Atlantic Pacific

18th February 2003

Ms Janet Whiteside
Chief Advisor
New Zealand Commerce Commission
44-52 The Terrace
Wellington
New Zealand

Dear Ms Whiteside,

RE: Air New Zealand/Qantas Alliance Application

Atlantic Pacific RADIUS (APR) is an agency dealing predominantly with New Zealand based business travellers. It is therefore a party who's economic interests are affected by Air New Zealand/Qantas Application for Authorisation and are able to assist the Commission in its determination. A submission on the application is enclosed.

APR is a privately owned New Zealand company with an annual turnover, as an agent, of $100M+. APR is one of the largest New Zealand business travel agencies for Qantas and Air New Zealand.

APR has a client base of corporates and Government agency bodies travelling domestically and overseas on business. A number of APR clients have agreements in place with airlines and consequently some are Air New Zealand preferred travellers and some are Qantas preferred.

APR is not in favour of the Air New Zealand/Qantas Alliance Application being approved for the reasons that competition between airlines is the key to maintaining service levels and competitive pricing levels for business travellers and because, in our view, Air New Zealand already has demonstrated willingness to use dominant market position to restrict competition in the travel distribution services market.

Yours faithfully,

Richard Spencer
Chief Financial Officer
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SUBMISSION – ATLANTIC PACIFIC RADIUS

We acknowledge that the Commission has previously concluded that the Domestic Passenger Air Services Markets can be separated into three markets:

- main trunk passenger air services;
- provincial passenger air services; and
- tourist passenger air services.

[Commission Decision 278, paragraph 135, page 58]

We offer the following observations with reference to the first two of these categories.

1. MAIN TRUNK PASSENGER AIR SERVICES (MAIN TRUNK)

The Alliance proposal would place Air New Zealand in a dominant competitive position in the main trunk market, which is predominantly made up of Government and corporate travellers. The following excerpt from the Qantas/Air New Zealand application details the extent of the co-ordination of pricing, scheduling, and capacity:

> *[Air New Zealand/Qantas Application, paragraph 25, sections (a),(b),(c),(d),(g) and (i), page 18].*
>
> *25. Qantas and Air New Zealand will co-ordinate the following services and activities in respect of the JOA Networks:*
>
> *(a) All aspects of the pricing of Applicants' passenger and freight services, including setting fares, rebates, levies and promotions, level of service fees, development of new fares, products, pricing and promotions of holiday destinations, commissions and agency incentives and joint tendering for corporate and government accounts. The Applicants will also co-ordinate procedures for pricing and inventory management. (Clause 5.2)*
>
> *(b) Exchange of information on schedules, financial information, pricing, yields, seat availability, sales and other information to enable co-ordination of the aspects of the parties respective businesses referred to in (i) above. (Clause 5.3)*
>
> *(c) Operations, routing, capacity, frequencies, aircraft types, connection requirements and range of times for any service provided as part of the JAO networks. (Clause 5.4)*
>
> *(d) Reciprocal Codeshare rights with each other for flights operated as part of the JAO Networks. Air New Zealand will also be able to codeshare on flights operated by Qantas that are not part of the JAO Networks where such flights reasonably connect to JAO Network flights. (Clause 5.5)*

(g) Subject to existing contractual restrictions, co-ordinate respective freight operations to improve the scope and availability of freight services. (Clause 5.8)

(i) Co-operate and give priority to the display of each other's flights on their respective reservation systems. (Clause 5.11)

i. Under the Alliance proposal yield managers will be in a position to manipulate the availability, to Government and corporate travellers, of all airfares including smart, saver and flexi fares. This could have the effect of increasing the average fare and without the necessity of changing published fares. The Alliance would not need to publicly acknowledge by how much average fares have increased but would be able to increase costs to business travellers by employing a route management strategy which targets the services they frequently use.

"A company which acquires a dominant position in a market would, by definition, find it profitable to reduce output and raise the price, compared to the output price which would exist in the same market if it were competitive." [Commission Decision 278, paragraph 442, page 93]

ii. In the calculation of the savings due to scheduling efficiencies of $47M, [Air New Zealand / Qantas application, table page 106], in our view, no account has been taken of the detrimental effect to the traveller of reduced occurrence of cheaper fares because one aircraft is to operate where two operated previously. The Commissions Decision No. 278 made the observation:

"Two separate flights on a 'thin' route might suffer lower load factors (more empty seats) and hence reduced profit yield, whereas one code-shared flight, with fewer seats for each airline to fill, could have higher load factors, hence better profit yield." [Commission Decision 278, paragraph 34, page 40]

Logically the most likely occurrence of this will be on main trunk routes where competition has been prevailing. The rationalisation in frequency of service will be to the detriment of main trunk travellers.

iii. Price elasticity of demand will not be a sufficient restraint on fare rises. The NECG report, provided by Air New Zealand/Qantas in support of their application, overstates the importance of elasticity of demand, for business travellers, because it does not take into account the fact that these travellers have no practical substitute for air travel between New Zealand's main centres. Business travellers, particularly, have an essential requirement to travel efficiently and therefore by air, in the conduct of commerce and government affairs, in person. The Commissions Decision No. 278 made the observation

"The Commission concurs with Dr Gale's view, on the basis that speed and convenience are significant factors for most passengers using air services, and that air services generally constitute separate markets from other forms of

transportation." [Commission Decision 278, paragraph 111, page 54]

iv. The NECG report offers price elasticity values of -0.70 for business customers and -1.65 for leisure customers and advises these figures were arrived at simply after discussion with the airlines [NECG report page 110]. A large volume of detailed analysis is then provided in the report using these figures. In a competitive environment where business travellers have an alternative airline to choose on main trunk routes, price elasticity values such as these might apply, but in the monopolistic environment proposed by the Alliance, this theory has no relevance.

v. The Air New Zealand/Qantas Application places considerable reliance on the premise that barriers to entry are low for a Value Based Airline (VBA) such as Virgin Blue and the threat of a new entrant will be sufficient to have the affect of restricting price rises on main trunk routes. In similar circumstances, the Commissions Decision No. 278 came to the conclusion that:

"The Commission believes that an immediate, vigorous incumbent response would be mounted against a new entrant to the main trunk routes, whether a full service entrant or a value based entrant." [Commission Decision 278, paragraph 100, page 90]

"The Commission concludes that, together, the factors affecting entry as listed above, indicate that a new entrant, whether a value based airline or full service airline, must prepare for considerable practical and financial difficulty." [Commission Decision 278, paragraph 103, page 91]

vi. The Air New Zealand/Qantas Application includes the provision they will co-ordinate on a range of activities including joint tendering for corporate and Government accounts, [Air New Zealand/Qantas Application, paragraph 25, section (a), page 18]. In our view, this inevitably implies that current agreements in place for Government agencies and corporates will be under threat and it is doubtful, under the Alliance proposal that they would continue. Even if these agreements do continue, Government agencies and corporates will be left with minimal or no room for negotiation in the future. In the past, these agreements have provided significant cost savings for Government and corporates and include SLA's on airline performance. In a monopoly situation, the Commissions Decision No. 278 came to the conclusion:

"The lack of competitive pressures on a dominant firm is also likely to result in a product of inferior quality being offered. The company and it staff are likely to adopt a 'take it or leave it attitude' to customers, aware that customers have no alternative to which to turn. As noted earlier, the level of service to customers in the domestic passenger air services market has improved significantly as a result of competition. Mr Copeland, for Qantas, emphasised the importance of flight

frequency and punctuality, especially for business people. If competition should disappear the position might be reversed." [Commission Decision 278, paragraph 469, page 100]

2. PROVINCIAL PASSENGER AIR SERVICES MARKET

The Air New Zealand/Qantas Application further claims the growth of Origin Pacific in the past six years is evidence that barriers to entry have been low [New Zealand/Qantas Application, paragraph 188, page 62]. The reality is that conditions will be different, if the Alliance proposal proceeds. In addition, because Origin Pacific will lose its code sharing arrangement with Qantas it will be disadvantaged. Origin Pacific has provided an essential service and should not be penalised now they are established. The NECG report concludes that, in the future, the Alliance may impact on the ability of Origin Pacific to compete:

"A loss of code sharing is therefore likely to make expansion more difficult for Origin Pacific and indeed might even lead to some contraction." [NECG Report section 4.3, page 119]

3. TRAVEL DISTRIBUTION SERVICES

The Commerce Commission Decision 278 (1996) concluded that the travel distribution services market was a separate market [Decision 278, paragraph 168, page 62] and we offer the following observations relevant to that market.

The Alliance proposal will allow Air New Zealand to exercise dominance in the market for travel distribution services, particularly in the Government and business travel segment of that market.

i. There is a scheme currently operated by Air New Zealand to allow some agents to earn a payment and the scheme is called ARIS. Under this scheme, the airline pays agent distributors for travel on competing routes. Should the Alliance proposal proceed, then Air New Zealand will be in total control of which routes will be considered competing routes. In fact, Air New Zealand would be in such a dominant position the airline would be able to cease ARIS payments for travel altogether.

ii. One example currently of Air New Zealand exercising market power with a view to favouring its own distribution outlets and to the disadvantage of other travel service distributors is the GDS channelling fee currently charged by Air New Zealand on every booking made through a GDS. This fee is not paid by Air New Zealand's own Travel Centres or its own agency Business Direct and they are not required to book through the airline web-site.

iii. A further example of Air New Zealand using its dominant position to favour its own distribution system is in the method of charging transaction fees. Currently these transaction fees, charged by Business Direct, can be charged to corporate clients through the Travelcard billing system along with the corporates air travel costs. Fees charged by independent agencies must be collected from the corporate separately from the ticket. Air New Zealand could solve this problem for independent agencies by setting up a new 'Tax Code' field for transaction fees. Additional codes can be set up reasonably quickly as demonstrated when separate security charges were introduced by the airlines.

4. PUBLIC BENEFITS

The cost savings of $627M after five years [Air New Zealand/Qantas application, table page 106] are based on economies of scale and improved aircraft selection. No mention is made of the detriments, in the form of cost wastage that a monopoly market will undoubtedly bring. On the question of airline monopolies the Commissions Decision No. 278 made the observation:

"A dominant firm which faces little or no competition in the market is under less pressure to minimise costs and to avoid waste than one which needs to be efficient in order to survive in a competitive market." [Commission Decision 278, paragraph 464, page 99]

And specifically on the question of Air New Zealand's efficiency when in a dominant market position:

Recent history shows that prior to the deregulation of air services, and to the corporatisation and then privatisation of Air New Zealand, that company suffered from high staffing levels and other excessive costs. While the inefficiency reflected partly an outmoded style of economic management of the economy, and partly government ownership in a protected market environment, it is also indicative of what might happen when a company enjoys a sheltered, near-monopoly position. [Commission Decision 278, paragraph 465, page 99]

5. CONCLUSION

The maintenance of on-going competitive tension between Air New Zealand and Qantas in New Zealand's Domestic, Trans Tasman and International markets is key to maintaining service levels and competitive pricing. Should the Air New Zealand/Qantas application be approved, there is the potential for welfare losses from the dominance of the Air New Zealand/Qantas Alliance.

We are not in favour of the Air New Zealand/Qantas application and respectfully request the Commission do not approve it. Our reasons are summarised:

i. In our view, the expected increase in travel costs, through yield management alone, will be far greater than the Alliance proposal advises because it cannot readily be monitored by independent sources.

ii. Airline loyalty agreements currently in place for clients, including Government Agencies, will probably cease.

iii. Government Agencies and Corporates have no substitute for air travel and will face increased costs for conducting essential business.

iv. The Alliance monopoly situation will inevitably lead to cost and wastage through inefficiencies and a reduction in service levels leading to a restoration of a 'take it or leave it' attitude amongst airline staff.

v. Should a new competitor enter the Main Trunk or Trans Tasman markets the Alliance will be well positioned to offer an immediate and vigorous incumbent response and the entrant will face considerable practical and financial difficulty.

vi. The Alliance proposal will have a negative impact on Origin Pacific's ability to compete and they may face contraction.

vii. The Alliance will use its dominant position to compete unfairly in the travel distribution services market and will have the potential to destroy the unbiased travel distribution services market.

Reference Sources

1. *ISSN No. 0114 – 2720, Commerce Commission Decision No. 278, (3rd April 1996).*

2. *Air New Zealand Limited and Qantas, Commerce Act 1986: Restrictive Trade Practice, Section 58: Notice Seeking Authorisation. (9th December 2002)*

3. *NECG Report on the Competitive Effects and Public Benefits Arising from the proposed Alliance between Qantas and Air New Zealand. (8th December 2002)*