

CHAPTER 14

CONDITIONS OFFERED TO THE COMMISSION BY THE APPLICANTS

INTRODUCTION

14.1 This Chapter sets out the substantive conditions the Applicants offer to the Commission. In the Applicants' view, the proposed conditions (the **Conditions**) will facilitate substantive new entry on Tasman and Domestic New Zealand Routes. This new entry will materially reduce any competitive detriment arising from the Alliance. The Conditions also ensure the delivery of other significant public benefits that flow from the Alliance.

14.2 In the Draft Determination the Commission cited a number of practical considerations that it would take into account in considering whether any conditions put forward might be appropriate. The Commission noted that:

- (i) to be effective in a complex and dynamic market, conditions may need to be so intrusive as to likely stifle competition and competitive processes;
- (ii) the enforcement of conditions may be difficult and of necessity will only occur after a breach;
- (iii) conditions require frequent monitoring; and
- (iv) conditions are inflexible and unresponsive to market changes.

14.3 In offering the Conditions, the Applicants are cognisant of the Commission's requirements. Accordingly, the Applicants have structured the Conditions in two parts:

- (i) Part A Conditions, which fulfil the criteria of being simple, easy to police and enforce and costless; and
- (ii) Part B Conditions, which are more complex than the Part A Conditions.

14.4 Accordingly, to the extent that the Commission retains any residual concern that the Alliance will, or be likely to, result in a substantial lessening of competition and that the benefits of the Alliance do not outweigh the detriments, the Applicants submit that the Conditions should provide the Commission with the necessary comfort that its concerns will not materialise.

Summary of Part A Conditions

14.5 Part A Conditions:

- (a) facilitate access to facilities;
- (b) facilitate access to aircraft;
- (c) place restrictions on the operations of Freedom Air; and
- (d) place capacity restrictions on the Applicants.

14.6 Part A Conditions are designed to ensure that, under the Alliance, substantive new entry will occur on Tasman and Domestic New Zealand Routes.

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Summary of Part B Conditions

14.7 Part B Conditions relate to:

- (a) the establishment of a capacity floor;
- (b) the establishment of a price cap on Tasman services;
- (c) a condition whereby the Applicants will commence services on certain new direct routes;
- (d) spend of a specified amount on implementing the Qantas Holidays' Business Plan;
- (e) operation of back of the clock freight services; and
- (f) establishing an independent third party to monitor the Applicants' compliance with the Part A Conditions and Part B Conditions.

14.8 With respect to the Tasman price cap, in the Applicants view, the Alliance will not result in material increases in prices on the Tasman or Domestic New Zealand Routes. In the first place, the Applicants have analysed various international business models and concluded that the best way to compete is to stimulate market demand by offering more flexible and lower fares to passengers. Secondly, the Applicants believe their submissions demonstrate that VBA entry is certain to occur. As stated in Chapter 5, VBA entry will constrain the Applicants irrespective of the level of VBA entry. In the present case, Virgin Blue sits with an established and successful VBA operation in the Australian segment of the market. Accordingly, Virgin Blue is able to expand onto Tasman and Domestic New Zealand Routes whenever it determines to do so. The Applicants cannot ignore that immediate and substantial threat. However, should the Commission retain any residual concerns, the Applicants offer a price cap on the Tasman.

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INTERPRETATION OF CONDITIONS

Capacity means available seat kilometres.

Domestic New Zealand Routes means the city pairs between Auckland, Christchurch and Wellington.

Domestic New Zealand City Pair means a city pair in the Domestic New Zealand Routes.

Effective Date means the date of satisfaction of the conditions precedent in the Strategic Alliance Agreement (including grant of authorisation by the Commission and the ACCC and Air New Zealand shareholder approval).

Facilities & Services means:

- (a) departure and arrival slots;
- (b) airport gates;
- (c) airport counter facilities;
- (d) line maintenance services (including spares and parts as part of those services);
and
- (e) ground handling services.

Independent Third Party means a person appointed jointly by the Operating Carriers, after obtaining approval of the candidate by the Commission.

New Entrant, in relation to routes or a city pair, means a Single Aviation Market (SAM) airline that does not operate flights on those routes or that city pair on the Effective Date.

Operating Carrier means Air New Zealand (and its subsidiaries) or Qantas (and its subsidiaries).

Operating Carriers means Air New Zealand and Qantas.

Regulated City Pair means those Tasman City Pairs and Domestic New Zealand City Pairs on which, on the Effective Date, the Operating Carriers or either of them operate flights and no other airline (other than Origin Pacific) operates flights.

Tasman Routes means the city pairs between Australia and New Zealand.

Tasman City Pair means a city pair in the Tasman Routes.

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PART A CONDITIONS

Entry Facilitation

Facilities & Services

Tasman

1. The Operating Carriers offer a condition to alter Alliance schedules on Tasman Routes to provide New Entrants to Tasman Routes access to such Facilities & Services at Auckland, Sydney and Christchurch airports (and such other airports as the Commission may identify) as may be reasonably required for the New Entrants (in aggregate) to establish and operate a reasonable level of services on the Tasman Routes. For the purposes of this condition, a reasonable level of service will be a five aircraft schedule on Tasman Routes.

Domestic New Zealand

2. The Operating Carriers offer a condition to alter Alliance schedules on Domestic New Zealand Routes to provide New Entrants to Domestic New Zealand Routes access to such Facilities & Services as may be reasonably required for the New Entrants (in aggregate) to establish and operate a reasonable level of services on Domestic New Zealand Routes. For the purpose of this condition, a reasonable level of services will be a level up to or equivalent to the five B737 aircraft schedule operated by Qantas in Domestic New Zealand during April 2003.

General

3. The Facilities & Services will be provided on the following terms:
 - (a) at an equivalent rate and on similar conditions to those offered by the Operating Carrier at the relevant airport to other airlines with similar requirements (but disregarding terms attributable to global alliance membership and reciprocity); or
 - (b) where the facility or service is not provided by an Operating Carrier to another airline at the relevant airport, on reasonable commercial terms.
4. The Facilities & Services in this condition do not include Facilities & Services that:
 - (a) are not controlled by an Operating Carrier; or
 - (b) are not used by the Operating Carriers to provide services on Tasman Routes Domestic New Zealand Routes;
 - (c) are required by the New Entrants to operate schedules which do not distribute flights through the day and to airports on a similar basis to those provided by the Operating Carriers;
 - (d) would require the Operating Carriers to alter more than 25% of the Alliance's schedules on the Tasman Routes; or
 - (e) are available to the New Entrants on similar commercial terms from the airport or other third parties.

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5. Where Facilities & Services were utilised by Operating Carriers but must be made available to a New Entrant by an airport or other third party, the Operating Carriers will use all reasonable endeavours to assist a New Entrant to obtain those Facilities & Services on terms similar to those previously obtained by the Operating Carriers.
6. Where the Operating Carriers and a New Entrant disagree about the application of this condition or are unable to agree on terms, the dispute will be referred to the Independent Third Party.
7. This condition, and the provision of any Facilities & Services under it, will terminate upon the first to occur of the expiry of the authorisation granted by the Commission or five years from the Effective Date.

Freedom and New Entry Facilitation

Freedom

8. From the date that a New Entrant commences Trans-Tasman services into Brisbane, Air New Zealand offers a condition that, within three months of being advised, Freedom will only operate Trans-Tasman services into Brisbane that operate from secondary airports in New Zealand (that is airports other than Auckland, Wellington or Christchurch).
9. From the date that a New Entrant commences Trans-Tasman services into Melbourne, Air New Zealand offers a condition that, within three months of being advised, Freedom will only operate Trans-Tasman services into Melbourne that operate from secondary airports in New Zealand (that is airports other than Auckland, Wellington or Christchurch).
10. From the date that a New Entrant commences Trans-Tasman Services into Sydney, Air New Zealand offers a condition that, within three months of being advised, Freedom will only operate Trans-Tasman services into Sydney that operate from secondary airports in New Zealand (that is airports other than Auckland, Wellington or Christchurch).
11. From the date a New Entrant commences Trans-Tasman Services, Air New Zealand offers a condition that Freedom will not grow its Tasman schedules by more than one aircraft each calendar year.
12. Air New Zealand offers a condition that Freedom will not operate on Domestic New Zealand Routes.
13. The conditions in clauses 8 to 12 will terminate:
 - (a) three years after the Effective Date; or
 - (b) except in respect of clause 11, on a City Pair by City Pair basis upon a New Entrant or New Entrants achieving 50% of the Alliance capacity on that City Pair.

Market Entry with "Critical Mass"

14. The Operating Carriers offer a condition to lease up to four B737-300 aircraft to one New Entrant for operations on Tasman and/or Domestic New Zealand Routes.
15. The leases will be subject to receipt of six months notice (to allow the Operating Carriers to implement the leases) and will be provided on the following terms:

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- (a) the aircraft will be in an all economy configuration;
 - (b) the aircraft will be leased at market rates (based on those then paid by Freedom (to be verified by the Independent Third Party));
 - (c) the term of the lease would be up to three years;
 - (d) the leases will be subject to the provision of normal financial security;
 - (e) the lease would include aircraft maintenance provided by the Applicants; and
 - (f) the Operating Carriers would be willing to include in the lease technical and/or cabin crews for the period required for the New Entrant to train their own staff (the technical and cabin crew could be withdrawn with six months notice).
16. This condition will terminate three years after the Effective Date.

Capacity Ceiling

17. The Operating Carriers offer a condition, in respect of each Regulated City Pair, not to increase the Operating Carriers' combined capacity on that city pair during the period of 18 months following the date on which the first New Entrant officially announces its intention to commence operating flights on that city pair, except as permitted in this clause.
18. The condition in clause 17 will be terminated in respect of any Regulated City Pair:
- (a) if the New Entrant does not accept bookings within three months of officially announcing its intention to commence operating flights on that Regulated City Pair;
 - (b) if the New Entrant does not commence scheduled flights within six months of officially announcing its intention to commence operating flights on that Regulated City Pair; or
 - (c) if the New Entrant ceases to operate flights on that Regulated City Pair.
19. The condition in clause 17 will not apply to:
- (a) temporary increases in capacity for periods not greater than 14 days (for example, changing aircraft type to cover operational requirements such as planned and unplanned maintenance and engineering);
 - (b) increases in capacity announced by either Operating Carrier prior to the New Entrant's official announcement of its intention to commence operating flights; or
 - (c) the capacity added to meet the freight condition in clause 35 and 36.
20. The following will not be treated as an increase in capacity on any city pair:
- (a) for Air New Zealand, the replacement of B737 aircraft with an equivalent number of A320 aircraft; and

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- (b) for each Operating Carrier, the replacement of any aircraft series (for example B737-300) with an equivalent number of aircraft of the same type (for example B737-800).
21. This condition, and the restrictions in clause 17, will terminate:
- (a) upon the first to occur of the expiry of the authorisation granted by the Commission or five years from the Effective Date; or
 - (b) on any Regulated City Pair, upon the New Entrants achieving capacity equal to 50% of the Operating Carriers' capacity on that Regulated City Pair.

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PART B CONDITIONS

Capacity Floor

22. The Operating Carriers offer a condition, in respect of each Regulated City Pair, not to reduce the Operating Carriers' combined capacity on that city pair, except as permitted by this clause.
23. The Operating Carriers offer a condition to increase capacity on each Regulated City Pair at the same average rate as the remainder of the Tasman Routes or Domestic New Zealand Routes (as applicable).
24. The conditions in clauses 22 and 23 will terminate in respect of any Regulated City Pair on the earlier of:
 - (a) the first to occur of the expiry of the authorisation granted by the Commission or five years from the Effective Date; or
 - (b) another airline commencing operating flights and, in respect of clause 22 only, achieving a 20% capacity share on that city pair.
25. During the period of operation of this condition, the Operating Carriers may reduce capacity on a Regulated City Pair if, for any continuous three month period, seat factors decline to less than 70% or yield declines by more than 5%, provided they first obtain the written confirmation of the Independent Third Party.

Tasman Price Cap

26. The Operating Carriers offer a condition not to increase prices on Regulated City Pairs on the Tasman beyond airline cost base increases (measured in accordance with an appropriate structured producer price index for an Australasian airline operating on the Tasman) for market and fare segments (originating from Australia or New Zealand) to be agreed with the Commission.
27. This condition will terminate in respect of any Regulated City Pair on the Tasman on the earlier of:
 - (a) the first to occur of the expiry of the authorisation granted by the Commission or five years from the Effective Date; or
 - (b) another airline commencing operating flights on that city pair.

New Services

28. The Operating Carriers offer a condition to commence operating:
 - (a) eight weekly flights (four return services) between Auckland and Adelaide within one year of the Effective Date; and
 - (b) two weekly flights (one return service) on each of the following city pairs within one year of the Effective Date:
 - (i) Auckland – Hobart;

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- (ii) Wellington – Canberra; and
 - (iii) Auckland – Canberra.
29. The Operating Carriers will continue operating flights on these city pairs for a period of one year.
30. The Operating Carriers may reduce capacity, or cease operating, on a city pair in clause 28 if, for any continuous three month period, seat factors decline to less than 70% or yield declines by more than 5% (against the business case), provided they first obtain the written confirmation of the Independent Third Party.
31. The condition in clause 28 will terminate in respect of a city pair immediately upon another airline commencing operating flights on that city pair.

Tourism

32. The Operating Carriers offer a condition to spend an additional A\$5.4 million in the year following the Effective Date on costs directly associated with the implementation of the Qantas Holidays business plan and designed to stimulate an additional 50,000 tourists to New Zealand (including 18,000 dual destination tourists) which includes A\$1.75 million on direct sales and marketing.
33. The A\$1.75 million amount in clause 32 will be spent in conjunction with national and state tourism bodies where that is likely to maximise tourism flow.
34. If tourism targets are not met for any reason other than force majeure (such as SARS) by the end of year 3, the Operating Carriers will spend a further A\$5.4 million on direct sales and marketing in conjunction with national and state tourism bodies where that is likely to maximise tourism flow.

Freight

35. The Operating Carriers offer a condition to add two weekly return Tasman wide-bodied “back of the clock” services specifically for freight to each of Auckland and Christchurch.
36. The Operating Carriers may reduce capacity, or cease operating, the additional freight services to Auckland and Christchurch for any period where there is a material adverse change to the financial returns earned by the Operating Carriers on that service.

Monitoring

37. The Operating Carriers offer a condition to provide annual audited reports (in a form to be agreed with the Commission) to the Commission demonstrating compliance with the Part A Conditions and Part B Conditions.
38. Should the Commission request, the Operating Carriers will fund an Independent Third Party to receive the annual audited reports and monitor compliance with the Part A Conditions and Part B Conditions.
39. Any Independent Third Party will act as agent of the Commission, and will be obliged to deal with all issues concerning implementation of these conditions, including the adjudication of all disputes arising in the course of implementation and report to the Commission on compliance.

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40. Protocols for duties of any Independent Third Party to the Commission and to the Operating Carriers will be prepared for approval by the Commission.