



Consumers' Institute

**Submission in response to
application by Air NZ and Qantas for
authorisation of proposed arrangement**

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1. Consumers' Institute

Consumers' Institute is a broad-based national consumer organisation. On behalf of our 100,000 members we test products, compare the quality of services, research and comment on current consumer issues and expose exploitation of consumers by unscrupulous traders.

Our prime purpose is to inform and protect the interests of our membership. However, our work also has a benefit to all New Zealand consumers. This is particularly so when we take up an issue of broad public interest. The arrangement proposed by Air NZ and Qantas is such an issue.

We believe the Commission should refuse to grant the application.

For the reasons outlined below, we don't think the applicants have demonstrated that there are public benefits likely to flow from the arrangement that would outweigh the detriments of the lessening of competition undoubtedly resulting from authorisation.

2. Flawed assumptions

The applicants' reasoning is based on a series of self-serving assumptions about the possible effects of the proposal. These assumptions are no more likely to be borne out than a range of other scenarios.

It's well-known that the airline industry is highly unpredictable and subject to a range of factors largely outside the industry's control. The volatility of the industry (particularly internationally) combined with these highly questionable assumptions has resulted in an application that is unconvincing to the point where it lacks credibility.

The counterfactual adopted by the applicants is not based on a "pragmatic and commercial" assessment of what is most likely to transpire in the absence of the proposed arrangement going ahead. It is based on a collection of worst-case scenarios chosen for

their support of the applicants' case rather than for any particular likelihood that they will eventuate.

We hope the Commission will look beyond the application and adopt a counterfactual based on its own "pragmatic and commercial" assessment.

We don't believe the assertion in the application that Air NZ is incapable of meeting the threat of head-on competition with Qantas should go unchallenged. Air NZ is currently doing well and incidentally offering the travelling New Zealand public the best fares they've ever had.

3. Claimed public benefits

The Commission can't be satisfied that the application contains the balance necessary for a reasoned weighing of benefits and detriments.

3.1 Poor economic analysis

The economic analysis used by the applicants to assess the proposal is vague and too often relies on statements that are not supported by reasoning. Indeed the paper freely admits the weakness of the authors' case.

By way of example, the section on "public benefits" carries statements such as:

- "the quantification of that benefit is problematic... we have no reliable way of evaluating those benefits, although it is apparent they exist" (5.2.2 Enhanced connectivity);
- "we are not in a position to quantify these benefits with any degree of precision" (5.6.1 Improved governance);

- “we are not in a position to quantify the extent of these effects with any certainty...” (5.6.2 Deadweight costs of taxation);
- “although it is not possible to quantify the public benefits associated with having a more robust and viable international airline located in this region, we nonetheless believe that such benefits do exist and are significant” (5.7.1 Global competitiveness).

Given the central importance to the application of a clearly demonstrated public benefit, this sort of guesswork is not good enough. The quantification of the benefits to be gained is precisely the point of the exercise.

3.2 Cost efficiencies

The applicants promise cost efficiencies through economies of scale and improved aircraft selection.

Our response to that is:

- There is no obligation for the applicants to pass on to customers any efficiencies gained. Nor, in the absence of competition would there appear to be any incentive to do so. We would expect the applicants to behave like other businesses and retain the efficiencies as increased profit.
- It appears likely the applicants will each have to duplicate capacity for certain core services to avoid being caught short if the arrangement should fail down the track. This will tell against the capturing of cost efficiencies.

3.4 Tourism

The applicants claim substantial benefits for the New Zealand tourism market.

Air NZ already does a good job of promoting itself and NZ internationally. It has an excellent reputation with international travellers. (By way of example, we attach the results of a customer-satisfaction survey published by the British Consumers' Association. Air NZ topped a long list of international airlines).

The future for tourism in this country is looking strong for all sorts of reasons, and there is certainly no urgent need for promotion, nor any threat to the tourism industry, that justifies the risks inherent in the proposal.

3.5 Benefits possible even without arrangement

The application doesn't demonstrate that the claimed benefits could only accrue in the event of the proposed arrangement going ahead. Nor could it sensibly do so, given the benefits such as low fares and increased passenger numbers currently being seen. That strongly tells against taking the risks associated with a lessening of competition.

4. Detriments

The application doesn't seriously address the potential detriments inherent in the proposed arrangement. As with the assessment of benefits, the applicants have tended to fall back on untested assumptions.

The application also focuses (at the expense of an assessment of public detriments associated with the lessening of competition) on potential detriments to the parties resulting from the arrangement not proceeding.

There is an apparent assumption that what's bad for the airlines is necessarily bad for the public (and that what's good for the airlines is good for the rest of us).

Obviously, the proposed arrangement will substantially lessen competition and will effectively grant a monopoly. Experience tells us monopolies are inevitably abused and lead to higher prices and reduced responsiveness to customers.

Talk of “costs savings” and “improved quality of service” is cheap. Unfortunately, it’s not borne out by any observance of monopoly behaviour.

In the absence of competition, there will be no incentive for the applicants to maintain the low fares currently being enjoyed by the flying public. Nor will there be an incentive for the applicants to improve or maintain services, beyond a maximisation of their profits.

5. Risks not justified

The applicants have not adequately demonstrated that the benefits of the proposed arrangements cannot be gained by simply allowing a strategic alliance, without the need for Qantas to buy into Air NZ.

If the arrangement is approved and then fails at some time in the near future, we will potentially be in the situation where Air NZ faces all-out competition (as suggested in the applicants’ counterfactual) with a competitor which has been privy to its corporate secrets.

We think that simply increases the risk that Air NZ would be overwhelmed in a battle with its larger ex-partner – a self-fulfilling prophecy.

If, as the applicants claim, the alternative to the proposed arrangement is Air NZ being crushed by Qantas, why should we now trust Qantas to act in new Zealanders’ interests?

6. New entrants

It is generally agreed that the entry into New Zealand of new players (most likely a VBA such as Virgin Blue) would be in the interest of the travelling public.

We don't agree with the applicants' assertion that the proposed arrangement will facilitate such entry. Nor do we think it can be said that the applicants have provided any arguments that are capable of supporting the assertion.

If there is not sufficient room for both Air NZ and Qantas in the New Zealand market (a proposition inherent in the application), one would expect any new entrants would stand no chance of survival (with or without the proposal going ahead). Yet the applicants claim that the proposed arrangement will make it easier for Virgin Blue or another VBA to successfully enter the market.

We don't see that they can have it both ways. If the market can be accommodate another airline, why do the parties need protection now from market forces?

And if Air NZ can't survive intense competition on its own, how likely is it that a new entrant would survive when pitted against the combined resources of two well-established incumbents?

The applicants claim that should the proposal be approved, the "threat" of entry by the likes of Virgin Blue will be sufficient to constrain any tendencies to abuse their monopolistic position.

We don't agree. It is competition itself, rather than a potential "threat", that constrains monopolies. Companies in a monopolistic position can wait until the threat has actually materialised before changing their behaviour. Until then, they are not constrained.

History shows that Air NZ can act quickly to meet competition where it actually materialises – and New Zealanders are currently enjoying the benefits of competition.

7. Flag carrier

The applicants place great emphasis on the value to New Zealand of having a “flag carrier”. We think this value is overstated and misplaced.

The application assumes that there is an inherent value in having a national airline to “fly the flag” overseas. That may be so, but there is a more substantial and valuable public interest in having a well-maintained national airline that provides a service the public wants, and does it well.

National pride at having Air NZ as our ambassador abroad should take a back seat to an Air NZ that delivers tangible benefits to the public.

The applicants should also acknowledge that given the political importance of maintaining a flag carrier, they have a special responsibility to avoid risking the situation where the public has to once again bail out the national airline.

8. Conditions

If the application is approved, protections for consumers should be explicit. Realising the Commission may grant authorisations subject to conditions, we would suggest any approval should be made conditional on at least a bare minimum floor of consumer protection.

8.1 Provision for facilitating new entrants

As stated above, the entry of new players into the market would be in the interest of the travelling public.

We believe any authorisation should be conditional on Air NZ divesting Freedom Air. This would go some way to removing the obstacles which the authorisation would place in the way of entry by a new VBA.

8.2 Mechanism to measure customer satisfaction/service standards

We don't believe the Commission should grant the application unless there is a mechanism put in place to ensure the delivery of the benefits which the applicants claim will accrue to the public.

There are a number of models on which such a mechanism could be based. Any scheme would need to take into account the issues which are important to the travelling public.

Under a sector-specific Ombudsman-type scheme, the airline industry could be required to work with an independent body to develop a code of practice. That body would then measure the performance of industry participants against the code and perhaps consider public complaints of code transgressions.

Other models include, by way of example, NZ Post's annual audit, by an independent company, against service performance indicators, and Telecom's annual reporting to the Ministry of Consumer Affairs.

We note the Civil Aviation Authority already carries out extensive monitoring of aircraft operators and this could perhaps be an avenue for addressing this concern.

8.3 Commitment to transparency in fares

We believe the applicants need to make a commitment to transparency of fare structures, fare availability and advertising.

Customers and industry observers are currently unable to assess the availability of advertised fares. The fare structure itself is so complex as to make comparisons between operators (and an assessment of whether claimed benefits are actually being delivered) extremely difficult.

Add to that the problems that have been seen recently with confusing advertising, and it's clear this is an area where the industry should be required to lift its performance – even more so if there's to be a lessening of competition.

Conclusion

While properly designed conditions might go some way to allaying the concerns that we have about the application, we stress that our strongly held view is that the authorisation should not be granted in any form.

We should not be risking serious potential detriment to the public interest on anything but the clearest possible evidence that we will most likely benefit from the exercise. As this submission will have made clear, our view is that the application falls well short of establishing that threshold.