AIR NEW ZEALAND / QANTAS AUTHORISATION APPLICATIONS – RESPONSES TO THIRD PARTY SUBMISSIONS

PART A – INTRODUCTION

This document contains the formal response of Air New Zealand Limited (**Air NZ**) and Qantas Airways Limited (**Qantas**) (together the **Applicants**) to the submissions received by the New Zealand Commerce Commission (the **Commerce Commission**) and the Australian Competition and Consumer Commission (the **ACCC**) (together the **Commissions**) from third parties as of Friday 7 March 2003 (the **Submissions**).

The Applicants' response is divided into 3 Parts:

- Part A – this introduction;
- Part B – response to substantive issues; and
- Part C – A paper prepared by NECG which is an integral part of this response.

The substantive matters raised in the Submissions can be grouped broadly into 11 categories:

(i) counterfactual;

(ii) VBA entry/expansion;

(iii) freight capacity;

(iv) travel distribution;

(v) tourism;

(vi) undertakings/conditions;

(vii) price and capacity changes;

(viii) impact on Origin Pacific Airways Limited (**Origin Pacific**);

(ix) impact on employment in Australia;

(x) relevance of Australian air traffic rights; and

(xi) frequent flyer points.

The above characterisation of issues is structured to assist the Commissions in understanding the Applicants' responses to issues raised in either or both jurisdictions. Clearly all issues are not relevant to both jurisdictions and this response should not be taken to represent the Applicants' views on any jurisdictional issues.

This response should also be read in conjunction with all additional papers filed by the Applicants. For example, the Applicants have recently filed a report prepared by Tourism Futures International dated 5 February 2003 (the **TFI Report**) and the Qantas Holidays Business Plan filed with the Commissions on 6 March 2003 (the **QH Business Plan**), which the Applicants believe address the Submissions on tourism. The Applicants are happy to respond to any further questions the Commissions may have or comment on other aspects of Submissions the Commissions consider relevant.

Part C of this response is NECG's response to the economic arguments raised in Submissions (the **NECG Response**).

PART B – RESPONSE TO SUBSTANTIVE ISSUES

General

The large number of Submissions reflects the level of interest in the Applications. However, many submissions do not fully appreciate the environment within which committed network airlines such as Qantas and Air NZ operate. In a network environment each international and domestic city pair and route group is, to some extent, interdependent on, and impacts on, every other city pair and route group. When travel across the network is involved this interdependence can mean that a route that is not generating adequate return on a standalone basis may well be contributing significantly to returns on other routes on the airline's wider network.

That is not to say a failure by Air NZ to maintain profitability on its core domestic network would be offset by advantages accruing to its long haul network. To the contrary, an important justification for Air NZ retaining a (largely loss making) long haul network is to assist the profitability of Air NZ's core domestic network.

The risk to Air NZ is that without the Alliance, Qantas has substantial commercial incentive to (and will) expand its presence on core domestic New Zealand routes which Qantas considers to be an integral part of its home market and necessary to replace feed at risk after the bankruptcy of Tasman Pacific Airways Limited (**Tasman Pacific**). Qantas' expansion would place Air NZ's profitability on its core domestic network at significant risk.

Although the New Zealand Government has not made a submission, considerable thought has been given to the issue by a number of Government Departments and substantial professional advice has been given. Most of this process has been publicly communicated by the Government's release of substantial amounts of information following requests under the Official Information Act. This information and its analysis addresses many of the issues raised in various submissions by third parties.

1. Counterfactual

Several Submissions misunderstand the Counterfactual modelled by NECG. They assume the modelled 'war of attrition' will give rise to an explosive battle between the airlines rather than the slow wearing down of resources that the Counterfactual actually entails. For that reason, they assume that the modelled Counterfactual is unrealistic. This issue is discussed in greater detail in section 4 of the NECG Response.

1.1 Qantas' underlying business rationale

In accordance with the Australian and New Zealand Governments' Single Aviation Market policy, Qantas sees its home market of Australia and New Zealand as fundamentally important to its international strategic position. Consistent with this view, Qantas has not only maintained and expanded its long-standing trans-Tasman network, but is also developing a comprehensive presence in New Zealand. Qantas initially had a presence through its arrangements with Ansett New Zealand and Tasman Pacific (trading as Qantas New Zealand) and in 2001 commenced its own operations (see paragraphs 75-89 of the section 58 Application to the Commerce Commission and paragraphs 5.25-5.32 of the submission to the ACCC).

From an operational perspective, Qantas' current level of capacity in domestic New Zealand is sub-optimal. Its domestic New Zealand revenue share is less than its capacity share, reflecting the fact that its flight frequencies are not yet sufficient to make it an attractive proposition for a sufficient number of high yield passengers. The additional capacity added under the Counterfactual is rational and, taking into account normal demand growth, Qantas' capacity under the Counterfactual is still broadly in line with that operated by Ansett New Zealand in domestic New Zealand in 1999. The key difference, however, between Qantas and Ansett New Zealand is that Qantas is an Australasian full service international carrier with the connectivity, international reach and financial resources to be a more effective competitor to Air NZ.

In its submission, Virgin Blue Airlines Pty Limited (**Virgin Blue**) agrees that Qantas is likely to increase its capacity in domestic New Zealand, although it believes Qantas' increase will be more gradual than that put forward in Qantas' Counterfactual. Virgin Blue's submission reflects the perspective of an airline focussed on point-to-point

operations. It fails to adequately recognise the significance of network benefits for network carriers such as Qantas and Air NZ. These are substantial, and, in conjunction with the other considerations such as the city presence and network reach that its New Zealand services contribute, more than justify the commitment of the Qantas Counterfactual capacity to domestic New Zealand.

Furthermore, the Air NZ Board and management explicitly and independently recognised the business logic and inevitability of an increase in capacity by Qantas in Air NZ's core market.

These points are expanded upon in Part 2 of the attached Counterfactual Paper and also in the NECG Response.

1.2 Air NZ is showing a marked increase in profitability.

The reasons for the recent increase in Air NZ's profitability are:

(a) external factors beyond the control of Air NZ:

- supply – Qantas has only begun to add the Counterfactual capacity and Virgin Blue has not yet expanded onto the domestic New Zealand and trans-Tasman routes;
- demand – New Zealand has been sheltered somewhat from the effects of September 11, partly due to its safe haven status and the temporary effects of the America's Cup and the Lord of the Rings promotions;
- fuel prices – Air NZ has benefited from reduced fuel prices; and
- foreign exchange – foreign exchange rates have moved in Air NZ's favour (fuel and aircraft costs are the major impacts); and

(b) factors within the control of Air NZ, namely the introduction of NZ Express in domestic New Zealand to reduce unit costs.

All the external factors are currently favourable. However, the potential for material external shocks has never been greater. Indeed, John Palmer, Chairman of Air NZ at Air NZ's half annual profit announcement stated:

> We have benefited in this result from lower fuel costs and a higher New Zealand dollar. These factors are not controllable by management over the longer term and so we must be careful in taking credit for them.

The turnaround in profitability should be treated with caution because Qantas has only begun adding the Counterfactual capacity. For example, Macquarie Research Equities (MRE) state that:

> The second half environment should remain positive for Air NZ because:
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> Domestically, as it applied for JAO approval with Qantas, MRE doubts any aggressive competition. Thus the lower pricing created from the Air NZ "Express pass" is driving higher load factors on lower cost airlines, without any excess competitive response impacting volumes.[1]

The airline industry is highly uncertain and an improvement in profitability for a period of 6 months provides little indication of longer term viability. For example, in the 1999 financial year, Ansett recorded a 143% increase in profit before tax to A$200.4m. Two years later it was placed into administration.

Finally, the Applicants do not have any information to suggest that one of them is, overall, a higher or lower cost carrier than the other.

As Air NZ has stated on a number of occasions, it has carefully investigated alternative options. From Air NZ's perspective an equity issue alone (even if it was available) would not deal with the effect of Qantas' expansion in domestic New Zealand, give Air NZ access to Australian feed, provide Air NZ with codesharing opportunities, enhance

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[1] Macquarie Research Equities, 28 February 2003.

promotion of New Zealand tourism, or produce the other industry-specific benefits that the Alliance provides.

With all of the forecasting tools and industry experience available to it, Air NZ does not believe that it can make an adequate return on capital in the face of Qantas expansion, VBA expansion on trans-Tasman and domestic New Zealand routes (which Virgin Blue states will occur in the near future), and Fifth Freedom competition on trans-Tasman routes. The effect of such expansion on Air NZ's return on capital employed is independently supported by the report from First NZ Capital, which was obtained by the New Zealand Government in reaching its "in principle" decision to approve the equity investment as Kiwi Shareholder. It should also be noted in this context that the inadequacy of capital returns for airlines is a globally recognised issue that has gained greater focus in recent times.

2. Entry or expansion by Virgin Blue or another airline

Virgin Blue has confirmed it will commence operations on domestic New Zealand main trunk and trans-Tasman routes, irrespective of whether the Alliance proceeds.

2.1 Expansion

Virgin Blue's expansion plans are consistent with an objective assessment of the characteristics of the domestic New Zealand and trans-Tasman routes. These routes are short haul, point to point sectors between cities with a population of more than 50,000, which ideally suits Virgin Blue's declared business model.

Given that there can be no doubt that Virgin Blue will expand its operations, the remainder of this section explains why the scale of its expansion under the Factual will be greater than under the Counterfactual.

2.2 Scale of expansion

Virgin Blue says:

> It is true that a reduction in head to head competition between Qantas and Air NZ resulting in higher prices and reduced capacity on key routes represents an opportunity for Virgin Blue to expand its intended scale of operations.

Somewhat disingenuously, it goes on to assert that the extent of its expansion would be less in the Factual. Virgin Blue attempts to explain this inconsistency by claiming, without any credible foundation or analysis, that in the Factual retaliatory increases in capacity are more likely to occur.

Virgin Blue's apparent concern about the scale of its operations under the Factual is inconsistent with its demonstrable success in domestic Australia. Virgin Blue entered Australia in August 2000, and has rapidly achieved approximately 30% market share (and confidently predicts growing to 50%). Virgin Blue achieved this result originally competing against Qantas, Ansett and Impulse. Since September 2001, it has competed head to head with Qantas – a large, well-resourced international carrier, with a significant share of high fare customers. During this period of intense competition (precisely the environment that Virgin Blue claims hinders the scale of its expansion in domestic New Zealand and trans-Tasman) Virgin Blue has exceeded its profit and growth forecasts and is now reportedly close to announcing a float in order to further fund its strong expansion plans.

Having regard to Virgin Blue's experience in Australia, its apparent concerns about the enhanced ability for the Applicants to constrain Virgin Blue's operation under the Factual should be seen as self-serving and afforded no weight.

In relation to other specific claims made by Virgin Blue, the Applicants respond as follows:

(a) The Applicants will have a higher proportion of high fare customers giving them a greater ability to cross-subsidise low fares.

- Virgin Blue has confused the yield management systems employed by the Applicants with the concept of cross-subsidisation. In employing yield management systems, the Applicants seek to maximise revenue from each flight by attempting to align the availability of capacity for individual fare types

with demand for those fare types. That process inevitably results in a range of fares. It does not involve any notion of cross-subsidisation, which necessitates selling at least some fares within that spread or range below the incremental cost of providing the service.

A more detailed response and analysis of this issue is contained in the NECG Response.

(b) The Applicants will have additional capacity free to engage the VBA entrant.

- The Counterfactual involves a slow and wasteful capacity war. Capacity is greater under the Counterfactual, which is why expansion under the Factual is more profitable for Virgin Blue than under the Counterfactual.

(c) The Applicants will enter routes that it would not be viable for them to enter individually.

- The Alliance allows the Applicants to service some additional direct routes. It is possible that Virgin Blue's lower cost structure would permit it to service those same routes direct. Importantly, in these circumstances the Alliance makes these routes contestable.

(d) The Applicants will not have to compete with each other for price inelastic customers.

- Although the Applicants will no longer actively compete with each other, they will compete with Virgin Blue. Virgin Blue has stated it will actively target business (high-fare/less price elastic) customers. In those circumstances, there will be no discernible reduction in competition for the more inelastic segment of customers.

(e) The combined financial resources of the Applicants allow them to sustain operating losses arising from a competitive response to VBA entry.

- VBAs frequently offer cut-price fares on entry (see Virgin Blue's entry into Australia), which they can sustain from their very low cost base. On the other

hand the Applicants, as committed network operators, must necessarily incur associated costs such as connectivity, frequent flyer points, unionised staff, reservation systems and must meet those cut-price fares from a higher cost base. For example, in FY02, Air NZ spent NZ$[ ] on in-flight food and beverages on trans-Tasman flights, which represented [ ] of the total cost of these flights. A VBA would not only avoid this cost, but would further benefit from the revenue generated from the additional seats in place of a galley.

The Applicants acknowledge it is inevitable that Virgin Blue or another VBA will expand in and grow the entire Australasian market. In that context the Applicants will seek to maximise profits within the competitive environment.

Any residual concern the Commissions may have regarding the scale of Virgin Blue's expansion under the Factual compared to the Counterfactual will be removed by the undertakings the Applicants have proffered and are willing to negotiate with the Commissions.

3. Freight capacity

Various submitters have argued that the Alliance will lead to increased freight prices, reduced capacity and reduced choice.[2] It is important to reiterate that, as stated at paragraph 2.4 of the NECG Report, for specialised freight operators, entry and expansion barriers in freight markets are low.

In terms of capacity, for the reasons outlined below, the Alliance (when fully implemented) is expected to provide an additional freight capacity of 177 tonnes per week when measured against the Counterfactual – an increase of 3.1%. Significantly, there is an additional 168 tonnes of capacity to Asia in year 3 of the Alliance, as a result of the Applicants utilising larger 747 aircraft to Singapore and Hong Kong, and operating additional flights to Japan.

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[2] MacKenzie District Council, NZEGO, Export New Zealand, Jeremy Laurenson, Importers' Institute, John Kershaw, Dunedin City Council

The capacity increase is primarily driven by the greater number of wide-body aircraft the Applicants will operate in the Factual as a result of being able to aggregate certain passenger demand to justify operating larger aircraft.

Importers and exporters have a strong preference for containerised freight because cargo is typically packaged into containers prior to dispatch to the airport. Conversely, the transportation of freight in narrow-body aircraft requires that airport staff unload the cargo from the container, hand-stack it into the aircraft's cargo hold, un-stack the cargo at the destination airport and reload the freight into a container. This process of unloading, hand-stacking, un-stacking and reloading is a time consuming and costly process that significantly increases the risk of damage to the cargo.

The reluctance of exporters and importers to use un-containerised freight is evident when comparing the difference in freight load factors for narrow-body and wide-body aircraft.

As noted in the NECG Report, some of the additional freight capacity is provided by the use of 'back of the clock' flying using B767 aircraft that currently overnight in Melbourne. These services will only be possible with the aggregation of the two airlines' demand. The additional services will enhance links to Qantas' time sensitive Australian network, and, because non-time sensitive freight will be diverted to the 'back of the clock' services, will allow additional time-sensitive freight to be carried during the day. Further, these 'back-of-clock' services do not have to carry a full load of passenger baggage. This allows additional freight to be carried.

4. Travel distribution

Submissions have been made that the Alliance could result in Air NZ and Qantas reducing their level of remuneration to travel agents, which - it is alleged - will affect competition in the Travel Distribution Services Market and competition between airlines. In addition, it is claimed that Qantas Holidays (**QH**) (an entity that currently maintains a presence in New Zealand through only one General Sales Agent (**GSA**) that is aligned with QH to sell holiday packages) would expand under the Alliance to such an extent that other holiday package providers would exit the market in sufficient numbers to affect the process of competition.

4.1 Travel Distribution Services Market

Although the Strategic Alliance Agreement provides for the Applicants to co-ordinate remuneration of travel agents, clause 1.2(g) specifically states that co-ordination or co-operation shall not, unless specifically stated to the contrary, require alignment of product or service offering.

There is no positive obligation on the Applicants to align the level of remuneration paid to travel agents, and Qantas remains committed to the maintenance of the travel agency system as a key platform in its distribution arrangements. Qantas has no plans to change the level of remuneration. Accordingly, any change to Qantas' level of remuneration is likely to be as a result of external factors and, therefore, form part of the Counterfactual as well as the Factual.

As the Commissions are aware, the effects of the Alliance must be measured against the appropriate counterfactual. In this light, concerns expressed by travel agents must be viewed against the world-wide trend by airlines to reduce costs in order to be able to offer lower fares to maintain competitiveness. This trend will continue irrespective of the Alliance. The success of the VBA model (which typically does not involve remunerating agents) and new internet technology are facilitating this trend. Internationally, VBAs utilise direct selling to lower distribution costs. For example, easyJet does not remunerate agents and sells approximately 90% of its seats over the internet. In footnote 34 of its submission, Virgin Blue states that 90% of its sales are made through the internet.

In any event, a reduction in travel agent remuneration by the Applicants will not materially affect the Travel Distribution Services Market. Travel agents will be likely to react by imposing a service fee on consumers for their services (as opposed to receiving commissions from airlines), and will continue to receive commission from a number of other carriers. Air NZ's Travelcentres and call centres currently charge a service fee.

A significant number of travel agents currently charge consumers a service fee for providing value-added services. Travel agents have provided no evidence showing why the Alliance threatens the ability to charge such a fee in return for providing a

service consumers value. Indeed, travel agents themselves acknowledge they have been able to charge service fees because they offer consumers an independent service and can locate the best fare for that individual consumer. House of Travel's *Searchflight* is one example. The TAANZ website lists the following services travel agents can provide consumers:

(a) the best value for money – travel agents inform customers of all available choices;

(b) maximum choice;

(c) convenient one-stop shopping;

(d) customer advocacy;

(e) expert guidance;

(f) personalised service;

(g) professional advice;

(h) time savings;

(i) a trusted service; and

(j) unbiased information.[3]

If consumers value such services, it is difficult to see why travel agents could not charge for them.

A key service offered by travel agents is their ability to locate the most appropriate fare across the various airlines. The Alliance does not remove travel agents' ability to locate and compare Air NZ and Qantas fares because the Applicants will charge different fares for different levels of service. The large number of different fares (and

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[3] http://www.taanz.org.nz/offer.htm.

associated conditions) likely to be offered by the Applicants (depending on the product e.g., NZ Express versus Qantas Business Class and Qantas full service economy) provides scope for agents to offer customers a value added comparative service. In addition, the Alliance does not remove travel agents' ability to compare fares between:

- Air NZ / Qantas, Origin Pacific and (shortly) Virgin Blue on domestic New Zealand routes;
- the 9 carriers currently offering trans-Tasman services (which will soon include Virgin Blue); and
- the 18 carriers currently operating on other ex-New Zealand international routes[4].

Agents have also expressed the concern that the Applicants will discriminate in favour of their own vertically integrated retail channels. Air NZ charges a service fee to consumers that book through its retail Travelcentres and call centres.

4.2 **Passenger Air Services Market**

Any co-ordination between the Applicants in respect of travel agent commissions will not raise concerns in terms of the ability of other airlines to compete. Even if it were assumed that the Applicants ceased remunerating agents entirely (which is not the intention of Qantas), the following factors would mitigate any effect on competition among airlines:

(a) for the reasons set out above, the Alliance would not result in the exit of a material number of travel agents – access to an independent source of distribution would continue;

(b) the commissions offered by other airlines would create a relatively greater incentive for travel agents to promote those airlines, rather than promoting, for example, Air NZ's services for which the agent received no remuneration; and

[4] Air NZ and Freedom counter as one.

(c) the increasing use of the internet as a distribution channel would continue to reduce airlines' reliance on travel agents as a distribution channel.

4.3 Expansion of QH

The concern that has been expressed over the impact of QH on the wholesale distribution market in New Zealand is misplaced.

QH currently offers inbound New Zealand product sold in Australia. It has minimal outbound product offering in New Zealand.

The QH Business Plan illustrates that, under the Alliance, QH will focus on growing the New Zealand inbound tourism market, rather than promoting package travel to outbound New Zealand tourists. A growth strategy focused on inbound markets has been adopted by QH because, with respect to Australia, these markets provide the highest growth potential compared to the Australian domestic and outbound leisure market. Inbound New Zealand tourism fits well with this strategic direction and enhances the Australasian offering.

Given the current low level of QH activity in promoting holiday packages to outbound New Zealand tourists and QH's proposed focus on inbound New Zealand tourism under the Alliance, there is no prospect QH's proposed conduct will materially impact on any existing holiday package providers. For further details regarding proposed QH activities see the QH Business Plan and the TFI Report.

5. Tourism benefits

Some submissions have queried aspects of the tourism benefits flowing from the proposed Alliance and/or the importance of New Zealand having a national flag carrier,[5] although even within those submissions key stakeholders have confirmed their

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[5] Norm Geary , Anonymous , Harvey Bell , Tourism Industry Association New Zealand, Jared Ball, Anonymous, Alex Gray, Consumer's Institute NZ Inc, Major Accommodation Providers, Danny Freilich, Mackenzie District Council, Bon Voyage, and Save Air New Zealand, WIAL, United Travel, Gullivers Pacific, and Infratil, Prendergast et al. There are different views on the need for a national carrier; Consumer's Institute NZ Inc thinks this overstated and misplaced"(p8), whereas Tourism Industry Association New Zealand suggests that "**Preservation of the brand 'Air New Zealand',**

view that the Alliance will be likely to deliver tourism benefits.[6] For example, Tourism Industry Association New Zealand (**TIANZ**)[7] comments that "There are a number of identified public good benefits that are clearly evident"[8] under the proposed Alliance. The Australian Tourism Export Council also "cautiously supports the submission".

The Applicants do not propose commenting further on tourism benefits at this stage given that these benefits are discussed in detail in the QH Business Plan and the TFI Report.

For present purposes, the Applicants note that the QH Business Plan identifies a number of proposed initiatives available as a result of the ability jointly to leverage the Applicants' brand, footprint and capabilities. These initiatives are expected to achieve a targeted an additional 50,000 leisure passengers to New Zealand per annum, and an additional 18,000 dual destination passengers to Australia per annum. These are incremental tourists who would not have travelled to either New Zealand or Australia without the Alliance.

6. Proposed undertakings/conditions

Several submissions have discussed the nature and extent of the proposed undertakings/conditions. With the exception of the discussion in relation to the "employment" undertakings proposed by the Australian Council of Trade Unions (**ACTU**) and Australian Manufacturing Workers' Union (**AMWU**) (see section 9), the

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opportunity for extension of the brand through combined marketing to important visitor markets such as Europe and USA is a **clear public good benefit arising from the Alliance**" (p9, emphasis added). Similarly, TAANZ accepts the importance of New Zealand retaining a national airline.

[6] Tourism Industry Association New Zealand, Major Accommodation Providers

[7] Which notes that Air New Zealand and TIANZ "are the two organisations that market the totality of the destination", with Air New Zealand's marketing efforts containing "intrinsic public good promotion of New Zealand"; Tourism Industry Association New Zealand.

[8] Tourism Industry Association New Zealand p9 emphasis added). TIANZ also notes that successful tourism requires "international services to key countries of origin that source valuable visitor streams" (p5).

Applicants make only limited comment on the proposed undertakings in this submission.

The Applicants have offered a range of undertakings/conditions. A number of submissions have suggested that Freedom should be divested to facilitate VBA expansion into the trans-Tasman and domestic New Zealand. The Applicants comment:

(a) Virgin Blue has confirmed it is expanding onto trans-Tasman and domestic New Zealand routes, "with or without the Proposed Alliance", which means it does not need Freedom in order to achieve its publicly stated business plans;

(b) Virgin Blue has a well-recognised brand with established infrastructure (including an Airline Operating Certificate) and ample access to new and used aircraft. The reasons provided by Virgin Blue for requiring the divestment of Freedom are disingenuous; and

(c) Freedom is an integral part of Air NZ's core operations, where it is positioned to stimulate tourist demand principally on secondary leisure routes.

All FSAs are using every possible means to reduce their costs.

It is not appropriate to restrict product or pricing offerings to consumers those a competitive market would otherwise set.

United Airlines has requested that the ACCC impose certain undertakings relating to its commercial relationship with the Applicants. The Applicants have commercial arrangements with many international airlines. These have been negotiated on the basis of reciprocal benefits in the home markets of each carrier. Qantas is currently in commercial discussions with United Airlines and this is the appropriate forum for the issues raised by United Airlines in its submission.

7. Price and capacity impacts

Submitters have argued that prices will increase and capacity will decrease as a result of the Alliance. The variations that have been modelled by NECG are as a result of

comparing two alternative futures, i.e. the Counterfactual and the Factual and not comparing prices under the Alliance (Factual) with current prices.

The NECG Report filed with the Applications models the projected price and capacity impacts, which have been factored into the net benefit calculations. The NECG Response addresses those submissions that assert the Alliance will have a greater impact on prices or capacity than modelled by NECG.

8. Impact on Origin Pacific

In its submission Origin Pacific identified a number of concerns it has in relation to the proposed Alliance. It also questioned aspects of the reasoning in support of the Applicants' position that the proposed Alliance will deliver net public benefits. This section responds to the issues raised by Origin Pacific that refer to the impact of the proposed Alliance on Origin Pacific itself. The assertions made by Origin Pacific that are more general, for example, Origin Pacific's opinion as to the nature of the barriers to entry and expansion, the efficacy of the counterfactual and the likely impact on tourism, are addressed in detail elsewhere in this response.

In summary, the Applicants agree with much of what Origin Pacific has said. However, to the extent that Origin Pacific considers that Qantas feed is critical to its survival, that the Alliance will have market power to engage in predatory practices, and that the Alliance will raise barriers to entry, the Applicants disagree.

8.1 Qantas Feed

Origin Pacific notes that it was formed in 1997. At that time, the provincial routes, which would have accounted for almost the entirety of Origin Pacific's business, were served by Air NZ and Ansett New Zealand. Ansett New Zealand was sold to Tasman Pacific in 1999. Qantas had a strong commercial relationship with these airlines and they obtained Qantas feed.

Accordingly, in entering and participating in the relevant segment of the market, Origin Pacific did not and could not have contemplated receiving feed or any other form of

support or assistance from either Air NZ or Qantas. Air NZ, Tasman Pacific and Origin Pacific competed aggressively. This fact is revealing for several reasons.

(a) The assertion throughout Origin Pacific's submission that the access to feed from Qantas is essential to its continued viability is simply not correct. Feed from Qantas certainly formed no part of Origin Pacific's original entry and early expansion. Furthermore, ongoing feed from Qantas of itself cannot be a guarantee of continued viability as the demise of Tasman Pacific in April 2001 clearly demonstrates.

If the effect of the Alliance, over time, is that Origin Pacific does not obtain feed from either Qantas or Air NZ, and has limited code share opportunities, in a worst case scenario, it will merely result in Origin Pacific returning to a scale of operation and growth rate that it envisaged when it initially entered the segment in 1997. In any event, there is no prospect of the "worst case" scenario eventuating. Virgin Blue has committed to expand and will provide a source of feed for Origin Pacific. Furthermore, there is the prospect of feed from Fifth Freedom and other international carriers.

(b) A related point is that Origin Pacific itself concedes (see paragraphs 25 and 26) that:

> [T]he Qantas code share is not a forever commitment. But it is a very important present requirement....
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> As already said, the Qantas relationship is not necessarily forever, But it is important now and has been a key factor in Origin Pacific's growth to date.

It would be inappropriate to consider rejecting the proposed Alliance, and the demonstrable net public benefit that will accrue from it, merely because Origin Pacific is concerned about the loss of feed and code share opportunity from Qantas, which it only wants now but not "forever" and in any event, will be replaced by feed from Virgin Blue and other international carriers.

8.2 **Alliance conduct**

Origin Pacific's submission misunderstands the role and effect of the Commerce Act. Origin Pacific confuses robust competition with anti-competitive (illegal) predatory conduct. Origin Pacific asserts that approval of the Application will create "huge market power in the proposed Alliance which will in itself be a major barrier to entry and expansion in all New Zealand markets" (see paragraph 50). It then goes on to assert that the alleged market power can and will be used to engage in predatory practices. Curiously, it then recites the fact that the predatory practices (including lowering prices and increasing capacity) have already been engaged in by both Air NZ (with respect to Origin Pacific) and Qantas. It must follow that from Origin Pacific's perspective, those alleged illegal practices do not require Qantas and Air NZ to be united. The Applicants deny that they have ever engaged in illegal practices or contemplate doing so under the Alliance.

The concerns (both past and future) Origin Pacific has about conduct that involves lower prices and increases in capacity was conduct recently the subject of a decision of the High Court of Australia in *Boral v ACCC* [2003] HCA 5. In that case, the High Court urged great caution against the temptation to readily infer illegal predatory conduct from conduct that merely consists of lowering prices and increasing capacity.

8.3 **Barriers to entry and expansion**

Origin Pacific's submission also traverses its view of the size and scope of barriers to entry and expansion and yet disregards the simple fact that it itself represents evidence of successful entry and expansion (during periods of alleged "predatory" behaviour from Air NZ and Qantas). It also disregards Virgin Blue's clearly stated expansion plans. The High Court decision in *Boral* is a timely reminder that the essential analysis concerning barriers to entry must focus on the structural features of the relevant markets. The Applicants view as to the extent of barriers to entry is contained in the Applications and the NECG Response.

8.4 **Applicants' additional comments**

Origin Pacific focuses on the "provincial market" and notes the "huge" support, "encouragement" and "assistance" it has received. This assistance was "particularly noticeable in areas where Air New Zealand was the sole operator and was able to set its own prices and services" (paragraph 35). If the Alliance resulted in areas being served by one operator (i.e., the Alliance) and Origin Pacific wished to expand into those areas, to the extent it was needed, there is no reason suggested by Origin Pacific that it would not continue to receive the "huge support, encouragement and assistance" it received in the past. Indeed, the Alliance may well stimulate sentiment in Origin Pacific's favour.

Finally, it is important for the Commerce Commission to be aware of the ongoing relationship between Qantas and Origin Pacific. [

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To the extent necessary, the above arrangements will assist Origin Pacific in dealing with the transition period prior to Virgin Blue's expansion.

9. **The Alliance's impact on employment in Australia**

The submissions lodged by the ACTU and the AMWU state that the "public interest" test for authorisation should include employment. The ACTU proposes that the

Applicants undertake that staff will not be made redundant or disadvantaged. The AMWU proposes undertakings designed to encourage the growth and development of Qantas maintenance activities and to ensure that Qantas continues to maintain its aircraft in Australia.

The Applicants submit that the undertakings proposed by the ACTU and AMWU are not appropriate. There will be no decrease in capacity in the Factual compared to today. As such, there will be no job losses as a direct result of the Alliance. The Alliance will not affect Qantas' ability to service Department of Defence maintenance contracts.

10. The relevance of Australian air traffic rights

Some submissions to the ACCC present an argument for further liberalisation of aviation policy, and extension of the traffic rights of foreign flag carriers.[9]

Capacity and traffic rights and the policies that relate to them are matters for the governments of Australia and New Zealand. The policies of both governments are very liberal and ensure that in affected markets decisions in relation to foreign flag carrier rights reflect, as a matter of course, all relevant considerations, including the extent and nature of authorisations provided to incumbent airlines. Policy dictates that these decisions are made in the national interest.

The Applicants' assessment of competition has not assumed that the Australian or New Zealand Governments will implement any change in aviation policy.

The Applicants request the ACCC and the Commerce Commission make their determinations on the basis of the current regulatory environments.

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[9] Air Freight Council of Queensland, Melbourne Airport, Victorian Department of Innovation, Industry and Regional Development, Tourism Task Force, Brisbane Airport Corporation, Australian Airports' Association, Premier's Department New South Wales, Australian Tourism Export Council, Commonwealth Department of Industry, Tourism and Resources, Western Australian Minister for Planning and Infrastructure.

11. **Frequent flyer points**

The Alliance will not adversely affect existing Air NZ and Qantas frequent flyer members. To the contrary, once the Alliance is fully implemented, Air NZ Airpoints members and Qantas Frequent Flyers will be able to earn and redeem points on both Air NZ, Qantas and their then alliance partners.

AIR NEW ZEALAND – QANTAS
APPLICATIONS FOR AUTHORISATION

FURTHER DESCRIPTION OF
QANTAS AND AIR NEW ZEALAND
COUNTERFACTUAL

PART 1: INTRODUCTION

1. In line with New Zealand Commerce Commission (**Commerce Commission**) and Australian Competition and Consumer Commission (**ACCC**) precedent and guidelines, a key feature in assessing the competitive impact of any arrangement is a comparison of how competition in the relevant market is likely to develop into the future, both with, and without, the arrangement in place. In accordance with this approach, NECG has compared the world as it is likely to develop without the Alliance ("Counterfactual") relative to the world as it is likely to develop with the Alliance ("Factual") when assessing the costs and benefits of the Alliance in its report dated 8 December 2002 (**NECG Report**). NECG's analysis has also taken into account developments and amendments to the schedules since it issued its initial Report, as described further in Part 4 of this paper.

NECG process

2. In order to understand how the Applicants expected competition to develop in both the Counterfactual and Factual, NECG obtained from each of the airlines schedules showing their predicted flight frequencies, aircraft usage and capacity, under each of the Counterfactual and Factual scenarios.

3. For the purposes of analysing the Counterfactual, as described in section 4.1.4 of the NECG Report (page 110), each airline prepared two Counterfactual schedules, setting out for years 1 to 3 what the airline expected its own aircraft, frequencies and capacity would be absent the Alliance, and what it expected the other would do in response. These Counterfactual schedules were prepared independently by each of Qantas and Air NZ and supplied under confidentiality to NECG. NECG then consolidated these schedules into a single Counterfactual. In this process, NECG observed that the airlines predicted with reasonable accuracy the likely actions of the other. Where there were differences between the schedules, NECG preferred the airline's own information over the estimate of its competitor. In other words, if Qantas' prediction of which aircraft or frequencies Air NZ would operate on a particular route were different to that predicted by Air NZ, NECG would have used Air NZ's schedules as the basis for its modelling.

4. The Factual schedules were prepared jointly by Qantas and Air NZ on the basis of the joint airline operations ("JAO") contemplated by the Alliance arrangements.

5. As a final step in the process, NECG tested the commercial rationale for the Counterfactual and Factual schedules with the airlines, and found the predicted behaviour to be economically rational in the case of both sets of schedules.

6. The Counterfactual and Factual schedules prepared by the parties reflect their best estimates at the time the schedules were compiled. Inevitably there will be events which will affect the actual future schedules. For example, the occurrence of war in Iraq or significant changes to the global economy will result in changes to the schedules. The airlines and industry commentators believe that a war in Iraq is likely to result in an immediate reduction in international demand of up to 20%.

7. Already since the schedules were compiled, changes have taken place to the competitive landscape as United Airlines has filed for Chapter 11 bankruptcy and withdrawn from the Auckland-Los Angeles route, precipitating Air NZ's increase in capacity on Auckland-Los Angeles and its withdrawal from Sydney-Los Angeles. These changes have been factored in to NECG's analysis in a revised prediction of net benefits, and the parties have modified their schedules accordingly. The modified Counterfactual and Factual is discussed in Part 4 of this paper.

8. The principal purpose of this paper is to supply the Commerce Commission and ACCC with additional information relating to the factors considered by each airline in arriving at their respective Counterfactual schedules. A detailed description of the changes in capacity for each city-pair modelled by NECG is also set out in Annex 2.

PART 2: QANTAS COUNTERFACTUAL (Contains elements confidential to Qantas)

9. Submissions from some third parties in response to the Applications suggest that the Qantas Counterfactual might overstate the amount of capacity which it intends to commit absent the Alliance, in particular to domestic New Zealand and Tasman routes.

10. As developed in more detail below, and verified by NECG in its Report and subsequent analysis, the capacity which Qantas indicates it will commit to these routes under the Counterfactual is logical and consistent with its strategy to maintain a strong presence in New Zealand. It is also consistent with historical and projected demand growth, and Qantas' modelling demonstrates that it is economically rational behaviour particularly in light of the total network benefits which these routes contribute to its operations.

Qantas Domestic New Zealand Strategy

11. Qantas regards the Australasian (Australia and New Zealand) market as its "home" market and domestic New Zealand is an important part of this market. The significance of domestic New Zealand to Qantas is reflected in the way it has increased its presence in New Zealand since the late 1980s. This was initially via its relationship with Ansett New Zealand, which was replaced by Tasman Pacific, and, since the demise of Tasman Pacific in 2001, through a direct presence in New Zealand.

12. Qantas views domestic New Zealand as being of significant size, and comprised of passengers travelling locally, and passengers who also provide benefits in the form of travel on the wider Qantas network. Qantas believes it has not yet achieved the required level of frequencies in domestic New Zealand to serve both these market segments adequately. The increase in capacity in domestic New Zealand under the Counterfactual reflects Qantas' desire to match more closely the Air NZ domestic operation in order to attract the important high yield customers travelling locally within New Zealand, and to provide adequate capacity for the carriage of passengers travelling within New Zealand as part of a more comprehensive itinerary across the Qantas network.

13. In 2001/02 Qantas operated substantially less capacity than Air NZ. The lower level of capacity, frequency and city presence operated by Qantas translates into a less attractive network compared with that of Air NZ, particularly to the high yield passengers. Based on 2001/02 results compiled by NECG, while Qantas accounted for [ ] of domestic New Zealand capacity (in terms of ASKs), it accounted for only [ ] of domestic New Zealand revenues.

14. While the addition of capacity in domestic New Zealand under the Counterfactual detailed in Annex 2 may appear to be greater than the rate of normal demand growth, it is important to note that any increase in aircraft operated in domestic New Zealand will be reflected as a relatively large proportional increase in total capacity, as the addition of the capacity of one aircraft is large relative to the amount of total capacity operated in domestic New Zealand. Having said that, the capacity which Qantas proposes to operate in domestic New Zealand if the Alliance does not proceed is not dissimilar to the capacity previously operated by Ansett New Zealand after allowing for natural market growth since it ceased operations. For example, in 1999 Ansett New Zealand operated 8 BAe146 aircraft, which is approximately equivalent in terms of seat capacity to 5 B733 aircraft. Compared with the 5 aircraft now operated by Qantas in domestic New Zealand increasing to [ ] aircraft by year 3, the Counterfactual is not inconsistent with past levels of capacity operated by competitors to Air NZ, given natural market growth rates.

15. Qantas believes that absent the Alliance its expansion in domestic New Zealand would enable it to compete successfully with Air NZ where others have failed, primarily because past operators have been constrained by a lack of connectivity, particularly on the Tasman. Neither Ansett New Zealand nor Tasman Pacific had an integrated Australasian and international network and consequently did not derive any network contribution from having a presence in domestic New Zealand (even Ansett did not have an operation linking its Australian and New Zealand networks). On the other hand, Qantas' domestic New Zealand operations form an integral part of Qantas' Australasian network, providing important feed to Qantas services on the Tasman, domestic Australian and other international sectors. As a result Qantas is well positioned to sustain a strong and growing presence in domestic New Zealand where Ansett and Tasman Pacific could not.[10]

16. The network benefits which domestic New Zealand services provide to Qantas are significant, both in terms of network reach and revenue from connecting traffic. As a result, when examining benefits accruing from its domestic New Zealand network and making growth decisions, Qantas also takes into account these network contributions. Based on the Counterfactual schedules, the network benefits emanating from Qantas'

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[10] The view that Qantas can and will succeed in establishing a strong presence in domestic New Zealand, where others have failed, has also been independently reached by NECG (see p 13 of the NECG Report).

domestic New Zealand operations show that its domestic New Zealand operations contribute positively to Qantas' overall profitability.

17. To assess the contribution which the domestic New Zealand routes make to Qantas' wider network, Qantas uses information which details for each Qantas passenger with a domestic New Zealand sector in their itinerary, the additional routes contained within that passenger's broader itinerary.[11] The analysis shows that for every NZ$100 of revenue on a domestic New Zealand sector, Qantas receives on average an additional NZ$[ ] of revenue on Tasman, Australian domestic, and other international routes operated by Qantas[12].

18. An assessment of the overall contribution of the New Zealand domestic routes to Qantas' performance is set out in Table 1 below.[13]

Table 1

Qantas Counterfactual

Total profitability of Domestic New Zealand

NZ$ (m)

	2004f	2005f	2006f
Number of aircraft	[ ]	[ ]	[ ]

[11] Passenger itineraries for the 6 months period MAR-AUG 2002 were used to illustrate the link between revenue achieved on the New Zealand domestic routes with the remainder of the Qantas network. Revenue is based on Qantas marketed revenue i.e. flight coupons with a Qantas flight number.

[12] If anything, this analysis will understate the network revenue accruing to Qantas as a result of its domestic New Zealand operations, as the data only includes onward bookings made at the same time as a domestic New Zealand booking. If the passenger subsequently books onward flights with Qantas, on a separate booking (or "passenger name record"), this will not be captured in the analysis.

[13] The analysis was done on a fully allocated cost basis for Tasman and Auckland-Los Angeles. For Australian domestic and other international routes these passengers contribute less than 1 percentage point of seat factor (i.e. load factor), therefore costs have been allocated on a marginal basis to include only direct passenger and selling costs.

Forecast PBT (Profit Before Tax)	[ ]	[ ]	[ ]
Network Benefit (PBT on other parts of QF Network)	[ ]	[ ]	[ ]
Net PBT result	**[ ]**	**[ ]**	**[ ]**

19. The "Forecast PBT" figures set out in Table 1 have already been provided in response to the ACCC's question 5 of its 29 January 2003 information request, and copied to Commerce Commission, on 27 February 2003. While these figures show a net operating loss in domestic New Zealand, they were prepared in late 2002 for the purposes of modelling the Alliance, and Qantas believes they are quite conservative. [

]

20. Table1 shows that, even using these conservative figures as the basis for assessing the overall performance of the domestic New Zealand operation it can be seen that while Qantas' planned increase in capacity under the Counterfactual is forecast to result in negative profitability when viewed on a stand-alone, fully allocated cost basis, the net contribution from domestic New Zealand, after taking into account network benefits, is positive.

21. Although not all of the wider network benefit set out in Table 1 would be at risk if Qantas were to exit domestic New Zealand, a large percentage would be. In addition, by achieving a critical level of capacity and frequencies in domestic New Zealand Qantas can simultaneously and more effectively compete with Air NZ in its (highly profitable) core sector, providing Qantas with a competitive advantage on other international routes.

Tasman

22. Under the Counterfactual, Qantas also increases capacity on the Tasman. Given Qantas' long established presence and existing operations and the projected scope

and scale of VBA entry on the Tasman its increases in capacity under the Counterfactual are not as significant as they are for domestic New Zealand.

23. NECG has prepared an analysis of historical growth rates on the Tasman, which is set out in its Response to Third Party Submissions paper, filed with the Commerce Commission and ACCC simultaneously with this paper. That analysis shows that the (simple) average annual increase in capacity for Qantas on Tasman routes assumed under the Counterfactual is [ ] only slightly higher than the [ ] growth in capacity between 1994/95 and 2002/03. [14] Therefore, the growth of Qantas on the Tasman under the Counterfactual is in line with historic growth..

24. Qantas' projected PBT results on the Tasman are positive.[15] Its Tasman operations also contribute significant network benefits to its broader operations, in the same way as in domestic New Zealand.

25. A detailed analysis of Qantas capacity changes on the Tasman under the Counterfactual and Factual, by city pair, is set out at Annex 2.

[

[14] It is important to note that these figures exclude all capacity that does not terminate in New Zealand. Qantas also operates substantial capacity on the Tasman that terminates in the US and South America.

[15] See response to question 5 of ACCC information request of 29 January 2003, supplied to the ACCC and Commerce Commission on 27 February 2003. As the notes to those tables show, while those results show a greater level of profit on the Tasman under the Counterfactual than the Factual, this is primarily due to the fact that the Factual PBT figures take into account the management fee and adjustment payments due under the Alliance.

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Auckland-Los Angeles

33. Under the Counterfactual schedules Qantas plans to increase capacity on this route from [ ] departures per week in year 1 to [ ] departures in year 3. The Counterfactual schedules also assume that Air NZ continues to codeshare with United on Auckland-Los Angeles and that United does not recommence operations on the route. (By contrast, under the Factual, the Parties believe that United or another international airline will commence / recommence operations on this route in year 3, and this has been included in the further NECG modelling.)

Other routes

34. The Counterfactual schedules do not involve Qantas commencing operations from New Zealand to any other destinations which will fall within the JAO. Qantas does maintain a code-share presence on other routes with airlines, such as Air Pacific, and would plan to continue to do so. As set out in the NECG Report, in light of Qantas' 46.3% shareholding in Air Pacific, these entities are treated as one for modelling purposes in any event.

Qantas development and modelling of the schedules

35. To determine the Counterfactual (and Factual) schedules, Qantas considered a wide range of factors including[16]:

    (a) aircraft types available in the fleet during the relevant period;

    (b) the relative cost levels of each aircraft type and where possible cost estimates of competing airlines;

    (c) the revenue generating potential of existing or planned services;

    (d) alternative uses of available fleet time;

    (e) requirements of both the passenger and freight markets;

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16 The capacity provisions contained in the Counterfactual schedules developed by Qantas for modelling purposes were developed at a particular point in time and took into account the types of considerations listed above. However, they should not be interpreted to be a full and final plan.

(f) developments in total market size;

(g) competitive developments;

(h) network benefits that may be gained from the addition of capacity; and

(i) the provisions of Air Services Agreements.

36. Qantas then modelled the schedules to estimate projected revenue, costs and profitability by: [

]

37. The modelling process produced PBT results for Qantas for the years to 2003 - 2006, calculated on the basis of yield, load, passenger and other revenue, operating costs,

EBITDRA, aircraft costs, non-aircraft depreciation, and interest expense. The headline results for each sector analysed are set out in Table 2 below.

Table 2
Qantas Counterfactual PBT Results by Route Group
(NZ$m)

Route Group	2004	2005	2006
Tasman	[ ]	[ ]	[ ]
NZ Domestic	[ ]	[ ]	[ ]
AKL-LAX	[ ]	[ ]	[ ]
[ ]	[ ]	[ ]	[ ]

Notes:

In addition to this modelling, in undertaking this analysis, Qantas also considered the broader network benefits that relate to the operation of the services.

PART 3: AIR NZ COUNTERFACTUAL (Contains elements confidential to Air NZ)

General Explanation

- In determining the Air NZ view of the counterfactual including its response to anticipated Qantas changes in capacity the company assumed that over three years (and where applicable based on Air NZ's modelling: [

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The Qantas information was gained from public statements by Qantas and other market intelligence.

39. In Air NZ's view, the outcome of the foregoing increases in capacity would result in there being surplus capacity in each of the above described markets well beyond anticipated normal annual growth. In each case, Air NZ formed the view that the anticipated additional capacity likely to be applied by Qantas was rational from that company's perspective on longer-term profitability.

40. Air NZ is not currently, and is unlikely to be, in a position to thwart an aggressive Qantas expansion plan by substantially increasing the size of its fleet, beyond its current A320 program. The Air NZ increase in total jet fleet size from 35 to 39 aircraft

results in a modest capacity increase as the average seats per aircraft decrease with the introduction of A320 aircraft.

41. Air NZ also believes that increases in industry supply should be kept in line with industry demand and profitability requirements. Any capacity matching to preserve market share in the face of aggressive capacity additions by competitors would place severe pressure on profitability further reducing Air NZ's future ability to acquire additional aircraft.

42. For the foregoing reasons, Air NZ's counterfactual, relative to its own fleet and capacity plans: [

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Vanilla Financial Modelling

44. For the purpose of forecasting Air NZ's future financial performance with and without a partnership with Qantas, a detailed excel model was created. This model captured a broad and quite detailed range of assumptions and was used to forecast 3 years of Air NZ and anticipated Qantas performance (2004 to 2006).

45. [

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48. The Table 3 sets out the modelled EBIT for the relevant periods:

Table 3 Air NZ Counterfactual EBIT Results by Route Group (NZ$m)				
Counterfactual[d]	**2003[a] (Base Year)**	**2004 (Year 1)**	**2005 (Year 2)**	**2006 (Year 3)**
Trans Tasman	[ ]	[ ]	[ ]	[ ]
SYD-LAX	[ ]	[ ]	[ ]	[ ]
Other long haul	[ ]	[ ]	[ ]	[ ]
Domestic New Zealand	[ ]	[ ]	[ ]	[ ]
Total	[ ]	[ ]	[ ]	[ ]

49. Although Air NZ has shown some improvement in profit, overall profits are still inadequate when compared with the company's cost of capital. This is especially true for the Tasman and most other international routes.

50. Recovery to date has been largely due to favourable changes in external factors such as supply (current competitive position on which the forecasts were based was relatively benign – Qantas is assumed to have only added one additional aircraft), and demand, fuel prices and exchange rates. It is unreasonable to expect all these factors

to hold constant much less continue to improve and therefore maintenance of forecast profitability is not certain absent the Alliance. All returns from flying in the future are vulnerable to changes due to the external factors listed in the Applicants' response to the Commerce Commission's written questions. All returns from flying are vulnerable to increased competition from Qantas or from entry/expansion by Virgin Blue from Australia.

PART 4: DEVELOPMENTS SINCE THE NECG REPORT

51. Since the airlines prepared their Factual and Counterfactual schedules, United Airlines has filed for Chapter 11 bankruptcy. United's subsequent withdrawal from the Auckland-Los Angeles route has resulted in Air NZ adding capacity on the Auckland-Los Angeles route, and withdrawing from Sydney-Los Angeles.

52. NECG have captured the effect of these changes on the net benefit calculation. This was provided to the Commerce Commission and the ACCC under cover of letter dated 5 March 2003.

53. In addition, Qantas and Air NZ have prepared revised Factual and Counterfactual schedules to take into account these changes. These are contained in the revised model, sent to the Commerce Commission and ACCC on 6 March 2003.

PART 5: ALTERNATIVE COUNTERFACTUALS

54. Qantas and Air NZ have independently considered the alternative Counterfactuals postulated by NECG. They are also of the view that these are not credible.

"Cosy duopoly"

55. NECG has described several broad reasons why it does not believe that a "cosy duopoly" scenario is at all likely. In addition to those views, which are further elaborated below, the Counterfactual of a cosy duopoly is now even less credible as Virgin Blue has confirmed that it will enter the Tasman and domestic New Zealand routes (paragraph 1.4 of its submission regarding the Alliance dated 12 February 2003). It would simply be implausible to think that the Parties on the one hand, and Virgin Blue on the other, could form a "cosy duopoly".

56. NECG's reasons as to why a "cosy duopoly" is an unlikely Counterfactual are stated in section 3.2 of the NECG Report. The discussion in Annex 1, which has also been provided to the ACCC in response to its questions of 29 January 2003, elaborates on these views.

Alternative strategic alliance

57. Air NZ has explored the possibility of an alternative strategic Alliance but there is no alternative which would deliver the same efficiencies and cost savings and other benefits to New Zealand such as tourism related benefits, as those which are expected to be generated by the Alliance.

ANNEX 1:
NECG REBUTTAL OF "COSY DUOPOLY" THEORY

Economics of co-ordinated behaviour

1. In certain circumstances, firms may have the incentive and ability to engage in co-operative behaviour. The objective or at least outcome of co-operative behaviour is to reduce market competition, with the ultimate goal and/or effect of increasing prices and profits above those that would prevail otherwise.

2. Economic theory suggests that several conditions must hold in order to establish a co-ordinated arrangement.[17] We are of the view that these necessary conditions do not hold in the relevant market(s) in which air services are provided domestically within New Zealand and on Tasman routes due to the prevalence of several market characteristics. Specifically:

3. One necessary condition is that the Parties to the co-operative behaviour must have the ability to raise prices without inducing substantially increased competition from those not party to the arrangement. As discussed below, firms' ability to durably raise prices above the competitive level is limited by the relatively low level of expansion barriers. Virgin Blue's confirmation that it intends to expand on to these markets underscores the strength of this point.

4. A further condition is that the costs of establishing and enforcing an agreement must be low relative to the expected gains. As discussed below, the costs of establishing and monitoring an agreement in this instance are likely to be high due to the lack of transparency of prices and outputs for the differentiated products in question, market instability and airline industry cost structures.

Entry and expansion barriers

5. Significant entry barriers are a necessary condition for co-ordinated behaviour to persist. Without entry and expansion barriers, incumbent firms cannot durably raise market prices above the cost. As discussed in section 2.2.1 of NECG report, certain factors that can and do give rise to significant entry and expansion barriers to many airline markets are much less relevant to the markets at hand. These factors include regulatory restrictions, sunk costs and network/density economies. In particular, relative to most other airline markets:

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17 Carlton, D. and Perloff, J. (1994). *Modern Industrial Organization*, Harper Collins, p.180.

6. *Regulatory barriers are low*. This has been due largely to the deregulation and liberalisation in the Australia-New Zealand region that has occurred over the last decade. The Single Aviation Market (SAM) between Australia and New Zealand allows for designated SAM airlines to freely operate air passenger services domestically within Australia and New Zealand, as well as on the Tasman. This, for instance, has facilitated the entry of Qantas onto New Zealand domestic routes. The SAM also grants designated SAM airlines seventh freedom rights for dedicated air freighters. As noted in the NECG Report, designation as an SAM airline requires an airline to meet certain ownership and control requirements, unless an exemption is sought from both the Australian and New Zealand Governments. In this respect, the ability for airlines to create Australian or New Zealand based subsidiaries is one means of overcoming these restrictions, Virgin Blue being a case in point. Moreover, and importantly, we believe it is unlikely that the Australian and New Zealand Governments would not grant a SAM exemption were it to be requested by a potential entering or expanding airline. Hence, in contrast to many airline markets where bilateral restrictions significantly constrain entry and expansion, regulatory restrictions for the Australia-New Zealand market can be regarded as being minimal.

7. *Sunk cost requirements are low relative to other airline markets*. As discussed in our report, in the US and (to a lesser extent) Europe, complex and interleaving route structures create scope for economies to be achieved by organising traffic around hub and spoke networks. Control of a major hub can then confer an advantage to an incumbent carrier, as an entrant, to compete, would need to replicate a substantial infrastructure providing and carrying feeder traffic. This can require substantial sunk costs. As noted in the NECG Report, since a handful of routes account for the bulk of overall revenues generated on Tasman and New Zealand domestic routes, entrants do not need to invest in significant infrastructure in order to compete. This is a major factor that differentiates these routes from the pattern that emerged in the US in the late 1980's, where control over 'fortress hubs' allowed major carriers to somewhat insulate their operations from direct competition. That said, it is worth emphasising that the US pattern ultimately proved unstable, as it merely induced competitive expansion by VBAs offering direct service. Nonetheless, the point remains that to the extent to which horizontal differentiation (as effected by 'fortress hubs') can allow for some degree of concerted action, that factor simply does not characterise the routes here at issue.

8. In summary, these two factors result in significantly lower entry and expansion barriers to the relevant markets, with the consequence that the ability for incumbent airlines to implement any strategy of tacit collusion is strictly limited.

Establishment and enforcement of collusive agreement

9. According to a classic article by Stigler,[18] firms will only give effect to a co-operative (or more colloquially, tacitly collusive) arrangement if there is some self-policing mechanism to maintain the arrangement over time. Self-policing is required to ensure that 'cheating' does not occur and, if it does, that it can be punished. (Typically, if a party to a co-operative agreement can secretly violate it (i.e. cheat), it will gain larger profits than by conforming to it. This in turn makes the agreement inherently unviable.[19]) Stigler finds that whether such a self-policing mechanism is available depends on several factors.

10. One important factor is the transparency of prices and costs. Where price and cost transparency is typically low, it is difficult to both establish and monitor adherence to the collusive price, and hence, to persistently co-ordinate behaviour.

11. The routes on which services are provided domestically within New Zealand and on the Tasman, are characterised by complex price structure. Within any given flight, there are a number of different inventory classes to which tickets are assigned and reallocated in response to changes in demand. This process of (re)allocating tickets in order to maximise load factors and yields is known as yield management. Airlines are not privy to each other's yield management systems. For instance, an airline will not typically know how many tickets have been allocated by another airline to any given inventory class. Due to this lack of transparency, co-ordinated pricing behaviour would appear to be a very unlikely outcome.

12. Moreover, significant market instability and uncertainties are likely to undermine co-operative behaviour. In particular, fluctuating costs and prices makes co-ordinated price setting difficult, both in terms of establishing, maintaining and monitoring prices. Such uncertainly also undermines the likelihood of firms reaping the benefits

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18 Stigler G, 1964, "A Theory of Oligopoly", *Journal of Political Economy,* 72:44-61

19 See Osborne D, 1976, "Cartel Problems", *American Economic Review*, 66-5:835-844, for a representation of this situation as a prisoner's dilemma. While Osborne focuses on cartels, the same issues operate, likely with even greater force, in respect of tacit forms of collusion.

associated with co-operative behaviour. For example, where markets are subject to frequent shocks, it may be difficult for a party to a co-operative agreement to determine whether observed low prices by another firm are a consequence of a deviation from collusive pricing or from a low realisation of a demand shock.[20]

13. There is inherent uncertainty and instability in airline markets, including the markets relevant to the matter at hand. Obviously, instability and uncertainty in the market has been aggravated by exogenous shocks to demand, for instance, the events of September 11. A further reason for ongoing instability relates to the composition of airline costs. It is clear that a significant fraction of airline costs are beyond the control of airlines (e.g. fuel, airport charges and wages). Many of these costs are subject to significant fluctuation, either directly (e.g. fuel prices) or, since many costs are denominated in foreign currencies, due to exchange rate movements. In practice, airlines have somewhat different degrees of exposure to these costs, so it is not easy for airlines to distinguish the response of prices to exogenous movements from the use of prices to gain competitive advantage.

14. Finally, as noted in section 3.2 of the NECG Report, airlines operate in markets where, in the short term, fixed costs are high. A firm's incentive to adhere to a collusive agreement to increase price is negatively affected by the extent of sales that it can afford to lose if another firm cheats on the agreement and does not increase its price (or provides say, secret discounts and other price rebates). The amount of sales that a firm can afford to lose is lower for firms that have high fixed costs and low marginal costs. Consequently, firms with low marginal costs will be less likely to adhere to a price co-ordination agreement than those with higher marginal costs.[21] Realising this, firms will be less likely to engage in co-operative behaviour, and where they do engage in such behaviour, it is unlikely to persist.

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20 See Green E J and Porter R H, 1984, ''Noncooperative Collusion Under Imperfect Price Competition'' *Econometrica*, 52:87–100. By allowing for uncertainty and asymmetric information, Green and Porter obtained price wars as a part of equilibrium behaviour. They considered repeated oligopolistic interactions with imperfect monitoring and where demand is subject to random unobservable shocks. It should be noted that Stigler, 1964, *op. cit.*, does mention random factors but without presenting an analytical solution as complete as Green and Porter, essentially because it is a pre-game theoretic paper. Obviously, other forms of shocks are also possible. For example, Kyle and Athey analyse private cost shocks. See Kyle B and Athey S, 2001, "Optimal Collusion with Private Information", *Rand Journal of Economics*, 32-3:428-465.

21 See Harris and Simons (1989), p. 222 and Cabral L M B, 2000, *Introduction to Industrial Organization*, MIT Press, p.221.

Empirical evidence

15. A further factor that should lead the ACCC to clearly reject the plausibility of a durable "cosy duopoly" as an outcome is that it is so rarely observed in liberalised airline markets. Indeed, the only circumstances where it might occur are those where the airlines at issue are strongly horizontally differentiated – for example, as a result of controlling "fortress hubs" which substantially separate the territories they serve. Where that is the case, the fact that in practice each airline will face relatively inelastic demand when it competes for the core traffic of its competitor may tend to attenuate price competition (as geographical separation generally does). Even then, however, the US experience suggests duopoly pricing by horizontally differentiated carriers merely induces competitive expansion by VBAs.

16. In the markets relevant here, the Parties' operations, far from being geographically separated, very substantially overlap – indeed, Qantas effectively covers all of Air NZ's service territory. We are unfamiliar with any case where such head-to-head competition, in a liberalised market, has resulted in a "cosy duopoly."

17. Indeed, it is far more plausible to believe that liberalised airline markets lack a core than to think that they give rise to tacitly co-ordinated behaviour.[22] To the extent to which the ACCC believes it ought to consider alternative patterns of competitive interaction, core-less markets would seem to offer a far more plausible scenario than does co-ordinated interaction, all the more so as such markets are not uncommon in transport industries.[23]

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22 See for example Button, K. (2002) "Empty Cores in Airline Markets", 5th Hamburg Aviation Conference, Hamburg, February 2002.

23 See Pirrong, S. C. (1992) "An application of core theory to the analysis of ocean shipping markets" 35 *Journal of Law and Economics* 89.

ANNEX 2:
COUNTERFACTUAL AND FACTUAL ANALYSIS BY CITY-PAIR

A description of Qantas' specific commercial rationale for its Counterfactual schedule and corresponding Factual schedules, by city-pair, is set out below. The order in which the city-pairs appear follows Appendix C and confidential Appendix D of the NECG Report.

Qantas Counterfactual and Factual

Auckland – Sydney (AKL-SYD)

[

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Factual: Under the Factual, the Alliance will decrease the frequency of its AKL-SYD departures from the current 148 departures per week to 118 per week in year 1 (QF: B744, B743, B763, B733; NZ: B744, A320), 120 in year 2, and then a further increase to 126 departures per week in years 3 to 5.

However there will be an increase in capacity on the AKL-SYD route from the current 29,214 seats per week to 30,248 seats per week in year 1 (3.5% increase), 30,830 seats in year 2 (1.9% increase), and 31,988 seats in years 3 to 5 (3.8% increase). This represents an average annual capacity increase of 3.1% per annum over the three year period.

The increase in Alliance capacity of 3.5% in year 1 (due to the use of larger aircraft) reflects normal market growth when the VBA and other airlines' capacity is also taken into account (total market capacity growth is 9.8%). The apparent 20% reduction in

frequency in year 1 is effectively the elimination of duplicate flying. Windows of departure remain unaffected or are enhanced by the Alliance as there are currently 10 departures per day which are duplicated as between QF and NZ on this route.

Auckland – Melbourne (AKL-MEL)

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Factual: Under the Factual, the Alliance will initially increase the frequency of its AKL-MEL departures from the current 56 departures per week to 74 per week in year 1 and in year 2, and in years 3 to 5 increase to 82 per week (QF: B763, NZ: A320).

This will represent an increase in capacity on the AKL-MEL route from the current 12,268 seats per week to 13,684 seats per week in year 1 (11.5% increase), 13,684 seats in year 2 (0% increase), and 14,852 seats in years 3 to 5 (8.5% increase). This represents an average annual capacity increase of 6.6% per annum over the three

year period. The increase in capacity is largely due to the increase in the number of departures of the A320 aircraft.

On this sector one of the benefits of the Alliance is apparent – the addition of 4 departures on the wide bodied B763 to increase freight capacity as compared with the current Qantas capacity and as compared with the Counterfactual. While Qantas does not believe that there will be a substantial number of passengers on this flight, it will use aircraft which would otherwise sit in MEL overnight as part of the Qantas domestic operations, so it only needs to cover marginal costs to make this operation profitable. In addition, this facilitates Qantas access to the distribution centre of Australian AirExpress, its freight joint venture with Australia Post, which has its distribution centre in MEL. Therefore as well as accessing the Australian freight distribution centres, Qantas will also be able to access some international freight capacity out of MEL and also out of SYD (for which MEL is a through route).

Auckland – Brisbane (AKL-BNE)

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Factual: Under the Factual, the Alliance will maintain the frequency of its AKL-BNE departures at the current 36 departures per week in years 1 and 2 (QF: B744; NZ:A320) but will increase departures to 40 per week in years 3-5. This includes 8 departures per week operated by Freedom Air[24] in years 1 and 2 increasing to 12 per week in year 3.

This will represent a slight decrease in capacity on the AKL-BNE route from the current 9,470 seats per week to 9,228 seats per week in years 1 and 2 (2.6% decrease). In years 3 to 5 however the Alliance will increase capacity to 10,036 seats per week (8.8% increase). This represents an average annual capacity increase of 2% per annum over the three year period. Air NZ will move to A320 aircraft in year 1. They then start to phase in Freedom's operation of the new A320s in year 2, but this process would not be complete until year 3, and for this sector the upgrade would not be completed until year 3.

As a result of aircraft changes, overall capacity of the Alliance will decrease on this route by 2.6% despite maintaining frequency. However the parties expect overall market capacity will grow in year 1 by 13.6% on this route due to the expected entry by a VBA. The VBA is expected to operate a daily flight in year 1, moving to double daily in year 2, representing overall increase in market by 23.4%. In years 3 to 5, the Alliance increases capacity by 8.8%, which effectively represents the phasing out by Freedom Air of B733 aircraft and replacement with A320s, the addition of another 4 departures on this sector.

Wellington – Sydney (WLG-SYD)

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24 While the Freedom Air flights do not appear in Appendix C of the NECG Report, as they are modelled as a separate airline in the NECG spreadsheets, this does not affect the NECG calculation of benefits and detriments as Freedom is included with Air NZ in the Cournot calculations.

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Factual: Under the Factual, the Alliance will decrease the frequency of its WLG-SYD departures from the current 54 departures per week to 48 per week in year 1 (QF: B733; NZ: A320), 34 in year 2 (QF: B763; NZ: A320), maintaining 34 departures per week in years 3 to 5 (QF: B763; NZ: A320).

This will represent a slight decrease in capacity on the WLG-SYD route from the current 6,212 seats per week to 6,168 seats per week in year 1 (0.7% decrease), thereafter increasing the capacity to 6,224 seats in year 2 (0.9% increase), and 6,224 seats in years 3 to 5 (0% increase). This represents an average annual capacity increase of 0.1% per annum over the three year period.

As this is a relatively large sector, the parties have assumed that there would be VBA entry in year 1, increasing total market capacity by 28.3%, with the VBA operating 10 departures for years 1 to 5.

In year 2, Qantas will move from the B733 aircraft to the more cost-effective wide-bodied B767. Passengers still have the frequency choice of a double-daily service, with wide-bodied aircraft which customers prefer, and the Alliance is able to deliver this with a mix of A320s and B767s, through cost-savings on this route.

Wellington – Melbourne (WLG-MEL)

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Factual: Under the Factual, the Alliance will maintain the frequency of its WLG-MEL departures at the current 24 departures per week in year 1 (QF: B733; NZ: B733A), and year 2 (QF: B733; NZ: A320) then reduce to 14 departures per week in years 3 to 5 (B763).

This will represent a maintaining of capacity on the WLG-MEL route at 2,756 seats in year 1 (0% increase). In year 2, the Alliance will operate 3,204 seats per week (16.3% increase), and with the expected entry of the VBA, and Air NZ moving to A320, it predicts a total market capacity increase of 55.4%. In years 3 to 5 the Alliance will further increase its capacity to 3,304 seats per week, representing increased capacity of 3.1% and an average annual capacity increase of 6.2% per annum over the three year period.

By year 3 the Alliance will be operating solely wide-bodied aircraft on this route, which will also contribute to available freight capacity.

Wellington – Brisbane (WLG-BNE)

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Factual: Under the Factual, the Alliance will maintain the frequency of its WLG-BNE departures at the current 18 departures per week in year 1 (B733), decreasing to 16 in year 2 (QF:B763, B733; NZ:A320), however, the introduction of A320 aircraft on this route mean that overall capacity will increase despite the reduction in frequency. In years 3 to 5 the number of departures reduces again to 14 departures per week (QF: B763; NZ; A320), taking into account the likely scale of VBA presence in on the route in comparison to the volume of traffic.

Capacity will remain constant on the WLG-BNE route at 2,400 seats per week in year 1, and this will increase to 2,944 seats per week in year 2 (22.7% increase), decreasing slightly to 2,712 seats per week in years 3 to 5 (7.9% decrease). This represents an average annual capacity increase of 4.2% per annum over the three year period. In terms of branding, Freedom Air has effectively replaced Air NZ on this route under both the Factual and Counterfactual.

The Alliance expects VBA entry on this route in year 1 with 6 departures per week, continuing at this capacity in years 2 to 5. Overall, capacity on this route is expected to increase by 16.5% over the period, with the Alliance contributing 4.2%.

Christchurch – Sydney (CHC-SYD)

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Factual: Under the Factual, the Alliance will decrease the frequency of its CHC-SYD departures from the current 70 departures per week to 66 per week in year 1 (QF: B763, B733; NZ: A320, increasing to 70 in year 2 (QF: B763, B733; NZ: A320), then reduce to 68 departures per week in years 3 to 5 (QF: B763; NZ: A320).

This will represent a decrease in capacity operated by Qantas and Air NZ from the current 13,528 seats per week to 12,576 seats per week in year 1 (7.0% decrease), increasing to 13,280 seats per week in year 2 (5.6% increase) and increasing again to 13,516 seats per week in years 3 to 5 (1.8% increase). This represents a negligible average annual capacity decrease per annum over the three year period. By years 3

to 5, Qantas will have ceased to operate narrow-bodied aircraft, further facilitating freight movement on this route.

With the expected VBA entry operating daily return flights from year 1, overall capacity on this route is expected to increase by 11.6% in year 1. In year 2 the increase in Alliance capacity of 5.6% contributes to an overall market increase in capacity of 4.7%. The overall market increases by an average of 5.8% per annum over the total three year period.

Christchurch – Melbourne (CHC-MEL)

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Factual: Under the Factual, the Alliance will maintain the frequency of its CHC-MEL departures at the current 26 departures per week in years 1 (QF: B763, B733; NZ: B733A), 2 (QF: B763, B733; NZ: A320), and 3 to 5 (QF: B763; NZ: A320).

However the Alliance capacity will increase over the 3 year period by 13.8% as Qantas upgrades its B733 operations to the wide bodied B763 aircraft to increase freight capacity on the CHC-MEL route. This has the effect of also increasing seat capacity from the current 3,468 seats per week to 3,948 seats per week in year 1 (13.8% increase). In year 2 the capacity increases again by 11.3% to 4,396 seats per week due to Air NZ phasing out its B733 aircraft and replacing them with the A320 aircraft.

There is a further predicted increase in capacity of 10.9% in year 3 to 4,876 seats per week as Qantas upgrades its remaining B733 services to wide-bodied B763 aircraft. This represents an average annual capacity increase of 12.0% per annum over the three year period.

The alliance expects VBA entry on this route in year 2 at a constant 6 departures per week, as this is a core trans-Tasman sector.

Christchurch – Brisbane (CHC-BNE)

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Factual: Under the Factual, the Alliance will increase the frequency of its CHC-BNE departures from the current 24 departures per week to 26 per week in year 1 (QF: B763, B733; NZ: B733A; NZ: B737), and year 2 (QF: B763, B733; NZ: A320 NZ:A320), and decrease to 20 per week in years 3 to 5 (QF: B763; NZ:A320).

This will represent an increase in capacity on the CHC-BNE route from the current 3,620 seats per week to 3,848 seats per week in year 1 (6.3% increase), and to 4,320 seats per week in year 2 (12.3% increase), and then decreasing to 3,684 seats per week in year 3 (14.7% decrease). In year 3 Air NZ withdraws its remaining A320

services leaving QF and Freedom Air on this route. This represents an average annual capacity increase of 0.6% per annum over the three year period.

This is a Brisbane based leisure route, which gives access to key tourist gateways, so the parties expect a VBA entrant to commence at a reasonably high level with 10 departures per week in year 1, increasing to 14 departures per week in years 2 to 5. As a result the parties expect an overall average annual growth rate on this route of 19.7% in the period.

Sydney – Queenstown (SYD-ZQN)

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Factual: Under the Factual, the Alliance will increase the frequency of its SYD-ZQN departures from the current 2 departures per week to 6 in year 1 (QF: B733; NZ: B733), 6 in year 2 (QF: B733; NZ: A320), and 6 departures per week in years 3 to 5 (QF: B733; NZ: A320).

This will represent an increase in capacity on the SYD-ZQN route from the current 228 seats per week to 776 seats per week in year 1 (340.0% increase), 816 seats per week in year 2 (5.2% increase), and 816 seats per week in years 3 to 5.

Auckland – Los Angeles (AKL-LAX).

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Factual: Under the Factual, the Alliance will increase the frequency of its AKL-LAX departures from the current 42 departures per week to 48 per week in year 1, then increase to 52 departures per week in years 2 to 5 (QF: B744; NZ: B744).

This will represent an increase in capacity on the AKL-LAX route from the current 16,390 seats per week to 19,616 seats per week in year 1 (19.7% increase), and 21,184 seats per week in years 2 to 5 (8.0% increase). This represents an average annual capacity percentage increase of 8.9% over the first three years of the Alliance.

Since United's withdrawal from the route, the factual has been updated to reflect the Alliance operating 24,640 seats per week by year 3. This represents an average annual capacity percentage increase of 14.6% over the first three years of the Alliance.

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Auckland – Wellington (AKL-WLG)

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Factual: Under the Factual, the Alliance will maintain the frequency of its AKL-WLG departures at the current 362 departures per week in year 1, in year 2, and maintaining this level of 362 departures per week in years 3 to 5 (QF: B733; NZ: B733).

This will represent a sustaining of capacity on the AKL-WLG route at the current 46,192 seats per week in years 1, 2 and in years 3 to 5.

Auckland – Christchurch (AKL-CHC)

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Factual: Under the Factual, the Alliance will maintain the frequency of its AKL-CHC departures at the current 318 departures per week in year 1, in year 2, and maintaining this level of 318 departures per week in years 3 to 5 (QF: B733; NZ: B733).

This will represent a slight decrease in capacity on the AKL-CHC route from the current 43,136 seats per week to 40,448 seats per week in year 1 (6.2% decrease), in year 2, in years 3 to 5. This represents an average annual capacity decrease of 2.1% over the first three years of the Alliance.

Christchurch – Wellington (CHC-WLG)

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Factual: Under the Factual, the Alliance will maintain the frequency of its CHC-WLG departures at the current 118 departures per week in year 1, in year 2, and in years 3 to 5 (B733).

This will represent a sustaining of the current capacity of 16,048 seats per week on the CHC-WLG route through years 1, 2 and 3 – 5.

Christchurch – Queenstown (CHC-ZQN)

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Factual: Under the Factual, the Alliance will maintain the frequency of its CHC-ZQN departures at the current 32 departures per week in years 1, 2 and in years 3 to 5 (B733).

This will represent a constant level of capacity on the CHC-ZQN route at the current 4,272 seats per week in year 1, year 2, and in years 3 to 5.

Auckland – Queenstown (AKL-ZQN)

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Factual: Under the Factual, the Alliance will maintain the frequency of its AKL-ZQN departures at the current 26 departures per week in years 1, 2 and in years 3 to 5 (NZ: B733).

This will represent sustained capacity on the AKL-ZQN route at the current 3,536 seats per week in year 1, in year 2, and in years 3 to 5 of the Alliance.

Wellington – Dunedin (WLG-DUD)

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Factual: Under the Factual, the Alliance will maintain the frequency of its WLG-DUD departures at the current 26 departures per week in years 1, 2 and years 3 to 5 (B733).

This will represent a sustaining of the capacity on the WLG-DUD route of the 3,536 seats per week in years 1, 2 and in years 3-5 of the Alliance.