Invercargill Airport Limited (IAL)

Submissions to New Zealand Commerce Commission (NZCC)

Re

Application for Approval by Air New Zealand & Qantas ("The Application")

For approval of

A Strategic Alliance Agreement ("The Alliance")

And

The NZCC Draft Determinations on the Above

Dated 10 April 2003

Contents

Introduction

These submissions have been compiled against the background of the original Applications as well as the subsequent Draft Determinations of the Commission and its subsequent 66 requests for comment on matters arising there from dated 10 April 2003.

References to those requests for comment that are considered to be relevant are included where appropriate.

The central theme of IAL's submissions is the strong ambition of the Southern Tourism Region (STR) to develop inbound tourism, using Invercargill Airport as a Trans Tasman gateway, and achieve incremental economic benefits for the region.

The principal factor that prevents realisation of this ambition arises out of the conflict between the ostensible reasons for the New Zealand Taxpayer having had (under pressure) to invest in a national flag airline and the inability of the public to obtain important benefits from that expensive investment.

The financial rescue of Air New Zealand was justified by the State in the Public Interest, especially on the grounds that a national flag airline was essential to the maintenance and future growth of this country's inbound tourism industry.

The Applications fail to credibly demonstrate either an airline strategy designed to achieve that national growth purpose or, as a subset, any commitment to regional development of inbound tourism - which is, of course, where IAL's interest lies.

With regard to that conflict between the nation's Public Interest and the Applicants' lack of intention or commitment, the Commission's attention is drawn to the following;

Report of the Controller and Auditor General: Results of 2001/02 Audits

At Section 4 of the Report the Auditor General makes the following (summarised) comments relating to Air New Zealand;

4.1 Several Members of Parliament have expressed concern about the extent of accountability to Parliament for the Crown's investment in Air New Zealand.

4.2 Because the government's stake is a controlling interest, Air New Zealand is consolidated in the nation's Financial Statements.

4.3 As a publicly listed company under the Companies Act, Air New Zealand is neither a State Owned Enterprise nor a Crown Entity.

4.4 It is the only publicly listed company listed on the stock exchange in which the Crown has an interest.

4.5 It is subject to none of the accountability requirements to Parliament laid down in legislation.

4.6 It is not automatically subject to annual financial review of its performance and current operations.

4.7 In summary, Air New Zealand has no accountability to Parliament.

4.8 The Auditor General invited Parliament to consider the appropriateness of these arrangements.

In subsequent media reporting of the Auditor General's Report (reference New Zealand Herald of Monday 16 June the Minister of Finance is reported as saying to Parliament's Finance and Expenditure Subcommittee that "the relationship of Air New Zealand to the Crown is problematic" and "it is a difficult relationship, I accept that".

From the above it is quite clear that if Air New Zealand (and its co-Applicant Qantas) do not volunteer to co-operate with other New Zealand tourism interests to implement any positive programmes of regional inbound tourism development, such as that proposed by IAL on behalf of the STR, the State is in no position to insist on it or even exert influence.

Having invested the Taxpayers money in an 82% controlling interest with the best of Public Interest intentions, the State finds itself unable to influence its flag airline's policy or operations or hold it accountable for results.

The heart of the matter is, however, that the State needs to achieve a significant benefit from inbound tourism growth because, as matters stand, it has taken on board a significant commercial exposure but is unlikely to obtain a direct commercial return from its investment.

The Commission has asked for comment regarding the financial viability of Air New Zealand in the near term.

From other airline submissions to the Commission on the structure of the aviation industry, the proposed Alliance appears to have potential for substantially lowering the costs of supply of air services in Australasia. IAL submits that achievement of lower costs is highly desirable in the overall Public Interest but also desirable if it removes a principal objection to IAL's proposals for trans Tasman air service supply (i.e. by removing airline allegations that it would be too expensive/risky, etc.).

Recent profit forecasts attributed to the airline do not appear to take account of the huge benefit to the airline of the New Zealand dollar appreciation since the start of this year. Since a majority of airline costs are US dollar based (aircraft, spares, leases, insurance etc) the effect of a sharply rising NZD has a powerful impact on the New Zealand airline's bottom line. Adjustment for this windfall would probably reveal a much less optimistic position and would underscore just how risky the airline business is.

Q3.	Financial viability of Air New Zealand in the near term.

Similarly, media comments to the effect that the State has (at June 2003 share price) achieved a profit of NZD 900 million on the original price paid for new shares take no account of the fact that the share price is set by only 18% of the shares being traded at the margin, since the State does not trade its majority shares.

There is no buyer for the State's 82%. Foreigners are not allowed and no takeover by New Zealand private interests is even remotely likely.

Thus, the profit is on paper only and realisation of it an illusion. Notwithstanding those issues, the State has already decided that a national flag airline is essential.

Unlike the problems (4.1 – 4.8 above) experienced by the State, the options open to the Commerce Commission are very much more potent, especially as regards its powers to consider the Applications and grant approval subject to conditions that are either volunteered by the Applicants or generated by interested parties or formulated by the Commission itself.

It is already evident from concessions volunteered by the Applicants that they are vitally interested in achieving an approval.

With all of the above considerations in mind, IAL has prepared its case for specific conditions that it submits should be applied to any approval given.

1. Executive Summary

Invercargill Airport Limited (IAL) is an unlisted public company owned by the City of Invercargill (55%) and the government of New Zealand (45%).

The airport serves a large local catchment area but is also the logical entry point for overseas tourist visitors to a Southern Tourism Region (STR) encompassing Southland, Fiordland, Stewart Island and the surrounding district.

At present the airport is served only by propeller aircraft on domestic New Zealand routes. IAL is, however, the alternate airport for domestic jets serving Dunedin and Queenstown and Trans Tasman jets serving Queenstown.

IAL acts as a co-ordinator of attempts by interested parties in the Southern Tourism Region (STR) to obtain direct trans-Tasman flights and would be their gateway airport of choice to operate such flights.

Those interested parties include the Invercargill Airport Company, local and regional Territorial Authorities, local and regional tourism and commerce business interests as well as potential investors.

IAL submits that there are significant implications in the proposed airline Alliance that it notes as follows;

1.1 Impacts of the Alliance

1.1.1 In the absence of mitigation, STR's objective of achieving direct flights via IAL may be threatened by the Alliance proposal. IAL believes that new, direct Trans Tasman flights would substantially increase tourist arrivals into the STR and this has been confirmed by several independent studies. Such increase would be incremental, not diversionary from other New Zealand airports.

1.1.2 Since the Alliance would be the dominating force on the Tasman opportunities for the STR to secure direct trans-Tasman flights would virtually be eliminated thus preventing access to wider economic benefits for the Region estimated at $11 million per annum and $65 million over 5 years.

Q28.	Barriers to (airline) entry to the Tasman market.
Q30.	Substantially lessening competition in the Tasman Market

1.1.3 Competition will be substantially reduced by Qantas and its associate Air Pacific joining in an exclusive club with Air New Zealand and it's wholly owned subsidiary Freedom Air. A "Joint Airline Operation (JAO) will be created that will be commercially managed entirely by Air New Zealand. *(Refer: the "Section 58 Notice Seeking Authorisation, Page 1, Executive Summary, paras 3 & 4).* Based on Air New Zealand's policy of "no new international airports in New Zealand" there will be no future opportunity to develop new inbound tourism to the STR on a direct service basis. The existing indirect routeings via other airports will become set in concrete.

1.1.4 The Applicants claim as justification an objective to increase tourism and this is directly in line with the STR's objectives also. There is also a claim that direct services will have exactly the increased tourism effects that are sought by the STR *(i.e. Direct operations and enhanced connectivity).* The promoters are not, however, prepared to put their claims into practice in STR's case although they are prepared to do so for Canberra, Adelaide and Hobart.

(Refer: Undertakings to the ACCC, Page 2, Section 3, Public Benefits).

From its own studies of tourism potential IAL is acutely aware of the tourism industry's fundamentals and considers there are three components that are critical to a successful tourism strategy in the STR, namely;

- **Capacities on the Ground**; airport, accommodation, tourist attractions, transport.
- **Co-ordinated and Widely Distributed** tourism products that are well advertised in target markets.
- **Reliable Trans Tasman Air Services** from one or more Australian main centres

The first two components are within the control of local interests but the third is not.

1.1.5 In support of the Alliance proposal the New Zealand government stated in its Media Release of 18 December 2002 (page 2, paragraph 8) that; "The second perspective from which the government had to judge the proposal was as Kiwi share holder and guardian of the national interest. The considerations used to guide this judgement were (inter alia)

- Provision of effective channels for international tourism and travel"

As noted in the Introduction on Pages 3 & 4, the State finds itself unable to enforce compliance with that provision and so it devolves upon the Commission to ensure the Applicants make adequate commitments in this regard (by attaching appropriate conditions to any approval).

IAL submits that the government's bail out of the national flag airline a year ago carries with it obligations for the bailee to act in the Public Interest and support inbound tourism, which includes regional inbound tourism into the STR.

Qs 53 – 55 inclusive

1.1.6 In the NECG Report that was submitted by the Applicants to justify their Alliance proposal the comment was made that the business plans of "Value Based Airlines" (VBAs) invariably concentrate their competitive efforts on existing, high volume routes, not on start-up ventures (like that proposed by IAL).

Q29. Likelihood of Virgin Blue entering the Tasman Market

1.2. IAL's Observations

1.2.1 The objectives and public benefits claimed by the Alliance include the promotion of increased inbound tourism into New Zealand and direct trans-Tasman services instead of indirect.

The Applicants, somewhat perversely, have offered to institute new, direct services – but out of New Zealand and into Australia, not the other way around. There would be minimal benefit to New Zealand.

IAL's view is that direct services have demonstrably provided tourist traffic increases when new services into new international airports in New Zealand have been introduced in the past. The counter argument, advanced by the airlines to IAL, alleging that proliferation of new international airports in New Zealand is just an increase in their costs with no benefit is rejected. If that were the case then international operations from Hamilton, Palmerston North, Dunedin (and possibly Queenstown) would have ceased with the demise of their original proponents such as Kiwi Air.

In fact, it can be argued that airline costs could become lower because provincial airports are much cheaper to operate from than main centre airports for both incremental traffic (and even traffic that could be diverted by deliberate scheduling and thus reducing the frequency of flights through the more expensive airports.

This is an important point, given the recent controversy sparked by the airlines' objections and legal challenges of the considerable increases in charges imposed by New Zealand main centre airports.

1.2.2 On behalf of the STR, IAL believes the Applicants' objective of increasing inbound tourism to New Zealand is both valid and achievable and should be supported. However, it also believes that approval of the Alliance should carry obligations to make good on the objectives in a <u>positive, tangible and quantifiable</u> manner and in a form that the STR can share in. Hence the recommendations made to the Commission in 1.3 below.

1.2.3 The NECG Report assumes that each incremental trans-Tasman tourist will spend $1828 while in New Zealand. This figure is supported by STR analysis and highlights the value placed upon the STR increasing its own tourism.

(Refer: NECG, Page 160 at table 27 "Assumed Expenditure by Tourist").

1.3 Recommendations to the Commission

It is submitted that the New Zealand government financially rescued Air New Zealand in 2002 and that acquisition cost the taxpayer $885 million (plus assurances of further availability of $150 million). The rescue was justified on the ground that the airline was essential to New Zealand's inbound tourist industry, present and future, of which the STR forms part.

It is further submitted that, for reasons that are not justified, the Applicants have refused to supply a required Trans Tasman air service into IAL even in the face of assurances that such operations would suffer no loss.

IAL does not presume to judge whether or not approval for the entire Application is warranted but if it is the Commission's judgement that the Application should be allowed then IAL respectfully requests the approval to be qualified as follows;

"The Alliance shall undertake to provide a minimum of one weekly return service between Invercargill Airport and at least one port in Eastern Australia at the choice of the IAL using a jet aircraft of B737-300 size or equivalent for a period of not less than two consecutive years.

Further; such services are to be conducted as fully commercial operations on terms and conditions no less favourable as to scheduling, fares, marketing support and all other commercial and operational matters as are accorded by the operating airline to services between other international ports in New Zealand and Australia.

Further; that the airline selected by the Alliance shall be entitled to retain all passenger ticket and freight waybill revenues collected by it on the services provided and, in addition and in the event that such revenues do not exceed actual costs, consideration will be given to underwriting of up to 10% of annual incremental operating costs, based upon, and not exceeding, the costs submitted by the Alliance in support of the Application (see reference next paragraph below) on production of independently audited accounts. IAL to have the right to suspend services at one months notice in the event the airline is perceived not to be employing "best endeavours" to make the route a success.

(Refer: NECG Report, Page 139, wherein the per annum incremental cost of one new weekly direct return flight trans-Tasman is shown as between $1.3 million (AKL-ADL $18.5 million for 14 flights) and $1.5 million (AKL-ADL, AKL-CBR & WLG-CBR $3.0 million for 2 flights/weekly).

Further; that such operations are to commence upon the completion of civil works undertaken by IAL to modify its runway."

Further; that there shall not be any reductions in current domestic operations into IAL by the Alliance carriers or their subsidiaries and associates.

IAL submits that the above qualifications are fair and reasonable in the light of the circumstances of the arguments employed by the Alliance in seeking approval of its Agreement.

IAL further submits that the Alliance has the necessary under-utilised aircraft resources.

(Refer: the Application, Page 114, Clause 421. The reference is to supplementary freight operations on the trans-Tasman but states "Under the Transactions a number of routes will be supplemented by "back of the clock" flying using B 767 aircraft currently overnighting in Melbourne").

IAL is aware that the B767 aircraft referred to are not sole freighters but passenger aircraft with belly hold cargo space. They could equally be used for a new route into Invercargill. There are also B 737 aircraft that overnight at eastern Australian airports and New Zealand airports.

The conditions proposed by IAL are in line with the New Zealand government's publicised reason for reinvesting in a national flag airline. That is to say, protecting and increasing inbound tourism to New Zealand, preservation of a New Zealand national flag airline and improvement to the country's economy. The Southland Region is entitled to ask for its share of that opportunity and the key is the application of a minute proportion of the Alliance's total resources to the task.

Otherwise the question could well be asked, "What is the benefit to the Southern Region (and, indeed, the whole New Zealand Public Interest) of supporting a national flag airline with huge amounts of taxpayers money?"

(Refer: the Application, Page 117, Clause 428).

Also, Refer to "Conclusions" at Section 5 of these submissions.

The following information is presented in support of the above Recommendations.

2. Background to these Submissions

2.1 General Situation

IAL is desirous of expanding itself so as to provide a gateway to the tourist attractions of the Southern Tourism Region and has been frustrated in that ambition by factors beyond its control that are discussed in the following sections and which have a bearing on the National flag airline/Qantas Alliance agreement.

IAL's split shareholding between local and national governments is an inhibitor since the national government is not committed to the long-term ownership of airports. Thus, it is not prepared to invest in further development.

The airport, in its current state of development, is capable of limited Trans Tasman operations by Boeing B737 aircraft. The limitation is a payload penalty that substantially limits loads that can be carried by B737 sized aircraft travelling west against the strong, high altitude, jet stream winds.

Unlike Queenstown, which is limited by topography, IAL has scope for expansion by extending the runway so as to both remove the existing limitations and accommodate larger jet aircraft up to Boeing B767 size.

In late 2002, IAL commissioned consultants Beca Carter to carry out civil engineering assessments of the runway expansion and its cost. The expansion is quite feasible.

International facilities consisting of a departure lounge and an arrivals hall were constructed in 1994 in anticipation of trans Tasman services commencing in that year but which did not eventuate.

For several years, IAL has lobbied airlines to commence Trans Tasman services with the primary objective of attracting additional tourism business for the Region.

In support of its contention that such services would be profitable for the airlines, IAL has commissioned its own studies as well as supporting independent assessments, by other Southern Region interests, of both the feasibility of developing the airport and expectations of potential economic benefits to the Region.

Those studies and assessments all proved positive and are summarised and discussed in the following table and explanatory sections.

Table 1

Report/Study Sponsor	Objective
Invercargill Airport Limited 1998	Request to Airlines for Proposal to Operate Services
Invercargill Airport Limited 1998	Application for Investment Capital, Invest South Limited (ISL)
Southern Tourism Limited	Tourism Marketing Planning

1998	
Invercargill Airport Limited 1998	Feasibility Study: Runway Extension
Venture Southland 2002	Draft Feasibility Study covering Economic Benefits to STR of Extending the Runway

All of these studies were based on the assumption that IAL's runway would be extended to facilitate full flights in both directions and this was also a requirement of the airlines that were approached to provide services.

IAL does not have a balance sheet capable of supporting the entire capital expenditure needed to achieve its expansion and so must borrow, or attract additional capital, or obtain a regional development grant.

Its efforts to obtain financial support have consistently foundered upon the insistence of potential lenders and investors that the airport first obtain a commitment from a reputable airline to use the extended airport runway.

Strenuous efforts to obtain such a commitment have resulted in IAL striking stubborn intransigence from the airlines, particularly the New Zealand flag airline that has stated an intention to avoid the creation of any more international airports in New Zealand.

Other carriers that have been approached (Refer: Section 4) were either under the New Zealand flag airline's control or influence or did not have the aircraft available or would have added irrecoverable positioning costs or did not wish to risk retaliation as had previously occurred in the case of Kiwi Air.

Thus, the result of IAL's efforts has been a merry-go-round of feasibility studies that consistently identified huge Public Interest benefits; leading to funding applications to modify its runway that investors/lenders are supportive of but make conditional on a firm commitment from a reputable airline to commence operations that IAL is unable to obtain.

2.2 Relevance to the Air New Zealand and Qantas Applications

When faced with the Air New Zealand problem the State clearly concluded that the wider economic benefits of tourism for the nation outweighed any consideration of airline profit or loss. The resulting decision to intervene was aimed at preserving not just the airline but, much more importantly, preserving that wider economic benefit for the future.

On a smaller scale IAL is addressing a very similar issue although, in its case, the wider public benefit is not an established fact but, instead, is a potentially huge gain to the local economy. In a similar manner to the state, the STR has been prepared to intervene financially but, having no leverage, is now asking the Commission to intervene on its behalf.

The refusal of the national flag airline to make any commitment to commence operations, even in the face of offers by regional interests to underwrite operations is not consistent with the tourism and promotion of direct services objectives avowed in the Application.

The Alliance airlines allege that their agreement will result in considerable increases in tourist arrivals into New Zealand and that substantial economic benefits will accrue to the country as a result.

No credible evidence is presented to support the allegation such as is present in the various studies carried out by the STR but that said, the STR is entitled to seek a share in those “substantial economic benefits”.

3. Studies and Assessments of Tourism Potential & Benefits

This section is included to demonstrate that tourism interests in the STR have been very proactive in attempts to prove their case and demonstrate to airlines that there is considerable, untapped potential in the lower South Island that is not being realised by the current network of trans-Tasman air services that only serve the STR indirectly.

With reference to Table 1, the conclusions reached in these studies are summarised as follows;

3.1 Venture Southland August 2002/February 2003: Feasibility Study of Runway Extension Invercargill Airport

This document was compiled by Venture Southland itself with inputs from various specialist consultancies.

It was not, as might be supposed from its title, an assessment of the pros and cons of the runway extension itself. Instead, it was structured as an application to the government’s venture capital fund, Industry New Zealand, for a grant of funds to supplement locally raised funding and enable IAL to carry out the runway extensions.

The application included further independent market research that confirmed the assessments of potential economic benefits uncovered by the studies that had preceded it. It identifies wider economic benefits for the STR of $11 million per annum (in 2002 dollars).

The Feasibility Study has reached an advanced stage of completion and is a very positive document but it has not yet been lodged with Industry New Zealand pending the outcome of airline industry events including the Applications.

3.2 Invercargill Airport March 1998: Feasibility Study

The assignment was carried out by independent aviation consultants in January/March 1998 and was designed to test the feasibility of trans-Tasman operations using IAL as the STR gateway.

The document set out a pathway for IAL and the STR to gain commercial benefit from the Trans-Tasman Single Aviation Market.

It conceptualised a basic airline operation at the level of one round trip per week between IAL and alternating each week Sydney and Melbourne. Aircraft and associated operating costs and marketing expenses were compared with revenue forecasts based on a range of fares.

The principal recommendation made that is relevant to these submissions was that the results were sufficiently positive to support air operations. A project was structured that envisaged a series of charters being purchased from an airline. Accordingly, it was recommended that;

A "Request for Proposal" (RFP) should be prepared and proceeded with.

The airlines to be initially approached with the RFP were to be;

Air New Zealand

Freedom Air

Ansett Australia

Qantas

The recommendation was accepted and put into effect. (See section 4).

Special note: At the time, Air New Zealand, Freedom and Ansett Australia all belonged in the same group. Thus, IAL's choices were necessarily limited even though all of the airlines claimed to be autonomous in their choices of routes.

3.3 Southern Tourism Limited: Marketing Planning

This study was carried in July/August 1998 and addressed issues of, firstly; the likely level of demand for incremental inbound tourism from Australia to the Southland Region and, secondly; how the Region could assemble the marketing effort needed to access the potential and, thirdly; whether it could be practical to use IAL as the gateway airport.

The findings were that potential existed for incremental tourism expenditure in the Region served by IAL of up to $10 million (in 1998 dollars) per annum per weekly inbound tourist flight as a result of non-stop services.

A comparison with Queenstown Airport was also made which identified that it had flight operational limitations also but that topographical constraints existed that prevented them being remedied.

Queenstown can handle full trans Tasman flights inbound (B737-300 size) but there is no land at either end to extend the runway sufficiently to handle B 767 aircraft.

Also, the mountain ranges limit flights to daylight only.

3.4 Invercargill Airport June 1998: Application to Invest South Limited (ISL) for contributory Capital Investment

This independent study was compiled in May/June 1998. It was similar in design and content to the later draft application to Industry New Zealand but sought investment capital, rather than a grant.

This was in accordance with Invest South Limited's rules, which allowed for purchase of shareholdings or lending but not outright grants.

It was lodged with Invest South Limited and proceeded to the stage of ISL making a funding offer that was a mix of capital and loans but on a scale and terms unacceptable to the project's sponsors. A firm commitment by a reputable airline was again the sticking point.

4. Requests for Proposals (RFP) from Airlines

In spite of the fact that the RFP was couched in terms of a "no risk and no loss" scenario and offered the possibility of utilising jet aircraft that were normally idle overnight in both Australia and New Zealand (with corresponding benefit in lowering their unit costs) there was a mixed response from the airlines that were approached.

Due to that factor, the RFP was discussed with several other airlines, known to be operating suitable aircraft, in addition to the original four, namely; Qantas, Air New Zealand, Freedom Air and National flag airline.

Results of the RFP exercise are summarised as follows;

4.1 Qantas

The New Zealand management of Qantas were originally keen enough for them to go public on the possibility of operating at IAL. Their enthusiasm was, unfortunately, not shared by Qantas head office in Sydney, which preferred to concentrate on Queenstown.

The IAL idea was, therefore, judged "not within policy" and contact with the airline subsequently ceased.

There were also operational considerations. For example, there was not sufficient time elapsing between the grounding of suitable aircraft in Australian ports at the end of their working day to enable the aircraft to do a return trip to IAL including a diversion via Christchurch on the westbound leg and still get back to base in time to start the following mornings regular schedule.

4.2 Air New Zealand

Initially expressed interest in the RFP, which resulted in it being proposed to senior management. It progressed no further and several sources within the airline commented that it was not the airline's intention to encourage any more international airports in New Zealand. They were alleged to be simply sources of increased costs for traffic that would anyway go through other gateways already established, notwithstanding that visitors to the Southland region might have to travel indirectly and at higher cost and would not receive the same promotional support that was accorded the established gateways.

IAL notes that Freedom Air was created in response to Kiwi Air and, suddenly, it was imperative for the national flag airline group to operate Hamilton, Palmerston North and Dunedin that had never previously been international airports.

Similarly, jet operations by Air New Zealand into Queenstown were a reaction to an Ansett New Zealand initiative and direct Trans-Tasman operations into Queenstown were in response to a Qantas seasonal initiative.

As an addendum to the Application, the Alliance has committed (to the ACCC in Australia) to the creation of three new trans-Tasman gateways. These were previously held, over many years, to be uneconomic by the very airlines now offering them. See Section 5.

All of these new gateways are in Australia, however, and will produce no economic benefit to New Zealand.

4.3 Freedom Air

Freedom is a wholly owned subsidiary of Air New Zealand and has no freedom of action in the matters of which city pairs it will connect and with what frequency.

It must always defer to Air New Zealand in strategic matters such as the IAL proposal and did so in this case, with results the same as in 4.2 above.

4.4 Ansett Australia

This airline no longer exists, of course, but at the time the RFP was issued in 1998 it had been 50% owned by Air New Zealand for two years.

Initially, Ansett's Head Office in Melbourne responded positively and a draft contract was drawn up and negotiations were entered into.

That interest cooled rapidly for no apparent reasons associated with the contract but from verbal comments received it appears the project reached the stage of discussion at the Ansett board level and was not supported by the directors from Air New Zealand.

Attempts to re-ignite Ansett's earlier enthusiasm were not responded to and the project disappeared in the airline's major management shuffle that took place late in 1998 post the Air New Zealand share purchase.

4.5 Air Pacific

Air Pacific is 46.32% owned by Qantas but is believed to have a fair degree of autonomy because of the majority 51% ownership by the government of Fiji.

The airline was, however, short of capacity to operate its own core routes and, in any case, would have burdened the IAL project with un-recoverable costs due to the need for positioning aircraft on dead legs in order to operate the proposed services.

4.6 Air Nauru

The airline was initially keen to do business but could not meet the marketing requirements of the RFP. Also, changes in management and consequential changes in priorities intervened. As the operator of only one aircraft there would, in any case, have been positioning penalties as well as possible difficulty in maintaining a consistent, year round schedule.

4.7 Polynesian Airlines

As the (then) operator of only one B737-300 jet, Polynesian had no spare flight hours it could devote to the task. Also, its route network is such that it would have incurred positioning dead leg running that would have penalised the cost structure of the project.

4.7 Results of RFP

In summary, therefore, some of the airlines initially responded positively but fell away one by one. In some cases the reasons were legitimately operational but in most, including the most reputable and capable, the reasons appeared to be more aeropolitical rather than any fault of the project.

It was clear from the RFP experience that airlines were shy of engaging in new route development and that there was a marked lack of competition between them, reinforced by the aggregation of supposedly independent airlines within the Air New Zealand group.

IAL and the STR interests attempted to break through by exploring ways and means of reducing costs and risks to the airlines and by suggesting incentives. In reality the Alliance airlines are the only potential air service suppliers and their collective policy towards cost containment (unless spurred by a new competitor) is the primary obstruction to IAL/STR.

IAL does not agree that the marginal costs of air service supply are significant (because of the potential to utilise overnight aircraft time otherwise spent on the ground) and does not agree either that the production costs of the Applicants are optimised.

Qs. 46 - 51

5. Conclusions

IAL and the STR have laboured hard and at significant cost to develop their tourism potential but have been frustrated by the refusal of the Alliance airlines to provide air service supply in the Public Interest.

Thus, it is difficult for IAL and its Southern Tourism Region colleagues to accept that the Alliance should be approved without qualifications.

IAL believes that if the Alliance can be constructed in such a manner as to significantly lower air service production costs then it will be in the Public Interest to confer an approval on conditions that ensure growth of inbound tourism.

The Alliance will, however, create a bloc that will be able to exert power market power over resource allocation in the trans-Tasman market that will be on a scale very close to a total monopoly if not mitigated by conditions and regular reviews.

IAL notes that the "JAO" envisioned by the Alliance already has a 100% share of 11 out of the 13 trans-Tasman city pair routes (including all of the secondary gateway airports) and, of the remaining two, has 75.2% on AKL-SYD and 56.1% on AKL-BNE.

(Refer: the Application, Page 87, Clause 301).

IAL believes that such power should not be allowed unless there are corresponding obligations imposed to do those things that are promised, especially with regard to inbound tourism and promotion of direct services that are beneficial to the New Zealand, not Australian, Public Interest.

The undertakings that the Alliance intends making to the ACCC to operate new routes such as;

Auckland-Canberra	14 services per week		
Wellington-Canberra	2	"	"
Auckland-Hobart	2	"	"
Auckland-Adelaide	2	"	"

These concessions are to be applauded but it is notable that Canberra, Hobart and Adelaide have been Australian winners of the new routes while all of the services are from traditional New Zealand trans-Tasman gateway airports.

There are no new gateway airports offered by the Alliance for New Zealand.

In the light of the undertakings favouring new gateway airports in Australia and in the face of the New Zealand flag carrier's consistent intransigence towards the legitimate claim of IAL and the STR to participate in the trans-Tasman market, a balance in New Zealand's favour by creating IAL as a new gateway airport ought to be struck.

Regional development in New Zealand is an issue often promised but not so often delivered. The assessed gains for the Southern Tourism Region are very considerable and the means of achieving it are within reach and at low cost.

(Refer: NECG Report, Page 36 in which the consultants say, " We accept that the Alliance will result in a significant increase in market concentration. Having said that we believe the costs of expansion on the Tasman or main trunk routes in New Zealand would likely be low for a carrier already established in Australia or New Zealand".

The context of the above quote is a discussion on entry of new carriers to the trans-Tasman market but must also hold good for the Alliance.

The airline that would carry out operations from IAL would be supported by a conditional underwriting agreement although it would be given every encouragement to make a success of the route.

IAL respectfully submits that there is every reason why its recommendations to the Commission should be conditions of any approval.