

## **APPENDIX: EXTRACT FROM WIAL SUBMISSION**

### **ALTERNATIVES TO THE CARTEL**

492. WIAL believes that if the application is not authorised, the likely medium term counter-factual is more important and possibly more complicated than the Airlines have publicly stated.
493. Airlines seek to create the impression that the TNA is the only option and the only deal on offer. The Airlines have consistently claimed that, without authorisation, the consequences will be dire and that there are no alternatives. But Qantas and Air NZ are highly professional and successful companies. They are extremely unlikely to simply allow their businesses to be damaged if the authorisation is not granted. Like most businesses they will adapt, and in large part have already started to do so, albeit that a competitive malaise must surely develop between the parties when arrangements such as the Alliance and the code-share are being developed and negotiated over a prolonged period (at least the last four years).
494. However, in a speech to the Chamber of Commerce in Wellington on 4 May, Rob Fyfe said that there are at least three other options for Air NZ:
- (a) Unilaterally withdraw from routes (which it is doing in any case under the TNA);
  - (b) Unilaterally increase fares– even a small increase in fares of 1-4% would increase Air NZ revenues by \$18 million per annum; or
  - (c) Unilaterally reduce capacity (although in the applications the Airlines claim they cannot do so).
495. This is unlikely to be the full suite of options, but each (a) to (c) would be preferable to the cartel, especially since there will be service withdrawals, capacity reductions and fare increases under the cartel. They just wont be disciplined by any competition.
496. Qantas has publicly referred to a "plan B". The head of New Zealand operations, Grant Lilly said so as the recent TRENZ conference in Christchurch.
497. Until now, a great deal of effort within the two Airlines has been focused on an arrangement between them. However, if the authorisation is not granted it is likely that their efforts will individually turn to other strategies. Indeed, when the Qantas-Air NZ Alliance was rejected by the New Zealand High Court, Qantas' CEO Geoff Dixon was quoted as proclaiming it "dead". It is very unlikely that at that point, Qantas and Air NZ did not consider a

range of alternatives that they are yet to pursue. The current application is but one of those options.

#### **Arrangements with other airlines**

498. Air NZ in particular has argued that it needs an arrangement on the Tasman with an Australian airline. The issue with the current application is that the proposed arrangement is with ***the other major competitor***, Qantas. It is possible that Air NZ could pursue an arrangement with another airline without the negative consequences of the current proposal.
499. In the case of Virgin Blue, an arrangement with Air NZ could be even more extensive than the TNA in that, in addition to the various Tasman markets, it could involve the domestic networks of Virgin (in Australia) and Air NZ (in New Zealand). It is worth noting that there are changes in control at a parent company level that may allow such proposals to be revisited, even though they have been dismissed in the past.
500. On occasions, Air NZ has said that the obstacle with Virgin Blue is that it does not have the systems to allow it to code-share and interline. As the Airlines state in their own submission, this is no longer correct. Virgin Blue has invested in new systems capable of integrating with full service carriers and has managers with those duties. It has interlining arrangements with some carriers already.
501. For Virgin, this would accelerate their capability to fly the Pacific routes, since Air NZ already has services and expertise in these areas.
502. This would result in two stable but competitive blocks in Australasia: Qantas/Jetstar and Air NZ/Virgin. This would be an excellent outcome for consumers – and as, several people have said, a “marriage made in heaven” for Air NZ and Virgin.
503. The fact that many ex Air NZ executives now work at Virgin would surely make it easier.

#### **Further development of lower cost product and brands by each airline**

504. In other airline markets, including the Australian domestic market, there has been an acceptance that competition and lower fare environments will be a permanent feature of short haul routes. That is, those markets have been transformed by airlines offering high frequency, high convenience, affordable prices and a product to meet every part of the market. This is certainly the case in Europe and it is increasingly the case in other regions. Airlines of this type have a specific strategy of low costs and stimulating new markets through affordable fares, direct services and new routes.

- (a) In Australia, there was a major shift with the entry of Virgin and then Jetstar. Although customer acceptance of Jetstar has been mixed on some Qantas routes, it was a very positive initiative, well executed and has proven highly successful. Few would like to see Jetstar and Virgin disappear from the Australian domestic scene. At the same time, Qantas remains a highly valued airline for a large body of travellers. The Australian domestic market has demonstrated a demand for a variety of products and airline models.
- (b) On Tasman routes, the transformation is far from complete, although there have been some halting moves toward new short haul models:
- Air NZ started Freedom in 1996 in the face of competition from Kiwi Air. Freedom has been a positive force in many ways, but has not developed to the extent of other low cost leisure carriers and struggled to get brand presence in Australia. Freedom has largely been integrated back into Air NZ.
  - Virgin was welcomed onto some Tasman markets in 2004, based in Christchurch. However, after more than two years, they have entered the market in a reasonably limited way. It remains a relatively small player compared to its presence in Australian domestic markets and compared to the Airlines on the Tasman.
  - Air NZ introduced Tasman Express fares in late 2003 and Qantas did the same, but this reflected a reaction on fares rather than a permanent shift in underlying costs.
  - Air NZ has been taking steps to address its costs and in some cases this has required some hard decisions. They would no doubt argue that this application is part of that process. But transformations to low cost environments are not achieved through anti-competitive arrangements.
- (c) Jetstar entered the Christchurch market in December 2005 and was very welcome. Jetstar has made it quite clear that, for the time being, it will only serve Christchurch. This is different to the experience of low cost carriers in other markets, including Australian domestic markets where Jetstar and Virgin have opened up routes previously unavailable to consumers. In the absence of the TNA, Jetstar might be expected to enter more markets (which may explain some of the enthusiasm for the TNA by at least one of the Airlines).

505. However, there is unlikely to be a full and permanent shift to new models for short haul travel on the Tasman while the two major players pursue an

arrangement between themselves. That is, we will see a fuller transformation and diversification of product when Qantas and Air NZ are liberated from any sense of competitive inactivity.

**Unilateral Actions to Improve Performance on the Tasman Markets**

506. It is open to airlines to take unilateral actions in accordance with their own assessment of the potential passenger markets. If the judgement of those who would withdraw capacity or put up prices is correct, their competitors will probably do the same. If not, then the arguments put for the authorisation are flawed and it should not proceed.
507. We note that the Airlines have ruled out unilateral action as their network may be considered inferior and that their passengers would "spill" to the other applicant or other competitors.
508. This is in contrast to their position that Emirates, Pacific Blue, Lan Chile, Royal Brunei, Garuda, Aerolineas Argentinas are genuine competitors on Auckland routes (and to a lesser extent Christchurch), despite their poor frequencies and network.
509. However, in their public statements, the Airlines have made very clear that they can and will act unilaterally without the code-share (see Rob Fyfe's comments of 4 May 2006 in Wellington and Grant Lilly from Jetconnect comments about Qantas' plan B at TRENZ in June 2006). Rob Fyfe in particular has been very forthright in saying that he will not hesitate to act unilaterally on the Tasman.
510. As we have set out in an earlier section of this submission, not only will they act unilaterally on Tasman capacity and fares, they have already done so.

**Proposals for more limited arrangements between Qantas and Air NZ**

511. It is also possible that the Airlines will continue to focus on an arrangement between them, but of a more limited nature and without price-collusion. This may include a small number of routes where there is some level of genuine competition. It is not at all uncommon for code-shares to have "carve outs". There are no such routes out of Wellington with genuine competition, and even in Auckland, not all routes would qualify. If that were the alternative pursued, some very precise controls would be required to avoid diminution of competition in other markets, and any authorisations would need to have regular sunset clauses to revisit the markets in question (rather than periods of five years as sought by the Airlines).