Wellington Airport

Wellington International Airport Limited

Submission

to the

Commerce Commission

On

Commerce Act 1986:

Restrictive Trade Practice Section 58:

Business Acquisition Section 67:

Notices Seeking Authorisation

Applications

by

Air New Zealand Limited

and

Qantas Airways Limited

14 February 2003

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1. EXECUTIVE SUMMARY

1.1 Wellington International Airport Limited (**WIAL**) is a supplier of airport services and an informed participant in the New Zealand aviation market. WIAL is making a submission in respect of the authorisation applications because it considers that the anti-competitive consequences of the applications will harm all users of air transport services in New Zealand and Trans-Tasman and all industry service providers. They will harm the New Zealand and Wellington Regional economies.

1.2 In part WIAL's submission is intended to draw the Commission's attention to certain aspects of the airlines' proposals; in part it draws attention to deficiencies in the proposals and its supporting economic analysis. However, WIAL does not have access to all the information provided or available to the Commission. WIAL's submission therefore does not purport to provide the level and detail of economic analysis that we consider the Commission is required to undertake.

The Applications are highly anti-competitive

1.3 The proposed Strategic Alliance comprises a very extensive market restriction. Air New Zealand will manage the commercial aspects of the Strategic Alliance and the Applicants will co-ordinate all network and pricing decisions under the review of a single body. This will affect Air New Zealand and Qantas services within, and to and from New Zealand on the competitive issues of:

- Destinations
- Frequency of services
- Type and size of aircraft
- Capacity
- Pricing
- Marketing

1.4 The Strategic Alliance proposal eliminates or substantially reduces effective competition on all of the nominated services and on price and service quality.

1.5 A stated aim of the Strategic Alliance is to improve yields, i.e. the objective is to increase pricing. In the short term the Applicants are proposing to increase air transport costs as well as to reduce services (e.g. at Wellington). Pricing is the key stimulus of demand. Should pricing increase, New Zealand as a destination will become less competitive and growth in the inbound tourist market will be dampened as a result.

Marketing of New Zealand will decline

1.6 Air travel is sensitive to marketing. Over the longer term (including beyond the five years addressed in the NECG analysis) the Strategic Alliance will almost certainly see less marketing of New Zealand as an international visitor destination. Air New Zealand is the main promoter of New Zealand as a holiday destination and the subjugation of Air New Zealand within the Strategic Alliance is very unlikely to see an increased spend or focus on the marketing of New Zealand.

Connections to Wellington substantially reduced

1.7 The Applicants forecast a 30% reduction in the numbers of Trans-Tasman services from Wellington if the Strategic Alliance proceeds (from 48 per week to 33), and are silent on the future of the Applicants' competing global alliances yet claim to offer greater connections. WIAL cannot reconcile those claims. The flow-on consequences for local businesses and Wellington as a business location can only be negative.

Strategic Alliance represents a fundamental structural change with long-term consequences

1.8 The proposed Strategic Alliance represents a fundamental shift in the structure of the markets for air transport services for New Zealand. Its consequences in this and other markets will be significant and felt over the long term.

1.9 For such a Strategic Alliance to be approved, the long and short term benefits would need to be unequivocal, and the alternative(s) robustly assessed and shown to be credible and deficient relative to the Strategic Alliance.

1.10 From the documentation provided to date WIAL considers the alternatives (the Counterfactual) to be contrived, the barriers to entry and competitive detriment analysis understated, and the notional public benefits to be uncertain and potentially able to be eroded by the Applicants as a consequence of their market dominance.

Applicants' Factual and Counterfactual Analyses are flawed

1.11 The Applicants' analysis assumes that Air New Zealand is profitable on domestic sectors and unprofitable on international routes. While that may be the case now, historically it has not always been so. It is potentially misleading to rely on the current sector profitability to model future behaviours.

1.12 A substantive and aggressive capacity driven expansion into the New Zealand market by Qantas (the Counterfactual) is contrary to the past behaviour of Qantas. WIAL is not convinced by the explanations provided by the Applicants as to why Qantas would change its behaviour as opposed to a more measured expansion into the market.

1.13 The competitive influence of Origin Pacific on the main trunk markets is overstated given their current market strength and reliance solely on turbo-props.

1.14 The Applicants' scenario assumes a new Value-Based Airline (**VBA**) entrant would need to start operations in head to head competition with a single well-capitalised incumbent, on the incumbent's strategic routes from the "incumbent's" airports. This contrasts markedly with the overseas experience of the VBA establishment model. WIAL is therefore not persuaded that in the New Zealand market the presence of the Strategic Alliance would enhance the proposals of a VBA entering the market.

1.15 The Applicants' overall assumptions that barriers to VBA entry are low under-emphasise the challenges faced and are contrary to the Commission's previous findings.

1.16 The Applicants' forecast levels of domestic/trunk activity appear inconsistent with past experience.

1.17 Given that the Applicants propose to coordinate pricing/scheduling, WIAL considers it most likely that the Strategic Alliance will ultimately lead to reductions in both frequency and capacity as the Applicants enhance their yields.

1.18 The engineering benefits appear to be based on behaviour by Qantas that is destructive of their shareholder value, and contrary to the practice described in other sections of the NEGC Report.

1.19 Overall, the Counterfactual with its reliance on capacity driven competition needs to be rigorously reviewed by the Commission.

Access to WIAL's airport facilities

1.20 With particular respect to access to facilities at Wellington International Airport, there are currently limited barriers to entry for new entrants, and the presence of the Strategic Alliance would not materially change that position. WIAL is unique in this respect; the challenges at other airports may be more significant.

2. INTRODUCTION

2.1 This is the submission of Wellington International Airport Limited on the Application by Air New Zealand Limited and Qantas Airways Limited seeking authorisation pursuant to section 58 of the Commerce Act 1986 to implement the terms of a Strategic Alliance Agreement, in response to the public notice issued by the Commission on 18 December 2002 (the **Restrictive Trade Practices Application**). It is also a submission on the application by Qantas Airways Limited to acquire up to 22.5% of the voting equities in Air New Zealand, as invited by the Commission's media release of 18 December 2002 (the **Share Acquisition Application**).

2.2 Our contact person is:

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The Applications

2.3 The Restrictive Trade Practices Application relates to a Strategic Alliance Agreement between the Applicants. The Share Acquisition Application relates to a Subscription Agreement between the Applicants. For the purposes of background to our submissions, we note that, in summary, these agreements provide as follows:

The Strategic Alliance Agreement

2.4 Under the Strategic Alliance Agreement, the Applicants agree to form a Strategic Alliance to co-operate and co-ordinate various aspects of their respective businesses, by way of Joint Airline Operations (JAO). The Strategic Alliance Agreement provides that the commercial operations of the

JAO networks will be under Air New Zealand's management. Services are to be co-ordinated including scheduling, operations, routing, frequencies, aircraft type, connection arrangements and range of times. Moreover, all aspects of pricing including passenger fares, rebates, discounts, service fees, new fare products, promotion packages, commissions and agency incentives, and joint tendering are to be co-ordinated. There will also be sharing of information between the parties.

2.5 Under clause 10 of the Strategic Alliance Agreement, Air New Zealand, its Airline Affiliates, and Freedom Air will not be allowed to operate on any non-Trans-Tasman routes departing from or arriving in Australia, apart from continuing with its Sydney to Los Angeles Sector (which Air New Zealand recently announced it will withdraw from 27 April 2003); and Qantas and its Airline Affiliates will not be allowed to operate on any Sectors departing from or arriving in New Zealand, other than by flying as part of the JAO networks.

The Subscription Agreement

2.6 Under the Subscription Agreement, as described in the Share Acquisition Application, Qantas have subscribed for redeemable convertible notes equivalent to 4.99% of the voting equity in Air New Zealand on receipt of Kiwi Shareholder approval (authorisation has not been sought for the acquisition of the convertible notes). On receipt of authorisation by the Commission, the ACCC, and on the approval of Air New Zealand shareholders, the redeemable convertible notes will apparently automatically convert to Air New Zealand ordinary shares.

2.7 Subsequently Qantas will apparently subscribe to acquire such number of Air New Zealand shares as would, along with the ordinary shares arising from the convertible notes, result in Qantas holding a total of 15% of the voting equity in Air New Zealand. (These additional shares are called the **Tranche 1 Placement Shares**.) Qantas may also elect to subscribe for such number of Air New Zealand ordinary shares (**Tranche 2 Placement Shares**) to make the total voting equity held by Qantas up to 22.5%.

2.8 If Qantas does not subscribe for the Tranche 2 Placement Shares at the same time as it subscribes for the Tranche 1 Placement Shares, the Share Acquisition Application apparently states that Qantas must subscribe for them on or about the third anniversary of the date Air New Zealand shareholder approval is obtained. Qantas will be entitled to maintain this level of shareholding due to "top up" arrangements contained in a Top-Up Deed that Air New Zealand and Qantas have entered into. The parties have sought authorisation for the acquisition of the Tranche 1 and Tranche 2 Placement Shares, including the relevant aspects of the Top-Up Deed.

Supporting Information and Analysis used by Applicants

2.9 The Applications rely on the Factual and Counterfactual scenarios, and the analysis of competitive detriment and benefit, in a report on the Competitive Effects and Public Benefits Arising from the Proposed Strategic Alliance between Qantas and Air New Zealand dated 8 December 2002 prepared by Network Economics Consulting Group (the **NECG Report**). Accordingly, this submission mainly addresses the analysis of these matters in the NECG Report.

2.10 Considerable information relating to the Applications has not been made publicly available. In particular, significant portions of the Strategic Alliance Agreement between Air New Zealand and Qantas, and all of the Subscription Agreement, the Counterfactual Schedules set out in Appendix D of the NECG Report and the alternative Counterfactual set out in Appendix F of the NECG Report have been withheld.

2.11 On 12 February 2003 the Treasury released a large number of documents relating to the Government's consideration of the applications for Kiwi Shareholder and principal shareholder consent to the Strategic Alliance. Due to the release of these documents only a short time before this submission was due, WIAL has not had the opportunity to fully consider the relevance and significance of the documents. WIAL may make a further submission to the Commission after it has had an opportunity to fully review this material. Nevertheless, we note that they do not contain any of the withheld information.

2.12 Without this crucial information, WIAL has not been able to understand all the implications of the Strategic Alliance.

2.13 Notwithstanding this, based on our limited review of the Applications and the NECG Report, as set out in more detail later in this submission, we question whether the Counterfactual proposed by NECG is the most likely Counterfactual. We also consider that the Applicants have significantly understated the competitive detriments from the proposed transactions. In addition, we have some doubts over whether some of the benefits claimed by the Applicants will eventuate.

Preliminary issues

2.14 There are a number of issues relating to the approach that the Commission is required to take to considering the Applications that we wish to raise.

Commission must consider applications independent of ACCC

2.15 At the same time as the Applications to the Commission were made, the Applicants also made applications to the ACCC for authorisation of the Strategic Alliance Agreement and the share acquisition.

2.16 Various media statements have indicated that the ACCC and the Commerce Commission may follow a joint process in considering the respective applications.

2.17 While this may be convenient to the Applicants, this process should not have the effect of limiting participation by other parties in the Commission's decision-making process. Moreover, the Commission must ensure that it considers the Applications under New Zealand law, independently of the ACCC.

2.18 In paragraphs 6.45-6.49 of this submission, WIAL comments on the differences between the Commission's and the ACCC's powers in relation to undertakings.

Commission must ignore Government's interests in capacities as shareholder

2.19 As the Kiwi shareholder in Air New Zealand and, as principal shareholder, the Government gave in-principle approval on 18 December 2002 to the Strategic Alliance and the share acquisition subject to authorisation being granted by the Commission and the ACCC and there being no material changes to the proposals, or significant new information revealed, during the competition authorisation and other regulatory processes.

2.20 The Government has not transmitted any statement of economic policy relating to the Applications to the Commission.

2.21 The Commission must therefore consider the Applications solely in terms of the provisions in the Commerce Act. It must ensure that its consideration of the Applications is not affected by the in-principle approval given by the Government to the Strategic Alliance.

Commission must separately identify the detriments and benefits of the Strategic Alliance Agreement and the Share Acquisition

2.22 The Applicants argue that the analysis of the competitive detriments and benefits from the share acquisition and the Strategic Alliance Agreement cannot be separated (paragraph 45 of Share Acquisition Application). They therefore claim the same detriments and benefits from both.

2.23 WIAL understands that the Commerce Act requires the Commission, in considering the restrictive trade practices application, to identify the detriments and benefits that specifically arise from the Strategic Alliance Agreement and, in considering the Share Acquisition Application, to identify the detriments and benefits that specifically arise from the acquisition of shares in Air New Zealand.

2.24 WIAL therefore questions whether it is correct for the Applicants to identify the same detriments and benefits arising from both the Restrictive Trade Practices Application and the Share Acquisition Application. WIAL understands that the detriments and benefits arising from the Strategic Alliance Agreement and the share acquisition must be separately identified.

2.25 In the public version of the Share Acquisition Application, Qantas argues that if the detriments and benefits cannot be separately identified, then any detriments and benefits would arguably flow from the Strategic Alliance, and the share acquisition would have no further substantial competitive effects. This comment, however, is not consistent with the acknowledgment at page 11 of the public version of the Share Acquisition Application that the share acquisitions "*raise competition issues in respect of a number of aviation and related markets*". It is also not consistent with Commission statements in its *Air New Zealand; Ansett Holdings Ltd; Bodas Pty Ltd* decision where it referred to earlier Commission views that Qantas would be able to "exert a substantial influence" over Air New Zealand at a shareholding of 19.9% or if it were to acquire an additional 7.5% shareholding in Air New Zealand (para. 185).

2.26 It appears to WIAL that a shareholding of 22.5%, or even possibly of 15% would give Qantas significant influence over Air New Zealand and access to important confidential information such that a substantial lessening of competition would be likely to occur if the acquisitions proceeded independently of the Strategic Alliance Agreement.

2.27 This submission responds to the detriment and benefit analysis submitted by the Applicants and set out in the NECG Report, which appears to identify only benefits arising from the Strategic Alliance Agreement. However, the Applicants must demonstrate that there are separately identifiable benefits arising from the share acquisition.

2.28 WIAL comments separately in this submission on the likely competitive detriments arising from the share acquisition.

Structure of this submission

2.29 For ease of reference, the conventional short-form names for the airlines, namely Qantas and Air New Zealand are used, and where both airlines are referred to collectively we use the phrase the Applicants.

2.30 The submission generally follows the order of the Restricted Trade Practices Application and addresses the following points:

(a) Section 3 gives a brief description of WIAL and outlines some of WIAL's interests in the Applications;

(b) Section 4 comments on the Factual and Counterfactual scenarios proposed by the Applicants in light of past aviation activity and market characteristics and critically evaluates the Factual airline schedules in the NECG report;

(c) Section 5 comments on NECG's market definitions and statements on barriers to entry/expansion and market characteristics;

(d) Section 6 comments on the Applicants' Competitive Detriment and Benefit Analysis;

(e) Section 7 outlines issues and conclusions on access to airport facilities and services at Wellington Airport.

2.31 The Commission should note at the outset that WIAL has not been able to critique all aspects of the benefit/detriment methodology adopted by NECG. Further WIAL has not checked the numerical accuracy of NECG's modelling. Those are both matters WIAL considers the Commission needs to examine critically.

3. WIAL AND ITS INTERESTS IN THE APPLICATION

3.1 As stated in WIAL's letter to the Commission of 22 January 2003, registering its interest in the Restrictive Trade Practices Application, WIAL's reasons for being interested in the application (as well as the Share Acquisition Application) are due to its interest in the following markets referred to in the application:

(a) The markets for passenger air services.

(b) Domestic and international air freight markets.

(c) The market for the provision of terminal and ground handling services.

3.2 As a supplier of goods and services to the Applicants, and given the background of its management and its ongoing relationship with the airlines, WIAL considers it can assist the Commission by providing comment on relevant aviation market issues potentially impacted by the Application. In particular, WIAL is able to provide an historical perspective on certain issues, and the prospects for a VBA entry, that will assist the Commission in determining an appropriate Counterfactual and to test the Applicants' assumptions under the Factual.

WIAL is a supplier of goods and services to the Applicants

3.3 WIAL is a supplier of airport services to the Applicants and other commercial airline operators. These services principally take the form of:

Airfield Services

(a) Runways, taxiways, and parking aprons for aircraft including equipment such as ground power outlets, apron lighting, and physical security.

(b) Rescue fire, safety and environmental control services.

Passenger Terminal Services

(c) Check-in and boarding counters and related queuing areas.

(d) Baggage collection, conveying, make-up and reclaim systems plus the related areas required to operate the equipment.

(e) Aerobridges and related boarding equipment

(f) Flight information display systems (FIDS).

(g) Common areas through-out the terminal for the queuing, gathering and transiting of passengers.

(h) Sole use areas within the terminal leased to the Applicants for activities such as lounges, back of house processing etc.

3.4 In section 7 WIAL outlines how these services are provided, the extent to which there are barriers to entry in respect of those services, and whether the Applications could prospectively create barriers to entry.

Aircraft and Freight Activities

3.5 Air New Zealand holds a ground lease for the area occupied by the Flight Kitchen, and for the old hangar and apron area, although the latter is used for valet car-parking.

Commercial

3.6 In addition to the aeronautical activities, WIAL leases spaces to Air New Zealand for its valet parking close to the terminal, leases the valet booth and leases staff car-parks to the Applicants.

3.7 WIAL receives income from the Applicants either through:

(a) Landing and terminal charges – being a volume (times) rate arrangement;

(b) Lease arrangements – various rentals.

3.8 WIAL applies the same charges and rental rates to each of the Applicants (and any of their competitors).

3.9 In total for the year ending 31 March 2002 WIAL earned 91% of its aeronautical income from the Applicants' operations, in the form of landing fees and leases, and departure fees from the Applicants' international passengers.

WIAL is interested in the Prosperity of the Wellington Region

3.10 The presence of efficient and reliable air services, and in particular international connections, is a key factor in the economic prosperity of any city or region.

3.11 On behalf of WIAL, CM Research interviewed Wellington Region CEOs and identified the following themes:

(a) Business wants more frequent flights, not a greater number of seats.

(b) Cost is not as great a concern as availability of flights.

(c) The majority of business travellers feel greatly inconvenienced if there is a domestic leg involved in Trans-Tasman travel.

(Airport Connections, December 2000 issue)

3.12 Frequency and timing of services is very important for the business market. Should services to Australia from Wellington be rationalised to such an extent that it becomes difficult to transact business out of Wellington, companies may take the decision to relocate their entire business to another city. The introduction of a VBA may not necessarily overcome this issue, as flight timings and product levels of the VBA may not be what the business market is seeking. In any event, any intervening period between implementation of the Strategic Alliance and entry of a VBA will create concerns for businesses.

3.13 WIAL has no direct interest in long-haul flights addressed in the Restrictive Trade Practices Application.

3.14 Given the physical constraints at the airport, WIAL considers that the region's best interests are served through the presence of:

(a) Frequent and reliable point to point services to/from the Australian East Coast either as destinations in their own right or as connections to other networks.

(b) A network of connections within New Zealand.

3.15 WIAL's comments provide its perspective on the extent to which the Strategic Alliance Agreement and the Share Acquisition are likely to achieve those interests.

3.16 WIAL's conclusion is that the Applicants' proposals neither enhance nor secure either of those outcomes.

4. WIAL'S COMMENTS ON APPLICANTS' FACTUAL AND COUNTER FACTUAL ANALYSES

Précis of Applicants' market situation analysis

4.1 The Applications and the NECG Report describe an aviation market place facing significant turmoil.

4.2 More particularly they describe Air New Zealand currently as being:

(a) Under-capitalised relative to its principal competitor Qantas, therefore vulnerable to a war of attrition.

(b) A full network operator progressively moving towards the VBA+ model, but unable to make the transition to VBA (precisely because it is a network operator rather than point to point operator) and therefore vulnerable to entry by a full VBA on the profitable routes.

(c) Relatively more profitable on domestic routes than on Trans-Tasman and international long haul.

4.3 The Counterfactual postulated is one where:

(a) Qantas stays in the NZ market, but competes more aggressively in terms of capacity and price, which ultimately only Qantas, the better capitalised carrier will win.

(b) Potential new entrants, confronted by ramped up capacity from the incumbents are less likely to enter the market.

(c) Air New Zealand's competitive response would involve retrenchment to the more profitable routes thereby unravelling the advantages of being a network carrier, with a potential for several strategic (for New Zealand) routes to be abandoned.

4.4 The Applicants and NECG therefore do not paint a catastrophe scenario; rather one where the national carrier faces a slow erosion of competitiveness giving rise to a national detriment compared to the position under the Factual scenario.

4.5 The Factual scenario underpinning the Applications is one where:

(a) The Applicants' Strategic Alliance proceeds with scheduling, pricing, code sharing etc coordinated under the JAO arrangements.

(b) Because the Applicants are not competing through capacity, the market is more attractive to potential VBA entrants.

(c) Because there is limited network based competition, the JAO is less likely to retrench from some less profitable strategic routes. Which of the two airlines making up the Strategic Alliance will retrench on unprofitable routes is problematic.

(d) Marketing of Australia and New Zealand as a single regional destination is more likely to yield benefits to New Zealand than marketing New Zealand alone.

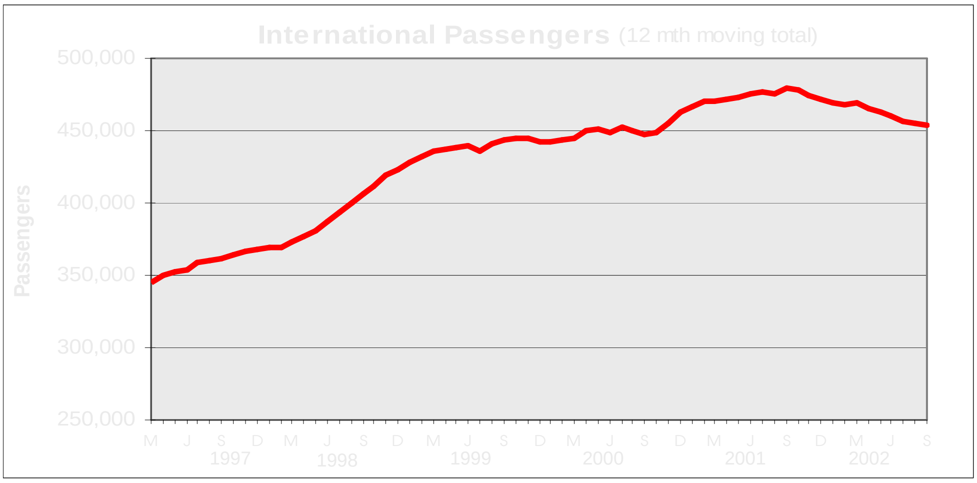
4.6 The Applicants conclude that the public benefits of the Strategic Alliance substantially exceed the competitive detriments arising from the Counterfactual.

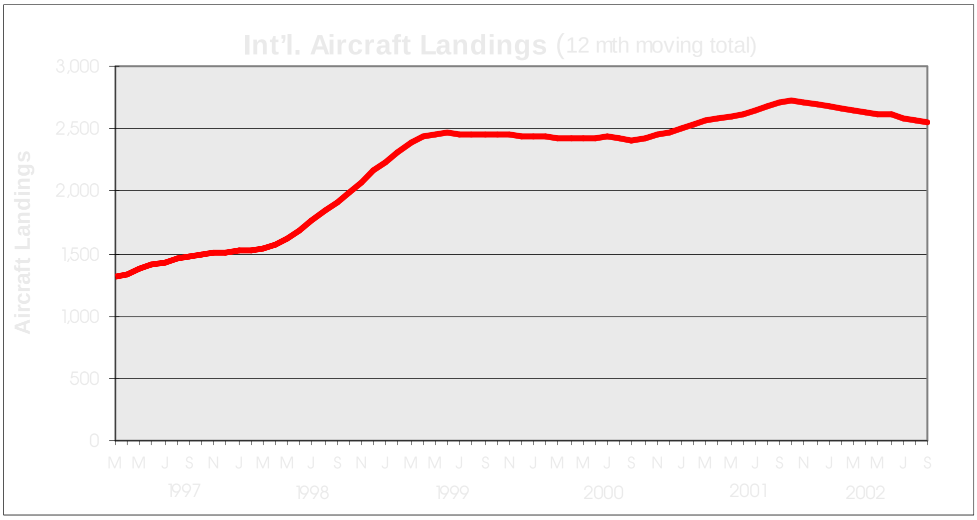
4.7 WIAL questions whether the Counterfactual proposed by the Applicants is likely, particularly in light of an historical analysis of the aviation markets in New Zealand. WIAL also questions several aspects of the assumptions made under the Factual scenario.

Historical Perspective

Trans-Tasman

4.8 In the past Wellington's international connections have been provided in turn by one carrier (Qantas), two carriers (the Applicants) using code share, and two carriers (the Applicants) in competition. The first set of graphs below show how competition spurred growth in Trans-Tasman travel through Wellington in the period from May 1997 to September 2001 and the subsequent decline to September 2002 following Qantas schedule changes in October 2001. Further details are available on the web site www.infratil.co.nz.



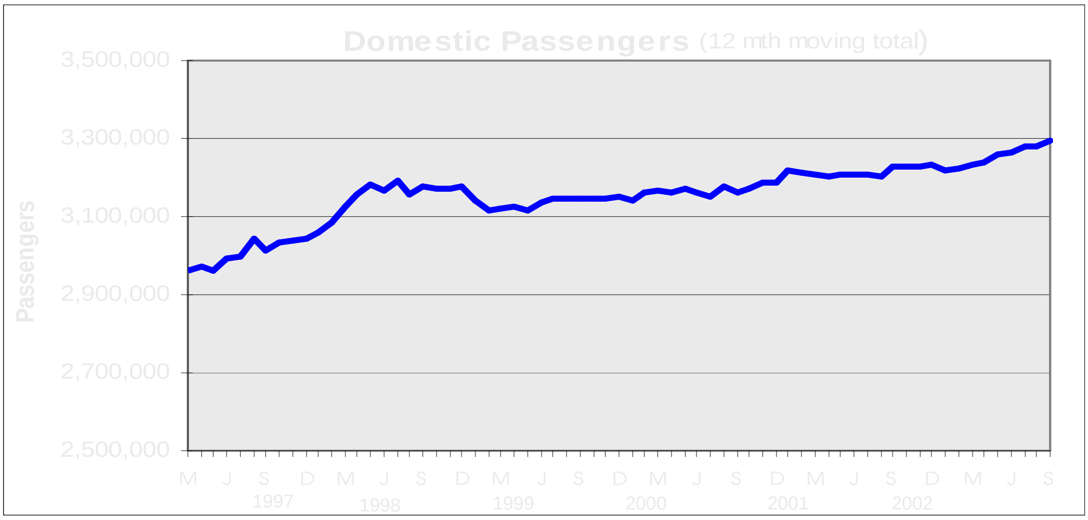


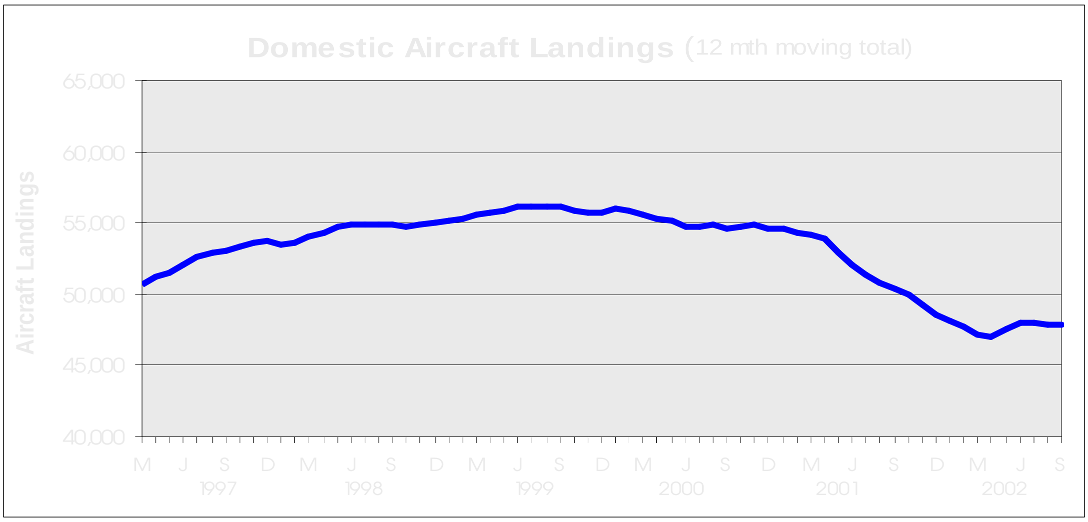
Domestic

4.9 Since the early 1990s two carriers have provided nearly all the capacity on the domestic main trunk market. They have been, respectively, Air New Zealand and Ansett NZ, then Air New Zealand and Tasman Pacific Airways (Qantas New Zealand), and currently Air New Zealand and Qantas Airways. The Applicants' operations together account for 91% of the aeronautical revenue of WIAL.

4.10 On the provincial market Origin Pacific has a growing presence, and by entering into a Strategic Alliance with Qantas has enabled Qantas to offer a partial network without incurring all the capital outlays.

4.11 The graphs below show how that market has changed in the 5 years to September 2002.





4.12 WIAL has also tracked market share (by capacity rather than passengers), and the following points emerge from that analysis:

(a) While Air New Zealand has always been the dominant domestic player, a new entrant (Ansett) was able to make inroads into its market share.

(b) A combination of more aggressive marketing by Air New Zealand, the collapse of Tasman Pacific, and relatively low level competitive entry by Qantas has allowed Air New Zealand to claw back this share to be in its most dominant domestic position since the early 1990s.

4.13 WIAL suggests that the extent of Air New Zealand's current dominance on the domestic market (and possibly the extent of its profitability on the domestic market) is not the norm but simply a point on a cycle.

4.14 WIAL also notes that historically the airlines have always tended to represent the domestic services as being relatively less profitable, but a necessary adjunct to the more profitable international services. Having said that, the combination of domestic market dominance, a seemingly well executed move towards the VBA+ model, and the international downturn all suggest that the current situation of the air services markets is as described in the Applications.

4.15 The key point the Commission needs to consider is whether the "point in time" analysis presented by the Applicants, and the Factual and Counterfactuals that emerge from that, fully reflect the dynamic nature of the aviation sectors.

Questions on the Counterfactual Market Assumptions

(paragraphs 90—115 – Restrictive Trade Practices Application)

Overview

4.16 WIAL observes that the airlines contend that the current duopoly (some 95% of WIAL's passengers are carried by the two airlines) is not stable and they put forward a Counterfactual outcome that strongly favours the Strategic Alliance being approved. Over the last decade WIAL's international and domestic links have mainly been served by only two airlines at any one point in time. This arrangement has given rise to periods of adjustment when one or another has altered their offering, but, by and large there is no reason to infer that new economic drivers will now cause the airlines to act in a wholly destructive manner so that one or the other is driven from the market.

Qantas Competitive Response

4.17 The presence of Qantas in the New Zealand domestic aviation market is the exception rather than the norm.

4.18 The Applicants strongly emphasise the importance of the NZ domestic market to Qantas but, if past behaviour is any guide, the supporting evidence for that assumption is limited. Until recently, Qantas has not directly participated in the New Zealand domestic market either through ownership of competitors to Air New Zealand or its own operations. The rationale for Qantas embarking on a capacity driven war of market dominance needs to be challenged.

4.19 WIAL accepts that Qantas may not wish to stay operating at the current level of service. However, the impact of a more measured Qantas response involving more active marketing and a limited scaling up of capacity ought to be considered as an alternative Counterfactual, given that it is in fact a great deal more plausible than any alternative. The most plausible way forward for Qantas is to look to address the shortcomings of its existing services, before deciding whether to increase or reduce capacity. In a marginal sense, such an investment would appear to be a great deal more prospective than either a pull-out or significant up-scale.

4.20 Effective competition does not require full replication of each airline's services. The Australasian aviation markets can support more than one airline.

4.21 WIAL observes that the behaviour suggested by the Applicants under the Counterfactual verges on actions that could themselves be subject to investigation under the Commerce Act (e.g. predatory behaviour).

4.22 WIAL also observes that the Applicants' Counterfactual is based on a competitive threat from the party seeking the equity interest. The Commission clearly will need to judge the extent to which that Counterfactual is influenced by that ultimate goal.

New Entrants

4.23 The Applicants assume that a new entrant is less likely to enter while there is substantial competition driven capacity in the market. We comment more fully on that assumption in our comments on the Factual.

Air New Zealand Response

4.24 The Applicants suggest that Air New Zealand, in the face of the competition would need to withdraw from nationally strategic but commercially less profitable long haul routes.

4.25 That assumption appears to be based on the "current point of time" relative profitability of the domestic and international routes. As commented above, the stance by Air New Zealand historically has been that the long haul international services were the core profitable services. The Applicants have not made information publicly available about the route-by-route profitability of its international operations or disclosed the cost allocation methodology they use for determining whether particular routes are profitable. Both these matters are critical to evaluating the Applicants' claims. Moreover, the Applicants have not provided information showing that international routes will continue to be unprofitable. Even if international routes are presently unprofitable, it does not follow that this will continue.

4.26 An alternative scenario might, therefore, include the possibility that long haul routes progressively regain their profitability. The commercial responses and resulting detriment/benefits ought to be assessed from that alternative perspective.

4.27 The Counterfactual appears to WIAL to be based on a worst-case scenario. WIAL considers that the radical change outcome forecast in the Counterfactual is implausible given all past actions of the Applicants and the fact that many of the predicted actions seem to have been available in the past and not taken. The current duopoly seems to function satisfactorily for both airlines.

4.28 If Qantas is in fact losing money in New Zealand, then a range of Counterfactuals need to be considered, but the course of action that should be given the greatest weight in the Commission's analysis is the one that offers Qantas the best prospect of a reasonable return on funds invested. WIAL submits that that would be to devote greater effort to managing the existing operation, rather than either withdrawing (and no doubt incurring a substantial write-off) or dramatically expanding from a weak base.

4.29 The Applicants' proposition that Air New Zealand would abandon large parts of its international network is implausible. Withdrawing from these services would impact upon overall network operations. It is not reasonable for Air New Zealand to use a point-to-point measure of profitability, when it operates a network business.

Questions on Factual Market Assumptions

(paragraphs 75-88 – Restrictive Trade Practices Application)

Prospects of New Entrants in Particular VBAs

4.30 The Applicants consider there is an enhanced prospect of a VBA entry under the Factual scenario. There is no supporting evidence given for this assertion. In any event, it is a second best scenario compared to the independent presence of Qantas, which would not occur under the Strategic Alliance.

4.31 In general, WIAL believes that the entry of a VBA, whether Virgin Blue or another value airline will depend on such a VBA being able to capture a satisfactory market niche (as occurred with Freedom before its withdrawal from domestic services in November 2002).

4.32 Virgin Blue's entry to Australia coincided with what most external commentators saw as a cosy duopoly. The Applicants have made it clear that would not be the case under the Factual or Counterfactual in New Zealand.

4.33 In paragraph 201 the Applicants claim that VBA's can, by operating the trunk routes, access 54% of the passenger markets at day 1. The

Applicants compare that favourably with the overseas circumstances where VBAs have had to target marginal routes. The Commission should question whether that is reasonable. The success of European VBAs was due in part to the fact that they tackled the FSAs' unprofitable routes first and established a position before engaging the established players. Further they operated into facilities where there was less airspace congestion (and therefore fewer delays) and limited airport infrastructure (and therefore lower cost structure).

4.34 VBA entry does not guarantee effective competition. The air travel market is segmented. Travellers are influenced in their decisions by price, frequency, connections, marketing, and extras such as airports and lounges. Different classes of travellers are more sensitive to one influence than another. When Air New Zealand operated its VBA service (Freedom) on the New Zealand trunk, it was notable that total domestic passenger numbers did not change from trend and there was little apparent price response from either Air New Zealand or Qantas on their trunk services. Freedom was not able to appeal to a wide range of travellers, but only to those for whom price was the over-riding consideration. There have been a number of Australasian VBA's that have failed (e.g. Impulse, Kiwi). While Air New Zealand Express is apparently initially successful, it is still a full network operation rather than a point-to-point VBA operation.

4.35 In New Zealand a VBA will have to attack the incumbents on their strategic routes from day one and likely operate from the same airports. As discussed in paragraphs 5.3-5.7, the barriers to entry for a VBA would be high under the Strategic Alliance.

4.36 WIAL therefore challenges the proposition that VBA entry is more likely under the Strategic Alliance or would be as extensive, as claimed by the Applicants.

Trans-Tasman Schedule Assumptions – NECG Table 5 & 7 and Schedule C

4.37 What the schedules appear to be saying is that if the Alliance proceeds there will be fewer services on the Trans-Tasman. They appear to say that the gap in service numbers will be filled by the entry of a VBA. However the data provided is unclear and the Commission needs to verify the assumptions made.

4.38 WIAL notes that both table 7 and Schedule C refer to weekly departures. At Wellington Airport the figures used by NECG are twice the current volumes. WIAL assumes that the table refers to departures from each city (i.e. return services on a sector). WIAL assumes that NECG's public benefit calculations do not double count, but the Commission should verify this point.

4.39 WIAL also notes there is a discrepancy between Table 7 and the Schedule it summarises. The difference is in the WLG-BNE sector where the table shows 12 Air New Zealand departures, whereas Schedule C shows nil. The difference WIAL assumes are the Freedom Air services. The Commission should verify what is the true base for calculation.

4.40 The table below show the annual historic, forecast and scenario capacity from the Applicants, for Trans-Tasman services.

Table 1 Weekly Volumes: Freedom Air Services included (as per NECG Table 7)

	Weekly Landings and Takeoffs at Wellington	Seats (Capacity)
2000 – 2001	94	11,169
2001 – 2002	100	11,947
2002 – 2003 (forecast year end)	96	12,136
2003 – 2004 (WIAL forecast)	94	11,694
Factual year 1	90	11,196
Factual year 2	78	12,540
Factual year 3	66	12,408

Table 2 – Weekly Volumes: Freedom Air Services excluded (as per NECG Schedule C)

	Weekly Landings and Takeoffs at Wellington	Seats (Capacity)
2000 – 2001	94	11,169
2001 – 2002	100	11,947
2002 – 2003 (forecast year end)	90	11,426
2003 – 2004 (WIAL forecast)	82	10,158
Factual year 1	78	9,732
Factual year 2	66	11,076
Factual year 3	54	10,944

4.41 Under either scenario, growth in capacity from under the Factual at Wellington is modest, with a decline from current levels in year 1. In all cases the number of services is significantly below the current level.

4.42 WIAL notes that given that the Applicants will control price and scheduling even the capacity projected may not be achieved.

4.43 It is difficult to assess the assumed impact of a VBA entrant under the Factual. To avoid doubt WIAL has assumed that NECG Table 5 is presented on the same basis as Table 7 (ie the numbers refer to arrivals and departures).

4.44 The impact of the new entrant assumptions is shown in table 3.

Table 3 – Weekly Volumes Including New Entrants (per NECG table 5) plus Freedom Air Services included (per NECG Table 7)

	Weekly Landings and Takeoffs at Wellington	Seats (Capacity)
2000 – 2001	94	11,169
2001 – 2002	100	11,947
2002 – 2003 (forecast year end)	96	12,136
2003 – 2004 (WIAL forecast)	94	11,694
Factual year 1	90 + 16 = 106	14,076
Factual year 2	78 + 22 = 100	16,500
Factual year 3	66 + 22 = 88	16,368

4.45 This table clearly shows the competitive benefit of a new entrant. The core issues for the Commission to determine is the extent to which:

(a) The Factual is likely to encourage/discourage market entry.

(b) The Applicants’ Counterfactual would impact the VBA assumption .

(c) The proposed Counterfactual is the most credible assumption.

4.46 WIAL does not have information on what the schedules would be under the Counterfactual. In the absence of this information WIAL relies on the Commission to look at the frequency/capacity assumptions for year 3 relative to the volumes in table 3 above. A key uncertainty for WIAL is the extent to which the capacity under the Counterfactual exceeds the competitive levels in table 3.

Main Trunk Schedule Assumptions – NECG Table 5 & 7 and Schedule C

4.47 WIAL notes that the same confusion between departures and arrival/departures occurs when NECG’s assumptions are examined.

4.48 The analysis shows by year 3 there will be either 65,776 weekly seats without a VBA or 90,976 seats with a VBA. This compares to current levels of approximately 60,000 seats.

4.49 The analysis raises several matters the Commission should explore:

(a) The assumption that the Factual (no VBA) capacity will be 13% above 2002-2003 capacity when the Applicants are clearly looking to rationalise operations.

(b) The assumption that the Factual (with VBA) capacity by year 3 will be 57% greater than 2002-2003 capacity.

(c) The extent to which the Factual (with VBA) capacity compares to the levels in the Counterfactual

4.50 WIAL considers that the forecast capacity levels in the NECG Report are not sufficiently robust and therefore any competitive detriment and public benefit analyses that flow from them must be questioned.

5. WIAL'S COMMENTS ON PARTICULAR MATTERS RELATING TO MARKET DEFINITION AND OTHER MARKET ISSUES

Market Definition

5.1 The NECG Report and the Applications argue for a single market for passenger air services that includes the New Zealand domestic main trunk route, Australian domestic main trunk routes and Trans-Tasman routes. However, both Applications later state that they are based on separate markets for New Zealand main trunk routes and Trans-Tasman routes. It is therefore confusing exactly what approach the Applicants and NECG have taken.

5.2 WIAL notes that in its *Air New Zealand, Ansett Holdings Ltd; Bodas Holdings Ltd* decision the Commission identified separate markets for main trunk passenger air services, provincial air services and tourist passenger air services. WIAL considers that this approach to market definition is appropriate. Otherwise, WIAL reserves comment on the Applicants' proposed market definitions.

Barriers to Entry/Expansion

(paragraphs 174-261 – Restrictive Trade Practices Application)

Comment on overall hypothesis

5.3 The key hypothesis being advanced by the Applicants is that the VBA business model has substantially changed the competitive nature of the airline industry. It therefore follows that many historical barriers to entry have either been lowered or in some cases removed. Examples quoted in support of that hypothesis are Virgin Blue and Origin Pacific.

5.4 WIAL agrees that the VBAs have changed the rules somewhat, but not to the extent argued by the Applicants.

5.5 The airlines contend that barriers to entry are low. WIAL contends that this is not so:

(a) WIAL notes the Qantas submissions to the Commerce Commission when the Commission was deciding on whether to allow Air New Zealand to acquire 50% of Ansett Australia Holdings. In those submissions Qantas stated that there were significant barriers to entering the New Zealand market and that these would become even higher after Air New Zealand acquired Ansett New Zealand (paragraph 233 of Commission decision).

(b) WIAL has had some direct experience of these barriers when it was promoting a Trans-Tasman service to Virgin Blue in 2001. At that time, WIAL undertook considerable work to promote and facilitate Virgin Blue commencing a Trans-Tasman service to WIAL.

(c) The airline market is fraught with barriers. The level of Governmental interest in the industry and the power of government agencies means that there is a complex web of regulatory and political requirements for any airline, especially one aspiring to international services, even before addressing commercial issues.

(d) The formation of a Trans-Tasman airline grouping that is primarily coming together to manage competition can only raise the already onerous barriers to any new entrant.

5.6 Origin Pacific is held up as an example of successful gradual market entry by the Applicants, and WIAL agrees that it is. However, in December 2002 it contributed only 3.7% of landing and terminal charges at Wellington Airport. The share at Auckland would likely be less.

5.7 WIAL notes that in *Air New Zealand; Ansett Holdings Ltd; Bodas Holdings Ltd* decision, the Commission concluded, based on the high financial costs of entry and the likely vigorous response from Air New Zealand, that the barriers to entry even for a VBA airline are such that entry is deterred (paragraph 337 of Commission decision).

Access to facilities

5.8 WIAL has commented specifically in section 7 on what if any barriers exist at Wellington Airport in relation to its facilities. The comments below are more general observations on the issue of barriers.

5.9 WIAL generally accepts the comments in paragraphs 204-205 and 238-240 but notes that there are likely to be specific issues to be addressed at the main trunk airports and the key tourist destinations regarding individual airport facilities.

Market Characteristics

Main Trunk Market (paragraphs 268-290 – Restrictive Trade Practices Application)

5.10 As the Applicants' data shows (in particular the table under paragraph 272) the Applicants currently dominate main trunk services. The sole existing competitor serves the CHC-WLG sector by virtue of its code share arrangement with Qantas at present, so under the Application the 96.14% share would likely rise to close to 100%.

5.11 Origin Pacific is an efficient niche player operating turbo-prop aircraft. It is a big step to move from that to competing with jets. The market has shown resistance to replacement of jet services, and however cost effective, a turbo-prop will always have a marketing disadvantage. The Commission should question the validity of Origin Pacific acting as a competitive threat to the Applicants on the main trunk routes.

New Zealand Provincial Market (paragraphs 291-298 – Restrictive Trade Practices Application)

5.12 WIAL accepts that the Application does not result in aggregation in this market.

5.13 The Commission may however want to investigate the extent to which the total dominance of the main trunk, and the advantages that gives the Applicants in terms of linkages/interchanges might erode the competitiveness of provincial operators who can only offer point-to-point services.

Trans-Tasman Market (paragraphs 299-323 – Restrictive Trade Practices Application)

5.14 WIAL notes, with the exception of routes out of Auckland, that the Applicants have 100% of the Trans-Tasman market.

5.15 The competition from Auckland from Singapore Airlines, Thai Airways International etc is correctly identified as arising from those carriers either having idle capacity at Auckland and/or as a consequence of their overall network operations. Neither of those circumstances are likely to arise for the rest of New Zealand and certainly not for the Wellington region.

Other markets (paragraphs 324-342 – Restrictive Trade Practices Application)

5.16 WIAL notes that since the Application was tabled United Airlines have withdrawn from AKL-LAX giving the Applicants 100% share of that route.

5.17 WIAL also notes that the Applicants have entered into a cooperation agreement with Air Pacific. The Commission ought to consider the implications of that move on the Pacific Market.

6. COMMENTS ON THE APPLICANTS' COMPETITIVE DETRIMENT AND BENEFIT ANALYSIS

6.1 As noted in the introduction WIAL has not reviewed all aspects of the detriment/benefit analysis in the NECG Report. The comments below are simply a list of matters that the Commission may need to factor into its evaluation.

6.2 Notwithstanding the limitations, WIAL believes

(a) That the Counterfactual case presented by the Applicants and NECG is not the most likely Counterfactual scenario. There are other Counterfactuals that are more likely.

(b) Because of this, the benefits identified by the Applicants and NECG have an inflated value.

(c) Certain of the benefits claimed are dubious.

(d) The competitive detriments are under-stated.

Detriment Analysis in the Restrictive Trade Practices Application

6.3 WIAL has not engaged independent specialist advisors to check either the validity of the conceptual approach used by NECG or the algebra of any of its calculations. At this initial stage WIAL relies on the Commission to undertake this work.

6.4 WIAL's comments below are therefore limited to the statements in the NECG Report.

Allocative efficiency (paragraphs 348-371 – Restrictive Trade Practices Application)

6.5 As a general point, in light of the broad scope of the restrictive trade practices set out in the Strategic Alliance Agreement, WIAL questions the relatively small amount of detriments quantified by the Applicants.

6.6 As noted in paragraph 2.4 above, the Strategic Alliance Agreement provides for the co-ordination of almost all aspects of the Applicants' operations in most areas on which the Applicants would normally compete.

6.7 It is therefore surprising to see the relatively low level of allocative efficiency detriments identified by NECG, and to see that these are limited to pricing detriments. WIAL would have expected some detriments by way of reduction in service quality and other aspects of quality.

6.8 WIAL also questions the level of claimed detriments in comparison to the Commission's analysis in its *Air New Zealand; Ansett Holdings Ltd; Bodas Pty Ltd* decision, which related only to domestic flights and did not consider the effects upon Trans-Tasman flights.

6.9 WIAL therefore suggests that the Commission needs to examine critically the Applicants' claims about detriments and pricing detriments particularly.

6.10 As a point of detail, WIAL is uncertain whether the relative price changes and passenger volumes (paragraph 355) are based on the Factual including or excluding the VBA. The table below shows the capacity and passenger assumptions for year 3 compared to the latest information available to WIAL.

6.11 The table below shows the workings to reconcile back to paragraph 355.

Table 4 -Weekly Trans-Tasman Volumes

	Current	Year 3 Excl VBA	Year 3 Incl VBA
Trans-Tasman capacity	12,136	12,408	16,368
Trans-Tasman pax	457,597 (divided by 52 = 8,800)	8,800 (times) 1.173 = 10,322	8,800 (times) 1.173 = 10,322
Trans-Tasman implied loads	72%	83%	63%

6.12 WIAL has difficulty reconciling the high load factor outcomes under the "excl VBA" column with assumptions on price competitiveness.

6.13 In the "with VBA column" the loads are inconsistent with the low margin VBA model that requires high loads to be profitable.

6.14 In summary, the numerical out-workings do not reconcile with a commercial view of the airline business. The Commission needs to question this.

6.15 It is unclear whether the NECG modelling accounts for the withdrawal of United Airlines from the Auckland-Los Angeles route and the impact of the cooperation agreement between the Applicants and Air Pacific. It is also unclear whether the impacts of the Strategic Alliance Agreement examined how the Applicants' ability to control the yield might reduce demand.

6.16 NECG has dismissed integration costs arising from the Strategic Alliance on the basis that they would be offset from the opportunities for more efficient fleet allocation and maintenance. The problem with this point is that it double counts the benefits of efficient fleet allocation and maintenance. NECG also argued that integration costs would be relatively insignificant on the basis that the parties themselves are well aware that such a cost exists and believe that they are still better off under the Strategic Alliance and that integration costs are one-off. Neither of these reasons, however, provide justification for considering the integration costs as insignificant. Further, we note that at page 135 the NECG report states that "*the parties to this Strategic Alliance acknowledge that integration is costly*".

6.17 We therefore question whether there is any justification for not counting integration costs.

Productive Efficiency (paragraph 372 – Restrictive Trade Practices Application)

6.18 The Application contains no meaningful statements on which to comment.

6.19 WIAL notes that in the *Air New Zealand*; *Ansett Holdings Ltd; Bodas Pty Ltd* decision, the Commission found a loss of productive efficiency in domestic passenger air services of between $8m and $80m. This was seen to arise from the lack of incentives on Air New Zealand to minimise costs and to avoid waste. We question whether it is appropriate for the Applicants to claim that there will be no loss of productive efficiency arising from the Strategic Alliance, particularly in light of our questions about the Counterfactual and the Factual.

Product/Service Quality (paragraph 373 – Restrictive Trade Practices Application)

6.20 The basic assumption is that relative to the Counterfactual, the Application is more likely to lead to a VBA entering the market and thereby increasing the spread of service offerings.

6.21 In earlier parts of this submission, WIAL has questioned the validity of the assumption that the Alliance makes VBA entry more likely, and does not repeat those comments.

Dynamic Efficiency (paragraph 374-376 – Restrictive Trade Practices Application)

6.22 The Applicants' conclusions of dynamic efficiency rest on the twin assumptions that the Application increases the likelihood of VBA entry and that the competition under the Counterfactual will be at such a level as to reduce investment capability.

6.23 As noted above WIAL questions those assumptions.

6.24 In the *Air New Zealand; Ansett Holdings Ltd; Bodas Pty Ltd* decision, the Commission found a loss of innovative efficiency between $8m and $20m per annum. We question whether it is appropriate for the Applicants to claim that there will be no loss of dynamic efficiency arising from the Strategic Alliance, particularly in light of our questions about the Counterfactual and the Factual.

Benefit Analysis in the Restrictive Trade Practices Application

Cost efficiencies (paragraphs 383-385 – Restrictive Trade Practices Application)

6.25 WIAL considers the NECG approach of ascribing a $0 to the economies of scale to be appropriate.

6.26 WIAL notes that NECG ascribe significant aircraft selection benefits to the Factual relative to the capacity driven competition Counterfactual. The question, addressed above, is whether the Applicants' Counterfactual is the only credible scenario.

Scheduling efficiencies (paragraphs 388-398 – Restrictive Trade Practices Application)

6.27 WIAL considers that the benefit of "enhanced connectivity" ought to be further explored. Currently Air New Zealand and Qantas are members of global alliances that together provide high levels of connectivity. However, we note that NECG (section 5.2.2) has not attempted to quantify the purported benefits. The fact that a decision on global alliances may be made in the future is no reason to avoid addressing the matter now. In WIAL's view, the most likely result if the Strategic Alliance proceeds is that one of the Applicants will withdraw from its global alliance. This should be taken into account by the Commission.

6.28 The Applicants are clear that they will look to rationalise capacity, utilising code-share arrangements and increase the size of aircraft on some routes. The NECG schedules confirm this point.

6.29 For Wellington, many of the competing Trans-Tasman services will likely be moved to a code-share arrangement. In paragraphs 390-391 of the Restricted Trade Practices Application, this is presented as a benefit because passengers have more choice of flight times. Analysis of the NECG schedules, however, shows a reduction in the weekly number of Trans-Tasman flights from 96 to 66.

6.30 WIAL is unable to reconcile the idea of a reduction in flight numbers and the potential loss of one global alliance with any notion of enhanced connectivity and benefits that might flow from that. The Commission needs to review the assumptions.

6.31 The effect of this global alliance loss will not be evenly felt around New Zealand. Auckland may continue to have airlines from both major global alliances. Other New Zealand airports will not. The effect will be marked. Today, for example, it is possible to buy a ticket from Wellington to London on both alliances. If the Strategic Alliance proceeds, that multi choice is likely to be removed.

Tourism benefits (paragraphs 399-416 – Restrictive Trade Practices Application)

6.32 Although the Applicants claim significant tourism benefits, WIAL considers that there could be considerable tourism detriments from the Strategic Alliance. Air New Zealand has provided substantial and critical marketing support to Tourism New Zealand and the regional tourism organisations over many decades. Air New Zealand's focus has been on promoting New Zealand. This has been achieved through various mediums, from direct promotional support, through to providing very competitive fares to the tourist and inbound wholesaler groups for their New Zealand travel packages.

6.33 A serious concern is that this focus on New Zealand and the level of historical marketing support will diminish over time.

6.34 Simple examples of actions that may be taken by the Applicants include:

(a) Promotional funds to tourism groups may be reduced or withdrawn.

(b) Tourism groups and inbound wholesalers may not be offered sharp fares for inclusion in their travel packages.

(c) Air New Zealand's inflight magazine and other promotional material may be scrapped and New Zealand as a destination could become the back pages in the Qantas inflight magazine.

(d) The Strategic Alliance may rationalise retail outlets worldwide, with the potential loss of Air New Zealand's brand name on "High Street".

(e) Sports sponsorships may be reduced.

6.35 The impact of reduced marketing support may not be immediate but over time it will undoubtedly have a detrimental impact on tourist numbers.

6.36 Turning to the Applicants' claims, the Application identifies significant growth in New Zealand tourism numbers because:

(a) Qantas Holidays will have the right commercial incentives to sell New Zealand destinations – which WIAL accepts is a reasonable inference.

(b) Joint Australia/New Zealand destination marketing will be more effective than marketing each destination separately – which is an assumption that WIAL considers ought to be questioned by parties with branding etc expertise.

6.37 WIAL notes that if Qantas Holidays is incentivised correctly under the proposed Strategic Alliance, then its incentives ought to be the same, if not greater, under any of the Counterfactuals. The Commission should check whether that assumption has been carried through.

Engineering and Maintenance (paragraph 417–420)

6.38 While the precise wording of paragraph 417 is confusing, WIAL infers from the overall comments that, absent the transaction, Qantas would not continue to source engineering services from Air New Zealand. Qantas would then apparently source services from other third parties with whom it has no arrangement and whose prices/quantity are at best “similar”.

6.39 Qantas may indeed carry through on its threat but if it did so it would seem to be acting in a manner that neither yielded any safety, quality benefits, nor created shareholder wealth. Paragraphs 241-243 appear to better describe the workings of the engineering services market.

6.40 The Commission should question the assumption that Qantas would act in the manner described in paragraphs 417-420.

6.41 Clause 4.7 of the Strategic Alliance Agreement states that Qantas will treat Air New Zealand as its preferred external supplier of heavy maintenance services provided that Air New Zealand’s charges and services remain competitive with other external alternatives available to Qantas. This provision does not prevent Qantas using its own internal heavy maintenance services in preference to Air New Zealand’s. Further, this provision is subject to the qualification that Air New Zealand’s charges and services remain competitive. WIAL therefore questions whether this provision provides sufficient assurance for the Applicants to be able to claim the alleged engineering and maintenance benefits set out in the NECG Report.

Improved freight operations (paragraph 421-424 – Restrictive Trade Practices Application)

6.42 WIAL notes that the Wellington Region is poorly served for airfreight capacity, in particular since the withdrawal of B767 aircraft 4-5 years ago.

6.43 Air New Zealand’s introduction of A320 aircraft configured for containers was seen as a positive step. WIAL accepts that any extra freight capacity arising from the Application ought to be counted as a benefit.

Other benefits (paragraphs 425-428 – Restrictive Trade Practices Application)

6.44 WIAL notes NECG has not ascribed a $ value to these issues.

Proposed undertakings to ACCC

6.45 The Applicants have proposed a number of undertakings to the ACCC , apparently as an attempt to mitigate the competitive detriments from the proposals and ensure that some of the benefits arising from VBA entry are achieved.

6.46 WIAL understands that the Commission has no power to accept behavioural undertakings of the nature proposed by the Applicants to the ACCC in respect of applications for authorisation of share acquisitions. WIAL understands that under section 69A of the Commerce Act, the Commission may, in relation to applications for authorisation of share acquisitions, accept undertakings only to dispose of assets or shares.

6.47 WIAL understands that for applications for authorisation of restrictive trade practices, there is no similar power to section 69A for the Commission to accept any kind of undertakings. The Commission can grant authorisations subject to conditions but WIAL understands that the undertakings proposed fall outside the scope of conditions that could be accepted by the Commission.

6.48 WIAL therefore understands that the Commission must ignore the proposed undertakings in considering both applications.

6.49 Incidentally, WIAL notes the International Air Services Commission (of Australia) submission to the ACCC, which states that the *"undertakings as they stand appear to be vague in several respects and open to interpretation".*

Competitive Detriment and Benefits arising from the Share Acquisition

6.50 As discussed in paragraphs 2.22-2.27 above, WIAL understands that the Commission must separately identify the competitive detriments and the benefits of the share acquisition from the competitive detriments and the benefits of the Strategic Alliance Agreement.

6.51 The NECG Report appears to describe the competitive benefits and detriments arising only from the Strategic Alliance Agreement.

6.52 Competitive Detriments that could arise from the Share Acquisition alone include a reduction in competition caused by Qantas, access to important confidential information and possible Qantas influence on Air New Zealand decision-making.

6.53 It is for the Applicants to establish the distinct benefits arising from the Share Acquisition.

Independent operation of Air New Zealand if Alliance terminated

6.54 In giving its in-principle approval to the Strategic Alliance, the Government wrote to Air New Zealand advising that it should ensure that any direct and indirect costs to Air New Zealand from any future termination of the Strategic Alliance are minimised and that, in the event of termination, Air New Zealand will be able to operate independently from Qantas within a reasonable period of time.

6.55 For Air New Zealand to give effect properly to these requirements, it will need to ensure that it does not become commercially and operationally intertwined with Qantas. This may require some changes to the level of integration or co-ordination envisaged in the Strategic Alliance Agreement.

6.56 These changes, and their consequent dilution of the claimed public benefit will need to be accounted for by the Commission.

7. ACCESS TO AIRPORT FACILITIES AND SERVICES AT WELLINGTON

Overview

7.1 The Applicants consider that access to airport facilities and services are not significant barriers to entry for a new airline.

7.2 As far as Wellington is concerned, the position in relation to airport facilities is unique in Australasia. In constructing the new terminal, (and after settlement of Air New Zealand High Court proceedings in 1996 seeking the right to construct its own terminal) WIAL moved from a position where the airport and airlines each owned parts of the airport infrastructure to the situation where WIAL owns all the infrastructure and leases it to users.

7.3 Prior to construction of the new terminal there was no consistency between the property rights of respective airlines and WIAL. The new structure provides airlines with a common set of rights.

7.4 As all airport facilities are now provided by WIAL, at Wellington, airlines are unable to create complex barriers to entry of new competitors e.g. when Ansett New Zealand was set up it was obliged to build terminals throughout New Zealand to enable it to compete with Air New Zealand.

7.5 Another unique feature of Wellington is that airlines can use the same gate for domestic and international services.

7.6 In the case of operators wishing to use Wellington Airport, WIAL therefore agrees with the Applicants that there are no significant barriers to entry. A new entrant would be able to obtain access to facilities on reasonably short notice, as further discussed below, although some changes to the current gate and counter agreements would be required.

Potential constraints – and likely implications

7.7 If a VBA entered the market, its core airport requirements are access to:

(a) Runway (and airspace) occupancy times during peak hours.

(b) Check-in desks, baggage collection, baggage makeup and reclaim.

(c) Convenient gate positions and security processing.

(d) Proximate office/back of house.

(e) Means of communicating flight information to passengers.

7.8 In addition the VBA will need to have arrangements in place to staff these facilities, plus provision of engineering, ground handling and other services but those items are outside WIAL's direct interest.

Runway and Airspace During Peak Hours

7.9 As the NECG Report notes, a combination of low minima and peak hours gives rise to capacity constraints and delays. The industry has endeavoured to deal with this in a cooperative manner to date through the Capacity Forum. In addition, the replacement of the slow E110s with higher performing turbo props and reduced overall volumes has seen the problem diminish over recent times.

Check-in desks, baggage collection, baggage make up and reclaim

7.10 Check-in counters, the cable network that serves them and the baggage system are all owned by WIAL. The check-in systems hardware and software is either provided by airlines individually, or collectively as part of a CUTE arrangement. WIAL has no role in provision of those systems.

7.11 Access to counters is managed by means of a counter agreement that formed a schedule to the 1997 Deed Relating to Airport Charges and Services from 1 July 1997 until 30 June 2002 (the Deed). Although the Deed expired in 2002, features of the counter arrangement endure.

7.12 Access to a counter gives access as of right to all elements of the baggage system excepting reclaim belts.

7.13 WIAL and the Applicants would need to activate elements of the counter agreement to accommodate new arrangements, but this does not loom as a major barrier.

Convenient gate positions and security processing

Domestic

7.14 Although all gates and aerobridges are owned by WIAL, the Applicants do have preferential access to certain of those gates. This reflects historic practice, a desire to have the same daily service from the same position, and the clustering of supporting proprietary systems and facilities around the gate.

7.15 Access to gates is managed by means of an Aircraft Stand Allocation Agreement (Stand Agreement) that formed a schedule to the 1997 Deed. In common with the counter arrangements, although the Deed expired in 2002, features of the Stand Agreement endure until 2005.

7.16 The key issue for competitive entry is to secure access to the same set of gates on a daily basis thereby allowing the supporting operations (eg gate boarding and reconciliation etc) to cluster in the same area.

7.17 The Stand Agreement would need to be revisited.

International

7.18 International gates do not operate under a formal preferential access basis, although the Applicants, amongst themselves, have established an allocation mechanism that contains certain preferential elements. While the Applicants are the sole international operators, WIAL considers the airlines' approach to be pragmatic and reasonable.

7.19 Airlines endeavour to utilise their aircraft for two return Trans-Tasman flights a day. Given curfew conditions this means WIAL has peak occupancy 0600–0730 being early morning departures, 1430-1600 mid afternoon arrivals and departures, and 2300 – 0100 being late night arrivals. During this period there are routinely 4 aircraft on the ground. During other periods the gates are mainly empty.

7.20 Accommodating a new entrant in the off-peak hours would be a simple matter.

7.21 If the new entrant commenced during the peak hours, which WIAL considers more likely, the Stand Agreement would need to be revisited.

Proximate office/back of house

7.22 Given that all airlines pay the same $/m^2 rates, and that some spaces are available or able to be created WIAL sees no apparent limitations for a new entrant provided they pay equivalent rates.

Means of communicating flight information to passengers

7.23 WIAL owns PA systems and the Flight Information Display System (FIDS).

7.24 The Applicants have different arrangements for FIDS. Qantas updates information by means of a feed from its systems to WIAL. Air New Zealand utilises WIAL's hardware and software to run certain of its back of house operations and updates directly or via a feed from its other systems.

7.25 Provided conventional data integrity/security issues can be met by a new entrant, either approach above is possible. Therefore WIAL sees no apparent limitations for a new entrant.

Conclusion

7.26 There are no apparent major airport facilities constraints for new market entrants at Wellington Airport.

7.27 There are details in both the existing Counter and Stand Arrangements that require change if the Application, and new market entrant were to be accommodated.

7.28 The Agreements allow for those to be negotiated in the normal course of events.

7.29 With goodwill between the parties, WIAL sees no reason why any re-negotiation could not be completed.