

## **NEW ZEALAND AMALGAMATED ENGINEERING, PRINTING & MANUFACTURING UNION**

1. The New Zealand Amalgamated Engineering, Printing & Manufacturing Union (“EPMU” or “the union”) is New Zealand’s largest private sector union organising in a range of industries including aviation. Of our approximately 55,000 members nation-wide, we have approximately 3,000 employed in the aviation sector, predominantly by Air New Zealand Limited. Most of our members employed by Air New Zealand work in the engineering, terminal services, cargo and sales and marketing (reservations and airpoints) divisions.
2. The EPMU, like any union organising in Air New Zealand, has an interest in a stable and sustainable business. We, therefore, have an interest in the strategic decisions and arrangements the airline enters into. It should be remembered that it is not just shareholders who are risk-takers in a business. As with any business, employees assume a level of risk in their employment, i.e. the risk of bad management and leadership leading to corporate failure, the loss of employment and ultimately hardship for individual workers.
3. Our specific interest in the applications made to the Commerce Commission by the airlines are:
  - Ensuring that the Commission’s decision is consistent with a stable and sustainable aviation market in and out of New Zealand, and provides reasonably stable platform for work in order to attract and retain skilled workers.
  - Ensuring that the commitments made in relation to job creation, in particular in respect of engineering services, are genuine and deliverable.

## **CASE FOR PROPOSED ALLIANCE BETWEEN QANTAS AND AIR NEW ZEALAND**

4. We agree with the case made for the need for an arrangement of the nature proposed by the two airlines under this application.
5. Over the last 12-18 months, there has been significant restructuring and repositioning of major full service airlines world-wide. In the United States, we have seen U.S. Airways, American Airlines and United Airlines retrenching and/or seeking major concessions from their workforces in relation to terms and conditions of employment. They have done so in order to remain viable and/or to stave off bankruptcy.

6. In Europe, we have seen many long-standing airlines either collapsing, being forced into mergers with other airlines or being bailed out by governments.
7. In Australasia in 2001, we saw two significant airlines collapsing, Tasman Pacific Airways (trading as Qantas New Zealand; formerly Ansett New Zealand) and Ansett Australia (at the time, a recently acquired subsidiary of Air New Zealand). Air New Zealand, itself, has had to be supported by an injection of government equity in order to survive.
8. We agree with the analysis that the major pressure being exerted on airlines is not solely related to the events of 11 September 2001 in the U.S. but is more likely the product of an extended period of intense competition in which airlines have been driven to operate at marginal profit or below-cost pricing. The competition has intensified with the advent of value-based airlines (“VBAs”) which have been able to establish themselves with a significantly lower cost structure and a less costly operating network (operating point-to-point, no interlining obligations, reduced sales and distribution costs).
9. The situation in New Zealand as it pertains at the time of this application is that there are two major domestic competitors (three if Origin Pacific is included, but it code-shares with Qantas). Air New Zealand’s domestic operation is profitable and the New Zealand domestic Qantas operation is unprofitable. We regard it as unlikely that Qantas, in the absence of any agreement with Air New Zealand or any other party, will wish to continue this state of affairs.
10. Qantas’s New Zealand domestic operation makes commercial sense in the context of its trans-Tasman operations. It is, therefore, expected that Qantas will wish to maintain a presence in the domestic New Zealand market. We do not accept, however, that Qantas would wish to remain in New Zealand at any cost and on the basis of continuing significant losses. We accept that Qantas would wish, at some point, to ensure its New Zealand operation is economically viable in the long run. Accordingly, we regard it as likely, in the absence of any agreement with Air New Zealand, that Qantas would wish to compete to grow its market share and reduce Air New Zealand’s market presence, putting the profitability of Air New Zealand’s domestic operation under threat. The proportion of Qantas’s domestic New Zealand and trans-Tasman business to its total business world-wide suggests it has the economic strength to compete aggressively with Air New Zealand for a lengthy period of time to achieve its commercial objective. This is the counter-factual set out in the application and we consider that it is consistent

with the commercial realities of the New Zealand commercial aviation market as we observe them.

11. On the basis that Qantas would wish to maintain a presence in the New Zealand market as an extension of its trans-Tasman routes, we do not consider that the further variation of a VBA (other than Freedom Air) entering the New Zealand domestic market will change the outcome for Air New Zealand. Either way, Air New Zealand stands to lose market share, undermine its domestic profitability and threaten its international routes.
12. A further possible counterfactual is that Air New Zealand will be supported by local capital markets for future equity or be supported in the future by the New Zealand government should future equity needs not be met by local capital markets. Our understanding of airlines as a long-term investment proposition, and our observation of local capital markets, suggest that the local markets are an unreliable source of future capital. Furthermore, we doubt whether the New Zealand government has a long-term appetite for recurring equity injections into an airline, no matter how strategic.
13. Market behaviour in the New Zealand domestic aviation market over the last two years suggests that the market is not deep enough (either as a whole or on a segmented basis) to sustain two major airlines. Tasman Pacific airlines, and its predecessors operating Ansett New Zealand, did not make a profit during the 13 years it operated. Qantas operations in New Zealand are currently not profitable. No new entrant has shown any willingness to enter the domestic New Zealand market. We conclude from this, and from the fact of this application to the Commission, that the market has dictated that it cannot guarantee genuine competition.
14. To the extent that competition is relied on to protect consumer interests, we submit that where genuine competition is not possible then other measures are needed to protect consumers. Quality of service issues can be dealt with as a matter of contract and under consumer law (e.g. Fair Trading Act). Quantity of service (i.e. maintaining at least the existing network in New Zealand) could be a condition of approval of the arrangement. Protection against unjustified price hikes can be achieved through price control measures. In any event, it is possible to overstate the risk of monopolistic pricing behaviour. Air New Zealand, under the proposed JAO, must still be profitable, and thus its pricing must be consistent with maintaining close to current volumes.

15. In summary, and subject to the points we make in paragraphs 16-30 below, we consider that the proposed arrangement, in principle, is necessary to ensure stability and sustainability in New Zealand's domestic aviation market. To the extent that it is anti-competitive, we consider other measures are available to mitigate any potential negative impacts on consumers.

### **ENGINEERING SERVICES**

16. The filing of the airline's application with the New Zealand Commerce Commission coincided with public statements suggesting that one of the benefits of the application would be around 200 additional engineering jobs.
17. In a media release of 9 December 2002 under the heading "More jobs, tourists and direct destinations flow from airline alliance: statement made by Ralph Norris, Managing Director, Air New Zealand Limited" it was stated, amongst other things:

The strategic alliance between Air New Zealand and Qantas will create 200 new jobs in Air New Zealand and a minimum of 2,500 additional jobs in the tourist industry.

The new jobs within Air New Zealand will be in our Engineering Services operations in Christchurch and Auckland.

Currently, many of the engineers at our Engineering Services operation are employed as short-term contractors, and their work is underpinned by Air New Zealand successfully tendering for ad-hoc, third party contracts. Their ongoing employment is dependent on Air New Zealand continuing to win sufficient tender work from other international airlines and defence forces.

In the 2001/02 financial year we won 43 percent of the work Qantas put out to international tender at a value of \$20 million, and this supported the employment of some 100 of those engineers.

...

In addition we will be able to invest some \$100 million in new engineering infrastructure. This will create the opportunity to continue tendering for even more maintenance work from other international airlines, requiring more staff and increasing the overall engineering workforce by 200 over the number we currently employ. (underlining added).

18. These comments are consistent with comments made by Ralph Norris in an address to the American Chamber of Commerce on 6 December 2002. In that address, Mr Norris stated:

In addition we estimate that the alliance will lead to the creation of at least 200 additional highly skilled jobs within Air New Zealand. Let me repeat that point. The creation of at least 200 new, highly skilled jobs, the majority of which will be in Christchurch and Auckland. (underlining added).

19. The application, and the accompanying commentary by NECG suggests a more diluted assurance on the creation of new jobs. The section 58 application states, materially:

417. The applicants believe that in the absence of the Transactions, external work directed to Air New Zealand are (sic) likely to be as low as 10% of Qantas's external work requirements.

418. This is significantly less than the share of Qantas's sub-contracted heavy maintenance work undertaken by Air New Zealand in 2002/2003 (at 78%). Qantas has indicated a likelihood to Air New Zealand that Air New Zealand's share will reduce substantially in 2003/2004 in the absence of the Transactions. The reason for the predicted decrease is that third parties such as Singapore Technologies can provide a similar quantity of work at the same or similar price.

419. Under the Transactions, Qantas agrees that Air New Zealand will be its preferred supplier for sub-contracted heavy maintenance work. It is likely to result in Air New Zealand maintaining a share in the order of 80%, resulting in additional revenue of \$39m to New Zealand compared to \$6m without the Transactions. This is not only an annual benefit in monetary terms of \$39m but also represents the retention and/or creation of nearly 200 skilled engineering jobs.

20. The NECG report states, materially at page 33:

... in particular, if the alliance proceeds, Qantas will have incentives to continue contracting a substantial part of its outsourced heavy maintenance to Air New Zealand. Qantas's equity share in Air New Zealand will make continued reliance on Air New Zealand's maintenance operations commercially attractive for Qantas, even if there exist more competitive alternatives. This assurance of future volumes amounting to some \$39 m in annual billings will, in turn, allow Air New Zealand to invest in new maintenance facilities at its Auckland-based facilities which can be used to compete for maintenance work internationally. The result will be to provide expansion of

servicing activities in New Zealand and to provide employment security for the skilled staff involved, preventing the loss of these skills to overseas. We have taken a conservative approach to the value of these benefits, only valuing the known increase in servicing expenditure due to the alliance. This amounts to \$39m per year (or \$35m in present value terms).

And at page 160:

In 2001/02, Qantas directed 43% of its subcontracted heavy maintenance work to Air New Zealand. This provided revenue of \$20m and supported the employment of up to 100 skilled engineering staff. In 2002/2003, this will increase to 78% of subcontracted heavy maintenance corresponding to revenue of \$40m and support of 200 skilled engineering staff.

21. Contrary to the statements of Air New Zealand's managing director in the media release of 9 December 2002, we are not aware of engineers at the engineering services operation being employed as short-term contractors. We are not aware of up to 100 engineering staff whose jobs are, therefore, contingent on either ongoing or new work from Qantas whether as part of the proposed agreement or not.
22. Taking this into account, and taking the figures as they appear in the application, if it is correct that in the current year 78% of Qantas's outsourced heavy engineering work went to Air New Zealand, then it would appear that that work has been or is being accommodated with the existing staff complement. If this is the case, then it is difficult to see where the 200 additional jobs will materialise from.
23. Moreover, again on the basis of the material in the application, if the 78% of Qantas outsourced work is currently being carried out in existing facilities and within the existing capacity of engineering facilities it is difficult to see how this alone would commercially justify a further investment of \$100 million for new or additional facilities.
24. The proposed agreement itself, in clause 4.7(b), merely requires Qantas to treat Air New Zealand as its preferred external supplier of heavy maintenance services providing that Air New Zealand's charges and service levels remain competitive with other external alternatives available to Qantas. Clause 4.7(a) confirms that it "is not intended" to give Qantas any "review, control, influence or other decision-making right" over the Air New Zealand engineering business. Beyond these commitments, there are no commitments in the agreement about the use of engineering services and there is no commitment suggesting or implying the prospect of a \$100 million investment in new engineering facilities.

25. Given the public statements on engineering services and the prospect of 200 additional jobs and given the more equivocal terms of the agreement and the application submitted to the Commerce Commission, it is submitted that at the very least some clarity is required on what the correct position is in relation to the possibility of additional engineering jobs.
26. Assurances about additional work being created merely by the existence of the agreement as proposed must be seen in the context of the purpose of the agreement which is about ensuring the viability of the airlines (clause 3.1(a) of the proposed agreement) and to “deliver cost savings through improved asset utilisation including achieving efficiency improvements in the use of aircraft and other resources” (clause 3.2(c)(iii)).
27. In respect of some non-engineering areas of employment, the application says “[c]urrently, the parties do not intend to co-ordinate their sales, marketing and customer service operations (para 18). Nevertheless, the proposed agreement provides for co-ordination and efficiencies in these respects. We expect, as a commercial reality, that there would be some immediate rationalisation of Qantas operations in New Zealand.
28. Given the expectation that efficiencies will be achieved in the early life of the proposed arrangement, any commitment to create new jobs in engineering must be given serious consideration as part of the balancing of respective benefits and detriments. It is not clear which of the parties is likely to be the beneficiary of efficiencies in non-engineering functions and so the parties should be held to commitments to new jobs in engineering.
29. Notwithstanding the need for more clarity on what the correct position is in relation to engineering jobs, it is submitted that the Commission should exercise its power under section 61(2) of the Commerce Act 1986 to impose conditions on any approval that are consistent with assurances that additional engineering jobs will be created. We suggest the following conditions:
  - (1) That Qantas not alter the proportion of heavy maintenance engineering work that it currently contracts out.
  - (2) That Qantas direct no less than 80% of such work to Air New Zealand engineering providing Air New Zealand can perform the work to a level and rate comparable to or competitive with Qantas itself.

8.

- (3) That within the first year of the operation of the arrangement Air New Zealand furnish to the Commission a business plan for engineering based on the establishment of 200 extra positions and the investment of \$100 million in new plant and equipment, and a timeframe for implementation.
30. We note that should additional jobs be generated out of Qantas's existing practice of contracting out a proportion of its heavy maintenance engineering work to a third party contractor then it will have little or no impact on existing jobs in Australia.

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**SUBMISSION ON BEHALF OF**

**NEW ZEALAND AMALGAMATED ENGINEERING,  
PRINTING & MANUFACTURING UNION**

**TO**

**THE COMMERCE COMMISSION**

**ON APPLICATIONS BY AIR NEW ZEALAND LIMITED  
AND QANTAS AIRWAYS LIMITED UNDER THE  
COMMERCE ACT 1986 FOR AUTHORISATION  
OF A PROPOSED ARRANGEMENT**

**FEBRUARY 2003**