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Dear Ms Whiteside

Air New Zealand/Qantas proposed transactions

Introduction

House of Travel is an independent, owner-operated travel organisation. House of Travel began operations in Christchurch in 1987 and now consists of 83 travel agencies throughout New Zealand. Each House of Travel travel agency is formed as a partnership, with its owner operator and House of Travel Holdings Limited each having a half share in the business. The group's turnover now exceeds \$500 million per annum.

House of Travel Holdings provides support services to the House of Travel outlets including accounting, legal, IT and marketing services. In addition to its retail business, House of Travel operates a travel wholesaler, Travelplan, which provides airfare consolidation, wholesale shorthaul and longhaul land packages not only for House of Travel outlets but also for sale to the New Zealand retail travel industry as a whole.

House of Travel deals with both Air New Zealand and Qantas in almost every aspect of the services it provides to its customers. In addition, for the reasons set out below, House of Travel considers that there is the potential for the proposed transactions to have a very real effect on its business and therefore considers that it has an interest in the proposed transactions, pursuant to the Commerce Act.

House of Travel's position

In their application to the Commerce Commission Air New Zealand and Qantas have argued that the strategic alliance is necessary for the survival of both airlines. House of Travel considers that it does not have sufficient information or expertise to comment on this argument. Fundamentally, House of Travel does not oppose the proposed strategic alliance and share acquisition insofar as it is necessary for the survival of Air New Zealand. However, House of Travel has concerns about the potential impact of the transactions in two principal areas, on which the application is silent:

1. the threat to the viability of a value based airline ("VBA") as a new entrant into the New Zealand domestic and trans-Tasman air services markets, which exists by the ongoing presence of Freedom Air;
2. the threat that Qantas Holidays presents to the ability of third parties to compete in the provision of wholesale holiday packages, including the likelihood and ability of third parties to establish an internet distribution system for wholesale holiday packages.

1. The viability of a VBA

The parties have argued in their submissions to the Commerce Commission that barriers to entry to the New Zealand domestic and the trans-Tasman air services markets are sufficiently low that any VBA could enter with relative ease. The parties have also identified Virgin Blue as the most likely entrant into either of these markets. The likelihood of a VBA entry is, the applicants state, supported by their economists' economic modelling, which shows that it would be profitable for a VBA such as Virgin Blue to enter the New Zealand domestic market and that it would do so by the second year of the proposed alliance (see paragraph 288). The applicants reach similar conclusions in relation to trans-Tasman markets (see paragraphs 314 to 321)

House of Travel considers that it would be very difficult for any VBA, including Virgin Blue, to enter the New Zealand domestic or trans-Tasman air services markets while there is another VBA already operating or where there is the threat of the imminent entry of a VBA. While House of Travel accepts that even after Air New Zealand rebranded its New Zealand domestic operations (the "NZ Express" services), Air New Zealand is not operating as a true VBA (see paragraph 106). Nonetheless, Air New Zealand currently operates a VBA in the form of its wholly-owned subsidiary, Freedom Air.

House of Travel believes that there is a real possibility that Freedom Air could recommence domestic operations if another VBA expressed its interest in entering the New Zealand domestic market. Furthermore, House of Travel believes that if another VBA were to enter on the trans-Tasman markets then Freedom could increase its capacity on those routes potentially within a matter of weeks of any decision to do so.

With the strength of both parent airlines behind it, including existing customer loyalty, branding, access to engineering services, airport services and everything else necessary to operate, Freedom Air could immediately fill any perceived gap in the market for a VBA. The prospect that Freedom Air might enter the New Zealand domestic markets or increase capacity on the trans-Tasman routes is very real. The application makes no mention of the parties' plans for Freedom and there is nothing in the proposed undertakings provided to the Australian Competition And Consumer Commission to prevent the parties from taking precisely this course.

House of Travel considers that given the ongoing threat generated by the presence of Freedom Air and the very real risk that it could enter the domestic markets or significantly increase its trans-Tasman operations, then the incentive for any new entrant, including Virgin Blue, to enter the New Zealand domestic air services markets is negligible. Even Virgin Blue with its existing Australian-based infrastructure would incur significant sunk costs in entry and would also query the profitability in competing head-on with an existing VBA supported by two strong parents.

Indeed, House of Travel considers that Virgin Blue's statements in this morning's edition of *The Press* about its proposals for the New Zealand domestic and trans-Tasman air services markets is indicative of its concerns about the parties' plans for Freedom and therefore Virgin Blue's likelihood of success were it to enter these markets.

House of Travel believes that a new entrant might also face certain difficulties in obtaining access to terminal services at the New Zealand domestic airports, particularly at Auckland. There has recently been much speculation that the former military airfield at Whenuapai might present an alternative to Auckland International Airport for a VBA. House of Travel considers that Whenuapai would not be a viable alternative, for the following reasons:

- there is currently no infrastructure for a commercial airline, including terminal facilities, carparks and baggage handling facilities;
- there are no public transport links to downtown Auckland or the Auckland International Airport; and

- it is unlikely that any VBA would be able to provide the necessary flight infrastructure to offer connecting flights to its passengers, with the result that any passengers wishing to travel further than Auckland would have to transfer to or from the Auckland International Airport.

In relation to the facilities necessary for trans-Tasman operations, House of Travel considers that any new entrant seeking to fly to or from Sydney could face significant difficulties in obtaining takeoff and landing slots at this already highly congested airport. In addition, House of Travel understands that there are already constraints on terminal facilities and that any new entrant may find it difficult to obtain the necessary access to terminals. Freedom Air has, of course, already secured access to all the facilities necessary for both domestic and trans-Tasman operations.

House of Travel therefore considers that the only way in which future competition in the New Zealand domestic and trans-Tasman air services markets can be guaranteed would be through requiring the parties to divest themselves of all assets relating to Freedom Air.

2. Wholesale holiday packages

Providers of wholesale holiday packages package together a variety of services, which might include airfares, hotel accommodation, tickets to sporting and other events and car rental, for example. The essential ingredient in any holiday package is the airfare component. Holiday package wholesalers are typically owned by travel agent chains. For example, House of Travel owns a wholesaler called TravelPlan; Flightcentre owns a wholesaler called Infinity; and Holiday Shoppe is owned by a wholesaler called Gullivers. These wholesalers can provide holiday packages to their travel agent owners for distribution to the public at a price that is cheaper than the cost of the total of each of the component parts because the wholesaler is a specialist provider of the services, with resulting economies of scale and also because the wholesaler will benefit from certain bulk discounts from service providers.

The importance of the package holiday market should not be underestimated. Indeed, House of Travel believes that the package holiday market is growing in New Zealand. Tables 1 and 2 below show the proportion that package holidays represent of trans-Tasman and Pacific Islands travel, based on House of Travel's own bookings data.

Table 1: Trans-Tasman travel by type

Travel type	2000 (%)	2001 (%)	2002 (%)
Visiting Friends & Relatives ("VFR")	[]	[]	[]
Business	[]	[]	[]
Package	[]	[]	[]

Source: House of Travel estimates

Table 2: Pacific Islands travel by type

Travel type	2000 (%)	2001 (%)	2002 (%)
VFR	[]	[]	[]
Business	[]	[]	[]
Package	[]	[]	[]

Source: House of Travel Estimates

House of Travel has concerns that the New Zealand market for wholesale holiday packages is likely to suffer from significantly reduced competition as result of the proposed strategic alliance and the resultant entry by Qantas Holidays into New Zealand. House of Travel believes that the experience in the equivalent Australian market is indicative of the likely outcome in New Zealand if the proposed transactions are allowed to proceed. This would be exacerbated by the fact that the Air New Zealand Qantas alliance would be in a totally dominant position whereas in the Australian market the airline does have competition.

Qantas Holidays currently provides wholesale holiday packages to the Australian market. It used to compete with a number of other holiday package wholesalers. In creating any given holiday package, wholesalers had previously been able to approach both Qantas and Ansett to obtain the essential airfares component of a package. Both airlines were therefore under an incentive to provide wholesalers with the best possible airfare, to ensure that they were the successful provider of the air services in question. Qantas Holidays also had to ensure that its packages were priced at a level competitive with the other holiday packages available.

Qantas is the dominant provider of airfares to holiday package wholesalers, as well as being the dominant wholesaler in this market through Qantas Holidays. Qantas Holidays continues to compete aggressively with other wholesalers by offering them prices for the essential airfare components that are rather higher than the fares that had previously been available. At the same time, Qantas Holidays continues to offer packages to travel agents and directly to the public at prices that were only slightly higher than the cost at which other package holiday wholesalers could offer similar packages. Accordingly, the difference between the cost and the retail price of these packages has not sufficient to enable wholesalers to maintain an adequate margin to cover their own costs. Consequently, all but one major wholesaler that had previously been operating in Australia have exited the market, leaving Qantas Holidays as essentially the sole provider of wholesale holiday packages. Qantas Holidays initiates all product and price incentives on all package tour sales out of Australia to all destinations.

House of Travel believes that if Qantas Holidays were to begin competing in New Zealand as aggressively as it did in Australia then wholesalers will have no choice other than to sell Qantas Holidays' packages and will ultimately be forced to exit the market as the margins offered to wholesalers by Qantas would be insufficient to operate profitably.

House of Travel does not consider that other airlines would be able to provide any constraint on Qantas Holidays once the various independent wholesalers had been forced from the market, as they would need to operate flights on the routes in question in order to be able to offer prices on the same basis as Qantas Holidays. The most important holiday package destinations from New Zealand are trans-Tasman and to the Pacific Islands. If the proposed strategic alliance were to proceed, then there would be no competing airline with any significant presence on these routes. Indeed, as set out in the parties' application (at paragraph 301), the parties' combined share of capacity on trans-Tasman routes is as much as 85.2 percent. On the principal routes to Pacific Island package destinations (Fiji and the Cook Islands) Qantas, Air New Zealand and Air Pacific will also control almost 100 percent of the available capacity.

In particular, House of Travel does not consider that Virgin Blue or any other VBA would be able to exercise any constraint in this regard on trans-Tasman routes, even if any VBA were to enter this market. Virgin Blue does not currently provide package services (although there are links on its web site to other web sites through which hotel and other bookings can be made). In addition, VBAs do not generally expand their operations into this field, preferring to focus on their core business. Indeed, Freedom Air currently has contracts with House of Travel under which House of Travel provides holiday packages using Freedom Air airfares.

While the travelling public might benefit in the short-term from the price reductions that Qantas Holidays might offer, it is self-evident that if it were left as the only package holiday provider in New Zealand, the incentives on it to maintain low prices in the longer run would be non-existent.

It is also unlikely that any competition from internet-based holiday package distributors would act as a sufficient constraint on Qantas Holidays. In the travel industry as in so many other industries, the growth of the internet has had a significant impact on the way airlines and travel agents do business. In particular, there has been significant growth in internet based travel aggregators, including www.travelocity.com, www.expedia.com and www.opodo.co.uk. New Zealand has not seen the same growth in such internet travel providers as has been experienced in many other larger countries, by virtue of its small size.

These internet based travel aggregators are owned by a variety of parties including other internet businesses (Microsoft was responsible for establishing Expedia), travel industry participants (Sabre, the Global Distribution System, is a shareholder in Travelocity) and airlines (Opodo is owned by a consortium of the airlines whose services are offered on the web site, including British Airways, Air France and Lufthansa).

Zuji (www.zuji.com), owned by a number of airlines including Singapore Airlines, Cathay Pacific, Air New Zealand, Qantas and Japan Airlines, has recently announced its intention to begin operations in New Zealand, and it already operates in Australia.

House of Travel considers that, given the likely extent of Qantas Holidays' presence in the traditional travel distribution markets (as described further above) this entry will not change the competitive situation in New Zealand. In particular, no other operator will have a relationship with an airline that is necessary to compete as a distributor. Indeed, Qantas' ownership of both the traditional and the internet distribution methods will make it more difficult for other competitors to continue to compete.

Conclusion

For the reasons set out above, House of Travel has very real concerns about the likely effect of the proposed transaction on competition in the New Zealand domestic and trans-Tasman air services markets. Indeed, House of Travel believes that the only way in which continued competition in these markets can be ensured is through the Commission requiring the parties to divest themselves of all of the assets of Freedom Air.

In addition, House of Travel considers that the proposed transaction will significantly reduce competition in the market for the provision of wholesale holiday packages, to such an extent that Qantas Holidays is likely to be left as the only provider of services in this market.

Yours faithfully

Chris Paulsen
MANAGING DIRECTOR