Submission on the Draft Determination
of the NZ Commerce Commission on the matter of:

Commerce Act 1986 – Section 58 Application by Air New Zealand and Qantas Airways Ltd

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Background:

Bon Voyage Marketing Ltd is a travel company operating as **Bon Voyage Cruises and Travel** and **e-travel.co.nz** . The company has been trading for 9 years and operates as a personal travel consultancy for leisure and business travellers and a retail travel agency. The company is totally independent in ownership and operation.

Gerard Murphy has been involved in the travel industry for over 20 years and has held roles from Travel Consultant through to General Management in wholesale and retail travel companies and travel groups, prior to forming this business. Gerard holds tertiary qualifications in travel consultancy, marketing and management.

Being in daily contact with those most affected by these proposals, the members of the travelling public and with over 20 years experience in this industry and with over 20 years experience of dealings with the two protagonists, we believe we are uniquely qualified to offer a common sense view.

This Submission:

This second submission builds on our preliminary submission and addresses:

- The Draft determination and questions posed by the NZ Commerce Commission
- Air New Zealand and Qantas undertakings announced 13 May 2003
- Comment on marketplace developments since February 2003

We again looks at the effects of the proposed merger on New Zealanders travelling both domestically and internationally, as this is the main area of our business operation. We leave those more involved to address the ramifications of the proposed merger on the inbound tourist market and freight markets.

We reiterate that while this merger proposal makes great financial sense to the executives on performance bonuses, board members and shareholders of the respective carriers. It is hugely enriching to all those parties but at a huge cost to the New Zealand consumer.

Our view is that the proposed merging of Air New Zealand's and Qantas' New Zealand based operations and Qantas' shareholding in Air New Zealand should not be approved for the following reasons:

- The proposal is still plainly anti-competitive with no real consumer benefit for New Zealanders, in fact the opposite.

- The undertakings from Air New Zealand / Qantas are of little value.

- Entry of new airlines on the Auckland Trans-Tasman routes does not substantially change the monopoly position NZ/QF will achieve through the merger and in no way alleviates the monopoly position in the New Zealand domestic market nor the North American market.

- The proposed merger is not in New Zealand's national interest – tourism and/or employment.

- The proposal will result in a market dominant virtual monopoly, forcing structural changes detrimental to the sustainability of the NZ travel agency sector and to services to the consumer.

The Draft Determination:

We largely concur with the findings and conclusions made by the NZ Commerce Commission and the ACCC in their draft determinations.

We do have different views on the importance, position and function of the "Tour Operators / Wholesalers" and "Retail Travel Agents". Our position is very close to that of the Travel Agents Association of New Zealand (TAANZ) detailed in their submission of 20 June 2003.

Commerce Commission Questions:

We received a set of "Draft Determinations Questions" from the NZ Commerce Commission sent to all submitters in April and we wish to comment on a number of these questions directly:

Q1. The Commission seeks comment on its approach of considering the two applications together.

We agree with the NZCC approach.

Q3. The Commission seeks comment on the financial viability of Air NZ in the near term.

It is our belief that Air New Zealand is exaggerating its financial position downwards. Air New Zealand's outbound revenue for 9 months to April is up on last year, domestic revenue is up. Without doubt SARS and the Iraq War will be blamed for some downturn but we would suggest that Air NZ also benefited significantly from Europe bound passengers switching off Asian carriers to Air NZ services via Los Angeles.

The effect of USD exchange rates is positive and fuel prices have stabilised. Overall barring what will be a relatively short term blip caused by SARS, Air New Zealand is in a significantly better position than 18 months ago.

The airline still needs to make significant capital investment to update its international mid-range and long range fleet to remain competitive. This investment is required with or without the NZ/QF merger. There is no evidence that Air New Zealand cannot obtain these funds through public share placement or other alternative funding avenues.

Q5. The Commission seeks comment on the likelihood of the "war of attrition" counterfactual as proposed by the applicants.

We do not believe there is any evidence in their history, in the applications or any submissions that Air New Zealand and Qantas would get really involved in a war of attrition. Neither airline can afford to – even though both airlines are large enough to die very slowly in such a war, the cost to the victor would be inordinate compared to the future value of the victory.

Q6. The Commission seeks comment on the capital requirements of entry to the main trunk market and particularly seeks comment on whether the capital requirements constitute a barrier to entry to the market.

The Newmans, Ansett New Zealand and Tasman Pacific experiences indicate that for a carrier to provide a competitive schedule on the main trunk for the lucrative corporate sector they would require 5 or 6 jet aircraft of the 737 size. Any smaller fleet produces a skeletal timetable and fleet availability unable to cope with weather or break-down disruptions (as experienced more recently with Qantas operating just four 737s until recently).

While some of the airlines mentioned above are widely acknowledged now to have been poorly managed and saddled with excessive costs structures (Ansett and Tasman Pacific aircraft lease arrangements and terminal development), Virgin Blue and others have demonstrated that start-up airlines can be efficiently managed and profitable. The start-up capital requirement is still significant and is a barrier to entry

9. The Commission seeks comment on the likely incumbent response to entry to the main trunk market and particularly seeks comment on whether the likely incumbent response would constitute a barrier to entry to the market.

Air New Zealand and Qantas merged, or as separate entities, would fight fiercely against any new entrant. Air New Zealand has inordinate market power already with its main trunk and regional networks and can compete on schedule, not just price. Air New Zealand mercilessly aided the suicidal tendencies of Kiwi Air then retained Freedom Air acknowledging it as a strategic barrier to entry to new players on domestic and Trans-Tasman routes.

Qantas while smaller in New Zealand has demonstrated in Australia many times how it handles and generally disposes of new and old competitors to its market. Examples include Compass twice, the dying Ansett Australia, Impulse Airways and in recent years Virgin Blue. A merged Air NZ/Qantas would make entry to the main trunk in any meaningful scale impossible.

10. The Commission seeks comment on the scale and scope required for entry to the main trunk market and particularly seeks comment on whether the scale and scope required constitutes a barrier to entry to the market.

See response to Q6 above

12. The Commission seeks comment on availability of travel distribution services required for entry to the main trunk market and particularly seeks comment on whether access to these services would constitute a barrier to entry to the market.

There is no barrier to entry due to distribution and indeed competition would be welcomed and assisted by the retail and corporate travel agent networks.

13. The Commission seeks comment on whether feeder traffic is required for entry to the main trunk market and particularly seeks comment on whether access to feeder traffic would constitute a barrier to entry to the market.

Approximately 60% of main trunk travel is for business reasons and these travellers pay significantly more than leisure travellers so are the bread and butter of domestic airlines. Rather than considering provincial routes as “feeder” traffic to main trunk flights, the consideration should be given to the importance of a comprehensive network to a main trunk airline.

The ability of business travellers to take round trips involving main trunk and provincial routes with single ticket and billing transactions is vital. Large corporate requirements would favour having just one ‘preferred’ airline deal. Qantas has attempted to achieve this by partnering with Origin Pacific in the regions with mixed success. Air New Zealand dominates this sector.

Q14. The Commission seeks comment on whether access to a CRS or GDS is required for entry to the main trunk market and particularly seeks comment on whether access to CRS or GDS would constitute a barrier to entry to the market.

No airline of any scale could operate without a CRS (computer reservations system), but many airlines overseas and Origin Pacific in New Zealand have operated without connection to a GDS. It should be noted that Virgin Blue now offers travel agents connection through the Sabre GDS – this move was made in 2002 to assist it in securing large corporate accounts in Australia via travel agents. We do not believe access to a GDS is a barrier to entry.

Q16. The Commission seeks comment whether loyalty schemes, either the presence of existing incumbent schemes, or a requirement to develop one, would constitute a barrier to entry to the main trunk market.

Air New Zealand and Qantas operate the two major loyalty schemes in the New Zealand market. The next most popular schemes being United Airlines’ Mileage Plus and Thai Airways’ Royal Orchid scheme are compatible with Air New Zealand’s Airpoints scheme.

Air New Zealand’s Airpoints and Qantas Frequent Flyer schemes should be viewed as a significant barrier to entry in the corporate travel sector.

While a new competitor can compete on price without offering a loyalty scheme in the leisure market, as evidenced by Freedom Air, our experience is that a significant number of leisure travellers chase frequent flyer points particularly since non-flying loyalty schemes such as those offered by credit card companies enable them to earn significant Airpoints or miles.

A proportion of leisure travellers will pay a higher fare to stay with their nominated airline to earn points. The surcharge paid is sometimes higher than the value of points earned; such is the pulling power of these schemes!

Air New Zealand has used its Airpoints scheme very effectively as a competitive weapon in the last 10 years to the point that even Qantas was forced to match its frequent flyer offers just over 12 months ago. Without Airpoints Air New Zealand would not have survived its last financial crisis.

Q17. The Commission seeks comment whether the need to either have a recognised brand, or the requirement to develop a brand would constitute a barrier to entry to the main trunk market.

More important than an established brand would be a perception of financial strength. Any new entrant can quickly build brand equity by building on the publicity that would be generated purely through their presence! This brand position can be converted to direct sales, but only if the entrant is believed to be financially strong. After Kiwi Air and Canada 3000 people will be wary of a small or unknown entity.

Virgin Blue has significant brand awareness in New Zealand already, with no advertising or physical presence. Indeed many members of the public think Virgin Blue fly here already!

Q21. The Commission seeks comment on whether Virgin Blue is likely to enter the main trunk market under both the factual or counterfactual scenarios.

If the NZ/QF merger proceeds we believe Virgin Blue will not enter the NZ domestic market in the short term. The merged entity would have dominance not worth attacking in the short term. They may offer positioning flights but these add nothing to the competitive environment.

It is simple for Virgin Blue to fly the Trans-Tasman routes with two cycles (four flights) per day from its Australian bases with limited infrastructure and personnel investment in New Zealand. To create a competitive presence in the New Zealand domestic market it would really be required to base aircraft and crew here. The investment requirements and risk are substantial. We see Trans-Tasman as their first priority

Q22. The Commission seeks comment on whether Origin Pacific would be likely to expand in the main trunk market under both the factual or counterfactual scenarios. Alternatively, the Commission seeks comment on whether Origin Pacific would be likely to retrench in the event that the proposed Alliance proceeded.

Origin Pacific has answered these questions directly in their 20 June submission.

Q23. The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the main trunk market when compared with the counterfactual.

Answered in Q9 above

Q24. The Commission seeks comment on the barriers to entry to the provincial market.

Answered in Q9 and Q13 above

Q25. The Commission seeks comment on whether Virgin Blue is likely to enter the provincial market under either the factual or counterfactual scenarios.

Highly unlikely given their 737 jet only fleet!

Q26. The Commission seeks comment on whether Origin Pacific would be likely to expand or retrench in the provincial market under either the factual or counterfactual scenarios.

Origin Pacific has answered these questions directly in their 20 June submission.

Q27. The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the Provincial market when compared with the counterfactual.

The merged Air NZ /Qantas airline would completely dominate the NZ domestic market as a virtual monopoly. Suggestions that the two airlines would retain separate brands and fleets under one management are beyond rational belief! In summary there would be no effective competition, particularly on main trunk routes and in the corporate travel market

Q28. The Commission seeks comment on the barriers to entry to the Tasman market.

We do not see any significant barriers to entry for an established airline to compete on the Trans-Tasman market assuming traffic rights exist for them to do so.

A start-up airline faces significant the barriers of funding, scale and market perception. A start-up airline would need at least four 737 equivalent aircraft to have any chance of mounting a competitive schedule. The days of a one aircraft start-up such as Kiwi Air are long gone.

Q29. The Commission seeks comment on whether Virgin Blue is likely to enter the Tasman market under both the factual or counterfactual scenarios.

Our belief is that Virgin Blue will fly the Trans-Tasman routes regardless. The speed and scale of their entry will be influenced by the outcome of this application. We believe they will be able to compete effectively against Air New Zealand and Qantas as separate entities.

Their entry will be considerably more challenging with a merged NZ/QF competitor who can compete vigorously on scheduling, capacity and price. Richard Branson has demonstrated many times that he is not afraid of a fight and his lieutenants as Virgin Blue have shown their mettle again Ansett Australia, Impulse and Qantas. They have a huge public following in New Zealand already and would benefit from a perception as the airline that brought choice.

Their opposition to these applications is driven by self interest aimed at achieving significant market entry concessions. Anyone in the same position would adopt the same strategy.

Q30. The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the Tasman market when compared with the counterfactual.

A merged NZ/QF would have a monopoly position in all markets south of the Bombay Hills, and there would be no competition unless a new competitor arrived. Forced divestment or withdrawal of Freedom Air services will be of little assistance as Air New Zealand would enter the budget market with Express class service to compete head on with Freedom’s successor or replacement.

The merged NZ/QF would still have 70% of the market ex Auckland and as the competitors are largely fifth freedom carriers operating large aircraft they are unable to compete on schedule and are therefore unlikely to provide real competition in the corporate travel sector of the market.

Entry of Virgin Blue or other VBA's would aid competition but only in the leisure travel market as they would not initially offer the schedule demanded by corporate travellers.

Q31. The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the NZ-Asia market when compared with the counterfactual.

The lessening of competition depends on the route(s) and market sector. There is effective competition offered by Malaysia Airlines, Singapore Airlines, Korean Airlines and Thai Airways in their home markets. The NZ/QF merged airline would however have an effective monopoly on direct Japanese routes and Hong Kong through partnerships between JAL and Air New Zealand and Qantas; and between Cathay Pacific and Qantas.

It should be noted that Singapore Airlines, Malaysia Airlines and Thai Airways offer significant competition between New Zealand and most Asian destinations. This competition is more relevant for the leisure travel market, but less so for corporate travellers who prefer non-stop flights which these two airlines do not offer apart to their home ports.

Q32. The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the NZ-Pacific market when compared with the counterfactual.

With an NZ/QF merger there would be virtually no competition on the South Pacific routes. We repeat the list of destinations affected from our initial submission:

Fiji	Monopoly with Qantas/Air Pacific partnership.
Rarotonga	Air NZ existing monopoly position.
Apia	Virtual monopoly with Polynesian Airlines, a code-share partner of Qantas.
Noumea	Air NZ existing monopoly shared route with Air Calin.
Norfolk Island	Air NZ existing monopoly position.
Papeete	Limited competition from Air Tahiti Nui, itself a code-share partner of Qantas.

Q33. The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the NZ-US market when compared with the counterfactual.

With an NZ/QF merger there would be virtually no competition on the North American routes routes:

Honolulu	Monopoly with Qantas/Air Pacific and Air Canada/Air New Zealand.
Los Angeles	Monopoly on direct flights and very limited competition from Air Tahiti Nui, itself a code-share partner of Qantas.
Vancouver:	Monopoly with Qantas/Air Pacific and Air Canada/Air New Zealand

Q34. The Commission seeks comment on its preliminary view that the proposed Alliance would not have or be likely to have the effect of substantially lessening competition in the International market when compared with the counterfactual.

The NZ/QF merged airline should have less competitive effect on 'international routes' beyond Pacific rim gateway points due to the huge number of airlines and routes available.

The effect of either airline leaving its current alliance, putting both airlines in either Star Alliance or One World would have a significant influence on all routes including those beyond Pacific Rim points. This is covered further under Q41.

Q38. The Commission seeks comment on its preliminary view that the proposed Alliance would have or would be likely to have the effect of substantially lessening competition in the national wholesale travel services market when compared with the counterfactual.

As Air New Zealand and Qantas are the major suppliers of air seats incorporated in outbound package holidays, a merger between the two will significantly reduce competition in this sector.

Currently the wholesale travel services market is made up of six significant wholesale companies (with five owners), four of who have significant retail travel agency chain alignment:

Wholesale Company:	Ownership:	Retail travel agency alignment:
Escape Holidays	BTI Travel Group	Travelsmart, Harveyworld
Go Pacific	{PITC Australia/UK	Various
TAL Pacific	{PITC Australia/UK	Various
Gullivers Pacific	Andrew Bagnall	Holiday Shoppe, United Travel
Infinity	Flight Centre	Flight Centre
Travelplan Holidays	House of Travel	House of Travel

The merged NZ/QF airline no longer having competitive pressures between them could easily decide not to deal with any one or number of the companies listed above or as currently rumoured, purchase one of these operations effectively taking that wholesale operation in-house.

Such moves would have significant effect on the package holiday market and airfare consolidation and serious detrimental effect on one or more retail travel agency chains which are generally owned by individual owner-operator members.

Q39. The Commission seeks comment on its preliminary view that the proposed Alliance would result in fixing controlling or maintaining prices and is therefore deemed to substantially lessen competition.

One would hope that New Zealand competition law would preclude such activity! However if NZ/QF are allowed to jointly tender for corporate and government travel accounts the effect would be exactly the same as price fixing.

Maintenance and increase of prices due to a monopoly position in the Domestic and North American markets and dominance in the Trans-Tasman are discussed in other parts of this submission.

Q41. The Commission seeks further submissions on the implications of a possible switch by Air NZ to the Oneworld Alliance.

A switch by Air New Zealand to the **one**world alliance or by Qantas to the Star Alliance would have serious consequences for members of each airlines current scheme in New Zealand and for tourism in New Zealand. Further such changes would significantly limit choice for New Zealanders travelling 'around the world'.

Members of each airline's scheme in New Zealand, while their points would no doubt be protected, would lose access to the airlines they are used to flying and access to the airlines they have been expecting to be able to use for reward travel.

These worldwide alliances play a huge role in New Zealand tourism. Corporate Frequent Flyers overseas particularly in North America often use their earned points to 'purchase' reward travel tickets for their holidays to New Zealand. Many of these travellers are points fanatics.

A switch by either airline would eliminate all North American members of American Airlines' "Aadvantage" scheme (**one**world) or United Airlines' "Mileage Plus" who number in the millions of one scheme from accessing travel to New Zealand. Even if these customers were prepared to purchase a normal ticket to travel down here they would be deterred because such travel would not earn further points.

Such a switch with no member airline flying between Auckland and Los Angeles for either Star Alliance or **one**world makes the currently popular "Round the World" fares offered by each group a choice of one. Travellers of the other alliance, if there were no flights offered between Auckland to Los Angeles, would be forced to travel via Asia to North America. This involves additional flying, additional miles and higher fares! They would realistically be forced to take the choice of one!

Air New Zealand and Qantas Undertakings:

We wish to comment directly on one of the undertakings offered by Air New Zealand and Qantas to the NZCC:

The NZ/QF undertaking of **"A restriction of up to five years on increases on some Trans-Tasman fares"** is not worth the paper it is written on.

These airlines have vast departments and have made huge investments in computer technology to manage yield - the objective being to increase the total fare return on each route and indeed each flight. The airlines have the ability to manipulate fares to increase revenue, without publicly increasing advertised airfares.

A simple example below shows how revenue on a typical Trans-Tasman flight can be manipulated, improved, and average fares increased to the travelling public by close to 6% by slightly altering the 'stock' of seats at various price levels and actually selling less seats.

Sample Route / Fares: Return fare	Special Fare	14 Day Advance	10 Day Advance	7 Day Advance	Return Flight Revenue
Auckland Sydney Return	499.00	689.00	825.00	929.00	
Seats stock available	50	100	25	25	
	24950.00	68900.00	20625.00	23225.00	137700.00
Auckland Sydney Return	499.00	689.00	825.00	929.00	
Seats stock available	25	100	50	25	
	12475.00	68900.00	41250.00	23225.00	145850.00
					+5.92%

None of the fares published or advertised above has been increased, so the undertaking is 'honoured' but the average fare has in fact been increased.

In addition bulk buy contract fares with corporate clients can be cancelled at any time by the airlines, (as recently happened with 95% of all Air NZ domestic contract fares) providing a revenue and fare increase to the airlines, without altering published or advertised fares.

Unless this fare undertaking is rigorously monitored measuring a weighted average airfare, by an outside agency these guarantees are worthless.

Market Changes after February 2003

- The new Trans-Tasman Market and Reliance on Fifth Freedom Carriers

Much media attention has been given to the pending arrival of Emirates on Trans-Tasman routes suggesting that this increased competition should satisfy the NZCC and the ACCC.

Emirates three daily return flights are potentially a major development in this market. Like other fifth freedom carriers (Thai and Malaysia Airlines) who do not focus their sales efforts on the Trans-Tasman segments, Emirates is expected to focus its marketing efforts on selling long-haul travel - Kiwis to Europe and Europeans and Middle Eastern traffic to New Zealand.

Therefore their capacity available for Trans-Tasman sectors at 40% of total capacity on three wide-body aircraft daily would only be equivalent to one 747 terminating flight. The addition of Emirates to this route does nothing to alter the monopoly position of the merged Air New Zealand/Qantas in all markets south of the Bombay Hills.

Entry of Royal Brunei to the New Zealand market is also expected in 2003. Again they are likely to fly only to Auckland and actual capacity will be limited.

While the increase in the numbers of airlines is to be welcomed by the travel agency segment and the travelling public, history demonstrates foreign carriers have an appalling history of lack of commitment to the New Zealand market when times get tough.

Here is the list of foreign carriers who have served New Zealand and withdrawn or significantly reduced services often with limited notice. Distant head offices can easily erase New Zealand from the airline's route map with no real thought or market conscience.

Continental Airlines	Daily flights Trans-Tasman & USA suddenly withdrawn early 1990's
American Airlines	Daily flights to USA withdrawn twice - in the 1980's and 1990
Aerolineas Argentinas	Schedules cancelled in late 90's and 2002, now restored
Malaysia Airlines	Daily flights cancelled in 2002 then restarted, reduced again 2003
United Airlines	Daily services to Melbourne cancelled twice in late 90's – 2002.
	- Daily North American services cancelled 2003
Garuda	Services reduced 2000 - 2003
China Airlines	Services started and withdrawn to Taiwan
CAAC	Services to China and Sydney started and cancelled within months
Korean Airlines	Services reduced and re-started several times
Royal Tongan	Services to Tonga withdrawn and restarted several times

Reliance on fifth freedom airlines to provide Trans-Tasman competition or competition on any route in the long term would be a risky prospect particularly for New Zealand.

Fifth Freedom Carriers arriving in New Zealand via, Asia or Australia, participate in competition only in the leisure travel sector of the Auckland to Australia market. Their scheduling means that they are not active in the corporate travel market. Their schedules are back to front from that generally demanded by corporate travellers - departing Auckland in the afternoon or evening and returning to Auckland early in the morning.

An NZ/QF merged airline will still have excessive market power Trans-Tasman - in excess of 70% market share ex Auckland and 100% market share in Wellington, Christchurch and regional markets - unless Virgin Blue or other new carriers enter the market for Wellington, Christchurch and regional centres.

Conclusion:

The proposal for Air New Zealand to manage all Air New Zealand flights and all Qantas flights into, out of and within New Zealand amounts to a monopoly in the crucial domestic market, to/from North America and Trans-Tasman routes south of the Bombay Hills.

New entrants on the Trans-Tasman routes will have little alleviating effect at least in the short term and entry for a new VBA will be considerably more difficult against this monopoly.

Both airlines have a history of 'tough' treatment of new competitors and combined we believe this will certainly continue.

Any undertakings offered by the applicants are of no value unless they are strictly monitored by an independent outside agency. Technology would allow fare and capacity undertakings to be flouted invisible form public view.

We are strongly of the opinion that the applications should be declined and the New Zealand Commerce Commission Draft Determination should be confirmed as the final determination.