceable undertakings that provide for the future operation of engineering and maintenance services.

Australian Services Union

The Australian Services Union made a submission to the Commission in support of the ACTU submission in relation to this matter.

Australian Tourism Export Council

ATEC submitted that it “cautiously supports” the submission by Qantas and Air NZ for the Strategic Alliance Proposal.

The Australian Tourism Export Council (“ATEC”) submitted that a sustainable aviation sector that delivers growth to Australia’s tourism export industry is the fundamental concern of the Australian tourism export industry. ATEC submitted that, given the current aviation climate, Australia requires a carrier that is sustainable in the long term. ATEC also submitted that it accepts that the Proposed Arrangements may deliver a stronger international carrier, but that this network is likely to benefit the New Zealand market more than the Australian market.

ATEC submitted that the Commission should look at the behaviour of Qantas and BA on the London-Australia route, where the fares have remained low. ATEC also submitted that the Commission should consider the likely entrant of a VBA on the trans-Tasman route and also that on-line carriers to Australia and New Zealand should be granted fifth and sixth freedom rights on the trans-Tasman route.

ATEC submitted that additional undertakings should be considered, including:

- a review of undertakings regarding price monitoring;
- a commitment from the Applicants to contribute to a marketing support fund to specifically market Australia for the next five years;
- support by the Commonwealth for a regulatory and policy framework that encourages a competitive aviation environment;
- an undertaking requiring the Applicants to report to the Commission and the Australian tourism export industry on alliance marketing activities;
- a commitment from the Applicants that they will provide equal and fair access to wholesale fares to wholesale distribution partners and that they will not provide wholesale discount fares exclusively to their own holiday divisions;
- a commitment from the Applicants that they will not use the market power of their combined holiday divisions to significantly undercut other wholesale and inbound distributors of ground products.

Australian Tourist Commission

The Australian Tourist Commission (“ATC”) provided the Commission with background on the Australian inbound tourism market and marketing support for Australian tourism.

ATC submitted that it accepts the counterfactual proposed by the Applicants in broad terms. It suggested that the counterfactual would benefit from being extended beyond five years in order to incorporate the possible impact of Air NZ disappearing or shrinking as the New Zealand Government comes under financial pressure to withdraw support.

ATC identified three key areas in relation to the consideration of the Proposed Arrangements:

- potential overall loss of yield/export earnings for Australia from dual destination visits;
- completeness of travel forecasting arrivals; and
- the impact on the United States’ inbound tourism market.

In relation to the Proposed Alliance’s shift in marketing, ATC submitted that it is likely that this shift in marketing will result in many more third country tourists to Australia dividing their holiday (in both duration and budget) between Australia and New Zealand. ATC submitted that total visitor nights and spending in Australia will fall unless there is significant growth in overall arrivals due to increased marketing. In this regard, ATC noted that an evaluation of campaigns run in the past year by Qantas and Air NZ show that the “Australian only” campaign was more effective in delivering yield to the Australian tourism industry. ATC submitted that, therefore, the Applicants have underestimated both the costs to Australian inbound tourism and the benefits to New Zealand inbound tourism from the Proposed Arrangements.

ATC also submitted that the Applicants’ tourism analysis does not provide a robust explanation of forecast arrivals to Australia from New Zealand as a result of the Proposed Arrangements. For example, ATC notes that the Applicants’ expectation that an additional 28,000 tourist arrivals in the third year will result from the Proposed Arrangements in the third year is only about 0.5 per cent of Australian inbound arrivals but, according to the Applicants, these arrivals will account for 2,500 more tourism industry jobs. ATC also notes that the failure of Virgin Blue to enter the market at the assumed level and/or the short term impact of capacity reductions and price increases on the Tasman will put Australian inbound tourism market at risk and may, in fact, result in Australian inbound tourism yield from New Zealand falling in the first two years of the Proposed Arrangements.

In relation to the Australia-United States routes, ATC submitted that there is a risk that these routes will only be offered by the Applicants, with only non-stop flights offered by Qantas. ATC submitted that this puts the Australian inbound tourism industry at risk.

ATC submitted that there appears to be a focus from Qantas and Air NZ on the east coast of Australia and that, as a result, Western Australia, South Australia, Northern Territory and Tasmania might expect to receive a reduced focus from Qantas.

ATC submitted that priority should be given to “open skies” negotiations should the Proposed Arrangements be authorised by the Commission.

In conclusion, ATC submitted that the Proposed Arrangements should be supported subject to additional protections for the Australian inbound tourism for the next five years.

Bon Voyage Marketing Ltd

Bon Voyage Marketing Ltd (“BVM”) is a travel company operating in New Zealand. BVM made a submission to the NZCC in relation to this matter. Aspects of this submission that the Commission considers relevant to its consideration of this matter are outlined below.

BVM submitted that the Proposed Arrangements is anti-competitive and has no real benefits to consumers in either Australia or New Zealand. BVM submitted that the Proposed Arrangements will result in a market dominant virtual monopoly, forcing structural changes detrimental to the sustainability of the New Zealand travel agency sector and to services to the consumer.

BVM recommended that prior to approval of the Proposed Arrangements:

- Air NZ and Qantas should be forced to maintain competition in its current form until a new operator reaches the current size of Qantas’ main trunk operation in New Zealand;
- an independent authority (funded by the Applicants) should be established to control flight schedules, control/monitor advertised low fare availability, control fares and monitor undertakings;
- Air NZ fully explore alternatives to the Proposed Arrangements; and
- an undertaking in relation to travel agent remuneration should be provided.

Brisbane Airport Corporation Ltd

Brisbane Airport Corporation Ltd (“BAC”) submitted that, in an international context, the Proposed Arrangements may be desirable to enable the Applicants to compete more effectively on the “world stage”. However, it expressed concern at the potential for anti-competitive effects on the trans-Tasman route and noted that this concern is primarily a function of “inappropriate bilateral regulatory arrangements associated with international air services and potential for duopolistic outcomes in the trans-Tasman aviation market”.

In relation to the undertakings proposed by the Applicants, BAC submitted that:

- neither Qantas nor Air NZ have any rights associated with international gates and check-in counters at Australian airports;
- undertakings in relation to the number of seats or services should not be from the date of implementation of the Proposed Arrangements, but instead from an earlier date;
- undertakings in relation to new entrants should be from the date the new operator commences services, not from the date of any announcement; and
- it is difficult to see the value of the proposed undertakings in their current form due to the quantity of “provisos/qualifications”.

In order to minimise the anti-competitive effects of the Proposed Arrangements, BAC submitted that the following should occur:

- the Australian and New Zealand governments should liberalise the trans-Tasman aviation market;
- the Australian Commonwealth Government should bring forward the implementation of recommendations that flowed from the Productivity Commission’s inquiry into international air services; and
- until such measures are fully implemented, the Commission should strengthen undertakings proposed by the Applicants to ensure passenger and freight capacity is not diminished for three years or until a new carrier has operated for 12 months.

Consolidated Travel Pty Ltd

Consolidated Travel Pty Ltd (“Consolidated Travel”) submitted that the Proposed Arrangements will ensure the viability of both Qantas and Air NZ both within the markets directly affected by the Proposal, but will also assist the Applicants to compete in the increasingly competitive and volatile global aviation market.

Consolidated Travel submitted that it is of the view that, without the support of Qantas, Air NZ may not be able to withstand competition in the New Zealand market.

Consolidated Travel submitted that the “open skies” agreement between Australia and New Zealand and the proposed agreement with Singapore together provide opportunities for other carriers to enter the markets.

Consolidated Travel submitted that it supports the Application.

Danzas AEI Pty Limited

Danzas AEI Pty Limited (“Danzas”) submitted that a failure for the Proposed Arrangements to proceed would not only expose Air NZ in the domestic New Zealand

and international markets, but could also destabilise the Australian aviation market and Qantas.

Danzas submitted that the increased stability in the aviation market following the Proposals will make the aviation market more attractive for new entrants in the long term and could therefore deliver most, if not all, of the public benefits usually expected as a result of new competition entering a “closely held” industry. In relation to the likely impact of the Proposed Arrangements on freight, Danzas submitted that improved flight frequency and scheduling, in particular to New Zealand airports other than Auckland, will support freight capacity and assist importers and exporters in both Australia and New Zealand.

Danzas submitted that the Commission should authorise both the Strategic Alliance Proposal and the Equity Proposal.

Department of Industry, Tourism and Resources

The Department of Industry, Tourism and Resources (“DITR”) submitted that it supported conditional approval of the Applications.

DITR submitted that, while the counterfactual seems to be a “worst case scenario”, it is possible given the current international aviation environment. DITR submitted that Australia needs to retain a strong, sustainable domestic carrier.

DITR expressed a number of concerns including that that, while it is difficult to address the net effects of the Proposed Arrangements on tourism, it is likely that competition on routes between Australia and New Zealand will be reduced and that this is likely to place upward pressure on airfares. DITR noted that the increased level of dual destination travel claimed as a public benefit by the Applicants may come at the expense of mono-destination travel to Australia in way of, for example, a reduction in the average length of stay. DITR also submitted that the uncertainty around the status of global alliances under the Proposed Arrangements made it difficult to assess the precise tourism benefits. DITR submitted that there appears to be only a marginal positive impact on Australian tourism.

DITR submitted that facilitating entry by new carriers is crucial to supporting growth from the market if the Proposed Arrangements is authorised.

DITR submitted that aviation liberalisation would minimise the risks to Australian tourism.

To this end, DITR proposed that the Applications be authorised by the Commission, subject to the following conditions:

- rigorous enforceable undertakings to allow for sustainable entry by new airline entrants and to ensure no reduction in marketing expenditure (including on cooperative marketing with the Australian Tourist Commission);
- a commitment by the Applicants that they will not exercise price restraint; and

- a further review of the Agreement following a three year period.

Department of Transport and Regional Services

The Department of Transport and Regional Services (“DTRS”) submitted that it is in Australia’s interest to have at least one airline grouping based in this region, particularly one built around a strong and efficient local carrier. DTRS submitted that, while a partnership between Qantas and Air NZ is a step in the “right direction”, the Proposed Arrangements has anti-competitive elements in its current form.

DTRS submitted that it is important that there is enough competition on domestic and international routes to ensure that Qantas and Air NZ remain efficient and continue to provide consumer choices and benefits, and to ensure reasonably priced access to major aviation markets. In this context, DTRS submitted that:

- the Proposed Arrangements will dominate traffic carried on two of Australia’s five major international routes;
- Qantas and Air NZ would carry nine out of ten passengers on the trans-Tasman route and almost two out of three passengers on the USA route; and
- the joint pricing and scheduling arrangements would significantly reduce competition on significant trade routes.

In relation to the undertakings proposed by the Applicants, DTRS submitted that anti-competitive concerns would need to be mitigated by undertakings that are stronger than those currently proposed and the time limits currently proposed in the undertakings do not give a new entrant a suitable timeframe to establish and consolidate new services.

In relation to the anti-competitive effects of the Proposed Arrangements, DTRS noted that “on the face of it” the trans-Tasman route could be described as having scope for robust competition, with 35 current bi-lateral agreements but said that actual factual figures indicates that Qantas, Air NZ and Air Pacific have a combined share of over 90 per cent of the total origin/destination traffic. DTRS also submitted that, the Strategic Alliance and Equity Proposals effectively remove the opportunity for the development of domestic competition through possible future expansion of a New Zealand carrier into the Australian domestic market through the Single Aviation Market agreement. DTRS submitted that it is not insignificant that, under the Proposals, the threat of entry by Air NZ and Freedom Air has been specifically removed. DTRS submitted that the existing level of third country carrier competition on the trans-Tasman and trans-Pacific routes is not sufficient to maintain consumer access to low fares and choice through adequate competition.

DTRS also submitted that the Commission should put in place an “expiry and review mechanism” on any authorisation(s) and should apply a condition to the authorisation requiring that the Applicants provide, for the purpose of publication, statistics by which competing airlines may make informed decisions on entry to routes only served by Air NZ and Qantas.

DHL International (Aust) Pty/Ltd

In relation to the undertakings proposed by the Applicants, DHL International (Aust) Pty/Ltd (“DHL”) submitted that they be strengthened, particularly in respect of the undertaking relating to the “removal of threat of misuse of market power”. DHL submitted that the current wording of this undertaking relates to price increases as a result of reductions in capacity but does not deal with price increases that are unrelated to capacity reductions.

DHL submitted that a situation where Qantas acquires a monopoly position as a result of Air NZ’s failure should be avoided.

Flight Attendants’ Association of Australia

The Flight Attendants’ Association of Australia submitted that it supports the submission made by the ACTU to the Commission in relation to this matter.

Gullivers Pacific Group

The Commission received a copy of a submission provided to the New Zealand Commerce Commission by Gullivers Pacific Group (“GPG”), on behalf of a number of businesses operating in the wholesale, retail and corporate travel markets of New Zealand and Australia. GPG submitted that the proposed alliance, if implemented in its entirety, would lead to the closure of a number of travel agencies, tour operators and associated services, which would in turn result in a loss of competition and negative economic value to New Zealand.

GPG submitted that the Applicants’ proposal and supporting NECG analysis overstated likely public benefits and understated anti-competitive detriment. GPG further submitted that the proposed collaborative arrangements are likely to inhibit competition and market entry in all the relevant markets.

GPG submitted that other viable options are open to the Applicants without the Proposed Arrangements, but suggested that should the Commission decide to grant authorisation it should be subject to appropriate constraints to address competition issues.

Professor Tim Hazledine (University of Auckland)

Professor Hazledine submitted that the Proposed Arrangements is highly unlikely to generate public benefits of the scale claimed by the Applicants and said that the benefits claimed by the Applicants are either “spurious, unsubstantiated or exaggerated”. Professor Hazledine also submitted that the deadweight losses claimed by the Applicants are substantially understated and that there are significant income transfers from the New Zealand Government, New Zealand consumers, Australian consumers and foreign consumers.

Professor Hazledine submitted that the Proposed Arrangements decisively fails the “public interest” test and should not be authorised.

Importers Institute of New Zealand

The Importers Institute of New Zealand (“IINZ”) submitted that it is opposed to the Proposed Arrangements and that the conduct would reduce capacity and increase freight rates. IINZ also submitted that the Proposed Arrangements would entrench the Applicants’ in a dominant position and that this would have the effect of deterring future competitors from entering the market.

In relation to the counterfactual proposed by the Applicants, IINZ submitted that there are alternative counterfactuals that the Applicants have not considered and are using a “worst case scenario” in order to support the factual (the Proposed Arrangements).

International Air Services Commission

The International Air Services Commission (“IASC”) noted that a number of approvals associated with the Proposed Arrangements had not been lodged by the Applicants with the IASC (as at 6 February 2003).

IASC noted the extensive scope and substantial scale of the Proposed Arrangements and submitted that the arrangements can be expected to have significant effects on current and future competition on the routes involved.

IASC noted that the estimates of the costs and benefits are predicated on assumptions such as the entry of a VBA on the affected routes and the effects on Air NZ if the Proposed Arrangements is not authorised and in this regard, suggested that the Commission test the assumptions underlying the analysis.

IASC noted that the stronger any undertakings are in preserving scope for competition, the less likely it is that the Proposed Arrangements will result in public detriment.

IASC noted that that code sharing on Australia-New Zealand city pairs would be likely to raise competition concerns for IASC.

International Federation of Freight Forwarders Associations

The International Federation of Freight Forwarders Associations submitted that its views on this issue would be expressed by the Australian Federation of International Forwarders (“AFIF”).

Jumpjet Airlines Limited

Jumpjet Airlines Limited (“Jumpjet”) intends to establish a value based regional international tourist-orientated airline based in Wellington. Jumpjet intends to operate air passenger services between Wellington and the east coast of Australia (this intention is dependent on Jumpjet finding “Suitable funding”).

Jumpjet made two submissions to the NZCC in relation to this matter. An outline of the aspects of these submission considered relevant to the Commission’s assessment of this matter follows.

Jumpjet submitted that a “monopoly of alliances” would exist in the region should the Proposed Arrangements be authorised, with the major groups involved being the Virgin Group/Patrick Corporation, Singapore Airlines, Qantas, Air NZ and their subsidiaries. Jumpjet submitted that this “monopoly” 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; and
- dominate the market in a predatory sense preventing fair competition emerging.

Mr Hugh Melton

Mr Melton submitted that without a new entrant in the market, it is inevitable that the Proposed Arrangements will result in a reduction in competition. Mr Melton also discussed pricing and profitability on trans-Tasman routes and the Proposed Undertakings.

New South Wales Government

The Premier’s Department of New South Wales made a submission to the Commission on behalf of the New South Wales Government (“NSW Govt”). The NSW Govt submitted that it supported the Proposed Arrangements in principle but had a number of concerns relating to the potential impact on regional aviation, employment and tourism.

The NSW Govt submitted that it has concerns that Qantas may withdraw services from less viable intrastate routes while continuing to dominate smaller competitors on more profitable intrastate markets.

The NSW Govt submitted that any negative impact of the Proposed Arrangements would be on Qantas’ existing operations and facilities in Sydney and would affect the general public through a loss of competition, particularly on trans-Tasman routes. The NSW Govt submitted that the Supporting Submission has not dealt with the potential impact on employees and facilities in New South Wales.

In order to alleviate concerns relating to a reduction in competition on routes impacted by the Proposed Arrangements, the NSW Govt submitted that any authorisation should only be granted if the Commonwealth Government amends its aviation policy to open the trans-Pacific route to more competition. The NSW Govt also submitted that the Commission should consider continuing the encouragement of fifth freedom carriers.

The NSW Govt submitted that, in relation to the impacts on tourism, it is concerned about pricing and scheduling arrangements.

Ms Jan Norrish

Ms Norrish submitted that airfares to New Zealand are likely to increase substantially under the Proposed Arrangements and submitted that the Commission should consider implementing safeguards to ensure that this is not the case.

Northern Territory Airports Pty Ltd

Northern Territory Airports Pty Ltd (“NT Airports”) submitted that the undertakings provided by the Applicants should be expanded to include an additional direct route, Auckland-Darwin, in order to ensure effective competition and choices for airline services into and out of remote areas such as the Northern Territory. NT Airports submitted that marketing should also be undertaken to develop the New Zealand origin market to the Northern Territory and that an over-Auckland route is promoted for North American traffic to the Northern Territory.

Northern Territory Tourist Commission

The Northern Territory Tourist Commission (“NTTC”) submitted that it is supportive of the Proposed Arrangements as it will provide greater competitive certainty for an Australian carrier in the long term.

NTTC submitted that the undertakings proposed by the Applicants; appear reasonable, however, submitted that the Applicants’ should undertake to provide an additional new route, with two return services, on the Auckland-Darwin sector. NTCC submitted that, if this new route is not serviced and direct services to the East Coast are increased, the Northern Territory is likely to be disadvantaged.

Origin Pacific Airways Ltd

Origin Pacific Airways Ltd (“Origin Pacific”) was formed in 1997 and is an airline operating on 14 routes in New Zealand in various provincial and tourist areas and on the main trunk route of Christchurch/Wellington. Origin Pacific also operates charter services. In 2001, Origin Pacific commenced a code share agreement with Qantas on the Christchurch-Wellington, Christchurch-Rotorua and Christchurch-Queenstown routes. The agreement now extends to other major provincial routes and all services operated by Origin Pacific’s larger aircraft including Auckland, Hamilton, Rotorua, Palmerston, North Wellington, Nelson, Christchurch, Dunedin, Queenstown and Invercargill.

Origin Pacific made a submission to the New Zealand Commerce Commission (“NZCC”) in relation to the Proposed Arrangements. Information contained in that submission that is considered relevant to the Commission’s consideration of this matter is outlined below.

Origin Pacific submitted that the Proposed Arrangements are likely to result in the use of substantial economic dominance on domestic, trans-Tasman and other routes, and the superior capital position of Air NZ and Qantas to cross-subsidise and engage in anti-competitive practices. Origin Pacific submitted that the Proposed Arrangements (if authorised) would have a significant impact on sustainable competition on regional

and tourist routes in New Zealand, with the prospect of major detriment to those regions and to carriers such as Origin Pacific.

Origin Pacific submitted that there are high barriers to entry and expansion in all markets and that these will be increased should the Proposed Arrangements be authorised.

Origin Pacific submitted that these anti-competitive detriments are not offset by the claimed benefits.

In relation to the Applicants' claims regarding the counterfactual, Origin Pacific submitted that a "war of attrition" is not the most likely or best scenario – rather, it is more likely that Qantas and Air NZ would co-exist and, contrary to the Applicants' submissions, Air NZ is likely to have a future as an international airline without Qantas.

Queensland Government

The Queensland Government ("Qld Govt") submitted that it is supportive of the Proposed Arrangements and that this support is predicated on the Proposals creating a commercially sustainable Australasian airline group that is able to withstand the economic and political volatility of the global aviation environment.

The Qld Govt submitted that the Proposed Arrangements are essential to the future viability of Air NZ. The Qld Govt also submitted that Air NZ's exit from regional and/or international markets would disadvantage the tourism and economic development objectives of not only Air NZ, but also Australia. The Qld Govt also submitted that the operation of Air NZ and Qantas in global markets is important for the long term realisation of tourism and economic development objectives for both countries.

The Qld Govt the Proposed Arrangements would have a positive impact on Queensland trans-Tasman routes if it contributed to the entry of a VBA and that VBA entry (for example by Virgin Blue) would act as a competitive constraint in terms of pricing and capacity decisions. The Qld Govt therefore supports the Applicants' intention to negotiate enforceable undertakings in relation to facilities access, capacity, tourism benefits and freight benefits.

The Qld Govt also submitted that it would support the Commonwealth Government in continuing to liberalise Fifth Freedom access for airlines wishing to operate trans-Tasman and Australia-North America routes.

Regional Express

Regional Express ("Rex") submitted that the Proposed Arrangements would be detrimental to its business. Rex submitted that they do not support the application.

Rex submitted that, in order for the Applicants to receive benefits in terms of direct cost efficiencies and scheduling efficiencies, consumers will be adversely affected in terms of price, scheduling and reduced flexibility and choice.

In relation to the Applicants view on the appropriate market definition, Rex submitted that Australia and New Zealand are two separate markets and that these two markets compete for traffic. Rex submitted that there are several appropriate geographic segments, separate passenger and freight segments and travel distribution segments.

Rex submitted that cooperative advertising (for dual destination travel) would lead to increased tourism traffic for Australia at the expense of New Zealand traffic. Rex also submitted that it is “absurd” to suggest that reduced competition will stimulate trans-Tasman tourism.

In relation to the Applicants’ claim that the Proposed Arrangements will lead to improved freight operations, Rex submitted that it is likely that the conduct will lead to reduced capacity in the market and that the monopolistic carriage of freight will drive prices up. Rex noted that the entry of Virgin Blue into the market will not alleviate this situation, given it has not focused on freight carriage and its aircraft do not have significant freight capacity.

Rex also submitted that preserving a monopoly position for the Applicants is not in the interests of trans-Tasman travellers, trans-Pacific travellers or in the national interest.

Rex submitted that a number of barriers to entry exist in the Australian domestic market, including:

- access to airport slots;
- heavy alignment of agency distribution to Qantas;
- the existence and control of interline agreements with Qantas;
- access to check-in links with Qantas which allow regional passengers to connect with domestic and international flights;
- access to airport facilities;
- Qantas Business Travel’s dominance of government and corporate travel contracts; and
- product bundling.

Rex submitted that it is currently getting little, if any, interline traffic and that any agreements signed with Air NZ have stalled in the lead up to the Alliance. Rex submitted that it is not permitted to sell tickets on either Qantas or Air NZ services, which makes travel more complicated for regional travellers.

In relation to the undertakings proposed by the Applicants, Rex submitted that no consideration has been given to regional services that will be impacted by the Proposed Arrangements and that undertakings in relation to misuse of market power need to be clarified and expanded.

South Australian Government

The Hon Mike Rann MP (Premier of South Australia) made a submission on behalf of the South Australian Government (“SA Govt”).

The SA Govt submitted that it supports the implementation of the Proposed Arrangements between the Applicants as it is of the view that additional flights between New Zealand and Adelaide will deliver a public benefit to South Australia. The SA Govt noted that the Applicants’ Submission does not consider the addition to “state gross product” that will be realised through the generation of new inbound tourism and the availability of direct flights and lower fares, the savings to existing exporters forced to bear the cost of transporting products via other gateways or the export growth that lower transport costs and shorter shipment times will generate. The SA Govt also noted that the Applicants’ submission does not identify that new direct flights will generate a “small but significant” proportion of the total public benefits claimed and that in the absence of the proposed new direct services, the Proposed Arrangements will have the effect of exacerbating the price disadvantages that South Australian tourism operators suffer compared to other Australian destinations.

The SA Govt submitted that approval of the Proposed Arrangements should be conditional on a more specific commitment to new flights and that:

- “direct flights” be taken to mean non-stop flights between Adelaide and Auckland;
- the flights be implemented within twelve months of authorisation of the Proposed Arrangements;
- the initial frequency be no less than four return flights per week, increasing to daily services within three years of authorisation;
- the flights not be withdrawn at any time during the development of daily services, except under the most adverse financial conditions and for at least 12 months thereafter; and
- independent of any promotion of the SA Govt, the Applicants should be prepared to commit to significant expenditure for new product development and advertising to promote the new flights between Adelaide and New Zealand.

The SA Govt submitted that the above expenditure should be in the vicinity of NZ\$500,000 in the first year and NZ\$300,000 annually thereafter in New Zealand, with similar expenditure in Australia.

Sydney Airports Corporation Limited

Sydney Airports Corporation Limited (“SACL”) submitted that, on balance, it supports the Proposed Arrangements.

In relation to the counterfactual proposed by the Applicants (that is, that absent the Proposed Arrangements, Air NZ’s operations would contract), SACL submitted that,

while it may not be the only feasible outcome, it is possible given the current uncertainty in the aviation market. SACL submitted that it is in Australia's economic interest to have a strong "flag carrier".

SACL also submitted that rationalisation associated with the Proposed Arrangements may mitigate the current capacity constraints at the airport and enhance the efficiency of the airport's operations for a period.

SACL noted that the cost savings from increased efficiency are likely to accrue to the Applicants and are not expected to be passed on to consumers in the form of lower airfares. In this regard, SACL submitted that the Commission should monitor and review any authorisation after an initial period in order to assess the impact on average benchmark fares and seat capacity.

In relation to the Proposed Undertakings, SACL noted that they provide access to facilities for 12 months only and are subject to a number of qualifications. SACL submitted that these undertakings do not provide sufficient safeguards in relation to access to facilities.

SACL submitted that it would be prudent for the Commission to consider whether further liberalisation of key air routes is warranted following any authorisation.

Tasmanian Government

The Department of Premier and Cabinet (Tasmania) made a submission to the Commission in relation to this matter on behalf of the Tasmanian Government.

The Tasmanian Government submitted that the Proposed Arrangements provides the opportunity for greater efficiencies and more flexible scheduling at a time when increasing capacity and falling yield are placing airlines at risk and that this should deliver advantages to trans-Tasman travellers. The Tasmanian Government submitted that, in particular, the addition of direct flights across the Tasman (such as the Auckland-Hobart route) will provide new opportunities for the development of tourism, freight and other strategic partnerships.

The Tasmanian Government also submitted that spare capacity is likely to become available for freight which will provide opportunities for local producers. The Tasmanian Government submitted that the growth in Tasmanian food production will need to be supported by increased capacity to export and increased freight opportunities out of Melbourne, in particular, are likely to assist this market development and access.

Tourism Industry Association New Zealand

The Tourism Industry Association New Zealand ("TIANZ") made a submission to the NZCC in relation to this matter. Aspects of the TIANZ submission that are relevant to the Commission's consideration of this matter are outlined below.

In relation to possible future scenarios, TIANZ submitted that the New Zealand domestic market is too small to sustain multiple FSAs. TIANZ submitted that the status quo would result in intense competition over the short term as VBAs enter the

market which would, in turn, generate short term benefits for consumers. TIANZ submitted that these benefits are likely to be at the expense of suppliers in the marketplace and are likely to lead to airlines failing and some routes being closed.

TIANZ submitted that the Proposed Arrangements will result in greater consolidation of activities and the possibility of greater returns to suppliers. However, TIANZ submitted that it is concerned that the Proposed Arrangements would result in a lessening of competition and that this could lead to declining service standards and may effectively diminish the ability of new suppliers to enter the market.

TIANZ submitted that it supports the Proposed Arrangements in relation to the international market. In respect of the domestic New Zealand market, TIANZ submitted that it supports a “hybrid” approach where the Proposed Arrangements are tempered with effective undertakings that prevent the possibility or perception of self-serving behaviour at the expense of the consumer.

Tourism Task Force

The Tourism Task Force (“TTF”) submitted that the trans-Tasman route has a “soft” demand growth outlook in the longer term. TTF submitted that, without the Proposed Arrangements, this is likely to result in contracting capacity and upward price pressure in the long term. TTF submitted that, should the Commission authorise the Proposed Arrangements, greater certainty and stability for consumers, government and business would result. TTF submitted that the Commission should therefore support the Proposed Arrangements, subject to a number of conditions.

TTF submitted that the Commission should consider the Proposed Arrangements in the context of direct government support for Air NZ from the New Zealand Government and should treat such support as a price subsidy when analysing the impact on capacity and prices on the trans-Tasman route.

TTF submitted that projections from the Australian Government’s Tourism Forecasting Council show that the growth rate of inbound tourism to New Zealand is expected to be lower than the overall inbound tourism market and, accordingly, capacity on the route over the longer term is expected to fall.

TTF submitted that the more concentrated market structure under the Proposed Arrangements is likely to have implications on market performance and competition, at least in the short term. TTF submitted that the Proposed Arrangements are likely to put upward pressure on prices and downward pressure on capacity. In this regard, TTF submitted that the Commission should consider longer term demand trends and any associated capacity falls and price rises when assessing the impact of the Proposed Arrangements. TTF submitted that the Commission should also consider the impact of reducing market and non-market barriers to entry.

TTF submitted that, in order to monitor the emergence of anti-competitive behaviour resulting from increased market concentration, the Commission should monitor market conditions over a period of two years if it authorises the Proposed Arrangements.

Given that the benefits claimed by the Applicants in respect of the Proposed Arrangements rely heavily on entry of a VBA, a condition of the Commission's approval of the Proposed Arrangements should be the sale of Freedom Air to an unrelated party and prohibitions on Qantas and Air NZ establishing their own VBA or using a related VBA for two years.

In relation to the Proposed Undertakings, TTF submitted that it is satisfied that the Applicants will be required to allow VBA access to airport facilities and that the Applicants will not be allowed to "capacity dump".

TTF submitted that a Singapore Open Skies agreement should be encouraged and that a condition of authorisation should be that the Applicants provide evidence of greater levels and longer term investment in cooperative marketing to arrest the fall in growth rates in the tourism market.

Transport Workers' Union of Australia

The Transport Workers' Union of Australia made a submission to the Commission in support of the ACTU submission in relation to this matter.

United Airlines

United Airlines ("United") submitted that it did not object to the proposed alliance, subject to the provision of undertakings by Qantas.

United submitted that due to various regulatory, economic and structural factors, it is the only carrier that can compete effectively with the proposed alliance with regard to Australia-United States services. United further submitted that the Commission should seek undertakings in order to preserve competition on these routes. United suggested the following undertakings:

- Qantas should modify its current prorated agreement with United on "most favoured nation" terms;
- Qantas should provide United with full access to its seat inventory so that United can provide service to and from interior Australian points;
- Qantas should enter into an automation agreement with United to allow through check-in for passengers travelling between the US and Australia; and
- Qantas should display United's code for through passengers connecting to and from United's flights between Sydney and interior Australian points.

United stated that it is currently not able to interline or code share for other airlines and Star Alliance partners on its Sydney-Melbourne flights. United submitted that this restriction should be removed by the Department of Transport and Regional Services in order to increase the viability of United's Sydney-Melbourne service.

The Hon Mark Vaile MP (Minister for Trade)

Minister Vaile submitted that the Government places a high value on Pacific relationships and is committed to broadening and deepening these relationships. Minister Vaile submitted that greater efficiency in the delivery of air services across the Australia and Pacific region would likely bring considerable benefits to the Australian economy via benefits to exporters and tourists.

Minister Vaile submitted that, in relation to the undertakings proposed by the Applicants, successful negotiation and enforcement of the undertakings will be vital in ensuring the preservation of rights to entry by new airlines and to ensure that the benefits of competitive pricing structures are captured.

Victorian State Government

The Department of Innovation, Industry and Regional Development (Victoria) made a submission to the Commission on behalf of the Victorian State Government ("Victorian Govt"). The Victorian Govt submitted that economic efficiencies are likely from the Proposed Arrangements, however, the conduct is also likely to encourage competition outcomes that are to Qantas and Air NZ's favour which are likely to lead to increased airfares and lower capacity.

The Victorian Govt submitted that the Proposed Arrangements should be considered in the context of aviation policy reforms that facilitate an environment of increased contestability and increased consumer choice. The Victorian Govt proposed aviation reforms including the following:

- revision of current aviation policy to nominate Sydney as the only tradeable point in bilateral agreements;
- full fifth freedom rights and third country code share rights to carriers wishing to serve the Melbourne-Auckland and Melbourne-New Zealand routes;
- New Zealand being listed as an intermediate point to Australia on relevant bilateral agreements;
- own stopover rights being extended to foreign carriers on Australian sectors covered by the Proposed Arrangements; and
- change of gauge entitlements being available to foreign carriers operating trans-Tasman services.

The Victorian Govt submitted that the Commission should make this request to the Commonwealth Government.

The Victorian Govt submitted that, absent these policy reforms, the Proposed Arrangements would be likely to result in anticompetitive aspects outweighing efficiency gains and, as such, the authorisation should be subject to these aviation reforms being implemented.

Virgin Atlantic

Virgin Atlantic submitted that it is concerned by the Proposed Arrangements and is of the view that the Proposed Arrangements (if authorised) will adversely affect competition in the relevant markets, including in the Australia-Europe markets, given the level of market power that Qantas and Air NZ can expect to enjoy. Virgin Atlantic submitted that these anti-competitive effects will not be outweighed by public benefits arising from the Proposed Arrangements. Virgin Atlantic submitted that the public benefit outlined in the NECG Report is substantially overstated and that the detriment associated with the conduct is underestimated.

In relation to the public benefits claimed by the Applicants, Virgin Atlantic submitted that NECG makes unrealistic assumptions about Virgin Blue's behaviour, that it is unlikely that there will be substantial cost savings associated with the Proposed Arrangements and that a reduction in competition will not lead to market growth. Virgin Atlantic noted that Virgin Blue's ability to act as a competitive constraint on Qantas and Air NZ will depend on the terms and conditions under which any authorisation is granted. Virgin Atlantic notes Virgin Blue's submission in this respect.

In relation to the assumptions underlying the NECG Model, Virgin Atlantic submitted that:

- studies have shown that there are approximately constant returns to scale in air transport and, accordingly, there are no reductions in per unit costs associated with increased size;
- there will be no reduction in overheads because Qantas and Air NZ will both retain their current management structures under the Proposal – in fact, these costs are likely to increase; and
- a reduction in competition will provide little incentive for the Applicants to provide output levels, prices and levels of service similar to those which are produced in competitive markets.

Virgin Atlantic further submitted that the Proposed Arrangements will not lead to any scheduling benefits or new direct services as claimed. Further, Virgin Atlantic submitted that the Applicants have the ability to improve scheduling in the absence of the Proposed Arrangements and that NECG has compared the proposed scheduling efficiencies with the current schedules rather than with the counterfactual schedules, which is inconsistent.

Virgin Atlantic submitted that it is unlikely that “protecting a firm” will “enhance that firm’s competitiveness”, rather, the best way to ensure international competitiveness is to subject firms to competition.

In relation to the likely anti-competitive effects of the Proposed Arrangements, Virgin Atlantic submitted that the conduct is likely to increase the market power already enjoyed by the Applicants and will result in higher costs and prices. Virgin Atlantic submitted that higher frequency of flights increases market power more than

proportionately due to the “s-curve effect” as the carrier with the higher frequency is able to attract a greater proportion of (high yield) time-sensitive passengers.

Virgin Atlantic also submitted that the Applicants have not considered the impact of the size of a carrier’s slot portfolio, airport presence, loyalty programs, and “feed” on market power.

Virgin Atlantic submitted that, should the Commission authorise the Proposed Arrangements, consideration should be given to undertakings relating to airport access, frequent flyer programs, interlining arrangements, computer reservation systems and travel agent and corporate deals. Virgin Atlantic also submitted that the conduct should only be authorised for a limited period.

Virgin Blue

Virgin Blue noted that the Applicants referred to the prospective entrance of Virgin Blue to key routes. Virgin Blue submitted that with or without the proposed alliance, it will commence servicing those routes. However, Virgin Blue submitted that the timing and scale of Virgin Blue’s entry will depend upon two main barriers to entry:

- access to facilities and commercial agreements for necessary ground support and handling; and
- the threat of strategic capacity and pricing conduct by the Applicants, particularly through their low cost operations.

Virgin Blue submitted that, in general, the undertakings should apply for the period for which the Strategic Alliance is authorised and in effect.

In relation to facilities undertakings, Virgin Blue submitted that it supported such an undertaking but was of the view that the undertakings offered were inadequate and for example submitted that:

- they do not provide for the relinquishment of capacity at relevant facilities;
- they only apply to facilities not being used by the Applicants and are therefore unlikely to apply in peak periods;
- licence fees are proposed which include a margin for the Applicants, so that a new entrant pays more than the Applicants for access to the same facilities; and
- they may provide no more than what is required under contractual “make available” requirements already in place with the airport.

In relation to capacity undertakings, Virgin Blue expressed the view that the undertakings proposed were inadequate and for example submitted that:

- they apply only to the routes at the date of commencement of the proposed Strategic Alliance where the Applicants are the sole operators. Virgin point out that they would not therefore apply on