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25 AUGUST 2003

PRESENTATION BY BON VOYAGE

CHAIR: Good morning ladies and gentlemen, welcome to the sixth and final day of the Commerce Commission's Conference being held in relation to the application by Air New Zealand and Qantas Airways who are seeking authorisation to enter into a Strategic Alliance Agreement and related agreements and the application by Qantas Airways seeking authorisation to subscribe for up to 22.5% of the voting equity in Air New Zealand.

First today we have Bon Voyage and I believe it's Mr Murphy, and I will ask you just simply for the record to state your name again and your position with the company, and ask you to present when you're ready. Thank you.

MR MURPHY: Thank you. Good morning Commissioners, ladies and gentlemen. My name is Gerard Murphy from Bon Voyage Cruises & Travel and e-travel.co.nz. I sincerely value the opportunity to address the conference today. Thank you.

I am here because I firmly believe that the Conference needs some balance to the huge weight of evidence produced by the Applicants and the economic theory espoused and argued over the past week.

While I very much respect the calibre and quality of the experts appearing for both the Applicants and opponents, experience has taught me to maintain a healthy disrespect of academic and economic theory versus what happens in practice.

Experience has also taught me not to believe everything I'm told. The Applicants are past masters of spin, and

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1 I believe that without the scrutiny such as provided by the
2 Commerce Commission and ACCC processes, the alliance could
3 easily be sold as a great idea, which of course it is if you
4 are an airline owner or a manager on incentives.

5 The applications could be believable if one did not
6 adopt a more skeptical attitude. Indeed, certain parts of
7 theory and evidence produced during this process remind me
8 very much of Hans Christian Anderson's fairytale, the
9 Emperor's New Clothes.

10 Perhaps in presenting today I am acting the part of the
11 small child, stating the obvious but in doing so exposing
12 these applications for what they are; a blatant attempt to
13 monopolise and manipulate the New Zealand travel market.

14 The Applicants in their cross-submission dated 18 July
15 said:

16 "Third parties have provided very little in the way of
17 supporting evidence for the statements and assertions made
18 in their submissions. The Applicants believe the Commission
19 must prefer the Applicants' submissions, which are backed by
20 substantial and detailed evidence, to the submissions of
21 third parties that are largely unsupported by any
22 objectively verifiable evidence."

23 This cross-submission concluded with point 65:

24 "The Applicants note that none of these third party
25 submitters have demonstrated any special skill or knowledge
26 relative to the statements and assertions that they make."

27 Unlike many of their hired guns, I have not included a
28 verbose CV in my submissions, but for the benefit of those
29 assembled here today perhaps I should quickly run through my
30 background.

31 My name is Gerard Murphy, I am the owner of a travel

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1 agency in Pakuranga, Auckland; Bon Voyage Cruises & Travel.
2 We have a substantial website and growing on-line business
3 through e-travel.co.nz.

4 I have spent 7 years in tertiary study part time and
5 hold an NZIM Management Diploma, a graduate diploma of
6 business with a marketing major and a Masters of Business
7 Administration from the University of Auckland. In
8 addition, I hold both Preliminary and Advanced IATA/UFTAA
9 diplomas. I believe, therefore, that I have an academic and
10 technical background to make a valuable input to this
11 process.

12 My travel experience includes wholesale and retail
13 roles, from consultant to branch management and ownership,
14 and senior marketing roles for two substantial travel agency
15 chains.

16 Most importantly, I have had over 23 years experience in
17 direct and close contact with both travellers and the
18 industry, suppliers and airlines, including the two
19 Applicants. I believe this also gives me the professional
20 industry experience to make a valuable input.

21 Assertions and statements contained in my two
22 submissions, the cross-submission, and today's presentation
23 are based on these 23 years of experience, and current
24 coalface participation in the travel market, that the
25 proposed alliance would change substantially, not just for
26 me as a participant, but also for the consumers; the
27 travelling public.

28 Incidentally, I am probably the only person appearing
29 before the Commission who has actually sold an air ticket to
30 a member of the public in the past month.

31 The Applicants also criticised the opponents for

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1 repetition. Having read countless pages of submissions from
2 Applicants and their experts, I need to suggest that this
3 criticism is certainly one of the pot calling the kettle
4 black.

5 Today I wish to question the quality and accuracy of
6 submissions provided by the Applicants' experts. It seems
7 the Applicants' view is that if they can get enough high
8 powered experts espousing theory, facts and figures, that we
9 will all blindly believe them just like in the fairytale.

10 The July 28 report of Dr Willig and Margaret Geurin-
11 Calvert is an example. Much of its 52 pages is repeated
12 evidence from other Applicant submissions and their own
13 earlier submission. Further, the 12 pages in this report
14 devoted to savings from on-line fares are completely
15 misleading. Frankly, I was shocked at the faulty analysis.

16 The authors attempt to suggest that the alliance will
17 produce consumer benefits of between \$42 million and
18 \$66 million. This is based on consumers being able to buy
19 one on-line ticket, and that's not on the internet -- on-
20 line means one carrier -- fare ticket with Air New Zealand
21 and Qantas between a large number of city pairs beyond the
22 main Trans-Tasman gateways in New Zealand or Australia,
23 rather than buying two or more tickets to get to more
24 distant points.

25 The authors conveniently overlooked the fact that these
26 on-line inter-line fares already exist between Air New
27 Zealand and Qantas. They cite 20 routing examples as shown
28 on the screen to demonstrate savings of an average of 21.1%.

29 What they fail to tell us is that Air New Zealand
30 currently offers inter-line through fares at these levels,
31 on one ticket, between at least 414 city pairs combining Air

1 New Zealand and Qantas flights. Therefore, these savings of
2 \$23 million to New Zealanders are simply nonexistent. I had
3 to get a dig in.

4 Had the authors consulted a travel agent instead of
5 doing their own research over the internet, they would have
6 been advised correctly.

7 Even with Air New Zealand's lower Express Class fares
8 released the week before last, inter-line through fares are
9 available combining the two carriers. Sure you can't get
10 one ticket from Westport-Wagga Wagga or Napier-Narrabri, but
11 there are over 400 other combinations as shown on the
12 screen. The number of travellers wanting other city pairs
13 beyond these combinations would be below the margin of error
14 in any statistical analysis.

15 The Applicants may argue that if the alliance is not
16 approved, that Air New Zealand and Qantas would refuse to
17 co-operate on such fares. This could be true but I suggest
18 is unlikely. Both airlines negotiate with countless other
19 airlines worldwide, including competitors, to create inter-
20 line fares in all continents.

21 Should they in fact refuse to co-operate, which is a
22 possibility, in this way, Qantas themselves would still
23 offer 57 city pairs between New Zealand and Australia and
24 assuming that under the counterfactual Qantas would in fact
25 strengthen its relationship with Origin Pacific, they could
26 together offer 228 city pairs.

27 Air New Zealand on their own would offer 115 city pairs,
28 and Virgin Blue could offer between 57 and 95, depending on
29 whether they have 3, 4 or 5 cities in New Zealand. It needs
30 to be remembered that with VBA entry a combination of two
31 cheaper tickets may in fact be considerably cheaper than one

1 ticket on-line or inter-line fares anyway.

2 To summarise, as there will be a huge number of city
3 pair options for one ticket on-line or inter-line fares
4 under the factual and the counterfactual, the claimed
5 savings are simply nonexistent.

6 Fifth Freedom competition: The analysis of Fifth Freedom
7 competition and Virgin Blue's likely Trans-Tasman entry
8 glosses over some key issues that I have raised before.

9 Fifth Freedom competition is confined to the Auckland
10 market. No-one south of the Bombay Hills benefits directly
11 and there is no real evidence that any Fifth Freedom carrier
12 will fly south.

13 The Applicants repeat their claim that a number of Fifth
14 Freedom carriers could commence Trans-Tasman flights just
15 because they, A, have the rights or B, they have aircraft
16 idle in Australia.

17 To suggest that United Airlines, which terminated
18 services and laid off all its New Zealand staff this year,
19 or American Airlines who have entered and withdrawn from
20 New Zealand twice already, or even BA who are currently
21 suggesting a possible withdrawal from Australia, would
22 recommence Trans-Tasman operations is a bizarre notion.

23 Theory would suggest that travellers will be attracted
24 by cheaper fares on Fifth Freedom carriers. In practice we
25 find that flight schedules are more important than you may
26 expect. Many leisure travellers are put off by early
27 morning departures from Australia and revert to Air New
28 Zealand or Qantas paying more in most cases.

29 Business travellers are attracted by a Fifth Freedom
30 carriers' fares, currently offering savings of close to \$900
31 in Economy Class for a midweek business trip. But they are

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1 put off by having to purchase additional accommodation to
2 make their itinerary work and in most cases losing a day due
3 to schedules, even though the saving could be \$300 to \$500.
4 I had an example of that just last Thursday.

5 Virgin Blue: The Applicants suggest that Virgin Blue's
6 recent Boeing order means that Virgin will be able to
7 allocate resources here at the drop of a hat. Virgin's
8 early publicity suggested that six 737s would be allocated
9 to offshore routes from Australia including Fiji, Vanuatu
10 and New Zealand in the short-term.

11 Even if Virgin did allocate all six aircraft to
12 New Zealand, it would not be enough to provide credible
13 competition to the alliance Trans-Tasman, particularly if
14 they are expected to run up and down the main trunk with the
15 same fleet.

16 David Huttner's suggestion last week that a market share
17 closer to 30% was required to provide truly effective
18 competition seems to have been confirmed by Geoff Dixon's
19 announcement that 30% was the line in the sand that Qantas
20 would vigorously defend.

21 In the short to medium term an alliance would still be
22 able to dominate, particularly south of the Bombay Hills;
23 the two-thirds of New Zealand seemingly ignored by the
24 Applicants during this process. I have added a possible
25 Virgin Blue schedule using five 737 aircraft to table 3
26 taken from Dr Willig's report. The resulting table shows
27 that apart from Auckland to Brisbane and Melbourne, Qantas
28 and Air New Zealand would still have significant shares or
29 dominate most routes, and they could correct any loss of
30 shares simply by adding slightly to their schedules.

31 There have been a number of comments that Virgin would

1 look at operating to or from any centre with a population of
2 50,000 or more. I suggest this figure is off the mark.

3 I have looked at Southwest, JetBlue, Skywest and indeed
4 Virgin Blue and found that apart from a handful of ports,
5 most of their destinations have populations closer to
6 100,000, often many more. I would suggest that the minimum
7 economic population base for a 737 is much more like
8 100,000.

9 A tourist destination with a lower population can also
10 be successful and explains Virgin Blue's services to Broome
11 and Whitsundays destinations. Most of Virgin Blue's routes
12 have a city of a population of a million or more, at least
13 at one end of the sector. So, as recognised by Dr Willig, a
14 50,000 population is only part of the equation.

15 Given population catchments, distance from existing VBA
16 ports and current airport infrastructure, I would suggest
17 only Napier, Rotorua and Nelson/Blenheim area would be
18 considered as new VBA ports. Access to these ports would
19 depend on council and/or investor initiative to upgrade or
20 extend runways and airport facilities.

21 The facts are that if Virgin Blue does decide to operate
22 domestically in New Zealand, it is currently limited by 737
23 capable airports, meaning it could only fly the main trunk
24 including Dunedin plus Queenstown, Hamilton and Palmerston
25 North until new airport facilities are available. This
26 means that Virgin Blue will not provide true competition to
27 Air New Zealand's very effective domestic network, at least
28 in the short-term.

29 Recognising this, the Applicants' Ivy League experts
30 have conveniently paired off Virgin Blue with Qantas'
31 discarded friend, Origin Pacific. They assume the two could

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1 cobble together a worthwhile working relationship and
2 provide some competition to their monopoly. This is an
3 arranged marriage without the bride and groom even having
4 the opportunity to court.

5 Air New Zealand has a dominant market share of the
6 New Zealand domestic market because of its network combining
7 main trunk jet services and its comprehensive provincial
8 route structure.

9 Currently, Qantas loses substantial business as would
10 Virgin or Origin Pacific individually or together as they
11 cannot provide the same seamless service and network
12 connections. Connecting and open jaw passengers are
13 currently constantly forced back to Air New Zealand.

14 Regardless of Air New Zealand's move to switch customers
15 to on-line/internet reservations, approximately 60% of all
16 domestic travel is still transacted by travel agents.
17 Unless Virgin and Origin can truly work in partnership co-
18 ordinating schedules and sharing common reservation systems
19 accessible to these travel agents, there will be no true
20 competition on domestic New Zealand routes.

21 Fare increases and undertakings: The probability of the
22 merged Applicants using their market position to manipulate
23 the market and raise prices has been raised in a number of
24 submissions. The Applicants, through their experts, have
25 produced evidence in an attempt to dispel these beliefs.

26 The Applicants have offered several undertakings,
27 including an offer to maintain airfares at current levels.
28 In an earlier submission we demonstrated how an airline
29 could maintain and advertised low fare, yet manipulate its
30 seat stock using sophisticated yield management systems to
31 achieve real fare increases.

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1 The introduction of Trans-Tasman Express Class last week
2 gives us some indication of Air New Zealand's real
3 intentions with fare structures. The airline's own
4 literature states that they would offer 25% on average of
5 its seats at the lower level smart-saver fares.

6 Of course the flipside of this statement is that 75% of
7 its seats will be sold at higher levels, flexi-saver fares
8 or flexi fares. These fares Trans-Tasman start at \$589. If
9 booked by phone or person, \$50 more, making a total of \$639,
10 which is hardly any saving on the pre-Express fare levels.

11 The Express fare introduction gives us a very real
12 example of the airline's ability to use its position and
13 more covert methods to increase fares in real terms.
14 Currently larger corporate clients in New Zealand will
15 generally have a contract with Air New Zealand and/or
16 Qantas, offering Trans-Tasman fares with relaxed conditions;
17 for example, no Saturday minimum stay, refund ability, and
18 ticket change flexibility. These fares range anywhere
19 between \$600 to \$800 depending on client company size.

20 With the introduction of Express Class, Air New Zealand
21 has announced that these contracts will not be renewed, as
22 it did when it introduced Express Class domestically. Under
23 the new fare structure a fare offering similar flexibility
24 will be starting at \$1,078 an increase between 33% and 76%,
25 which I'm sure you'll agree is huge. While we accept that
26 some companies could take the cheapest Express fares, our
27 experience with the same fare structure on the domestic
28 routes is that clients are forced to buy the flexible fare
29 levels, as the risks of the lower use it or lose it type
30 fares are just too great.

31 This is a demonstration of the fare increase mechanisms

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1 available to the airlines. If the application is approved
2 I'm sure these fare increases to major corporates will
3 proceed. However, under the counterfactual Qantas may have
4 other ideas and compete for this business on price, forcing
5 Air New Zealand to back down. Unfortunately no other
6 carrier has the route network or frequency to compete for
7 this high volume corporate business.

8 **CHAIR:** Can I just ask you a question as a way of clarification.
9 Was that what you had in mind when you said "covert means"
10 in your statement earlier, "That there would be more covert
11 methods to increase fares in real terms"?

12 **MR MURPHY:** Yes, that and the ability to change the number of
13 seats available on any given flight to any fare.

14 Loyalty schemes: We agree with the Commerce Commission
15 that the lack of loyalty schemes could be an issue for a new
16 entrant.

17 We note in the Willig-Geurin-Calvert report that the
18 Applicants claim that 21 and 29% of their Trans-Tasman
19 travellers were frequent flyer schemes members. These
20 figures are surprisingly low and are vastly different to our
21 experience. A quick poll of our current bookings shows that
22 83% of international long haul passengers and 64% of Trans-
23 Tasman passengers will be affiliated frequent flyer members
24 of the airline they are flying.

25 The status level of the members is irrelevant. The
26 Applicants and credit card companies have encouraged
27 millions of people to join frequent flyer schemes, and each
28 of these traveller members believes he or she will benefit.
29 Indeed, a member does not have to have an elevated status,
30 i.e. Actually fly frequently, as suggested by Dr Willig in
31 the report. The return trip to London plus one Trans-Tasman

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1 ticket will give most members a further Trans-Tasman trip
2 free, but still not offer them an elevated status.

3 While a new airline such as Virgin Blue can enter the
4 market without a scheme, if fares are competitive a frequent
5 flyer will always choose his usual airline. As many will be
6 aware, consumer behaviour is not always rational. On many
7 occasions we have experienced people choosing their airline
8 to earn points, paying a surcharge to do so. Often the
9 additional fare costs far outweighs the benefit of the
10 earned points.

11 Qantas and Air New Zealand have over 3 million members
12 in their schemes. This database can be used as a weapon of
13 mass reservation in the battle of the Tasman; that is
14 distinct competitive advantage to the alliance.

15 A number of VBAs do have frequent flyer schemes.
16 Southwest, JetBlue and Westjet. It is rumoured also in
17 Australia that Virgin Blue is also about to release its own
18 frequent flyer scheme, so it seems that these leading VBAs
19 see the need for loyalty schemes.

20 It is interesting that our Applicants want us to believe
21 it is unimportant. I am sure they would squeal if a
22 condition of the alliance approval was that frequent flyer
23 benefits could not be offered on Trans-Tasman or domestic
24 markets.

25 Other markets beyond New Zealand and Australia: I have
26 been seriously concerned through this whole process how
27 little focus has been given to other markets that will be
28 seriously affected by this alliance until last week, it
29 seems.

30 In our earlier submissions we identified that the North
31 American market will be monopolised and a number of other

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1 markets will come under the influence of the alliance and
2 its partner or codeshare carriers. These markets include
3 Japan, Hong Kong, Fiji, Samoa, New Caledonia and Norfolk.
4 These routes account for close to 15% of all out-bound
5 departures and 17.3% of all business travel departures from
6 New Zealand, and that's not including travel to Europe via
7 North America.

8 The North American routes alone are even more vital to
9 New Zealand's tourism interests, producing 12% of all
10 visitor arrivals, and these are the cream of all tourists;
11 again, this is not accounting for travel from Europe via
12 North America.

13 The North American routes alone are clearly extremely
14 important, both out-bound and in-bound, and it is equally
15 clear that the alliance will have an absolute monopoly on
16 these routes. For this reason alone, I believe the
17 applications should be rejected.

18 Please also consider the importance of Japan and Hong
19 Kong, usually. The relationship that Air New Zealand and
20 Qantas have with Japan Airlines and Qantas has with Cathay
21 Pacific means that coupled with the other routes they will
22 have a virtual control of over more than 35% of our in-bound
23 tourist arrivals, on top of the huge influence they will
24 exert over the tourist market in Australia which accounts
25 for nearly 50% of our arrivals alone.

26 Having one airline group with control or serious
27 influence over such a huge proportion of our in-bound market
28 is simply unacceptable.

29 Finally I would like to look at the One World and Star
30 Alliance relationships. The power of these relationships
31 cannot be underestimated and I believe it is of vital

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1 importance to New Zealand to have strong members of each
2 flying into New Zealand.

3 With the merger it is highly likely that Air New Zealand
4 will be forced to leave the Star Alliance. This means that
5 there will be no Star Alliance carrier operating between
6 here and North America, Japan or Hong Kong. This will
7 seriously compromise access to New Zealand for millions of
8 potential tourists on round-the-world type tickets.

9 United Airlines and Lufthansa alone have close to
10 50 million frequent flyer members who will likely no longer
11 consider New Zealand in their holiday decisions. Anecdotal
12 evidence said that United Airlines load factors were
13 considerably enhanced by their frequent flyers using points.
14 These tourists simply won't come if Air New Zealand is
15 unavailable to them.

16 In addition, many thousands of New Zealand travellers
17 who currently enjoy the benefits of Star Alliance fares and
18 Star Alliance loyalty programmes will simply have these
19 benefits taken from them.

20 Conclusion: I believe that the benefits of the Air New
21 Zealand/Qantas alliance have been seriously overstated and
22 the downside seriously understated by the Applicants.

23 Air New Zealand is not in dire straits as will be proven
24 this week. There will not be a war of attrition, it is in
25 no-one's interest. Indeed, Dr Willig states in point 60 of
26 the 28 July report that:

27 "If an incumbent does not believe that it can force an
28 entrant out of the market, it will not have the incentive to
29 engage in predatory behaviour."

30 I think this statement applies as much to competitors as
31 new entrants.

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1 I hope that the Commission has seen comprehensive
2 evidence that Air New Zealand has actually seriously
3 examined other strategic options other than the Qantas
4 merger. I doubt that any alternative has been seriously
5 pursued. Indeed, Mr Norris' opening remarks implied that
6 management had considered only two -- had considered two but
7 only briefly and it seems only because the Board required
8 them to.

9 It seems that they have their hearts set on just one
10 outcome. One hopes, however, that somewhere there is a plan
11 B, as I'm sure Qantas have a plan B and probably a C or D.

12 In the interests of New Zealand, our travellers and
13 visitors, I believe it is vital that we maintain Air New
14 Zealand as an independent entity, competing against Qantas
15 and all commerce. New Zealanders use initiative, innovate
16 and find plan Bs. We go around obstacles, not wait for them
17 to crush us.

18 To say that Air New Zealand will fail without this
19 alliance is simply one horrific ending to this story. But
20 as we all know, fairytales usually have a happy ending.

21 Has Air New Zealand met the beautiful princess? Is her
22 name Qantas? I think not. She may be a witch in disguise.
23 Likely the wise people at the Commission can save him and he
24 can go searching off in far lands for the beautiful
25 princess. Could this princess too come from the land of
26 alliances? Could her name be Star? Will they marry and
27 everybody live happily every after? The future was left in
28 the hands of the wise Commissioners and all the people of
29 the land wished them well. Thank you.

30 **CHAIR:** Thank you for that, Mr Murphy. I don't know quite how
31 to respond to that, but it was a nice way to start the

1 morning, however.

2 Can I just go back to your comments about your own
3 database and what it tells you about the number of people
4 who are in these programmes.

5 Isn't it possible that your database may say that, but
6 your database doesn't actually reflect what the average is
7 across all of Air New Zealand and Qantas' customers?

8 **MR MURPHY:** Yes, I've taken that into consideration, but I've
9 already considered that a lot of Air New Zealand's and
10 Qantas' direct business is their large corporate accounts
11 and I would assume that their staff is very active in
12 signing people up to their frequent flyer schemes as well.

13 I accept there could be infrequent travellers who book
14 with Air New Zealand directly that may not have any frequent
15 flyer relationship, but those figures frankly I found too
16 low. It could be a timing issue. I believe they were from
17 a year prior to ending somewhere in the beginning of last
18 year. Since then there's been a huge increase in frequent
19 flyer membership due to credit card companies and other
20 people promoting them.

21 **CHAIR:** The reason I'm pursuing that is this; it does seem to
22 me, whatever the numbers are, we see evidence in many
23 industries like this where you have high fixed cost, that it
24 doesn't actually take necessarily a large number of
25 consumers to be contested in order to put a constraint on a
26 large player.

27 I guess it leaves me wondering, is this perhaps one of
28 those situations where there may be large numbers of
29 customers for some reason that are not contestable directly,
30 but there may still be enough, in order to constrain the
31 market power of, for instance, the Applicants.

1 And so, I'd just like you to comment on that
2 proposition.

3 **MR MURPHY:** I think any traveller, including members of those
4 frequent flyer schemes, is vulnerable to poaching I suppose
5 with lower fares, but those are only one component. The
6 schedule, the fares, everything else has to be reasonably
7 equal. I'd say that Air New Zealand and Qantas with those
8 3 million members and the ability to contact many of them
9 reasonably quickly, is in a considerably stronger position
10 than they'd be if they didn't have those frequent flyer
11 schemes. Indeed I think Air New Zealand was saved in the
12 last, you know, in recent history due to having its
13 airpoints members and that loyalty.

14 **CHAIR:** That leads on to the second question I had really, which
15 is that a business such as what the alliance would be, if
16 this were to be authorised, may have certain advantages in
17 terms of their frequent flyer programme, or a whole range of
18 other things, but we've been told that the key to entry by
19 Virgin Blue is their lower cost structure and that that
20 gives them a phenomenal advantage that the alliance will
21 have trouble meeting, even with the long list of presumably
22 advantages that the alliance might have; and it does seem to
23 me at least a reasonable proposition to make that, yes, the
24 alliance has some advantages, but so does a low cost carrier
25 such as Virgin Blue, and this Commission should not
26 necessarily be concerned simply because one business has
27 certain competitive advantages over another.

28 I'd like your view on whether this low cost structure
29 that Virgin Blue would have isn't sufficient to constrain
30 and provide a counterbalance to the other benefits that the
31 alliance might have over it?

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1 **MR MURPHY:** I can only assume that the Commission has been privy
2 to more information in terms of cost structure, because we
3 simply don't have that information. I think the Express
4 Class fares that were introduced last week would indicate
5 that Air New Zealand's cost structure is not necessarily
6 that far from its competitors now or future competitors.

7 Indeed the industry was very surprised at the level
8 those fares were introduced at. Everyone had been expecting
9 something much lower, and we believe that's really a
10 situation where Air New Zealand has decided to back off from
11 that VBA model slightly by continuing to have meals and
12 snacks, or whatever they are, and drinks.

13 We suspect that Air New Zealand's taken a part way step
14 and that when Virgin comes in they may find that there is
15 the ability to lower their fares even more. I'd suggest
16 that their cost structure is not necessarily that much
17 higher than the opposition.

18 **CHAIR:** I just have one last question then I'll let my
19 colleagues ask questions. If the war of attrition tale was
20 right and somebody was going to go out of business and that
21 somebody was going to be Air New Zealand, would you still
22 maintain your position that the #proposal should not be
23 authorised?

24 **MR MURPHY:** As I think you've stated on -- as I heard at least
25 once on Friday, that that's not the Commission's position to
26 necessarily provide for one competitor over another to be
27 surviving. Personally, I believe that if Air New Zealand
28 can't foot it with the opposition, then there's something
29 seriously wrong. As I stated, New Zealanders are all about
30 innovating, number 8 wire, finding another way of doing
31 things. I don't think there's any reason Air New Zealand

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1 can't be competitive. I think there is -- and I have spoken
2 to a number of reasonably senior people in the industry --
3 very good opportunity for Air New Zealand to be in true
4 partnership with the Star Alliance friends, and remain very
5 strong. I don't really believe that there's any possibility
6 that Air New Zealand would fail.

7 **CHAIR:** But my question was a hypothetical and I believe your
8 answer was, well, if they can't make it, then so be it?

9 **MR MURPHY:** In that case, if Air New Zealand was to fail, I
10 would have to swallow my nationalistic pride somewhat and
11 hope that we could, as a nation, forge a very good
12 relationship with Qantas. I believe if Air New Zealand
13 fails, then it doesn't deserve to be there, and I wouldn't
14 change my view.

15 **CHAIR:** Thank you for that.

16 **MR CURTIN:** I just had one question, if I may, it's all by way
17 of further explanation, if you wouldn't mind.

18 I was interested in your comments on the corporate
19 market where you say that Air New Zealand is proposing to
20 scrap existing arrangements with corporates.

21 My understanding has been that Air New Zealand and
22 Qantas have tended to scrap quite a lot over those corporate
23 accounts and every now and then the corporates put them up
24 for tender and see what happens.

25 It just came as a bit of a surprise to me that someone
26 would voluntarily -- I'm not disputing the facts -- that
27 someone would say, right fine, we'll tear up the
28 arrangements, and I suppose I'm trying to understand why
29 they would do that and I was wondering if you had any more
30 background on that?

31 **MR MURPHY:** Certainly from the domestic experience the

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1 justification was that the corporate traveller could benefit
2 from the much lower fares with the conditions and by buying
3 in advance and planning better they could in fact effect a
4 saving. Prior to the domestic Express Class there were
5 major discounts in the corporate market, and most of those
6 contracts were simply not renewed. I understand there are
7 somewhere in the order of 10 to 20 larger companies who
8 I believe for legal reasons have managed to maintain a fare,
9 but those contracts are due to expire soon. And certainly
10 the indication from colleagues is this they won't be
11 renewed.

12 Indeed, following on from that, I believe that from the
13 applications that Air New Zealand and Qantas -- Air New
14 Zealand would undertake the negotiation of the large
15 corporate contracts for Qantas and Air New Zealand, so I
16 just -- I believe that there's no reason to believe that
17 those contracts will be renewed and in fact the fares will
18 go up.

19 **MR CURTIN:** Okay. Thank you.

20 **MS BATES QC:** You told us that you didn't think, on the
21 provincial routes, that Qantas was able to provide the same
22 seamless service and network connection. Can I ask you to
23 comment on what you think the level of competition is on
24 those provincial routes at the moment?

25 **MR MURPHY:** Well, I was surprised the other day to hear that
26 there could be a market share in the order of 95% to Air New
27 Zealand; I wouldn't have thought it was that high. But in
28 terms of what we sell, and I suppose many other travel
29 agents sell, we don't often sell Origin Pacific on its own,
30 and that's mainly because, for example, if we had someone
31 going Auckland-Christchurch and they wanted to come back

1 into Nelson, then we're on the Air New Zealand computer
2 system; whether or not it's right, the tendency is just then
3 to use the Air New Zealand flights and provide the
4 connection back into Nelson and back up to Auckland, where
5 we could use Origin on those other sectors.

6 **MS BATES QC:** So, is Origin cheaper on those sectors?

7 **MR MURPHY:** Unfortunately, we have to change computer systems,
8 go on to the internet, to find out.

9 **MS BATES QC:** So, it's a practical problem?

10 **MR MURPHY:** So, there is additional work which is counting
11 against them. Which is why I've said in my presentation
12 today that, if Virgin and Origin Pacific were to truly
13 provide competition in New Zealand, they would have to be on
14 one common platform.

15 **MS BATES QC:** The Air New Zealand Express fares, you said you
16 were surprised that they weren't lower. Do you accept that
17 they -- there was a 20% reduction across the board, fare
18 reduction across the board?

19 **MR MURPHY:** On figures that can be printed and produced on a
20 table, yes. In reality, the airline if it wants to can show
21 us as travel agents on our computer screens 7 seats or 77
22 seats; no one's to know. There could only be 7 seats on any
23 given flight that are at the cheapest level.

24 **MS BATES QC:** Yes, I think that's what you've said in your
25 presentation, I was just clarifying that point with you.

26 On the loyalty schemes question, I just make the
27 observation that Virgin in Australia has managed to capture
28 30% of the market without yet having a loyalty scheme, so it
29 seems they're not essential.

30 **MR MURPHY:** They're not the only factor, but in terms of Virgin
31 in Australia, I believe that the biggest single reason for

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1 them getting to that 30% market share was the demise of
2 Ansett, and it wasn't just Virgin that caused that, it was
3 management issues, aircraft fleet issues and there was also
4 another competitor, Impulse.

5 **MS BATES QC:** Yes, but they have managed to consolidate their
6 position.

7 **MR MURPHY:** I would be interested to know how much of that 30%
8 is one-off new leisure travellers as compared to corporate
9 frequent flyers, and domestically in New Zealand the money
10 is made out of corporate travellers.

11 **MS BATES QC:** Now, just finally on the importance of the
12 Star Alliance; I understand the point you made on that. I
13 just want to know whether, to what extent you would see the
14 loss of Star Alliance being compensated by One World?

15 **MR MURPHY:** I don't see it compensated at all. We already have
16 all the benefits of One World on all those routes. If Air
17 New Zealand was lost to the Star Alliance -- if we have, as
18 I said, no North American connection and certainly in our
19 business round the world fares are very important and that
20 would basically eliminate 50% of our sales in terms of what
21 fares people buy.

22 Certainly, they could go on One World, but I would
23 suggest that not -- more importantly, probably in-bound to
24 New Zealand, if we lost that Star Alliance connection,
25 I believe it's crucial. New Zealanders would adapt and go
26 on the One World carriers; it's not as important, but people
27 who have Star Alliance memberships already would be
28 frustrated and annoyed for certainly the short-term.

29 **MS BATES QC:** There is one more question, it's something that I
30 don't think you covered in your presentation, I rather
31 thought you might; but the proposition that, if the alliance

1 goes ahead, that Qantas Holidays will be able to bring in a
2 further 50,000 tourists to New Zealand on package deals.
3 From your experience in your business, do you think you
4 could offer us a view on a likelihood of that being able to
5 be achieved?

6 **MR MURPHY:** I'm not an expert on in-bound, but I have a
7 reasonable knowledge. I would suggest that airlines
8 generally have not been good tour operators. Air New
9 Zealand has had a number of tour operations, operations hot
10 pack and Air New Zealand destinations currently, they've
11 also owned JetSet Tours in Australia, which basically was
12 sold, and I would suggest was a near failure.

13 I don't believe they've ever been very good at
14 wholesaling tour operations.

15 **MS BATES QC:** What about Qantas Holidays?

16 **MR MURPHY:** I'm not really that --

17 **MS BATES QC:** You can't tell us?

18 **MR MURPHY:** I'm not really that familiar with Qantas Holidays,
19 but I would suggest that 50,000 additional tourists is less
20 than the average growth we've had anyway. So, I don't know
21 how they're going to quantify it; I think it's just a figure
22 that's been put out there.

23 **MS BATES QC:** So you think it's -- the figure is not that much?

24 **MR MURPHY:** Well, it's a significant -- it is a significant
25 figure, but the growth rates we've had in New Zealand
26 tourism have been over 50,000, quite a number of times, with
27 no real explanation or breakdown of where they've come from.

28 **MS BATES QC:** Yeah, that just makes me just want to pursue it a
29 little bit further, because if they were operating well,
30 then it would seem that that may be an achievable figure for
31 them?

1 **MR MURPHY:** I think the point was made by Mr Bagnall last week
2 that many overseas travel agents wouldn't have heard of
3 Qantas Holidays as we haven't heard of, say, BMI Holidays
4 out of UK. We don't have access to their programmes from
5 here, and I would think someone in the midwest of the
6 United States probably wouldn't have access to Qantas
7 Holidays brochures or information. They can find them on
8 the internet and perhaps do something with it, but they're
9 far more likely to have access to a Brendan Tours, who is a
10 large tour operator in the States, or Tout(?) Tours, someone
11 like that they would know and respect. I would expect that
12 those people are probably going to be able to produce more
13 for those agents beyond the main, perhaps Los Angeles or
14 something like that.

15 **CHAIR:** Are there any questions from --

16 **MR AINSWORTH:** Would you explain the percentages on your slide
17 15, please?

18 **MR MURPHY:** The percentages?

19 **MR AINSWORTH:** Yes.

20 **MR MURPHY:** I've purely taken the arrival figures from Asmal,
21 from June.

22 **MR AINSWORTH:** So, 632,000 is supposed to be about 50% of
23 2 million? Or am I misunderstanding that? If you add up
24 the 12 plus 2.25 plus 13.5, that doesn't come to 35, or am I
25 misunderstanding that as well?

26 **MR MURPHY:** Sorry, I think I've taken out of that subtotal here,
27 I've taken out the likes of other Pacific points. I'll have
28 to check that and clarify it for you. But obviously --
29 sorry, that figure is wrong -- [**refers to 49.52**] -- it
30 should be more like 20 something.

31 **DR PICKFORD:** There is an argument that on New Zealand domestic

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1 that the market is not large enough to sustain even two, and
2 certainly not three separate airlines all competing for
3 business with Virgin Blue coming in likely; that's going to
4 produce the three airlines, so I just wondered what your
5 view would be as to how competition might pan out in the
6 eventuality of three airlines all competing?

7 **MR MURPHY:** Certainly from what I've seen and read, and I
8 haven't seen anything in the last week that's given me any
9 other idea, that if Virgin is certainly initially coming in
10 with five aircraft, I think that would be largely allocated
11 to Trans-Tasman. If they are going to compete domestically
12 it may be several connecting flights to get aircraft to and
13 from Wellington, Christchurch or Auckland.

14 I do find it interesting that Air New Zealand have
15 argued that there will be the opportunity for a full service
16 and a VBA, yet they seem to have wanted to take the VBA
17 position already. So I don't know where they're going with
18 that. But I don't see that, even Qantas until recently only
19 had four aircraft, I think, running up and down the main
20 trunk. That was not really a viable competitor in terms of
21 schedule, and until -- I would say until Virgin is prepared
22 to put many more aircraft in the New Zealand market I don't
23 think they're going to be a major competitor for a long
24 time.

25 **CHAIR:** Mr Murphy, I'd now like to thank Bon Voyage for its
26 submission. It is important to our deliberations to have
27 access to expertise in the related markets to those that the
28 Applicants operate in, and the Commission is appreciative of
29 that. So, with that, I'll thank you once again.

30 I will now ask the Travel Agents Association to come
31 forward, please.

1 **PRESENTATION BY TRAVEL AGENTS ASSOCIATION**
2 **OF NEW ZEALAND**

3
4 **CHAIR:** I'll ask you do introduce yourselves for the record,
5 please.

6 **MR MARSHALL:** Madam Chair, Members of the Commission, my name is
7 Andy Marshall, I'm a solicitor, I practice in Wellington and
8 I've acted for the Travel Agents Association for in excess
9 of a decade. It's my privilege to introduce to you today
10 the team from the Travel Agents Association.

11 On my right is Mr James Langton, he's the president of
12 TAANZ, he's an owner/operator of a boutique travel agency in
13 Auckland known as Global Travel Management which operates in
14 the leisure small business area. He's been in the industry
15 for 35 years.

16 Next to Mr Langton is Mr Peter Lowry. Mr Lowry is the
17 Chief Executive Officer of TAANZ, a position he's held for
18 25 years. Prior to that he has worked in the travel
19 distribution industry; in fact, he's worked his whole life
20 in the travel distribution industry.

21 On my left is Mr Neil Tolich, he's a TAANZ Board member.
22 He's the managing director of Atlantic & Pacific Business
23 Travel Limited, which is a TMC. He's had extensive
24 experience in the industry, and I believe you know Mr Andrew
25 Bagnall, he's presented to you already, he's the Managing
26 Director, I understand, of Gullivers Pacific Group, and he's
27 had extensive experience within the industry.

28 Collectively, as you'll realise, this group has had
29 significant practical hands-on experience in distribution of
30 travel. If it suits the Commission, we would like to spend
31 the time that we have before you in the following way; I

TAANZ

1 will present a very brief overview of the TAANZ position.
2 Mr Tolich will then answer the specific questions that the
3 Commission had following our second written presentation,
4 and he will go on to comment on some of the comments that
5 were made by the Applicants in their cross-submission, and
6 then we would like you to ask any questions that you may
7 wish in relation to the practical, or issue related matters
8 that you think we may be able to assist with.

9 Our presentation is focused primarily on the
10 distribution side. I'll just start by providing the brief
11 overview, it's really just a series of dot points. But in
12 essence, as you will have gathered from our two written
13 presentations the Travel Agents Association is opposed to
14 the application and the alliance. It wishes to reaffirm the
15 position and the comments and content of its two written
16 submissions.

17 There are benefits to the New Zealand public in having a
18 healthy and independent distribution services network, and
19 we ask that the Commission consider the effect of the
20 proposed alliance and the effect that it will have on
21 corporate travel distribution services market, the retail
22 and leisure and distribution services market, and the
23 wholesale distribution services market.

24 TAANZ has a very different view of the effect the
25 proposed alliance will have on distribution to that put
26 forward by the alliance. If the application is approved,
27 TAANZ does not see any new entrant into the various air
28 service markets providing the alliance with anywhere near
29 the level of competition that currently exists in those
30 markets. The alliance will dominate the various air service
31 markets and that domination, whether it be an effective

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1 monopoly or something less, will have a significant impact
2 on the ability that travel agents currently have to offer
3 the consumer choice of airline product.

4 TAANZ believes that the most likely outcome is that the
5 alliance will have effective control of the supply of
6 airline services within and out of New Zealand. TAANZ does
7 not believe that any new entrant into the air services
8 market will be able to obtain a sufficient share of the
9 market to enable travel agents to remain truly independent.

10 To survive, travel agents will need to become in effect
11 agents of the alliance. This will represent a significant
12 change to what currently prevails and what would prevail
13 under the counterfactual. Travel agents are able to operate
14 currently with a reasonable degree of independence, and it's
15 most unlikely that that will continue.

16 Currently, under the counterfactual, and under the
17 counterfactual, travel agents control their own destiny.
18 Under the alliance it's unlikely that that will be the same,
19 certainly not to the same extent. The consequences will be
20 that, under the alliance travel agents will survive so long
21 the alliance --

22 **CHAIR:** Sorry to interrupt, but Commissioner Taylor just noticed
23 that that cable's not actually in that computer -- you've
24 got that?

25 **MR MARSHALL:** No wonder it's not working. [**Pause for**
26 **technology**].

27 So I was saying that the consequences will be that under
28 the alliance travel agents will survive as long as the
29 alliance wants them to survive; the alliance will therefore
30 control the various distribution markets and this will
31 strengthen the alliance's control over the air services

1 markets, because the two are closely linked, and in our view
2 in conclusion, the approval of the alliance will result in
3 significant public detriment in the distribution service
4 markets.

5 Now, that's really a short synopsis of what's in the
6 written material, and I'll now ask Mr Tolich to make a
7 presentation.

8 **MR TOLICH:** Thank you Andy. Thank you Madam Chair and
9 Commissioners.

10 I'd just like to start very briefly by just commending
11 Gerard. He's a small owner/operator business in our
12 industry, one of our TAANZ members, and I think when you
13 think of the resource that he has not got to draw on, what
14 he has done today is pretty spectacular and I wouldn't want
15 you to think that because his numbers didn't quite add up
16 that they weren't fundamentally on the right track. He did
17 a great job as far as I'm concerned and in fact he's talked
18 about a lot of the issues that we need to address to you as
19 well. So, well done Gerard; the industry's alive and well.

20 **CHAIR:** Can I just say that I don't think there will be any
21 difficulty, and that was simply his corrected numbers, and
22 we do understand the expertise that was behind the
23 presentation, yeah. Thank you.

24 **MR TOLICH:** Thank you.

25 **MR MARSHALL:** I might add, there are other people here who have
26 sold airline tickets in the last year. [Pause].

27 **MR TOLICH:** And I think that's the nub of it; today you are
28 talking to people who are on the other side of the fence; we
29 are at the coalface, we are the people who handle the
30 customers; we're doing that day in and day out, but our
31 businesses are the businesses we own, the businesses we

1 manage.

2 The TAANZ board is made up of a wonderful mixture of
3 people who have been in the industry for a very long time;
4 some of us started when 75% of kiwis went to England by
5 boat, believe it or not. So, some of us have been around
6 for a long time but we don't feel that old, but some of us
7 are really fresh and interesting and into the industry in a
8 new and exciting way.

9 I should point out that when you think of some of the
10 brands that are out there, you have Holiday Shoppe which is
11 a large brand, you have Flight Centre which is a major brand
12 globally and 2.3 billion market cap gives you a feel for how
13 successful these retail organisations are.

14 So, I just want you to get a feel for who we are and who
15 we represent. House of Travel is another significant
16 retailer out there. But at the coalface we see a lot that
17 is going on. Today we're going to be talking about the
18 agency distribution system, we're going to be talking about
19 leisure agents and TMCs, and we'll just make some general
20 observations.

21 I think I should also briefly point out that my own
22 experience is substantial. I have been in the industry also
23 for over 30 years. I have been in senior management
24 positions with Westpac, Travel with American Express, I
25 served on the board of Radius, which is an American company
26 that we have a shareholding in for the last 15 years; it
27 wrote US\$13 billion in global travel sales last year.

28 We have sat there and watched every airline go through
29 the machinations of net fares, of zero fares, of collapse of
30 growth, of start up, of start down, of slow down; we see it
31 all, and we do know what we're talking about even though we

1 may not have the PR abilities that the airlines have,
2 because they have spectacular PR abilities, and advertising
3 budgets which we don't have.

4 The agency distribution system, I don't want anybody --
5 none of us want anybody to feel that it is on its last legs,
6 that it is a dying breed. Far from it. But the issues that
7 we have broached in our submissions are critical to the
8 consumer and to how they are serviced around New Zealand,
9 and what happens with them.

10 A minor observation, I know we're talking about VBAs and
11 full service airlines, but at our neck of the woods we see
12 them simply as low cost or high cost airlines. There are
13 some low cost airlines who provide full service, there's
14 some low cost airlines who provide terrible service, there's
15 some high cost airlines who provide full service and there
16 are some high cost airlines who provide terrible service.
17 So, it's a question of costs rather than the VB plus or VB
18 minus, or whatever you want to call yourself.

19 It's also all about attacking the sacred cows that exist
20 in the full cost, high cost airlines. Some of the easy meat
21 is at the front end and some of the hard stuff is right in
22 the middle of your business that you've really got to get
23 into and clean out.

24 We received questions from Janet Whiteside, Chief
25 Advisor to the Commerce Commission on 23 July, three
26 questions that she wanted us to clarify and I thought they
27 would be a good way to start. Janet asks:

28 "On page 6 of your submission, how was the 28 to 40%
29 cost increase range arrived at? What does the cost increase
30 refer to?"

31 So in the TAANZ submission we had referred to cost

1 increases likely if the alliance goes ahead of 28 to 40%.
2 Before I explain, I'll just explain the next graph;
3 basically what it will show you is -- which Gerard has
4 already referred to -- is whilst there were minimal or no
5 airfares over a period of time, airfare increases over a
6 period of time, how easy it is to manage the yields and push
7 the average purchase price of domestic tickets -- I'm using
8 as an example, the same applies on the Tasman -- up or down,
9 depend on what you need to do as an airline.

10 So, this very simple but very telling scale tells you
11 this: On the left-hand side you have it starting at a fare
12 of \$230. Now, this is a TMC, a Travel Management Company
13 which handles corporate business. This is not a holiday
14 shop or a leisure shop, this is TMCs and to give you an
15 idea, the TMCs around New Zealand for travel management
16 companies like TQ3, like Atlantic & Pacific Radius, which is
17 my company, we write 100 to \$150 million worth of sales
18 annually. So, we have a fair bulk of businesses running
19 through to give you a fair fix on what the market's doing.

20 So the left-hand figure starts in December 99, it shows
21 a \$230 average fare. Ansett New Zealand and Air New Zealand
22 were competing quite vigorously during that first level
23 period, until, for various reasons, Ansett started to
24 struggle, there were pilot strikes that basically crippled
25 it from that point on and a few other issues, but the
26 airfares started to grow.

27 The highest point is April 2001. That's an increase of
28 28% over that 14, 15 month period. 28% was the average
29 price that corporate travellers were paying, 28% increase,
30 was what corporate travellers were paying in their average
31 ticket price. So that's how much it grew by over that

1 period.

2 **MR CURTIN:** This is the average across all domestic routes?

3 **MR TOLICH:** All domestic routes; this is the average Air New
4 Zealand fare across all domestic routes. It doesn't take
5 into account Freedom, it's the average corporate fare.

6 Now, mum and dad, Mr and Mrs Smith buying a ticket from
7 Christchurch to Auckland certainly have advance purchase
8 fares which they can take advantage of, but the corporates
9 are much more at the mercy of where the yield managers play,
10 and I'll come back to that shortly to show you how much
11 value that corporate business is to the airline.

12 So, middle of the graph it's up at its peak and then we
13 have an issue with Qantas New Zealand going broke, and a
14 couple of months later they come back into the market in a
15 different form, but what it showed was Air New Zealand quite
16 correctly did not rort the market when its competitor
17 disappeared, they couldn't and they wouldn't, and they
18 actually played the game very well, so they held prices and
19 even reduced them slightly, but then competition kicked in,
20 until the big drop is when NZ Express started to fly in
21 November last year.

22 So, it shows on the right-hand side of the graph a
23 lovely level -- lower level than ever before average
24 domestic fare price for the corporate traveller. Except,
25 back before 01 November last year when the Tasman Express
26 came in all of our corporate buyers had rebates on the Air
27 New Zealand travel card billing system between 5 to 45%
28 rebates. So that left-hand column starting at \$230, every
29 buyer was buying tickets for a minimum of 5% discount, many
30 many in the 20 to 25% rebate area, some of the 45 --
31 actually there was one or two over that.

1 So what I'm trying to say is the corporate traveller,
2 the biggies are marginally worse off, maybe the same, but
3 the SME, the small to medium enterprises certainly have been
4 buying better in the last nine months. The critical thing
5 about this is to show you how yield managers can push the
6 price up over a period of 15 to 16 months without any fare
7 increase. So we've looked at history, said that's what
8 they've done, what's stopping them from doing that in the
9 next 3 years?

10 Any business that can say we're not gonna put airfares
11 up or prices up for 3 years, you'd have to ask, how on earth
12 can they do that unless there's some mechanism behind the
13 scenes to protect them? Otherwise, you couldn't do it, you
14 wouldn't be stupid enough to do it.

15 Janet also asks:

16 "With respect to travel management companies in the
17 corporate/business activity and travel agents in the
18 retail/leisure activity, is there any evidence of A) either
19 types of business being involved in both activities? And,
20 B) either type of business switching from one activity to
21 the other?"

22 Now, I think the reasoning behind this was to try and
23 demonstrate vertical integration in the industry, but let me
24 say this: That, for example, in our business, which is
25 Atlantic & Pacific Radius, which is a business travel
26 corporate writing \$120 million or so a year; 10% of our
27 business is leisure, 90% is corporate. If you look at a
28 leisure agency, like a Flight Centre, retail shop, or a
29 Holiday Shoppe, or a House of Travel outlet, it's the other
30 way around; 90% of their business is holidays, but they
31 might have the odd person popping in and say, look, I'm

1 going to go on a business trip to Sydney, and that will be a
2 bit of their cheap ticket stuff, but they're not a TMC, a
3 travel management company. We sit there doing a whole lot
4 more which we will touch on in a minute, so they're two
5 significantly businesses, you can't do both; you've got to
6 specialise in one or the other.

7 In terms of businesses switching from one to the other,
8 maybe 20 years ago when Atlantic & Pacific was a primarily
9 retail business, it started to move into corporate but these
10 days there's no such thing as a switch; you can't do it. I
11 should point out that, we talk icon brands, our business
12 started in New Zealand in 1955, so it will be 50 in a couple
13 of years' time and we've survived it.

14 The same query in respect to out-bound travel
15 wholesalers and air consolidators in the wholesale travel
16 services market. That's in terms of switch or cross-over.

17 Now, Andrew Bagnall from Gullivers Pacific has really
18 outlined, I think, a lot of the detail of how the wholesale
19 side worked last Friday, so I don't know, Janet, whether you
20 need any more clarification of that or not, but it was
21 basically -- no, okay. Thank you.

22 Now, we then received the Applicants' cross-submission
23 in response to third party submissions headed "Travel Agents
24 Association of New Zealand" so what we're going to walk
25 through now is the Applicants' response to our submission in
26 terms of what was said and what wasn't said and how they've
27 interpreted what we've said.

28 There are a number of sections to it, but the key ones
29 which I think are relevant all the way through are: It's
30 interesting by the way that in all of this they talk
31 Applicants with an "S", the Applicants, and yet wherever

TAANZ

1 there's an airline mentioned it's purely Air New Zealand,
2 and I'm surprised that we don't see it all the way through
3 their response Qantas and Air New Zealand, it's all
4 referring to how Air New Zealand will behave, or how Air New
5 Zealand will respond, but really as far as we're concerned
6 it's both airlines.

7 In this section the Applicants are interpreting what
8 we've said as saying TAANZ is a trade organisation committed
9 to promoting its members' interests. The Applicants are
10 saying it's in TAANZ' interests to ensure that there are as
11 many travel agents in New Zealand as possible, regardless
12 that this means perpetuating the existence of
13 inefficiencies. I mean, that is about the most offensive
14 thing they've ever said to us, and they've said a few
15 things.

16 In this respect, the Applicants note that TAANZ'
17 submission is directed to maintaining the status quo --
18 which is nonsense, but it shows how it is easy to manipulate
19 what we were trying to say and what they are saying back to
20 us -- rather than providing consumers with efficient and
21 valuable travel distribution services.

22 Now we will say to you, the only words that matter in
23 what they have said are the last few; "We are there to
24 provide consumers with efficient and valuable travel
25 distribution services", is what this is about as far as
26 we're concerned, not their interpretation of it.

27 They also say:

28 "In a departure from its earlier submission, TAANZ now
29 submits, in addition to wholesale travel distribution, there
30 are separate markets for corporate travel distribution
31 services and retail and leisure distribution services".

TAANZ

1 Now it's not that we decided that oh there's another
2 opportunity here, it was when we saw the way that the
3 Applicants were handling the specific corporate versus
4 retail or leisure markets that we realised they were not
5 wanting to differentiate them, they were trying to keep them
6 tight as one for good purpose. So that's why we had to make
7 it clear in our second submission why there are two clear
8 markets, they are handled separately and differently. We'll
9 answer these in a minute.

10 S.50; "TAANZ argues that the alliance will result in a
11 substantial lessening of competition in these two markets",
12 the Applicants are suggesting. Notwithstanding the fact
13 that the Applicants believe that TAANZ' market definitions
14 are incorrect. So we're here but both Qantas and Air New
15 Zealand believe our market definitions of corporate travel
16 and retail are fundamentally incorrect. Now, that's just
17 nonsense. Both airlines have huge investments in
18 recognising and targeting and servicing and retaining the
19 corporate travel market, and they have quite separate
20 investments and strategies to retain and market and grow the
21 leisure business. There are two separate markets. We
22 totally refute and reject that comment from them.

23 They also say that what we do -- now, this is travel
24 management companies as opposed to retail travel agents, but
25 basically there's an element of truth in both. What travel
26 management companies do, and these are the large corporate
27 travel agencies. We manage the purchase and implementation
28 of travel services on behalf of customers. We manage and
29 process consolidated billings for corporate customers. This
30 is the contentious one; we manage travel tender processes
31 for corporate customers. We manage loyalty programmes on

1 behalf of corporate customers, and we organise and co-
2 ordinate meetings and conferences.

3 Now, there are other things we do as well, but that's
4 how the Applicants have seen us and how we indicated some of
5 the things we do.

6 Then they say:

7 "TAANZ argued that TMC's viability is driven by their
8 ability to leverage off competition between Air New Zealand
9 and Qantas so as to provide cost savings to their corporate
10 customers. By removing competition between Air New Zealand
11 and Qantas, TMC's ability to retain some of these cost
12 savings is diminished and, therefore, TMC's viability will
13 be at risk".

14 So, that's the Applicants' interpretation of our concern
15 that competition will diminish.

16 Let me say this: The process that we go through in a
17 travel management company when a corporate account comes to
18 the market to tender, and I'm talking Government business,
19 we're talking corporate commercial business, we're talking a
20 vast range of New Zealand companies. Some deal direct with
21 Air New Zealand and some do say what's the deal and they go
22 to Qantas and they say what's the deal.

23 But many are being managed by ourselves and large
24 corporations, any of the benchmark corporations in the
25 country and they are able to discuss issues that are in the
26 marketplace, what should we do, how should we approach it.
27 We sit there and talk to Qantas. In fact Qantas encourage
28 us to talk because they don't have the infrastructure on the
29 ground in New Zealand that Air New Zealand does, but we also
30 talk to Air New Zealand's commercial sales teams closely.
31 We look at their customer base, we say what's going on in

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1 the market. Then we sit down with the clients and start to
2 review the pricing and the marketing issues that they're
3 looking to do to renew their tenders.

4 In the end Air New Zealand do sign the contracts and
5 Qantas do sign the contracts. We don't sign any contracts,
6 but we are critical of the tension, the pricing tension that
7 goes on between the two airlines -- other airlines,
8 Singapore Airlines comes in if it's a longer haul
9 international, United used to until they disappeared; so
10 that's the process we play, I would say, for more than 50 to
11 60% of the corporate market.

12 It says, "TAANZ's representation of the role for TMC is
13 misleading", and that's where they talk about the tendering
14 process. We're not just there to book flights, we're not
15 just there to write tickets, there is a very critical role
16 that we play in the marketplace.

17 I should also say that the corporate market in
18 New Zealand, 65% of Air New Zealand's domestic travellers
19 are corporate travellers, writing something like 80 to 82%
20 of their revenue. Now, Air New Zealand --

21 **MS BATES QC:** Sorry, say that again?

22 **MR TOLICH:** The numbers we've been able to get indicate that 65%
23 of travellers in New Zealand are corporate, writing is in
24 the region of 80 to 28% of the revenue. Now, it might not
25 be as quite as high as that, but that's the numbers that we
26 got from Air New Zealand.

27 **MR CURTIN:** My colleague and I were both interested in that
28 number because it isn't quite where I would have made a
29 guess if I was guessing myself. It seems to be on the high
30 side. Could you give us a little bit of background as how
31 you made that calculation?

1 **MR TOLICH:** The information was given to us from within, because
2 we can only assess that from external, but we have been told
3 that if you look at Air New Zealand's total -- I'm not
4 talking passenger numbers, I'm talking the revenue. So, if
5 you look at flights running up and down the country day by
6 day, certainly on their main trunk routes, on their high
7 revenue routes, the prime time flights in the morning and in
8 the evening are full of corporate travellers with rare
9 exception. During the day some corporates will be going
10 down at midday, at late morning, mid-after, and that is
11 roughly 65% of all their travellers.

12 Now, we are also told that on the Tasman 38% of their
13 business is corporate, providing approximately 60% of their
14 revenue.

15 **MS BATES QC:** How much of their revenue?

16 **MR TOLICH:** 60. They'll be able to verify this. I think the
17 issue here is, what we're saying is that when I look at,
18 say, for example our airfares from Wellington or Wellington-
19 Auckland, mum and dad buy a ticket at \$79 but the corporates
20 are buying tickets at \$200 on average each way, \$150, 180 or
21 200, 210 because that's the nature of the yield management
22 process and blocking off the cheap seats at prime time.

23 So it's a critical market to them. Without corporates
24 they wouldn't survive, they wouldn't exist, it would be a
25 totally different airline. And yet they really don't talk
26 much about them in their submission. They do talk about
27 them in one critical area, which is a major reason why this
28 shouldn't progress any further, the JAO will set the prices
29 for corporate and Government travel, the joint airline
30 operation.

31 So Air New Zealand will set the prices for both

1 airlines. So, if one of the large Government Departments,
2 40 odd Government Departments who buy lots of travel, and
3 currently they go to both airlines; some are preferred
4 Qantas travellers, some are preferred Air New Zealand
5 travellers, and they get still attention there and they
6 still get something in terms of what's coming back to them.

7 Qantas have been more generous than Air New Zealand
8 because Air New Zealand, correctly when they pulled down
9 their NZ Express product prices didn't feel the need to give
10 the big volume buyers the rebates that they were once
11 getting, but there's still something there. But they are
12 now going to set the price for both airlines; there will be
13 no competition between either airline, on the Tasman and
14 domestically.

15 **MR CURTIN:** Just while we're on the corporate travel business.
16 You were probably here for Mr Murphy when he was talking
17 about Air New Zealand's apparent decision to withdraw a lot
18 of these corporate discounts that they'd previously been
19 getting according to him. I just wonder, you mentioned
20 yourself that this is a very important market, at least
21 currently, with the two of them slugging it out. Can you
22 confirm or otherwise what Mr Murphy told us about the
23 withdrawal of these discounts and perhaps give us some more
24 evidence on the issue?

25 **MR TOLICH:** I can. I will not mention names of large
26 corporations, but Air New Zealand when it went to the market
27 back in November and said, we are now getting rid of all
28 commissions for agents and all corporate rebates for
29 corporate New Zealand, it was an incredibly brave move and
30 it succeeded. They basically got rid of those 5 to 45%
31 rebates on the travel card that I referred to earlier on;

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1 all of those have virtually disappeared, with rare
2 exception, but there are some. We hear anything from 10 to
3 20 large corporations, and they are the biggies, who are
4 spending millions upon millions of dollars a year with them.
5 They do get an acknowledgment, to what level -- we believe
6 it's in the 3% to 5% range, or one or two may still have
7 some contracts left that Air New Zealand can't get out of
8 until the contract expires.

9 But by-in-large the large corporates will be paying
10 more. For example, the Tasman Express starts 01 November;
11 some of the contract rates Auckland-Sydney, Auckland-
12 Wellington, Sydney-Wellington will go up anything from 20%
13 to 40% we estimate, and Gerard estimates more when the new
14 fares come into play.

15 So, their biggest customers are going to be hurt, but
16 that's the way it works, because politically no-one cares
17 about that. Mum and dad travellers is where the market sees
18 it, and it's very easy to market to them and get the warm
19 fuzzies going.

20 **CHAIR:** Can I ask you a follow-up question. We've heard that,
21 while Virgin Blue has had a difficult time contesting in the
22 Government market, it has been quite successful with the
23 core price in Australia. Why would they not be able to
24 effectively constrain any market power of the airports?

25 **MR TOLICH:** It's interesting. If you look back at Virgin's
26 entrance into the Australian market. Before then you had
27 Qantas and you had Ansett fighting it out, and they used to
28 work 50/50 market share, and there was good price tension
29 between both, and if you were a corporate buyer you would
30 work with both and you'd get the deal. But then for various
31 reasons Ansett Australia started to slip and their market

1 share was dropping, Virgin Blue's just started to look at
2 coming into the market when they basically collapsed.

3 So, overnight Qantas was handed 100% almost market
4 share. Qantas was told by every consumer watchdog that
5 existed and Government, do not do anything to abuse your
6 position of power, that's public, that's on record, do not
7 rort the market, do not do anything to undermine this
8 fledgling Virgin who's coming into the market.

9 And they had to sit there and watch; they could not
10 compete. They have sat and watched, absolutely, hands tied
11 behind their back, letting Virgin quietly pick away; I'm
12 surprised Virgin haven't done it more quickly. It's been
13 astounding how slow they've taken it, given the environment
14 they've been allowed to work in.

15 So they have got there by getting Ansett customers, I
16 would say very few disaffected Qantas customers, and Qantas'
17 market share is still at 70%, and now they'll start
18 fighting; that was declared last week. They will start
19 fighting now. Good luck Virgin.

20 **MR CURTIN:** On the same topic, and I'm sorry; in the corporate,
21 I'm operating on the presumption that Air New Zealand and
22 Qantas are still competing in this domestic market, so if
23 you flag away a whole bunch of corporate discounts why
24 doesn't Qantas Hoover them all up?

25 **MR TOLICH:** It's a very good question. Qantas have hoovered --
26 you mean the corporate market? Qantas have hoovered some of
27 it up, but I think you've seen Qantas compete not quite as
28 aggressively as it possibly could and I think that's what
29 Air New Zealand's concerned about quite correctly, that if
30 Qantas does decide to compete more aggressively then they
31 would have to fight a bit harder. But Air New Zealand is

1 leaner and meaner than Qantas for a start, so I think that
2 will be interesting.

3 But to answer your question, some customers switched to
4 Qantas, some actually left Qantas to go back to Air New
5 Zealand for loyalty reasons. You've got to understand at
6 the time there was a huge feeling of kiwi parochial support
7 for Air New Zealand and they really played on that and to
8 their success it helped, and people do pay more to fly Air
9 New Zealand, no question, we see it all the time.

10 **MR PJM TAYLOR:** Just following up on this issue, Mr Tolich, is
11 Origin seen by the business traveller as effective
12 competition for the Air New Zealand non-main trunk domestic
13 routes?

14 **MR TOLICH:** Yes, we do see that. I think Origin's opportunity
15 is purely how they attack the next phase of their growth,
16 and that's a big problem for Origin or a Virgin.

17 If you look at e.g. Jets in the southwest of America,
18 they've got tiny market share, 3, 4% market share, that's
19 easy. It's when you start to want to be the 30 to 40 to 50%
20 carrier that your infrastructure has to become bigger, your
21 tentacles and your networks have to grow, your costs go
22 through the roof.

23 So Origin's at that crossroads where it needs to now get
24 into the global GDS distribution systems, which cost US\$3 a
25 booking a segment, so it's a cost they have to weigh up,
26 which is what the other airlines always weigh up as well.
27 But we think it's peanuts. 90% of Air New Zealand's
28 business comes from travel agents around the world and
29 wholesalers and it costs them US\$3 roughly a segment plus
30 Commission.

31 **MR PJM TAYLOR:** 90% of Air New Zealand's?

1 **MR TOLICH:** Business globally comes not on the internet, it's
2 coming from travel agents and wholesalers from around the
3 world. I mean, is there nodding going on? Is there head
4 shaking? I don't know what's going on behind me, but...

5 **CHAIR:** I'm just mindful of the time, so we'll ask you to...

6 **MR TOLICH:** Because we've sort of ranged around, I can just
7 finish up. I think it's important that we also stress that
8 what we've just talked about relates to the mum and dad
9 travellers in Gore and Te Awamutu and Hamilton and Auckland
10 dealing with retail travel agencies. Those agencies, if
11 this alliance goes ahead, 98, 99% of the domestic market,
12 100% of the USA markets and Pacific routes, 80 odd plus
13 percent of the Tasman, it's a very powerful position for the
14 alliance to be in to reduce commissions still further, and
15 in all of the Applicants' submissions they talk about
16 distribution services and they actually say that, if the
17 travel agents add value, the consumer will pay through fees.

18 They talk about, hey, fees, customers are happy to pay;
19 we have no problem with that. What we absolute cannot
20 accept, but it gets more dangerous as they get more
21 powerful, is that they need to pay us as well, because we
22 are doing a huge job for them. We've got 10,000 staff out
23 there in our industry that, if we disappear tomorrow, Air
24 New Zealand would have to employ, give screens, give desks,
25 house them, because no-one's gonna do it on the internet;
26 10%, 15% might, but the rest will want people to help them.
27 That's what we do. We are their distribution. But, you
28 clamp it tight and they don't have to pay us, they honestly
29 can do whatever they -- keep it real lean, real tight, no
30 price tension, no tension anywhere.

31 I hope I've sort of given that -- so finally, I think

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1 we've talked about the importance of corporate and
2 Government business and the pricing strategies that JOA will
3 bring to the market, which is unacceptable. We've touched
4 on the relevance of leisure travel, but it's actually
5 critical to the Kiwi traveller, its contribution to Air New
6 Zealand is significant but not as significant as the
7 corporate business.

8 The Virgin factor, all I'll say about Virgin is, they
9 are a bottom feeder, they've flipped and flopped around the
10 media and the Commerce Commission for the last 2 years, and
11 what they're gonna do, who cares. Slightly dysfunctional in
12 some areas.

13 And the alliance factor we've touched on as well in more
14 ways than one. I think we should just basically summarise
15 by saying that, the alliance has got the leverage -- if it
16 goes ahead, the leverage, the market dominance, the product,
17 the frequencies, the grunt to do whatever it absolutely
18 wants to in New Zealand and to the New Zealand marketplace,
19 at its whim. I think that's the nub of it.

20 **CHAIR:** It does make me wonder why Qantas wasn't able to squash
21 Virgin Blue once Ansett left.

22 **MR TOLICH:** They couldn't. They couldn't. When Ansett left the
23 market -- and you may not recall, but there was a lot of
24 media and Government saying "you will not", I mean, we saw
25 it.

26 **CHAIR:** Do you think they were forbidden to compete?

27 **MR TOLISH:** They did not introduce their Express product, they
28 introduced Australian, a new low-cost airline operating on
29 some minor international routes; they weren't allowed to
30 bring it domestically.

31 **CHAIR:** I'd just ask our staff or external advisors if they have

1 any questions. Thank you.

2 **DR PICKFORD:** You've said that, with the alliance, that the
3 combined entity would have the incentive to crush
4 independent travel distributors, but surely there's an
5 argument to the contrary that, because as you've been
6 saying, they're so important to marketing airline services,
7 that there's a possible benefit generated from their
8 competitive activity in generating more business for them,
9 and that they'd have an incentive rather to create a more
10 vibrant distribution service?

11 **MR TOLICH:** I think the temptation for them is to control it and
12 to own it, and you look at say, for example, at Qantas
13 Holidays which we haven't really touched on; they have
14 genuinely and systematically crushed out any real wholesale
15 competition in the Australian marketplace by not offering
16 the pricing benefits that a wholesaler needs to get the job
17 done.

18 Example: \$800, say, for a return airfare to Sydney for
19 us to buy. A wholesaler who gives them thousands of seats a
20 week might negotiate \$650, then they'll package it up with a
21 hotel, with transfers, with a few theatre tickets and so on
22 for \$825; over the retail price, but that's how a wholesaler
23 works.

24 But when you've got no competition in the marketplace,
25 the airline says, we don't have to give a \$650 wholesale
26 fare, we'll make it 800 bucks. Everybody can pay, if you
27 haven't got a job to do, you haven't got a job to do
28 Mr Wholesaler. The customer will go and buy it themselves.

29 Now, you might say well, that's fair enough, but the
30 customer will pay more. That's how it works; real simple.
31 The same applies in the leisure travel side; they can keep

1 us tight, keep us squeezed or take it all direct, and I'm
2 afraid there are Air New Zealand and Qantas executives who
3 are desperate to get it direct. They control the market,
4 control the customer, the more they have direct.

5 **MR CASEY:** If Qantas Holidays does have that power, is it not
6 then good for New Zealand in-bound tourism to have access to
7 that?

8 **MR TOLICH:** Good question. I think you've got to look at what
9 Qantas Holidays have already done. Qantas Holidays wants to
10 market fabulous destinations to Auzzies. Now, you would
11 have thought for the last X number of years, if New Zealand
12 was the hottest destination around, that they would have
13 done their level best to generate as much business as they
14 can at the highest possible price and yield for them to get
15 them to New Zealand.

16 So, to suggest that all of a sudden they're now going to
17 find another magic formula that gets another 50,000 Kiwis
18 across here; the only way -- and bearing in mind that we
19 have the highest profile of any overseas market for Auzzies,
20 we have a huge attraction to them, we're desirable -- well,
21 you mightn't be -- we have big exposure in the marketplace,
22 so generally they have done a damn good job already of
23 marketing Auzzies to New Zealand.

24 To get an extra 50,000; yes, they can do it. They might
25 do a one-off \$199 airfare which we might all say great, well
26 then they've achieved their objective. But that's just a
27 oncer; that's not gonna make them any money, so we shouldn't
28 be fooled by that. What you want is a sustained 50,000
29 people annually, purely coming in from their activity, and I
30 reckon the market's pretty much where it's gonna be. But
31 there will be hiccups and aberrations, as Gerard touched on,

1 from around the world; there will be more than 50,000 people
2 coming, but not necessarily because of what Qantas Holidays
3 does.

4 **MR PJM TAYLOR:** It's interesting you raised the conversation you
5 have, and thinking back to Mr Bagnall's comments, on Friday
6 I think it was; part of the argument for the 50,000 was
7 about accessing under-exported markets in Europe, suffering
8 from capacity constraint on the airlines.

9 Could you maybe discuss that issue with respect to the
10 UK market. Is the Air New Zealand flights out of -- or are
11 the Air New Zealand flights out of London capacity
12 constrained to the extent that the market cannot be
13 exploited, but with the incentives that Qantas would then
14 have to bring to bear on that market, would you still make
15 the comment that you think there's 50,000 not achievable.

16 **MR TOLICH:** The 50,000 is achievable whatever they do and I
17 guess what I'm trying to say is --

18 **MR PJM TAYLOR:** I'm talking about the little bit that's coming
19 out of the UK, I think was 5,000 they were projecting.

20 **MR TOLICH:** To get the 5,000 out of the UK they could do that
21 with some marketing initiatives. The Lord of the Rings will
22 get it to damn sight more than that. There's a whole lot of
23 issues that you will have to measure to know what has
24 achieved that growth. But I think what Gerard touched on,
25 we shouldn't be seduced by the thought of an extra 50,000
26 people. That doesn't argue against what we're saying. All
27 we're saying is, that is not unachievable given various
28 factors that could go on globally.

29 I think that's what I'm trying to say, Peter; it's not
30 just going to be a Qantas Holidays/Qantas promotional
31 effort. Why would Qantas promote to bring people to

1 New Zealand? They want to bring them to Aussie, number one,
2 that's all they're interested in, if they spin-off to here,
3 fine. You know, Qantas is in this for Qantas, not for Air
4 New Zealand, Air New Zealand will have to fight its own
5 battle in the UK market and the European.

6 **MR PJM TAYLOR:** Notwithstanding the arguments in the submission,
7 that's still your position?

8 **MR TOLICH:** That's still my position, totally.

9 **MR RENNIE QC:** Is the travel agent the agent of the customer or
10 the agent of the airline?

11 **MR TOLICH:** I love that question.

12 **MR MARSHALL:** Well, that's very difficult, isn't it, really.

13 **MR TOLICH:** We're totally the agent of the customer, and I think
14 the issue there is one of the great tragedies of history, is
15 that, when dear old Thomas Cook started this whole game off,
16 the way he started it was, he was a wonderful traveller and
17 all of a sudden his mates used to say, hey, where have you
18 been this time, he'd say this, and he'd say, look, why don't
19 you go down to P&O Shipping Lines and book your travel to
20 India or whatever, and in the end P&O started to pay him a
21 Commission for doing the job. His big failing was not
22 charging his customer, his friends as well for doing the job
23 for him. So, in the end, if it wasn't for his customer
24 base, we're there for the customer; that's the only reason
25 we exist.

26 **MR RENNIE QC:** And is that freedom constrained by any ongoing
27 contract with the airline?

28 **MR MARSHALL:** Well, these are legal issues really, but it's
29 becoming very very clouded legally because of course more
30 and more frequently the airlines aren't paying the agents
31 any commission, certainly not a base commission, and

1 although there are international passenger sales agency
2 agreements between principals and agents, airline principals
3 and agents, the whole area is very very clouded and I don't
4 know that we can get too far.

5 Certainly, there are contracts between travel agents and
6 their customers as well as the Passenger Sales Agency
7 Agreement, but it's a very difficult legal issue and it's
8 going to become more so the more that airlines refuse to
9 pay, or decline to pay any form of remuneration to their
10 agent, which seems to be the way it's going.

11 **CHAIR:** Just a follow-up question from Commissioner Taylor,
12 please.

13 **MR PJM TAYLOR:** With reference to your comments about Virgin
14 Blue, you seem to imply that your view was, they are
15 irrelevant to the discussions we're having.

16 **MR TOLICH:** No, I shouldn't say that, I don't want you to think
17 that, I wasn't being --

18 **MR PJM TAYLOR:** I quite clearly got that message actually.

19 **MR TOLICH:** Okay, well, then I don't want you to think I was
20 being flippant about that, because that's not fair. They
21 have been factored into everything we've said, in terms of
22 our own assessments, but what we're trying to say is that
23 Virgin Blue have yet to show us what they're going to do.
24 And I think we've touched on for the last few days the ease
25 for which these carriers can come in and go away. That's
26 what I'm trying to say, Commissioner.

27 **MR PJM TAYLOR:** Thank you. And, to go one step further, do you
28 think Air New Zealand has pre-empted the low cost carrier
29 space with regard to main trunk New Zealand, or domestic
30 New Zealand and Tasman?

31 **MR TOLICH:** I think they've done a fabulous job, I think you'd

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1 have to say that what they've done is exceptional, and I
2 think they have pre-empted the -- it must be harder for
3 Virgin Blue to really think seriously about attacking the
4 market full on, and remembering that Air New Zealand still
5 have behind all of that, if they really wanted to, Freedom,
6 and there's nothing stopping Freedom from really taking it
7 to Virgin if Air New Zealand wants to do that, and so they
8 should if they come.

9 **MS BATES QC:** Just following on from what you said to
10 Commissioner Taylor, I'm a little puzzled by that given what
11 you say is the level of business coming from the corporate
12 sector. I would have thought that -- and given what you say
13 about the real effect of the Express fares on the corporate
14 sector, then I would have thought that would have actually
15 given Virgin ample opportunity to come in and get some of
16 that corporate business. Why wouldn't it be able to do
17 that?

18 **MR TOLICH:** Good point. I think Virgin in the end, if it comes
19 in, will still have to satisfy a whole lot of issues
20 regarding the corporate traveller. Its not just a case of
21 offering slightly cheaper fares or significantly cheaper
22 fares, and I tell you now that, if they do, that will bring
23 Air New Zealand I guess to a point where they will start to
24 offer the corporate market -- a better range of fares
25 possibly for the corporate market.

26 But, as has been touched on earlier, there's also a
27 driver in the corporate market of frequency, of flexibility,
28 of interchangeability and interconnectivity with
29 international routes and services as well. So, there will
30 be an element of that going on, but they're not gonna lose
31 their shirt. Pricing is already good, and the flexibility

1 in their pricing structures is there, so if they want to
2 pull it down, they can, or pull Freedom in. Does that
3 answer it, or is that...?

4 **MS BATES QC:** Yes, that's assisting me. Just following on from
5 that; do you actually -- in your business, do you actually
6 book people on Virgin in Australia?

7 **MR TOLICH:** Yes, we do. Not many.

8 **MS BATES QC:** Why not?

9 **MR TOLICH:** It's a good question. They pay commission. You
10 would say so, you would say -- because I think that was
11 behind "why wouldn't we", and the interesting that thing is
12 that ultimately under most of our structures these days,
13 which are management fee structures, so we often give back
14 levels of commission anyhow that we earn depending on what
15 the structure is.

16 But with Virgin, if you've got someone flying Auckland-
17 Sydney, Melbourne-Auckland, they will invariably inter-line
18 with Qantas or with -- with Qantas internally, even if it's
19 an Air New Zealand traveller. Occasionally they'll buy
20 Virgin, and that's what they do, but it's not often. I
21 mean, it's a tiny portion of our business.

22 **MS BATES QC:** I don't want to be too long, because we're a bit
23 time constrained, as you know, but I'm a just a bit puzzled
24 because --

25 **MR TOLICH:** Well, they don't.

26 **MS BATES QC:** -- if you are acting in the interests of your
27 corporate customer, and you can get a much better deal
28 through Virgin, why don't you suggest it to them?

29 **MR TOLICH:** Oh, we do. Oh, no, but you can. I mean, you can
30 suggest all sorts of things to a client, and the corporate
31 traveller is an interesting animal. Sitting at home on the

1 internet at night we will look for the cheapest deals. The
2 corporate traveller wants a bulk deal overall; they can't
3 afford to muck about all the time. So, if they're going on
4 one carrier to Sydney, they will look at Virgin to go to
5 Melbourne, and we will book it; we will offer it, it's
6 offered, but they don't always take it. It's a proportional
7 thing. It's small compared to what they'll do with Qantas.

8 **DR PICKFORD:** Can you tell us a little more about the trend in
9 internet bookings for tickets please? The Applicants have
10 claimed that this is a way the customers bypass the
11 distribution system and it's likely to get more important in
12 the future.

13 **MR TOLICH:** We have our views on it and I think what we all have
14 to appreciate is, as corporate travellers and as holiday
15 travellers, that the internet is both the world's biggest
16 time saver and the world's biggest time waster, and if you
17 have any -- the airlines are very good at encouraging
18 corporate and holiday people to book direct believing it is
19 the cheapest way of buying your ticket. It's not. You may
20 find the cheapest Air New Zealand fare on the website, but
21 you won't find the cheapest Qantas fare, or the cheapest
22 Virgin fare, or the cheapest Thai fare or the cheapest
23 whatever fare for a start.

24 But moreover, it's the time that it takes. So, I think
25 the effort and the marketing effort that's going in by
26 airlines to encourage clients to book on the web is slightly
27 mischievous, because it's transferring the cost back to the
28 client, to the consumer. The time that corporate
29 New Zealand is spending fiddling around on the web trying to
30 find a cheaper deal; if anybody's got staff or travellers or
31 executives sitting at their screen at work spending half an

1 hour trying to find a cheaper fare to Wellington or
2 Christchurch; who's encouraged you to do that? And, why?

3 I guess my point being, that if your -- your travel
4 agency is critical there, so there is a propensity -- to use
5 the word -- but it's been encouraged by pricing perhaps, and
6 also by marketing. You're not going to necessarily get the
7 best deal by doing it that way.

8 **CHAIR:** Okay, I would now like to thank the Travel Agents
9 Association for the submission and, as I indicated to
10 Mr Murphy, it is important for the Commission to have access
11 to people who have expertise in downstream markets. So, we
12 are grateful to you, so thank you very much.

13 I propose now to take a tea break and to resume at 25
14 minutes to the hour, so the meeting is adjourned.

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17 **Adjournment taken from 11.25 am to 11.45 am**

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PRESENTATION BY SAVE AIR NEW ZEALAND

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3 **CHAIR:** I'd like to reconvene this session, and welcome the Save
4 Air New Zealand submitters, and ask you to please introduce
5 yourselves for the record and begin with your submission
6 when you're ready. Thank you.

7 **MR HALLIDAY:** Madam Chair, Commissioners, it's my privilege as
8 Convenor of the Save Air New Zealand group to take part in
9 this meeting and to present to you those who are also
10 participating; on my left Robin Halliday, a person who's had
11 a distinguished record in working in a number of important
12 communities issues, including international positions and
13 including other areas. Alastair Thompson who's editor of
14 Scoop Media who's been acting as the communications adviser
15 to our organisation since we first established.

16 Oh, and I am Dr Ian Prior. I'm here, I guess, because
17 over a number of years I've been involved in what seem to me
18 to be important social issues, and on the basis of that I
19 became involved with Air New Zealand.

20 So, the Commissioners will be aware from the three
21 submissions that we've made that our organisation developed
22 out of an organisation called Debate Air New Zealand which
23 came together when we first heard publicly about the
24 development of this alliance, and at that stage we initially
25 sought to promote debate and discussion about the proposed
26 alliance.

27 We had a very good meeting attended by a number of
28 leaders of the political parties who were very much in
29 favour of looking critically at the proposal. We had to
30 change direction, however, when on the 18th of December the
31 Government in fact passed the proposal and any question of

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1 debate about it over to the Commerce Commission.

2 Save Air New Zealand, as part of our strategy, has
3 sought to find out from a wide range of New Zealanders their
4 views on the proposal and its long-term implications. As
5 someone who has done a lot of his life's work in terms of
6 epidemiology and working with populations, we tried to think
7 out critical questions that could be easily asked and yet
8 give us some indication of what were thinking.

9 We found that most were aware that our New Zealand
10 Government injected more than 800 million on behalf of the
11 people of New Zealand to rescue Air New Zealand from
12 receivership, from what Mr Norris has described as near
13 bankruptcy. We use simple questions, we asked people, "Do
14 you believe the proposed Air New Zealand/Qantas merger
15 should go ahead?" the answer, almost universally was no.

16 Opinion polls found in fact that 90% of New Zealanders
17 were against the proposal, and we believe that is because
18 New Zealanders well understood the shortcomings of
19 monopolies that we had experienced in the past, but also,
20 had a strong feeling of loyalty towards Air New Zealand even
21 though that had been considerably stressed by the sad
22 situation in which it has got into when Brierleys and others
23 were in charge.

24 The Right Honourable Michael Cullen's response to these
25 polls was to agree that he thought 90% of the population
26 were against the merger, but felt that this was just a
27 hysterical anti-Australian answer. We challenge that, but
28 we decided that it was probably necessary to do further
29 research into New Zealanders and find out why they were
30 against the deal. And also, to continue to sense whether
31 they did have a distrust, whether there was a strong public

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1 distrust of the deal and how it might impact on the market
2 that they were concerned about through lack of competition.

3 On setting up our organisation, Save Air New Zealand, it
4 was clear from the letters we received, from all sections,
5 from politicians and others, and contacts we had, that there
6 was in fact considerable opposition among business leaders
7 and members of the political parties, excluding Government,
8 to the proposal. And, as I've already said, the swift move
9 to pass it over to the Commerce Commission cut across any
10 opportunity for debate through Select Committees, as some
11 politicians hoped, or in other ways.

12 We tried to think of a pattern of strategies that we
13 could get to try and consolidate what was going on and our
14 views about it. We developed a website, and my colleague
15 here was responsible for that, in a very effective way
16 through his organisation and around 700 people, many of them
17 from the industry but many of them from business, many of
18 them from up and down the country, came in on that website,
19 especially in opposition to the proposed merger.

20 And, in the document that is available to the
21 Commissioners and to the press and will be on the
22 Commission's website, there's a list of the 700 people and
23 their occupations and you will see that there's a very wide
24 group, very strong people and so on.

25 The other thing we did was to closely monitor the media
26 coverage of the project, and we have in fact done that from
27 almost the outset. We have sent some of this to the
28 Commission, we employed a researcher to do it, she went
29 through these, and the media for the most part. The analyst
30 dealing with aircraft, the analysts on the business side
31 almost all have really critically looked at this proposal

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1 and it makes very interesting reading.

2 We also reviewed the form of submissions made to the
3 Commission and printed them all out; there were 82 or
4 something I think there are. This identified a number of
5 people with considerable experience in the aircraft industry
6 and also in business and other things who were really really
7 concerned and critical of the project. I will quote from
8 one of these this is a man who, I'll give you his name at
9 the end:

10 "I am of the clear view that the arrangements as
11 proposed are unnecessary and against the long-term
12 development of Air New Zealand, the tourism industry of
13 New Zealand, the travelling public and the national
14 interest. Air New Zealand has in the past been a very
15 successful airline. In my view it can once again be
16 successful without entering into what is an unacceptable
17 series of transactions with Qantas which would seriously
18 compromise the future of the company."

19 This is from Norman Geary who is a previous CEO of Air
20 New Zealand, he was Chairman of the New Zealand Tourist
21 Board, and he and others like him with his experience, and I
22 won't have time to go into all of them, although they made
23 quite exciting reading, had a strong basis of thinking going
24 into this.

25 We also made other investigations, which I don't have
26 time to go into, such as looking at some of the critical
27 things people were saying about this development and the
28 advantages of it; the fact that we were going to go into
29 bankruptcy, Air New Zealand would go bankruptcy, and I think
30 it was Mr Norris, but in fact we're all aware how Air New
31 Zealand is now improving itself in many directions and

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1 there's a lot of new thinking coming into it, and we
2 appreciate that.

3 Now, one of the key objectives of our organisation has
4 been to provide the man in the street representation to this
5 Commerce Commission process. This process is inherently
6 rather threatening to the ordinary citizen. Complex
7 economic arguments and lawyers do not create an encouraging
8 environment for the general public, and so Save Air
9 New Zealand believes we have had to consider our
10 responsibility to try and present their point of view.

11 Although, I have learnt in previous campaigns, when
12 people come up to you and say, "How's it going?" and I say,
13 "Oh, not bad". They say, "Well, keep going", and I won't go
14 into that, but to me that's been important.

15 I think it's also important that the Consumers Institute
16 is represented here by David Russell, the very able
17 director, and we expect they too will make important
18 contribution to the thinking that has to go on.

19 In conclusion, I would like to make it clear to the
20 Commission that Save Air New Zealand does have some high
21 quality people and thinking involved in it; we do not
22 believe our task ends at 2 o'clock today or whenever your
23 deliberations come out, we intend to continue to perform the
24 function we have performed to date until this debate is
25 finally concluded, and this may take some time, particularly
26 as someone has suggested, that it may be carried to further
27 courts and all that sort of thing.

28 Well, thank you, I may have gone over my six minutes,
29 but I will now pass the torch to Robin Halliday, secretary
30 of Save Air New Zealand and she'll make a few observations
31 about the deal from the thinking that we have developed and

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1 from the point of view of the man in the street and then to
2 Alastair Thompson. So, Robin.

3 **MR HALLIDAY:** Thank you. Well, I cannot claim to be an expert,
4 I'm not part of the airline industry as Ian has said, or a
5 major customer. My usual interests are in foreign affairs
6 or international affairs and in the arena of the
7 resettlement of refugees.

8 When I was sort of thinking of a reason for being here,
9 apart from encouraging Ian, as he said, to keep going, which
10 I did, I could say that as Chair of the Refugee Commission,
11 that we do bring 750 quota refugees here a year, plus about
12 500 family members. That is a very very small group of
13 people travelling on our airlines, but it is a group.

14 As a New Zealander, though, I do believe that the
15 proposed merger would not promote market efficiency by
16 fostering healthy competition or offer a real choice to
17 customers and be of sound economic regulation. This,
18 I believe, is the purpose of the Commission as I understand
19 it to rule on.

20 It is acknowledged by the Applicants to be anti-
21 competitive, and as we have heard it could lead to
22 restrictive trade practices. Save Air New Zealand, though,
23 agrees with Air New Zealand's Chief Executive Officer that
24 the future of the airline is critical to the future of
25 New Zealand's tourism industry and, therefore, to the future
26 well-being of New Zealand.

27 Indeed, it is our national carrier and it's koru
28 branding connects us when we're overseas and we see it in
29 some way as a national icon. I think it connects to those
30 who are overseas with New Zealand as a way of identifying
31 them.

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1 New Zealanders see this role as including the promoting
2 of New Zealand as a prime destination. They want too a
3 reliable service for exporters, many of whom are in the
4 regions, and so we also need a competitive market in the
5 domestic aviation.

6 We know of the flower growers of Otago but there are
7 many others, especially in the niche markets and primary
8 products and specialist small manufacturers, who need
9 guaranteed capacity, reliable network facilities and
10 competitive pricing. In short, Air New Zealand is critical
11 to keeping New Zealanders working and the economy
12 functioning.

13 New Zealander's view of Qantas is interesting. Qantas
14 Chief Executive, Geoff Dixon paints a very gloomy picture of
15 the airline industry. At a Futures Conference in Australia
16 in June, and I used to do some work for the Futures Trust
17 here, so perhaps I noted this in particular. He spoke of
18 Qantas as being "in a race to the bottom", it was in answer
19 to a question.

20 Does he now believe that Air New Zealand can rescue
21 Qantas? Or is there to be a mutual suicide pact? If so, it
22 would seem to be a huge shame. Qantas has been far slower
23 to adapt to circumstances than Air New Zealand. It is only
24 now moving to compete in the VBA market, and it is in the
25 process of laying off up to 9,000 staff.

26 Air New Zealand meanwhile is thriving, notwithstanding
27 the fact that their management spend as much time running
28 down their prospects, which they seem to do, as to promoting
29 their new strategies. We have heard from the tourist
30 industry, from a number of groups who have congratulated Air
31 New Zealand on their current management style and where they

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1 are going and what they are doing.

2 New Zealanders want choice. The much vaunted war of
3 attrition between Qantas and Air New Zealand has become more
4 or less, at their own admission, not much more than an
5 annoying drip. So, we say, cut out the fat, the lawyers,
6 the threats of High Court action, the spin doctors, the
7 overseas economists -- which I felt a little sorry for at
8 times -- Air New Zealand doesn't need Qantas, and Qantas
9 doesn't need Air New Zealand.

10 New Zealand does, though, need an airline to focus on
11 its needs, kept efficient by healthy competition. We have a
12 simple message for Air New Zealand; believe in yourself.
13 And, I thank you for allowing us to present.

14 **DR PRIOR:** I'd now like to ask Alastair to contribute.

15 **MR THOMPSON:** Some of you may be wondering why a news reporter
16 is involved in lobby groups such as Save Air New Zealand,
17 and the answer to this question illuminates one of the
18 aspects of this process.

19 As Dr Prior said, the pace with which this proposal
20 moved from a twinkle in the Minister of Finance's eye to a
21 full-blown proposal before this Commission was breathtaking.

22 Dr Prior asked me to assist him and, as time went on, it
23 became apparent that unless our group opposed this deal
24 publicly, nobody probably would do so. It's quite pleasing
25 to see that there are several groups here also opposing it,
26 but they haven't had a very high profile.

27 We, Save Air New Zealand, are not comfortable with the
28 extensive use of -- the nature of this process means that
29 the Commerce Commission is very much being relied on to
30 represent the public interest itself and we thank you for
31 doing so and your initial finding in particular was a

1 victory for commonsense we feel.

2 We, Save Air New Zealand, are not comfortable with the
3 extensive use of computer models because of the uncertainty
4 as to how or why the models come up with their outputs.
5 There is no justice being seen to be done if commonsense can
6 be subsumed from the output of a computer-based model.
7 Computer models are particularly poor, especially at
8 reckoning the attitudes, prejudices and biases of consumers.

9 Real consumers are strongly influenced by support for an
10 airline that they feel is theirs and which, by virtue of a
11 Government shareholding, is in fact theirs. How is this
12 factored into the computer model?

13 The Commission has hear quite extensive presentations
14 from a range of people who would be impacted by this
15 proposal, but there are great many more people that are
16 going to be impacted who have not turned up to present to
17 you, but please don't assume that their absence is to do
18 with apathy or indifference.

19 I note there that the Travel Agents Association was
20 talking a lot about the corporate market and the impact that
21 this is likely to have on them. A lot of the corporates
22 have actually in fact signed up to the Save Air New Zealand
23 campaign, including some very prominent business people.

24 The comments we've received from people over the past
25 months indicate that the process is very intimidating.
26 Moreover, our experience in Save Air New Zealand indicates
27 that for some people involved in businesses impacted on by
28 Air New Zealand the intimidation has at times been more
29 direct and this, in our view, is a huge shame. The fact
30 that Air New Zealand has sought to stifle debate over its
31 proposal through such means tends to indicate that it may

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1 not be all together confident in the merits of its own
2 proposal.

3 Ms Rebstock noted last week that it helped to have
4 interested parties turn up and have their say. We want to
5 make the point that merely because a lot of interested
6 parties are not here doesn't mean that they're not
7 interested.

8 We understand at the heart of the Commission's
9 deliberation is the question over whether the travellers'
10 loss is outweighed by the airlines' gain and this is a point
11 that we'd strongly disagree with. Firstly there's the
12 question of the gain for the airlines. Perhaps Qantas has
13 something to gain out of a relationship with Air New
14 Zealand; reduce competitive pressures and costs in New
15 Zealand, more profit on the Trans-Tasman routes seem to come
16 to mind, but it is difficult in the extreme to see what is
17 in it for Air New Zealand.

18 Though Air New Zealand claims it will be impacted by new
19 competitors such as Virgin Blue, these are at present merely
20 proposals, and with the Express Class in place it is hard to
21 see how Qantas' war of attrition would have a significant
22 negative effect.

23 Regarding the extent of travellers' loss needed to
24 provide for this chimerous benefit, the question is begged;
25 why should travellers incur any losses? In our view, this
26 is also a wrong-headed way to approach the question.

27 In the alternative the argument in favour of this deal
28 accepts around several propositions for which there are no
29 evidence. These are firstly that Air New Zealand is doomed
30 without an alliance. All available evidence thus far
31 suggesting that Air New Zealand is actually doing extremely

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1 well.

2 Secondly there's the argument that there will be a war
3 of attrition if the deal is rejected. Whether this is the
4 case or not is entirely within the power of the Applicants.
5 This argument is a little like them saying unless we get
6 what we want we'll shoot each other. There's no reason for
7 this to happen save for pure stubbornness.

8 Thirdly, that the deal will help New Zealand tourism and
9 the economy as a whole. New Zealand tourism has been
10 growing much faster than Australian tourism for some time,
11 meanwhile the end of Air New Zealand's involvement in the
12 Star Alliance, it is conceded, will have a negative effect
13 on tourism. Any positive effect through Qantas financed
14 promotion is purely speculative and as other submitters have
15 pointed out, flies in the face of commonsense.

16 Finally, there's the argument that consumers will not be
17 negatively impacted by a lessening of competition because
18 efficiency gains will enable lower prices to be delivered.
19 If this was the case, then why does the Commission look
20 askance at any monopolies? Respectfully, this argument is a
21 little like saying down is up and that black is white.

22 Finally, there were a number of specific points that
23 Save Air New Zealand would also like to reiterate from its
24 submission. Firstly, the users of airlines are what
25 matters. Airlines are not altruistic and they can only be
26 relied on to focus on the users when competitors oblige them
27 to do so.

28 Virgin, the Emirates and other airlines may or may not
29 fly in or fly out of New Zealand. The long history of
30 New Zealand aviation is that New Zealanders are a scarce
31 commodity. Some of the historic barriers to entry may no

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1 longer be prevalent, but until Virgin have really set up and
2 are up and running and have significant market share, it
3 would be a brave Commission who would act as though they
4 were already here.

5 The New Zealand Government has backed Air New Zealand
6 because it saw it as a company that was too important to
7 fail. The Government should not be relied on to always be
8 there, but the reality is that the Government does stand
9 behind Air New Zealand and that is a real provable fact, not
10 a hypothesis or a forecast. All decisions made by the
11 Commerce Commission should reflect Governmental support of
12 Air New Zealand as the main provider of air travel in and to
13 and from New Zealand.

14 Qantas' Geoff Dixon said that Asian airlines have
15 Government support and he effectively said that the
16 New Zealand Government should further support Air New
17 Zealand by granting it a virtual monopoly. That should not
18 happen, if Government wants to support Air New Zealand
19 because of what it does it should do so directly and
20 transparently via funding, not by allowing it to extract
21 monopoly rents from New Zealand aviation consumers. I would
22 add that Mr Dixon's remark reveals a lot about what his real
23 motives may be.

24 This deal is not good for Air New Zealand as a business.
25 It is an easy way out of doing what any real business ought
26 to do, which is compete, and it is not a route for long-term
27 growth and strength.

28 An important factor to Qantas feeling it should maintain
29 an independent NZ presence is that it will be obliged to
30 work really hard on this market, will have to be innovative,
31 develop support, and generally try hard to recruit

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1 New Zealand consumers. That sounds great for New Zealand,
2 and it certainly isn't something that should just be given
3 away.

4 Finally, in respect to the airline proposal and the
5 support it received from previous and other airline CEOs
6 etc, we note that much of the supporting evidence was aimed
7 at drawing analogies between the things that happened in the
8 US, in Europe and/or are considered likely to happen in
9 those places. The Commission should be very careful about
10 putting weight on attenuated inferences. For a start, the
11 European and United States markets involve large numbers of
12 payers and latticework of routes. New Zealand is an
13 isolated market and has only two players.

14 The Commission should also note that as I stated at the
15 beginning of this presentation, that Air New Zealand is a
16 company that New Zealanders like and support. This may not
17 be something you can easily factor into a computer model,
18 but it is undoubtedly out there and something that should be
19 recognised in the Commission's final decision. Thank you
20 very much for listening.

21 **CHAIR:** Thank you. We have a few questions now, if you're
22 agreeable.

23 **DR PRIOR:** What would happen if I said we were not?

24 **CHAIR:** We'd probably ask them anyway.

25 **DR PRIOR:** No, we're very agreeable.

26 **CHAIR:** Actually, I always tell people who want to use all the
27 time for presentations, that it would be unfair of them to
28 not have the opportunity to respond to the Commission's
29 questions, because it usually tells the parties something
30 about where the key issues sit. So, I hope you'll find it
31 useful to take the questions.

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1 I just want to go back to the comment that you made
2 about, and I believe it was Mr Thompson, made the comment
3 about Virgin may or may not fly in and out of New Zealand,
4 and it would be brave of the Commission to act as if they
5 were here.

6 Can I take it from that comment, that if they had
7 actually entered and were up and running here, that you'd be
8 far more comfortable about the competitive impacts of this
9 proposal?

10 **MR THOMPSON:** It wouldn't be the creation of a monopoly in that
11 circumstance, so yes, we probably would be a little bit more
12 comfortable about it.

13 **MS HALLIDAY:** Could I just say something. We didn't perhaps
14 talk but others have about VBAs and other entries expanding
15 the market. We've talked -- so much has been focused on
16 market share rather than the market size. We believe there
17 is tremendous potential for expanding our market.

18 One of the things that we stressed of course, is that
19 the Star Alliance network is immensely important, but many
20 of our potential markets are places like central Europe,
21 China. There's 40,000 Chinese students here and 60,000
22 Chinese tourists a year. Now, if you extrapolate the growth
23 in that, then that is a huge market.

24 Asia and the Middle East. The Middle East, I know of
25 refugees who are looking at going in and in fact are going
26 into the tourist market because they are Arabic speakers and
27 they believe that there is potential there. These things
28 are exciting, if we see them as that, rather than simply
29 competition. It is a bigger market for everybody to operate
30 in.

31 **CHAIR:** I might just follow that up, because it is a point that

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1 we've heard a lot of submission on, that a lot of the
2 benefits will come from expanding the market, and there have
3 been a lot of judgments made about how that might happen,
4 and we've heard a great deal of evidence that low cost
5 carriers are very effective at expanding markets such as
6 this, and there's two competing views.

7 One is, is that the alliance actually makes more room
8 for that low cost carrier to come in and set up and,
9 therefore, achieve those benefits, and the other view is
10 that, no, the low cost carrier will do better if it's got
11 the two companies to compete against it separately.

12 I'd like your view on that, because in a way we've seen
13 Virgin Blue sort of shift their relative position on some of
14 these matters, so I'd be interested in your comments on
15 that.

16 **MR HALLIDAY:** I challenged The Herald journalist here last week
17 about their headline about, "virgin wants the alliance now"
18 because, listening to them, I would have said they sat more
19 on the fence on that, trying to judge presumably what is
20 best for them. But I guess it is one factor, and an
21 important factor, in their decision as to whether they come
22 or not.

23 **DR PRIOR:** I don't think we should use that as an indication for
24 supporting the alliance. Let both major airlines stay
25 essentially separate and develop some relationships, and
26 recognise that important things are happening.

27 I had to get up early to get here today. I heard on the
28 news how Auckland Airport is being almost flooded by planes
29 coming in with people who have got money in their pockets
30 and want to see the country. It's become apparent to me
31 that we're at a state of extraordinary developments going

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1 on, that you have to keep an indication of how they're
2 happening and how they can strengthen our country, and maybe
3 strengthen Qantas as well. Did I answer you?

4 **CHAIR:** I think you did. I might follow up with a slightly
5 different question, if I can.

6 You seemed, in some of the presentation, to be very
7 concerned about the Air New Zealand brand and the way both
8 New Zealanders and others view it, and yet the proposal
9 seems to secure that brand in the sense that the Air New
10 Zealand brand will remain in place, and I wonder if that
11 doesn't go a long ways to meeting some of the concerns?

12 **MR THOMPSON:** Well, I can't speak for everybody, but for my part
13 it's not the brand that has been the major issue; it's the
14 issue of a monopoly. I find that the prospect of the
15 Commission establishing what is effectively a 100% monopoly
16 within the New Zealand market, is an anathema to all logic.

17 **CHAIR:** I guess that's dependent, isn't it, on coming to the
18 view that entry is not likely --

19 **MR THOMPSON:** I don't know if it is dependent on entry being
20 likely or not. Virgin Blue has made a large number of
21 different statements and changed its position on a monthly
22 basis. For all we know, they could have a plane crash or
23 something could happen, or who knows what would happen. I
24 don't know -- I just seem -- as I said, it seems it's a
25 courageous Commission that would come to the conclusion that
26 we're going to be defended from a monopoly by a player who
27 doesn't even exist at this point in time.

28 **CHAIR:** I'll ask you one question and then I'll allow other
29 Commissioners, but did you want to follow that up, Dr Prior?

30 **DR PRIOR:** Following on from what you said, I think
31 New Zealanders are both very proud and feel we should hang

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1 on to our brand and the koru, we shouldn't link it quite
2 like this -- [**holds up Listener magazine**] -- as it came in
3 The Listener when Campbell, the writer, spoke of this:
4 "Fish need bicycles as much as Air New Zealand would seem to
5 need a strategic alliance".

6 One thing that has concerned me while watching this, in
7 the very full presentation by Mr Norris he mentioned that
8 this alliance was going to have a very good understanding
9 with Qantas in terms of how decisions were made, and that we
10 knew that there were more planes coming in, more Qantas
11 planes coming in, 200 more people, a bigger operation, and
12 yet it said Air New Zealand is still going to be the body
13 responsible for using these and disposing them in the
14 country. I may have misinterpreted it because it sounded
15 very trusting of Qantas, and I didn't really think they
16 would accept that. So...

17 **CHAIR:** I just want to come back to a matter that seems to
18 underlie your submission, and certainly the title of your
19 group; it seems to suggest that Air New Zealand itself
20 doesn't know what's best for it, and it's an interesting
21 thing when you see -- you know, and I think everyone has
22 seen the polls that you refer to, there's wide resistance to
23 a change of tack; and yet the company is proceeding down
24 that path, and they themselves have submitted to us that,
25 you know, in the absence of better information on some of
26 these things we should accept their submission.

27 But, you do seem to have -- there seems to be a
28 presumption here that you know what's better for this
29 company than they know, and that you also think it would be
30 better for the nation, but you certainly seem to have come
31 to a view that they're able to survive as they are now,

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1 which is contrary to the position that they have stated.

2 So, I wonder what your views are on the position the
3 company itself has taken?

4 **MR THOMPSON:** I think, it's a very interesting question as to
5 why Air New Zealand chose to go down this path, and I think
6 that the answer -- I mean I'm a political journalist by
7 trade and I think the answers are essentially political. I
8 think that Geoff Dixon has always wanted Air New Zealand to
9 be a subsidiary of Qantas and he went to his political
10 allies in Canberra and said, "can you help us have a bit of
11 Air New Zealand?" And then Michael Cullen and Helen Clark,
12 who were probably a little bit concerned about their
13 relationship with Australia at the time due to the war in
14 Iraq and various other things, said, "Well, okay, maybe we
15 can't support you on that, but I mean we'll help you get a
16 bit of Air New Zealand", and then the Board of Air New
17 Zealand essentially responded to those political signals.

18 At the beginning of this whole process when we set up
19 and we initially decided that we were called Debate Air New
20 Zealand, we thought there would be a political argument.
21 There wasn't. There was a long period where Michael Cullen
22 denied absolutely that any negotiations were underway with
23 Qantas and then all of a sudden there was a 700
24 page proposal and there wasn't allowed to be any discussion.
25 Now, that doesn't strike me as the sort of circumstances
26 that would arise if there was a genuine commercial debate
27 going on.

28 **DR PRIOR:** Another point that I had to exclude from my earlier
29 paper because of the shortage of time was that it became
30 clear that the Honourable Dr Michael Cullen said that this
31 could give New Zealand an opportunity to become -- the link

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1 with Qantas -- the third largest airline in the world. That
2 to me didn't seem a good way to go.

3 Coming back to your other point, we have to accept that
4 Air New Zealand for a number of years has not been really
5 properly well managed in terms of how decisions were made,
6 and that led to the receivership. If you read it up, of
7 course all those board members very wisely moved off.

8 We think now the present management of Air New Zealand
9 is in good hands, they're making good decisions, and that
10 decision to get married to Qantas goes back a bit, and we
11 think it has to be re-looked at in terms of the new
12 information coming forward; the profit they're making, the
13 new -- Freedom Air going, the Express air, Tasman Express
14 and start taking advantage of all that at a time of change.

15 I've learnt long ago, you know, if a patient is doing
16 well or starting to show signs of recovery, just wait and
17 see and encourage. It's only when they're sick that you
18 have to make drastic action, and I think this was looked at
19 as drastic action way back by our two -- by the two airlines
20 and by our political leaders, thinking oh golly, we must
21 somehow save this. But the patient's improving.

22 **CHAIR:** Thank you. [**Pause**]. Okay, I would like to thank you
23 now for your submission. I would like to note a couple of
24 things. You did comment that proceedings such as this can
25 sometimes be intimidating for the wider public, and I do
26 understand that the technicality of it can put people off,
27 and the Commission though is clearly of the view that we
28 benefit hugely; in fact it's highly desirable and necessary
29 that we get submissions from the public and from people who
30 are trying to represent the public's view. The test clearly
31 is a net public benefit test and we do need to know what the

1 public thinks.

2 I also noted in your submission a concern about the
3 timetable, and I would say for the record that, as far as
4 I'm aware everyone at this proceeding was given the time
5 they requested except for the Applicants, which even the
6 Applicants, I suspect, eventually got the time that they
7 wanted. So I do hope that people feel that they have had an
8 adequate chance to present and be heard by the Commission.

9 So, having said that, I do thank you most sincerely for
10 your submission.

11 **DR PRIOR:** Going through the 80 odd submissions that were
12 formerly put forward to you, from a whole range of people
13 and I think that answers to some extent the question; you in
14 fact have been exposed to views from a wide range of things.

15 The timing of it, all I can say is, I'm glad that we are
16 talking on Monday rather than last Friday, because we're
17 making a much better case.

18 **MR HALLIDAY:** I would like to thank you too having -- this is my
19 first experience of this Commission, and I would like to
20 thank you for the time you have allowed us, for the
21 submissions and so forth all being available on the web, and
22 for the access that has been there, thank you very much.

23 I think, though, there is a perception perhaps rather
24 than a reality about how intimidating it is. Thank you.

25 **DR PRIOR:** Everyone in this room should get this book -- [**holds**
26 **up book**] -- A Century of Aviation in New Zealand, and you
27 will become really proud of what we've come through. TEAL,
28 NAC, Air New Zealand, and whatever outcomes forward.

29 **CHAIR:** Thank you very much. Now, I will ask the Consumers
30 Institute to come forward, please.

Consumers Institute

1 obviously a volatile industry. We've seen all sorts of
2 competing economic analyses that have resulted in a huge
3 range of possible outcomes. Who's right? I don't know.
4 There's hundreds of millions of dollars worth of variations
5 resulting from various economic analyses; they can't all be
6 right, and it doesn't seem to us that it can be said with
7 any certainty that any one is correct.

8 Also there's a new uncertainty, if you like, that seems
9 to have arisen over the last week; exactly what is happening
10 with the entry of Virgin into the market. It seems Virgin
11 is a vital part of any public benefit that's going to
12 happen, and it's very unclear exactly what form that entry
13 is going to take at the moment.

14 We said in our original submission and we still believe,
15 that it can't be said that Air New Zealand's incapable of
16 meeting the threat of competition with Qantas, that the war
17 of attrition will result in Air New Zealand being destroyed,
18 and we really just point to the fact that Air New Zealand is
19 doing very well at the moment, the New Zealand public is
20 enjoying really good fares, the best fares we've ever seen,
21 and planes are full, they're flying full flights and that
22 that should continue.

23 Air New Zealand's not a little minnow, it's a well-
24 established airline, it's a big incumbent airline in
25 New Zealand, and it has the advantages of being perceived as
26 "our airline".

27 The economic analyses we've seen, we've had a huge range
28 of experts, we've had a vast range of views, and it seems to
29 us that all we can say now with any certainty, that it's
30 impossible to be certain about what's going to happen.

31 We've had a lot of economic analysis from the Applicants

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1 based on foreign airline experiences, particularly in the
2 USA, and naturally New Zealand's a very different market,
3 it's a very small market and we've got two big players at
4 the moment who want a monopoly next week.

5 We think that the Commission should place a lot of
6 weight on its own analysis and on the analysis of opponents
7 of the merger; analyses which have taken into account the
8 New Zealand situation in a way that the Applicants and
9 economic analysis never did.

10 The Applicants have made a great play of opponents being
11 ignorant of the airline business and of being vested
12 interests; a view that only we know how to run an airline.
13 Our response to that is that the Commission should rely on
14 its own analysis as being an unbiased assessment of the
15 application, and we would also like to point out that the
16 Applicants surely have the most vested interest of anyone.

17 The Applicants have promised cost efficiencies through
18 the application. Our response really is that there's no
19 obligation for the Applicants to pass on those efficiencies
20 to customers and our experience is that monopolies don't
21 tend to pass efficiencies on to customers. One person's
22 efficiency is another person's fare increase really.

23 There's also the fact that Applicants are likely to have
24 to duplicate capacity for certain services so that they can
25 unwind the application later on if it turns out it doesn't
26 work out, and that seems to us to be a barrier to capturing
27 efficiencies; in fact, it seems highly inefficient that some
28 infrastructure will have to be duplicated to enable an
29 unwinding down the track.

30 Picking up on something that Save Air New Zealand were
31 talking about; the application proceeded on the basis that

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1 what's good for Air New Zealand is good for the rest of us,
2 and we don't agree with that. You also have to assume, for
3 the application to make sense, that there's something about
4 Air New Zealand that just flies an exemption from the rules
5 by which the rest of business in this country are expected
6 to operate. If that's the case, it seems strange that we'd
7 want to sell to an Australian airline, but I think you need
8 to balance the nebulous pride in having our own airline with
9 the fact that -- sorry, balance that pride with the fact
10 that what New Zealanders really want is good, continued
11 service, continued cheap fares.

12 Now, I think New Zealanders will support their airline,
13 but I don't think they should have to do so at the cost of
14 higher fares.

15 It doesn't seem to us that the application has
16 demonstrated that the benefits can only accrue with the
17 proposed arrangement going ahead. The application shouldn't
18 be authorised without a clear demonstration that benefits
19 can't be captured by code sharing with any other non-anti-
20 competitive arrangement.

21 **CHAIR:** On that particular point, if I can just interrupt you
22 for a second if you don't mind.

23 Are you referring specifically to the benefits that have
24 been claimed vis-a-vis the tourism benefits, or is it mostly
25 the inter-line activity?

26 **MR DOOCEY:** It was more a general observation really, that the
27 benefits that are claimed for the application should be
28 benefits that are only available if the authorisation
29 continues.

30 **CHAIR:** Okay. Thank you.

31 **MR DOOCEY:** We touched in our short submission on conditions.

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1 We're not sure that there are conditions that could deal
2 with the concerns that we have -- deal with the dangers of a
3 monopoly. This is a market that seems to change quickly and
4 change frequently, and conditions must accordingly be
5 difficult to enforce, difficult to put in place. We're not
6 convinced that any of the conditions the Applicants have
7 offered go far enough in dealing with the potential
8 problems, and in fact I think the sort of conditions that
9 you'd have to put in place to deal with potential problems
10 make the whole exercise pointless.

11 Other than that, really we stand by our original
12 submission.

13 **CHAIR:** Thank you for that. I might just start, if I may, with
14 some questions. I think at the beginning of your submission
15 today you picked up on a really important point that has not
16 been raised here, and that is, the issue about the degree of
17 certainty that the benefits should be achieved. I'm sure
18 you're aware that the Act actually talks about the
19 Commission needing to be satisfied that the proposed
20 arrangement would in all the circumstances result, or likely
21 result in a benefit to the public that would outweigh the
22 lessening, and I decided to come back to it, not because I
23 disagreed with you, but because it is such an important
24 matter, that the test -- it is a strong test, it's a high
25 hurdle, it's because of the nature of these arrangements
26 that the test is set out in that way.

27 So, I assume that you were drawing on that aspect of the
28 Act when you made those comments?

29 **MR DOOCEY:** Yes.

30 **CHAIR:** I don't know if you have anything further you wish to
31 say on that, but I think you are one of the few submitters

1 who have commented on that, so I --

2 **MR DOOCEY:** Well, it seems to me that there's almost been an
3 assumption, that if there are benefits, that that's enough.
4 But obviously the benefits need to outweigh detriments, and
5 that it seems to me, given the wide range of views that the
6 Commission's heard, that it's very difficult to have that
7 certainty, and if you're not certain then the application
8 shouldn't be authorised.

9 **MR RUSSELL:** It may sound like heresy, but if New Zealand -- Air
10 New Zealand failed, others would come in and take its place.
11 So what we're talking about here is constantly, or what I've
12 heard so far constantly, is the survival of Air New Zealand
13 and how essential it is to the economy of New Zealand for
14 the survival of Air New Zealand.

15 That doesn't necessarily -- or isn't a necessary
16 conclusion to reach, if Air New Zealand doesn't foot it in a
17 competitive market, then it is quite possible that there
18 will be others who will, and they then could, just as Air
19 New Zealand claims it's going to by this alliance, provide
20 benefit for the consumer of New Zealand.

21 So, there is this underlying national desire, which I as
22 a red-blooded New Zealander of course would dearly wish that
23 Air New Zealand does continue to survive, but nevertheless
24 in terms of benefit to the consumer as a consumer of air
25 travel, it doesn't follow that the benefit is going to be
26 provided solely by Air New Zealand.

27 **CHAIR:** I might just follow that up, Mr Russell, because you may
28 not have heard, but on the opening -- in the opening day we
29 had a submission from Mr Dixon that, if it was right that
30 one of -- and certainly they're submitting that it would be
31 Air New Zealand that would not survive; he strongly

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1 suggested, having watched Ansett fail in Australia and the
2 consequences to Australia of that, that there were huge
3 benefits here and a soft landing in terms of a smoothing
4 transition through time rather than allowing a company to --
5 a company that is so important to an economy to fail.

6 You've taken quite a different position on that. That
7 your view is, they should be left to compete and, if they
8 fail, then they fail?

9 **MR RUSSELL:** Yes, I believe that that is so, and their success -
10 - I mean, if you look at what's happened with Qantas and
11 what has happened with New Zealand over recent time, the
12 likelihood of Air New Zealand failing I think diminishes as
13 time goes by as the new management takes over and sorts out
14 the airline.

15 You know, there were matters in history that led to Air
16 New Zealand's rather precarious position that required a
17 bail out from the Government, but that is historic and it's
18 not the present. So, we truly do believe that the
19 competitive market is going to provide the best outcome for
20 the consumer of New Zealand, and what we're witnessing here
21 is an application that is going to provide a virtual
22 monopoly in some areas of air transport, and by all examples
23 of history, that is not a good thing for the consumer,
24 unless of course you have some heavy-handed intervention on
25 the part of the authorities.

26 **MR DOOCEY:** Can I add to that. We've said that we -- I don't
27 think -- we don't think that Air New Zealand is going to
28 disappear, when we say we think the real interests of the
29 New Zealand public is in having a viable airline providing a
30 good, cheap service rather than flying our flag, which is a
31 more nebulous benefit. We don't think that's going to

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1 happen, we don't believe that Air New Zealand is going to
2 fail absent this authorisation, and Air New Zealand is doing
3 well at the moment and there's no reason to think they can't
4 compete. The sort of things we're seeing at the moment seem
5 to us to be competitive behaviour, producing a good result.

6 **CHAIR:** In terms of a good result we've heard a lot of
7 submissions, and I know that you've been here for it, that
8 these companies over very long periods of time are not
9 earning their cost of capital, and yet, you make the comment
10 that they're doing very well and I wonder if that remark is
11 really sustainable.

12 **MR DOOCEY:** Well, yeah -- we can't obviously provide the sort of
13 economic analysis that other people have, we don't have
14 access to those resources, but I think the Commission's
15 heard that it is sustainable from other people who are in a
16 better place to tell.

17 **CHAIR:** I'll just see if my colleagues have questions.

18 **MR CURTIN:** Just one. Earlier this morning we had a bit of
19 evidence from various travel agents that the airlines have
20 these yield management systems and there may be headline
21 discount rates, but on average people may pay any old thing;
22 that was the gist of it.

23 I was wondering if you're looking at individual sectors
24 of products, if you folks at Consumer had looked at
25 airline -- best airline deals or whether you had any feel on
26 the trend in airline prices in New Zealand?

27 **MR RUSSEL:** It's very very difficult to do because of the
28 structure of the pricing of the airlines. Internationally
29 they have so many break points, they have -- and you know,
30 we've got to be very complimentary in some respects about
31 Air New Zealand; it has come clean and is now telling us how

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1 many seats are going to be available at certain prices, but
2 up till now that has been an arched trade secret on the part
3 of airlines that they wouldn't reveal. So, any analysis
4 that we did, if we promoted the cheap fare that was being
5 offered, A) it was likely to go the next day, or we would
6 have no idea at all of the number of seats that would be
7 available.

8 I'm sorry, that's a very long answer to your question;
9 it hasn't been possible to accurately do a survey of airline
10 prices, and that is a problem that has faced consumers.

11 **MR CURTIN:** Thank you.

12 **MR PJM TAYLOR:** Just to follow-up that last point, this question
13 of the number of seats at the cheap prices being known and
14 available. I think it was day one we had a discussion on
15 yield management from, I think it was Air New Zealand, where
16 there was a discussion about override of the yield
17 management numbers that -- or the seats that would be at the
18 cheaper prices, to the stage that you could be left with a
19 view that there was a bit of opaqueness about this, and yet
20 you are being reasonably positive that the numbers were
21 available leading to an analysis of yields being able to be
22 done?

23 **MR RUSSELL:** Well, I'm merely making my comment on the reported
24 comments of Air New Zealand, or undertakings that Air New
25 Zealand have made when they announced their new Express
26 fares -- Trans-Tasman Express fares, when they made it clear
27 that there were going to be a certain percentage, on
28 average -- there is a certain opaqueness I will agree,
29 because they did use the word "on average" so we've got to
30 be careful about that, and we believe that there is a need
31 for even greater transparency. But at least we're getting

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1 an indication now, where before we certainly did not have
2 any indication and it was carefully disguised. The only way
3 you could get any idea at all would be, you know, six months
4 ahead of time to try and book one of these cheap fares and
5 find that they weren't available.

6 **MR PJM TAYLOR:** Thank you.

7 **CHAIR:** Any questions from staff? [**No questions**]. As I said,
8 to the Save Air New Zealand group, the Commission is
9 grateful to the Consumers Institute who are often available
10 to come forward before this Commission and speak to the
11 issues as they affect consumers. It is vitally important
12 and we are -- when you do not appear in these hearings we're
13 alarmed and today we are grateful to have you. So, thank
14 you very much for your submission and your presentation.

15 I would now like to ask Invercargill Airport to please
16 come forward.

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Invercargill Airport

1 shore New Zealand and in markets overseas, particularly
2 relevant to the discussions that have been about Qantas
3 Holidays and so on.

4 Similarly, I was for a similar period director of a
5 50/50 joint venture that Air New Zealand had with
6 Australia's biggest travel wholesaler at the time -- it was
7 mentioned this morning as JetSet. I also served on the
8 Government's tourism advisory committee which was the
9 predecessor of the now Tourism Board, and oversaw the
10 investment of the Government's annual tourism vote.

11 I've been for the last 10 years an independent aviation
12 management consultant and I'm a Transport Accident
13 Investigation Commissioner and I mention that because I tend
14 to use words like "train crash" when dealing with some of
15 the war stories of the past when they come up. But I can
16 assure the Commission that, although a past employee of Air
17 New Zealand and a consultant currently, neither Qantas, nor
18 Air New Zealand, nor Air Pacific are clients of mine. So,
19 I'm coming on behalf of Invercargill Airport but in an
20 independent capacity.

21 Turning to Invercargill Airport itself: It's an
22 unlisted public company, it's 55% owned by the City of
23 Invercargill and 45% owned by the New Zealand Government.
24 There is a high profile of public interest in the south end
25 of the country in all of these proceedings, and that's
26 particularly what we're here to address today.

27 But for the Commission's information, the background is
28 that, Invercargill Airport has acted as spokesperson and co-
29 ordinator for the southern tourism region which in our
30 submissions -- we said at Southland, Fiordland,
31 Stewart Island as well as Invercargill city and surround.

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1 Invercargill Airport is an aspiring Trans-Tasman
2 international airport, that's primarily why we're here
3 today.

4 The potential in the southern tourism region for
5 increased tourism has been fully evaluated on a number of
6 occasions in the past as we said in the submissions, but
7 like the chicken and the egg, which comes first; the
8 potential is recognised but the air service link in the
9 chain is not there.

10 In the next few slides I'd just like to note that I've
11 used IATA codes for the airlines purely to get everything
12 into the slides. So, QF is Qantas, NZ is Air New Zealand
13 and NTO, where I've used it, is National Tourism Office in
14 this country, of course the Tourism Board.

15 I'd like to just draw the Commission's attention, one
16 after the other, to these six lines. If you were to take
17 the presentation by the Applicants, particularly in tourism
18 and Qantas Holidays and so on, you might get the impression
19 that the airlines do it all and what I'd like to draw to the
20 Commission's attention is that is true in very large part,
21 but it isn't true completely.

22 Line number 2 gives a slight variation on-line number 1,
23 and what it says is that, the tourism business is a chain
24 and the chain really starts at the left-hand side with the
25 consumer in a foreign country making up his mind whether to
26 travel to this country or go to many other destinations that
27 are available as choices. The National Tourism Office in
28 that second column; well, in our case that's the Tourism
29 Board and it has a very large vote from Government every
30 year which it spends specifically on advertising and
31 promoting this country.

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1 So, the airlines have said, well we're the biggest
2 spenders in that area, but there's also a very big
3 Government input as well. Another necessary link in the
4 chain, but a link that does not have any income. The
5 tourism board is a spender. Air New Zealand is a spender in
6 tourism. The Tourism Board doesn't actually earn any money.
7 The airlines claim that they do, and I'll come on to that in
8 a moment.

9 But where the dollars are really delivered in this chain
10 is on the ground in New Zealand, and there's been very
11 little emphasis given to that; in fact, I could detect
12 almost none at all during the course of last week. That
13 when you come to who is earning the money in this, there's
14 an old Scottish expression, it's called "cherchez la
15 dollar". Where are the cashflows?

16 If I take you along line 3 where it talks about
17 accommodation suppliers, on the ground transport, food and
18 beverage outlets and so forth and so fifth, you can see that
19 when it comes to the tourism benefit to New Zealand, where
20 is it actually earnt? And on line 4 I just have given an
21 example which says that one Trans-Tasman passenger coming
22 out of Australia into New Zealand, and using Air New
23 Zealand's latest fare, you find that NZ\$510 is being earned
24 by the airline for the round trip, and it might not be Air
25 New Zealand that sells it, it might be Qantas that sells it.
26 So that the actual dollars that are returned to this country
27 from the airline activity, which I repeat is absolutely
28 essential to the process, that it's not where the dollars
29 actually get into the bank.

30 I put it to you that the line of thought under the
31 national tourism office is representative of the fact that

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1 the Government is spending a very large budget every year
2 overseas to generate tourism. It is successful, I believe,
3 in doing that, but it can't actually point to its own
4 activity as being the one that created it. It knows it's in
5 the mix there somewhere, the airlines know they're in the
6 mix there somewhere, but the two of them don't actually get
7 the cashflow.

8 Where the cashflow comes in -- and I've used the 1828
9 number straight out of the NECG report. No argument with
10 that, it's an average figure, and the average of course is
11 at the disadvantage, and it depends on which country the
12 tourist comes from, on how much he actually spends; but
13 that's where the dollars are.

14 One could say that, it might have been useful to the
15 Applicants if they had focused on that to some extent rather
16 than taking the approach that Qantas Holidays will be able
17 to do everything, because Qantas Holidays really is a two-
18 way conduit; it's a system whereby you're feeding available
19 choices to the public in foreign countries, and back the
20 other way coming in the way of bookings and money, and the
21 money ends up being paid to the suppliers of the services on
22 the ground when the clients eventually get here.

23 So, you can see that what the airlines actually
24 contribute by way of the tourism benefit is quite small.
25 They're absolutely necessary in the process of getting
26 tourists to come here, but the amount of money that sticks
27 to New Zealand's hands as a result of that is quite small
28 compared to what the people on the ground supply and get
29 paid for.

30 So, in line 5 there I've just multiplied this out a bit
31 because the famous 50,000 passengers extra tourists a year

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1 has been bandied about a lot; is it valid, isn't it valid
2 and so on. I would just like to remark that, against the
3 total in-bound tourism market, which is getting on for
4 3 million a year now, 50,000 doesn't actually represent much
5 of a claim.

6 If the Applicants had said in their representation that
7 the number was going to be 150,000, I would still have been
8 quite happy to accept that as a possibility, because the
9 tourism market in New Zealand is not that well developed,
10 certainly not as well as it could be, and the potential is
11 very high. So we're only talking really about how you get
12 them here, not whether they can be handled.

13 So, on that line 5 there, there's 26 million of
14 contestable dollars between the airlines that are actually
15 bringing tourists into the country, and that's not just Air
16 New Zealand and Qantas; there's a considerable number of
17 airlines, as we've all heard, who are taking part in that
18 process. So the actual amount of money that sticks to
19 New Zealand's hands is relative.

20 On the other hand, those tourists, once they get here,
21 nobody else gets a share of the money, this country gets it
22 all. So you take your 1828 and you multiply it by your
23 50,000 and you start getting really serious numbers.

24 Invercargill Airport Limited is simply looking at a
25 situation whereby, having identified a large potential for
26 incremental business in the southern part of the
27 South Island, how can it get to it? Because, it represents
28 a big opportunity. We've said only 11 million there; a big
29 opportunity locally to supply goods and services to the
30 tourism trade.

31 And really what we're primarily interested in achieving

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1 that, and we can't because over a long period of time the
2 national carrier in particular has adopted a policy of
3 feeding overseas tourists through as few airports as
4 possible, and for many many years until such time as Kiwi
5 Air came on the scene and sort of broke that down a bit, all
6 tourists were as a matter of policy to be directed through
7 Auckland and Christchurch. It was only as a result of Kiwi
8 Air that that changed.

9 A core issue in this, and I don't propose to go through
10 this slide in detail, but it represents --

11 **CHAIR:** I'm sorry to interrupt, but we've lost --

12 [Pause for technology]

13 **MR McFARLANE:** I apologise for the technology, but for the
14 record just in passing having sat through the whole of last
15 week I do wonder sometimes if King Solomon is still in the
16 consulting business, because --

17 **MR CURTIN:** He's got very very expensive.

18 **MR McFARLANE:** He might be helpful to you.

19 **CHAIR:** I'm sure we'll remember that suggestion at some point.

20 [Pause for technology]

21 **MR McFARLANE:** Shall we pick up?

22 **CHAIR:** Please.

23 **MR McFARLANE:** Thank you. The purpose behind this slide was to
24 just record the fact that the airline, the national flag
25 carrier has gone through some extensive change here, and
26 principally the issue is that it's gone from being wholly-
27 owned by the Government of New Zealand through a 10 year
28 period when it was privately owned and it's now 82% back in
29 the public arena.

30 And one can understand that in the heat of the moment
31 when, as Mr Norris put it, the airline was within two hours

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1 of receivership, that the deal that the Government did to
2 assist it in keeping it going didn't include minor details
3 perhaps like where the return on the investment was going to
4 come from, and during the course of these hearings we have
5 heard quite a lot of evidence to the fact that it may be
6 rather a chilly day in hell for Dr Cullen to get a
7 sufficient return from airline operations out of dividends,
8 but in my earlier slide I said, well that really isn't where
9 the public interest in this whole business actually comes
10 from; a big piece of it comes from those tourist earnings on
11 the ground.

12 So a question that is frequently asked in the southern
13 part of the country being represented here, is that, you
14 know, we also are taxpayers, a large piece of our money went
15 into this, and we don't perceive that there is an obligation
16 on the national carrier to actually deliver the sort of
17 regional benefit that we understand and we believe is there.

18 So, while we note that after many years of a policy of
19 only two airports for in-bound traffic, that when
20 competition came along from Kiwi Air, that all of a sudden
21 Hamilton and Palmerston North and Dunedin and Queenstown
22 became airports that suddenly were going to be profitable
23 operations and operations were commenced by the national
24 carrier, as well as Kiwi Air, in three of them anyway.

25 So, where does that take us? I have personally heard no
26 suggestion, either in the public arena over a long period of
27 time since they started, or during the course of these
28 hearings, that airline operations into those provincial
29 airports are not profitable or that they are on the block
30 for chopping as a result of some cost saving exercise.
31 They're still there, they're still being operated and I can

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1 only assume that they must be profitable.

2 So, Invercargill Airport came very close to becoming an
3 international airport, and actually built on terminal
4 extensions in anticipation of it happening, but
5 unfortunately the competition went away at the time before
6 it actually started. So, a high piece of public interest in
7 these applications is not so much the macro situation that's
8 been put forward by the Applicants and discussed and
9 vilified often by previous presenters, but how can we get to
10 a situation where the airline puts that missing link into
11 the southern tourism region's tourism chain and actually
12 delivers tourists on the ground?

13 That is a, if you like, a micro situation, but I would
14 like to offer the Commission the thought that, Qantas and
15 Air New Zealand are huge operations, enormous; we're talking
16 A\$11 billion turnover reported by Qantas last week. But it
17 is important to remember that they're made up many many
18 small transactions, and Invercargill Airport frankly simply
19 wants to be one of their small transactions, because the
20 commitment of the resources that would have to go into the
21 sort of service that Invercargill would like to see
22 commenced, is really very very tiny indeed.

23 So, that in essence is the reason why we're here today,
24 to ask for that.

25 Basically, I could take the view that Invercargill
26 Airport Limited isn't offering the Commission a view on the
27 totality of the applications, other than to say that, if
28 authorisation is given, then it would be Invercargill
29 Airport's desire to see a qualification along the lines of
30 the suggestion that there should at least be a pilot project
31 into Invercargill; after all, why should Invercargill be any

Invercargill Airport

1 less a potential than Dunedin was, that Palmerston North
2 was, that Hamilton was when the airline had denied for years
3 that there was any possibility at all of those being
4 profitable, at all; only when forced into it did it actually
5 do it. It must have been successful because they're still
6 doing it, and Invercargill just simply wants to be in the
7 loop.

8 Now, in terms of where the major shareholder, the 82%
9 shareholder sits in all this, it was intriguing to see the
10 Auditor-General's report to Parliament earlier this year
11 where it was stated by the Auditor-General that there were
12 no powers to direct Air New Zealand, it's a publicly listed
13 company, and it's subject to the provisions of the Companies
14 Act.

15 It's not something that Mr Cullen can say, well, look,
16 I'm getting my welfare benefit from this industry by virtue
17 of what's done on the ground, so I want you, Air New
18 Zealand, to deliver me more on the ground. He can't
19 actually say that, but the Commission can. The Commission
20 has applications in front of it and it can deal with those
21 applications either as an outright "yes" or an outright "no"
22 or some variations in between, or it can attach conditions.
23 Invercargill Airport would like to have the condition that
24 its suggested tied into this.

25 Now, Invercargill Airport doesn't offer the Commission
26 any view on whether the authorisation should be accepted or
27 not, but if they are accepted it would like its condition
28 attached.

29 I would just like to read into the record a final
30 statement which says, Invercargill Airport supports the
31 concept of the Applicant's dealing in the reduction of their

Invercargill Airport

1 costs, and that's important because a great deal of this
2 application is about reducing costs, and Invercargill's view
3 in a general sense is that, if airlines are allowed to
4 reduce their costs then that is a public welfare benefit
5 that could be of considerable magnitude -- it should be
6 allowed anyway, and if it is and the airlines do get their
7 costs down, then it makes lower fares -- you know, this
8 Valhalla of lower fares that everybody wants in an industry
9 that isn't cheap to run anyway, then they should be allowed
10 to do that because it will deliver a public welfare benefit,
11 it will deliver lower fares on a much more sustainable basis
12 than just bashing heads together between two airlines.

13 Invercargill Airport is concerned about any impact the
14 alliance may have on the operations of Origin Pacific,
15 because at the moment Invercargill has no international
16 services dependent for air connections on domestic services
17 only, some of which are provided by Origin Pacific, and
18 Invercargill believes it's imperative that sustainable
19 competition is maintained, not only on the main trunk
20 routes, but also on the provincial routes where competing
21 airlines currently operate. Provided any approval
22 considered by the Commission incorporates Invercargill's
23 proposed conditions and also recognises the importance of
24 maintaining sustainable competition on provincial routes,
25 then Invercargill will be prepared to support applications.

26 So, thank you very much for the opportunity to address
27 you on those matters, and I do apologise for the technical
28 hitches on the way through.

29 **CHAIR:** Don't worry about the technical hitches, we've had a few
30 during the proceedings. Thank you for your presentation,
31 and I might just start with a few questions.

Invercargill Airport

1 I may have misunderstood something you said, but I seem
2 to have heard you suggesting that other provincial areas or
3 cities throughout the country were originally served because
4 Air New Zealand had to at some point in response to
5 pressure, and what I understand you to be saying is, you
6 want the Commission to put conditions on this authorisation
7 should we authorise it to ensure that Air New Zealand -- or
8 that the alliance basically provides greater service into
9 the southern tourism region, and another take on it could
10 simply be that, with the impending rival of Virgin, we'll
11 see far more competition and a greater likelihood that each
12 of these airlines feel they need to be in additional
13 markets, especially if Virgin does grow the market
14 substantially.

15 And so, I wonder why -- on one hand it seemed to me some
16 of your arguments suggested your best bet was to see a third
17 carrier come in and grow the market, instead of looking to
18 this Commission to basically regulate on an ongoing basis
19 the whole of this industry.

20 I put that in a fairly provocative way, not because it's
21 necessarily my view, but to try to elicit your response.

22 **MR McFARLANE:** Yes, let me put it this way and say that, one of
23 the unfortunate things about staying in this industry for
24 any great length of time is that you do experience a
25 considerable amount of change, and I won't bore you with the
26 war stories on that, but suffice to say that new entrants
27 come and new entrants go, and so far the pattern in both
28 Australia and New Zealand has been that new entrants have
29 come and new entrants have gone.

30 So, I've listened during the past week very carefully to
31 the debate about Virgin Blue, and whether Virgin Blue starts

Invercargill Airport

1 or doesn't start is in my opinion a decision entirely for
2 them because I don't believe there are any barriers; in fact
3 I'll be provocative in return and say that I think they came
4 before the Commission to, in a nice way, blackmail because,
5 are we in, are we not in, will we start, are we not gonna
6 start, and if we start are we gonna stay and what are we
7 gonna do, and so on and so forth.

8 The history has been that every new entrant has started
9 up in a blaze of glory and they've all said, existing
10 systems too expensive we're going to cut the fares and we're
11 gonna do it differently and better because we are new; but
12 there are barriers and we want to take barriers down, we
13 want somebody to take barriers down for it. So there are
14 always barriers before a new entrant, that's part of the
15 application process.

16 After that, well they're in the market. Generally
17 things aren't going too well so they decide that somebody
18 must be doing it to them, so the Qantas in Australia or the
19 Air New Zealand in New Zealand get blamed for all sorts of
20 things. Well, each new entrant comes in with a new and
21 different and all-encompassing business plan.

22 In the past business plans that they've come in with
23 have not succeeded, so there's no certainty that Virgin Blue
24 will firstly come in and secondly stay in, or thirdly that
25 it will develop the market in anything like a short
26 timescale to the level of Invercargill. They're gonna come
27 in and they're gonna spend time on the main trunk, they're
28 gonna bleed that one as much as they can and good luck to
29 them. But then they might move on and then they might
30 consider additional routes across the Tasman to smaller
31 provincial areas some way down the track, and it could be a

Invercargill Airport

1 long way down. Sorry for the length of that.

2 **CHAIR:** I'll just see if my colleagues have questions.

3 **MS BATES QC:** I just want to ask you about the Queenstown
4 Airport, because you probably know about, it, that's not too
5 far away from you.

6 **MR McFARLANE:** Yes, a bit like Hamilton, it's not too far from
7 Auckland.

8 **MS BATES QC:** Not too far. Do you know how many flights come in
9 direct from Australia into Queenstown?

10 **MR McFARLANE:** Today? No, I can't, I don't off-the-cuff. There
11 would be daily services.

12 **MR WALSH:** Most of their traffic is at the weekend and Qantas
13 put two direct return flights in on a Saturday, and so do
14 Air New Zealand, both airlines do one each from Brisbane and
15 Sydney. During the week, I'm not sure, I think there may be
16 one per week operated by Air New Zealand ex Sydney. I'm not
17 too sure on that.

18 **MS BATES QC:** I thought -- I had an idea that it was much less
19 than daily, and the reason I'm asking you about that is
20 because, it seems that the Otago area is -- I mean,
21 particularly around Queenstown, is quite a developed tourist
22 destination -- unless I am wrong, much more developed than
23 Invercargill and its environs, so could you perhaps assist
24 me on that?

25 Where this is leading to is, well, if you've only got
26 that far with flights flying into Queenstown, is flights
27 flying in from Australia to Invercargill, are they really
28 needed to support the tourism industry that's there?

29 **MR WALSH:** I think it's more than support it, I think it's to
30 develop it. We've come here acting today for the
31 considerable institutions in Southland who are putting

Invercargill Airport

1 pressures on us all the time to have direct flights; they
2 want to grow the tourism, they're willing to do their bit,
3 promote it, but there's frustration there that they can't
4 get the direct flights.

5 We understand that the industry will go where it's got
6 an assured market. We do get a lot of feedback from people
7 who are trying to get into Queenstown who complain that they
8 can't get in there directly, and I'm not sure the reason for
9 that, there may be congestion in Queenstown at the weekend,
10 but we're talking initially of just one flight per week
11 coming into Invercargill, 6,000 passengers over per annum,
12 it's not very much, and we feel it would start to develop
13 and grow the market.

14 **MS BATES QC:** So, what you're saying is, you don't know if it's
15 a profitable route for the airline at the moment, or
16 whichever way it goes, the alliance or the -- well, let's
17 say it's the alliance, but you think the Commission should
18 impose a condition making it -- making the airline do it
19 regardless of whether it's profitable for it?

20 **MR WALSH:** Well, we believe it is profitable. We believe the
21 local community were prepared to share the risk on that, and
22 the local community are prepared to develop extra
23 infrastructure, not the airport company itself but the local
24 institutions. We also believe that one of the reasons for
25 this proposed alliance was that it would grow tourism in
26 New Zealand, and we thought this is a good opportunity for
27 the alliance to demonstrate that, that they are growing
28 tourism into new areas where they currently don't have an
29 in-bound service from Australia. We note that they propose
30 services into Hobart and Adelaide and Canberra, but there's
31 been no proposed service into new ports into New Zealand

Invercargill Airport

1 into in-bound tourism and to develop the regions.

2 **MS BATES QC:** Okay, thank you.

3 **MR McFARLANE:** I might just add to that, if I may. It does
4 puzzle a lot of people as to why the airlines have
5 volunteered to have new services to Auckland to the ports
6 that Mr Walsh mentioned, because that seems to be in the
7 opposite and wrong direction. The argument is, if you're
8 going to deliver tourists into New Zealand, why would you
9 deliver them into Australia? I just draw the Commission's
10 attention to that sort of abnormality, if I can call it
11 that.

12 **CHAIR:** I'll ask if there are any questions from staff.

13 **PROF GILLEN:** Where do you think the market failure is currently
14 that doesn't bring tourism into Invercargill?

15 **MR McFARLANE:** Well, I described the tourism chain as I
16 perceived it early on, and the link that's missing is the
17 one that's normally provided by an airline. There are
18 considerable investments in ground infrastructure already in
19 the area that we're talking about. You know, it is
20 conventional that everybody seems to think that it's the
21 airlines that make big investments, but you know the people
22 who provide the services and earn the money on the ground
23 have considerable total investment as well. So, the simple
24 answer to your question is, the failure is the lack of an
25 air service, and if you take it to the limit, it's the lack
26 of an air service that is represented by the airline as not
27 being profitable but is unproven by them.

28 We know that we've got the potential to earn a lot of
29 dollars here. The airlines, well, they have not tested
30 that. We think they should test it.

31 **CHAIR:** Unless you have any further comments...?

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1 **MR MCFARLANE:** Thank you.

2 **CHAIR:** I'd just like to thank you both for your presentation
3 and Invercargill Airport for the submission. We have heard
4 from a number of airports and no doubt the proposed alliance
5 would impact on each of you, so we're grateful for your
6 submission.

7 I now propose to break for lunch and I would ask the
8 parties to return by a quarter past the hour, at which time
9 we will hear Polynesian Airlines followed by Jumpjet, then
10 take a short afternoon tea break and then have the right of
11 reply from the Applicants. Thank you very much.

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15 **Adjournment taken from 1.25 pm to 2.20 pm**

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*Polynesian Airlines*1 **PRESENTATION BY POLYNESIAN AIRLINES**

2

3 **CHAIR:** Okay, I'll ask everyone to be seated and I will
4 reconvene this session. Welcome, Polynesian Airlines, and
5 invite you to introduce yourselves for the record and begin
6 your presentation when you're ready. Thank you.

7 **MR McFARLANE:** Thank you. My name is Norman McFarlane, I'm here
8 today to present on behalf of Polynesian Airlines, and my
9 credentials stand as in the previous presentation. On my
10 right is Mr Richard Gates, retired earlier this year as
11 Chief Executive of Polynesian Airlines, and since it's
12 become the convention to record with the Commission how many
13 years experience we combine between the two of us, Mr Gates
14 was Chief Executive of Polynesian for 9 years and prior to
15 that was 29 years full career with Air New Zealand in quite
16 a number of latterly very senior positions. So between us,
17 for the record, we lay claim to 58 years experience
18 combined, for the Commission's information.

19 Polynesian's position on these applications is support
20 for both of them. As regards the application for Qantas to
21 take a shareholding of 22.5% in Air New Zealand in an
22 overall sense Polynesian believes that that is in the public
23 interest, and it's worth mentioning that Qantas was, of
24 course, previously I think a 24.9% investor in Air New
25 Zealand; it was during my period of experience with them, I
26 attended board meetings, and the Qantas people attended
27 board meetings, and there were no detrimental effects from
28 that experience that I could perceive at the time.

29 That shareholding reduces, of course, the contingent
30 liability for the New Zealand taxpayer as currently 82%
31 fully exposed to the airline and I'll come on to my reasons

Polynesian Airlines

1 for saying that later. It represents a funding injection
2 for Air New Zealand at a time when it's been said to the
3 Commission that it's behind with its investment in its
4 product, and someone somewhere, the taxpayer otherwise,
5 would have to find all the money.

6 As regards the alliance application, Polynesian supports
7 that application, particularly on a question of fixed cost
8 reduction. The point has been made many times that this is
9 a very high fixed cost industry and that those fixed costs
10 are excessive and have been embedded, particularly in the
11 very many decades that these airlines, Qantas and Air New
12 Zealand, both were in a fully regulated environment and
13 built up a cost structure that is no longer sustainable by
14 them.

15 Secondly Polynesian believes that if the alliance is
16 approved, that Polynesian should be in it; also, along with
17 Qantas, Air New Zealand and of course Air Pacific because it
18 hasn't really been mentioned that Air Pacific was attached
19 to these applications. So as I go through I'll show that
20 Polynesian is in fact in a sense already inside this
21 alliance, although that fact wasn't recorded in the
22 applications. The problem is that it will be forced out of
23 its current alliance arrangements if they are approved as on
24 the papers, and, as I said, Polynesian believes it should be
25 in it, not out of it.

26 Polynesian submits that Samoa and Niue are in reality
27 part of the regional aviation market which, by the way, was
28 referred to by Mr Dixon in his presentation as Australia and
29 New Zealand. Polynesian has submitted that the situation is
30 rather wider than that, and that view is politically shared
31 by the Pacific forum, which includes both the countries of

Polynesian Airlines

1 New Zealand and Australia; that only a week ago reaffirmed
2 support for a South Pacific open skies formula for the
3 region and that was widely reported and the Commissioner
4 would have seen it.

5 Polynesian agrees with the Commission in the Draft
6 Determinations that the Australia-New Zealand to
7 Pacific Islands market is distinct from the Applicant's
8 version that included Asia. The New Zealand, Samoa and Niue
9 markets do come under threat from the applications as they
10 are currently written and specifically to the future
11 survival of Polynesian.

12 There are very very large ethnic populations of Pacific
13 Islanders resident in New Zealand and the VFR traffic
14 between New Zealand and the Pacific Islands is extensive.
15 The New Zealand Samoa route is currently competed by
16 Polynesian and Air New Zealand and Qantas in a codeshare
17 with Polynesian. Polynesian Airlines is a critical
18 component of both the Samoan and Niuean tourism markets for
19 exactly the same reasons advanced by Air New Zealand for its
20 place in the New Zealand tourism market, as a tourism
21 generator. A considerable strategic change would occur if
22 the factual eventuates as written and it is fair to say
23 that, because of their size and influence, anything Qantas
24 and Air New Zealand do inevitably impacts on the fragile
25 Pacific Island markets.

26 The alliance is exactly that kind of major strategic
27 move and has implications that are potentially fatal for
28 Polynesian if not mitigated. The alliance forecasts a
29 monopoly for New Zealand on Polynesian's prime route between
30 Auckland and Apia and that will occur as a result of
31 capacity increases included in the NECG report.

Polynesian Airlines

1 The pressure couldn't be sustained by Polynesian and the
2 only result would be its exit from the market. The outcome
3 would be an Air New Zealand monopoly that would, of course,
4 search the relatively high price high yielding VFR market --
5 and by VFR I mean the visiting friends and relatives market
6 sector -- but would not promote the tourism market which is
7 vital to the Samoan economy.

8 Having said that, Polynesian is also a full service
9 airline, and it's afflicted by exactly the same problems
10 that the Commission has heard so much about during its
11 Conference last week, and of course Polynesian is seeking to
12 position itself with similar solutions as far as getting out
13 of past cost commitments.

14 The full service airline industry in general is caught
15 in a web of Government/bilateral imposed constraints that
16 effectively prevent national flag airlines from accessing
17 the benefits of consolidation that they would seek if they
18 were free to do so; the point here is, they're not free to
19 do so.

20 Polynesian recognises that the Applicants are seeking to
21 reduce their costs. When I'm talking about "costs" I do
22 think that presentations to the Commission have mainly
23 focused on one set of costs, whereas taking the example of
24 Air New Zealand and Mr Dixon the other day, he's talking
25 about a different set of costs; and so, in a sense, the
26 Applicants and the interested parties are talking past each
27 other, and I'll come to the reason why I say that in a
28 moment. So, Polynesian recognises that desire to reduce
29 costs and, likewise, wants to participate in that process as
30 much as possible.

31 The Commission has heard much about the full service

Polynesian Airlines

1 airline industry's problems, but Polynesian thinks it fair
2 to stress that the full service airline business is both
3 highly artificial and extremely risky. Full service airline
4 business models are not coping with today's environment,
5 mostly because deregulation has impacted their revenues and
6 profits but has not similarly reduced their ability to lower
7 costs, and has not either removed the constraints or
8 ownership and cross-border consolidation that would
9 inevitably, I suggest, have happened a long time ago barring
10 these artificialities.

11 I think one has to consider that, at the time that Air
12 New Zealand was privatised, and being involved in that
13 situation myself, if Qantas had been and British Airways had
14 been allowed to buy into Air New Zealand on a 100% basis,
15 then they would have done so. It's also worth dwelling on
16 the possibility that Qantas itself might have been bought
17 out completely by British Airways had consolidation been
18 allowed. The point I'm making is that, the inability to
19 consolidate has built in enormous costs in this industry
20 that really the markets are no longer prepared to support.

21 Governments so far, and not just the New Zealand
22 Government but also a lot of Governments around the world,
23 have chosen to ignore this problem. There was an attempt in
24 the early 1990s to raise international interest in modifying
25 the international system that dates from about 1946, but
26 this was still borne when it was recognised that reform
27 would likely see some flag airlines disappear all together
28 because consolidation would take place.

29 The bilateral system remains with us with all its
30 faults, and a consequence of that is that flag airlines
31 attempting to cut costs by merger substitutes, which is what

Polynesian Airlines

1 alliances tend to be in various forms, they're substitutes
2 for what the airlines really have to do and would like to do
3 but are prevented from doing, which is consolidating between
4 themselves.

5 So, it's worth contemplating also that the only reason
6 that the Applicants have come before the Commerce Commission
7 is to do something that they absolutely have to do, whereas
8 there has been much talk about VBA entry; the VBAs don't
9 have to come and ask for permission to do any cost
10 reductions, because they're coming into the market and
11 they're able to do so on the basis of today's costs, whereas
12 Qantas and Air New Zealand are stuck with essentially the
13 results of past Governments' policy on other side of the
14 Tasman.

15 To date, the full service airlines problems across the
16 world have been solved with tax payer's money while doing
17 absolutely nothing about the business risk except to switch
18 it back from private shareholders to the tax payer. In our
19 submissions we gave a table of examples of those.

20 Thus really, the Government induced but not reformed
21 problem has been dumped in this Commission's lap. The
22 cracks, though, have only been papered over and the full
23 service airlines do still have to hunt for solutions of
24 which these applications are one example.

25 Polynesian has suggested that, absent any relief, these
26 processes have the outcome of building up a potentially huge
27 contingent liability for taxpayers as long as the belief
28 exists that each country must have its own substantially
29 owned and controlled flag airline. Airline failures are not
30 infrequent and Air New Zealand could well require the
31 taxpayer to again provide enormous support in the aftermath

Polynesian Airlines

1 of expected future events. And I would comment that this
2 has already happened twice.

3 In my Lexicon I tend to think of Air New Zealand in its
4 present form today as being Air New Zealand number three,
5 and although quite a number of interested parties have come
6 before the Commission and said they don't believe that Air
7 New Zealand can fail, well that ignores history. In my
8 recollection it's failed at least twice; once was in 1981
9 and some who are as old as me might recall the infamous \$90
10 million loss, biggest ever in commercial history in
11 New Zealand that occurred that year and required the
12 taxpayer to pump in \$50 million to keep it going.

13 What was kept going I tend to think of as Air New
14 Zealand number two, and that lasted until just 2 years ago
15 when again it failed and had to be rescued by the taxpayer,
16 thus creating Air New Zealand number three, and successive
17 managements and particularly the current management, have
18 the job of rebuilding the airline from what it was just 10
19 years ago before it went into private ownership, back to
20 that sort of standard from, you know, an incredibly low
21 position really.

22 Turning to the specific case of Polynesian, after sort
23 of skating lightly over the industry situation, this slide
24 here shows the progression of what is happening to
25 Polynesian and what it is we're expecting to happen in the
26 future.

27 The line with 2001 on it is a description of the
28 alliance relationships at that time. Qantas and Polynesian
29 are shown in an alliance on the left side of the screen that
30 was in competition with Air New Zealand and at the time its
31 Ansett Australia partner. Notice the ownership situation;

Polynesian Airlines

1 the three biggest players are all private at that stage,
2 only Polynesian was Government owned.

3 The line marked 2002 shows the effect of the Ansett
4 Australia collapse.

5 Line 2003 represents the factual and the enforced
6 isolation of Polynesian and the on-set of the forecast high
7 pressure from increased Air New Zealand capacity. We go
8 from an alliance that is competitive to outside in the cold.

9 The line marked 2004 is the end result; Polynesian exits
10 the market and both the Samoan and Niuean tourism markets
11 are the losers. New Zealand is in print, I have to say, as
12 refusing to serve Niue.

13 This next slide is a representation of the same factual
14 from the perspective of cost competition. Line 2002 shows
15 where the mutual benefits of the Qantas/Polynesian alliance
16 actually lay. The plus signs represent positives for
17 Polynesian. Polynesian's fixed costs known in the trade as
18 the ACMI, or aircraft crew maintenance and insurance, which
19 are the commitments you have to make before you actually fly
20 an airplane anywhere; just to have it there costs -- those
21 very substantial amounts.

22 The ACMI column was all positive, of course, there's not
23 much that can be done on the insurance costs as between
24 airlines and an alliance because that market is highly
25 competitive and it's very difficult for one airline to get a
26 cheaper insurance than another, although you would think
27 that a Qantas would be able to deal more effectively than
28 Polynesian would.

29 Polynesian's aircraft utilisation was very high, and in
30 fact Polynesian at that time held the record for the highest
31 utilisation of a Boeing 737 family type in the whole of the

Polynesian Airlines

1 worldwide Boeing fleet. So, the point I'm making there is,
2 we're not talking about a small airline that is inefficient
3 in its operation, we're talking about a very small airline
4 that was the most efficient in terms of the use of its
5 airplanes in the whole of the world at that time.

6 The airline's overheads were spread over two latest
7 generation jet aircraft; Boeing 737-800s, which are the
8 worthy aircraft of choice just a year ago by Qantas for
9 replacement of its domestic fleet. The type is operated by
10 Air Pacific also, and it's the type of choice for Virgin
11 Blue. So, we're not also talking about an airline with
12 clapped out equipment, we're talking about a small airline
13 that's operating the most technically advanced equipment
14 probably in the world, arguably at least as good as anything
15 that the competing manufacturer, Airbus, can produce.

16 The line marked 2003 shows the deterioration that
17 coincided with the evolution of the Qantas/Air New Zealand
18 alliance application. Now, I don't want to leave the
19 Commission with the idea that Qantas should have done
20 anything or should do anything that it doesn't think is a
21 good business decision anyway. I'm merely pointing to the
22 fact that, since the original application was lodged with
23 this Commission there have been significant changes that
24 have progressively moved Polynesian towards that dangerous
25 right-hand side of the previous slide.

26 The Qantas damp lease of one aircraft equivalent was
27 terminated and some other alliance elements have fallen
28 away, particularly a service that was operated between
29 Auckland and Tahiti which was code shared by Qantas and they
30 supplied most of the passengers for it, but that's no longer
31 operating. So that resulted in major positives turning to

Polynesian Airlines

1 major negatives for Polynesian.

2 Polynesian has had to react quickly and has given up one
3 jet aircraft. I'd like to just leave the Commission with
4 some relativities in this, because Mr Dixon announced
5 Qantas' results late last week, and you can see from that
6 that Qantas is a A\$11 billion turnover organisation, with
7 huge fleets of various kinds of aircraft and so forth and so
8 fifth.

9 In the case of Polynesian, we're talking about an
10 airline that operates one single aircraft, albeit the most
11 technically advanced that there are, and its annual turnover
12 will be this year about NZ\$50 million. So, Air New Zealand
13 of course is somewhere in between and below Qantas, but we
14 haven't seen their annual result as yet -- coming out next
15 week -- but we're talking not about three airlines that, you
16 know, the names can be bandied around as if they're roughly
17 equivalent; we're talking about two giants in the ring, and
18 we've got this little mouse in there that, if it isn't
19 careful, it's not necessary for its competitors to -- in an
20 alliance that it's not part of -- to compete it out of
21 existence.

22 They can easily do it by accident. Easily do it by
23 accident, and I'd like to just briefly say to the Commission
24 that, having identified a problem in the NECG forecasts,
25 that Polynesian had discussions with both airlines like Toot
26 Sweet(?), and our impression overall from those discussions
27 was that we'd been accidentally left out rather than
28 somebody took a deliberate decision to leave us out.

29 At the alliance we had with Qantas, it was a bit like,
30 "oops", and I think also it was a bit like "oops", as far as
31 Air Pacific was concerned, because I think you'd note that

Polynesian Airlines

1 the applications came in without Air Pacific and they had to
2 catch up with that one.

3 So we're not making any complaint on that score, we're
4 saying that we don't actually represent a large blip on the
5 radar screen of these airlines, but when you are a regional
6 pond and in that pond there are two great big things and one
7 very small thing then, you know, nobody's going to look
8 after your interests but yourself.

9 On the next slide -- this was a representation of
10 Polynesian's case for inclusion in the proposed JAO, which
11 is not based on the request for any competitive privilege to
12 be awarded by the Commission. Polynesian believes strongly
13 that full service airlines should be able to reduce their
14 costs. It's in their public interest that they be allowed
15 to do that so as to allow convergence with long-term
16 sustainability over their networks.

17 It's important that those cost reductions are not just
18 little bits at the margin; they have to be major structural
19 change costs that come out. I would describe it to you this
20 way; that you have Air New Zealand on this side of the
21 Tasman that has a fixed cost structure that was built up
22 over time during regulation.

23 If you were to start with a clean sheet of paper today,
24 if Air New Zealand had gone into receivership and no longer
25 existed rather than being rescued by the taxpayer, if it
26 wasn't there and somebody wanted to start up with a clean
27 sheet of paper, there is no way that the outcome would be
28 the same or even remotely similar to the structure that
29 exists in Air New Zealand today; you just would not put
30 those sorts of costs into it.

31 So, looked at it in that light, that's one problem.

Polynesian Airlines

1 That's the vertical structure of Air New Zealand. On the
2 other side of the Tasman you have Qantas, bigger, much
3 bigger, with the same cost structure; they're like mirror
4 images, one obviously a lot bigger than the other. And
5 between the two of them, they're facing each other across
6 the Tasman with a network structure in each case that
7 exactly is parlous.

8 So Australia and New Zealand and the Pacific Islands,
9 you could say, are the recipients of an air services
10 structure created in an artificial environment which is far
11 greater than it would be if you were doing the same thing
12 again today; even if you were building a full service
13 airline as opposed to a VBA.

14 From observation at this Conference a lay observer could
15 be led to believe that it was all about whether Qantas and
16 Air New Zealand will or will not inhibit a VBA entry to the
17 New Zealand domestic and Trans-Tasman markets, and whether
18 they will or will not exert pressure after the new entrant
19 starts up.

20 On an industry basis Polynesian sees the applications as
21 being much more broadly based than that. The structural
22 change that I referred to earlier is absolutely necessary to
23 occur whether a VBA enters this market or not, enters the
24 Trans-Tasman market or not. So, in essence, it seemed to
25 me, from listening all through last week, that really this
26 was all about two airlines going like this -- slam two fists
27 together -- whereas the real problem for the two full
28 service airlines is that they are competing against their
29 own cost structure.

30 And you will remember that Mr Huttner referred to that,
31 I think it was Commissioner Bates who asked him the

Polynesian Airlines

1 question, "What do you think the real difference is between
2 your VBA cost structure and Air New Zealand's", and his
3 answer was, "I don't care because I'm not competing with
4 their cost structure, I'm competing with my own", and in
5 behind that -- he's obviously a very astute man -- in behind
6 that he realises that there is no way anyway that the full
7 service airlines like Air New Zealand are gonna be able to
8 replicate what he's got. They simply cannot do it. I'll
9 come on to that perhaps in the next slide.

10 Can I ask you to just contemplate this one, because on
11 the left-hand side there's a representation of the sort of
12 cost management that I'm talking about. Listening to all of
13 the Applicants' case and the representations that have been
14 made by others, you could say that almost all of the debate
15 has been in that red column. The debate has been about
16 revenues, and it's the area where you get all these
17 emotional emotive terms like "cartel" and "anti-
18 competitiveness" and "monopoly" and so forth. When I said
19 earlier that really the Applicants and many of the
20 presenters are talking past each other, this is what I mean.

21 There was comparatively little attention seemed to be
22 given by anybody to this core fact that the airlines are --
23 the full service airlines are uncompetitive on their own
24 costs.

25 Our final slide is a summary of Polynesian's position,
26 which is largely self-explanatory. We feel that the
27 Commission's Draft Determinations didn't allow sufficient
28 weight to -- whether you call it wider public interest,
29 economic benefit, so on, in the applications and adjustment
30 is needed for that. We did not feel at all comfortable with
31 the Draft Determinations in that regard.

Polynesian Airlines

1 The fundamental situation is that the Applicants, being
2 full service airlines, do have obsolete business models that
3 have been artificially induced, mostly against their will,
4 very high cost bases that the markets are saying they will
5 no longer support, and that's evident in their profitability
6 returns.

7 I would like to just briefly comment on Air New
8 Zealand's position and perhaps Qantas as well. Because, it
9 has been said here several times oh Air New Zealand's doing
10 all right now, it doesn't need this alliance; it's doing
11 fine. Commissioner Bates made the comment that Air New
12 Zealand has done remarkably well; a comment with which I
13 agree, but it has to be in the context of, compared with the
14 situation it was in when the taxpayer had to rescue it, and
15 I repeat, many people have said to you as Commissioners that
16 they don't believe Air New Zealand can fail.

17 Air New Zealand has, and can easily do so again, but
18 it's less likely because any money that's required to keep
19 it going is going to have to be found by the taxpayer. I
20 don't believe there is a commercial market provided that's
21 going to provide Air New Zealand with money if it goes out
22 with a rights issue. At the moment 82% of it is going to
23 have to be taken up by the State, and I would suspect that
24 probably they would have to underwrite a good deal of the
25 remaining 18%.

26 So, that's where the capital market is as far as the
27 airline's concerned. I do think that it's worth recalling
28 that when push came to shove, and again Mr Norris two hours
29 from having his airline fold up underneath him, that the
30 private sector shareholders, you know, the great white hope
31 Singapore Airlines and Brierley Investments, one of

Polynesian Airlines

1 New Zealand's major corporations, walked away. They said
2 "we will not put any money in", they cast the airline on the
3 shareholders' mercy. Fortunately the shareholder recognised
4 what was needing to be done and did it.

5 But, having said that, we believe that it is very much
6 in the public interest that the airline industry should
7 reduce those overly large structural costs, and I would put
8 it to the Commission that in that debate last Friday about
9 VBA costs versus full service airline costs, I think it
10 needs to be recognised that a VBA can come in as an
11 immediate start up and have an immediate effect. It will
12 take a lot of money, a lot of front end investment, a
13 considerable amount of intestinal fortitude on behalf of the
14 managers and the shareholders of Air New Zealand, and
15 Qantas, to overcome the barriers that they have to reduction
16 of those fixed costs. It won't be easy. Big numbers in
17 redundancies, big numbers in relocations, all big numbers
18 because this is a big number industry.

19 How are they actually going to take out a material
20 proportion of the fixed costs that have been built in over
21 time if they don't have the money to do it with? Again,
22 it's one of those things, you can't get your costs down
23 unless you invest; it will cost you a lot of money up-front
24 in order to gain a benefit down the road. I didn't think
25 that that was recognised.

26 But regardless of any VBA activity the full service
27 airlines have to adjust, and the danger is, if the
28 Commission doesn't allow them to do that, then the
29 artificiality will be continued and a side effect of that, I
30 suggest, would be that an unfair competitive advantage will
31 actually be donated to a new entrant. Because of their

Polynesian Airlines

1 artificiality, Qantas and Air New Zealand have had to apply
2 to the Commission; new entrants don't have to apply to the
3 Commission, and that puts them at an artificial competitive
4 disadvantage -- the Applicants, I mean -- for reasons they
5 are seeking to address here.

6 Polynesian itself is at a serious disadvantage and
7 that's why it seeks to be part of the proposed alliance,
8 arguing that it's already in it and the applications
9 approved on the papers are going to push it out. We believe
10 that the applications have a rational basis for cost
11 reduction, and they ought to be approved, but in part and
12 with the inclusion of Polynesian. I think the Commission
13 really has the opportunity to approve the applications in
14 total or disprove them in total, or take a position that may
15 be in between, or a position that says we will give
16 authorisation but there will be a time when you have to come
17 back and re-apply, and Polynesian believes that that is a
18 reasonable and rational solution to a very very difficult
19 problem, but it doesn't believe that it's an answer for the
20 Commission to refuse the applications thereby denying the
21 airlines the opportunity to get that fixed cost base down,
22 and they can do that actually without removing their brands
23 or their competition in the marketplace.

24 In our submission we gave an example out of my own past
25 18 years with British Petroleum where I spelled out how the
26 oil industry manages to keep its production costs down by
27 sharing production facilities, but at the same time manages
28 to keep competition going at the retail end of the
29 marketplace.

30 So, I hope it wasn't too much over time. That's
31 Polynesian's position on it.

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1 **CHAIR:** Thank you very much. I might just start with a few
2 questions. Can I get an understand of where your
3 discussions are currently with the Applicants?

4 **MR GATES:** Yes, Madam Chair. Well currently we've had
5 discussions with them immediately after their first
6 submissions or application to the Commerce Commission in
7 which we highlighted the NECG report which indicated that we
8 would be competed out of business. Both they and Qantas, I
9 might add, were caught a little short because they didn't
10 realise that it was the implication, and we agreed -- or
11 they agreed that they would look after us and for us to
12 write a letter to them telling us what we want.

13 However, in contemplating a letter of that nature it
14 would have been anti-competitive and we could have ended up
15 in front of this Commission for another reason, so we
16 decided not to do that and take the course of applying a
17 submission to the Commerce Commission in respect of what our
18 view of the alliance proposals and the equity proposals
19 would do to Polynesian and what would be a solution -- a
20 viable solution for us.

21 We essentially are not in conflict with both Qantas or
22 Air New Zealand; we essentially agree with the proposed
23 alliance because we see that, in terms of the size of the
24 market here, it's logical to assume that you couldn't
25 sustain more than two FSAs and one VBA and at the same time
26 there had to be left room for the wishes and strategic needs
27 of small Pacific Island States who have exactly the same
28 requirement in terms of tourism that New Zealand does.

29 So essentially we're not in conflict with them, we just
30 wanted to really bring the matter up here in the sense that,
31 the determination that is made by the Commerce Commission

Polynesian Airlines

1 may provide a greater opportunity for us.

2 **CHAIR:** So you haven't actually come to any understanding with
3 the Applicants about being a party to this alliance?

4 **MR McFARLANE:** May I address that, please? No. There is
5 something to add to Mr Gates' comment, because having
6 discussed the matter with Air New Zealand which was
7 represented to Polynesian as being the driver of the
8 applications, their view is that, if Polynesian has a
9 problem, please send us a letter and we will give you
10 comfort. We contemplated that and concluded that it was not
11 within Air New Zealand's gift to give comfort to this
12 situation, because they could not assume many of the powers
13 of the Commerce Commission, and so that's basically why
14 we're here.

15 **CHAIR:** Do you think it's in our jurisdiction, to make you
16 parties of an alliance, when the members of that alliance
17 haven't invited you to be in it?

18 **MR McFARLANE:** I come back to what I said earlier in the slides
19 I showed, that we are actually in a alliance with Qantas at
20 the moment. A precedent has been created by Air Pacific
21 being included in that alliance, for perfectly good reasons
22 that I can see, and there is no reason at all why we should
23 not be allowed to stay in a position that we were already
24 in.

25 **CHAIR:** Can I --

26 **MR McFARLANE:** Sorry, I should say that, I don't think we got as
27 far as anybody considering whether we should be in it or
28 not, but we did get as far as the airlines -- or Air New
29 Zealand I should say, telling us that we didn't understand,
30 that we had misread the papers, and they really didn't mean
31 what the papers said. But at the same time they weren't

Polynesian Airlines

1 prepared to alter that on the grounds that, well, we don't
2 want to confuse the Commission by muddying the waters.

3 So, it's not a comfortable position for Polynesian to be
4 in at all.

5 **CHAIR:** Can I just switch directions for a minute, and come to
6 the fourth bullet point on your slide up there which says
7 that entry barriers to the Pacific
8 Island/domestics/provincial markets are nonexistent.

9 I ask, if that's the case, why should it be a problem
10 for anyone, including Polynesian? If there are no barriers
11 what could possibly be the difficulty in competing in the
12 market?

13 **MR MCFARLANE:** Mr Gates is saying there's an economy of scale
14 issue here. I did remark earlier that the choices for a one
15 jet aircraft operator are few. If business is doing well
16 and you want to increase capacity, you have to increase it
17 by 100% or you have to get some lesser figure from an
18 alliance arrangement that you have, and if you don't have an
19 alliance with anybody then there is no flexibility, you are
20 up 100%.

21 Similarly in the opposite direction, if business isn't
22 too good, but if you have an alliance, then that capacity
23 that you have that's surplus to your demand can be shared
24 with your alliance partner and that's exactly what
25 Polynesian and Qantas were doing between the two of them.
26 Qantas was taking the efficient use of effectively half of
27 Polynesian's capacity at a time when markets had down turned
28 and there was this big hole created in Australia where
29 Qantas all of a sudden had a massive demand for more
30 aircraft to fill the hole.

31 So, the alliance between the two carriers worked exactly

Polynesian Airlines

1 like that; too much demand on their side of the bed and too
2 little on our side. So, the alliance worked very well. So,
3 that issue of economy of scale is particularly pertinent to
4 us because you can't imagine Qantas overnight going up by
5 100% in total.

6 **CHAIR:** I just have one last question and I'll see if my
7 colleagues have questions and it's in a different area, but
8 if the proposed alliance went ahead, I wonder if you can
9 tell me whether you could see any other airlines entering
10 the New Zealand Pacific routes?

11 **MR GATES:** Madam Chair, the opportunity does exist, Samoa has an
12 open skies policy on air rights, similarly with New Zealand
13 and with the Cook Islands, and so there's no constraint on
14 capacity or other carriers coming in; the only rule or the
15 only test is the substantial ownership and effective control
16 issue of that other carrier. So, there is no constraint
17 there.

18 But if I may, Madam Chair, the issue for Samoa, because
19 the airline Polynesian is inextricably interwoven with
20 Government policy, is that they want to continue with having
21 their national carrier as they see it as an instrument in
22 developing tourism, which is an important economic plank in
23 the future growth of the economy. It is a fragile economy
24 with no natural resources except its scenery and its people
25 and now tourism is the largest export earner for the
26 country, and it is -- whilst it's always sometimes
27 debatable, I don't think that there's any argument that the
28 national carrier plays a large role in providing that
29 stimulus to tourism; much the same as is postulated here by
30 Air New Zealand in respect of tourism in New Zealand.

31 The difficulty Samoa has is that the traffic is in an

Polynesian Airlines

1 imbalance; there's 175,000 people in Samoa and, probably
2 100,000 ethnic Samoans in New Zealand and probably getting
3 close to 50,000 in Australia. It forms a basis for traffic
4 and the Government is very keen to ensure that the Samoans
5 have their national carrier and see that that effort is
6 maintained to retain contact with their foreign communities
7 or their ethnic communities overseas and then use that also
8 as an instrument to develop tourism.

9 The issue for the shareholder, that is the Government of
10 Samoa, is of course that, whilst not disagreeing with what
11 is being attempted in this commercial alliance between
12 Qantas and Air New Zealand, the problem we have is, we
13 become an unintentional victim in terms of being vulnerable
14 on our prime routes to that capacity that has been outlined
15 in the NECG report.

16 So, no, there's no-one stopping anybody from flying into
17 Samoa, any other carrier. The issue for them is that the
18 traffic, the main room, is an imbalance; there's only
19 175,000 people at one end. And so it's very difficult for
20 any carrier to see that as an opportunity, and hence,
21 underlines my reasons -- the reasons for the Samoan
22 Government wanting their own carrier, because they don't
23 want to see people come and go and they don't want to see
24 their economy and the development of their tourism
25 dissipated by Polynesian disappearing and being in the hands
26 of somebody else.

27 **CHAIR:** Thank you.

28 **MR CURTIN:** Just one question, if I may. Does Virgin Blue, from
29 a regulatory point of view, have the capability to fly on
30 Polynesian routes? Are you expecting them to if they have?

31 **MR GATES:** Commissioner Curtin, they do have the right, there's

Polynesian Airlines

1 no problem with that because if there's an open skies policy
2 between the two countries. However, I don't believe that
3 they will because it is not a -- well, in fact, it's not a
4 route they would cherry pick because of the numbers. Too
5 small. That's why they've chosen Fiji. There is a huge
6 tourist market in South Pacific terms there already
7 developed. In Samoa it is not developed. I believe Virgin
8 would only move into that route once somebody else has done
9 the development, and that's not being unkind to them; that's
10 not their role.

11 **CHAIR:** I'll just ask Commission staff advisors if they have any
12 questions, please.

13 **MR RENNIE QC:** In what country is the operating company of
14 Polynesian incorporated?

15 **MR GATES:** It's incorporated in Samoa.

16 **MR RENNIE QC:** If the alliance had an anti-competitive effect in
17 Samoa, what is the position under Samoan law?

18 **MR GATES:** Unfortunately Samoa doesn't have any Acts on anti-
19 competitive behaviour. Whilst they've got the -- they don't
20 have a Commerce Act for a start, and so they tend to mirror
21 New Zealand legislation but that was in effect some 20 years
22 ago to be honest.

23 **MR RENNIE QC:** Would you accept that the anti-competitive
24 effects that you point to in relation to Samoa are more a
25 matter in Samoa than a matter in New Zealand?

26 **MR McFARLANE:** No, we wouldn't agree with that, because I come
27 back to what is really at the core, we believe, of these
28 applications; I may describe it thus as "production cost".
29 The production cost of the Applicants is very very high and
30 much higher than it should be, and much higher than it needs
31 to be if these airlines are to survive.

Polynesian Airlines

1 But the point is that they have an ability to reduce
2 them, and they can reduce them to the detriment of
3 Polynesian if it's not involved in it, because Polynesian
4 cannot reduce any fixed cost; there's nowhere to go. You
5 either have one airplane or you have no airplane. As long
6 as you're running your operation efficiently your fixed
7 costs are fixed and there's no opportunity to reduce it;
8 except, as I mentioned earlier, by the alliance with another
9 operator which already exists of course in the case of
10 Qantas.

11 And I would just go on to say, well, why should
12 Polynesian be pushed out of the opportunity to reduce its
13 costs and be more profitable, while still maintaining its
14 own brand and its own ability to compete in the marketplace?
15 Because, we would very much like to get to a situation where
16 Polynesian is able to access production of air services at
17 the same unit costs as would be available under the JAO to
18 Air Pacific, Air New Zealand and Qantas.

19 **MR GATES:** There's also a corollary to the question that you
20 asked, and why should Samoa as an independent State, any
21 decision made in the New Zealand jurisdiction, how will that
22 affect Samoa? The interesting part about Samoa, Samoa is
23 the only country in which New Zealand has a treaty of
24 friendship and the two countries are inextricably interwoven
25 both culturally and trade and many aspects, and in fact
26 Samoa up until 1962 was administered by New Zealand, from
27 1914 to 1962, so the linkages are close.

28 In a Samoan view of life it regards New Zealand as a big
29 brother and in the same family. So, you've also got to take
30 the emotional aspects to it as well, so I'm not saying that
31 the Qantas/Air New Zealand alliance would be an unfriendly

Polynesian Airlines

1 act, it's not; it's a commonsense approach to a
2 fundamentally flawed airline cost structure.

3 But, the side effect of it is, it's knocking a friend
4 about and the friend wants to be part of that because I
5 think I personally believe it's in New Zealand's interests
6 in its relationship with Samoa to ensure that Samoa's
7 economy develop, because at the end of the day someone's got
8 to pick up the problem if it doesn't. Does that answer your
9 question?

10 **MR MCFARLANE:** I'd just like to add to that that in the Civil
11 Aviation sense that the links are so close that Polynesian
12 operates under the Civil Aviation Rules of New Zealand so,
13 its cost structure, if you like, is driven by New Zealand,
14 not by the Government of Samoa.

15 **DR PICKFORD:** To what extent is it necessary for a Pacific
16 Island to have its own airline to develop its tourism given
17 that if it were an attractive destination then presumably
18 other airlines would want to fly to it?

19 Following on from that, has Polynesian invested much in
20 creating and encouraging tourism like Air New Zealand has
21 for New Zealand?

22 **MR GATES:** Firstly, why does it need an airline to develop
23 tourism, I think I answered the question before actually
24 because I'm saying no other operator's going in there. Air
25 New Zealand currently goes in there, but it is really
26 carrying what is called VFR traffic, there's been no really
27 active promotion of Samoa as a tourist destination and to a
28 degree Samoa was ambivalent about tourism up to about 10
29 years ago.

30 The Qantas alliance we had was part of that process to
31 develop tourism, and it's been very active to the point

Polynesian Airlines

1 where the Government is now underwriting tourism resort
2 development through tax incentives and providing land for
3 tourism resort development.

4 The airline is an absolutely critical element in that
5 any proposal for development of tourism, investors look to
6 seeing whether they have a State carrier which they can lean
7 on to develop the traffic flows that they require to make
8 the resort a success.

9 **MR MCFARLANE:** Sorry, may I add to that by saying that, the
10 short answer and the quick answer to your question is that
11 the reason Samoa has a national carrier are exactly the same
12 arguments that have been presented to this Commission as to
13 why New Zealand should have a national flag carrier. It's
14 the same thing, and the Government of Samoa perhaps
15 realistically is less concerned, although it is concerned,
16 it's less concerned with whether the airline is going to
17 provide it with big dividends as a business; it's utterly
18 concerned with what I described earlier as the delivery of
19 tourists into the Samoan economy so that money can be earned
20 from them by the ground product. Again, exactly the
21 argument for New Zealand and Australia and every other
22 country that participants in tourism; that's why it's there.

23 **PROF GILLEN:** I have a question about Qantas Holidays. Given
24 that you have an alliance with Qantas, has Qantas Holidays
25 actively brought tourists into your area?

26 **MR GATES:** Yes, not in the numbers we would like, and
27 essentially the development of the product with Qantas
28 Holidays has been a little slow. We're a pretty small
29 destination in the bigger scheme of things, however Qantas
30 Holidays has helped immensely so, yeah.

31 I mean, the Qantas Holidays thing is one of those things

Polynesian Airlines

1 that you've really got to be oiling the wheels the whole
2 time and they've been very helpful. Our product is in
3 there, and it is marketed and distributed through the
4 Northern Hemisphere, but where -- only until recent years
5 Samoa has been a low destination, pretty hard to compete
6 against Tahiti and Fiji, and it's pretty hard to compete
7 against the Cook Islands where Air New Zealand have invested
8 huge money in developing tourism there. I wish they would
9 have done something like that for Samoa.

10 **PROF GILLEN:** I have a second question relating to costs in your
11 arguments for supporting the application.

12 Over the last two weeks Qantas has announced initiatives
13 of a cost reduction of A\$1 billion, and we've seen over the
14 last little while Air New Zealand has been successful in
15 developing its Express products.

16 Those two numbers would be far in excess of the
17 \$96 million in cost savings we're talking about in terms of
18 reducing capacity here, and so I'm a little puzzled as to
19 why your support, given that all those other cost saving
20 initiatives that are taking place outside of this
21 application are very substantial, and are clearly going to
22 affect your airline.

23 **MR MCFARLANE:** Yes, the issue is still, though, one of this very
24 high cost base, and I keep using the term "fixed cost base"
25 as opposed to "operational cost base".

26 In a situation like New Zealand Express, my view of
27 that, and it's only my opinion, is that the airline has
28 claimed cost savings for that and I believe there are cost
29 savings in operations. I don't perceive a structural cost
30 saving there, yet; but those structural cost savings are
31 going to have to come along the road. Richard, you might

Polynesian Airlines

1 like to pick up on that.

2 **MR GATES:** No, I think that pretty well answers the question
3 really. As Norman has said, and I think Geoff Dixon
4 expressed it when he made his address on Monday, that aiming
5 to cut \$1 billion out, and that's a huge amount and it's
6 going to take them a long time, and he is in that process
7 attempting to hit the historical structural problems they
8 have, but that may only be part of the need, to be honest.

9 He's not talking about operating costs there, so...

10 **CHAIR:** Okay, thank you very much to Polynesian Airlines for
11 your submission. It has been important to hear from the
12 other airlines that will be affected by the alliance, so we
13 thank you for your time.

14 I now ask Jumpjet Airlines to come forward, please.

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Jumpjet Airlines

1 market access and barriers to that access; and we'd like to
2 make a concluding statement to you.

3 Moving on to the opening: The purpose of Jumpjet
4 submissions have, we would hope, have added value to the
5 Commerce Commission's deliberations. We have endeavoured to
6 provide a practical analogy, we've endeavoured to identify
7 industry strategies existing in the market, we've
8 endeavoured to identify predatory commercialism, and we've
9 in the past presented to you, in our submissions, some legal
10 contention.

11 We understand the applications here before you are
12 concerning a strategic alliance and equity acquisition of
13 22.5% by Qantas with Air New Zealand under s.58 and s.67 of
14 the Act, of the Commerce Act. The style of presentations by
15 the Applicants are noted to be extensive and descriptive and
16 cover very significant economic argument, but very little
17 law. It is our impression that the decisions will be made
18 based on law.

19 In reality, Madam Chair, the impending applications were
20 the establishment, or the reality was that an establishment
21 which could be declared a market lock-up strategy was in
22 motion with the Applicants and certain major players within
23 the industry. This was planned to be achieved through a
24 monopoly of alliances based on equity association and based
25 on marketing alliance association; both are in a current
26 state and also in a projected state following the handing
27 down of a positive result of the applications before you.

28 In addition, Virgin Blue, the prize for Virgin Blue was
29 the control of the discount market within Australia, within
30 New Zealand and across the Tasman. The dual expenditure
31 capability of the Applicants, the dual promotion capability

Jumpjet Airlines

1 of the Applicants, the dual market and capability of the
2 Applicants and their alliance structure would exhibit
3 substantial power in the market. Substantial power in the
4 market over and above that power in the market that they
5 possess individually today.

6 We'd like to touch a little on globalisation, merely
7 accepting that it is virtually a political topic, but we
8 feel it has merit at this forum because of the effect of
9 globalisation on the aviation industry.

10 The focus by politicians, bureaucrats and politics in
11 general has been to push for the policy of globalisation.
12 In our opinion globalisation, the results of globalisation
13 have been simply a dilution of the economic wealth in the
14 communities of Australia and New Zealand and the transfer of
15 that economic wealth to -- a transfer of that economic
16 wealth to communities outside of Australia and New Zealand,
17 i.e. Overseas. Year-by-year local communities are becoming
18 poorer and poorer.

19 The globalisation and its effect in the aviation
20 industry is simply to support global positioning of wealthy
21 overseas carriers in our market. We talk here of the Trans-
22 Tasman market because this is the market that Jumpjet wishes
23 to gain access to. Global positioning by these major
24 carriers is the exploitation of unrestrained access of
25 freedom rights, and with each award of a new carrier coming
26 into the region there's a consequential destruction of
27 opportunity that is local opportunity in a local market.
28 This is not an international market, the Trans-Tasman
29 market, it is a local market; it is our market.

30 The contribution of these carriers to regional economic
31 development is virtually nothing. We'd like to move on to

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1 predatory activity in the market, and it's very fitting to
2 mention as an item under predatory activity, the demolition
3 of Ansett Australia.

4 We accept that there have been other factors that were
5 involved with the demolition of Ansett, but in any case
6 Ansett was denied the opportunity to restructure, which is
7 occurring with 80% of the major carriers within the world
8 today.

9 There is no doubt about it that predatory commercialism
10 played a major role in the destruction of Ansett and we
11 believe it's pertinent to bring before this forum the mess
12 of the aftermath in terms of statistics. There were
13 3.6 million creditors created by the downfall of Ansett.
14 There were 50,000 people placed on the dole queues, most of
15 which were aviation people or associated people from the
16 industry. There were six airlines bankrupted. There were
17 numerous peripheral companies that were suppliers and
18 contractors to Ansett International who were bankrupted
19 also. There was and is disposal still being undertaken for
20 in excess of 130 large aircraft. The value of those assets
21 were in excess, or are in excess of A\$2 billion. In
22 conclusion, there were five superannuation funds which were
23 substantially damaged and a number may not recover.

24 Such is the effects of predatory activity in the market.
25 Also, a number of items which identify predatory activity in
26 the market are airfare wars and capital shipping. These are
27 functions of predatory commercialism in the market. You may
28 recall that Impulse Airlines was brought down by an airfare
29 war in Australia which was part of predatory activity.

30 Capital shipping is the practice of parent companies
31 shipping cash equity to their subsidiaries in order that

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1 those subsidiaries can trade in the market, below operating
2 costs and remain legally and technically solvent.

3 The final item under this topic we'd like to raise to
4 your attention is regional alliances. Regional alliances
5 can indeed be a barrier to entry for new entry operators
6 attempting to gain access to the market. In the Trans-
7 Tasman market there is an extensive network of regional
8 alliances. Some 14 Trans-Tasman airlines exist with some 37
9 marketing alliances. The result and the airfare structures
10 could be classified as a duopoly style of airfare structures
11 in that they are harmoniously competitive.

12 We'd like to move on now to the legal conviction. The
13 effects of the integrated merger, and let's identify the
14 Applicants as an integrated merger in this century, the
15 acquisitions of a 22.5% equity would be considered overall
16 an integrated type merger. The effects are a substantial
17 lessening of competition in the market. A substantial
18 lessening of the competition in the market as a result of
19 the applications before you has been identified by the
20 Commission. It has been admitted by the Applicants, and it
21 has been universally accepted by the public that there will
22 be a substantial lessening of competition in the market.

23 Our forte is not to instruct the Commission in these
24 areas but merely to identify potential legal breaches under
25 the Act. As a new entrant carrier, Jumpjet is vitally
26 interested in the restraint capability of the Commission and
27 the restraint capability of commercial law.

28 There is seemingly also sufficient evidence that has
29 been placed before the Commission or is available as public
30 evidence to suggest that there may be grounds for an
31 investigation into collaboration under the Act on behalf of

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1 the Applicants and certain major players.

2 Section 36A, we'd like to cover, which deals with taking
3 advantage of market power. This integrated merger, no doubt
4 if successful, would take advantage of power in the market.
5 It may restrict, it may prevent, it may deter, or it may
6 eliminate new entrant carriers entering a market of which
7 Jumpjet Airlines is seeking access as one of those.

8 Also we'd like to raise awareness to s.47 of the Act
9 which covers certain acquisitions which are prohibited.
10 Certain business assets or shares cannot be acquired if
11 there is a substantial lessening of competition in the
12 market. We put it to the Commission that there is such of a
13 substantial lessening of competition in the market brought
14 about by intense current marketing associations, by intense
15 current equity associations, by intense current projected
16 marketing and equity associations was a result of a positive
17 decision in relation to the applications before you.

18 Finally, s.67, where the Commission may grant
19 authorisations for business acquisition; it comes in two
20 parts, as we know. The first part covers substantial
21 lessening of competition in the market and we believe that
22 such substantial lessening of competition in the market does
23 exist. The recent political intervention which has resulted
24 in Emirates entering the market in our view does not change
25 substantial lessening of competition in the market.

26 Let's look a little at Emirates and Emirates' arrival on
27 the scene. In point of fact, Emirates does have alliance
28 connections. It has a connection with the Star Alliance
29 carrier and one other on the Trans-Tasman market. The fare
30 structures that have been advertised and published by
31 Emirates indicate a duopoly style of fare structure in that

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1 they are harmoniously competitive, being harmonious fares.

2 The worst aspect, and this is an aspect we share with
3 the Applicants, is that the arrival of Emirates equals now
4 30%, a 30% slice of the market being passed to overseas
5 carriers. Not Invercargill to Ballarat, but the best, the
6 cream of the market has been passed to wealthy overseas
7 carriers. This is our market.

8 The second part of s.67 covers public detriment versus
9 public benefit. There is no doubt as a result of the
10 Commission's investigations and deliberations that public
11 benefit far -- correction, public detriment far outweighs
12 public benefit on this issue.

13 Moving now to the Air Services Agreement: A little on
14 the history, to refresh the minds of people here, that we
15 remember that the Air Services Agreement was set in motion
16 from an historic point of view to open the skies within
17 Australia, within New Zealand and between. This was in the
18 interests of encouraging CER, or closer economic relations,
19 in that, in our case, in the industry's case, it enabled
20 suitably qualified local airlines to freely operate in those
21 markets.

22 The result of the Air Services Agreement produced two
23 airlines. It produced a single aviation market or SAM
24 Airline, and it produced a designated airline; both of these
25 airlines have requirements.

26 In terms of the SAM Airline requirements, if we could
27 broadly brings these to the attention of the forum; the
28 effective control must rest in the hands of Australian or
29 New Zealand nationals, the majority shareholders must be
30 Australian or New Zealand nationals, two-thirds majority of
31 the board must be Australian or New Zealand nationals, the

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1 Chairman must be an Australian or New Zealand national.

2 If we could move to the designated airline requirements:
3 There has been a noted regulatory relaxation with the
4 requirements of the designated airline in that the system
5 now is able to approve more and more overseas carriers into
6 the market at the expense of local industry.

7 The designated airline has become nothing more than a
8 stepping stone to global open skies, hand-in-hand with
9 global positioning, hand-in-hand with globalisation and such
10 a policy. Even so, there is a requirement of note which we
11 bring to the forum, and that is that effective control of an
12 airline, such an airline must be in the hands of Australian
13 or New Zealand nationals.

14 So we pose a logic question to the Commission: If the
15 board system is used for the governance of the board, is
16 that airline in effective control of the airline, is it in
17 the hands of Australian or New Zealand nationals? We put it
18 to you that that is not the case.

19 Finally, the final item under this air services
20 agreement topic is the status of the carrier, Virgin Blue.
21 We believe that clearly Virgin Blue does not qualify for SAM
22 status. We believe clearly because of court system's
23 determination of board policy, that Virgin Blue remains
24 unqualified for designated airline status. The recent award
25 of designated airline status by the Australian Department of
26 Transport is merely, in our view, an exercise in
27 favouritism. The decision by the International Air Services
28 Commission which has resulted in the award of unlimited
29 capacity for Virgin Blue across the Tasman, and within these
30 markets is again an exercise of favouritism.

31 The ownership -- they tell us the ownership has been

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1 sorted out in relation to Virgin Blue, however let's look at
2 it technically; that can be sorted out with 0.001%. The
3 fact remains that Virgin Blue is a subsidiary of a global
4 carrier, and that global carrier is the Virgin Group which
5 consists of 200 companies in 25 countries with a turnover of
6 equivalent of NZ\$9 billion each year, per annum.

7 A little more on the unlimited capacity as we go through
8 this presentation. Madam Chair, moving to Jumpjet market
9 access, some issues: We'd like to bring to this forum some
10 history in relation to local entrant carriers and make some
11 comment in this regard.

12 There has been many factors against local entrant
13 carriers gaining access to the market; these in general have
14 been, a lack of support by politics, a distinct lack of
15 support from commercial and aviation regulations, a distinct
16 lack of support from financial and investment institutions
17 in the region. The skies are in fact less competitive today
18 than they have been for decades.

19 We'd like to touch briefly on the definition of market
20 forces and an explanation of market forces in that we have
21 been privy to Conferences that have waived market forces as
22 some magic wand in the industry. We do accept that the
23 structure of the industry is determined by market forces,
24 that outcomes are determined by market forces, but we put it
25 to that forum that market forces are in fact man-made.
26 Market forces are constrained by fair competition in the
27 market. Market forces are restrained by regulation; it
28 necessary follows that market forces are man-made.

29 Jumpjet is seeking access to the market as a niche
30 market development carrier, as a hybrid carrier with a
31 tourist focus aimed at developing that niche. The company

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1 has modest company growth expectations, the objective is to
2 enter with value, service and integrity.

3 The company wishes to compete on the market, on the
4 Trans-Tasman market for growth only; that is, through to 6%
5 expanding in some years to around 12%. This has been a
6 moderate growth market for in excess of a decade.

7 Jumpjet believes that a new era has arrived in which the
8 New Zealand commercial law permits access to the market,
9 permits access to a fair market, and permits that market to
10 remain fair, or causes that market to remain fair, and
11 surely, this is a desirable outcome, or outcomes with such a
12 scenario are far more desirable than some of the statistics
13 that we've indicated to you today in terms of predatory
14 commercialism operating within the markets.

15 We'd like to cover objections, complaints and appeals
16 from our perspective, mainly as a result of the Commission's
17 response to us for our s.36A application against Virgin Blue
18 for its award, or against the award of Virgin Blue for
19 unlimited capacity in the market.

20 The Commission raised the possibility that Jumpjet did
21 not place an objection in relation to this application
22 before the international Air Services Commission. Madam
23 Chair, nothing could be further from the truth. Since May
24 2001 Jumpjet, in its public relations circulation, and in
25 its efforts have provided written objection against any
26 waivers given to any carrier entering the CM market or the
27 markets of Australia and New Zealand. These objections have
28 been submitted in writing to the Minister of Transport in
29 New Zealand, to the Minister of Transport in Australia, to
30 the Prime Minister's Office in Australia, to the Department
31 of Transport in Australia and to the Ministry of Transport

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1 in New Zealand.

2 Let's look a little at the unlimited capacity award to
3 Virgin Blue via the International Air Services Commission
4 recently. There were 100 stakeholders notified and sought
5 to make comment in relation to the potential award of
6 unlimited capacity in the market. Unfortunately, Jumpjet
7 was not one of those stakeholders that were, and in fact,
8 notified.

9 We protest in that the Jumpjet approach consists of two
10 incorporated companies in New Zealand, a valid board, and we
11 are trade marked adequately in both New Zealand and
12 Australia. The Chairman of the International Air Services
13 Commission at the time happened to be the Merger
14 Commissioner for the ACCC; there was no excuse for not
15 knowing that Jumpjet is around.

16 It must be said that a lack of autonomous due process
17 has taken place. We have lodged a complaint with the
18 Minister of -- the Australian Minister of Transport to his
19 office, a copy is held by the Commission of that complaint
20 and that letter, and the system has ignored us; the Minister
21 has preferred not to answer that approach.

22 We would like to reiterate from an appeal point of view
23 that we have not only placed objection but we would consider
24 consultive information on industry outcomes and industry
25 activity to the recipients we've previously mentioned to you
26 over the period there May 2001.

27 Moving to the s.36A application that we placed before
28 you --

29 **CHAIR:** Can I just interrupt you for just a minute. I know that
30 you've got other matters that you've raised with the
31 Commission, but I want to make sure that they're relevant to

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1 the consideration we're giving here today. So, I assume
2 you're going to link this back to your submission to us on
3 this matter?

4 **MR KILE:** Well yes, I will try to do that, Madam Chair.

5 **CHAIR:** I think it's important you do because really we're here
6 today to hear submissions on this authorisation application.

7 **MR KILE:** We would just simply like to express our
8 disappointment at the Commission's decision on inaction in
9 relation to that s.36 application. Jumpjet is vitally
10 interested in the restraint capability of the Commission and
11 the restraint capability of the Commerce Act and the Fair
12 Trading Act in relation to predatory commercialism within
13 the industry.

14 We do appreciate the reasoning the Commission has passed
15 to us in that the crime must be virtually committed before
16 any form of action or prosecution to take place. We simply
17 put it to you the Commission that perhaps that crime is not
18 too far away.

19 I'd like to make some concluding comments, if I may, in
20 relation to the applications before the Commission. In our
21 view, the Commission's approval of s.58 would be merely an
22 endorsement of a sort of restricted trade practice which
23 could rest on predatory commercialism within the market and
24 provide a barrier to market access for a new entrant
25 carrier.

26 In conclusion, the Jumpjet submissions that have already
27 been presented to you have aimed at identifying potential
28 breaches under s.36, under s.47 and under s.67.

29 In conclusion, the public benefit argument; we believe
30 that the detriment outweighs -- simply public detriment
31 outweighs public benefit.

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1 In conclusion, industry behaviour patterns in the
2 aviation industry have always been constrained by fare
3 competition in the market. They have always been
4 restrained -- correction, they've always been restrained by
5 law. Law directs market forces, law prevents predatory
6 commercialism, or it should.

7 In conclusion, Jumpjet supports the confirmation of the
8 Draft Determinations handed down by the Commission in that,
9 based on the evidence available, the applications are in
10 fact illegal if they were approved.

11 We would simply like to close by covering the official
12 launch of Jumpjet and we can simply report that from a
13 capitalisation and contract point of view, that the funding
14 issues for Jumpjet are progressing well, and we expect to be
15 in -- the company expects to be in a position to officially
16 launch Jumpjet in the near future.

17 On that note I'd like to, on behalf of John and Chris
18 today, and the Jumpjet team, I'd like to express a note of
19 appreciation to the Commission and the Commissioners for
20 their patience and application in regard to the issues under
21 determination and on that note I thank you for your
22 attention.

23 **CHAIR:** Thank you for that, Mr Kile. I would like to just start
24 with a clarification; when you said your goal was to reach a
25 12% market share? Is that --

26 **MR KILE:** I'm sorry?

27 **CHAIR:** Did you say that your market share goal was 12%?

28 **MR KILE:** No, that was merely the identification of a statistic
29 in the market that was that on average the Trans-Tasman is
30 growing per year of 3 to 6%.

31 **CHAIR:** Okay. What sort of objectives have you set for yourself

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1 in terms of growth once you've entered, if you can tell us.
2 If you can't, that's fine.

3 **MR KILE:** Let's state that, if we quiver a bit, it's not wishing
4 to withhold information from you, we're quite happy to
5 answer any question you may have in a confidential session,
6 we'll do our best to attempt such answers.

7 **CHAIR:** I'll rephrase the question. What sort of timeframe do
8 you think you'd need before you as a company were able to
9 exercise significant constraint on the Applicants?

10 **MR KILE:** We'll be entering -- we can say that we're entering
11 with a single aircraft, and that we very heavily are -- our
12 business model, when one considers research into the history
13 of predatory commercialism in the market, we will be resting
14 heavily on commercial law giving us some degree of
15 protection while we are free to trade our product in the
16 market to gain a foothold and gain a clientele which we
17 believe to be additional to the clientele that already
18 support the current carriers in the market.

19 **CHAIR:** I'll just see if there are further questions. [**Pause**].
20 Any questions from staff or advisors? [**No questions**].

21 Okay, it's left for me then to thank you very much for
22 your submission, and again we are interested in these
23 submissions from new entrants, it's important for us to
24 understand what are the market barriers that you face. Once
25 again, I thank you for your submission.

26 **MR KILE:** Our pleasure Madam Chair, thank you.

27 **CHAIR:** Now, I propose to break for 15 minutes, ask people to be
28 back promptly at 5 past at which time we'll have the right
29 of reply from the Applicants. Thank you.

30

31 **Adjournment taken from 3.50 pm to 4.05 pm**

*Applicants in Reply - Economists***PRESENTATION BY APPLICANTS IN REPLY****ECONOMISTS**

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4 **CHAIR:** I'd' just like to now reconvene this final session of
5 these hearings and, as everyone is aware, it is now the
6 session in which the Applicants have a right of reply, and I
7 will ask the Applicants to please state for the record who
8 will be addressing this session. Thank you.

9 **MR P TAYLOR:** Madam Chair, thank you. This right of reply is
10 going to comprise both written and oral presentations; the
11 written presentations have been handed in, they will not be
12 addressed to directly, they are simply placed into the
13 record and they are a response by Dr Tretheway to a
14 statement by Morrison & Co regarding information on the
15 European low cost carrier market share, a very brief
16 response to certain factual errors of a page and bit, and a
17 response to presentations made at the hearing by third
18 parties on behalf of the economics group that will be
19 addressed in short form, not directly to the paper, but just
20 in a presentation.

21 **CHAIR:** And are you proposing to --

22 **MR P TAYLOR:** We're proposing there are three short parts to it.
23 First of all to meet Dr Tretheway's need to get away to the
24 airport we'll have a presentation of about 35, 40 minutes
25 from the economics team, then about 10 to 15 minutes
26 presentation from Qantas and about 10 to 15 minutes
27 presentation from Air New Zealand.

28 **CHAIR:** Thank you for that. Please proceed when your ready.

29 **DR GUERIN-CALVERT:** We'd like to thank the Commission again for
30 the opportunity to be present today. What we have tried to
31 do in this presentation in coordination among us is, having

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1 listened to the questions that have been asked over the
2 course of the last week and the issues that have been raised
3 by other economists, what we thought we would try to do in a
4 very focused way is to address what we thought were the key
5 outstanding questions or issues of significant difference.

6 We wanted very briefly, in terms of our presentation
7 today, to go through the context for the economic analysis,
8 make some very specific comments on some of the key
9 theoretical or empirical issues that were raised with
10 respect to the competitive effects analysis, particularly
11 with respect to issues related to efficacy and sufficiency
12 of entry as well as pricing effects.

13 There have been a number of issues addressed with
14 respect to modelling, there are a few of those that we
15 thought since the questions were consistently coming up,
16 that we wanted to make sure there was an opportunity to try
17 to answer those questions. There have been some specific
18 presentations by other economists or individuals who raised
19 some specific issues with respect to the magnitude or the
20 quantification of the benefits and we thought it would be
21 useful to address that very briefly as well as the balancing
22 and in a few summary comments.

23 In particular, with respect to the context for the
24 economic analysis, as I think we started out at the
25 beginning, we think that the proposed alliance presents an
26 opportunity or a prospect for benefits. The nature of those
27 benefits come from the consolidation and the optimisation of
28 the two airlines' networks and a variety of other sources,
29 and that as economists how we have endeavoured and how other
30 economists in this proceeding have endeavoured to inform
31 you, is to provide a framework to address the question that

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1 is before the Commission which is whether, with this change
2 in the competitive landscape with the formation of an
3 alliance is likely, nonetheless, to produce substantial net
4 benefits.

5 We think that in terms of the competitive effects
6 questions, there really have been two key questions that
7 have come up within the last few days that we thought bore
8 addressing somewhat more specifically before you today.

9 The first is, are there entry barriers -- I'll try to
10 slow down, I just realised I'm going too fast -- are there
11 entry barriers in the markets at issue, the domestic, the
12 Tasman and international markets such that there might be a
13 concern about competition and pricing.

14 The second is, are VBAs a substantial constraint as
15 competitors on the Tasman and in domestic New Zealand?

16 What I'd like to do is, in terms of addressing those
17 issues with respect to VBA entry, whether it is sufficient,
18 effective and sustainable, to turn the presentation over to
19 Professor Tretheway to go through very briefly the research
20 and then most importantly for you, to go through the
21 critiques that have been raised and our combined response on
22 that.

23 **DR TRETHERWAY:** Thank you. One of the pieces of evidence that
24 was put forth by the Applicants was research by APG based on
25 US data which found that 5% VBA capacity in US markets
26 appears to drive major yield reductions in the
27 United States; further market share reduces yield somewhat,
28 but the big effect takes place with very small amounts of
29 VBA capacity.

30 Professor Winston then researched this same issue using
31 Australia data so that we did not overall use United States

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1 data, and his results showed that the presence of Virgin
2 Blue on a route reduces Qantas' fares by roughly 11%.

3 Professor Hausman critiqued Dr Winston's study; we
4 listened to his critique and our view of it is that, it is
5 fundamentally incorrect. What Professor Hausman did is, he
6 introduced time effects -- this is a term of art in
7 econometrics -- into the regressions that Professor Winston
8 had done. However, whether time effects or firm effects are
9 introduced, inference must consider whether the effects are
10 picking up this coefficient. It's actually a body of
11 research Professor Hausman did himself in the late 70s and
12 early 80s.

13 Professor Gillen put a question to Dr Hausman about this
14 issue, as to whether the time effects could be picking up
15 the effect of Virgin Blue in the markets, and Professor
16 Hausman conceded this point.

17 Another issue that came up with respect to the VBA
18 constraint came from Infratil, specifically Morrison &
19 Company. They had a presentation based largely on a
20 McKinsey & Company report of a few years ago. One of the
21 claims that they put forth -- Infratil that is, or Morrison
22 & Co -- was that VBAs would be capped at a 25% share of
23 passengers in the market. There's no evidence that VBAs face
24 a substantial constraint on their ability to grow share in
25 competition with FSAs. First of all, VBAs already exceed a
26 25% passenger share in the United States, Canada and
27 Australia. It just is not consistent with the cap of 25% on
28 these carriers.

29 Morrison & Company, again using the McKinsey & Company
30 study, claimed that value based airlines in Europe are small
31 and they wouldn't reach a 14% market share until 2007; in

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1 particular, their current share, meaning 2001, was 7%.

2 In the past few days we have replicated the McKinsey &
3 Company work and have confirmed that the 7% share in 2001 is
4 correct, and that includes European FSAs, VBAs, as well as
5 European charter carriers. However, when you apply the same
6 methodology to 2002 data, European VBAs already had a 12%
7 market share, a 5% share increase in a single year.

8 If we look at capacity data, and this is contained in
9 the brief written response I have, it appears that European
10 VBAs will end this year with roughly a 15% market share in
11 Europe.

12 Morrison & Co also claimed that VBAs are becoming more
13 like FSAs in their services and cost. However in our view
14 they inappropriately assume that increased service offerings
15 by VBAs necessarily imply FSA cost levels. But VBAs add
16 services in a different manner. They add them as profit
17 centres and they charge separately for these services. For
18 example, lounges. The VBAs will add value creating services
19 if it's a profitable means of enhancing their competitive
20 position or a profit means of simply making additional
21 money.

22 What are the implications of our findings on this?
23 Well, our view is contrary to what was suggested by Morrison
24 & Company; VBAs provide an effective constraint on FSA
25 conduct. Despite having different business models, they are
26 in direct competition with the FSAs. They compete broadly
27 for the same passengers, business travellers do not confine
28 their patronage only to FSAs.

29 We also looked at the issue of productive and dynamic
30 efficiency for FSAs, an issue that was raised in some of the
31 third party submissions, as well as in questions from the

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1 Commission. We observe the commonsense fact that VBAs are
2 driving major efficiencies in business model redesigns in
3 Canada, in Europe and in the United States and in the
4 Australian-New Zealand region, the VBAs are under severe
5 pressure and they are achieving efficiencies.

6 We also remind the Commission of the NECG TFP study
7 which had two very important results. First is that the
8 alliance between British Airways and Qantas, the Joint
9 Services Agreement or JSA, was in fact productivity
10 enhancing. Second, their TFP results indicated there was no
11 reduction in Qantas' total factor productivity after the
12 Ansett collapse which increased Qantas' market share.

13 **DR GUERIN-CALVERT:** If I can add one point; one of our reasons
14 too for spending time on this last point in particular is an
15 issue that had come up earlier in the week as a way to draw
16 a linkage between the models that had been presented that do
17 show productive and dynamic efficiency and trying to capture
18 back in again the interplay and the competition between VBA
19 and FSAs and whether it does indeed generate the kinds of
20 productive and dynamic efficiencies that one would be
21 seeking.

22 **MR TRETHERWAY:** Another major area was raised by Professor
23 Hausman regarding the Los Angeles-Auckland market.
24 Professor Hausman asserts that substantial price effects
25 would take place in this market, but he makes three
26 fundamental errors in his analysis.

27 First, he understates continuing competition and
28 competitive constraint, particularly entry. Again, we did
29 some investigation and can verify that 20 to 25% of the
30 passengers on this route have reasonable alternative
31 routings, for example European origins, who can travel over

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1 other gateways and carriers.

2 LAX, Los Angeles International Airport will continue to
3 be a competitive route for 2 years. We're not sure that
4 Professor Hausman understood that this is a part of the
5 alliance, that that route would continue to be operated
6 separately by Qantas and Air New Zealand, hence his
7 criticism of the NECG modelling results is incorrect which
8 had included this.

9 We point out as well that there are Fifth Freedom rights
10 available today in this market for both Singapore Airlines
11 and Air Canada and with the growing number of US open skies
12 bilaterals including unconstrained Fifth Freedoms, there can
13 indeed be others. There's also a Sixth Freedom operator on
14 this route, Air Tahiti Niue. Fundamentally there's no
15 barriers to entry on this route and US carriers could re-
16 enter this market.

17 **DR GUERIN-CALVERT:** The only two other things I would add is
18 that, when Michael talks about 20 to 25% of the passengers,
19 we looked at numbers for those actually flowing over the LA-
20 Auckland route who had origin points outside of the US from
21 Europe. In addition, if you look at passengers originating
22 in the UK who come to New Zealand, it is already the case
23 that they're deploying other gateways to a significant
24 extent.

25 I believe Dr Stone in response to Commissioner Taylor
26 mentioned that there were about 11 alternative routings.
27 Probably the most significant of those is about 40% of the
28 UK originating passengers in early 2003 go over Singapore
29 and an additional large percent go over Malaysia, over Kuala
30 Lumpur, some by Cathay, Thai and Korean, but by far the
31 single largest alternative is Singapore.

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1 I also wanted to, particularly on the last point, to
2 raise something: Professor Hausman characterised the
3 decision with respect to the AA-BA codeshare alliance as a
4 decision that the Department of Transportation reached,
5 denying it based on -- he seemed to imply or mentioned
6 primarily concentration. That was one that a conditional
7 approval had been given, the parties did not proceed with it
8 but the reason for the conditioning was on specific routes
9 where there was a very specific concern about entry
10 restrictions. It was a slot and gate restraint particularly
11 at Heathrow that was of concern and there were some open
12 skies issues as well. So factually a very different
13 circumstance than here with respect to entry.

14 **MR TRETHERWAY:** A second error that Professor Hausman made was in
15 overstating the price rise on this route, the 40% plus price
16 rise is implausible. This route has a substantial leisure
17 component and tourism is well-known to have a very elastic
18 demand. Tourists have choices of destinations. The
19 alliance partners in fact will have incentive to attract
20 tourists for additional flights and double destination stops
21 from the US. They have less incentive to raise price and to
22 choke off this traffic. We point out that even a monopolist
23 would have little power to raise price in such a highly
24 price elastic market.

25 A third error is that he overstates the New Zealand
26 welfare impacts of a price rise. It should be kept in mind
27 that 60% of any price effects on this route will fall on
28 foreigners and not on New Zealand residents. So, if you
29 postulate that demand is inelastic, something we would
30 dispute, there would be little or no increase in deadweight
31 loss since the price impacts over a majority will be falling

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1 on non-residents.

2 In the NECG model, even with an estimated price rise,
3 over 5 years allocative efficiencies, including transfers
4 from foreigners of the postulated higher prices actually
5 increases.

6 **DR GUERIN-CALVERT:** We'd like to turn now to the issue of
7 modelling and to mention again in transition that the first
8 half of this presentation, what we have tried to focus on is
9 really the analytical framework looking at the factors to
10 specifically address the issues as to competitive
11 constraints in the marketplace and the factors that will
12 provide opportunities for benefits.

13 As we all have heard, there have been a number of models
14 that have been developed to assist the Commission in
15 quantifying benefits and detriments, and we have --
16 previously Professor Willig went through a framework to
17 assist the Commission in how to evaluate the models; that
18 essentially again, just to refresh, our view is that the
19 model that best captures the competitive dynamics of a
20 marketplace, most particularly that tries to understand and
21 measure and deal with the impact of a value based carrier
22 and to take into account as much of the facts and the
23 analytics on a route-by-route basis really provides a robust
24 framework.

25 In general, of the models that have been presented, the
26 NECG model as Professor Willig indicated, comes the closest
27 to really trying to grapple with those issues and to model
28 those dynamics. Nonetheless there have been some criticisms
29 raised and a number of questions, specific questions that
30 were addressed to not only the three economists sitting
31 here, and to Professor Willig, but also to another

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1 economist, and what we wanted to do was just very briefly
2 walk through the answer to four questions that have come up
3 a number of times; the issues that they raise are not unique
4 to the NEEG models but they have been raised in the context
5 of those models, and there have been some specific comments
6 by Professor Zhang that we believe warrant a little bit of
7 additional clarification.

8 So, with that, I will turn it over to Professor Ergas to
9 go through the four themes that particularly the Commission
10 staff has raised.

11 **PROF ERGAS:** There were four sets of issues which arose in
12 virtually all of the sessions with economists, and those
13 issues are listed on the slide. The first issue is, is the
14 NEEG model really a Cournot model, since it takes capacity
15 as exogenous?

16 The second issue is, is the NEEG model flawed since
17 decreased capacity in the factual relative to the
18 counterfactual is observed to result in increased welfare?

19 Third issue is, how come on some city pairs there is
20 increased capacity and higher prices in the factual compared
21 to the counterfactual?

22 And then a fourth and final issue is, how should one
23 deal with product differentiation?

24 Let me start with the first issue, which is, is the NEEG
25 model really a Cournot model? Now, in all three of the
26 models that have been put to you capacity is treated
27 exogenously. In other words, capacity is not determined
28 within the model or in some super game that sits around the
29 model, rather capacity is determined on the basis of
30 schedules and of the choices made by airlines.

31 What it's important to note, though, is that capacity is

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1 not output. Capacity is broadly the number of planes that
2 fly in the sky. Output is the number of trips that are
3 taken. So you can think of capacity in terms of available
4 seats and output in terms of seats that are actually taken
5 up.

6 The NECG model has exogenous capacity but output is
7 determined within the model. This is also the case with the
8 other models that are in front of you. Indeed, all three
9 models have exogenous capacity, endogenous output in
10 essentially the same way of going from capacity to output.
11 In that sense the NECG model is a Cournot model in exactly
12 the same way as the other models are.

13 The second question that was raised was that of; how is
14 it that you can decrease capacity in the factual and get
15 increased welfare? Now, what it's important to note is that
16 all three models have this property. And the reason this
17 property arises is because, in these models capacity is
18 exogenous and output is not determined on the basis of
19 capacity.

20 When capacity is reduced there is a big cost savings.
21 You get a cost rectangle that is avoided. However, in the
22 models, because capacity and output are determined
23 separately, reduced capacity may have little or no output
24 reduction.

25 This effect is most pronounced in the Hazledine model.
26 In that model there is no link at all between capacity and
27 output. So, with that model you can readily show that you
28 could take capacity to zero hence avoiding all of the costs
29 of having planes in the sky, and yet, output would remain
30 unchanged, resulting in an enormous apparent welfare gain.

31 The effect is also pronounced in Professor Gillen's

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1 model where capacity and output are only linked through the
2 capacity effect on demand. The effect is less pronounced
3 in the NECG model because in the NECG model the link between
4 capacity and output is tighter than it is in the other
5 models.

6 So, what can we make of this result? Is it a criticism
7 of the models? No, it isn't. What it highlights is the
8 fact that in all of these models, because of the
9 complexities involved in determining capacity, capacity is
10 determined separately from output. As a result, when you
11 impose a sensitivity test, you have to ensure that it's a
12 sensitive test, that it's a test that is sensible in the
13 light of the way the models work. Ultimately, you cannot
14 keep on reducing capacity without reducing output; that
15 would make no sense at all. And since the models don't
16 force you to make this link it's the tester that must ensure
17 that it is nonetheless made. If you don't make that link,
18 then you will get a result which has no economic meaning.

19 Let me turn to the third issue which has been raised,
20 which is that of how it is that we observe in some cases in
21 the factual increased capacity and increased prices. Now,
22 this only happens on a few city pairs, about 11% of market
23 revenues if you exclude LAX. The mechanics whereby it
24 happens are related to the way these models work. As a
25 result, although models, if they're run at the city pair
26 level and if they have capacity that is higher in the
27 factual than in the counterfactual, all three models should
28 display this effect.

29 The effect is most noticeable in the NECG model
30 essentially for two reasons. The first reason is that the
31 NECG model is a city pair by city pair model, so it is a

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1 disaggregated model, and that means it has the least
2 aggregation ever in it.

3 The second reason is that in our base case NECG model,
4 that is in the NECG model that we used in the initial
5 submission, we calibrated marginal costs of factual
6 capacity. So factual capacity has an effect on marginal
7 cost in the way the model works.

8 Now, the fact of life is that, if you want to run a
9 model of this type, you have to calibrate it. There are a
10 range of choices that you can make about how you calibrate
11 that model. We calibrated marginal costs using factual
12 capacity, and the reason we did that is because it requires
13 you to make fewer assumptions, because the factual schedule
14 captures the parties' information about network effects and
15 about expectations of entrant costs, and also, keying
16 marginal costs of factual capacity is conservative.

17 Now, alternatively one could take the approach, which
18 was recommended by Professor Willig, of calibrating marginal
19 costs off the base case. In our view, that requires making
20 additional assumptions. As well as that, the reason we did
21 not do that, or at least one important reason we did not do
22 that, is that it results in lower estimated detriments. And
23 so, yes, you could avoid this kind of effect or at least
24 attenuate it by using base case calibration, but what would
25 happen?

26 What would happen is that you would reduce the estimated
27 detriment from \$23 million to \$13 million. Given that
28 economic theory doesn't provide you with strong guidance in
29 that respect, we chose the most conservative approach of the
30 two which seemed sensible in the context.

31 The fourth and final issue is that of product

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1 differentiation and how do you deal with that fact.
2 Professor Hausman criticised the NECG model because he said
3 it ignores some elements of product differentiation. What
4 happens in the approach to product differentiation that is
5 adopted by professors Gillen and Hazledine? Well, what
6 happens is, they scale down the competitive pressure
7 impressed by the VBA. They assume that the VBA is less of a
8 competitive constraint than would arise if you had a
9 comparably sized full service airline. In fact, they assume
10 that broadly the VBA product has about half the price impact
11 on the FSA price which would be exercised by a comparable
12 competing FSA.

13 Now, this lessening of the competitive impact of a VBA
14 contradicts the empirical evidence as we found in Australia
15 and internationally. We presented some modelling results of
16 product differentiation models last week, and what these
17 showed is that when the arbitrary assumptions are replaced
18 by a more realistic representation of the VBA constraint,
19 the estimated competitive detriments, even in a product
20 differentiation context, decreases sharply.

21 We believe that VBAs are more potent competitors than
22 their FSA equivalents. And so, the approach that we've
23 adopted of using a Cournot representation of those
24 competitors is, in our view, extremely conservative.

25 **DR GUERIN-CALVERT:** To put it into context to link then the
26 modelling back into the framework, again just to echo the
27 words that Professor Willig had last week, is the view is
28 that the NECG model is the most appropriate model on the
29 table or before the Commission, particularly because it does
30 take into account the competitive impact of entry but
31 particularly entry by the value based carrier.

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1 It also does take into account the presence of the Fifth
2 Freedom operators which have substantial capacity on some of
3 the routes at issue, and it is particularly in terms of
4 looking at it in the route context, that the NECG model has
5 a strong basis by looking at the city pair approach; it
6 really does provide an opportunity to calibrate the models
7 at the appropriate level of inquiry, which is examining the
8 benefits, examining the potential detriments, examining the
9 efficiencies at the city pair level, based on airline
10 experts, and it does capture as well network benefits and
11 network effects.

12 We also wanted to address that one of the models,
13 Professor Hazledine's model, his most recent one, after
14 having gone through a number of iterations, many of his
15 results are seeming to converge on the NECG results,
16 particularly the model that he has that does try to take
17 into account entry in the factual.

18 We provided a paper -- Professor Willig did, that
19 addressed some of the specific information on the shares.
20 There had been some confusion at the end of last week about
21 the differences in shares. The one thing I would note is
22 that, an important correction that we would still recommend
23 making in the results of Professor Hazledine's model is to
24 be sure to treat the gains from the investment that has been
25 made for Air New Zealand, the \$550 million, and so it's
26 important to put that back in. Once one does that, there is
27 a positive benefit from that model.

28 So, in moving on, I think again we had noted in going
29 back through the record and through everyone's notes that
30 there was some very specific questions raised by some of the
31 commenters with respect to the tourism benefits, and I would

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1 like to turn the presentation back over to Professor Ergas
2 to look at, again, four specific questions that had been
3 raised that influenced the interpretation or the
4 understanding of those benefits.

5 **PROF ERGAS:** The four questions that were raised with respect to
6 tourism that are really relevant to the quantification that
7 we carried out are first, weren't the tourism numbers hard
8 wired in our analysis. The second question was, in valuing
9 the impacts of tourism, was it appropriate to use a
10 computable general equilibrium model?

11 Then a third question was, well, if it was appropriate
12 to use a computable general equilibrium model, why did we
13 use it only for tourism? And then a final question was, are
14 the multipliers that we derived from these models reasonable
15 ones?

16 It is true that we took the 50,000 impact as given. But
17 we did examine it carefully, and it seems to us to be an
18 extremely conservative estimate in view of the likely effect
19 of removing the current restraints on Air New Zealand's
20 ability to promote tourism.

21 What is also important is that, in translating an impact
22 into an overall change in tourism, contrary to what
23 Professor Hausman suggested, the effect of Cournot model
24 increases in prices were fully taken into account.

25 The price increases that are generated by the NECG
26 modelling are relatively large; for example, compared to
27 what the airlines and their financial advisors themselves
28 expect. They take no account of the higher price elasticity
29 of demand of tourists, the fact that tourists do have
30 alternative destinations, and so, they overstate the likely
31 increase in prices to tourists and hence understate the

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1 tourism gains.

2 Given our estimates of the changes in tourism, was it
3 appropriate to use a computable general equilibrium model?
4 Professor Hazledine was critical of our use of these models,
5 but in our view they are a standard tool for cross benefit
6 analysis and more generally for policy analysis when there
7 are significant inter-sectoral effects.

8 We agree with some of the comments that were made by the
9 Commission earlier in this process when it pointed out that,
10 if there are capacity constraints, not taking account of
11 those capacity constraints can overstate benefits. As a
12 result, we used a computable general equilibrium framework
13 so as to recognise those resource and capacity constraints
14 and the price effects that would flow from them and to
15 thereby calibrate our tourism impacts.

16 It's true that we didn't use a computer general
17 equilibrium approach for everything. In our view the CGE
18 modelling is only really necessary where you think that
19 there are going to be significant inter-sectoral effects.

20 Nor the non-tourism areas of impact, there was no reason
21 to expect significant inter-sectoral constraints on benefits
22 being realised. Indeed, for those areas our preliminary
23 assessment is that a CGE approach would lead to higher
24 estimated benefits. Using a CGE approach would therefore
25 add complexity without necessarily being fully consistent
26 with the conservative nature of the approach we've adopted.

27 Are the CGE multipliers that we've derived reasonable
28 ones? We relied on the most widely used computer general
29 equilibrium model in this part of the world. It's a model
30 that has been developed over a period of 30 years, that has
31 been published extensively, that has withstood any tests,

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1 that is widely used and subjected to much scrutiny.

2 We also looked at the main New Zealand model, but what
3 we found was that that model would produce significantly
4 larger estimates of the benefits. We therefore used the
5 Monash model which seemed to us to be both the most widely
6 accepted and tested and the most conservative of the models
7 available.

8 **DR GUERIN-CALVERT:** What we wanted to provide on this slide,
9 just in one place, and again this is largely a slide that
10 you have seen before in an earlier presentation by Professor
11 Ergas, but having just walked through the analytics and the
12 issues with respect to tourism benefits and also the
13 analytics and the questions that had been raised with
14 respect to the NECG models, we thought it would be
15 productive, just as a reminder, to lay out one more time the
16 lower bound estimates as well as the upper bound estimates
17 of the net benefits, both in an aggregated bottom line as
18 well as broken down into the individual categories.

19 Obviously, the detail on each of these areas is in the
20 submission, but we thought it would be useful just to put
21 forward to you again, where the different efficiencies are
22 coming from and the overall magnitude of them.

23 With that I would like to turn back over to Professor
24 Tretheway to try to link it all together for us with respect
25 to the economic analysis.

26 **DR TRETHERWAY:** Thank you. Professor Hausman outlined the
27 benefits of having three carriers in the market, but we ask
28 whether New Zealand can realistically support two FSAs and a
29 VBA.

30 In Canada, Professor Hausman appeared before the
31 national transportation agencies and stated that "Canada

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1 cannot support two national network carriers". To put this
2 in context, Canada's domestic market is larger than the
3 combined domestic markets of Australia and New Zealand.

4 The competitive analysis suggested that there will be at
5 least two strong carriers on the affected routes; an FSA and
6 a VBA. And a substantial number of other and potential
7 competitors on the Tasman and long haul routes. There are
8 no barriers to entry and no barriers to expansion.
9 Empirical analysis supports conclusions that there are
10 constraints on pricing and pressure on FSAs to keep their
11 costs low.

12 Is there a value, or "preserving an option" as Professor
13 Hausman would say, by taking a wait and see approach to
14 market outcomes? The potential upsides from waiting are
15 low. The modelling conducted here shows that gains from
16 maintaining the status quo are lower than the gains from the
17 alliance.

18 The potential downsides on the other hand for waiting
19 are high. There is considerable risk with Professor
20 Hausman's option. First, if Air New Zealand is unable to
21 earn its weighted average cost of capital, it will not be
22 able to invest and remain competitive.

23 Second, New Zealand would lose the benefits that are
24 immediately available from the alliance.

25 Third, there is limited competitive risk due to the
26 entry of a value based airline, and other actual and
27 potential competitors in these markets. On balance,
28 authorising the alliance is the best way of ensuring that
29 benefits are realised.

30 We thank you for the opportunity to appear today.

31 **CHAIR:** Thank you very much for that part of the presentation.

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1 I don't know if Professor Tretheway's going to be here for
2 he whole presentation, but...?

3 **MR P TAYLOR:** I think that Professor Tretheway and Margaret
4 Geurin-Calvert have both got to leave quite rapidly.

5 **CHAIR:** Okay, I'll take this opportunity then to thank you both.
6 We've been grateful to have your expertise to assist us in
7 this matter and I wish you a good trip back. Thank you.
8 [Pause].

9 Just before you start again, my colleague just suggested
10 that I do remind people, interested parties that are here
11 that it is not the convention of the Commission to ask
12 further questions in the right of reply otherwise the
13 process may go on forever, and we may have our own war of
14 attrition before it's over, so I just wanted to make sure
15 that all parties understand that that is the process at this
16 point.

17 So, on that note, I'll ask Qantas then to give their
18 right of reply.

19

20

21

22 **MR EDWARDS:** Thanks for the opportunity to respond to some of
23 the things that have been told to you over the last week.
24 We've heard many people tell you what Qantas will and won't
25 do. Let me remind you of some of the things that Qantas
26 will say about itself in response to what some of the
27 external experts have told you. They obviously view airline
28 competitive life in a different light to the way we see it.

29 I've realised during the last week that perhaps I wasn't
30 quite honest with you people when I fronted on Monday and
31 didn't quite explain to you enough about myself. My

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1 colleagues have goaded me into admitting that I'm a 40 year
2 veteran in the airline business, and that's given me many
3 years of experience in many aspects of airline life. I've
4 been involved in airlines with tiny aircraft, I've been
5 involved in airlines that expect to have 550 seat aircraft
6 before long.

7 I've been involved in airlines that have failed, some of
8 them succeeded, many of them have had to change. I've been
9 involved with regional airlines, domestic airlines,
10 international airlines. I've been involved with airlines
11 that have been bought and sold. I've been involved with
12 airline business studies and economic activities and
13 business transactions with airlines all around the world,
14 South America, North America, South Africa, throughout UK,
15 Europe, Australia and this part of the world.

16 My colleagues will also tell you that I have, in the
17 pursuit of those transactions, I have drunk kava in Vanuatu,
18 I have had depth-chargers in Korea, and I intend to have
19 some Pinot in Wellington tonight. But, before I can get to
20 that, I'm told I must complete this within 12 minutes.

21 With all of those airline activities I've been involved
22 in, one of the things that's been a very common theme is
23 that it's very hard to make money, and it's a very very
24 competitive business. And I'm not an economist, but I do
25 understand the economics of the airline industry. Just last
26 Monday Geoff commented in his presentation to you about the
27 state of crisis in the industry, the need for structural
28 change, the role of Governments in the industry, the
29 development of low cost carriers in the region and the need
30 for a strong healthy local industry.

31 This explained the search that was being undertaken by

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1 many airlines around the world for sustainability. The
2 pressure for consolidation explains why we hear of Lufthansa
3 talking to Swiss, why we hear of Air France talking to KLM
4 and why Qantas wants to be able to co-operate with Air New
5 Zealand.

6 What's happening here today is not unusual around the
7 world, and we may just be part of the leading part of the
8 process of making something work. The pressure to find a
9 new model that enables existing airlines to continue to
10 compete is driving the cost reduction programmes being
11 undertaken by many airlines.

12 During the week Geoff then emphasised these issues with
13 a series of announcements that he made during the week with
14 our annual results, and I'll just very briefly go through
15 those.

16 First of all in the annual results he pointed out that,
17 while it was a profit of just over \$500 million it was in
18 fact our first loss in a six month period since
19 privatisation. However, it was still one of the best
20 results for a full service airline, even though our
21 Australian domestic business had a profit decline of 34.5%,
22 this was brought about by the combined effects of the
23 international issues that we're all well aware of and the
24 emergence of Virgin Blue.

25 Geoff also commented upon the amount of effort going
26 into a product upgrade for our international services, where
27 we're continuing the essential investment necessary. We're
28 midway through a \$1.2 billion programme to upgrade our
29 product, it's the sort of thing that Air New Zealand will
30 need to be able to do to keep up with the rest of the
31 airlines in the international business.

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1 He also spoke again about the cost reduction programme
2 where we're extracting \$1 billion of costs out of the
3 business over the next 2 years, and it's necessary for us to
4 do that to improve the returns and also because, no matter
5 what, economic theory may suggest there is a continual
6 ongoing downward slope of the yield curve in domestic and
7 international airlines. The fares keep on going down and
8 the gap keeps on getting wider between our required returns
9 and our ability to achieve them.

10 Geoff also spoke about the need for flexibility in our
11 labour relationships and the fact that we're going to have
12 to increase the casualisation of our workforce because of
13 the peaks in activity.

14 He also commented on the establishment of a working
15 group to consider low cost leisure operations in domestic
16 Australia, and from this I'll read from some of his quotes:

17 "To seriously consider whether Qantas will start a low
18 domestic carrier in the leisure routes, a decision on that
19 probably by November, and there was probably a merge in
20 Australia for a position for a low cost carrier, and this is
21 not aimed at Virgin Blue."

22 In considering these announcements about the working
23 group, three aspects need comment. Firstly, Qantas has
24 already developed variants of lower cost operations. We
25 have Australian operating on all economy modified service
26 airline, that's the 767-300 operator, we've got JetConnect
27 operating here with a New Zealand cost base with costs that
28 would be lower than the Air New Zealand costs. We've got a
29 Boeing 717 operation in Australia of 14 aircraft; again all
30 economy with lower labour costs that came out of our
31 acquisition -- or partly came out of our acquisition with

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1 Impulse. We've got 737-300s, 10 of them at the moment
2 operating around Australia, again in an all economy
3 configuration picking up the seat efficiency attributes of
4 low cost carriers.

5 So, we already have operating in Australia a number of
6 airline units, if you like, that have variants and varying
7 characteristics of the low cost carriers. In recognising
8 that, that's just a continual part of the pressure on the
9 business to lower costs to remain competitive.

10 There are also some elements of the environment that
11 Qantas operates in Australia in particular that you need to
12 understand. First of all, everybody expects, or everybody
13 has a very high expectation of anything that has the Qantas
14 label on it. So, therefore when somebody hops on to a
15 Qantas aircraft, if they can't get into a flat sleeper seat
16 for the 50 minute flight and get the service they would like
17 on a trip to London, they're disappointed. So we have an
18 issue of how do we manage expectations of customers.

19 You've been reminded how difficult it is for FSAs to
20 change radically, but to compete we need to change, but we
21 need to remain a network carrier.

22 In concluding these comments about the announcements
23 during the week, I would just remind you that this is just a
24 study, it's very much work in progress, and a decision won't
25 be made on it until October-November.

26 Another aspect that I would like to comment on is the
27 Qantas counterfactual that attracted a bit of attention.
28 First of all, it is not a series of threats, as was
29 suggested during the Conference; it's merely a view by
30 Qantas on the most likely airline environment from a
31 business perspective that Qantas will encounter if the

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1 Qantas/Air New Zealand alliance is not approved. It shows
2 how Qantas will compete in that environment. Qantas
3 acknowledged that it competes hard but legally.

4 Qantas has consistently said that New Zealand is
5 important to Qantas as part of our home market and part of
6 our global network. The counterfactual replicates our
7 drivers for profitability that exist across our business.
8 The counterfactual is a continuation of the growth of the
9 Qantas business in New Zealand. The growth is not
10 excessive, it is similar to growth plans for other parts of
11 our business. In the factual we demonstrate our commitment
12 to New Zealand by working with Air New Zealand. In the
13 counterfactual we demonstrate it by doing it ourselves.

14 This approach through the counterfactual flows on to
15 other aspects of the proposed Qantas/Air New Zealand
16 relationship, like engineering and tourism. In the factual
17 we work with Air New Zealand, in the counterfactual we work
18 with others which will not deliver the same benefits to
19 New Zealand.

20 Another issue that was raised during the Conference was
21 the situation with Origin Pacific and we quite understand
22 the difficulties for Origin Pacific. It's hard for small
23 regional airlines to be profitable, especially if you're not
24 the largest player in the market. If you don't have
25 economies of scale, for instance, in Australia to get the
26 economies of scale we have concentrated all of our regional
27 airline activity into the Dash 8s and we now run 32 of them.
28 We have removed other smaller aircraft type and whatnot from
29 the operation and it's only in that sort of scale that you
30 get the savings that you need.

31 We also understand the difficulties they have when

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1 regional fares reduce as a result of competitive pressure.
2 It's very difficult for them to reduce costs when they're
3 not large enough to use technology to lower costs. The
4 technology costs of course are very high and have to be
5 spread over a small number of passengers and flights when
6 you're in a small business and the technology levels work
7 against them.

8 The point we'd make here is that Origin Pacific face
9 those difficulties whether the Qantas-Air New Zealand
10 alliance proceeds or not. The wet lease arrangement of the
11 two ATRs we have with them will be replaced with larger
12 Qantas aircraft as the market grows, and this will happen
13 both in the factual or the counterfactual, and this at the
14 moment would be about 80% of our relationship with Origin.

15 As Qantas expands in New Zealand, it will serve some of
16 these larger markets ourselves. In the network feed,
17 traffic that flows between Qantas and Origin will always
18 remain small as they lack the technology to provide the
19 customer service that will build that level of business. At
20 the moment we would expect that to be around about 10% of
21 the rest of the Origin Pacific revenue.

22 Another issue that was raised during the Conference that
23 we'd like to just comment about is technology and the use of
24 technology. In particular, by Qantas Holidays, but first of
25 all it's important to understand that Qantas is a leading
26 user of technology. We've introduced new reservation
27 systems, new revenue management systems, new airport
28 departure systems, quick check at airports, voice
29 recognition technology, we have a large EQ programme
30 underway, and there are many other technology innovations
31 that Qantas are working on; but this technology is very

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1 expensive.

2 Again, we're probably in the midst of a billion dollar
3 programme on technology expenditure, and this can only
4 happen for us because of the scale that we have to get the
5 appropriate returns. Again, this is the sort of thing Air
6 New Zealand needs to be able to invest in and as part of the
7 alliance Air New Zealand will have access to this
8 technology.

9 Qantas Holidays is also a big user of technology, and we
10 would readily admit that the base Calypso package can be
11 bought off the shelf down the street, it can be bought by
12 Tom, Dick, Harry and Andrew. Many of the enhancements that
13 Simon spoke about though, the 46 or 47, are there because of
14 the things that are needed for the Qantas Holidays, some of
15 these enhancements can't be used by others as they are the
16 links to the unique Qantas Holidays proprietary sub-systems
17 that they have.

18 These proprietor systems are contacting systems, image
19 libraries, management reporting and of course access to the
20 Qantas Holidays inventory. Other elements are being
21 developed continuously, for instance, things like a new
22 product loading system and web interfaces. And, to expect
23 Qantas and Qantas Holidays to licence that to Air New
24 Zealand if the deal -- the arrangements don't proceed, is a
25 little bit like expecting Coca-Cola to licence their recipes
26 to Pepsi. You know, there are just some things you won't
27 give away, some intellectual properties that you will
28 protect.

29 We estimate it would cost Air New Zealand something like
30 \$9 million and several years to replicate the Qantas
31 Holidays systems and then about \$10 million a year to run

Applicants in Reply - Economists

1 them.

2 Just before I close, I'd just like to make some comments
3 about some amazing thoughts from my perspective that have
4 been placed before the Commission during the week and these
5 to me are just glaringly not right.

6 The thought that Emirates will not be a competitive
7 constraint on the Applicants even though they'll be
8 providing nearly 1,000 seats a day into Auckland. That
9 patently just is not right. There will be too much capacity
10 in the market. The bit of economics I do understand means
11 there will be movements up and down the supply and demand
12 curve and we will have to sell cheaper to fill the seats,
13 and so, they will have an impact on price.

14 Another piece has already been spoken about by the
15 expert economists on Auckland-Los Angeles so I'll leave that
16 alone.

17 A piece that gave our CFO a nightmare was the thought
18 that, because airlines have not provided appropriate returns
19 in the past, they don't have to plan for them in the future.
20 I can't get to first base on that in getting my target set
21 for next year.

22 The other one that was also intriguing, and again is
23 just not true, is that you'll not find the cheapest fares on
24 the web. If you want a cheap fare to travel, you will find
25 it on the web and, you know, all airlines are using the web
26 now to make the cheapest fares available.

27 So in closing I would just like to thank you very much
28 for the opportunity of spending the week with you, and
29 explaining the ideas, reminding you that these applications
30 alter the competitive landscape but competition will remain,
31 although there will be a different competitive environment.

Applicants in Reply - Economists

1 Economic experts have already confirmed to you that the
2 economic benefits outweigh the detriments, and so put very
3 simply, these applications result in a significant public
4 benefit and are good for New Zealand.

5 Thank you very much, we've enjoyed the opportunity.
6 Thank you.

7 **CHAIR:** I'd like to thank Qantas for their closing remarks and
8 I believe Air New Zealand will make the final remarks today.

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Applicants in Reply - Air New Zealand

1 transform itself into a VBA? Can two FSAs survive in
2 New Zealand? And if two FSAs can't survive in New Zealand,
3 why is Air New Zealand the most likely casualty? And, post
4 approval, will effective competition remain?

5 I want to examine those issues and then return to the
6 key question.

7 Firstly, what is the real world situation and what, if
8 anything, has changed since the applications were lodged
9 nine months ago? The following simple facts are crucial and
10 some are easily overlooked.

11 Air New Zealand is less than two years on from the brink
12 of bankruptcy. Air New Zealand has made an excellent and
13 commendable recovery but has not yet addressed the core
14 operational weaknesses that contribute significantly to its
15 problems. These applications are crucial to solving those.
16 We cannot escape from our geography. We are a small country
17 in the South Pacific with a small population far removed
18 from many of our markets.

19 The advent of a VBA or a low cost carrier in recently
20 deregulated markets has irreversibly changed worldwide
21 aviation markets for full service airlines. We could not
22 have predicted the events of 9/11 or the SARS epidemic, but
23 those were chilling demonstrations of how the airline
24 business is exposed to severe one-off events and that over
25 the course of time that type of event occurs often and
26 unpredictably.

27 The lesson poorly learned in global aviation is that you
28 need a business structure and a balance sheet strong enough
29 to cope with those events. Air New Zealand currently has
30 neither. The alliance would give us the prospect of both.

31 In summary, the real world situation that we face is one

Applicants in Reply - Air New Zealand

1 of volatile demand and excess capacity. Since lodging our
2 application that has only changed for the worse and we
3 endorse Geoff Dixon's comments to the Commission on these
4 issues. These in turn reflect views recently expressed in
5 New Zealand by the Director General of IATA.

6 The next question is, why doesn't Air New Zealand
7 transform itself into a VBA? Post the recapitalisation of
8 Air New Zealand in late 2001 the Board and management were
9 faced with some difficult decisions. What should our
10 business be? What strategy should we pursue? What real
11 options did we have? What would give us the best chance of
12 generating shareholder value over time? What other
13 stakeholder considerations were important?

14 In developing a new strategy we vigorously debated the
15 whole spectrum of possibilities, but some facts were
16 inescapable. Air New Zealand's strategy based around Ansett
17 had failed, and the company had no immediate replacement
18 strategy. The business as structured was not sustainable.
19 The balance sheet was too weak to cope with any downturn.
20 The profitable bits, especially the domestic airline, would
21 almost certainly come under sustained attack from both
22 Qantas and Virgin Blue as they turned their focus on
23 New Zealand and the Tasman. The unprofitable bits will
24 continue to be subject to intense competition. Some people
25 would say, welcome to the international airline business.

26 We had to address the issue of operating cost in all of
27 our business. Although the Ansett implementation had
28 failed, we agreed that the underlying driver of an
29 Australasian basis for our business was correct, but we had
30 no realistic prospect of entering the domestic Australian
31 market with either of our brands, Air New Zealand or

Applicants in Reply - Air New Zealand

1 Freedom.

2 After intense scrutiny the Board and management resolved
3 that our aspiration for our shareholders and stakeholders
4 was to be an international aviation business. International
5 operations make up 75% of our airline revenues. It's also
6 the part of our business where being New Zealand's
7 international flag carrier provides us with a distinct
8 market advantage.

9 Our judgment was that, being the major airbridge between
10 New Zealand and the world, and particularly the Pacific rim,
11 was likely to provide us with the most sustainable long-term
12 business model. However, all business strategies have to
13 fill the void between aspiration and realisation.

14 For Air New Zealand, this required examination as to
15 whether this was the highest value alternative, and could it
16 be achieved? The idea of transforming into a VBA was
17 considered and rejected. Our long haul business, 70% of
18 which derives from in-bound passengers and is therefore
19 dependent on offshore distribution, is the foundation of our
20 business. At the other end we have a thin regional network.
21 Neither of these businesses are suitable for a VBA.

22 We agreed that we should always be a network airline,
23 although one with a much more competitive cost structure.
24 Our customers and their needs would be the heart of this and
25 we will certainly not imperil the loyalty of more than
26 800,000 frequent flyers.

27 Given our existing business and assets we also decided
28 that the cost of transformation to a VBA would be
29 prohibitive. From there it wasn't hard to agree that Air
30 New Zealand would not be successful going it alone.
31 Star Alliance or One World provide international presence,

Applicants in Reply - Air New Zealand

1 but do not for our cost base. We do not have the scale and
2 connectivity to be a successful long haul carrier alone.

3 In looking for potential partners, Qantas provided the
4 best fit, was willing to form an alliance, and shared our
5 view of the current and emerging problems of aviation in
6 this part of the world. The alliance arrangement met the
7 tests of strategic alignment, shareholder value and
8 doability.

9 The arrangements we have reached with Qantas are fair to
10 Air New Zealand. We couldn't have agreed to the deal if
11 they weren't. We reject the comments of Professor Hazledine
12 suggesting the deal was somehow skewed in favour of Qantas.
13 Confidential information provided by Air New Zealand to the
14 Commission, including Air New Zealand's board papers, show
15 he was wildly astray. This alliance will give Air New
16 Zealand the foundation for a sustainable business and the
17 equity arrangement strengthens the capital base of the
18 company.

19 Access to capital, while important, was secondary to
20 getting the strategic framework right. Capital should
21 follow strategy, not lead it.

22 The next question to consider is, can two FSAs survive
23 in New Zealand and, if not, why is the counterfactual the
24 most likely outcome? In deciding whether these applications
25 should be granted, the Commission must decide whether two
26 FSAs can survive in New Zealand. In our view, they cannot.
27 The market is too small to support two FSAs. The evidence
28 from a range of experts last week surely put this question
29 beyond doubt. Based on his experience with Ansett, Mr
30 Sheridan was also very clear that two FSAs cannot survive in
31 this market. We share that view and recent history gives

Applicants in Reply - Air New Zealand

1 ample evidence of it. It's a simple reflection of our
2 geography and our demography.

3 The question then becomes, can Air New Zealand win that
4 battle with Qantas? The business logic of the stronger
5 company winning that battle is hard to get past. As a
6 result of the single aviation market, this is an
7 Australasian market which gives Qantas a huge advantage.

8 Of course, Air New Zealand would seek to be competitive
9 and our Express initiatives are a good example of this.
10 However, the core advantages of scale and connectivity
11 would, in our view, prevail. In any event, even if Qantas
12 were the loser, the outcome must surely be the same in
13 competition terms; only one FSA. Neither of those outcomes
14 in our view would be as good for New Zealand as allowing
15 both airlines to co-operate within the alliance.

16 This brings us then to the question: Post the approval,
17 will effective competition still exist? In essence what
18 that means; is VBA entry certain? The evidence of last week
19 and the statements and activities of Virgin Blue, both at
20 this Conference and in the market, signal the certainty of
21 entry on the Tasman and in domestic New Zealand. The weight
22 of economists' advice is also in favour of that conclusion.
23 A VBA in the form of Virgin Blue will enter these markets
24 and have a sustainable position.

25 Further, and more importantly, is the weight of an
26 economists' views that a VBA will provide effective price
27 competition both in domestic New Zealand and on the Tasman.
28 It is also our view.

29 That leaves two areas where issues have been raised.
30 The first is regional New Zealand. Origin Pacific has
31 acknowledged that it is currently facing extremely difficult

Applicants in Reply - Air New Zealand

1 trading conditions. It has said those difficulties have
2 been largely brought about as a result of the introduction
3 of Air New Zealand Express.

4 In a very real way Origin Pacific is facing on a smaller
5 scale the same issues that bring Air New Zealand before the
6 Commission. As matters presently stand, there can be no
7 certainty that Origin Pacific will continue to provide
8 competition either with or without the alliance. With the
9 alliance operating Origin is likely to be assisted by
10 arrangements with Virgin Blue of the type Virgin Blue told
11 the Commission it has with regional carriers in Australia.

12 The second issue is the Auckland-Los Angeles route. The
13 Commission has heard a suggestion from Professor Hausman
14 that the alliance might result in a 42% price increase on
15 this route. It doesn't require much analysis or industry
16 knowledge to dismiss this suggestion and our economists have
17 also dealt with that.

18 Among other things, Professor Hausman appeared to be
19 unaware of the other carriers currently flying this route,
20 including Air Tahiti Niue, with a modern fleet of A340s
21 operating from New Zealand to Los Angeles via Tahiti three
22 times a week, or of the Fifth Freedom carriers who could fly
23 this route, including Singapore Airlines and Air Canada, not
24 to mention the likelihood of United Airlines or another US
25 airline resuming this service if prices rose in the way
26 Professor Hausman suggested.

27 That leaves the final key question, should the
28 Commission grant the applications on the basis of
29 demonstrated net public benefits, or should the market be
30 left to decide which of the existing FSAs will survive?
31 While others may argue that the Commission should allow the

Applicants in Reply - Air New Zealand

1 competitive forces to play out, I believe that would risk
2 serious harm to New Zealand as well as to Air New Zealand.

3 The alliance proposal is a market response, but one that
4 needs approval. Forcing the airlines to fight it out will
5 waste resources and will diminish the benefits that are
6 available to the airlines and to the country from allowing
7 the alliance. And if the structural changes force Air New
8 Zealand into an even more marginal role, or worse still lead
9 to its collapse, the opportunities both parties have today
10 to secure a future in global markets is likely to have been
11 foregone to the serious detriment of New Zealand. There is
12 not likely to be a second chance.

13 The benefits of the alliance to the New Zealand economy
14 have been subject to detailed examination by some of the
15 world's leading economists. I believe there is overwhelming
16 evidence that the benefits are substantial in terms of cost
17 savings, scheduling benefits, benefits to employment and
18 engineering, freight benefits and tourism.

19 No other airline is so central to New Zealand tourism or
20 is likely to be in any time in the foreseeable future.
21 Qantas Holidays will add to that by making Air New Zealand
22 Holidays a much more powerful marketing vehicle.

23 At the same time both airline industry experience and
24 economic analysis demonstrate that the competitive
25 detriments of the alliance on the New Zealand economy are
26 likely to be slight, either because the alliance will be
27 constrained by Virgin Blue and other carriers on long haul
28 routes, or because the counterfactual will involve Air New
29 Zealand being at best competitively marginalised.

30 Air New Zealand is not seeking special treatment from
31 the Commission. What we are seeking is authorisation of a

Applicants in Reply - Air New Zealand

1 transaction under a statutory procedure which provides for
2 authorisation where the benefits of transaction exceed the
3 detriments. We believe that threshold has been exceeded.

4 The Commission should, in our view, authorise the
5 alliance either permanently or for a period long enough to
6 enable the benefits to be achieved and demonstrated.

7 Madam Chair and Commissioners, we know this has been an
8 exhausting and exhaustive case. For Air New Zealand, we
9 have committed a huge amount of management time and effort
10 and significant expert help to ensure that we've made our
11 case compelling. We've done that because it's crucial to
12 Air New Zealand's future. We sincerely believe that the
13 demonstrated benefits make it equally compelling for
14 New Zealand.

15 Thank you. Madam Chair, can I simply close by thanking
16 you and the Commissioners for the manner in which the
17 Conference has been handled and the courtesies that you have
18 showed to us as the Applicants.

19 **CHAIR:** Thank you very much for that, Mr Palmer, and thank you
20 to Air New Zealand for its final remarks and also its
21 assistance in this process.

22 I will now just finish up today with a few closing
23 remarks before we adjourn the meeting.

24 **MR P TAYLOR:** Madam Chair, just before you do I think there is
25 just one legal issue that we were asked to provide an
26 additional submission to the Commission in relation to --

27 **MR PETERSON:** The point you raised.

28 **CHAIR:** Do you wish to speak to it?

29 **MR PETERSON:** No, I just wanted to make sure that you were aware
30 that, in response to the question raised by Commissioner
31 Bates on the question of onus, and a question by Mr Berry,

Closing Remarks by Commission Chair

1 we have provided a short note as requested, and I'm happy to
2 provide that to the Commission. [**Handed**].

3 **MS BATES QC:** Thank you very much, I appreciate that.

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CLOSING REMARKS BY COMMISSION CHAIR

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11 **CHAIR:** This concludes the Conference in relation to the
12 application by Air New Zealand and Qantas Airways who are
13 seeking authorisation to enter into a Strategic Alliance
14 Agreement and related agreements and the application by
15 Qantas Airways seeking authorisation to subscribe for up to
16 22.5% of the voting equity in Air New Zealand.

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I would like to close this Conference with the following
remarks: First, there have been two occasions during this
Conference where confidential information covered by an
s.100 order may have been inadvertently released. I would
repeat the statements I have already made in this regard,
that this material remains subject to a complete prohibition
against publication or communication under the s.100 order.
If anyone has obtained confidential information other than
through our official processes then I remind you that you
are not entitled to hold this material and it cannot be used
for any purpose. If you have any such material it must be
returned to the Commission or destroyed.

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Secondly, during this Conference the Commission has made
a number of requests for further information. A number of
these requests have already been complied with and I thank
those parties for their rapid response. However, there are

Closing Remarks by Commission Chair

1 a number of outstanding requests and I will go through them
2 quickly.

3 1. From the Applicants we've requested the percentage
4 breakdown of promotion spend by Tourism New Zealand, Air New
5 Zealand and other airlines.

6 2. The second point was the one I believe Mr Peterson
7 just provided us with.

8 3. The number of sales Qantas has made as a result of
9 the relationship with BA since it commenced.

10 4. Exact numbers of passengers and revenue Qantas
11 Holidays earn out-bound from Australia.

12 5. Air New Zealand revenue from out-bound tourism.

13 6. Response to David Peters' questions about disconnect
14 between price and capacity and modelling; Sydney-Queenstown,
15 Auckland-Wellington, and Auckland-Christchurch routes.

16 If it's not clear what we mean, we'll clarify it
17 afterwards.

18 **MR P TAYLOR:** That has actually been provided in the material I
19 handed up earlier.

20 **CHAIR:** Okay, we'll strike that.

21 7. Analysis of technical efficiency for Qantas and 25
22 other airlines, 2000. I'm not sure what that refers to, but
23 I'm sure someone will tell you.

24 8. I've added a comment from the Applicants on the
25 Hausman regression analysis, which we did not request, but I
26 have assumed you would want the opportunity to comment on.

27 Virgin Blue: We've requested figures on Virgin Blue
28 impact on freight rates in Australia, and comment on placing
29 a time limit on the authorisation.

30 Infratil: We've requested three items. The Murray Scott
31 and Lynch report regarding Government interest and

Closing Remarks by Commission Chair

1 competition issues from August 2002. The data from the last
2 graph that they had on New Zealand airfares, and Professor
3 Hausman's latest study and all other studies he referred to.

4 Christchurch Airport: We ask for their slide
5 presentation.

6 Bon Voyage: We ask for the correction to the percentages
7 in slide 15.

8 Is anyone aware of any other matters that has been
9 requested during these proceedings? [**No comments**].

10 I now ask that all requests are responded to within four
11 working days of this Conference closing, being 5 pm Friday
12 the 29th of August.

13 The third point that I wanted to comment on is, all
14 presenters who have provided the Commission with printed
15 material over the last six days, whether presentations or
16 supplementary material, are asked to provide electronic
17 copies to the Commission within three working days so that
18 they can be made available on our website. Please e-mail
19 these copies to Janet Whiteside.

20 Finally, the Commission wishes to make its position
21 clear in relation to any further evidence or submissions
22 after this Conference. In particular, we require all
23 information which we have sought under specific requests we
24 have made during this Conference. We note the possibility
25 that we may require further information from the Applicants
26 or interested parties, and if this does arise we will issue
27 a specific request.

28 Commerce is always dynamically changing and this seems
29 to be the case in airlines in particular. If after this
30 Conference information we may have been given becomes
31 invalid or untrue we may be willing to accept correcting

Closing Remarks by Commission Chair

1 information. This exception relates only to factual issues
2 and only where a prior request is made to the Commission for
3 leave to do this, and if we grant it.

4 Except as stated, the Commission considers that this
5 Conference marks the end of the application and submission
6 process. In particular, a full opportunity to express
7 opinions and arguments has been given and no further
8 submissions will be received.

9 On behalf of the Commission I would like to thank
10 everyone for the extensive submissions on this application.
11 We have especially appreciated the access to industry,
12 economic and legal expertise.

13 The Commission will now deliberate to reach a final
14 determination on these applications as quickly as
15 practicable.

16 As I stated at the opening of this Conference, the
17 Commission anticipates making the Final Determination by the
18 end of September. Nevertheless, urgency cannot get in the
19 way of sound decision-making. The issues we are considering
20 are complex and are of considerable commercial and public
21 interest.

22 However, I am confident that the Commission has been
23 provided with sufficient advice and expertise throughout
24 these proceedings and from earlier submissions to allow it
25 to determine this matter in a manner that will best serve
26 the economic interests of the public of New Zealand.

27 I would also like to thank Commission staff and external
28 advisors for the work done, and for what's going to be a
29 significant amount of work from here on, and to our
30 transcribers and our communications people who have assisted
31 us during the Conference.

Closing Remarks by Commission Chair

1 Finally, I would like to thank everyone for working with
2 the Commission to keep these proceedings as efficient as
3 possible.

4 Before I close I'll ask if there are any further
5 questions from any interested party? [No comments]. If
6 not, then once again to all those who have participated in
7 these proceedings, thank you indeed. The Conference is now
8 closed.

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Conference concluded at 5.30 pm

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