CROSS - SUBMISSION TO THE COMMERCE COMMISSION IN RESPECT OF THE SUBMISSIONS OF AIR NEW ZEALAND LIMITED AND QANTAS AIRWAYS LIMITED ON THE COMMERCE COMMISSION'S DRAFT DETERMINATION

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INTRODUCTION

1. The Save Air New Zealand group wishes to note its disagreement with the conclusion drawn by, and certain salient assertions contained in, the submission of Air New Zealand and Qantas Airways on the Commerce Commission's draft determination.

2. Save Air New Zealand relies on the Commerce Commission to continue to exert its expert judgement and to retain its original findings in the face of a range of misleading opinions as expressed in the Applicants' submission.

3. Save Air New Zealand has previously noted its scepticism about the use of detailed computer models to determine whether such complex transactions should occur or not. It is noted that the Applicants claim to have found flaws in the Commission's modelling work. Be that as it may, the simple logic of the propositions should not become subservient to fallible modelling work.

COMMENT ON THE APPLICANTS' APPROACH

4. It is noted that the Applicants have not materially modified their proposal. The transactions' structure and intention remains unchanged. The Applicants' case for being authorised to progress mainly rests on their proposition that the Commerce Commission was substantially wrong in its draft determination.

   This seems to be an unusual approach for companies that presumably focus on both risk and return. Most companies when faced with such a rejection would modify their proposal as well as attacking the critique. This may mean targeting a bit less than the desired outcome, but would increase the chances of getting something out of the transaction.

5. The Applicants' "all or nothing" approach should be noted by the Commerce Commission as a signal of the style and quality of the commercial judgements behind the Applicants' case.

   If a normal commercial approach to risk and return, the usual give and take, have not been employed in this area, it should raise questions as to other symptoms. These may include a high degree of extremism and irrationality in respect of much of the Applicants' "logic".

6. A particular instance of irrationality in the Applicants' proposition is in respect of the structure of Air New Zealand's basic case as expressed in the Application and as regularly reiterated by them in the media.

   This states that Air New Zealand needs these transactions to enable it to maintain its international network. Yet these transactions will garner Air New Zealand few if any benefits in its international areas of operation (taking international to mean exclusive of Tasman services).

7. The unique benefits to the Applicants of the transactions are two-fold:

(i) They would reduce competition within New Zealand and on the Tasman. The airlines will be able to charge more and provide a lower quality of service than would otherwise be the case.

(ii) Qantas Airlines would be able to "lock out" any other party that could be interested in becoming a shareholder in Air New Zealand, which would enable Air New Zealand (and other partner) to become an increased threat to Qantas.

All other benefits are not unique and/or are more problematic.

Neither area of benefit provides any advantage to Air New Zealand on its international service.

8. If Air New Zealand is a profit maximising company driven by an intention to achieve its cost of capital, it is hard to see how the transactions would influence its willingness, or capacity, to invest in its international services.

COMMENT ON PARTICULAR ASSERTIONS OF THE APPLICANTS

9. The Applicants' case, as defined in the submission on the Commerce Commission's draft determination, has undergone a subtle change relative to that originally put forward. There is now a core assertion that:

◊ VBA will come to New Zealand and the Tasman no matter what.

◊ VBA will set the prices in those markets.

In other words, whether the transactions occur or not the price in these markets for air travel will be the same.

10. Various tables and graphs are presented to support these assertions. The information seems far removed from the Australasian market. Experiences in Australasia have included:

◊ The serial failure of incoming airlines to compete with Qantas in Australia until Ansett's failure.

◊ The failure of Kiwi Air.

◊ Freedom's seeming limited impact on fares on the routes it services notwithstanding it achieving over 5% capacity on at least some of its routes.

◊ Freedom's negligible impact on New Zealand domestic fares/services during the period it operated domestically. Yet when Freedom withdrew Air New Zealand did have a major impact on fares, and demand, when it introduced "Express".

11. There are several implicit assertions to the Applicants claims that VBA will come and will set prices. Most notable is that VBA will make a satisfactory return on capital. Given Air New Zealand's advantages:

◊ As the incumbent "national carrier"

◊ The fact that it is mainly owned by New Zealanders who understand the benefits they get from patronising the airline in which they have invested.

◊ Its widespread community support.

◊ Its recent 20% reduction of fares and apparent maintenance of profitability.

◊ Its ability to "wheel in" Freedom to suit.

◊ Its extensive network. Which provides both feed and ability to cross-subsidise.

◊ Its existing marketing arrangements and networks.

◊ Its existing airport positions (in respect of gates, lounges, check-in areas).

◊ Its highly sophisticated and developed understanding of the New Zealand market and the approach it takes to segment that market to ensure that it optimises revenue given the different demand characteristic of different types of airline users.

It is apparent that any new entrant, even one as effective and efficient as Virgin Blue, will not find it easy to achieve a satisfactory return on capital if the commitment of capital is to be substantive.

12. A more commercially plausible VBA entry (than that proposed by the Applicants) will entail the incremental addition of services, probably based on taking advantage of the feed Virgin Blue can source from, or provide to, its Australian operations.

It is more likely that this nature of incremental addition of services will be more "price taking" than "price marking".

It should be noted by the Commerce Commission that:

◊ Unlike the Applicants, Virgin Blue is shortly to raise capital via a partial float of is shares. To achieve a good rating on these shares it will need to show sound business sense and that its investment plans provide a satisfactory return on capital.

The Applicants have "sunk capital", Virgin Blue does not. This is an important distinction.

◊ Virgin Blue has no proven cost, or any other, advantage vis-à-vis Air New Zealand.

◊ Any capital Virgin Blue commits to New Zealand will have to achieve a satisfactory return notwithstanding its disadvantages as the new-comer taking on the National carrier.

13. It may also be noted that there are various implied assertions made by the Applicants that in any three way struggle between Air New Zealand, Qantas and VBA, that Qantas's access to capital and VBA's low operating costs mean that it is Air New Zealand that will suffer.

Given Qantas' problems and that fact that it too must commit marginal capital to New Zealand if it is to force Air New Zealand's retrenchment, it seems more plausible to expect Qantas to be the loser from a three way battle, should it eventuate.

14. The Applicants have criticised the Commerce Commissions findings that airfares are likely to be substantially different depending on whether the transactions occur.

    It is noted that since 1990 the cost of domestic air travel has risen 66%. The cost of international air travel has risen 2%. (March quarter 1990 to June quarter 2003. Source Department of Statistics.

    It is clearly apparent from these figures that wide discrepancies in airfares can eventuate given different competitive dynamics.

    Australian data that breaks down fares by Business, Regular and Discount air service also shows that fares can vary markedly between market segments, even in the same geographic market, if there are different levels of competition in each market segment. (Australian Bureau of Transport and Regional Economics).

SUMMARY

15. The Applicants' submission contains few new suggestions. Its main argument is that the Commerce Commission got it wrong in the draft determination.

    Save Air New Zealand does not believe that the Commerce Commission got it wrong.

    Save Air New Zealand considers that the Applicants "all or nothing" proposal is indicative of a lack of commercial judgement.

16. There is no reason, given the history of commercial aviation in New Zealand and Australia to believe that VBA will come what may and will dominate the market.

17. Given the requirements on both Virgin Blue and Qantas to achieve a satisfactory return on capital committed to the New Zealand and Tasman markets, and their disadvantage to the incumbent Air New Zealand, it is likely that "normal" competitive markets will be the counterfactual should the Commerce Commission continue to interdict the transactions.

18. As shown by the Department of Statistic historic series. The cost of air travel can vary greatly between markets, where seemingly the main (if not only) difference is the level of competition in the respective markets.