

Submission

to the

Commerce Commission

on the

Draft Determination by the Commerce Commission relating to

Applications

by

Air New Zealand Limited

and

Qantas Airways Limited

for

Authorisations

under

Sections 58 and 67

of the

Commerce Act 1986

20 June 2003

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1. EXECUTIVE SUMMARY

1.1 Wellington International Airport Limited (**WIAL**) supports the Commission's conclusions in paragraphs 894 to 896 of the Draft Determination that:

- (a) the Commission cannot be satisfied that the Acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in a range of affected markets, and that the Acquisition will not result or be likely to result in such a benefit to the public that it should be permitted; and
- (b) the Commission cannot be satisfied that the Arrangement would result, or would be likely to result, in a benefit to the public that would outweigh the lessening of competition that would result or would be likely to result.

1.2 Accordingly, WIAL considers that the Commission's Draft Determination, indicating that it is likely to decline the Applications, is appropriate.

Introduction

1.3 Part 1 of this submission contains WIAL's submissions on the Commission's procedures, general comments on the substantive sections of the Draft Determination, and the Commission's powers relating to undertakings and conditions. Part 2 contains WIAL's responses to the Commission's questions to interested parties.

1.4 WIAL is aware that the Applicants have made submissions, including proposed revised undertakings, to the ACCC on 9 May 2003 in respect of the applications before that body. WIAL has made brief initial comments on the revised undertakings provided to the ACCC in section 5 of this submission, but WIAL does not consider those submissions substantively in this submission.

Commission procedures

1.5 In section 3 of this submission, WIAL provides its views on four issues relating to the Commission's procedures in considering the Applications, being:

- The need to consider the detriment and benefits of the Arrangement and Acquisition separately, while recognising their interdependence;
- The need for the Commission's final determination to be independent from the final determination of the ACCC;
- The timing of the conference on the Draft Determination.

- That the Applicants' proposals for revised undertakings or conditions should be submitted to the Commission in time for cross-submissions by interested parties.

Separate consideration of the Arrangement and Acquisition

- 1.6 The Commission rightly acknowledges that, as two separate Applications have been made under two different sections of the Act, it is required to make two separate determinations. Although the Arrangement and Acquisition are interdependent (but only as a matter of the current contractual arrangements between the Applicants) it is also necessary to identify, separately, the detriments and benefits of the respective Applications.
- 1.7 However, the Commission has combined the Applications and has undertaken its competition and public benefit analysis of the Applications as one total package. WIAL considers that the Commission should separately identify the detriments and benefits. To ensure that the final Determination is robust and protected from legal challenge, the Commission should not analyse the Applications as one total package.

Commission Determination to be independent from ACCC

- 1.8 The Commission must continue to ensure that it considers and determines the Applications under New Zealand law, and independently of the ACCC's deliberations.
- 1.9 The Commission and the ACCC chose to adopt parallel procedures for their respective determinations of the Applications before each of them.
- 1.10 The draft determinations of the Commission and the ACCC were issued on the same day, have a common outcome, and include very similar concerns about the Arrangement and Acquisition generally in terms of the detriments and purported public benefits of the Alliance.
- 1.11 Differences have emerged in the pathways that the respective sets of applications will now follow due to differences in the jurisdictions under which the Applications are to be determined and to the different procedural choices made by the Applicants under each jurisdiction.
- 1.12 The emergence of these differences and the inability of the Commission and the ACCC to maintain parallel processes highlight the need for the Commission to ensure that it considers and finally determines the Applications before it independently.

Change in timing of Commission conference

- 1.13 WIAL shares the view of a number of interested parties that the Commission should not have deferred the conference on the Draft Determination from 20-23 May 2003 to 18-22 August 2003 and extended the time for submissions on it by 10 weeks.
- 1.14 A conference (and the timing of a conference) is for the benefit of all interested parties, not just the applicants. This is reflected by the fact that section 62(3) enables all parties to whom the draft determination is sent (including the applicants, interested parties and any other person the Commission thinks may assist it in its determination), to call for a conference to be held.
- 1.15 Accordingly, WIAL considers that it is appropriate for all relevant interested parties to be provided with the opportunity to comment on any proposed changes to matters such as the timing of a conference.
- 1.16 WIAL welcomes the explicit provision the Commission has made for cross-submissions before the Conference but this decision ought not to have been a reason for the deferral of the Conference or the overall delay in the Commission process.
- 1.17 WIAL has serious doubts that the Commission is entitled under section 62(6) of the Commerce Act to defer a conference in respect of the Arrangement to a date beyond 27 May 2003. The minutes of the meeting at which the Commission decided to allow an extension (held on 29 April 2003) do not show that section 62(6), or in fact any provisions of the Act, were considered.
- 1.18 Moreover, no other interested party had an opportunity to call for a conference under section 62(3) in accordance with the prescribed time frame, as the Commission had determined to do so on its own motion under section 62(6) upon releasing the Draft Determination. Nor was any interested party given an opportunity to comment on the Applicants' request for an extension of submission dates which consequently also involved the Commission changing the conference date.

Applicants' proposals for revised undertakings and conditions

- 1.19 WIAL understands from the minutes of the Commission's meeting on 29 April 2003 that the extension was granted on the condition that third parties be given the opportunity to make cross submissions on the Applicant's submissions.
- 1.20 It is in this context that WIAL assumes that the Applicants' envisage providing revised undertakings and conditions with its submission on 20 June 2003 as reported in the media (Australian Financial Review 3-4 May 2003 at page 5).

- 1.21 In WIAL's view, the Commission's apparent intentions in granting the extension will be thwarted and other interested parties prejudiced unless the Applicants provide revised undertakings at the latest with the Applicant's submission on 20 June 2003.
- 1.22 Indeed, given that the Applicants have already provided the ACCC with Revised Undertakings (Qantas/Air New Zealand submission to the ACCC, 9 May 2003), WIAL can see no reason why similar undertakings have not already been provided to the Commission to enable third parties to make timely and effective submissions on the revised undertakings.

General views on the Draft Determination

- 1.23 In section 3 of this submission, WIAL has provided its general views on the Commission's analysis of market definitions, the Factual and Counterfactual, and the balancing of detriments and public benefits.

Market Definition

- 1.24 WIAL agrees with the Commission that there is a degree of differentiation between business and the VFR/leisure passenger air services products, but accepts the Commission's approach of considering these products as part of one market for the purposes of the Applications.
- 1.25 WIAL agrees with the geographic extent of the relevant markets identified by the Commission.
- 1.26 Ground handling services are provided differently at different airports. Paragraph 4.10 of this submission describes the provision of such services at Wellington International Airport.

Factual and Counterfactual

- 1.27 WIAL supports the Commission's conclusion that the Factual would result in the Applicants essentially operating as "one head" in the relevant markets.
- 1.28 In addition, WIAL supports the Commission's preliminary conclusion (as recorded in paragraph 13 of the executive summary to the Draft Determination) that a more realistic Counterfactual scenario is one involving a less aggressive form of competition between Air New Zealand and Qantas, and less entry, compared to the Counterfactual suggested by the Applicants (which relies heavily on non-profit-maximising behaviour).

- 1.29 WIAL remains of the view that, if a VBA is to constrain the Applicants, the VBA would need to tackle the incumbents head on from day one, on the incumbents' established routes. This is not likely.
- 1.30 In relation to barriers to entry and/or expansion, WIAL agrees with the Commission's draft conclusions on the comparison between the states of competition in the Counterfactual and Factual in the relevant air passenger services domestic, main trunk, provincial, and Tasman markets. WIAL is of the view that the prospect of entry is limited in these markets. WIAL supports the conclusions drawn by the Commission in respect of the air freight service markets.

Detriments and Public Benefits

- 1.31 WIAL has not engaged experts to comment on the assumptions or methodology adopted either by NECG or the Commission.
- 1.32 In WIAL's initial submission, WIAL highlighted that particular benefits claimed by the Applicants would in fact have a negative effect in relation to the Wellington region, without any corresponding benefits emerging elsewhere. The Commission does not appear to have acknowledged these concerns in the Draft Determination. Further, it appears to WIAL that the Applicants' case is based on a series of cross-subsidies between different routes. It is doubtful whether this model is plausible, and it should be recognised that it would have significant costs for smaller centres, which would effectively be asked to subsidise travel to and from larger centres. The Commission's analysis does not seem to have identified these costs.
- 1.33 There could be considerable tourism detriments arising from the Alliance, rather than benefits. Accordingly, WIAL again expresses its reservations about the existence of net tourism benefits (if any) flowing from the Alliance.
- 1.34 In respect of engineering and maintenance benefits, WIAL reiterates that it disagrees that any benefit could be said to flow from the Alliance. This is because the behaviour that the Applicants claim will occur in the absence of the Alliance is not credible. In addition, it is unclear whether the claimed benefit is of any relevance, given the Commission has provisionally determined that there is no aggregation in the engineering and maintenance services market.
- 1.35 WIAL accepts that extra freight capacity arising from the Applications in relation to Wellington should be counted as a benefit.

Commission powers relating to undertakings and conditions

1.36 This submission addresses the issue of undertakings (in respect of the Acquisition) and conditions (in respect of the Arrangement) separately. WIAL also comments on the Revised Undertakings provided by the Applicants to the ACCC on 9 May 2003.

Undertakings

1.37 As recorded by the Commission in paragraph 844 of the Draft Determination, none of the conditions currently proposed by the Applicants amount to structural undertakings that would be acceptable under section 69A of the Act. Nor do the Revised Undertakings provided to the ACCC on 9 May 2003.

1.38 Having regard to the significant detriments calculated as flowing from the Alliance, and the minimal benefits, WIAL finds it difficult to believe that any structural undertakings would lessen or remove competition concerns so as to enable authorisation of the Acquisition to be granted.

1.39 Even if the Applicants offered to divest Freedom Air, this would not decrease the detriment or create a benefit to such an extent that an authorisation should be granted in respect of the Acquisition. This is because Freedom Air is solely a Tasman market operator and enjoys no exclusive or special rights or privileges such as access to facilities. Freedom Air is simply a vehicle of Air New Zealand and its divestiture would not restrain the scope of the activities of the Alliance in the Tasman market.

1.40 In addition, Freedom Air has, largely been targeted at, and used by, leisure travellers, who constitute only a part of some of the markets identified by the Commission. The detriments identified by the Commission extend across many markets. WIAL's firm view is that, even if Freedom Air was divested, this would not decrease the detriments or increase benefits to such an extent that the Acquisition should be authorised.

Conditions

1.41 Like undertakings, conditions are generally only relevant when the existence of such conditions would make the difference between the granting or declining of an authorisation.

1.42 Again, having regard to the significant detriments and negligible benefits identified by the Commission, WIAL finds it difficult to believe that the Commission could formulate conditions effective enough to either reduce detriments, or enhance benefits or competition such that the Arrangement should be authorised.

1.43 WIAL considers that the requirement in section 61(2) of the Act, that conditions imposed cannot be inconsistent with the Act, must be given full weight, especially in relation to the severe nature and scope of the practices for which authorisation is sought in the present case. WIAL considers that it is extremely unlikely that conditions will be able to be formulated in such a way to address the relevant detriments/benefits, or even to be adequately implemented and enforced.

Revised Outline of Undertakings

1.44 WIAL assumes that the outline of revised undertakings provided to the ACCC on 9 May 2003 will also be provided to the Commission, and, on this basis, has provided preliminary views on the revised undertakings.

1.45 However, until the Applicants officially provide the revised undertakings to the Commission, WIAL will not comment comprehensively on the revised undertakings.

1.46 In any case, WIAL's view is that the revised undertakings, if they were to be provided to the Commission, are not sufficient to decrease the significant detriments or increase benefits such that the authorisation of the Alliance should be granted by the Commission.

WIAL's response to Commission questions

1.47 In Part 2 of this submission, WIAL responds to the questions posed by the Commission in its Draft Determination

Conclusion

1.48 WIAL strongly recommends that the Commission confirm its Draft Determination and decline the Applications.

2. INTRODUCTION

Preliminary

2.1 Wellington International Airport Limited (**WIAL**) welcomes the opportunity to comment on the Draft Determination by the Commerce Commission dated 10 April 2003 relating to:

- (a) the application by Air New Zealand Limited and Qantas Airways Limited for authorisation under section 58 of the Commerce Act 1986 to implement the terms of a Strategic Alliance Agreement (referred to by the Commission as the **Arrangement**); and
- (b) the application by Qantas Airways Limited for authorisation under section 67 of the Act to acquire up to 22.5% of the voting equities in Air New Zealand (referred to by the Commission as the **Acquisition**)

(collectively the **Applications**).

2.2 WIAL has adopted the same short hand references to the Arrangement, Acquisition, Applications and Alliance as those terms are used by the Commission in its Draft Determination. The term **Draft Determination** refers to the draft determination of each application.

2.3 WIAL's contact person is:

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Structure of this submission

2.4 This submission is divided into two parts:

- (a) Part 1, comprising section 3 to section 5, contains WIAL's submissions on the Commission's procedures, WIAL's general views on the substantive sections of the Draft Determination (although WIAL does not comment on all sections of the Draft Determination) and the Commission's powers relating to undertakings and conditions.

- (b) Part 2 of this submission contains a consolidated list of questions posed by the Commission in the Draft Determination, and WIAL's answers to those questions.

Scope of Submission

- 2.5 WIAL has not engaged experts to comment on aspects of the detriment/benefit methodology adopted by NECG and commented on by experts engaged by other parties and the Commission. Nor has WIAL checked the numerical accuracy of either the Commission's or NECG's modelling. Instead, consistent with its initial submission of 14 February 2003 (**initial submission**), WIAL has focussed on those matters where it has some direct knowledge of the aviation industry and conditions in the relevant markets.
- 2.6 This submission is complementary to WIAL's initial submission on the Applications. If this submission does not directly address an issue discussed in WIAL's initial submission, WIAL requests that the Commission refer to its initial submission.
- 2.7 WIAL is aware that the Applicants have made submissions to the ACCC on 9 May 2003, including proposed revised undertakings, in respect of the application before that body. To the extent those submissions are repeated in submissions to the Commission in respect of the Applications, WIAL will consider them for the purposes of its cross-submissions. WIAL has made brief initial comments, nevertheless, on the revised undertakings in section 5 of this submission.

3. COMMISSION PROCEDURES

3.1 This section addresses four issues relating to the Commission's procedures in considering the Applications. They are:

- The need to consider the detriment and benefits of the Arrangement and Acquisition separately, while recognising their interdependence;
- The need for the Commission's final determination to be independent from the final determination of the ACCC;
- The timing of the conference on the Draft Determination;
- That the Applicants' proposals for revised undertakings or conditions should be submitted in time for cross-submissions by interested parties.

Considering the Arrangement and Acquisition together

3.2 In paragraphs 2.22 to 2.28 of WIAL's initial submission, WIAL emphasised the importance of separately identifying the detriments and benefits of the Arrangement and the Acquisition.

3.3 In paragraph 8 of the Commission's Draft Determination, the Commission rightly acknowledges that, as two separate applications have been made under two different sections of the Act, the Commission is required to make two separate determinations. WIAL considers that this requires a separate assessment of the detriments and benefits flowing from the proposals under each of the two applications.

3.4 However, in considering the Applications as two parts of one overall Alliance and in treating the proposed Alliance as one total package, as set out in paragraphs 56-60 of the Draft Determination, the Commission has combined the two applications for the purposes of undertaking its competition analysis.

3.5 As a consequence, the Commission, in its "Public Benefits and Detriments" section (paragraphs 599-836 of the Draft Determination), has only considered the detriments and benefits of the Alliance overall.

3.6 WIAL does not consider that the benefits and detriments flowing from the Arrangement, and those flowing from the Acquisition are, or would be, identical. Given the statutory requirement to issue two separate determinations, it is more appropriate to separately identify the detriments and benefits. However, WIAL acknowledges that both the

Arrangement and the Acquisition are interdependent and that, in addition to their separate consideration, it is also appropriate to consider their overall effect.

- 3.7 It is important to bear in mind that, while the Applicants have advised the Commission that the “interdependent” nature of the Arrangement and the Acquisition mean that authorisation for both is required or the deal will not go ahead, the interdependent nature is a matter of current contractual arrangement only. There is no bar to the Applicants coming to a new agreement that would result in either the Arrangement or the Acquisition going ahead in the absence of the other.
- 3.8 Accordingly, to ensure that the final Determination is robust and protected from legal challenge, the Commission should not analyse the Applications as one total package.

Commission determinations required to be independent of ACCC

- 3.9 In paragraphs 2.15 to 2.29 of WIAL’s initial submission, WIAL emphasised that, although the Applicants had chosen to file applications with the ACCC and the Commission contemporaneously, the Commission must ensure that the Applications are considered and determined under New Zealand law and independently of the ACCC’s deliberations.
- 3.10 The draft determinations of the Commission and the ACCC were issued on the same day, have a common outcome, and share concerns over the Arrangement and Acquisition in terms of the impact of the proposed Alliance. However, there are differences between the content of the draft determinations, particularly different relevant markets, the scope of analysis undertaken by the Commission compared with the ACCC, and other jurisdictional matters.
- 3.11 It is clear from the Draft Determination that the Commission has been careful to make its own determination independent of that by the ACCC. This is important given that some differences have emerged in the pathways that the respective Applications to the Commission and the ACCC will now follow.
- 3.12 In Australia, once the ACCC had issued its draft determination, either the Applicants or other persons to whom a copy of the draft determination was sent, were able to notify the ACCC with a specified timeframe whether the Applicants or the other person wished the ACCC hold a conference.
- 3.13 Neither the applicant nor such other persons as were sent the Draft Determination notified the ACCC within the required timeframe. Accordingly, no conference has been held, and the ACCC is now able to issue its final determination. The Applicants have not, WIAL understands, requested a time extension. Indeed, Qantas has urged the ACCC to make that final determination as soon as possible (Qantas media release, 10 April 2003).

- 3.14 However, recent media reports have indicated that the timing of the ACCC's final determination is uncertain, and may in fact be two to three months away (ABC News Online, 12 June 2003, stuff.co.nz, 12 June 2003). This means that, at this stage, there is considerable uncertainty as to the process in Australia in respect of the Applications.
- 3.15 In contrast, the Commission in New Zealand determined under section 62(6) of the Act to hold a conference. Aside from the legal issues associated with the timing of this conference (these are discussed below), the deadline for submissions to the Commission is 20 June 2003, cross-submissions must be received by the Commission by 18 July 2003, and the conference is to be held between 18 and 22 August 2003. A final determination is anticipated by 30 September 2003.
- 3.16 As a result, before the Commission makes its final determination, it is possible that the ACCC will have made a final determination, and/or the Applicants will have appealed that determination to the Australian Competition Tribunal.
- 3.17 Accordingly, the parallel nature of the processes by the ACCC and Commission which have been evident to date, are clearly now no longer appropriate or possible.
- 3.18 Given the emerging divergence between the two processes, it is fundamental that each regulatory body must make its own independent decision under the respective statutes, irrespective of the decisions of its counterpart across the Tasman.

Timing of the Conference on the Draft Determination

- 3.19 WIAL shares the view of a number of interested parties that the Commission should not have deferred the conference on the Draft Determination from 20-23 May 2003 to 18-22 August 2003 or extended the time for submissions on the Draft Determination by 10 weeks.
- 3.20 WIAL acknowledges the explicit provision the Commission has made for cross-submissions before the conference but this decision ought not be a reason for the deferral of the conference or delaying the Commission's final Determination.
- 3.21 Paragraph 11 of the Draft Determination records that the Commission, of its own motion, determined to hold a conference on 20-23 May 2003 prior to making a final determination, in accordance with section 69B for the proposed Acquisition and section 62(6) for the proposed Arrangement.

- 3.22 In exercising its powers under section 62(6) in respect of the Arrangement, the Commission obviated the necessity for interested parties to call for a conference as provided for under section 62(3).¹
- 3.23 However, whether the conference is held as a consequence of an interested party requiring it, or of the Commission exercising its powers under section 62(6), the conference can commence no later than a total of 30 working days after the issue of the relevant draft determination. The 30 day period comprises a 10 working day period after the relevant Draft Determination is issued, within which the applicants or other relevant interested parties can notify the Commission that they wish a conference to be held, and a 20 working day period after the expiry of the 10 working day period.
- 3.24 In this situation, the Act therefore required that the conference must commence no later than 27 May 2003 and the Commission has no power under the Act to defer the date.
- 3.25 In respect of the Acquisition, other than the overall constraint on the date for determination of a business acquisition application (which may be extended by agreement between the Commission and the Applicant), there is no timing constraint in respect of a conference that the Commission determines to hold relating to an acquisition application.
- 3.26 However, in this case, the Applicants themselves have pressed the Commission to undertake, and the Commission has agreed to undertake, a parallel process under the Act in respect of the two Applications. This preference does not mean the Commission can ignore the statutory constraints in respect of a conference relating to the Arrangement and, as a consequence, the submission dates in respect of the application for the Arrangement.

Applicants' proposals for revised undertakings and conditions

- 3.27 WIAL understands from the minutes of the Commission's meeting on 29 April 2003, that the extension was granted on the condition that third parties be given the opportunity to make cross submissions on the Applicants' submissions.
- 3.28 It is in this context that WIAL assumes that the Applicants envisage providing revised undertakings and conditions with their submission on 20 June 2003.

¹ In contrast, in the recent Draft Determination in respect of the application by the Pohokura Joint Venture Parties for authorisation of the joint marketing of gas, issued on 16 May 2003, the Commission correctly gave notice to interested parties under section 62(3) in addition to indicating that the Commission intends, if no party requests a conference to be held, that it will hold a conference of its own motion in accordance with section 62(6). (Refer paragraphs 51 and 52, Pohokura Draft Determination).

- 3.29 In WIAL's view, the Commission's apparent intentions in granting the extension will be thwarted and other interested parties prejudiced unless the Applicants provide revised undertakings at the latest with the Applicant's submission on 20 June 2003.
- 3.30 Indeed, given that the Applicants have already provided the ACCC with revised undertakings, WIAL can see no reason why similar undertakings have not already been provided to the Commission to enable third parties to make timely and effective submissions on the revised undertakings.

4. WIAL'S GENERAL VIEWS ON THE DRAFT DETERMINATION

4.1 This section contains WIAL's general views on:

- (a) the Commission's analysis of market definition (paragraphs 144-223 of the Draft Determination);
- (b) the Factual and Counterfactual and related comparison of states of competition (paragraphs 224-597 of the Draft Determination); and
- (c) the balancing of detriments and public benefits (paragraphs 832-837 of the Draft Determination).

4.2 Section 6 supplements these general views with additional specific responses to the Commission's questions on these topics.

Market definition

4.3 In its initial submission, WIAL submitted that the Commission's approach to market definition for air passenger services in *Air New Zealand/Ansett Holdings/Bodas* (Decision 278, 3 April 1996) was more appropriate than the Applicants' suggestions.

4.4 The Commission, in its Draft Determination, reviews and makes minor modifications to the markets identified in *Bodas* based on updated information regarding the current market dimensions. WIAL accepts, for the purposes of this submission, the Commission's modifications and considers that these markets are more appropriate than the markets suggested by the Applicants.

4.5 WIAL's views on the particular markets are expanded below.

Product dimension of air passenger markets (paragraphs 151-169)

4.6 WIAL agrees with the Commission that there is a degree of differentiation between the business and VFR/leisure passenger products. Provided the different impacts of the Alliance on these markets are considered in the process of the Commission's evaluation of competition, benefits and detriments, WIAL accepts the Commission's approach of considering them as one market.

Geographic dimension of air passenger markets (paragraphs 172-193)

4.7 WIAL agrees with the Commission's updated approach to defining geographic markets (consolidating the tourist and route markets with the provincial market, but defining additional distinct international markets for air passenger services), although WIAL's

primary knowledge of, and interest in, international markets is in respect of the Tasman market and, to lesser extent, the New Zealand – Pacific Islands market.

Air freight services (paragraphs 195-205)

- 4.8 WIAL agrees with the Commission’s updated geographic differentiation between Tasman bellyhold and other international bellyhold freight services.

Ground handling services (paragraphs 219-221)

- 4.9 WIAL generally agrees with the Commission on the elements of this market but is aware of variations between airports as to how these facilities are provided. Any assessment of barriers to entry linked to the ground handling services market therefore needs to be airport specific.
- 4.10 The table below shows how the services are provided at WIAL, but the Commission should note that there are other approaches in New Zealand.

Item	How Provided by WIAL
Check in Counters and Gate Desks	Counters owned by WIAL and leased to airlines Cabling to counter owned by WIAL Check-in systems a mixture of CUTE and proprietary systems owned by airlines Operated by airline staff or their contractors
Lounges	Building shell owned by WIAL and leased to airlines, all fitout owned by airline.
Terminal Areas	Building shell and fitout owned by WIAL, airlines pay for area by means of a terminal charge
Gates	All owned by WIAL, airlines pay for area by means of a landing charge
Aerobridges	All owned by WIAL, airlines pay for use by means of a aerobridge charge
Departure slots	Not an issue at WIAL at present, responsibility of Airways Corporation

Baggage handling	Equipment within the terminal owned by WIAL All other equipment owned by airlines or their agents All equipment operated by airlines or their agents
Catering	Generally a third party contracting direct to the airlines
Aircraft cleaning and servicing	A mixture of airline direct employees or a third party contracting direct to the airlines

4.11 The Commission pays no further attention to this market as it concludes there is no market share aggregation arising from the proposal. The tabled information is, however, relevant to issues which arise in its comparative competition analysis relating to entry/expansion barriers.

Other market definitions (paragraphs 205-218)

4.12 WIAL has no comment on the Commission’s updated definitions in respect of other markets.

Factual and Counterfactual

4.13 WIAL’s initial submission (paragraphs 4.1- 4.50) raised serious questions about both the Applicants’ Factual Market Assumptions and proposed Counterfactual. In support of these questions, WIAL provided information and views based on its historical observations and experience and it suggested a more likely counterfactual scenario.

4.14 WIAL’s arguments in its initial submission may be summarised as follows:

- The Applicants’ assumption that Air New Zealand is profitable on domestic routes and unprofitable on some international routes is at odds with history. WIAL considers it potentially misleading to rely on current sector profitability, which is contrary to historic profitability, to model future scenarios.
- A substantive and aggressive capacity driven expansion into the New Zealand market by Qantas (the Counterfactual) is contrary to the past behaviour of Qantas. WIAL is unconvinced by the explanations provided by the Applicants as to why Qantas would change its behaviour as opposed to adopting a more measured expansion into the market.
- The competitive influence of Origin Pacific on the main trunk market is overstated given its current market strength and reliance solely on turbo-props.

- The Applicants' scenario assumes a new VBA would need to start operations in "head to head" competition with a single well-capitalised incumbent, on the incumbents' strategic routes from the "incumbents'" airports. This contrasts markedly with the overseas experience of the VBA establishment model.
- WIAL believes that the Alliance would discourage the possibility of a VBA entering the market.
- The Applicants' overall assumptions that barriers to VBA entry are low under-emphasise the challenges faced and are contrary to the Commission's previous findings. WIAL's own experience, when promoting a trans-Tasman service to Virgin Blue in 2001, is that it is difficult to achieve success with such initiatives.
- Given that the Applicants' proposal is to co-ordinate pricing and scheduling, WIAL considers it most likely that the Alliance will ultimately lead to reductions in both frequency and capacity as the Applicants enhance their yields. The Applicants' trans-Tasman forecasts confirm this.
- The engineering benefits appear to be based on behaviour by Qantas that is destructive of its shareholder value, and contrary to the practice described in other sections of the NECG report.

4.15 WIAL agrees with the Commission's conclusion that the Factual would result in the Applicants essentially operating as "one head" in the relevant markets identified by the Commission. WIAL notes particularly that there are two parts of the Factual, comprising the elements of the Acquisition and of the Arrangement respectively, and that the scope of the market restrictions involved under the Arrangement is very substantial indeed as detailed in paragraphs 227 to 229.

4.16 WIAL agrees with the Commission's preliminary conclusions regarding the characteristics of the Counterfactual, which essentially are that a less aggressive form of competition between Air New Zealand and Qantas will occur, and less entry, compared to the Counterfactual put forward by the Applicants (paragraphs 11-13 of the executive summary, and paragraph 300).

4.17 Although WIAL did not comment on issues relating to the extent of future investment support for Air New Zealand, insofar as it bears on the Counterfactual, WIAL generally accepts the Commission's analysis of information provided in publicly released Government papers on advice to the Government as shareholder (paragraphs 244-254; paragraphs 276-286).

- 4.18 In particular, as the Commission states, that Applicants have not attempted to claim that Air New Zealand is a “failing firm” in mitigation of the anti-competitive effects flowing from the proposed Alliance (paragraph 286). However, the Applicants’ counterfactual does rely heavily on behaviour that is not profit-maximising.
- 4.19 WIAL also notes the Commission’s discussion of the options of the New Zealand Government as major shareholder in Air New Zealand. It appears that the Government, according to reported comments on the Draft Determination, has misunderstood the appropriate tests under the Act and the Commission’s analysis. In a media release on 10 April 2003, Hon. Michael Cullen questioned “*the Commission’s assumptions about the availability of capital for the company given the turbulent financial environment surrounding the aviation industry at the present time and for the foreseeable future*”.
- 4.20 Dr. Cullen is also recorded in “Morning Report” on 11 April 2003 as saying that the Commission seems to assume that “*some kind of Fairy Godmother is going to appear in the wings at some date within the foreseeable future. Given the number of Fairy Godmothers in bankruptcy at the moment, that does not seem terribly likely.*”
- 4.21 Apart from apparently misunderstanding the appropriate tests, there is no evidence of any new factors which contradict the Government’s papers or Commission’s general analysis or any suggestion from the Applicants in media releases to date that a “failing company” claim is being contemplated. In addition, despite Dr Cullen’s statements, there is no reason for the Commission to suppose that the capital markets (with or without Government support) would not be willing to fund airline expansion plans that are supported by a robust business case.
- 4.22 If anything, it is possible that Air New Zealand, with its increasingly well established Express Class model able to be applied to trans-Tasman services, is well placed to meet competitive threats in the trans-Tasman market.
- 4.23 WIAL notes that the Commission has access to additional submissions and evidence concerning both the strategic behaviour of Qantas and new airline entry, including the perspectives of Virgin Blue and the scope for alternative alliances that were not available to WIAL. WIAL remains of the view, however, that for a VBA to provide any real constraint on the Applicants in the New Zealand context, the VBA would need to tackle the incumbents head-on from day one on the incumbents’ strategic routes. WIAL considers that this level of VBA entry is unlikely. WIAL also notes that reports of pending entry by Virgin Blue are, by themselves, not evidence of likely entry in the relevant timeframe being considered by the Commission.

- 4.24 In its comparison of the state of competition under the Factual and Counterfactual respectively in paragraphs 301 to 598, the Commission identifies the extent of barriers to entry or expansion in the relevant markets and other competition factors.
- 4.25 WIAL's views on barriers to entry/expansion and market characteristics are set out in paragraphs 5.3 to 5.17 of its initial submissions. WIAL agrees with the Commission's draft conclusions on the comparison between the states of competition of its Counterfactual and the Factual in the relevant air passenger services domestic, main trunk, provincial and Tasman markets. That is to say, coupled with the proposed Alliance having a high market share, there would be insignificant constraint from competitors, either existing or potential, and an increase in the barriers to entry when all the barriers are taken together (paragraphs 439, 460 and 502).
- 4.26 The prospect of entry is limited with uncertainty remaining in respect of Virgin Blue. If Virgin Blue does enter the market, WIAL does not anticipate that it would be to a sufficient extent or within a sufficient time frame. This is supported by recent media reports. There remain barriers to expansion for Origin Pacific in domestic markets. Overall, there is no constraint in any of the above markets from buyers or suppliers.
- 4.27 Similar conclusions are drawn by the Commission in respect of the air freight service markets. WIAL agrees with these conclusions.
- 4.28 In section 6 of this submission, WIAL provides responses to a number of the Commission's specific questions relating to relevant entry barriers including the availability of the airport facilities in responses to questions. WIAL reiterates its submissions and provides additional information in support of those views. In the case of Wellington International Airport, particularly, there should be no barriers to a new entrant using airport facilities in respect of either domestic markets or the Tasman market, given the particular arrangements in respect of the new terminal.

Detriments and public benefits

- 4.29 WIAL is not in a position to comment on the quantitative analyses undertaken by NECG for the Applicants and by or for other interested parties, including Prof. Hazeldine and Frontier Economics, or by the Commission, including the analysis undertaken by Prof. Gillen, and the latest round of calculations undertaken by the Commission.
- 4.30 The extent of public benefits and their quantification relative to quantified detriments is a function of the preliminary conclusions on the comparative analysis of Factual and Counterfactual scenarios. WIAL notes the particular points that public benefits must arise directly from the Application, must be of a public not private character and relevant to the markets in question. In paragraphs 6.25 to 6.31 of its initial submission, WIAL drew

attention to particular benefit claims which in fact would have a negative effect in the Wellington region without apparently any corresponding benefits elsewhere. These concerns do not appear to have been acknowledged by the Commission.

- 4.31 WIAL likewise considers there could be considerable tourism detriments arising from the Alliance rather than benefits, as is set out in paragraphs 6.3 to 6.37 of WIAL's initial submission. WIAL retains its reservations, therefore, about the existence of any net tourism benefits.
- 4.32 It appears to WIAL that the Applicants' case is based on a series of cross-subsidies between different routes. It is doubtful whether this model is plausible, and it should be recognised that it would have significant costs for smaller centres, which would effectively be asked to subsidise travel to and from larger centres. The Commission's analysis does not seem to have identified these costs.
- 4.33 In respect of engineering and maintenance benefits, WIAL continues to disagree that any benefit could result from the Alliance as the behaviour that the Applicant's claim will occur in the absence of the Alliance is not credible. WIAL also questions the relevance of this claimed benefit, given that the Commission has provisionally determined that it will not consider the relevant market given the lack of market aggregation.
- 4.34 WIAL accepts that any extra freight capacity arising from the Application should be counted as a benefit.

5. COMMISSION'S POWERS RELATING TO UNDERTAKINGS AND CONDITIONS

- 5.1 In paragraphs 210 to 219, the Commission sets out its views on its powers to accept undertakings in respect of the Acquisition, as part of an authorisation, and to impose conditions upon an authorisation of the Arrangement.
- 5.2 The proposed undertakings and conditions, in essence, will allow other airlines to capture only limited shares of some parts of some markets. Leaving aside workability and enforceability issues, it is counter-intuitive to suppose that users of air services will benefit if other airlines are brought into a cosy market sharing arrangement.
- 5.3 Since the Draft Determination was issued, the Applicants have made submissions to the ACCC in Australia. As part of their submissions, the Applicants provided a revised Outline of Undertakings (**Revised Undertakings**). To the best of WIAL's knowledge, the Revised Undertakings have not been provided to the Commission at this point in time.
- 5.4 However, WIAL assumes that the same Revised Undertakings will be offered to the Commission when the Applicants make their submissions in respect of the Draft Determination. On this basis, WIAL has briefly commented on those undertakings.
- 5.5 This section addresses the issue of undertakings (in respect of the Acquisition) and conditions (in respect of the Arrangement) separately.

Undertakings

- 5.6 As recorded by the Commission in paragraph 844 of the Draft Determination, none of the undertakings originally proposed by the Applicants amount to structural undertakings that would be acceptable under section 69A of the Act. Similarly, the Revised Undertakings submitted to the ACCC do not involve any undertakings that would be acceptable under section 69A of the Act.
- 5.7 However, in anticipation of the Applicants offering undertakings of a nature permissible under section 69A, WIAL has the following comments.
- 5.8 As recognised by the Commission, undertakings must be offered by the relevant applicants, and cannot be imposed by the Commission. Undertakings may be offered if a divestment would lessen or remove competition concerns so as to change the balance of the detriment and benefit analysis, and enable an authorisation to be granted in respect of the relevant application (paragraph 842 of the Draft Determination).
- 5.9 In this case, having regard to the significant detriments calculated, and the minimal value of benefits, WIAL finds it difficult to believe that any structural undertaking would lessen or remove competition concerns so as to enable an authorisation to be granted.

- 5.10 It is important to keep in mind the concerns expressed by the Commission in *Bodas* regarding the ability of a person to substantially influence the decision making process of another, even if such influence falls short of control (paragraph 180, *Bodas*).
- 5.11 In light of these concerns it is WIAL's view that, considered by itself, the Acquisition should not be authorised. The "package" nature of the Arrangement and the Acquisition should not obscure the severe detriments that would flow from Qantas acquiring a greater stake in Air New Zealand.
- 5.12 Some interested parties have suggested that Air New Zealand could divest Freedom Air as part of the current Alliance proposal. However, WIAL understands that this possibility had already been explicitly rejected by Air New Zealand. Nevertheless, in the Revised Undertakings the Applicants seem to have retreated slightly from their initial position, instead asserting that it would be "commercially difficult" for Air New Zealand to divest Freedom Air (paragraph 4, Revised of Undertakings).
- 5.13 WIAL considers it slightly disingenuous of the Applicants to suggest that it would be commercially difficult to divest Freedom Air, given the far more difficult and extensive arrangements required to facilitate the proposed Arrangement and the proposed Acquisition.
- 5.14 However, WIAL considers that, even if the Applicants offer to divest Freedom Air, this would not decrease the detriment or create a benefit to such an extent that an authorisation should be granted. As noted earlier, WIAL does not see a change in Freedom Air's ownership has having a material impact on the New Zealand aviation market. Freedom Air is solely a Tasman market operator. It enjoys no exclusive or special rights or privileges such as access to facilities (as acknowledged by Air New Zealand publicly). It is simply a vehicle of Air New Zealand and its divesture would not restrain the scope of the activities of the Alliance in the Tasman market. For example, the Alliance could continue to operate an Express Class service.
- 5.15 Although the dynamic, productive, and allocative efficiency losses calculated by the Commission are attributable in part to the Tasman market, WIAL doubts that the simple divestiture of Freedom Air would alleviate such losses.
- 5.16 In addition, Freedom Air has largely been targeted at, and used by, leisure travellers, who constitute only a part of some of the markets identified by the Commission. The detriments identified by the Commission extend across many markets. WIAL's firm view is that, even if Freedom Air was divested, this would not decrease the detriments or increase benefits to such an extent that the Acquisition should be authorised.

- 5.17 In relation to the benefits assessed by the Commission, even considering the Capacity Ceiling Condition and Capacity Floor Condition (whether revised or not) the continued and separate existence of Freedom Air may contribute somewhat to increase such benefits. However, WIAL considers that such a contribution would only be minimal.
- 5.18 In relation to the Commission's paragraph 849, WIAL assumes that the Commission is saying that, as discussed above a structural undertaking that involved the divestiture of Freedom Air would not ensure the claimed benefits of the proposed Acquisition would be delivered or enhanced, or that the detriments were lessened or removed. WIAL agrees with this assessment.

Conditions

- 5.19 As with undertakings, conditions are generally only relevant when the existence of such conditions would make the difference between the granting and declining of an authorisation in the relevant case.
- 5.20 WIAL reiterates that, having regard to the significant detriments and negligible benefits identified (paragraph 836 of the Draft Determination), WIAL finds it difficult to believe that the Commission could formulate conditions effective enough to either reduce detriments, or enhance benefits or competition, such that the application in relation to the Arrangement should be authorised.
- 5.21 Accordingly, WIAL supports the Commission's preliminary view (stated in paragraph 883) that the "Outline Undertakings (Conditions)" would not ensure that the entering into, or the giving effect to the Alliance would in all the circumstances result, or be likely to result, in a benefit to the public that would outweigh the lessening of competition that would result, or would be likely to result, or be deemed to result, from the Alliance.
- 5.22 As the Commission correctly identifies, sections 27 and 30 of the Act are relevant to the proposed Arrangement that forms part of the Alliance.
- 5.23 The complete Arrangement itself involves a significant number of practices which, by themselves, raise issues under section 27 and/or 30. These are summarised by the Commission in paragraph 227 of the Draft Determination.
- 5.24 A number of those proposed practices involve price fixing which is deemed to substantially lessen competition. Price fixing is a particularly pernicious market restriction that is per se illegal under the Commerce Act. WIAL considers that, given this fact, any conditions imposed by the Commission, if it were minded to do so, would have to reflect that the authorisation would condone price fixing.

- 5.25 As discussed above, the practices for which authorisation is sought constitute substantial market restrictions. These have been identified by the Commission's detailed calculation of detriments and benefits. It is accordingly important to quantify the nature and severity of the lessening of competition flowing from the Arrangement. However, given the substantial nature of the restrictions which would, or would be likely to result from the practices for which authorisation is sought, substantial conditions would be required to ameliorate the detriments, or enhance the benefits.
- 5.26 WIAL considers that the requirement in section 61(2) of the Act that conditions imposed cannot be inconsistent with the Act must be given full weight especially in relation to the severe nature and scope of the practices. This means that it is extremely unlikely that conditions will be able to be formulated in such a way to address the relevant detriments/benefits, or even to be adequately implemented and enforced.
- 5.27 WIAL encourages the Commission to consider the separate, legally severable elements of the proposed Arrangement and their severity.
- 5.28 In addition, given the importance of this matter, WIAL commends the Commission's statement in paragraph 856 that the Commission will normally only seek to impose conditions after consultation. WIAL considers that, given the extensive nature of the authorisation sought, it is appropriate that interested parties are offered the opportunity to comment on any possible conditions that may be imposed by the Commission. As submitted in section 3 of this submission, this opportunity must be timely and effective.

Applicants' 9 May Submission to the ACCC-Revised Undertakings

- 5.29 As discussed above, WIAL anticipates that the same Revised Undertakings as those offered by the Applicants to the ACCC on 9 May will be suggested to the Commission as possible conditions that the Commission may impose in respect of the Arrangement.
- 5.30 This would be consistent with the submission of identical undertakings to the ACCC and Commission earlier this year, prior to the ACCC and Commission issuing their respective draft determinations.
- 5.31 With this in mind, WIAL has the following comments regarding the Revised Undertakings, although WIAL intends to comment comprehensively on any such revised undertakings once they are officially submitted to the Commission.

Facilities and Services

- 5.32 Although the Applicants, in their revised Facilities and Services undertaking, have attempted to address the issue of relinquishing capacity identified by the Commission in

paragraph 886, a consequence of the Alliance is already anticipated to be a reduction in trans-Tasman service frequency by more than 30% from Wellington Airport. Accordingly, to the extent that the revised Facilities and Services undertaking suggested in paragraph 2.1 of the Revised Undertakings relates to Wellington Airport, the undertaking does not reduce the detriment, or increase the benefit flowing from the proposed Alliance.

- 5.33 As discussed elsewhere in this submission, WIAL owns the key airport facilities, not the airlines. Accordingly, no reduction in detriment or increase in benefit can be claimed to result from this particular undertaking in respect of Wellington Airport.
- 5.34 The revised Facilities and Services undertaking still does not give any guide as to a benchmark quality of facilities, a point noted by the Commission in respect of the original undertaking (paragraph 886).

Capacity Ceiling

- 5.35 The revised Capacity Ceiling undertaking still only applies to city pairs on which the Applicants are the sole operators. This means that the Applicants would not be constrained in their actions in respect of any other city pairs.
- 5.36 In addition, the proposed Capacity Ceiling in fact highlights the already distorted nature of the relevant markets, and would require frequent monitoring and assessment, particularly regarding timeframes and temporary increases.

Freedom and New Entry Facilitation

- 5.37 The Freedom and New Entry Facilitation undertaking is an entirely new undertaking proposed by the Applicants.
- 5.38 WIAL considers that, in practice, this proposed undertaking would terminate relatively swiftly.
- 5.39 The table below shows the current level of services from-Wellington to Melbourne, Sydney and Brisbane, the capacity, and implied levels of services that a new entrant would need to offer before it crossed the 50% threshold.

	Weekly Departures	Weekly Capacity - Seats	Weekly Capacity (excl Freedom)	50% capacity threshold	Number of Departures (assume 150 seat capacity)
Sydney	25	2,878	2,878	1,439	10
Melbourne	12	1,378	1,378	689	5
Brisbane	9	1,200	348	174	2

5.40 The table shows that it would take 2 services a week to Brisbane by a new entrant before the 50% threshold was reached. Even in respect of the Sydney route, a decision by a new entrant to dedicate one aircraft, thereby providing two services per day to the sector, would meet the revised capacity threshold proposed by the Applicants.

5.41 This demonstrates that the undertakings being offered by the Applicants will inevitably provide limited protection to new entrants and ultimately do little to increase the public benefit.

Market Entry with “Critical Mass”

5.42 The Market Entry with “Critical Mass” undertaking offered to the ACCC by the Applicants does not appear to WIAL to offer anything that a credible independent carrier could not arrange on its own account.

5.43 In addition, in paragraphs 418 – 419 of the Draft Determination, the Commission concluded that the availability of aircraft is not a barrier to entry in the main trunk market. This observation also applies to both the Provincial and the trans-Tasman markets.

5.44 In relation to paragraphs 4.8(a) to 4.8(d) of the Revised Undertakings, these undertakings appear to put the Applicants in the shoes of an aircraft leasing company, presumably in competition with other aircraft leasing companies with whom a new entrant could contract. In reality, a new entrant would not obtain better terms from the Applicants than from other participants in the leasing market, because any lease would be on “commercial terms”. These would undoubtedly be benchmarked against prevailing market rates and other terms.

5.45 It is unclear whether the Revised Undertaking set out in paragraph 4.8(e) would mean that the Applicants would provide engineering services as part of the lease arrangements, or on ordinary commercial terms. WIAL has assumed that the Applicants would not prevent new entrants from purchasing engineering services, in any case, at commercial rates.

5.46 WIAL notes that the Commission has already concluded (paragraph 417 of the Draft Determination) that there is no shortage of pilots. It is likely that this observation applies to the availability of cabin crew as well.

Capacity Floor

5.47 WIAL notes that the majority of New Zealand domestic trunk routes would be categorised as “Regulated City Pairs”, as would a majority of the provincial routes. WIAL assumes that the presence of a number of third tier airlines (Sounds Air, Air Wairarapa, Great Barrier Airlines etc) on some of these routes could not be construed to mean that the route is not a Regulated City Pair, but the Applicants’ revised capacity floor undertakings does not make this clear.

Tasman Price Cap

5.48 WIAL considers that the proposed Tasman Price Cap undertaking may raise issues in terms of section 30 of the Act. As discussed above, the Commission is not permitted by the Act to impose conditions that are inconsistent with the Act.

5.49 In addition, the proposed Price Cap is limited in its application to the Tasman market. The substantial lessening of competition identified as being likely to occur in the main trunk market and the provincial market as a result of the Alliance will therefore not be ameliorated by the proposed Price Cap undertaking.

5.50 WIAL therefore considers that the Tasman Price Cap to the extent that it may decrease detriments or increase benefits (which WIAL doubts) should be disregarded.

New Services

5.51 As a general point, if there is a sustainable business case for new services at 70% of existing load, then in all probability one or other of the Applicants would have introduced new services.

5.52 The New Services undertaking proposed by the Applicants does not in any real sense address the issues noted by the Commission in paragraph 889 of the Draft Determination.

5.53 Accordingly, WIAL does not consider that the slightly revised New Services undertaking would decrease detriments or increase benefits such that an authorisation should be granted.

Tourism and Freight

- 5.54 Neither the revised Tourism undertaking nor the revised Freight undertaking proposed by the Applicants in their 9 May submission to the ACCC differ in any real sense from the original undertakings offered by the Applicants.

Monitoring

- 5.55 The monitoring regime proposed by the Applicants illustrates that, in reality, the Applicants are creating a new regulatory regime to accommodate the Alliance. Such a regime itself creates additional detriments that would flow from the authorisation of the Alliance.

Summary

- 5.56 For the reasons outlined above, WIAL's preliminary view is that the Revised Undertakings would not ensure that the entry into, or the giving effect to of the provisions of the Alliance (particularly the Arrangement), would in all the circumstances result, or be likely to result, in a benefit which would outweigh the lessening in competition that would result, or be likely to result or be deemed to result from the Alliance.

PART 2

6. WIAL'S RESPONSE TO COMMISSION QUESTIONS

Question 1

The Commission seeks comment on its approach of considering the two Applications together.

- 6.1 The Commission rightly points out that, as two separate Applications have been made under two separate sections of the Act, the Commission is required to make two separate determinations.
- 6.2 WIAL recognises that the Acquisition and the Arrangement are inter-conditional. As discussed in section 3 of this submission, however, WIAL considers that the detriments and benefits should be identified separately, as well as overall.
- 6.3 The Commission should be mindful of the technical ability of Qantas and Air New Zealand, contractually, to disengage the Share Acquisition from the Strategic Alliance.
- 6.4 If the Acquisition were to proceed, but not the Arrangement, for instance, it appears to WIAL that a shareholding of 22.5%, or even possibly of 15% would give Qantas significant influence over Air New Zealand and access to important confidential information such that a substantial lessening of competition would be likely to occur.
- 6.5 WIAL also notes that considering the applications together seems to have complicated the conference procedures, as discussed in section 3 of this submission.

Question 2

The Commission seeks comment on its market definitions.

- 6.6 We refer to section 4 of this submission.

Question 3

The Commission seeks comment on the financial viability of Air New Zealand in the near term

- 6.7 We refer to section 4 of this submission. WIAL cannot comment in detail on Air New Zealand's financial viability. That would also require access to information not available to WIAL.

Question 4

The Commission seeks comment on its definition of the counterfactual

- 6.8 As noted in section 4 above, WIAL considers that the Commission's view of the Counterfactual represents a more credible basis upon which to base a benefit analysis.

Question 5

The Commission seeks comment on the likelihood of the "war of attrition" counterfactual as proposed by the Applicants

- 6.9 The Commission (paragraphs 255 – 274) presented a succinct summary of the various parties' positions noting the strong divergence of view between the submitters and the Applicants and in (paragraphs 287 – 289) critically evaluated the "war of attrition" scenario.
- 6.10 As the Commission observed (paragraph 266), WIAL's initial submission suggested that the war of attrition would be an unlikely scenario because it was counter to long established Qantas behaviour in New Zealand and value destructive. WIAL considers that this is still the case.

Question 6

The Commission seeks comment on the capital requirements of entry to the main trunk market and particularly seeks comment on whether the capital requirements constitute a barrier to entry to the market.

Question 7

The Commission seeks comment on the sunk costs of entry to the main trunk market and particularly seeks comment on whether the sunk costs constitute a barrier to entry to the market

- 6.11 WIAL agrees with the Commission's conclusion that a new entrant would require ongoing and substantial financial backing and that sunk costs do represent a risk to prospective entrants.
- 6.12 WIAL strongly supports the views of Origin Pacific in respect of the issue of sunk costs. Origin Pacific is an established player with a presence in most centres. Even from this established base Origin Pacific has identified that significant expenditure would be required to expand operations to move onto the main trunk market with jets. Any airline trying to gain entry to the main trunk market from a "standing start" would face a greater hurdle.

Question 8

The Commission seeks comment on the regulatory requirements of entry to the main trunk market and particularly seeks comment on whether the regulatory requirements constitute a barrier to entry to the market.

6.13 WIAL concurs with the Commission that the regulatory requirements are both transparent and ultimately achievable for a “credible” new entrant. It is probably fair to say that if the new entrant struggles to secure sufficient capital to navigate through the regulatory requirements, it would not survive in the market anyway.

Question 9

The Commission seeks comment on the likely incumbent response to entry to the main trunk market and particularly seeks comment on whether the likely incumbent response would constitute a barrier to entry to the market.

6.14 WIAL considers that the Alliance would represent a significant barrier to entry for a new operator and that the Alliance would have the capacity to mount a strong response.

6.15 As discussed in WIAL’s initial submission, historically VBAs have entered into markets either not served, or indirectly served, by FSAs rather than at day one tackling the incumbents on established routes. The example in New Zealand is that of Kiwi that commenced operations from Hamilton and other provincial centres. WIAL acknowledges that the experience in Australia with Virgin Blue was different, but Virgin Blue’s entry coincided with the collapse of Ansett.

6.16 In New Zealand the VBA would need to tackle the incumbents head on from day one on the incumbents’ established routes to provide any significant constraint on the Applicants. This level of entry is unlikely.

Question 10

The Commission seeks comment on the scale and scope required for entry to the main trunk market and particularly seeks comment on whether the scale and scope required constitutes a barrier to entry to the market.

6.17 WIAL notes that the Commission (at paragraph 375) has stated that to compete with the Alliance a new entrant would need to match frequencies at least for the business segment of the market, and possibly offer an equivalent product/service. WIAL considers the Commission may be overstating that case to the extent that the new entrant could initially concentrate on the peak travel market (0645 – 0845) and (1630 – 2000) and still reach a high percentage of business travellers.

Question 11

The Commission seeks comment on availability of facilities required for entry to the main trunk market and particularly seeks comment on whether access to these facilities would constitute a barrier to entry to the market

6.18 In its initial submission, WIAL outlined in some depth the type of facilities a new entrant would need to enter the main trunk market and concluded:

- There are no apparent major airport facilities constraints for new market entrants at Wellington Airport.
- There are details in both the existing Counter and Stand Arrangements that require change if the Application, and new market entrant were to be accommodated.
- The Agreements allow for those to be negotiated in the normal course of events.
- With goodwill between the parties, WIAL sees no reason why any re-negotiation could not be completed.

6.19 WIAL accepts that a successful market entry requires access at all the airports on the new operator's network and, to the extent there are constraints at one airport, these form a barrier to entry for the entire network.

6.20 However, at Wellington International Airport, WIAL does not consider there are barriers.

6.21 WIAL is aware that one submission made to the Commission suggested that, at peak hours, the domestic aerobridge gates at Wellington International Airport are sometimes fully occupied. However, the Commission should note that:

- (a) The terminal was specifically designed so that international gates that are not occupied at domestic peak hours can be brought into service;
- (b) The Stand Arrangements can be re-negotiated to accommodate the new entrant, or expansion by either of the Applicants.

6.22 WIAL considers that the Commission should give primary weight to WIAL's views on this matter.

Question 12

The Commission seeks comment on availability of travel distribution services required for entry to the main trunk market and particularly seeks comment on whether access to these services would constitute a barrier to entry to the market.

6.23 WIAL has no comment.

Question 13

The Commission seeks comment on whether feeder traffic is required for entry to the main trunk market and particularly seeks comment on whether access to these services would constitute a barrier to entry to the market.

6.24 WIAL has no comment.

Question 14

The Commission seeks comment on whether access to a CRS or GDS is required for entry to the main trunk market and particularly seeks comment on whether access to CRS or GDS would constitute a barrier to entry to the market

6.25 WIAL has no comment.

Question 15

The Commission seeks comment on the availability of catering services required for entry to the main trunk market and particularly seeks comment on whether access to these facilities would constitute a barrier to entry to the market.

6.26 WIAL observes that a new entrant is unlikely to require access to substantial catering facilities for its domestic operations, and considers it unlikely that the availability of catering services would constitute a substantial barrier.

Question 16

The Commission seeks comment on whether loyalty schemes, either the presence of existing incumbent schemes, or a requirement to develop one, would constitute a barrier to entry to the main trunk market.

6.27 WIAL's 2000 survey of the airport users showed the following proportions for purpose of travel.

Purpose of Travel	Total International and Domestic		Domestic Only
	Weekday	Weekend	All days
Business	60%	50%	58%
Leisure	32%	37%	40%
Both	6%	10%	N/A ⁽¹⁾
Other	2%	3%	2%
TOTAL	100%	100%	100%

1: The percentage figure for the “both” category is incorporated in the separate business and leisure categories above.

- 6.28 The survey also showed that of the people travelling, for whatever purpose, 64% of travellers held professional or executive management positions.
- 6.29 In WIAL’s experience, business travellers are also highly likely to belong to some form of loyalty scheme.
- 6.30 This suggests that, while price is a significant consideration, it is likely that a high percentage of all travellers, irrespective of purpose of travel, do consider matters such as Airpoints/Loyalty schemes when making a choice of airline to fly with.
- 6.31 To that extent, it is probable that the existing loyalty schemes do represent a barrier to entry.

Question 17

The Commission seeks comment on whether the need to either have a recognised brand, or the requirement to develop a brand would constitute a barrier to entry to the main trunk market.

- 6.32 WIAL accepts the view that to operate successfully a new entrant needs to develop a brand.
- 6.33 In the case of Virgin Blue, however, it is reasonable to assume that the Virgin brand is well established in the public domain and accordingly, in reality, Virgin Blue would not face such a barrier.

Question 18

The Commission seeks comment on whether the size of the main trunk market would constitute a barrier to entry to the market

6.34 In WIAL's view there is room for at least two substantial airlines in this market where there is appropriate commitment from those airlines to the market segments they are targeting.

Question 19 and Question 20 (identical questions)

The Commission seeks comment on whether access to pilots or aircraft would constitute a barrier to entry to the market

6.35 WIAL agrees with the Commission's analysis in paragraphs 417 to 419 of the Draft Determination.

Question 21

The Commission seeks comment on whether Virgin Blue is likely to enter the main trunk market under both the factual or counterfactual scenarios.

- 6.36 As stated in paragraphs 4.30 to 4.36 of WIAL's initial submission, the entry of a VBA (whether Virgin Blue or another value airline), will depend on such a VBA being able to capture a satisfactory market niche.
- 6.37 WIAL continues to hold the view that the presence of a VBA entry does not guarantee effective competition. The air travel market is segmented. Travellers are influenced in their decisions by price, frequency, connections, marketing, and extras such as loyalty schemes. Different classes of travellers are more sensitive to one influence than another.
- 6.38 When Air New Zealand operated its VBA service (Freedom Air) on the New Zealand trunk, total domestic passenger numbers did not change markedly from trend and Freedom Air did not seem to reduce passenger demand for Air New Zealand and Qantas, despite there being little apparent price response from either Air New Zealand or Qantas on their trunk services. However, this market outcome may have reflected the relatively short time that Freedom operated, its focus on "off peak" times, and its lack of marketing.
- 6.39 On the main trunk Freedom Air was not able to appeal to a wide range of travellers, rather, only to those for whom price was the over-riding consideration.
- 6.40 There have been a number of Australasian VBA's that have failed (e.g. Impulse, Kiwi). While Air New Zealand Express is apparently initially successful, it is still a full network operation rather than a point-to-point based operation typical of VBA entrants.

Question 21 (numbering replicated)

The Commission seeks comment on whether Origin Pacific would be likely to expand in the main trunk market under both the factual or counterfactual scenarios. Alternatively, the Commission seeks comment on whether Origin Pacific would be likely to retrench in the event that the proposed Alliance proceeded

- 6.41 WIAL considers it unlikely that Origin Pacific would expand in a significant manner into the main trunk market in either the factual or counterfactual.
- 6.42 The Origin Pacific submission outlined its prudent incremental strategy that to date has been the basis of its strategic success. WIAL sees no reason for this to change.
- 6.43 In paragraph 5.11 of WIAL's initial submission, it noted that it considered the competitive influence of Origin Pacific on the main trunk markets to be overstated by the Applicants. given Origin Pacific's current market strength and reliance solely on turbo-props.
- 6.44 Origin Pacific is an efficient niche player operating turbo-prop aircraft. It is a big step to move from that to competing with jets.

Question 23

The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the main trunk market when compared with the counterfactual.

- 6.45 WIAL agrees with the Commission that the proposed Alliance would result in a substantial lessening of competition when compared to the Counterfactual.

Question 24

The Commission seeks comment on the barriers to entry to the provincial market.

- 6.46 WIAL has no comment.

Question 25

The Commission seeks comment on whether Virgin Blue is likely to enter the provincial market under either the factual or counterfactual scenarios

- 6.47 WIAL considers it unlikely that Virgin Blue, or any other discount operator, would enter the provincial market.

Question 26

The Commission seeks comment on whether Origin Pacific would be likely to expand or retrench in the provincial market under either the factual or counterfactual scenarios.

6.48 WIAL considers it unlikely that the Factual scenario represents an opportunity for Origin Pacific, particularly in light of the arrangements it currently has with Qantas. Such arrangements could be threatened if Origin Pacific attempted to expand in the provincial market or by the presence of the Alliance itself.

6.49 Given that the Commission's Counterfactual represents essentially a status quo scenario, WIAL considers that Origin Pacific may view this Counterfactual as either neutral or an opportunity to grow their business.

Question 27

The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the Provincial market when compared with the counterfactual

6.50 WIAL agrees with the Commission's conclusion in paragraph 461.

Question 28

The Commission seeks comment on the barriers to entry to the Tasman market

6.51 WIAL agrees with the Commission's analysis in paragraphs 473 to 494 that there are barriers to entry that, for the most part, mirror those on the trunk market except to the extent that there is an additional competitive threat posed to a new operator by Freedom Air. WIAL's comments in paragraphs 14 to 17 on the barriers to entry in respect of the main trunk are equally applicable to the trans-Tasman market.

6.52 An added barrier is the political element of international air services. The sudden and somewhat surprising decision by the Australian Government to allow Emirates trans-Tasman operations, after long-standing opposition from Qantas was withdrawn, illustrates that some barriers are ill-defined but very real.

6.53 The ability of the Applicants collectively to influence the direction of public policy towards international services over time should not be underestimated.

6.54 With the exception of routes out of Auckland, the Applicants have, in reality, 100% of the trans-Tasman market. Any competition in Auckland from Singapore Airlines, Thai Airways International etc arises from those carriers either having idle capacity at Auckland and/or

as a consequence of their overall network operations. Neither of those circumstances are likely to arise for the rest of New Zealand and certainly not for the Wellington region.

Question 29

The Commission seeks comment on whether Virgin Blue is likely to enter the Tasman market under both the factual or counterfactual scenarios

6.55 WIAL cannot comment on the likelihood or not of a decision by Virgin Blue or any particular airline, such decisions would be made in the context of a wider corporate strategy that cannot be discerned from the “outside”. Virgin Blue have in fact made a number of contradictory statements on this prospect.

6.56 Under the Factual, the Applicants propose to reduce frequency of services from Wellington by 30%, but provide more or less the same capacity by using larger aircraft. The Applicants would clearly be flying at “preferred times”. Because of their dominance of the Tasman market, the Applicants would also have the ability to mount a competitive response to a new VBA. WIAL assumes any VBA would see this as a risk of market entry.

Question 30

The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the Tasman market when compared with the counterfactual

6.57 WIAL supports the Commission’s views stated in paragraph 503.

Questions 31 to 34 (relating to the NZ-Asia, NZ-US, NZ-Pacific Islands and International markets)

6.58 WIAL has no comment.

Question 35

The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the domestic air freight market when compared with the counterfactual.

6.59 WIAL supports the Commission’s conclusion.

Question 36

The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the Tasman belly hold market when compared with the counterfactual.

6.60 There is currently limited freight capacity from Wellington airport. Accordingly, it is difficult to anticipate how the Alliance would impact on this market.

Questions 37

The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the international belly hold freight market when compared with the counterfactual.

6.61 WIAL has no comment.

Question 38

The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the national wholesale travel distribution services market when compared with the counterfactual.

6.62 WIAL has no comment.

Question 39

The Commission seeks comment on its preliminary view that the proposed Alliance would result in fixing controlling or maintaining prices and is therefore deemed to substantially lessen competition

6.63 WIAL agrees that many aspects of the proposed arrangement have the prohibited purpose, the effect or likely effect of fixing, controlling or maintaining prices.

Question 40

The Commission seeks further commentary and analysis on the appropriateness of the assumptions used by NECG in its model of passenger air service markets

6.64 As discussed in paragraph 2.5 of this submission, WIAL has not engaged experts to assess the economic work carried out by NECG. Accordingly, WIAL is unable to answer this question.

Question 41

The Commission seeks further submissions on the implications of a possible switch by Air New Zealand to the oneworld Alliance

- 6.65 WIAL currently has limited information on Star/Oneworld passengers using Wellington International Airport. WIAL is, however, of the preliminary view that both alliances are important for passengers in determining which airline to fly.
- 6.66 For instance, Thai Airways has offered packages from Wellington which have relied on Wellington passengers flying Air New Zealand (both Thai and Air New Zealand are members of the Star Alliance) to Auckland for the Thai connection. The link to Thai would be lost if the Alliance proceeds.
- 6.67 WIAL remains critical of NECG's analysis for not factoring in one-off costs, whatever they are, and the likely erosion of passenger numbers arising from such a change.

Questions 42 – 50 (concerning assumptions and outcomes of Commission and NECG modelling)

- 6.68 As noted in section 2, WIAL has not engaged experts to enable it to comment on questions 42 to 50.

Question 51

The Commission seeks comments on its estimation of cost savings?

- 6.69 WIAL agrees with the Commission's view that the cost savings are overstated because the Applicant's Counterfactual is overstated.

Question 52

How would the marginal tourist's expenditure differ from that of the average tourist?

- 6.70 WIAL notes the view of Tourism New Zealand that mono-destination tourists stay longer and spend more. To that extent, the Commission is probably correct to differentiate the marginal tourist's expenditure from the average tourist.
- 6.71 However, WIAL has no information that could assist the Commission in establishing likely expenditure.

Question 53

The Commission seeks comments on its assumption that Qantas Holidays would sell packages that include Air New Zealand airfares if doing so did not deprive Qantas of additional passengers?

6.72 In paragraph 6.37 of WIAL's initial submission, WIAL questioned the Applicants' apparent discounting of incentives on Qantas Holidays under any of the Counterfactual Scenarios to sell New Zealand packages. WIAL therefore supports the conclusion reached by the Commission and stated in paragraph 755.

Question 54

How effective are national tourism organisations' promotions? Can airlines promote national tourism as effectively?

6.73 WIAL considers Air New Zealand to be an important element in the marketing of New Zealand as a destination in co-operation with other national agencies.

6.74 WIAL's concern has always been that the proposed Alliance would weaken a focus on New Zealand and potentially erode some of the co-operation between the airline and the national agency.

Question 55

The Commission seeks comments on its estimation of tourism benefits?

6.75 WIAL has no comment on this matter.

Question 56

How should aircraft capacity and tourism infrastructure constraints and risk affect the analysis?

New Fares and Products (paragraphs 768-770).

6.76 In light of the probable withdrawal from the Star Alliance WIAL considers any comments from the Applicants about "enhanced connectivity" to be questionable.

6.77 In WIAL's opinion, the effect will be higher fares and reduced connectivity, and that this in turn will have negative effects on tourism. Accordingly, WIAL agrees with the Commission's views.

Loss of Star Alliance (paragraphs 771 - 777)

- 6.78 WIAL concurs with the view that the most probable outcome of the Alliance would be for Air New Zealand to leave the Star Alliance. In WIAL's initial submission, WIAL criticised NECG for excluding analysis of the effect.
- 6.79 WIAL has not undertaken the type of economic analysis required to determine how exiting the Star Alliance would flow on to visitor numbers but assumes that there would be a significant reduction that needs to be reflected in the modelling.

Other matters

- 6.80 WIAL has not undertaken the type of economic evaluation required to prove/disprove assumptions over welfare gains and whether there has been double counting so can not make comment on that element.

Question 57

The Commission seeks comments on its estimation of scheduling benefits?

- 6.81 In the case of Wellington, the Applicants are proposing to cut the number of services by over 30%, which is unlikely to mean improved frequency.
- 6.82 Further, given that Wellington is constrained by a curfew, and that airlines will want to get four sectors per day from their aircraft, WIAL considers it most unlikely that the airline will 'schedule trans-Tasman services evenly through the day'.
- 6.83 WIAL has no comment on the waiting time values used.
- 6.84 WIAL concurs with the Commission's conclusion in paragraph 809 that the scheduling benefits are overstated.

Question 58

The Commission seeks comments on its estimation of direct flight benefits?

- 6.85 WIAL considers that there would be benefits from new direct flights but is not confident that the direct flights suggested by the Applicant would eventuate. For this reason, WIAL believes that the benefits, if any, that may occur, ought to be significantly discounted.
- 6.86 Finally WIAL, agrees with the observation expressed in paragraph 812 that, if these new routes are profitable, why has there been no attempt to provide them to date?

Question 59

The Commission seeks comments on its estimation of engineering and maintenance Benefits?

6.87 WIAL commented in its initial submission that the Applicants appeared to be saying that, absent the transaction, Qantas would not continue to source engineering services from Air New Zealand. Qantas would then apparently source services from other third parties with whom it has no arrangement and whose prices/quantity are at best “similar”.

6.88 WIAL considered this to be an extreme position. Although it is not possible to totally discount the risk that Qantas might carry through on its threat, it would seem to contemplate Qantas acting in a manner that will not yield any safety or quality benefits, nor create shareholder wealth.

6.89 WIAL has not undertaken an economic evaluation of the welfare benefits, but simply notes that the extreme behaviour suggested under the Applicant's Counterfactual makes little sense.

Question 60

The Commission seeks comments on its estimation of freight benefits?

6.90 WIAL notes that the Commission has discounted the possibility of freight benefits from the Alliance. Applied generally across New Zealand, this may be the case. However, WIAL considers that the Wellington region is poorly served in terms of airfreight capacity, in particular since the withdrawal of B767 aircraft 4-5 years ago. Air New Zealand's introduction of A320 aircraft configured for containers was seen as a positive step to remedy this deficiency.

6.91 The proposed schedules in the Application show the return of B767 aircraft, which, for the Wellington region, should be viewed as a benefit. However the extent of that benefit, over and above the benefit arising from the introduction of the A320's, may be limited.

Questions 61 - 65

The Commission seeks comments on its assessment of other benefits?

6.92 WIAL has no comment on questions 61 to 64.

Question 65

The Commission seeks comment on the likely effectiveness of the conditions suggested by the Applicants

6.93 We refer to section 5 of this Submission.

Question 66

The Commission seeks comments on any other conditions that might be appropriate

6.94 We refer to section 5 of this Submission.

7. CONCLUSION

- 7.1 WIAL strongly recommends that the Commission confirm its Draft Determination and decline the Applications.