

PUBLIC VERSION

CROSS SUBMISSIONS

OF

ORIGIN PACIFIC AIRWAYS LIMITED

TO THE SUBMISSIONS

OF THE APPLICANTS AND OTHERS TO THE

COMMERCE COMMISSION DRAFT DETERMINATIONS

ON THE

QANTAS/AIR NEW ZEALAND ALLIANCE APPLICATION

**CROSS SUBMISSIONS OF ORIGIN PACIFIC AIRWAYS LIMITED
("Origin Pacific") TO THE SUBMISSIONS OF THE APPLICANTS AND
OTHERS TO THE COMMERCE COMMISSION DRAFT
DETERMINATIONS ON THE QANTAS/AIR NEW ZEALAND
ALLIANCE APPLICATION ("The Application")**

Background to these Submissions

1. Origin Pacific filed initial submissions on the Application on 14 February 2003 and further submissions on the Draft Determinations on 20 June 2003. These submissions are now cross submissions to the Applicants' and others' submissions on the Draft Determinations.
2. Origin Pacific has concentrated in its submissions on the New Zealand main trunk and provincial airline markets in which it is involved and in which it has experience and expertise. Its submissions have emphasised the anti-competitive effect that the Alliance will have on these markets and on Origin Pacific's ability to compete.
3. In its initial submissions of 14 February 2003 it also made comment on various others aspects of the Application. These are widely covered in other submissions to the Draft Determinations and it wishes to support these. This is further covered in these submissions.

Overview of Applicants' Submissions

4. There is nothing in the Applicants' submissions which alters Origin Pacific's view of the Application or its support for the Draft Determinations. The proposed Qantas/Air New Zealand alliance ("the Alliance") remains hugely anti-competitive. There is no effort made to acknowledge the detriments to the regions or the effect of the Alliance on Origin Pacific. None of the conditions offered or suggested make any attempt to mitigate these detriments.
5. Origin Pacific confirms its previous submissions and its support of the Draft Determinations. It remains totally opposed to the Application.

Origin Pacific's Relationship with Qantas

6. The little comment there is in the Applicants' submissions in respect of Origin Pacific's relationship with Qantas under the Alliance gives a wrong and misleading view as to the

impact of the Alliance if it proceeded, on the Qantas/Origin Pacific relationship, and as a result, on Origin Pacific and to competition in the New Zealand main trunk and provincial markets.

7. The Applicants' answer to the Commission Question 27 repeats the Applicants' previous assertions that there will be no material impact on competition in the provincial market because except for codeshares with Origin Pacific Qantas does not operate in this market. This totally ignores reality. Not only will Origin Pacific lose the benefit of its relationship with Qantas including the feed advantages of this but it will have to compete with both Air New Zealand and Qantas with the huge market power that they will together have under the Alliance. The proposed alliance with its market power and the resulting environment in which the Alliance would be operating are totally different animals than that which would exist if the Alliance does not proceed.
8. There is a suggestion in the Applicants' submissions that Qantas may also limit its relationship with Origin Pacific under the counterfactual. Origin Pacific will presumably have little say or influence in this. However there is a major difference between the factual and the counterfactual which should be noted. Under the factual Qantas and Air New Zealand will operate together as the Alliance. Under the counterfactual they will still be in competition. Whatever the Applicants may now suggest, there must still be a far greater chance of a continuing Qantas/Origin Pacific relationship under the counterfactual than under the factual. Under the counterfactual they will still each have feed and other advantages to offer to the other. Under the factual they will not.
9. Sections 5.95 and 5.96 of the Applicants' submission apply to both the factual and the counterfactual and suggest that Origin Pacific might "choose" to continue a reduced form of code sharing with Qantas. This again ignores reality – particularly in respect of the factual. There is no suggestion of what the "reduced form" might be or what conditions or restrictions might apply. Further Origin Pacific cannot choose unless Qantas offers – and while this might be an open situation in the counterfactual it is substantially less likely under the factual. Qantas and Air New Zealand will operate the Alliance under a Strategic Alliance Agreement which clearly is intended for their own benefit.
10. Origin Pacific's relationship with Qantas is a crucial factor. This is presently continuing but is not now on the same basis as was originally envisaged. It is now for a limited period only and on more restrictive terms and conditions. Qantas' interests seem now clearly to be directed towards the Alliance. The Application does not protect Origin Pacific's position. If the Alliance is approved its relationship with Qantas will certainly diminish and very probably end.
11. **[Confidential]**
12. **[Confidential]**

Applicants' Views on Origin Pacific's Ability to Compete

13. The Applicants' submissions continue to take an unreal view of Origin Pacific's ability to compete against the Alliance – see for example the answers to the Commission Questions 22, 26 and 27. Origin Pacific has already clearly rejected this view and rejects it again

here. The Applicants either fail to realise or choose to ignore the huge market power that the two airlines together will exercise. If the Alliance proceeds as proposed, Origin Pacific's view, contrary to the Applicants' stance, is that Origin Pacific is highly unlikely to be able to compete sustainably against the proposed alliance whether it is under one or two Qantas/Air New Zealand brands.

14. Air New Zealand applies a different standard to itself when it claims as the whole basis of the Application that it could not compete sustainably with either Qantas or Qantas and Virgin Blue under the counterfactual. It is also raising against Qantas and Virgin Blue the same issues as Origin Pacific has raised against the Alliance relating to the difficulties of competing with bigger airlines and the opportunity this gives for predatory pricing (Air New Zealand CEO radio interview 24 June 2003).
15. The submissions suggest that Origin Pacific might make other alliances.
16. Section 5.96 suggests an alliance with Virgin Blue. This first assumes that Virgin Blue will enter the market on a significant scale, secondly assumes they will want to enter into an alliance with Origin Pacific, and thirdly ignores the fact that they do not have the size or scale of Qantas and cannot offer the feed and other advantages that Qantas offers. Qantas can offer the northern hemisphere passenger feed and other scale advantages.
17. Section 5.96 also suggests alliances with fifth freedom airlines. This is similarly unrealistic. Because of the nature of their traffic they would offer little feed benefit. In addition Origin Pacific does not have the presence in the Auckland market which would be needed to effectively align with their services. Origin Pacific has been thwarted from expanding its Auckland operations due to its inability to obtain airport space from Auckland International Airport Limited from which to operate.
18. The clear impression in all of this is that the Applicants are looking for any argument to suggest a continuing level of competition and constraint by Origin Pacific which in reality is unrealistic and wrong.
19. Using the same arguments Origin Pacific could make similar suggestions about possible Air New Zealand alliances. The recent reported comments that Singapore Airlines' study into setting up an Australian domestic airline was at an advanced stage (NZ Herald 9 July 2003) would suggest that they could be an alternative partner to Qantas. Similarly Emirates or other fifth freedom airlines. And presumably the reference in the submissions Section 5.96(b) to the "additional expansion opportunities" if Air New Zealand exited the Star Alliance would apply equally to Air New Zealand if it did not.
20. Does this reference to exiting the Star Alliance mean that this is going to happen – and if so what are the detriments in this?

Economic Analyses

21. Origin Pacific does not have the resources to play a major part in the economic analyses. It notes again the huge resources of the Applicants and it looks to the Commission to protect the public interest in this area. It makes three comments as this stage however:

22. First, Origin Pacific disagrees with the further NECG Report in Chapter 7 of the Applicants' submissions relating to the provincial routes paras 53-56. The contention here that strategic (predatory) conduct is not possible on the provincial routes is plainly incorrect. Origin Pacific stated in its initial submissions that it has had to deal with behaviour from Air New Zealand which it believes has been anti-competitive and predatory. Strategic conduct including matters such as pricing, schedules, capacity, incentives, frequent flyer benefits, aircraft type, airport facilities, etc, is equally as likely on NSN-WLG as on AKL-WLG.
23. Secondly Origin Pacific also disagrees with the comments of the Applicants' new economic witness Professor Willig in his report of 20 June 2003, criticising Professor Gillen's economic model for, and claiming as a flawed assumption, the disregarding of Origin Pacific as an actual competitor to the Alliance in the domestic market and as a potential competitor on the main trunk routes. Origin Pacific's position has been addressed by both Professor Gillen and the Commission in its Draft Determinations. Origin Pacific has consistently in its submissions rejected the Qantas/Air New Zealand views as to its ability to compete on a sustainable basis as put forward by the Applicants. Professor Willig's comments suggest that he has only a limited knowledge of the New Zealand airline situation. Certainly Professor Willig has not made any inquiry of Origin Pacific in forming his views.
24. Thirdly, Origin Pacific does not accept the views of Professor Willig, or the Applicants, that Professor Gillen's model (or, if that is being suggested, his views,) should be ignored. Professor Gillen is a recognised expert in his field. To the extent there are differences in view as to the correctness or otherwise of any modelling or other material it is for the Commission to address the issues raised to the extent relevant, rather than to ignore the material. The Applicants do not refer to extensive other overseas material as to alliances which support the concerns noted by the Commission in its draft. Examples of such material can be provided at the conference.

Regional Implications

25. The submissions continue the Applicants' serious downplaying of the detriments that the Alliance will have to the regions.
26. Origin Pacific covered this at length in its initial submissions and also in its submissions to the Draft Determinations.
27. Regional New Zealand sustains the New Zealand economy and competitive air services are fundamental to regional growth. The creation of a monopoly which dominates the main trunk services creates an environment where no smaller airline can generate enough traffic to offer regional competition let alone national presence. In the Application and their subsequent submissions the Applicants accepted this indicating that a possible outcome of the Alliance was the reversion of Origin Pacific to its pre Qantas position – although without acknowledging that the combining of Air New Zealand and Qantas would now make this a far more marginal operation. For the Commission to approve the Alliance and endorse this position would not only damage Origin Pacific but effectively legislate a permanent situation preventing any competitive air services to the regions. Origin Pacific is a low cost airline but even with its cost structure it is a fact of life that regional services require feed to and from main trunk services and key markets to have

any chance of sustained profitability. Journeys between regional destinations do not have sufficient economic capability to stand alone and are frequently cross subsidised by the major carriers in order to provide frequency of service to feed main trunk and international services. Against a combined Air New Zealand/Qantas dominance the future of regional services provided by any airline other than the Alliance is bleak.

28. Origin Pacific recently withdrew some services from New Plymouth on a seasonal basis owing to heavy maintenance requirements. It has subsequently received numerous calls asking for it to return because of a noticeable rise in Air New Zealand's available fares. Origin Pacific believes that if the Alliance was approved this would typify a general pattern of the cheaper fares diminishing in availability and the average fares rising as competitive services declined and more traffic was transferred to the Alliance.

Conditions Suggested by Applicants

29. Origin Pacific does not believe that the conditions offered or suggested by the Applicants are in any way sufficient to mitigate the anti-competitive effects of the Application.
30. Origin Pacific also notes that the conditions affecting the New Zealand markets apply only to the main trunk routes. No conditions have been offered or suggested in respect of the provincial routes or the airline services to the regions. If the Commission did decide to authorise the application, conditions and undertakings would be of key importance. If the Alliance was to proceed there would be detriments to the provincial (and related tourist) markets. Yet it is not the provincial or tourist market which is the driver for the Alliance. If contrary to the submissions being made the Alliance in some form was to be authorised, Origin Pacific considers it essential such detriments be addressed, yet that has not been done by the Applicants. Such mitigating conditions would in our view have to include on appropriate terms such things as:
- capacity ceilings
 - access to main trunk services via interline or codeshare arrangements
 - access to facilities
 - access to normal airline co-operative arrangements (including on detailed matters such as disrupts and baggage overloads)
 - access to aircraft engineering services
 - disclosure, at least to NZCC, of passenger, fare and capacity data for segments flown by Applicants (refer for example to US Department of Transportation requirements referred to in Chapter 3 of the Applicants' submission)
 - and other matters as may be appropriate.

The terms of such mitigating conditions or undertakings (and any others necessary), their enforceability and effectiveness, and the legal ability to impose or give them are matters which would require further consideration if the Commission became minded to approve the Application. As earlier noted, Origin Pacific opposes the Application and does not believe it should be approved and these comments on conditions or undertakings are not to derogate from that submission.

Answers to Commission Questions

31. For certainty and following the Applicants' answers in the submissions Origin Pacific answers again the Commission Questions 22, 23, 26 and 27

(22) Question

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

Answer

Under the factual Origin Pacific would certainly not expand in the main trunk market and would almost certainly retrench. It faces the loss of its Qantas relationship and it can see no way in which it could sustainably compete itself against the Alliance. Under the counterfactual it would be a more open position depending on what developments might be possible in its Qantas relationship and what circumstances or opportunities arose.

(23) Question

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

Answer

Origin Pacific agrees strongly with the Commission's preliminary view including for the reasons set out in the answer to Question 22.

(26) Question

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

Answer

Under the factual Origin Pacific would almost certainly retrench in the provincial market. It faces the loss of its Qantas relationship and it can see no way in which it could sustainably compete itself against the Alliance. Under the counterfactual Origin Pacific would look to continue its policy of steady expansion depending on developments in its relationship with Qantas and what circumstances or opportunities arose.

(27) Question

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

Answer

Origin Pacific agrees strongly with the Commission's preliminary view for the reasons set out in the answer to Question 26.

Support for Other Submissions

32. Origin Pacific supports the other submissions lodged with the Commission supporting the Draft Determinations and in particular the submissions of Bon Voyage, Gullivers Pacific, Infratil et al, and Wellington International Airport.

33. These submissions widely support Origin Pacific's view that the Applicants have overstated Origin Pacific's ability to compete with the Alliance in the main trunk and provincial markets.
34. They also cover wider areas of the Application which Origin Pacific wishes to support. These include in particular the submissions' comments and statements that (1) note Air New Zealand's stronger position (2) downplay the proposed counterfactual "war of attrition" (3) emphasise the importance of airline loyalty schemes to the business and corporate traveller and (4) emphasise the value of the Star Alliance to New Zealand. These are all important factors in any consideration of the Application.
35. Origin Pacific would also like to repeat the comment made in its initial submissions that nothing stays the same in the airline business. Air New Zealand has an improving position and potential and a wider range of potential partners is now possibly emerging. The alliance with Qantas may not be its only option. Bearing in mind the clear detriments and disadvantages of the Qantas alliance Origin Pacific suggests that it may be an appropriate time for Air New Zealand to reconsider its options. If the alliance with Qantas is approved it will have a possibly irreversible effect on the whole New Zealand airline structure.

Conclusion

36. Origin Pacific repeats that it sees nothing in the Applicants' submissions to the Draft Determinations to alter its view of the Application. It continues to believe (1) that approval of the Alliance would result in a substantial lessening of competition and (2) that the benefits claimed can in no way outweigh the detriments. It confirms its support for the Draft Determinations. It believes that the Application should be declined.