Freight Markets

Overview

NECG and the Commission have widely differing views as to likely competitive effects of Alliance on freight markets

- Commission concluded net welfare benefit would be zero:
  - Did not take issue with claimed freight benefits, but believed they would be cancelled out by detriments in Domestic NZ (‘Domestic’), Tasman belly hold (‘Tasman’) and international belly hold (‘International’) markets

- Commission’s market definition conclusions based on the following misconceptions:
  - Belly hold prices “much lower” than freighter prices: limits demand side substitution
  - Freighter costs “much higher” than belly hold prices: limits supply side substitution
  - Freighter scheduling constraints: further limits substitution

Overview

- Commission's SLC conclusions based on the following:
  - Incorrect appraisal of relevant markets
  - Domestic NZ: misconception that Applicants actually serve market
  - Tasman: not appreciating imminent changes in market structure
  - International: not appreciating existing competition and scope for indirect routing
- Correcting for these misconceptions, it is clear that the Alliance will not lead to the claimed detriments
- Hence, net benefits will be strictly positive

Belly hold versus freighter rates

Commission concludes low demand side substitution based on presumed differences in freight rates between belly hold and dedicated freighters

- No significant price differential after adjusting for cost factors which would affect both ‘modes’ equally (e.g. oversize, time of day, volume discounts, etc.)
- No significant difference in functionality:
  - Differences in handling requirements, space or mass limitations do not exist: *95% of Tasman air freight can be carried in either aircraft type*
  - Air New Zealand carries chilled meat to Europe both in belly hold and dedicated freighter, and charges the same price
- **Conclusion: Suggests significant scope for demand side substitution**

Economics of belly hold versus freighters

Commission believes supply side substitution is weak because dedicated freighters are said to have higher operating costs

Belly hold only achieves cost advantage when ratio of cargo demand to passenger demand falls into an ideal band.

Few relevant city pairs exhibit this ideal ratio

City Pair (a)		Passengers 2000/01	Freight (tonnes) 2000/01	Freight kg/pax 2000/01	
Hong Kong	- Melbourne	270,329	25,729	95.18	
Singapore	- Melbourne	619,443	47,767	77.11	
Kuala Lumpur	- Melbourne	207,089	14,534	70.18	
Seoul	- Sydney	293,259	18,663	63.64	
Auckland	- Melbourne	491,602	29,035	59.06	
Singapore	- Sydney	927,436	47,268	50.97	
Hong Kong	- Sydney	670,055	33,425	49.88	
Singapore	- Brisbane	369,577	18,361	49.68	
Auckland	- Sydney	1,009,428	50,134	49.67	
Singapore	- Perth	652,244	29,773	45.65	
Bangkok	- Melbourne	218,457	8,993	41.16	
Los Angeles	- Melbourne	289,977	11,131	38.38	B767-338ER
Tokyo	- Brisbane	236,105	9,019	38.20	
Los Angeles	- Sydney	824,361	29,621	35.93	B737-800
Christchurch	- Melbourne	170,803	5,653	33.10	
Auckland	- Brisbane	497,610	14,874	29.89	B747-438ER

Economics of belly hold versus freighters

Using Air NZ commercial data, we demonstrate that B747-400 freighter on Tasman route achieves higher contribution margin than B747-400 passenger aircraft

	Tasman 744 FY01	Tasman 763 FY01	Tasman 733 FY01	Tasman 767 FY01
All passenger revenue	[			
Passenger-specific expenses				
Net passenger contribution				
Net freight contribution (NFC)				]
Ratio "R" of freighter capacity to belly hold capacity for aircraft type	10.37	6.22	9.39	6.22
Est. freighter net contribution: NFC X "R"	[			
Sum of pax and bellyhold contributions				]
Ratio of freighter contribution to belly hold	1.08	0.87	0.33	0.65

- **Conclusion: Suggests significant scope for supply side substitution**

Freighter route networks and flight frequencies

Commission cite freighter route networks and flight frequencies as factors further limiting substitution

- Singapore Airlines, Cargolux and DHL alone provide ***nine*** dedicated freighters per week eastbound, and ***five*** per week westbound
  - The fact that different airlines might provide the eastbound and westbound services is no practical impediment to the use of freighters by freight forwarders

- Ignores Air NZ/LH dedicated freighters westbound, and Qantas, which is flying B767's "back of the clock" four nights a week carrying only freight

Conclusion on market definition

Dedicated freighters and belly hold freight are in the same market for the purpose of analysing detriments

- Few constraints limiting demand side substitution: Belly hold and freighter rates are comparable

- Few constraints limiting supply side substitution: Belly hold only achieves cost advantage when ratio of cargo demand to passenger demand falls to an ideal ratio that is only observed for a few relevant city pairs

- Few other constraints limiting substitution: Network routings and schedule frequencies for freighters sufficient in each direction to make substitution threat a real one

Competitive effects in Domestic market

Commission presumes that Air New Zealand and Qantas operate in domestic NZ, whereas they in fact do not

- Qantas does not carry freight in NZ domestic market
- Air New Zealand leases its belly hold to NZ Post

- NZ Post is the current dominant player with substantial capacity:
  - Acquisition of B737-200QC from Air NZ
  - 6 other aircraft
  - Carries live organs, automobile parts
  - Conducts international freight forwarding, customs clearance

- Virgin Blue would not be at any disadvantage:
  - Would use B737, exactly the same aircraft as that used by Air NZ and QF

Competitive effects in Tasman market

Commission does not appreciate the impact on market structure of Air NZ A320 strategy and imminent entry

- Commission's conclusion on Tasman market coloured by exclusion of freighters from relevant market

- Alliance's share likely to be eroded by Air NZ's move to narrow bodied aircraft and imminent market entry:
  - Air New Zealand's A320 strategy will substantially reduce its freight capacity, thereby limiting market share aggregation with Alliance
  - Figures presented by ACCC in its draft determination show significant market share gains by freighters on the Tasman 1999 – 2002 (5.6% to 14.4%)
  - Imminent entry of Emirates will add capacity equal to 32% of cargo carried on route in calendar 2001

Competitive effects in International market

Alliance would appear to face significant competition on many International routes

- Air NZ data shows that, looking only at belly hold route shares, Alliance would appear to face significant competition on many international routes
- Freighters are active in the South Pacific region, and can readily be redeployed in response to price signals
- More generally, significant scope for indirect routings on these routes

Summary

Correctly appraised, the Commission would conclude no SLC in any relevant freight market

- Domestic NZ: Applicants do not operate, and even if they did:
  - Alliance would face strong pressure from NZ Post
  - Virgin Blue would be at no competitive disadvantage

- Tasman: Alliance would not lead to significant market share aggregation because of Air NZ's A320 strategy and imminent entry by Emirates

- International: Alliance would face competition on many international routes, and there is significant scope for indirect routing on these routes necg

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