APPLICATIONS BY QANTAS AIRWAYS LIMITED AND AIR NEW ZEALAND LIMITED UNDER SECTIONS 58 AND 67 OF THE COMMERCE ACT 1986 FOR AUTHORISATIONS OF STRATEGIC ALLIANCE AND PROPOSED SHARE ACQUISITION

SUBMISSIONS ON PROCESS ISSUES

Introduction

1. A number of process issues should be addressed at the outset which are relevant to the determinations which the Commission is required to make. These are:

   (1) The decision by the Commission to consider both applications (for authorisations of the strategic alliance between Qantas and Air New Zealand and of the proposed share acquisition by Qantas of Air New Zealand shares) in a single determination and to consider benefits and detriments arising from each proposal as being relevant to the other.

   (2) The proper scope of the Conference and the obligation of the Commission to receive and consider all evidence presented to it before and at the Conference.

   (3) The relevant statutory test as to the standard of probability which the Commission must, as a matter of law, apply in determining whether or not to grant the authorisations.

2. In addition, there will be outlined the evidence that has been presented to the Commission, which in the submission of the Applicants, meets the statutory test and which dictates the granting of authorisations on both applications.

Single Determination

Infratil submission

3. A jurisdictional question has been raised in submissions made to the Commission by parties led by Infratil Limited, Wellington International Airport Limited and Gullivers Pacific Group[1] arising out of the fact that the Qantas/Air New Zealand proposal has been put before the Commission as 2 separate, though obviously interrelated, authorisation applications – one by Qantas under section 67 (business acquisition) and the other by Qantas and Air New Zealand under section 58 (restrictive trade practice).

4. That issue can be stated, shortly, as to whether the applicants must isolate the benefits and detriments that apply in respect of *each* application and whether the Commission must determine the applications accordingly. Put slightly differently, the question is whether the Commission is entitled to assess all the respective benefits and detriments arising from the entire proposal as a whole or whether it must ignore the obvious commercial inter-relationship between the acquisition that is the subject of the section 67 application and the strategic alliance which is contained within the section 58 application.

5. Notwithstanding that they are both dealt with in Part V of Commerce Act, Infratil and its supporters base their highly legalistic arguments on three differences in nuance between the authorisation provisions applying to acquisitions and restrictive trade practices respectively. These are:

   (a) differences in wording in the legal tests applicable to the grant (or refusal) of an authorisation application;
   (b) the fact that behavioural conditions can be imposed by the Commission under section 61(2) in respect of a restrictive trade practice authorisation but only structural divestment

[1] See submission dated 20 June 2003, paras. 9-17.

undertakings are possible (under section 69A(1)) in respect of an acquisition authorisation;

(c) the absence of any power to consider a material change of circumstances once an acquisition authorisation is granted and the existence of such a power, under section 65(1)(b), in the case of a restrictive trade practice authorisation.

Common features and differences

6. In responding to these points of difference, it should be noted that they are minor and are overwhelmed by the rules and processes which they share in common with each other. In particular, the basic procedures applicable to restrictive trade practices authorisation applications, including the holding of conferences, apply also to business acquisition authorisation applications, by virtue of section 67(2)(procedure) and section 69B(2)(conference). The principal difference is that section 62 requires the Commission to prepare and disseminate a draft determination in the case of restrictive trade practices applications whereas there is no similar requirement in the case of business acquisition applications. In practice, however, draft determinations are employed in the case of the latter.

6. There *is* a difference in the way in which the public benefit test is formulated as between business acquisition and restrictive trade practices authorisation applications. As Infratil points out, section 67(3)(b) provides that the Commission should grant an acquisition application if it is satisfied that the acquisition will result or will be likely to result "in such a benefit to the public *that it should be permitted*"[2] and there is no express provision for the balancing of public benefit against competitive detriment.

7. By contrast, section 61(6) provides that, in the case of a restrictive trade practice authorisation application, the Commission must be satisfied that the entering into or giving effect to the relevant practice "will in all the circumstances result, or be likely to result, *in a benefit to the public which*

[2] Emphasis added.

would outweigh the lessening in competition that would result, or would be likely to result or deemed to result therefrom"[3].

8. It is submitted that not too much should be read into this difference. In practice, the Commission, in considering whether or not a merger or acquisition should be permitted has always undertaken the same exercise of weighing or balancing competitive detriments against public benefits. This not only makes both commercial and regulatory sense but, having regard to the policy and intent of the Act as a whole, is an inevitable approach. Any other conclusion would mean that the Commission would retain a residual discretion to authorise a merger or acquisition where the public benefits were outweighed by competitive detriments (rather than the other way around) – a fairly startling proposition.

9. Support for this submission is found in Commerce Commission Decision No. 267 (*Kiwi Co-operative Dairies Limited and Moa-Nui Co-operative Dairies Limited*).[4] In that Decision, the Commission pointed to the wording in question, which by amendment in 1991 had changed the test from the previous wording which required an authorisation of a proposed merger or acquisition to be given if public benefits outweighed competitive detriments. It then said:

> "The Commission sees no practical change. It is still necessary to weigh any detriment from the loss of competition resulting from the acquisition against the public benefits created by the acquisition to assess the 'net' benefit."[5]

False issue

10. It is submitted that the primary issue raised by Infratil is a false issue. Infratil's statement of that issue fails to acknowledge that the two applications are *in fact* interdependent and that it is neither commercially realistic nor in accordance with the policy and scheme of the Commerce Act to consider them separately. Nor is it feasible, in any sense, to analyse

[3] Emphasis added.
[4] 9 April 1992.

competitive detriments and public benefits in respect of each application as if they exist in isolation one from the other.

11. Thus, in considering the effect of the Qantas share subscription, it would be nonsense to ignore the fact that it is conditional on the execution of the Alliance Agreement and then to take no account of the benefits (and detriments) that arise from that Agreement. Paradoxically, that course would inevitably lead to the grant of a *clearance* for the subscription. A 22.5% passive shareholding in a company which has a single majority shareholder holding over 70% of the company gives that minority shareholder no ability to affect the state of competition in the market. And, if the matter were considered on an *authorisation* application, the increase in capital of Air New Zealand that the subscription moneys represent can only be regarded as improving the airline's competitive capacity and therefore as being in the public good.

12. Similarly, in assessing the detriments and benefits arising from the Alliance Agreement, it would be misleading and commercially unrealistic to ignore the benefits of the additional capital that will go to Air New Zealand.

Sections 61(6) and 67(3)(b) compared

13. It is submitted that further support for the view expressed above is to be found in the statutory direction in section 61(6) that, in considering an application for authorisation of a restrictive trade practices authorisation, the Commission is to have regard to "all the circumstances". One of the important circumstances accompanying the Alliance Agreement is that it is conditional on the share subscription.

14. While there is no comparable phrase or explicit direction in the case of share or business acquisitions, under section 67(3)(b) the Commission is directed to consider the "result" of the acquisition. Any consideration of

[5] Determination, para. 82.

the share subscription without regard to the effects of the Alliance Agreement would not provide an accurate assessment of the result of the acquisition. Further, because the share subscription and the Alliance Agreement are inter-conditional, the share subscription will not proceed in the absence of that Agreement. In short, there will in that case be no resulting outcome of either the Alliance Agreement or of the share subscription agreement. That fact makes the separate consideration of detriments and benefits irrelevant to the statutory issue that requires determination.

15. Finally, it is submitted that nothing turns on the fact that the Commission is empowered to impose conditions in respect of restrictive trade practices authorisation applications but "only" divestment undertakings in respect of acquisition applications. That is a difference that reflects the inherently different character of restrictive trade practices, which involve continuing activity, and an acquisition, which is a one-off transactional event. That difference also explains the power given to the Commission to revisit a restrictive trade practices authorisation where there is a material change of circumstances and the absence of such a power in the case of an acquisition authorisation.

Scope of the Conference

16. In exercising its powers to grant or decline an application for an authorisation, whether relating to a restrictive trade practice or a business acquisition, the Commission is clearly exercising judicial powers (or at the very least what have sometimes been called quasi-judicial powers). An authorisation creates legal rights and immunities that are of enormous value. For that reason, and because the statute so provides, an applicant has enforceable statutory rights to have its application determined in accordance with the specific statutory procedures and in accordance with the requirements of natural justice and the obligations which the Courts

traditionally read into regulatory statutes requiring the regulator to adopt processes and procedures that are fair[6].

17. There are two procedural differences that exist as between authorisation applications in respect of restrictive trade practices and those for acquisitions. These are that, in the case of the former, the Commission *must* issue a draft determination as part of the process[7] and *must*, if required by the applicant or any other person to whom the draft determination has been sent, hold a conference[8]. By contrast, there is no express provision for the issue of a draft determination in relation to an acquisition application, although in practice the Commission invariably follows that course. Nor, in the case of an acquisition application, is there any *right* given to the applicant or to any other party to a conference on request; rather the Commission is given a statutory discretion to hold one[9].

18. Importantly, however, once a conference is appointed, no matter by what route and whether relating to a restrictive trade practice or an acquisition, the procedural requirements are to all intents and purposes the same[10]. These are set out in section 64 of the Act, as supplemented by the overriding obligations to observe the rules of natural justice and to act fairly as laid down by the Courts. Within those constraints, the Commission is directed to act with "as little formality and technicality as the requirements of [the] Act and a proper consideration of the application permits"[11].

19. This would obviously mean, for example, that the Commission is not bound by the legal rules of evidence and can therefore receive all manner of material, irrespective of whether it could be admitted as evidence in a

[6] The Courts have never required the obligation to observe natural justice and to act fairly to be expressly spelled out in the relevant statute but have for centuries regarded such duties to be fundamental to the exercise of statutory powers of this kind.
[7] Section 62(1).
[8] Section 62(5). The Commission may hold a conference of its own motion if no such request is made: section 62(6).
[9] Section 69B(1).
[10] See section 69B(2).
[11] Section 64(3).

Court hearing. However, the obligation to conduct the conference in a manner that is consistent with "a proper consideration of the application" does, it is submitted, mean that the Commission must carefully assess the *weight* that should be given to material that is mere assertion and not backed by appropriate expertise or empirical data. This will be particularly true of so-called industry opinion that is not corroborated by evidence or independent expert opinion that can be measured against appropriate qualitative standards. It is submitted that a considerable body of the material that has been elicited from those opposing the applications fails to meet any such standard.

20. In relation to the conduct of a conference, it is submitted, without embarking on a debate as to just what requirements under the natural justice and fairness heads a Court would read into section 64, that two express obligations are clear enough on the wording of the section alone. The first is that a "reasonable opportunity [must be] given for the expression of the views of persons participating in the conference".[12]

21. The second requirement is that the Commission *must* "have regard to all matters raised at the conference"[13]. That does not, it is submitted, entitle the Commission to give any ruling – whether at the conference or before it - that has the effect of limiting those participating at the conference from tabling or presenting any submission or evidence that could assist the Commission in giving a "proper consideration of the application"[14].

22. In this last respect, the Applicants have already expressed concern[15] at statements made in the letter of 31 July 2003 from the Manager, Market Structure Group of the Commerce Commission, purporting to limit the

[12] Section 64(5). That provision empowers a member of the Commission attending the Conference to bring it to an end when that member "is of the opinion" that such a reasonable opportunity has been given. Consistently with accepted canons of statutory interpretation, that opinion cannot be one that is formed arbitrarily. Put another way, its reasonableness would be reviewable on objective grounds by a Court.
[13] Section 64(6).
[14] Section 64(3); see above.
[15] Memorandum from the Applicants dated 4 August 2003 to the Commission.

material that the Commission is prepared to accept or give weight to. The letter also proposes a review of the 3 economic models presently before it and anticipates the possibility of a revision of the Gillen model. At the same time, the Commission has rejected the request by the Applicants that, in accordance with similar procedures that have been adopted in Australia and New Zealand, a meeting of the economic experts assisted by the Commission be held with those assisting the Applicants with a view to eliciting common ground and differences of view that would focus the Commission's consideration of the economic material.[16] It is respectfully submitted that the curtailment of any opportunity for the Applicants to present timely further commentary on the economic evidence that is being obtained by the Commission, particularly when that evidence is not yet in final form, would constitute a serious breach of both the statutory and common law obligations assumed by the Commission in conducting the process for giving proper consideration to the applications. The continuing uncertainty relating to Professor Zhang's review[17] provides an obvious instance of this concern.

Statutory Standard of Proof

23. In considering whether or not to grant an authorisation application, the Commission must be "satisfied" that the statutory criteria have been met. Section 61(6) directs the Commission not to grant an authorisation for a restrictive trade practice unless it is satisfied that there is likely to be a resulting benefit to the public that outweighs any lessening in competition that would result or would be likely to result. The structure of the equivalent provision relating to acquisitions – section 67(3)(b) and (c) – is a little more complex but the effect is the same.

[16] See e-mail dated 31 July 2003 from Janet Whiteside on behalf of the Commission to the Applicants' legal advisers.
[17] As referred to the letter dated 5 August 2003 from Mr Ken Stephen on behalf of the Commission to the Applicants' legal advisers.

24. Over 10 years ago, in the case of *Foodstuffs (Wellington) Co-operative Society Limited v. Commerce Commission*[18], a Full Court of the High Court ruled that "the standard of proof, the degree to which the commission must be carried to be satisfied, is the civil standard of the balance of probabilities". That was a ruling that the Commission was never comfortable with. In Decision No. 399 (*Application for Clearance by Southern Cross Medical Care Society of acquisition of Aetna Health (NZ) Limited)*, for example, it said that the statutory test was "deliberately conservative". In the ensuing appeal in the High Court, counsel for the Commission expressly reserved the right of the Commission to argue that the ruling in the *Foodstuffs case* was erroneous and that applicants faced a higher onus than the balance of probabilities standard which plaintiffs in civil litigation were required to meet.[19] That submission was not wholly accepted by the High Court which endorsed *Foodstuffs* (and the subsequent Court of Appeal decision in *Power New Zealand Limited v. Mercury Energy Limited and Commerce Commission*[20]), while saying however that "the too-rigid application of a Court's civil standard of proof may be something of a straitjacket"[21]

25. The Court of Appeal in the *Southern Cross case*[22] took a more straight forward view. While recognising that a degree of prediction was necessarily involved in the determination, the Court said that the "standard of proof is the balance of probabilities"[23]. The Court said that it was "unnecessary to say anything more on this topic"[24]. It is submitted therefore that the exercise is indeed a relatively straightforward one and that the Applicants need only establish likely outcomes to a balance of probabilities standard. It is submitted further that there can be no further debate on this issue.

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[18] (1992) 4 TCLR 713, 721-722.
[19] See Judgment of High Court, Williams J., CL29/00, 8 March 2001, para.[30].
[20] [1997] 2 NZLR 669, 674.
[21] Paras.[29]-[33].
[22] CA 89/01, 21 December 2001, paras.[7], [65][66].
[23] Para.[7].
[24] Para.[66].

Weight of evidence

26. The Applicants have provided substantial evidence in support of their position, including:

- The NECG report, which supports the economic description of the competitive effects of the Alliance in the relevant markets, including the quantification of benefits and detriments. The Cournot model is used, leading to the conclusion that benefits substantially outweigh any detriments;

- The PWC report, which confirms that from a technical perspective the model was properly implemented and benefits and detriments properly quantified;

- The Tourism Futures International report, which confirms by reference to international sources that the Qantas Holidays' estimate of the number of additional tourists arising from the Alliance is conservative;

- Dr Michael Tretheway, economist, who confirms the change in industry dynamics;

- Professor Willig and Margaret Guerin-Calvert, who demonstrate that the Gillen model cannot be relied upon [nor the Hazledine model], and who also confirm on the basis of independent analysis, that the Alliance is likely to result in substantial net benefits to New Zealand;

- Professor Winston and Dr Morrison, whose evidence supports other evidence of the likelihood and likely impact of VBA expansion in New Zealand;

- The Airline Planning Group, who also confirm the likelihood of Virgin Blue expansion in domestic New Zealand and the rational nature of Qantas' expansion in domestic New Zealand, absent the Alliance; and

- Dr John Small, Covec, who confirms that the quantification of the tourism benefits to New Zealand is reasonable.

Conclusion

27. In considering this evidence (and that of those opposing the Applications), it is respectfully submitted that the Commission should be mindful of the ruling given by Richardson J. (as the then was) in the Court of Appeal in the *AMPS-A case*[25] that the public benefit/competitive detriment analysis required on an acquisition authorisation application should be conducted, wherever possible, by reference to quantitative and empirical evidence (including, it is submitted, expert opinion evidence derived from industry and market data). As Richardson J. expressed it: …"there is, in my view, a responsibility on a regulatory body to attempt so far as possible to quantify detriments and benefits rather than rely on a purely intuitive judgment to justify a conclusion that detriments in fact exceed quantified benefits."

28. It is submitted that, on a proper analysis of the evidence that is before the Commission the case for the Applicants for authorisations has been clearly made out to the required statutory standard.

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14 August 2003

[25] *Telecom Corporation of New Zealand Limited v. Commerce Commission* [1992] 3 NZLR 429 at 447.