APPLICANTS' RESPONSE TO THIRD PARTY SUBMISSIONS – TASMAN NETWORKS AGREEMENT

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INTRODUCTION

1. Qantas Airways Limited (**Qantas**) and Air New Zealand Limited (**Air NZ**) (together, the **Applicants**) have prepared this document in response to the submissions filed with the Commission by third parties and made available on the Commission's public register as at 25 June 2006 in relation to the Tasman Networks Agreement (or **TNA**).

2. Many submissions broadly support (or do not object to) the authorisation of the TNA. These include submissions received from the Australian Tourism Export Council, DHL, Air Pacific, Tourism Queensland, the Northern Territory Government, TTF Australia Ltd, and the West Australian Government.

3. Where third party submissions oppose the TNA, the Applicants observe that certain key issues are consistently raised. As almost all of these key issues are addressed in the submission of Wellington International Airport Limited (**WIAL**), filed with the Commission on 15 May 2006, the Applicants have first responded to the WIAL submission and then to any additional issues identified in the remaining third party submissions.

4. The issues the WIAL submission addressed are:

   (a) Market definition;

   (b) Market developments since the decision of the Australian Competition Tribunal in *Re Qantas Airways Limited* [2004] ACompT 9 (the **Qantas/Air NZ Decision**);

   (c) Market shares;

   (d) Barriers to entry or expansion and the competitive constraint exercised by Virgin Blue and Emirates;

   (e) The rationale for the TNA;

   (f) The proposed "counterfactual";

   (g) The Applicants' low cost subsidiaries, Jetstar and Freedom Air; and

   (h) Public benefits.

WIAL SUBMISSION – GENERAL REMARKS

5. The WIAL submission focuses narrowly on a snap-shot view of the Tasman market. It extrapolates from past and current conduct of Virgin Blue and Emirates, based on conditions in today's marketplace, to reach broad conclusions about the constraint (or

lack thereof) they will impose on the Applicants under the TNA and the likely impact of the Applicants' proposed surplus capacity reduction. In so doing, WIAL places great weight on the static market shares of all airlines operating on the Tasman and evidence which, it claims, shows that nominal prices from Wellington have risen since the Qantas/Air NZ Decision.[1]

6. However, WIAL is unable to credibly demonstrate that any identifiable Tasman price increases since 2004 have gone beyond simply reflecting increases in costs (such as aviation fuel and airport charges) <u>or</u> that any reduction in capacity proposed by the Applicants under the TNA goes beyond a reduction in surplus capacity. Indeed, the WIAL submission appears to lack a credible factual basis for a large number of its assertions and as such is of limited probative value.

7. In contrast, the Applicants' submission and subsequent responses to the Commission's information requests, all demonstrate that there is significant excess capacity on the Tasman, and that the removal of some excess capacity (which is only possible under the TNA) will significantly reduce costs while not impacting upon consumers. When combined with the recognised constraints imposed by Emirates and Virgin Blue upon the Applicants, price rises under the TNA are not likely to occur above the competitive level and furthermore, sustainable low prices (due to reduced costs) are the likely market outcome. In summary:

(a) To enhance their competitive stance on the Tasman routes both Qantas and Air NZ need to continually secure any available cost reduction initiatives and improve their revenue per ASK performance.

(b) 6,300 empty one-way seats are flown across the Tasman every day (with 5,200 of those empty seats on the nine main Tasman routes) and of these seats Air NZ estimates that:

(i) **[RESTRICTION OF PUBLICATION CLAIMED]** empty seats per day are being flown on Wellington-Sydney;

(ii) **[RESTRICTION OF PUBLICATION CLAIMED]** empty seats per day are being flown on Wellington-Melbourne; and

(iii) **[RESTRICTION OF PUBLICATION CLAIMED]** empty seats per day are being flown on Wellington-Brisbane.

(c) The TNA will allow the removal of some of this excess capacity resulting in cost savings of **[RESTRICTION OF PUBLICATION CLAIMED]** per year for Air NZ and **[RESTRICTION OF PUBLICATION CLAIMED]** for Qantas.

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[1] This position contradicts the WIAL view (expressed elsewhere in the submission) that firms are entitled to make a return on their investments and that might mean a firm will increase prices in a competitive market (see [9]). The Tribunal stated likewise in the Qantas/Air NZ Decision at [464]:
"*If fares were to rise in the factual, it would not necessarily be the result of the applicants taking advantage of their market position, <u>but rather a consequence of the market forces (namely excess supply) that had previously caused fares to fall to commercially unsustainable levels</u>*" (emphasis added).

(d) The TNA will result in a more efficient use of remaining capacity, in terms of a better schedule spread and better load factors, which are forecast to improve from approximately 72.7% today, to an estimated 75% – 76.5% by Year 3 of the TNA, thereby further reducing operating costs and facilitating an improvement in revenue per ASK without necessarily impacting revenue per RPK (or average yield).

(e) Air NZ and Qantas are constrained by the capacity and potential for Virgin Blue and Emirates to expand.

8. The key matters raised by the WIAL submission are addressed below. A more detailed response to the less significant matters is attached at **Annexure A**.

ISSUE ONE: THE TASMAN MARKET

9. Various submitters[2], including WIAL, have argued that the appropriate market definition in this case involves a number of discrete geographic markets, with particular emphasis on routes into and out of Wellington. This is an inappropriate characterisation and inconsistent with the approach to market definition accepted by the Commission and the Tribunal in the Qantas/Air NZ Decision.

10. In considering the appropriate market definition, courts and tribunals will treat as persuasive the behaviour of the Applicants and their competitors. The commercial reality is that the Applicants treat the Tasman (including Wellington) as part of a single market and this is evidenced by their pricing and marketing practices:

(a) The level of publicity associated with the pricing of Tasman fares, means it is difficult (if not impossible) to discriminate against Wellington-based passengers or passengers seeking access to Wellington.

(b) The importance placed on the marginal passenger in airline markets[3] and the fact that such passengers, at least on the Tasman, are price sensitive and exercise a degree of demand substitutability between different destinations, direct/indirect routes and different airlines, provides further incentive for the Applicants to ensure that fares into and out of Wellington are comparable with fares into and out of Auckland and Christchurch.

(c) Both Applicants generally "common rate" the different Tasman routes. That is, the airlines align the base or year round fares offered in each fare category across all the Tasman routes (including Wellington).

(d) In most cases the Applicants also common rate the direct and indirect routes operating between the same two ports (for example, Sydney-Wellington and Sydney-Auckland-Wellington).

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[2] See also the submissions of Virgin Blue, Melbourne Airport, New Zealand Hotel Council, Wellington Regional Chamber of Commerce and Business Hutt Valley.
[3] The importance of the marginal passenger was addressed in some detail in the Applicants' original submission of 13 April 2006 and is canvassed again in response to Issue 3 below.

(e) An analysis of the Applicants' separate approaches to pricing and tactical promotion demonstrates that Wellington routes are consistently promoted at the same (or similar) price levels as fares from Auckland and Christchurch.

11. Although some of the submitters argue for narrower geographic markets, or sub-markets within the Tasman, they fail to delineate the boundaries of such markets. For example, it is unclear whether they envisage these as markets broken down by city pairs, or see all routes through a city as forming a market. This inability to precisely divide the Tasman into narrower markets or sub-markets reinforces the Applicants' submission that the Tasman can only be logically considered as one market.

Lack of Price Discrimination between Routes

12. While historically it may have been possible for airlines to discriminate against purchasers based upon the particular route selected, the high degree of transparency associated with booking via the internet has significantly eroded the airlines' ability to charge differential prices. The significant level of internet bookings, together with the active marketing of fares engaged in by all Tasman participants (but especially Virgin Blue and Emirates), greatly reduces information asymmetry between passengers and airlines. As a result, airlines cannot afford to charge significant price differentials on otherwise similar routes. This is because customer perceptions of what is "appropriate" or "fair" have been altered by the entry of Virgin Blue and the expanding marketing presence of Emirates, which acts as a practical constraint on the Applicants' Tasman pricing conduct.

Price Sensitive Travellers

13. In the Qantas/Air NZ Decision, the Tribunal identified price-sensitivity as a significant demand characteristic of Tasman passengers. This continues to be the case across all the Tasman routes, including into and out of Wellington[4] and is illustrated by the mix of fares sold by each of the Applicants (set out in **Table 1** and **Table 2** below).

Table 1: Air NZ Fare Mix By Fare Family[5]

City Pair	Business	Fully-Flexible	Flexi-saver	Smart-saver	Tactical[6]	% Smart-saver & tactical
AKL-BNE	#	#	#	#	#	#
AKL-MEL	#	#	#	#	#	#

[4] Indeed, this is acknowledged by a number of third party submitters, including WIAL.

[5] The term "fare family" describes a group of fares with the same rules but with different price levels and booking classes. The three economy fare families are Smart-saver, Flexi-saver and Fully-Flexible. Smart-saver fares are Air NZ's lowest year round fares: they are non-refundable and do not accrue Airpoints Dollars. They are designated L, S and G class in Air NZ's booking system. Flexi-saver fares are likewise non-refundable, but in contrast to Smart-saver fares, do accrue Airpoints Dollars. They are designated E, V, W and T class in Air NZ's booking system. Fully-Flexible fares can be changed right up until departure. They are designated Y, B and H class in Air NZ's booking system.

[6] Tactical fares refer to short term, promotional fares, which are designated in K class in Air NZ's booking system.

City Pair	Business	Fully-Flexible	Flexi-saver	Smart-saver	Tactical[6]	% Smart-saver & tactical
AKL-SYD	#	#	#	#	#	#
WLG-BNE	#	#	#	#	#	#
WLG-MEL	#	#	#	#	#	#
WLG-SYD	#	#	#	#	#	#
CHC-BNE	#	#	#	#	#	#
CHC-MEL	#	#	#	#	#	#
CHC-SYD	#	#	#	#	#	#

Source: Air NZ internal revenue accounting data

Table 2: Qantas Fare Mix[7]

City Pair	Full/ Very High	High	Medium	Low (incl. sales)	Other	% Low & Other
BNE-AKL	#	#	#	#	#	#
MEL-AKL	#	#	#	#	#	#
SYD-AKL	#	#	#	#	#	#
BNE-WLG	#	#	#	#	#	#
MEL-WLG	#	#	#	#	#	#
SYD-WLG	#	#	#	#	#	#
BNE-CHC	#	#	#	#	#	#
MEL-CHC	#	#	#	#	#	#
SYD-CHC	#	#	#	#	#	#

Source: FBook Travel Data Jul 03 – May 06 (MEL-CHC and BNE-CHC only to Nov 05 due to Jetstar commencement)

14. Though each Tasman route carries a slightly different passenger mix, which produces variations in the breakdowns outlined above, the clear message from Tables 1 and 2 is that Qantas and Air NZ both sell a very high percentage of Tasman fares in their respective low fare classes. In particular, Air NZ notes that on Wellington city pairs

[7] There are four Qantas "fare families": Business, Fully Flexible, Super Saver and Red E-Deals (some of which are short term, promotional fares). Each fare family is made up of different booking classes. **[RESTRICTION OF PUBLICATION CLAIMED]**

[RESTRICTION OF PUBLICATION CLAIMED] of total Air NZ fares are sold in the smart-saver and tactical fare families. Similarly, **[RESTRICTION OF PUBLICATION CLAIMED]** of total Qantas fares on the Wellington routes are sold in the low (which includes sale fares) and "other" fare categories.

15. As a broad generalisation, the experience of the Applicants is that these price-sensitive passengers are often persons travelling for leisure or in order to visit friends and relatives, but include many business passengers.

16. WIAL argues that these price-sensitive passengers do not treat indirect flights as substitutable for direct services and therefore, a single Tasman market is not appropriate.[8] However, the decision making process for price-sensitive passengers is far richer than a simple choice between direct or indirect services. This characterisation fails to fully capture that when making decisions in respect of travel price-sensitive Tasman passengers will examine prices and options within a matrix of factors, including:

(a) which airline they wish to fly;

(b) the time at which they wish to travel (i.e. morning, afternoon or evening);

(c) the time the journey takes relative to the price (i.e. direct vs. indirect);

(d) which destination they fly to in New Zealand or Australia (in the case of leisure passengers); and

(e) whether to travel to New Zealand/Australia or elsewhere (in the case of leisure passengers).

17. Some price-sensitive Tasman passengers may be indifferent to almost all these factors. For example, many leisure passengers will select a destination from a set of destinations that have the same travel characteristics, such as destinations which take a certain time to reach. This means that for a leisure traveller out of Australia, Wellington, Auckland and Christchurch are likely to be broadly substitutable, with the result that the passenger will compare airfares across a number of destinations as well as a number of airlines. Likewise, a leisure passenger travelling from Wellington may consider a broad set of destinations before finally selecting a particular destination. Alternatively, other price-sensitive passengers will be less indifferent in respect of certain factors such as destination or time (for example, business passengers).

18. It is often difficult for an airline to identify whether a particular price-sensitive passenger is indifferent to some or all of the above factors, or to tell an indifferent passenger from a passenger with a clear preference at any given fare level. This was recognised by the Tribunal who accepted that this information asymmetry meant that:

[8] WIAL submission at [32] – [37]

"… low fares offered by Virgin Blue and Emirates in their attempts to gain market share at the expense of the Alliance will flow through to all passengers in the market who wish to take advantage of them".[9]

19. For fares ex-Australia to Wellington, a similar statement can be made: the Applicants' cannot always tell the difference between a passenger who is indifferent (at any given fare level) between travelling to Wellington (as opposed to another destination or not at all), and a passenger committed to travelling to Wellington.

20. These varying degrees of demand substitutability between different Tasman destinations, direct/indirect routes and different airlines, coupled with the importance of price-sensitive traffic on the Tasman, means significant pressure is brought to bear on the Applicants to ensure that fares into and out of Wellington are comparable with fares into and out of Auckland and Christchurch.

Tasman Pricing Strategies

21. The fact that the Applicants' treat the Tasman as one market is evidenced by their pricing strategies, such as:

    (a) (**Common rating**) Both Applicants generally "common rate" the different Tasman routes. That is, the airlines align the base or year round fares offered in each fare category across all the Tasman routes (including Wellington). In most cases, the Applicants also common rate the direct and indirect routes operating between the same two ports (for example, Sydney-Wellington and Sydney-Auckland-Wellington). For further information in this regard we refer the Commission to the Applicants' forthcoming response to Q11, which will address this issue.

    (b) (**Promotional activity**) An analysis of the Applicants' independent approaches to pricing and tactical promotion demonstrates that Wellington routes are consistently promoted at the same (or similar) price level as fares to/from Auckland and Christchurch. This is highlighted in **Annexure B** for the period between December 2005 and May 2006.

Supply Side Substitution

22. On the supply side, while the airline industry has some aspects of a network industry, unlike other network industries it is <u>not</u> exemplified by large fixed and immovable infrastructure. Aircraft are readily available for purchase or lease, or alternatively, airlines can make adjustments to total seat capacity between city pairs in response to competitive activity, demand conditions or other factors.[10] This is particularly true for airlines that primarily operate on a point to point basis, such as Virgin Blue, which operates a common fleet. This is a key market feature that would not be picked up by an analysis that focuses solely on city pair markets and their current participants.

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[9] Qantas/Air NZ Decision at [444]

[10] There is a limit to the steps that a carrier can take in implementing capacity reductions without significantly reducing the value of its overall network through reductions in frequency or route density.

23. For further information in relation to the Applicants' supply side substitutability (and its practical limitations) we refer the Commission to the Applicants' response to Q3 and Q4 (20 June 2006), which canvassed this issue in some detail.

Conclusion – Geographic Market

24. Accordingly, as a matter of commercial reality, on both the demand and supply sides the Tasman routes to and from all New Zealand cities form part of the broader Tasman air services market. WIAL's submission ignores the factors outlined above and takes an overly narrow focus on current competition in and out of Wellington, as opposed to taking a broader commercial view of the constraints imposed by other destinations, other carriers and the other spending priorities of passengers.

Note – Business/Leisure Distinction

25. In relation to market definition, one submitter (the Australian Federation of Travel Agents or AFTA) has also argued in favour of separate business and leisure passenger markets on the Tasman.[11] AFTA's argument appears to be based upon the Applicants' deployment of their low cost subsidiaries on particular routes and AFTA's experience regarding the requirements of connecting passengers on the Tasman.[12]

26. The Applicants' decisions as to where their low cost subsidiaries will be deployed do not evidence the presence of separate business and leisure product markets on the Tasman. Instead, they simply illustrate the Applicants making use of their product range to lower costs where possible while most appropriately satisfying the prevailing demand conditions on the Tasman routes, which are all likely to contain different proportions of business and leisure passengers.

27. In reality, the extent to which separate markets exist primarily depends upon the degree of discontinuity in substitution possibilities between business and leisure passengers on the Tasman. In relation to the Tasman (as with other short-haul routes), business travellers are increasingly under pressure to minimise cost and are therefore increasingly price sensitive. Corporations are now more demonstrably cost conscious and will seek the lowest cost fare to suit their travel requirements. This is reflected in:

    (a) Virgin Blue undertaking to increase its appeal to business, as well as leisure, travellers in domestic Australia and on the Tasman through a range of initiatives canvassed in the Applicants' original submission of 13 April 2006;

    (b) the fact that the economy cabins of the Applicants on the Tasman will contain a mix of both business and leisure passengers[13]; and

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[11] AFTA Submission at [35].

[12] The AFTA Submission also refers to Commission Determination A90791 (IATA Passenger Agency Program) to support its argument (see [32]). The Applicants submit this Determination is not relevant in the context of the Tasman and, in any event, the Commission is simply making the uncontroversial point that a single air transport market for premium and economy passengers should not be assumed in all cases.

[13] This is illustrated by contrasting the Applicants' response to Q6 (13 June 2006), which identified the proportion of Qantas and Air NZ customers (respectively) who nominated the purpose for their Tasman travel as for "business or convention", and the percentage of fares sold in by Qantas and Air NZ in the

(c) the Commission's own Statement of Facts, Contentions and Issues to the Tribunal, which stated: "*Given the mainly short haul nature of the routes involved here it is unlikely that separate markets would be an issue in this matter*."[14]

28. The Applicants submit that given the short-haul nature of the routes, the number of frequencies offered by the Tasman's competing airlines and the practical reality that the Applicants, Virgin Blue and Emirates seek to concurrently target leisure and business travellers with the same or similar products, the required discontinuity in substitution possibilities simply does not exist on the Tasman routes.

ISSUE TWO: MARKET DEVELOPMENTS

Tribunal Findings Relevant

29. WIAL, along with Melbourne Airport, suggest that the developments in the Tasman market since the Qantas/Air NZ Decision have been of the kind that should render the Tribunal's analysis irrelevant in relation to the TNA. A key issue appears to be that the Tribunal predicted that Emirates and Virgin Blue would place a "growing" competitive constraint upon the Applicants and that, because Emirates and Virgin Blue have not rapidly expanded their presence in the intervening period, this prediction has not come to pass.[15]

30. However, it is important to note that the Tribunal's comments and predictions were in relation to how Virgin Blue and Emirates would respond if the previous proposed Alliance had been implemented (the "factual") and sought to raise prices above the competitive level or remove more than excess capacity. It did not make particular predictions as to how the market would unfold in the event the Alliance did not proceed. In the Qantas/Air NZ Decision, the Tribunal was comparing two future states of the world: one with the Alliance and one without. The key focus of the Tribunal was, therefore, its conclusion that in the factual:

> "…..*in the absence of barriers to expansion for Virgin Blue and Emirates, and given the capacity available to Virgin Blue and Emirates, we expect that the Alliance will be promptly and competitively constrained <u>should it seek to raise fares</u>*" (emphasis added).[16]

31. In other words, it was the ability and capacity of Virgin Blue and Emirates to respond to the Applicants, should they seek to exploit their position and raise fares above the competitive level, which created the constraint accepted by the Tribunal. Simply because the Applicants have not engaged in this hypothetical conduct (i.e. implementing the Alliance and then seeking to raise fares) does not mean the constraint never existed, does not exist today or would not equally exist if the TNA proceeded.

32. Furthermore, since June 2004 both Emirates and Virgin Blue have continued to increase their penetration of the Tasman market at the expense of Qantas and Air NZ. This is

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business cabin classes on Tasman routes (see Tables 1 and 2 above).

[14] *Commission Statement of Facts, Contentions and Issues* at [48] (filed with the Tribunal on 02/02/04)

[15] WIAL Submission at [42]

[16] See above **n9** at [445]

illustrated by the growth of Emirates and Virgin Blue passenger shares and load factors[17] since the Qantas/Air NZ Decision:

(a) According to Australian Department of Transport and Regional Services (**DoTaRS**), between the year ended 2003 and the year ended 2005, Emirates' Tasman passenger share has increased from 2.6% to 9.8%.[18] Furthermore, Air NZ estimates that Emirates' load factor has increased from approximately **[RESTRICTION OF PUBLICATION CLAIMED]**. This easily exceeds Emirates' publicly stated break-even Tasman load factor of 40%.[19]

(b) According to DoTaRS, Virgin Blue's Tasman passenger share for the year ended 2005 stands at 7.7%.[20] In addition, Air NZ estimates that Virgin Blue's Tasman load factor has continued an upward trend, and now exceeds **[RESTRICTION OF PUBLICATION CLAIMED]**.

33. The Tribunal also made a number of other key findings, including recognising the commercial reality that in airline markets, which exhibit high fixed costs, it is competition for the marginal (indifferent) passenger that influences fare levels. In addition, the Tribunal found that Tasman origin/destination passengers are price sensitive and that Emirates is able to target price sensitive customers by marginal cost pricing, while Virgin Blue (with its very low cost base) acts as a constraint on the routes it serves as well as on Tasman routes it does not serve.[21]

34. These fundamental conclusions, principles and findings of fact remain equally applicable today:

(a) Price-sensitivity remains a predominant characteristic of Tasman passengers (as acknowledged by WIAL and discussed in Issue 1 above).

(b) Competition between airlines on the Tasman, including Qantas, Air NZ, Emirates and Virgin Blue, remains for the marginal passenger (see Issue 4 below).

(c) There are no significant barriers to entry or expansion in the Tasman markets and WIAL provides no evidence to support its claims that there are (see Issue 4 below).

35. In approaching the TNA the Commission should examine the actual market developments on the Tasman since the Qantas/Air NZ Decision and ascertain whether they are broadly consistent with the principles outlined above, rather than whether they mirror the Tribunal's detailed predictions. After all, it is unlikely that <u>all</u> such predictions could eventuate in a market described by the Tribunal as dynamic and likely to "*move,*

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[17] The term "load factor" refers to the ratio of paid passenger seats to the total seating capacity on a particular flight (i.e. the percentage of seats an airline actually fills).

[18] See Tables 1 & 2, DoTaRS submission at page 2

[19] In early 2005 Emirates publicly claimed "… it only has to fill 40% of its seats to be profitable over the Tasman": Scott Rochford, "Emirates moves in on Tasman routes", The Age, 1 April 2005

[20] See Table 2, DoTaRS submission at page 2

[21] See above **n9** at [352], [355], [399], [401], [429] and [444]

ebb and flow according to the competitive interplay of market forces of supply and demand, particularly in relation to the marginal passenger".[22]

36. Market developments to date have produced a highly competitive Tasman environment, which only serves to underscore the Tribunal's reasoning. As DoTaRS noted in its submission:[23]

"*During this time* [i.e. year ended Dec 2003 to year ended Dec 2005] *the market also experienced: a 30% growth in passenger travel; a 64% growth in the market share of fifth freedom carriers; the emergence of Emirates as the dominant fifth freedom carrier; as well as the entry of Virgin Blue*."

Tasman Fares

37. Most importantly, despite WIAL having posed the question – If the market is so competitive why have average fares so readily increased since the Tribunal's decision? – WIAL has provided no evidence that fares on the Wellington routes (or elsewhere) have significantly increased beyond adjustments which take account of the growing cost base facing all airlines (primarily driven by significant cost increases in aviation fuel prices).

38. WIAL accepts that in some cases price increases are justified and implicitly must not reflect a lack of competitive constraint. Indeed, even in a perfectly competitive market, if marginal costs increase, then equilibrium prices will increase. However, WIAL provides no evidence that any Tasman price increases that may have occurred since the Qantas/Air NZ Decision are un-justified.

ISSUE THREE: MARKET SHARES

39. A number of third party submissions identified the current, combined market share of the Applicants as not only an indicium of their market dominance, but as evidence that they cannot be constrained by the conduct of any other Tasman competitors.[24] WIAL also goes on to suggest that in attempting to measure the market shares of various Tasman participants the use of capacity as a metric, as opposed to each airline's passenger share, is inappropriate.[25]

40. In the Qantas/Air NZ Decision, the Tribunal made abundantly clear the dangers inherent in relying on a firm's existing market share to determine the competitive effects of a merger:

[22] See above **n9** at [447]. See also the Australian Department of Transport and Regional Services' (DoTaRS) submission to the Commission, which notes that: "… the trans-Tasman is a dynamic competitive market that has changed significantly since Virgin Blue and Emirates commenced serious initiatives…" (at page 2)
[23] DoTaRS submission at page 3
[24] See WIAL submission at [67], AFTA submission at [5] – [6] and Virgin Blue at page 3
[25] In this context, the term "passenger share" measures the percentage of origin/destination Tasman passengers carried by a particular airline. In contrast, the term "capacity share" refers to the percentage of weekly seats flown on the Tasman (or each Tasman route) by a particular airline, regardless of whether those seats are carrying passengers or not.

We emphasise that although there must be recognition given to market share data when considering a merger of the type under consideration, it must also be recognised that significant consideration should be given to predictions of dynamic changes and competitive initiatives in the market in the future by rival firms, albeit with a relatively small market share, but who face no significant barriers to expansion. Market share tells us nothing about future competitive initiatives and outcomes in the market. Nor does it tell us anything about how that market share was arrived at" [emphasis added].[26]

41. However, to the extent market shares are relevant, capacity shares at least provide a guide to the amount of available production capacity in a market. In contrast, passenger shares might show how many passengers are being carried today; it does not tell one how many passengers can or will be carried in the future. In a dynamic market where entry and expansion play a key role in determining the level and intensity of competition, an analysis which reflects the ability of producers to expand production immediately must be preferred.

42. Moreover, there has been a continuing downward trend in the Applicants' origin/destination Tasman passenger share and a concurrent increase in the origin/destination passenger shares of Virgin Blue and Emirates. This is illustrated in Tables 2 and 3 of the Applicant's submission of 13 April 2006 and in paragraph 32 above. This trend, at least insofar as the Applicants are concerned, was also identified in the DoTaRS submission, which noted:[27]

"*The statistics illustrate that the combined Qantas (including Jetstar) and Air New Zealand (including Freedom Air) market share of the trans-Tasman dropped from 90.5% to 77.3% in 2 years* [December 2003 – December 2005] ….".

43. These identifiable trends show that a focus on static market shares, such as that adopted by WIAL and like submitters, obscures the underlying market dynamics – particularly in a market where a high percentage of operational costs are fixed with respect to passengers carried and the marginal costs of serving an additional passenger is relatively low. Indeed, a focus on static market shares has long been recognised as analytically unsound:

What does economic analysis tell us about the relation of share and monopoly power? Well, the one proposition which most people believe is that a small share shows the absence of monopoly power and a large share its presence….This is not true. The right question is that of what happens to share, or, more generally, to a firm's business when monopoly profits are sought. The fundamental issue is whether competitors are able to grow.

Thus, consider a firm which has a very large share of a particularly defined market. It may well be that such a firm is merely efficient and has achieved that share by charging low prices….Should we infer monopoly power from a large share in such cases? The answer is no, not necessarily. The right question to ask is whether that large share would survive an attempt to charge high price and earn monopoly profits. If the share is

[26] See above **n9** at [431]
[27] DoTaRS submission at page 2

maintained solely because of low prices or better products, then we are looking at what competition is supposed to do and not a monopoly.[28]

ISSUE FOUR: COMPETITIVE CONSTRAINTS

44. A key theme common to most of the submissions in opposition to the TNA is that the Applicants will face little, if any, competitive constraint on the Tasman from their competitors, specifically Emirates and Virgin Blue.[29] The broad reasoning underpinning these submissions can be summarised as follows:

(a) Emirates and Virgin Blue operate on only a subset of the Tasman routes and possess a small market share relative to the Applicants. Indeed, even on the routes where they do operate, Emirate and Virgin Blue generally offer fewer frequencies than Qantas or Air NZ.

(b) Emirates and Virgin Blue have not significantly expanded on the Tasman routes since the Qantas/Air NZ Decision.

(c) Emirates and Virgin Blue cannot significantly expand their services on the Tasman routes going forward (i.e. they face barriers to their expansion).

(d) As a result, Emirates and Virgin Blue cannot constrain the pricing, capacity and scheduling decisions of the Applicants under the TNA.

45. However, the third party submitters have not provided any meaningful evidence to support these assertions or rebut the Applicants' fundamental arguments. Indeed, the facts do not support this reasoning. The key competitive constraints faced by the Applicants on the Tasman, with or without the TNA, are:

(a) the presence of Emirates and Virgin Blue (as well as the other fifth freedom carriers), who have the ability and incentive to set the market price and represent serious sources of commercial rivalry for Qantas and Air NZ; and

(b) the absence of barriers to the entry or expansion of Emirates, Virgin Blue or other carriers.

Competitive Constraint

46. Despite the Applicants' current combined market share relative to Emirates and Virgin Blue, the strength of the constraint these competitors impose on the Applicants' pricing is <u>not</u> a function of their market shares or their rate of actual expansion. Instead, as the Tribunal noted:[30]

"… *competitive constraints occur at the margin, and impact on the marginal passenger. Rivals and potential competitors do not need to appeal to all of the incumbent's*

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[28] *Diagnosing Monopoly*, David Kinley Lecture, University of Illinois, 20 October 1978, published in *Industrial Organisation, Economics and the Law, Collected Papers of Franklin M Fisher* (ed. John Montz) at page 6

[29] See, by way of example, the WIAL submission at [54], [58] – [60, [69] and [91] – [101], the Melbourne Airport submission at pages 4 – 7 and the AFTA submission at [6] – [16]

[30] See above **n9** at [352]

passengers to exercise a competitive constraint upon them. Rather, it is necessary only that enough customers are affected at the margin to make any increase in fares by the incumbents unprofitable" [emphasis added].

47. Both Emirates and Virgin Blue provide a genuine competitive alternative to the Applicants in the contest for the marginal passenger on the Tasman and the Applicants must respond to their pricing and initiatives. This is because an unsold seat on a flight represents revenue lost, which is particularly significant for network airlines such as Qantas or Air NZ who face significant fixed costs that do not decline if passengers and revenue are lost. As a result, the profitability of network airlines can be significantly affected by a relatively small loss of paying passengers. This means that airlines prefer to sell a seat, even at a very low fare, rather than have it depart empty.

48. If the Applicants were to raise fares above the prevailing levels in an attempt to take advantage of their market position under the TNA, Virgin Blue or Emirates could exploit this opportunity to keep fares at their current level and attract marginal customers. Accordingly, the Applicants must monitor and respond to both the actual and potential behaviour of Emirates, Virgin Blue and other carriers to ensure the critical marginal passenger is not lost. This will occur regardless of whether the TNA is implemented.

49. The pricing constraint imposed on Qantas and Air NZ by Emirates and Virgin Blue was acknowledged by representatives of both Applicants, who appeared under oath before the Tribunal, and was accepted by the Tribunal in the Qantas/Air NZ Decision:[31]

"We therefore expect that competition for passengers at the margin will be intense. Each percentage point of market share gained is worth a considerable amount of profit to the airlines. Further, because airlines cannot easily discriminate between passengers at the margin and committed passengers, the low fares offered by Virgin Blue and Emirates in their attempts to gain market share at the expense of the Alliance will flow through to all passengers in the market who wish to take advantage of them."

50. These competitors represent a real and significant constraint upon the Applicants' pricing on those Tasman routes where they operate. This constraint is not limited to specific times of the day, nor does it depend on the frequency of the services offered by Emirates or Virgin Blue for the reasons articulated above. Furthermore, the prevalence of demand side substitutability across the Tasman routes (see Issue 1 above) and lack of any meaningful expansion barriers are such that Virgin Blue (or Emirates) is poised to enter new city pairs[32], which means that the pricing constraint extends beyond those particular routes to the Tasman market generally.

51. The competitive constraint Emirates, Virgin Blue and the other fifth freedom carriers bring to bear on the Applicants is most clearly illustrated in practice by:

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[31] Ibid. at [444]

[32] The one exception to this submission is the structural restriction that prevents Emirates (or other fifth freedom carriers) landing wide-bodied aircraft at Wellington Airport. However, in relation to the Wellington routes Virgin Blue already operates Brisbane-Wellington and remains poised to enter elsewhere. For further details see the discussion below in relation to barriers to entry or expansion generally.

(a) Air NZ redesigning its short haul offerings by introducing NZ Express (November 2002), Tasman Express (August 2003) and Pacific Express (March 2004). Each of these models utilised the major features of low cost carriers and reflected a need to reduce costs, for example:

(i) a move to reduce distribution costs and increased direct distribution – with internet bookings on the Tasman increasing to **[RESTRICTION OF PUBLICATION CLAIMED]**;

(ii) introducing self check in kiosks for domestic New Zealand flights: up to 50% of customers now use these kiosks where they are operational. Furthermore, electronic ticketing levels now exceed 90%;

(iii) removing frequent flyer accrual on the lowest fare type ("Smart Saver"), which now accounts for a substantial proportion of total tickets sold; and

(iv) enforcing excess baggage charges.

(b) Qantas launching Jetstar – a low cost carrier in its own right – in Australia and subsequently on selected Tasman routes.

(c) Each of the Applicants instituting far reaching internal cost savings programs in an effort to reduce costs and remove inefficiencies from their businesses in order to lower their cost bases to compete with low cost carriers such as Virgin Blue.

(d) Each of the Applicants significantly restructuring its fare offerings to reflect those offered by Virgin Blue and other low cost carriers (for Air NZ this was part of the Express model). This restructuring included:

(i) introducing attractive one-way fares;

(ii) removing minimum stay requirements, Saturday night restrictions, seasonal surcharges and advance purchase conditions; and

(iii) reducing the number of fare categories and reducing prices (in Air NZ's case by 20% on average and up to 50% in some cases, and in Qantas' case, for example, reducing lead-in fares on Auckland-Sydney by 33%). In most cases, these lead-in fares have not significantly increased over the intervening period.

Lack of Barriers to Entry or Expansion

52. In *Re Queensland Co-operative Milling Association Limited* (1976) (**QCMA**), the then Trade Practices Tribunal laid out the principles to be applied in assessing whether a market is likely to remain competitive post arrangement. The Tribunal relevantly noted[33]:

"…. *The elements of market structure which we would stress as needing to be scanned in any case are these: (1) the number and size distribution of independent sellers,*

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[33] *Re Queensland Co-operative Milling Association Limited* (1976) ATPR 40-012 at p.17,246

especially the degree of market concentration; (2) the height of barriers to entry, that is the ease with which new firms may enter and secure a viable market; (3) the extent to which the products of the industry are characterised by extreme product differentiation and sales promotion; (4) the character of "vertical relationships" with customers and with suppliers and the extent of vertical integration; and (5) the nature of any formal, stable and fundamental relationships between firms which restrict their ability to function as independent entities. Of all these elements of market structure, no doubt the most important is (2), the condition of entry. For it is the ease with which firms may enter which establishes the possibilities of market concentration over time; and it is the threat of entry of a new firm or a new plant into a market which operates as the ultimate regulator of competitive conduct" [emphasis added].

53. These principles have been quoted with approval and applied by the Tribunal and the Courts ever since the decision in QCMA.

54. WIAL and Melbourne Airport have submitted that fifth freedom carriers (including Emirates) face barriers to their expansion associated with the long-haul nature of their product offerings and the Australian Government's approach to international air services policy. WIAL also argues Virgin Blue has limited capacity for expansion, based on the current deployment of its aircraft.[34]

55. The Applicants dispute these submissions and refer the Commission to the Tribunal's conclusion in the Qantas/Air NZ Decision, which remains applicable today for the reasons expanded upon below:[35]

"*If the Alliance were to go ahead, there would not be any barriers to significant entry nor would there be any barriers to effective expansion by either or both of Virgin Blue or Emirates*."

56. (**Emirates**) As noted in the Applicants' submission of 13 April 2006, Emirates is a significant competitor on the Tasman. It has continued to expand its capacity and increase its share of Tasman origin/destination passengers since the Qantas/Air NZ Decision, capturing 12% of these passengers in March 2005 and 9.8% for the year ended December 2005.[36]

57. Moreover, Emirates has a high growth profile globally and specifically in relation to Australasia:

(a) Without any changes to its existing schedule, Emirates has one A340 aircraft on the ground in Melbourne which could be deployed on the Tasman in the event the airline determined it was profitable to do so.

(b) Emirates has announced an intention to fly the A380 aircraft on Tasman routes, once they are delivered, which will significantly increase its Tasman capacity.

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[34] See WIAL submission at [96] – [99] and Melbourne Airport submission at pages 5 – 7
[35] See above **n9** at [419]
[36] See Table 3 in the Applicants' original submission of 13 April 2006 and Table 2 in the DoTaRS submission

(c) Even though, as WIAL suggests, Emirates is unlikely to schedule flights from Dubai for the explicit purpose of Tasman flying, the airline has made no secret of its wish to increase the number of flights it operates into Australia.[37] As and when this occurs and Emirates increases its services to Australia, there will also be expanded capacity available for Tasman services. Just by way of illustration, if Emirates doubled its services to Australia, and thereby on the Tasman, this alone would deliver Emirates a Tasman capacity share of over 20%.

58. Although presently Emirates (along with the Applicants and other fifth freedom operators) cannot fly its wide-bodied aircraft on routes into and out of Wellington, due to aircraft size restrictions at Wellington Airport, this barrier will not be absolute over the medium term. WIAL has announced a major upgrade program in preparation for the Boeing 787 aircraft[38], which is scheduled to be available from 2008 and may well be purchased by a number of airlines with fifth freedom rights on the Tasman.

59. In conclusion, neither Emirates nor the other fifth freedom operators on the Tasman face substantial barriers to their entry or expansion on various city pairs (with the current exception of Wellington due to its runway limitations). In this regard, the Applicants note with approval the following comments from the DoTaRS submission:[39]

"While some of these [i.e. fifth freedom] *carriers have withdrawn from the route since 2003 others have entered, demonstrating both the low barriers to entry and exit in this market and the continued interest of international carriers to fly the trans-Tasman. Significantly, the total fifth freedom carrier market share has increased from 9.5% in 2003 (absent Emirates) to 15.6% in 2005….*

Australia's existing bilateral agreements provide significant opportunities for airlines from third countries to enter the trans-Tasman market and the Australian market and the Australian Government's aviation policy does not prevent the current competitors from expanding in the market."

60. Instead, Emirates remains well placed to take advantage of any attempt by the Applicants to exploit the benefits of the TNA to the detriment of passengers over the short to medium term, by winning additional market share through a combination of low fares and high quality service.

61. (**Virgin Blue**) Virgin Blue faces no barriers to entry or expansion on Tasman routes. While its rate of growth has slowed recently, this is simply a reflection of the degree of surplus capacity and competition currently on the Tasman.

62. Since the Qantas/Air NZ Decision, Virgin Blue has commenced services into Auckland from Brisbane and Coolangatta and recently announced an intention to expand its

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[37] As recently as April 2006 Emirates made a substantial submission to the Australian Government for phased, additional passenger frequency entitlements ramping up to at least four daily passenger frequencies to each of Sydney, Melbourne, Brisbane and Perth by 2014: *Emirates: A Friend of Australia* (April 2006)

[38] WIAL's Chief Executive has stated: "*The new wide-bodied Boeing 787 will be able to operate long haul off Wellington's runway, but these improvements increase safety for all aircraft*…" WIAL Media Release, "Wellington Airport makes good progress on Southern RESA" 8 May 2006

[39] See DoTaRS submission at page 3

Auckland – Brisbane and Christchurch – Brisbane services. This demonstrates Virgin Blue remains poised to expand where it sees a market opportunity.

63. WIAL notes the Commerce Commission's comment that Virgin Blue's growth in Australia was assisted by the collapse of Ansett. One would then expect that any move by the Applicants in the TNA to reduce capacity that was not truly surplus or to increase prices above competitive levels would simply gift a similar opportunity to Virgin Blue. That this has not happened is well explained by the Tribunal's statement that:

"*We do not expect that the Alliance would be so commercially inept as to present Virgin Blue and Emirates with such a golden opportunity to expand at its expense*".[40]

ISSUE FIVE: THE APPLICANTS' RATIONALE

64. The Applicants' principal commercial rationale in relation to the TNA is a reduction in both airlines' costs through the removal of some surplus Tasman capacity without adversely impacting upon the frequency of flights, the network offering and the city presence of each airline. The TNA arrangements allow the Applicants to maintain, and even improve, their network connectivity and schedule spread, which creates a higher standard of service offering for passengers, while at the same time removing some excess capacity and reducing costs.

65. The WIAL submission argues that the Tasman routes are not facing a significant degree of excess capacity and that the proposed withdrawal of capacity by the Applicants in fact indicates an absence of competitive constraint.[41] It also poses the following questions, directed at the Applicants' rationale for the TNA:

- If capacity reduction is necessary, can't capacity be reduced unilaterally by one or both of the Applicants?
- Why is it that the Applicants are only now seeking to respond to low cost carriers, who have been around for a long time?

Capacity Reductions

66. The WIAL submission states that there is a "natural range of load factors" for airlines and that the Applicants' current Tasman load factors fall within that range. As a result, the Applicants do not really need to remove capacity from the market and if they did, this could occur on a unilateral basis without any need for the joint conduct contemplated in the TNA.

67. However, the Applicants have already demonstrated the following:

(a) The Tasman load factors for Qantas and Air NZ have been declining. Indeed, over the period from June 2004 to May 2006, Air NZ has estimated that **[RESTRICTION OF PUBLICATION CLAIMED]**.

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[40] See above **n9** at [445]
[41] WIAL submission at [70] – [78] and [102]

(b) There are a large number of empty seats flown on the Tasman every day. A breakdown based on a per route and per airline basis was provided to the Commission in the Applicants' response to Q2 (13 June 2006).

(c) Removing some of this excess capacity will result in significant costs savings for the Applicants. These cost savings were quantified in the Applicants' original submission of 13 April 2006 and the bass upon which they were calculated was expanded upon in the Applicants' response to Q34 (13 June 2006).

68. The Applicants’ load factors following the removal of this excess capacity are forecast to improve from approximately 72.7% today to approximately 75% - 76.5% by Year 3 of the TNA.

69. By seeking to secure a reduction in some of the excess capacity the Applicants are not demonstrating they are unconstrained. As participants in a competitive Tasman aviation market, they are simply seeking to secure cost reductions, whilst maintaining (or improving) their network connectivity. There is no expectation that under the TNA the Applicants will be able to secure or maintain significant price increases beyond the competitive level, which is the hallmark of unconstrained conduct. Instead, in a competitive Tasman market the lower costs enjoyed by the Applicants due to the TNA will in turn promote sustainable low fares between Australia and New Zealand.

70. The reductions in capacity attributable to the TNA cannot be achieved by either one of the airlines acting unilaterally for reasons elaborated on in response to Q3 and Q4 on 20 June 2005. In summary, if Qantas or Air NZ were to take similar steps on a unilateral basis it would be likely to produce negative network consequences for the relevant airline, including the possibility that passengers would simply spill to a competitor. In turn, this would have an impact on the airline's wider network and "city presence".

Responding to Low Cost Carriers

71. To suggest that, to date, the Applicants have not reacted to low cost carrier entry is contrary to all the factual evidence available in the marketplace. Furthermore, this evidence should be well known to WIAL given its knowledge of the airline industry and its involvement in the previous Qantas/Air NZ proceedings in New Zealand (where substantial evidence was given of the major steps taken by the Applicants in response to the threat of low cost carriers).

72. Air NZ and Qantas have competed together on the Tasman for over 50 years. However, the development of the low cost carrier (or LCC) model generally, and the arrival of Virgin Blue in the Australian market in 1999 and its qualification to fly Tasman routes in 2001, was the genesis for rapid innovation and change in the market by both Air NZ and Qantas, as evidenced by the developments set out in paragraph 51 above.

73. All the steps taken by each of Air NZ and Qantas reflect an ongoing need to remove cost and complexity from their businesses, to lower their costs base and simplify their product offerings by realigning them with those offered by low cost carriers. The TNA is an integral part of the Applicants’ continuing drive to reduce their cost bases (in this case

principally by removing some of the surplus capacity) so as to be able to maintain a competitive position in the marketplace.

ISSUE SIX: THE COUNTERFACTUAL

74. WIAL proposes a range of alternative scenarios as possible counterfactuals to the TNA. In each case, there is no supporting material provided beyond WIAL's speculation. These scenarios include:

    (a) A "deal" between Air NZ and Virgin Blue.

    (b) A fuller diversification of the lower cost products (Jetstar and Freedom Air) – this scenario is addressed separately as Issue 7 (Jetstar and Freedom Air) below.

    (c) Unilateral actions by Qantas and Air NZ to improve their respective performance on the Tasman – the difficulties associated with this scenario are addressed separately in Issue 5 (The Applicants' Rationale) above.

    (d) A more limited arrangement between Qantas and Air NZ.

75. The Applicants' repeat WIAL's own statement that it has "no special access to the internal deliberations or views of Qantas, Air NZ or other airlines"[42] and suggest that its proposed counterfactuals should be dismissed as speculation rather than a considered and likely "future without" the TNA. Instead, the Applicants refer to the confidential responses of both airlines to Q19 (20 June 2006) as more authoritative and considered analyses of each airline's likely conduct in the event the TNA is not implemented.

ISSUE SEVEN: JETSTAR & FREEDOM AIR

76. In its submission, WIAL stated that in the counterfactual the Applicants are likely to further develop their respective low cost carriers, Jetstar and Freedom Air. It states that the LCC model has been slow to take hold on Tasman routes and that a "full and permanent shift to new models for short haul travel on the Tasman" will be more likely to occur in the counterfactual.

77. In response to this assertion, the Applicants refer to Qantas' responses to Q15 and Q20 and Air NZ's responses to Q7, Q19 and Q20[43], which were provided to the Commission on 13 and 20 June 2006.

78. **[RESTRICTION OF PUBLICATION CLAIMED].**

79. **[RESTRICTION OF PUBLICATION CLAIMED].**

[42] WIAL submission at [106]
[43] Some of these responses are confidential to the respective Applicants

ISSUE EIGHT: PUBLIC BENEFITS

80. In its submission, WIAL maintains that no public benefits will flow from the TNA.[44] Similarly, Melbourne Airport is sceptical about the benefits flowing from the TNA and counters them with its own commentary in its submission.[45]

81. However, the Applicants submit that the TNA provides a package of significant benefits to the public, while also serving the commercial objectives of the Applicants. In this regard, we draw attention to the Applicants' response to Q39 and emphasise the following:

(a) The primary commercial objective of the Applicants is to cut costs by removing some surplus capacity without adversely impacting upon the frequency of flights, the network offering and the city presence of each airline.

(b) By code-sharing and jointly setting schedules under the TNA, the Applicants are able not only to maintain but also to improve their network connectivity and schedule spread, creating a higher standard of service offering for passengers while at the same time achieving the business needs of the Applicants.

82. Furthermore, the benefits which flow from the TNA (both to the Applicants and the public as a whole) should be considered as a package. The TNA is the result of lengthy commercial negotiations between the Applicants and is the only commercial agreement on offer.

83. When considering the benefits flowing from the TNA, the issue is not whether one or more of the benefits could be achieved absent the TNA. Instead, consideration must be given to the package of benefits on offer which is accompanied by the reduction in costs and business efficiencies gained by the Applicants. In this regard, the questions raised by WIAL - why are the efficiency gains unique to the TNA?; why is the schedule spreading unique to the TNA? – are not relevant.

84. In addition, WIAL asks: "*Are the proposed service enhancements really inefficient add-ons that a competitive market would not sustain?*" In answer, the service enhancements available under the TNA cannot be considered "add-ons", nor are they "inefficient". Rather, they are improvements in the efficiency of the core service provided to passengers, i.e. flights. These improvements take the form of better scheduling, improved timing of flights, better connections and increased viability of new direct routes.

85. The key public benefits flowing from the TNA are described in the Applicants' response to Q39 (20 June 2006). In summary they are:

(a) cost savings;

(b) national interest;

(c) better spread of departure times – reduced wingtip flying;

[44] WIAL submission, p 32
[45] Melbourne Airport submission, page 9

(d) reduced waiting times for connecting passengers and an enhanced seamless service;

(e) increased likelihood of more direct route options and new services;

(f) greater flexibility for passengers to change itineraries; and

(g) increased frequent flyer benefits.

86. Further, the Applicants submit that the approach adopted by the Tribunal must be applied when considering public benefits. The Tribunal stated:[46]

We consider that the phrase "benefit to the public" is to be given a broad definition which, in addition to group interests takes into account (with proper weighting) individual interests to the extent that such interests are considered by society to be worthy of inclusion and measurement. This broad approach to public benefit promotes the achievement of both static and dynamic efficiencies."

87. Although some submitters have argued that cost efficiencies gained by the Applicants under the TNA are "private benefits"[47] and of little relevance, the correct test necessitates that consideration be given to such efficiencies and to the broader economic benefits which flow from them. Thus, applying the Tribunal's reasoning, the "private versus public dichotomy" employed by submitters in relation to cost savings is of limited assistance in assessing the public benefits under the TNA.[48]

OTHER ISSUES

Wellington Freight Transport

88. In its submission, the Wellington Regional Chamber of Commerce expressed concern that any reduction in capacity under the TNA, particularly on routes exiting Wellington, would reduce freight capacity. This freight capacity is currently used to transport fresh produce from the Wellington region to (or through) Australia. However, in the light of **[RESTRICTION OF PUBLICATION CLAIMED]**.

89. **[RESTRICTION OF PUBLICATION CLAIMED]**.

90. **[RESTRICTION OF PUBLICATION CLAIMED]**.

Travel Agents' Commissions

91. In its submission, AFTA stated that the TNA will result in a public detriment to the extent that there will be a reduction in the commissions payable to travel agents. In particular, it states that "the abolition of competition between the Applicants for market share on the Tasman routes must inevitably lead to a reduction of income paid to travel agents by the Applicants".

[46] See above **n9** at [187]
[47] For example, Melbourne Airport, p 9
[48] See above **n9** at [188]

92. The question of whether a reduction in travel agents' commissions constitutes a public detriment for the purposes of authorisation was considered in the Tribunal's decision. The Tribunal said:[49]

> *Put shortly, the fact that a travel agent might be deprived of an opportunity to make a commission by establishing competitive tension between two airlines does not necessarily, without more, mean that there will be any detrimental effect on the competitive process in the travel services distribution market.*

93. Furthermore, while the TNA does provide for a one-off adjustment of the basis upon which existing agents' incentives are paid, for the reasons set out in the Applicants' response to Q33 (13 June 2006), the TNA specifically reserves the determination of commission levels and incentive payments to each party acting unilaterally.[50].

[49] Ibid. at [618]
[50] Tasman Networks Agreement, Clause 3 of Schedule 10

ANNEXURE A: WIAL SUBMISSION – DETAILED COMMENTS

WIAL Submission		Applicants' response
46	Any argument that Air NZ is "in terminal decline" should be treated with caution this time around.	The Applicants are not arguing that Air NZ is in terminal decline in the current case, nor did the Tribunal reach its decision on the basis that Air NZ was in terminal decline.
67	"Tasman load factors for the applicants seem to be very similar to load factors of other reputable airlines on other international routes."	The Applicants' load factors on the Tasman have been declining. Their average load factor at present is estimated to be **72.7%** (see paragraph 11.5(b) in the Applicants' original submission of 13 April 2006). In contrast, the most recently available full year figures for major carriers worldwide on international routes illustrates that other airlines are achieving higher load factors: (a) European Scheduled Traffic, Total International (**76.9%**). (b) US Majors' Scheduled Traffic, Total International (**79.7%**). *Source: "Aviation Strategy", May 2006.*
75	"For airlines like the applicants with a variety of aircraft types operating the Tasman, it is possible and practicable to reduce capacity by changing aircraft types during periods of seasonal low demand. On routes already dominated by narrow bodied aircraft (such as those from Wellington), airlines often adjust capacity by making changes to schedules within seasons and adding or withdrawing services on days of particularly slow demand".	To provide an economic and cost efficient network service, the Applicants must maximise the utilisation of its fleet of aircraft. As a result, except for scheduled maintenance, all aircraft in the fleet should be flying at times of the day where it is commercially viable to do so. Accordingly, the Applicants would face a number of constraints that influence their ability to down-gauge aircraft size on a flight on any particular city pair due to low demand. Since a selection of aircraft of varying sizes is rarely sitting at each airport waiting to be called into service, there must be another route in the airline's network that has the opposite problem – demand for the flight greater than the scheduled aircraft's size. Furthermore, that high demand sector flight must be scheduled at the same departure time as the low demand sector flight, from the same city, and with approximately the same block hours of flying. If any one or more of these conditions is not satisfied, the aircraft would either have to be positioned between cities (at high cost) or other flights would need to be retimed or cancelled to make the schedule work. If any of these later steps had to be taken, it is unlikely that the down-gauging will be economic or make commercial sense. Clearly, these factors rarely converge to allow

WIAL Submission		Applicants' response
		an easy swap of aircraft type. The second point WIAL makes (i.e., that cancelling frequency during a season or on low demand days does not affect network coverage) is not correct. As a general proposition, cancelling frequencies reduces network coverage and is detrimental to consumers. With the TNA, however, the Applicants can reduce some capacity while the frequencies available to each airline's customers are increased.
83	WIAL unable to comment on prices because the sections on pricing are withheld.	Clause 6.2 of the TNA is public and sets out what aspects of tariffs the Applicants will agree. The sections of the TNA maintained as confidential relate only to the process by which fares will be agreed.
110	WIAL states "the idea of sharing revenue (but retaining independent responsibility for reducing costs) would seem to incentivise sub-optimal gaming such that both airlines will be looking to ensure that the other airline incurs the expense of carrying its passengers. This particular aspect of the proposed TNA is highly distortionary and therefore likely to give rise to additional detriment."	**[RESTRICTION OF PUBLICATION CLAIMED]**

ANNEXURE B: SALE FARE ACTIVTIY (DEC 2005 – MAY 2006)

A. Qantas Sale Fare Activity on Main Tasman Routes[1] (Dec '05 – May '06)

Sale	Red e-Sale		New Year Sale			Red e-Sale	Red e-Sale	Red e-Sale	Red e-Sale			Red e-Sale	Red e-Sale
Sale Period	01/12–07/12	08/12–16/12	29/12-02/01	03/01-04/01	05/01-06/01	10/02-15/03	28/02-15/03	17/03 – 21/03	22/03 – 09/04	10/04 – 16/04	22/03 – 19/03	20/04 – 30/04	08/05 – 19/05
BNE-AKL	-	-	-	-	-	-	137	117	137	137	-	137	130
MEL-AKL	160	137	159	140	125	169	140	-	-	-	140	140	133
SYD-AKL	156	127	149	135	120	159	134	-	-	-	134	134	127
BNE-WLG	137	137	159	137	122	169	137	117	137	137	-	-	130
MEL-WLG	160	137	159	140	125	169	140	-	-	-	140	-	133
SYD-WLG	156	127	149	135	120	159	134	-	-	-	134	134	127
BNE-CHC[2]	-	-	-	-	-	-	-	-	-	-	-	-	-
MEL-CHC[2]	-	-	-	-	-	-	-	-	-	-	-	-	-
SYD-CHC[2]	-	-	-	-	-	-	-	-	-	-	-	-	-

1. Advertised A$ fares one way (base fares only – i.e. excludes taxes, levies and charges), POS Australia
2. The Christchurch routes do not have Qantas sale fare activity, as they are predominantly flown by Jetstar

B. Air NZ Tactical Activity on Main Tasman Routes[1] (Dec '05 – May '06)

Sale	New Year Sale	Aussie Beach Break	Worldwide Sale	48 Hour Sale	South-East Queensland Sale
Sale Period	**26 Dec – 24 Jan**	**29 Jan – 14 Feb**	**22 Feb – 24 Mar**	**26 Mar – 27 Mar**	**18 Apr – 5 May**
AKL-BNE	189	189	189	159	189
AKL-MEL	189	-	189	159	-
AKL-SYD	189	-	189	159	-
WLG-BNE	189	189	189	159	189
WLG-MEL	189	-	189	159	-
WLG-SYD	189	-	189	159	-
CHC-BNE	189	189	189	159	189
CHC-MEL	189	-	189	159	-
CHC-SYD	189	-	189	159	-

1. Advertised NZ$ fares ex-NZ one way including fuel surcharge