# APPLICATIONS TO THE NEW ZEALAND COMMERCE COMMISSION FOR AUTHORISATION UNDER THE COMMERCE ACT BY AIR NEW ZEALAND LIMITED AND QANTAS AIRWAYS LIMITED

## SUBMISSION TO THE NEW ZEALAND COMMERCE COMMISSION BY NEW ZEALAND CHAMBERS OF COMMERCE AND INDUSTRY

### *Introduction*

New Zealand Chambers of Commerce and Industry speak for the interests of businesses and their communities throughout New Zealand. Our goal is to promote faster economic growth for New Zealand, through vibrant regional and national economies that create sustainable business development and employment opportunities.

2 We represent over 20,000 businesses – most of these are the small to medium enterprises that are the backbone of business in New Zealand. The Chambers exist to promote, support, and encourage these sustainable, profitable businesses. We do this because Business is the key wealth creator in our economy. Sustainable, profitable companies provide economic growth and ensure that additional resources are available to support our communities and create jobs for New Zealanders.

3 Chambers support an open economy, with removal of distortions and reduced costs to business. We are committed to positive government/business partnerships, which gives strength and focus to mutually-agreed outcomes.

4 As a general principle, Chambers also espouse strong international strategic alliances: both government-to-government and business-to-business. These alliances should serve to increase market access, enable easier identification of market demand, provide technology-sharing opportunities; and serve to benefit New Zealand consumers.

### The proposal

5 Late last year Air New Zealand and Qantas announced a proposed strategic alliance, subject to several conditions, one of which being approval from the relevant regulatory bodies. In New Zealand, the key requisite approval is from the Commerce Commission.

6 We note the Commission's confirmation that, under section 58 of the Commerce Act, the key issue for the Commission is the impact on domestic, trans-Tasman and trans-Pacific markets of the proposed alliance. Also, under section 67, the Commission will need to consider the extent to which the proposed equity holding by Qantas substantially lessens competition in a market.

7 We also note that in their press release of 12 February 2003, Government Ministers Cullen, Mallard and Swain said ***inter alia**:*

"We are satisfied at this stage that the proposed alliance will deliver substantial benefits to Air New Zealand as a company, and that it satisfies the national interest criteria identified by the Cabinet. The competition issues are best assessed by the experts at the Commerce Commission, working within what is one of the toughest pro-consumer regimes in the world".

**Chamber comments**

8 Chambers fully acknowledge that ANZ and Qantas have a perfect right to put the proposition forward on the basis that it makes commercial sense for them. The issue for the regulators is, will it provide net benefit to New Zealand? This is where we focus our comments.

9 Chambers regard the current alliance proposal as essentially amounting to a merger of operations. In other words we should think of the two as a single airline for all intents and purposes. But for the national landing rights issue, this would have been the logical end-point.

10 The alliance goes beyond code-sharing to actual planning of capacity utilization. It is therefore a **de facto** merger of Air New Zealand with the competing parts of the QF network. So far as we can see, the arrangement applies only to those routes that Air New Zealand flies. Under the proposed alliance, Air New Zealand would not appear to derive significant benefits from the rest of the QF network.

11 The key arguments put by the two airlines are that the public benefits will outweigh any public losses because:

There are no substantial barriers to entry to new airlines (or there is existing competition) in the various markets considered. In fact they argue that by combining their operations they make entry much more likely on the main trunk NZ routes. Their modelling of the effects of the alliance assumes entry to both the Trans Tasman and the NZ main trunk in 3 years.

There are major public gains from costs saving by the two airlines gaining economies of scale and increased NZ tourism numbers.

12 Both these main benefits are valued by the airlines at about $1b NPV.

13 Clearly, the Commerce Commission will need to test these assumptions fully.

14 The Commission must find that there will be a reduction in competition – so the key point is, how solid are these offsetting benefits / options? In Chambers' view, it is important to ascertain from the two likely parties who might plan to enter the market (Origin and Virgin Blue) what their views on the modelling are, and what are the conditions they would need to enter. It is not at all clear that a value-based airline will indeed start competing on most routes.

15 We note the view expressed in the NECG report commissioned last year by the airlines, that cost savings by the Alliance somehow becomes a public benefit. In our view, if another competitor comes in, there is likely to be duplication again (this is the cost of competition), so while the Alliance will make cost savings before entry by another competitor, both competitor and the Alliance will increase capacity once the competition reoccurs, so any benefit may be eroded again. It is important that the Commission should achieve some clarity on this issue.

16 The Commerce Commission has also to consider the counterfactual, and evaluate the likely impact if the alliance doesn't eventuate. What would happen otherwise? The alternatives would seem to be "the failing firm defence": i.e., the New Zealand taxpayer continues to keep Air NZ alive – but the retention of a "flag carrier" cannot be at all costs to the taxpayer. (We note that the parties to the application claim they see ANZ surviving - but in a weakened form- even if the deal does not go ahead).

17 Alternatively, Singapore Airlines might be motivated to return to the bargaining table and buy back into Air NZ. We would not entirely preclude this possibility. (Chambers believe that from the consumer welfare perspective, SQ / NZ would have been a much better deal because it would have maintained entrée to two global alliances).

18 Chambers also believe it is important to be realistic as to the Government's requirements that the Board of Air NZ should be able to back out of this deal with an airline intact. Our reading of the source of the gains would indicate that this arrangement is intended to be "for keeps". We note that Air New Zealand has now withdrawn from the Sydney – Los Angeles route. Our belief is that, on routes where Air New Zealand reduces capacity to accommodate QF, it will not be straightforward for Air New Zealand to return in the event that the proposed alliance is terminated at some point in the future.

20 Along with preserving the independent value of their brand, Air New Zealand will need to decide which global alliance they will be part of. There is a clear expectation that Air NZ will be obliged to quit the Star Alliance and join "One World", of which Qantas is a member. We anticipate there will be substantial costs in leaving the Star Alliance. Again, this underlines that if the proposed Air New Zealand – Qantas arrangement does not work out, it will nevertheless be costly for Air New Zealand to exit.

21 Our expectation is that QF will be more influential in terms of Board and management that their actual voting rights would suggest. The New Zealand Government -appointed directors will therefore need to be clear and well-organized as to the national interest.

22 Finally, a word on freight. Freight issues naturally loom large for our members. It appears that the capacity will be there – the question is, at what price? We have looked closely at the document containing what the Alliance has put on the table in terms of assurances - both on the term of the proposed agreements and pricing assurances. The freight assurance does not refer to price. However, it does provide the parties with an "escape clause" if there is a lack of market support. The latter will of course depend directly on the former.

23 In view of all the above considerations, should the deal proceed, the Chambers would wish the main focus to be on ensuring competitive entry alongside the new alliance in the marketplace We acknowledge that overall the arrangement makes good commercial sense for Air NZ and Qantas – our broader concern is to make sure that we get market entry from another player (as all the economic modelling commissioned by Air New Zealand / Qantas modelling assumes). The key here will therefore to ascertain what the likely market players require to come in.

**Summary**

24 Chambers are practical business organizations, and we recognize the practicalities here. Chambers are arguing for competition itself, ahead of ongoing competition between ANZ and Qantas. If the two can combine to form a strong regional airline and this has benefits in better services to NZ, and we can be assured that others will enter, and the relevant markets are controlled to some extent until that happens, then our members will be reasonably happy.

25 This said, we believe that more needs to be done in the interests of the consumer if an Air New Zealand / Qantas alliance is to be given Commerce Commission approval. The Commerce Commission might look at a structural solution, such as requiring Air New Zealand to sell Freedom Air. Conceivably, Virgin may be motivated to buy Freedom in order to restore a second player to the market.

26 New Zealand Chambers of Commerce and Industry would therefore encourage the Commerce Commission to look at the scope for structural solutions which would mitigate the loss of competition. In particular, the Commission should concentrate on ensuring there is scope for new entrants, and on the level of the controls – including on price - that will be required until such new entry occurs.

**New Zealand Chambers of Commerce and Industry**

**14 February 2003**