

**Christchurch International
Airport Limited**

**Submission to Commerce
Commission in Relation to
Air New Zealand/Qantas Applications**

14 February 2003

- 1 Christchurch International Airport Limited (CIAL) seeks to have its interest registered in relation to the application by Air New Zealand and Qantas seeking authorisation of a restrictive trade practice (Section 60(3), Commerce Act) and the application by Qantas (supported by Air New Zealand) seeking authorisation for a business acquisition.

Introduction

- 2 CIAL is vitally interested in the two applications. It appreciates the significance of the matter for Air New Zealand but the significance for CIAL is of no less moment. If authorisation is given, the Alliance will become CIAL's major customer at around 90% of airport charges (the figure can only be approximate because it fluctuates over time).
- 3 In making this submission, CIAL focuses on those particular issues which concern its interests or in respect of which it has particular information. This submission does not intend to be a comprehensive overview of the two applications nor a critique of every assertion made. Silence in respect of any particular argument does not imply that CIAL accepts what is asserted.

Some Practical Considerations

- 4 The Applicants postulate a factual and a counterfactual. While they assume that these will trace unique paths into the future, CIAL disagrees. It believes that within a relatively short term the two will converge. CIAL explains this in more detail in the next section below. The consequence, though, is that where there are presently two airlines – Air New Zealand and Qantas – ultimately there will be one (the Alliance or the survivor of a competitive war).
- 5 There are obvious enough competitive problems with each of these two outcomes. But CIAL submits that, commercially, they will effectively result in the same consequence. That is, the current competition between Qantas and Air New Zealand will be lost. There will be one airline where now there are two.
- 6 CIAL thinks it unwise to assume there will be new entry, including VBA entry. Historically such entry has been unreliable. Current market trends suggest it cannot be relied upon, either. For example, notwithstanding the collapse of Canadian Air, there has been no new independent entry into the Canadian market. Consequently, the threat of VBA entry will provide but limited constraints upon the Alliance.
- 7 Consequently, under either the factual or the counterfactual, we have much the same result. For CIAL, though, the best outcome would be the proposed Alliance but with further conditions. This recognises the commercial inevitability of such an outcome, but preserves the possibility of retrieving some positive aspects which might not be achieved under the counterfactual.
- 8 Under the counterfactual there will be a period of adjustment following the exit of one of the two airlines which will have flow-on negative externalities, particularly for regional economies. These will need to be brought to account.

Critical Assumptions in the Applications

- 9 The Alliance argues that the opportunity for competition under the factual is greater than under the counterfactual. In essence, it undertakes to limit its own capacity to allow this to occur. It is difficult to follow this reasoning.
- 10 First, under the factual, the incumbent Alliance with a VBA offshoot (Freedom Air) would operate as an effective cartel on nominated routes. Consequently, it is counter-intuitive for the Applicants to argue that a new entrant would rather enter a market and compete against a cartel than it would enter a market where two FSAs were competing head to head.
- 11 Secondly, the Applicants assume that new entrants would be prepared to limit their ambitions to the amount of the market that the Alliance, in effect, would allow them.
- 12 Underlying the Applicants' approach is an assumption that the factual and the counterfactual will trace unique paths into the future. For example, Table 5 of the NECG report sets out projections for weekly departures of VBAs under the factual and counterfactual. The analysis assumes that these differences will continue indefinitely into the future. There is no evidence nor argument supporting this supposition.
- 13 Given that the airline industry is characterised by rapid adjustment, there is every reason to expect that the factual and counterfactual would converge within a relatively short time. The estimates of the benefits of the Alliance are based on the assumption that the benefits of the factual will continue to exceed those of the counterfactual. If, as is more likely, the two converge, then the benefits are overstated.
- 14 CIAL has not attempted to analyse the benefits and the detriments, at least at this stage. Nevertheless, its clear impression is that the Applicants have claimed benefits that are likely to occur in any event, thus exaggerating the benefits that will flow from the proposed Alliance and acquisition. On the other hand, CIAL believes the detriments have been underestimated.

Freedom Air

- 15 Freedom Air has some ten services a week ex CIAL. The application is not clear as to the Alliance's proposals in relation to Freedom in the future. CIAL is anxious to ensure that Freedom Air continues to operate from CIAL as part of the Alliance.
- 16 There is no proposal that Freedom Air be divested. No doubt, there will be some pressure in some quarters to achieve that as a condition of any authorisation. While CIAL recognises the detriments if there is no divestment (see below), overall CIAL believes that the benefits of retention outweigh those detriments.
- 17 CIAL's belief comes back to a point made above. That is, CIAL is reluctant to assume VBA entry. If Freedom Air was to be divested then it is difficult to see the acquirer being other than a VBA. Freedom Air, in its current configuration,

is unlikely to survive as a stand-alone operation. Therefore, it is rational to assume that a new acquirer would include it as part of a larger VBA airline. CIAL believes there is a real risk that if Freedom Air is divested that it will effectively cease to exist, because VBA entry cannot be assumed.

- 18 There is no doubt, however, that the Applicants, together with Freedom Air, create substantial barriers to entry on the part of new entrants. Freedom is well placed virtually to close out, in a coordinated effort with the JAO, any new entrant on the trans-Tasman routes. Indeed, recent events (for example, Kiwi International) suggest this is a real risk.
- 19 CIAL believes that the best approach is to allow the Applicants to retain Freedom Air but to ensure that there are conditions on the grant of the authorisation.

Conditions

- 20 The fact that the Applicants are seeking authorisation for a restrictive trade practice focuses our attention on conduct as well as market structure. If the Commission is prepared to grant the authorisation then it is not unreasonable to expect the Commission to impose conditions, for example on route development or on minimum capacity levels on certain routes. Section 61(2), Commerce Act, authorises the making of such conditions.
- 21 Past behaviour can be a reasonable indicator of future behaviour. Following 11 September 2001 and the Ansett Australia collapse, Air New Zealand cut trans-Tasman capacity to Christchurch. The reduction in capacity had nothing to do with demand. There was clear evidence of excess demand for trans-Tasman seat capacity. Furthermore, freight capacity was very tight. CIAL is very wary of the Alliance doing this again. Therefore, if the Commission approved the Alliance's application, it must somehow ensure that the Alliance is not able to manipulate capacity in such a way that is damaging to other links in the travel and freight value chains, ie the inbound tourism industry and also industries reliant on there being sufficient export freight capacity to ship their goods.
- 22 At the present time, Air New Zealand and Qantas provide international services ex Christchurch. If Freedom is included within that grouping, then only Singapore Airlines, in addition, provides international services. In terms of total passenger numbers some 15% of the Alliance's international passengers enter or leave New Zealand through Christchurch. It is important that this relativity is maintained. A reduction will have significant flow-on effects into the relevant tourism, freight and engineering markets.

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