

THE ANTITRUST REVIEW OF THE QANTAS AIRWAYS- AIR NEW ZEALAND ALLIANCE

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On September 9, 2003 the Australian Competition and Consumer Commission (“ACCC”) denied the application of the country’s flag carrier, Qantas Airways (“Qantas”), and Air New Zealand (“Air NZ”) for an “authorisation”² that would have permitted a strategic alliance and an acquisition of 22.5% of Air NZ shares by Qantas. The carriers plan to appeal this decision to the Australian Competition Tribunal and are still awaiting a final determination from the New Zealand Commerce Commission (“NZCC”). Both the ACCC and the NZCC have issued thorough and detailed analyses of this proposal in the course of their reviews. In order to put this ongoing proceeding in perspective, this article will briefly examine the following: the airline industry in Australia and New Zealand, the details of the proposed alliance and equity transaction, the applicable laws, and the economic analyses used thus far.

In the fall of 2002, Qantas and Air NZ announced their intentions for a strategic alliance and equity transaction. Both airlines

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² See pages 18-20 below for an explanation of the authorisation process.

have felt the effects of events of the last two years that have affected airlines all over the world: the September 11 attacks, SARS, and war in Iraq. Mergers and alliances have become airlines’ form responses to uncertain economic conditions. True to form, Qantas and Air NZ responded with a mixture that combines elements of a merger as well as a comprehensive alliance. One of the most curious aspects of this proposed transaction is that the airlines blatantly proposed to create an effective monopoly in New Zealand and in the trans-Tasman Sea market, and openly admitted that the transaction would raise prices.³

The ACCC and NZCC coordinated their efforts in considering this international transaction. Both agencies issued “Draft Determinations” on April 10, 2003. A Draft Determination is a preliminary assessment of a transaction that precedes a Final Determination in both countries. Both the ACCC and NZCC were highly critical of the transaction in their respective Draft Determinations; both agencies expressed great concern about potential anticompetitive effects of the proposal and skepticism about its public benefits. In the case of the ACCC, the agency’s Draft Determination turned out to be a fairly definitive harbinger of its final decision.

The Companies And Their Home Markets

Qantas and Australia

Qantas is Australia’s largest airline and the twelfth largest worldwide as measured by revenue passenger kilometres (“RPK”).⁴ Qantas operates roughly 5,300 domestic

³ See Stephen Bartholomeusz, This Monopoly Looks OK, When Viewed on a Broader Canvas, The Age, December 13, 2002, <http://www.theage.com.au/articles/2002/12/21039656169082.html> (“Bartholomeusz”).

⁴ The analogous measure in the United States is revenue passenger miles.



The Transportation Antitrust Update

Transportation Industry Committee • Section of Antitrust Law • American Bar Association

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Our website includes pages with reports of recent developments, announcements of upcoming meetings, and useful links. Back issues of this newsletter are available as well. We invite you to visit the website and provide us with your feedback.

Note from the Chair:

In this issue of the newsletter, we begin with a summary of the history of regulation of computer reservations systems and issues currently under review at the U.S. Department of Transportation. David H. Coburn and Carol Gosain of Steptoe & Johnson LLP report on the DOT rulemaking proposals and the wide range of views expressed in the comments on those proposals. Naveen C. Rao of the Office of the Chief Counsel of the Federal Aviation Administration provides a review of the proposed alliance of Qantas Airways and Air New Zealand, including a discussion of the airline industry in Australia and New Zealand and the economic analyses considered by the competition agencies of the two countries to date. Finally, Ben Little and Jack Quinn of Blake, Cassels & Graydon, LLP summarize amendments to the Canada Transportation Act tabled in February 2003 and the report that accompanied those proposed amendments.

We are interested in recruiting new authors for future committee newsletters. If you would like to contribute to an upcoming issue, please contact Carolyn Corwin, 202-662-5338, ccorwin@cov.com.

Special thanks go to each of our contributors and to our “desktop publishers” at Covington & Burling. I am also pleased to recognize the contributions of our Committee Vice Chairs, Carolyn Corwin and Jennifer

flights and 540 international flights each week.⁵ It operates a low cost carrier, Australian Airlines,⁶ and has subsidiaries for regional services.⁷ Qantas is a member of the “oneworld” marketing alliance.⁸

For many years, aviation was a heavily regulated industry in a heavily regulated Australian economy. Beginning in the 1950s, the country adopted a two-airline policy for the domestic market.⁹ Ansett and Australian Airlines had almost equal shares of the domestic market, and Qantas was the sole designated international carrier for the country. These policies continued until 1988, when the government embarked on deregulation of the domestic market.

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⁵ Competition and Consumer Commission [Australia], *Draft Determination: Application for Authorisation A20220, A30221, A30222, A90862, and A90863; Acquisition by Qantas Airways Limited of Ordinary Shares in Air New Zealand Limited and Cooperative Arrangements between Qantas, Air New Zealand, and Air Pacific Limited*, April 10, 2003 (“ACCC Draft”), p. 3.

⁶ The current Australian Airlines should not be confused with the domestic airline of the same name. The latter carrier operated domestically until 1992, when it was acquired by Qantas.

⁷ The Qantas regional subsidiaries are QantasLink, Eastern Australian Airlines Pty Limited, Southern Australia Airlines Pty Limited, Sunstate Airlines (Qld) Pty Limited, Airlink Pty Limited, and Impulse Airlines Pty Limited. *Id.*

⁸ Oneworld consists of British Airways, American Airlines, Cathay Pacific, Aer Lingus, Finnair, Iberia, and Lan Chile. *See* www.oneworld.com.

⁹ Organisation for Economic Co-operation and Development, Directorate for Financial, Fiscal, and Enterprise Affairs Committee on Competition Law and Policy, *Airline Mergers and Alliances*, February 1, 2000, p. 129, <http://www.oecd.org/dataoecd/1/15/2379233.pdf>.

This initiative culminated in the deregulation of fares, aircraft imports, capacity controls, and route entry.¹⁰ Deregulation of international service occurred in the 1990s, with the most notable change being the end of the designation of a single international carrier. As part of the initiative to deregulate international aviation, the Government created the International Air Services Commission (“IASC”) to allocate frequencies available to designated Australian carriers under various bilateral agreements. Under “grandfather” provisions, Qantas was allowed to keep its existing international route authorities.¹¹

In 1999, Australia took further steps in the march towards greater liberalization. These measures included an initiative to seek more “open skies” agreements¹² when in the national interest and unrestricted access to all international airports for services with dedicated freighter aircraft. The most notable changes were the relaxation of restrictions on foreign ownership of Australian international airlines (49 percent foreign ownership is now permitted) and a provision permitting foreign persons to own 100 percent of the equity of an Australian domestic airline.¹³ The retention of a requirement of partial Australian-citizen ownership for the country’s international carriers was not a remnant of protectionist sentiment; rather, it was intended to satisfy nationality requirements contained in bilateral air service agreements. The complete elimination of foreign ownership restrictions for domestic airlines was intended to draw

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¹⁰ *ACCC Draft* at 11.

¹¹ *Id.*

¹² Open skies agreements are bilateral agreements that typically eliminate all restrictions on capacity and routes between signatory states.

¹³ *Id.* at 12.

international capital into the domestic market.¹⁴

Over the last three years, conditions in the domestic Australian market have been very volatile. Two carriers, Virgin Blue and Impulse, entered the market in 2000. In May 2001, Impulse failed and was acquired by Qantas.¹⁵ Ansett shut down in March 2002. In the aftermath of Ansett's demise, Qantas' share of the Australian domestic market spiked from 50 percent to nearly 90 percent. Thanks to growth at Virgin Blue, the Qantas share has subsequently stabilized around 75 percent.¹⁶

On the international side, the situation has been calm in comparison. There were 41 international airlines operating to Australia in 2001-2002.¹⁷ Although Qantas has seen its market share slip, it is still by far Australia's largest international carrier, with 34.5 percent of all international traffic in June 2002. The second place carrier, Singapore Airlines, carried only 11.8 percent of the international traffic in the same period. Air New Zealand was third, with 9.7 percent.¹⁸ The market for international air freight services roughly mirrors the passenger airline business, with Qantas as the dominant firm, followed by Singapore, Cathay Pacific, and Air NZ.¹⁹

Richard Branson, Chairman of Virgin Atlantic, has announced that his airline will begin service to Australia by late 2004. While Virgin Atlantic's potential entry may have little effect on the competitive environment,

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¹⁴ *Id.* In comparison, U.S. ownership requirements seem anachronistic. See 49 U.S.C. §§ 40102(a)(15) and 41101 *et seq.*

¹⁵ See http://www.abc.net.au/news/2001/05/item20010501151921_1.htm.

¹⁶ *ACCC Draft* at 16-17. Virgin Blue, part of the UK-based Virgin Group, is a low-fare airline.

¹⁷ *Id.* at 14.

¹⁸ *Id.*

¹⁹ *Id.* at 16.

Branson's trademark swagger has drawn some attention.²⁰

Air NZ and New Zealand

Air NZ is New Zealand's principal air carrier and the thirty-third largest airline worldwide.²¹ It is comprised of a group of companies, including regional carriers.²² Air NZ provides service to 48 destinations in 16 countries. Notably, the carrier derives 80 percent of its business (passenger and cargo) from its international operations.²³

From 1951 to 1983, New Zealand had a heavily regulated domestic market. Carriers were allowed to operate only after a demonstration of public need.²⁴ Beginning in 1983, any airline (including foreign-owned carriers) has been able to operate domestically so long as it obtained an operator certificate from the Civil Aviation Authority (a safety agency analogous to the U.S. Federal Aviation Administration.) There is no separate requirement to obtain an economic license from the Ministry of Transport.²⁵ Among others, Qantas provides domestic service in New Zealand. There are ownership restrictions for carriers seeking to provide international service, due to ownership requirements in bilateral agreements to which

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²⁰ See http://biz.yahoo.com/djus/030723/2010001912_1.html.

²¹ *ACCC Draft* at 3.

²² In November 2001, Air NZ re-branded all of its domestic operations as "Air NZ Express."

²³ Commerce Commission [New Zealand], *Draft Determinations: Qantas Airways Ltd., and Air New Zealand Ltd.*, 10 April 2003 ("NZCC Draft").

²⁴ Commerce Commission [New Zealand], *Decision No. 278- Determination under the Commerce Act 1986 in the Matter of a Business Acquisition Involving: Air New Zealand Ltd; Ansett Holdings Ltd; and Bodas Pty Ltd.*, 3 April 1996.

²⁵ *NZCC Draft* at 30.

New Zealand is a signatory.²⁶ Since 1961, Australia and New Zealand have been bound by their current air services agreement (“ASA”). In 1992, the countries signed a memorandum of understanding (“MOU”) to create a Single Aviation Market (“SAM”). Under 1996 amendments, travel between the two countries is treated as travel within the same country, and cabotage is allowed.²⁷ For services that touch points outside either country, the 1961 ASA still applies. For instance, Air NZ’s non-stop flights between Sydney and Los Angeles are fifth-freedom flights authorized under the 1961 ASA.²⁸

Impetus Behind This Transaction

The proposed Qantas/Air NZ transaction appears to be driven by a variety of factors, none of which provides a particularly compelling justification. Both airlines are full-service network carriers and are vulnerable to low-cost competitors.²⁹ However, neither carrier can claim to be a failing firm that needs this transaction in order to survive the immediate future. Air NZ and Qantas compete on routes between their two countries, to the United States, to Asia, and (to a far lesser extent) Europe. They appear to seek the perceived safe haven found in size and potential economies of scale. Both airlines have participated in various strategic alliances and equity transactions with European and Asian carriers over the past decade.³⁰

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²⁶ *Id.*

²⁷ “Cabotage” is the operation of domestic services by a foreign air carrier.

²⁸ *Id.* at 38.

²⁹ See *Bartholomeusz*.

³⁰ British Airways holds equity in Qantas, and they cooperate on services between their respective countries. These two carriers are members of the oneworld alliance. Singapore Airlines holds equity in Air NZ, and both are members of the Star Alliance.

The Strategic Alliance

The proposed transaction is essentially an alliance between two horizontal rivals. It would significantly reduce competition between the two carriers. These airlines are the dominant players in a vast but sparsely populated geographical region that is remote from the world’s other population and economic centers.

As noted above, both carriers concede the anti-competitive effects of the merger, but argue that it would be ultimately be in public interest because of the economic security that would be conferred on the airlines and because of service improvements for the traveling public. Presumably, the transaction would enhance their ability to cope with competition from outside their domain. Perhaps Air NZ and Qantas view the turmoil of the past two years as the needed political cover for the anti-competitive effects of the transaction.

In their strategic alliance proposal, Air NZ and Qantas propose to create a Joint Airline Operation Network (“JAO Network”) that would be commercially managed by Air NZ.³¹ The carriers would manage their own respective flight operations. The JAO Network would extend to all Air NZ flights and to those Qantas flights to, from, and within New Zealand. Activities would include coordination on pricing, scheduling, capacity, promotion, marketing, yield management, codesharing, and information sharing necessary for the coordination of the other activities.³² Air NZ management decision making with respect to JAO would be supported by a six-member Strategic Airline Advisory Group (“SAAG”), with three members appointed by each airline. SAAG’s decisions would have to be unanimous, and its

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³¹ As discussed earlier, Qantas would hold 22.5 percent of Air NZ voting shares.

³² *ACCC Draft* at 6.

recommendations would be accepted only if both Qantas and Air NZ agreed.³³ Simply stated, the JAO Network would be a new virtual airline, comprised of all Air NZ flights and those Qantas flights touching New Zealand.

The proposed alliance, which has a minimum term of five years, would also affect the two carriers' cooperation outside of the JAO Network.³⁴ For instance, the two carriers intend to coordinate their frequent flyer programs, development of their on-board products, possible aircraft acquisitions, joint purchasing, information technology, and airport facilities sharing. There are also covenants that would prevent the carriers from competing with one another. The ACCC points out that, with the exception of Air NZ's Los Angeles-Sydney service, Air NZ and its affiliates would not be allowed to operate non-trans-Tasman sea flights that touch Australia.³⁵ The proposal also contains provisions for allocating financial benefits between the two carriers by comparing their performance on the JAO networks.³⁶

Air Pacific (based in Fiji) is a minor player in the proposed alliance. Air Pacific is 46.23 percent owned by Qantas and 1.97 percent owned by Air NZ. It is the only direct operator between Australia and Fiji. Under the proposal, Air Pacific would be able to cooperate with Qantas and Air NZ on scheduling and pricing.³⁷

Applicable Laws

In view of the international character of the strategic alliance and acquisition of equity, the laws of both countries are applicable. The ACCC and the NZCC have combined forces

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³³ *Id.* at 15.

³⁴ *Id.* at 6-7.

³⁵ *Id.* at 7.

³⁶ *NZCC Draft* at 15.

³⁷ *ACCC Draft* at 5, 8.

to evaluate these proposals. Both agencies participate in a tripartite agreement with the Canadian Competition Bureau designed to promote cooperation and coordination among the agencies.³⁸

In Australia, the Trade Practices Act of 1974 ("TPA") sets out the law applicable to the strategic alliance and equity acquisition. The TPA is a broadly drawn piece of consumer welfare legislation that covers subjects ranging from anticompetitive practices and product liability to access to essential facilities and international liner cargo shipping.³⁹ It is enforced by the ACCC.

In New Zealand, the analog to the TPA is the Commerce Act of 1986 ("1986 Act"). The 1986 Act is intended to prevent anticompetitive practices and abuse of market power, as well as mergers and takeovers that may result in harmful acquisitions of market power. The 1986 Act was controversial at its introduction and was under review by 1988. In 1990 the law was amended to implement changes resulting from the review.⁴⁰

The Equity Transaction

In Australia, subsection 50(1) of the TPA sets out the standard applicable to the equity transaction. It states in relevant part:

A corporation must not directly or indirectly:

(a) acquire shares in the capital of a body corporate; or

(b) acquire any assets of a person

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³⁸ Organisation for Economic Co-operation and Development, Global Forum on Competition: Contribution from Australia, available at [http://www.oecd.org/daf/clp/GFC_October_2001/wd-Australia\(ses5\).pdf](http://www.oecd.org/daf/clp/GFC_October_2001/wd-Australia(ses5).pdf).

³⁹ See <http://www.accc.gov.au/about/about.htm>.

⁴⁰ Hunter M. Donaldson, The Development of New Zealand Competition Law, in *Competition Law and Policy in New Zealand* (Rex J. Ahdar, ed. 1991) ("Ahdar"), pp. 11-24.

if the acquisition would have the effect, or be likely to have the effect, of substantially lessening the competition in a market.⁴¹

Subsections 50(4) and 50(5) of the TPA “provide a mechanism for authorisation of existing contracts for the acquisition of shares or assets provided the contract is conditional on authorisation being granted.”⁴² (Qantas and Air NZ entered into such a contract.) An authorisation under subsection 88(9) of the TPA would protect Qantas and Air NZ from legal action by either the ACCC or other parties for potential breaches of section 50 of the TPA.⁴³

Under the TPA, the ACCC may consider applications for authorisation for no more than 30 days before making a decision. However, this time may be extended. The TPA allows 45 days for complex matters or longer periods when ACCC requests information from the applicants. If ACCC fails to make a determination within the relevant time period, the authorisation is deemed to have been granted.⁴⁴

Section 47 of the 1986 Act is the analogous provision to section 50 of the TPA. Section 47 states in relevant part: “(1) A person must not acquire assets of a business or shares if the acquisition would have or would be likely to have, the effect of substantially lessening competition in the market.” According to the Office of the New Zealand Government Executive, section 47 of the 1986 Act is intended to align with the provisions of section 50 of the TPA.⁴⁵

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41 Available at <http://scaleplus.law.gov.au/html/pasteact/0/115/0/PA001970.htm>.

42 *ACCC Draft* at 24.

43 *Id.* at 40.

44 *Id.*

45 See <http://www.executive.govt.nz/minister/mallard/commerce/comparison.htm>.

The Strategic Alliance

Section 45 of the TPA applies to the strategic alliance. The ACCC describes section 45 as prohibiting “the making of or the giving effect to contracts arrangements or understandings that have the purpose or effect of substantially lessening competition in a market or which contain an exclusionary provision.”⁴⁶

Section 27 of the 1986 Act contains the analogous provision of New Zealand law. It states:

(1) No person shall enter into a contract or arrangement, or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

(2) No person shall give effect to a provision of a contract, arrangement, or understanding that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

(3) Subsection (2) of this section applies in respect of a contract or arrangement entered into, or an understanding arrived at, whether before or after the commencement of this Act.

(4) No provision of a contract, whether made before or after the commencement of this Act, that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market is enforceable.

Standards For Authorisation

The laws of both Australia and New Zealand provide for “authorisations” that essentially immunize otherwise illegal

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46 *ACCC Draft* at 41. The full text of Section 45 appears at <http://scaleplus.law.gov.au/html/pasteact/0/115/0/PA001800.htm>.

agreements and transactions from the competition laws if the parties can demonstrate that the conduct in question is in the public interest. Authorisation is a concept unique to the laws of these countries. In the context of this proposed alliance, these “authorisation” provisions appear to function like 49 U.S.C. §§ 41308 and 41309, which allow the Secretary of Transportation to grant air carriers limited immunity from the antitrust laws. Unlike U.S. antitrust immunity, however, authorisations are not limited to particular industries. Authorisations reflect the greater receptivity of Australia and New Zealand to notions of public benefit, including non-economic benefit.⁴⁷

The ACCC and NZCC have wide power to obtain documents and take sworn statements in the course of reviewing an authorisation application. Both agencies must produce “Draft Determinations” prior to making a final decision. The laws of both countries allow the applicants or any other interested person to call for a conference with ACCC or NZCC after the issuance of the Draft Determination.⁴⁸

Section 88 of the TPA creates the authority for ACCC to grant authorisations, and section 90 of the TPA describes the statutory criteria that the ACCC must apply in deciding whether to grant an authorisation. Section 90 consists of several parts that contain almost identical language with minor variation.⁴⁹

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⁴⁷ Michael S. Jacobs, *An Outsider’s Perspective of Australian Competition Law*, in *25 Years of Australian Competition Law* 144-65 (Ray Steinwall ed., 2000); see also Rex Ahdar, *The Authorisation Process and the “Public Benefit” Test*, in *Ahdar*, pp. 217-48.

⁴⁸ *Ahdar* at 220-21. See also ACCC, *Authorisations and Notifications* (May 1999).

⁴⁹ The full text of the TPA is available at <http://scaleplus.law.gov.au/html/pasteact/0/115/top.htm>.

Section 90(6) is representative of these provisions:

The Commission shall not make a determination granting an authorisation under subsection 88(1), (5) or (8) in respect of a provision (not being a provision that is or may be an exclusionary provision) of a proposed contract, arrangement or understanding, in respect of a proposed covenant, or in respect of proposed conduct (other than conduct to which subsection 47(6) or (7) applies), unless it is satisfied in all the circumstances that the provision of the proposed contract, arrangement or understanding, the proposed covenant, or the proposed conduct, as the case may be, would result, or be likely to result, in a benefit to the public and that that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if:

- (a) the proposed contract or arrangement were made, or the proposed understanding were arrived at, and the provision concerned were given effect to;
- (b) the proposed covenant were given, and were complied with; or
- (c) the proposed conduct were engaged in; as the case may be.

The ACCC states that, “[w]hilst there is some variation in the language of the tests for authorisation set out in subsections 90(6), 90(7), 90(8), and 90(9), the Commission adopts the view. . . that in practical application the tests are essentially the same.”⁵⁰

Subsection 90(9A) of the TPA requires the agency to consider a “significant increase in

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⁵⁰ *ACCC Draft* at 42. It is unclear what purpose the subdivisions serve if they are not differentiated by the agency charged with enforcing them.

the real value of exports” or significant substitution of domestic products for imports as “public benefits” for the purposes of determining an application for authorisation.⁵¹ This subsection provides some insight into the values that underlie Australia’s competition policy. The ACCC noted that it applied the requirements of subsection 90(9A) in its evaluation of the proposed alliance.⁵²

Sections 58 and 61 of the 1986 Act are analogous to sections 88 and 90 of the TPA respectively. The statutory criteria for grant of an authorisation in New Zealand are thus largely parallel to the criteria applied by the ACCC.

The Economic Analyses

In their Draft Determinations, both competition agencies concluded that the competitive harm from the proposed transaction would outweigh the public benefits. The NZCC stated that, “[o]n a provisional basis, the detriments are estimated to fall in the range of \$202 million to \$432 million, and the benefits in the range of \$30.2 million to \$46.3 million.”⁵³ The ACCC stated more generally:

[T]he Commission is of the view that the highly anticompetitive effects of the Proposed Arrangements identified by the Commission would significantly outweigh the low public benefits flowing from the Proposed Arrangements accepted by the Commission. The Commission is of the view that the gap between the anti-competitive detriments and public benefits likely to flow from the Proposed Arrangements is of a size that is unlikely to be able to be reduced through undertakings including those

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51 *Id.*
52 *Id.*
53 *NZCC Draft* at 13.

proposed by the Applicants.⁵⁴

Given the similarities between the laws of Australia and New Zealand and cooperative efforts of their competition agencies, many of the analyses and conclusions presented in the Draft Determinations strongly resemble one another. As described below, they rely on similar or identical methodologies.

Market Definition

Both the ACCC and the NZCC broadly defined the products at issue as passenger transport, freight, and ticket distribution. The NZCC went into much greater detail, subdividing the passenger air service and freight market into categories based on geography and dimensions, such as time sensitivity and level in the production process.⁵⁵ In the domestic market, the NZCC identified two geographic markets: main trunk and provincial. “Main trunk” refers to routes between Auckland, Christchurch, and Wellington. “Provincial” refers to routes to smaller cities, such as Dunedin and Hamilton. The NZCC also identified specific international passenger markets and cargo markets in its analyses. These markets include service between New Zealand and Australia, the U.S., Pacific Islands, and Asia, as well as several other markets.⁵⁶

The ACCC analysis of markets was less detailed. Despite the existence of a single aviation market between the two countries, the ACCC concluded that the Australian domestic market should not be subsumed into a larger regional market.⁵⁷ The Australian agency also differentiated air passengers by their reason for traveling (*i.e.*, business or leisure), as opposed to focusing on the classes of tickets available.⁵⁸ The ACCC did not elaborate on

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54 *ACCC Draft* at iv.
55 *NZCC Draft* at 50.
56 *Id.* at 50-62.
57 *ACCC Draft* at 51.
58 *Id.* at 52.

its reasoning, but instead relied on an earlier decision involving ticket distribution.⁵⁹

Factual And Counterfactual Tests

Both agencies rely on a test that compares the “factual” with the “counterfactual,” or what the ACCC has termed a “future with-and-without test.” According to the ACCC, “[u]nder this test, the Commission compares the public benefit and anti-competitive detriment generated by the arrangements in the future if the authorisation is granted with those generated if the authorisation is not granted.”⁶⁰ The NZCC contrasts factual/counterfactual analyses to a “before and after” comparison.⁶¹ It seems clear that factual/counterfactual analyses involve a considerable degree of speculation; they are purely forward looking.

ACCC

The ACCC arrived at several conclusions in its counterfactual analysis. The agency concluded that, in the absence of an authorisation, Qantas would increase its presence in the New Zealand domestic market by 60 percent. Based on confidential information supplied by Qantas, the Commission disagreed with the carrier’s assertion that it would significantly increase capacity in the trans-Tasman market.⁶²

The agency stated that Qantas would increase capacity in New Zealand only if it expected to drive out a competitor (Air NZ) and reap the resulting profits.⁶³ In other words, the ACCC found that, in the “future-without” analysis, Qantas’ ambitions would make sense only under what could be

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⁵⁹ *Id.* at 54. The ACCC referred to its earlier decision A90408.

⁶⁰ *Id.* at 55.

⁶¹ *NZCC Draft* at 69.

⁶² *Id.* at 60-62.

⁶³ *Id.* at 64.

described as predation in U.S. antitrust parlance.

Contrary to Qantas’ position, the Commission seems to treat the New Zealand domestic market as a separate market. The ACCC believes that Air NZ could continue to be a formidable competitor to Qantas if the alliance and equity transaction were not to go forward, citing Air NZ’s established domestic presence, strong brand loyalty, and business in aviation support services. The ACCC also points to Air NZ’s recently improved financial performance, its plans for fleet renewal, and the withdrawal of United Airlines as a competitor on one of Air NZ’s most profitable routes.

The ACCC conclusion is in marked contrast to the views expressed by Air NZ and several other commenters, who believe that, in a “future-without” analysis, Air NZ could perish in an unwinnable war of attrition with Qantas.⁶⁴ This doom and gloom prediction is probably posturing on the part of Air NZ.⁶⁵ Even its own consultant stated that Air NZ would probably not perish, although it would be unable to make large capital investments without assistance from the government.⁶⁶

In the counterfactual analysis presented by the ACCC, the scenarios contemplate that both carriers will add capacity, thus driving down prices. The ACCC also cites alternative

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⁶⁴ *Id.* at 64-66.

⁶⁵ Dire predictions of the future appear to be part of the Air NZ strategy. Air NZ CEO Ralph Norris stated at the NZCC hearings that his company may not survive more than six years without an alliance with Qantas. See <http://www.theage.com.au/articles/2003/08/18/1061059775506.html>.

⁶⁶ See *Bartholomeusz*. Air NZ is 82% owned by the government of New Zealand and has a history of receiving assistance from its largest shareholder. See <http://www.airnz.co.nz/aboutus/corporateprofile/capitalstructure/default.htm#totalshares> and <http://old.smh.com.au/news/0111/28/biztech/biztech4.html>.

counterfactuals in which Air NZ could even prosper, through greater cost-cutting and various management actions⁶⁷

The ACCC views on Air NZ's prospects seem overly sanguine for several reasons. First, the ACCC points to strong brand loyalty as a strategic advantage for Air NZ. This reflects the positions urged by Virgin Blue and Gullivers Pacific Group (a travel distributor), both of which stressed the importance of brand loyalty.⁶⁸ However, in the long term, consumers around the world tend to treat airline seats and cargo service as a commodity, with price and schedule being the most significant decision variables. Evidence of this phenomenon appears in the rapid growth in Australia of Virgin Blue, which filled the vacuum following the failure of Ansett and has also gained business at the expense of the well-established Qantas.

Second, the ACCC assumes that Air NZ can continue to cut costs to become a leaner competitor. However, it is unclear how Air NZ would be able to accelerate its cost cutting. Anecdotal evidence from around the world attests to the difficulty and limitations of this strategy.

Finally, the ACCC seems to rely very heavily on Air NZ financial results over the past two years. The airline business is famously volatile, even in areas that are relatively free of conflict. For instance, Cathay Pacific of Hong Kong is consistently one of the world's more profitable airlines. However, the SARS outbreak that affected east Asia eviscerated Cathay's traffic for some time.

Air travel is a discretionary item. The ACCC concludes that the carriers would take a more measured approach to capacity rather than engaging in costly wars of attrition.⁶⁹

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⁶⁷ ACCC Draft at 66.

⁶⁸ *Id.* at 58-59.

⁶⁹ *Id.* at 66.

The measured approach seems to be a much more reasonable assumption.

NZCC

The NZCC cited six elements that are significant for the factual/counterfactual test: external environment, ability to draw investor capital, financial viability and profitability, Qantas' strategic behavior, Virgin Blue's entry into relevant markets, and Air NZ's prospects for alliance with an alternative carrier. With respect to the external environment, the NZCC agreed with the ACCC that Air NZ has bright long-term prospects and that its current financial vulnerability is probably short term in nature.⁷⁰ The NZCC also believes that, aside from the threat posed by low-cost carriers, Air NZ is fundamentally sound. It points to the creation of Air NZ subsidiaries, Freedom Air and NZ Express, as evidence of Air NZ's ability to respond effectively to low cost competition. NZCC also believes that tourists perceive New Zealand as safe and that the Asia-Pacific region as a whole has endured the economic downturn better than Europe and North America.⁷¹

Comparison To The Merger Of Japan Airlines And Japan Air System

In April 2002, the Japan Fair Trade Commission ("JFTC") approved the merger of Japan Airlines ("JAL") and Japan Air System ("JAS").⁷² The Air NZ-Qantas transaction and circumstances surrounding it are in some

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⁷⁰ Judging by Air NZ's latest financial report, the NZCC has certainly been vindicated for the time being: the carrier reported a 567% improvement in earnings (before tax and "unusuals") in the latest year. See http://www.airnewzealand.co.nz/resources/2003financial_results_media_release.pdf.

⁷¹ NZCC Draft at 77-78.

⁷² See Naveen C. Rao, The Antitrust Review of Japan Airlines and Japan Air System Merger, The Transportation Antitrust Update, Summer 2002, p. 2.

ways reminiscent of the JAL/JAS merger. Neither Japanese carrier was in imminent danger of collapse. The potential anti-competitive effects were plain before the merger was finally approved. And both JAL and JAS were seeking security in size.

However, to date the treatment of these transactions by the respective competition authorities is strikingly different. The JFTC, while it expressed some concerns about anti-competitive effects, was ultimately very receptive to the JAL/JAS merger. The minor divestitures the JFTC required are flyspecks compared with what Air NZ and Qantas may have to give up (assuming their transaction is ever approved).

The difference in treatment appears to reflect the relative vigor of competition law in Australia and New Zealand compared with its relatively low profile in Japan. To be fair, the Japanese market still has All Nippon Airways, a full-service carrier with a domestic and international presence, to constrain the new merged entity. In contrast, the most formidable competitor to an allied Air NZ and Qantas is the low-cost Virgin Blue, which is still in the nascent stages of growth and operates only in Australia at the moment.

The ACCC Final Determination

Ultimately the ACCC stood its ground. The Commission's position between draft and final determinations is substantially unchanged: it re-states its belief that the proposal would ultimately produce a high level of anti-competitive detriment that would outweigh low public benefits.⁷³ The ACCC identifies

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 73 Competition and Consumer Commission [Australia], *Applications for Authorisation A30220, A30221, A30222, A90862 and A90863; Acquisition by Qantas Airways Limited of Ordinary Shares in Air New Zealand Limited and Cooperative Arrangements Between Qantas, Air New Zealand and Air Pacific Limited*, 9 September 2003, p. 205 ("ACCC Final"), available at: www.accc.gov.au.

varying degrees of competitive harm that would have resulted from the proposal: high anti-competitive detriment in the trans-Tasman routes, little anti-competitive detriment between Australia and Pacific islands, anti-competitive detriment between Australia and North America, substantial anti-competitive detriment in the Australian domestic market, and some anti-competitive detriment in the market for sale of air travel.⁷⁴

The ACCC seems to reject outright claims that Australia would benefit from increased tourism and that any ameliorative measures the carriers would take in the freight market would result in public benefit.⁷⁵ The Commission also expresses serious doubts about whether any cost efficiencies would be passed on to the public in an environment with less competition.⁷⁶ The ACCC believes that public benefits of new direct services are virtually negligible.⁷⁷

The ACCC takes a conservative approach in its final determination by viewing anti-competitive effects as probable and treating public benefits as merely possible. The Commission's statements regarding Virgin Blue and Dubai-based Emirates Air provide good examples. Virgin Blue recently announced plans to enter the trans-Tasman market. The ACCC states that the effectiveness of Virgin Blue as a competitive constraint would depend on the scale and timing of its entry and expansion, its routes, and market response.⁷⁸ The ACCC presumes that Virgin Blue will not be a competitive constraint in the face of a virtually combined Qantas and Air NZ.⁷⁹ In effect, the Commission is adopting a strong presumption that Virgin Blue is a value based airline and

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 74 *Id.* at 204.
 75 *Id.* at 205.
 76 *Id.* at iv.
 77 *Id.* at 205.
 78 *Id.* at iii.
 79 *Id.* at 100.

should have a cost advantage versus Qantas and Air NZ.⁸⁰

Emirates actually entered the trans-Tasman market in recent months.⁸¹ The ACCC almost dismisses Emirates as a competitive constraint, saying that such fifth-freedom carriers cannot be considered permanent features of the market.⁸² Immediately after the Final Determination was issued, Emirates expressed its long term commitment to the trans-Tasman market.⁸³ Emirates is one of the fastest growing carriers in the world and has made headlines with its aggressive expansion plans.⁸⁴ Given the considerable financial wherewithal of Emirates, the ACCC's skepticism about its staying power appears overstated.

Conclusion

The Air NZ and Qantas applications for authorisation lay bare the tension between national transportation policies, which seek to sustain viable airlines, and competition laws. Governments in Asia, Europe, The Americas, and now the South Pacific have considered how to resolve this conundrum. In the most general terms, transportation authorities seek to promote aviation systems that are safe, efficient, and economical. It is the last element that has proven most difficult to achieve. For many technical and operational reasons, aviation is a very capital intensive, low (and often negative) return business. As a result, firms in the airline industry seek out economies of scale.

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⁸⁰ *Id.* at 108.

⁸¹ See http://www.emirates.com/AboutEmirates/EmiratesNews/news_22278.asp?ComponentID=22278&SourcePageID=955#1.

⁸² *ACCC Final* at iii.

⁸³ See http://biz.yahoo.com/djus/030909/2032001505_1.html.

⁸⁴ See <http://www.guardian.co.uk/airlines/story/0,1371,978613,00.html>.

While proposals for concentration arouse suspicion, antitrust authorities and consumers alike are undoubtedly aware of the financial turmoil that is endemic in the airline industry. Relaxation of competition laws is one tool available to policy makers to ease the chronic burden of economic cycles on airlines. On the one hand, allowing proposals such as the one presented by Qantas and Air NZ could result in more stability for the airline industry. On the other hand, it could send a very wrong signal to firms in other highly capital intensive, low-marginal cost industries.

Air NZ's chairman actually remains optimistic about an eventual alliance with Qantas.⁸⁵ With an ACCC denial already issued, it is not clear what the effect of a NZCC authorisation at this stage would be. Without a favorable result from the carriers' appeal to the Australian Competition Tribunal, a NZCC authorisation apparently would be worth little.⁸⁶ But the curtain has not fallen on Qantas and Air NZ yet. Stay tuned.

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⁸⁵ See http://biz.yahoo.com/djus/030909/0408000609_1.html.

⁸⁶ For information on the Australian Competition Tribunal, see http://www.fedcourt.gov.au/aboutct/aboutct_act.html.

A ROADMAP OF PROPOSED CHANGES TO THE CANADA TRANSPORTATION ACT

Ben Little and Jack Quinn¹

On February 25th, 2003, Canada's Minister of Transportation (the "Minister") tabled before the House of Commons a series of amendments to the *Canada Transportation Act* ("CTA"). The proposed amendments, which have now passed second reading, represent the Government's first step towards implementing the vision set out in a concurrently-tabled report entitled *Straight Ahead – A Vision For Transportation In Canada* ("*Straight Ahead*"). *Straight Ahead*, and the proposed amendments to the CTA, are the product of a broad consultation process with industry, stakeholders, and provincial and territorial governments, and reflect recommendations from reports by the CTA Review Panel and the Independent Transition Observer on Airline Restructuring. The following is a brief discussion of the proposed amendments that will be of particular interest to antitrust and competition lawyers.

Competition-Related Changes

Transportation Mergers and Acquisitions

The proposed amendments will implement a system of review by the Minister or the Canadian Transportation Agency (the "Agency") of all transactions that are pre-merger notifiable under the *Competition Act*, and involve a transportation undertaking.²

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¹ Ben Little is an Associate at Blake, Cassels & Graydon, LLP ("Blakes"). Jack Quinn is a Partner at Blakes.

² The Agency, established under the CTA, is an independent, quasi-judicial tribunal that makes decisions on a broad range of matters involving

These proposed amendments reflect the Government's concern that the scope of the review process under the *Competition Act* is limited to competition issues, and that a transportation-specific review process is required to review national or public interest issues. *Straight Ahead* noted that the proposed combination of Canadian National and Burlington Northern Santa Fe in 2000 "highlighted the lack of a public forum to review significant proposed transportation transactions."

The review system under the proposed amendments requires, in the case of transportation undertakings other than those involving air transportation, notice to the Minister by the date notice is required to be given to the Commissioner of Competition (the "Commissioner"). In the case of air transportation undertakings, notice must be given both to the Agency and to the Minister by the date notice is to be given to the Commissioner. The notice must contain the information required under the *Competition Act* and any additional information required by Ministry guidelines. If the Minister is of the opinion that the proposed transaction raises issues of public interest related to transportation, the Minister may have the Agency or another person examine and report on the issues. The examination may take up to 150 days, or longer if the Minister allows. No proposed transaction may be completed without approval by the Governor in Council (*i.e.*, Cabinet). If the transaction involves an air transportation undertaking, the Agency must determine that the transaction would result in an undertaking that is "Canadian."³

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federally regulated modes of transportation, including air, rail, and marine. The Agency has the rights, powers, and privileges of a Superior Court to exercise its authority.

³ "Canadian" is defined in subsection 55(1) of the CTA as, *inter alia*, "a corporation or other entity that is incorporated or formed under the laws of Canada or a province, that is controlled in fact by Canadians and of which at least seventy-five per cent, or such

The Commissioner must report to the Minister and the parties on any competition concerns within 150 days (or such longer period as the Minister allows). This report becomes public immediately after its receipt by the Minister. After receipt of the Commissioner's report and any report given by the Agency (or other person asked by the Minister to examine issues), but before the Minister makes a recommendation, there is to be a process of consultation between the Commissioner, the Minister, the Agency and the parties. There are also provisions that allow the parties to propose revisions to the transaction based on concerns expressed by the Minister and/or the Commissioner. The Minister must obtain the Commissioner's assessment of the adequacy of proposed undertakings before proceeding with a recommendation to the Cabinet (who may approve the transaction on the recommendation of the Minister and specify any terms and conditions that it considers appropriate).

Relationship Between the CTA and the Competition Act

Another noteworthy proposed amendment concerns the resolution of conflicts between the CTA and the *Competition Act*. Currently, when there is a conflict between the two, the *Competition Act* prevails. Under the proposed amendments, this will be qualified in two ways. First, the *Competition Act* will prevail only when the enforcement of that Act is undertaken by or on behalf of the Commissioner or the Attorney General of Canada. Second, with respect to the air services industry, when there is inconsistency between an international agreement or convention and the *Competition Act*, the agreement or convention will prevail.

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lesser percentage as the Governor in Council may by regulation specify, of the voting interests are owned and controlled by Canadians..."

Objectives of the CTA

The statutory policy statement underlying the CTA will be amended slightly. The amendment places increased emphasis on competition and market forces as opposed to government regulation. The focus will be shifted from subsidization and redistribution of costs and compensation between carriers to the desirability of pricing transport services so that users pay the actual costs of services chosen.

Changes Related To Air Transportation

Straight Ahead found that, in the airline industry, "the principal challenge facing the Government in the three years since Air Canada acquired Canadian Airlines has been the adequacy of competition [...]" The two "key challenges" identified for regulators were "defining clearly the line between aggressive competition and abuse of dominance" and "ensuring that small domestic operators have the tools necessary to compete effectively with a large carrier without unfairly penalising the latter."

It should be noted that the Government has already taken significant steps to protect competition in the domestic airline industry. In July 2000, Bill C-26 amended the abuse of dominance provisions of the *Competition Act* to focus on controlling possible predatory conduct in the domestic airline industry. The Bill C-26 amendments conferred on the federal Cabinet broad regulation-making powers to prohibit anti-competitive conduct by the incumbent dominant airline. These regulation-making powers covered both possible predatory strategies by the incumbent carrier, and access to essential facilities or services controlled by the incumbent carrier. Finally, the Commissioner was given special interim order powers to preserve the *status quo ante* while conducting investigations into allegations of predatory conduct in airline markets. On August 23, 2000, new regulations under the C-26 amendments came into force. The new regulations defined several new

“anti-competitive acts” that could be the subject of a legal challenge if engaged in by a dominant incumbent carrier.

The proposed amendments to the CTA provisions dealing with air transportation are best seen as extensions of the measures described above. The central policy objectives are consumer protection and the promotion/protection of domestic competition. The most noteworthy proposed amendments relate to advertising, new Agency powers, and access to loyalty programs and interlining.

Advertising

The proposed amendments impose several new restrictions on advertising in the air transport industry. These include: (i) requiring that advertised prices include the total amount to be paid by the purchaser, but allowing any charges collected on behalf of an airport authority or government to be listed separately from the price, so long as the charges appear in the advertisement; (ii) prohibiting air service providers from advertising the price of an air service if no person can obtain the service at that price; and (iii) requiring air service providers to include a provision in any contract with travel wholesalers, tour operators, charterers or other such persons requiring those persons to comply with the above provisions. The proposed amendments also require similar information to be provided on websites.

New Agency Powers

The proposed amendments provide the Agency with the power to commence an inquiry into fare and cargo rate increases (without first receiving a complaint), and allow the Agency discretion to take into consideration any information or factor in evaluating the fare or rate increase. Similarly, the proposed amendments permit the Agency to commence an inquiry, on its own initiative, into unreasonable terms or conditions of carriage.

The proposed amendments will add several provisions governing the issuance of domestic service provider licenses. Generally, these proposals would provide the Minister with considerable discretion in issuing licenses to operate in the Canadian market, including the discretion to waive the requirement that the applicant be Canadian “if the Minister considers it necessary or advisable in the public interest that a [license] be issued to a person who is not a Canadian.”

Loyalty Programs and Interlining

The proposed amendments will allow the Agency to order an air service provider to enter into an agreement that provides “requesting” air service providers with access to its loyalty marketing programs so long as the agreement is necessary to promote competition and the agreement would not result in financial hardship for the service provider subject to the order. Requesting carriers are also able to seek orders pertaining to: (i) the provision of domestic services on a continuous route by both licensees (interlining); (ii) a common fare applicable to the domestic services provided by both licensees on a continuous route (joint fares); and (iii) the allocation of revenue from a common fare for domestic services between both licensees on a continuous route (prorates).

Changes Related To Rail Transportation

Straight Ahead generally found Canada’s rail system to be working well. The system was “fundamentally competitive and efficient,” and “most shippers in most markets within Canada are well served.” Consistent with this positive review of the rail industry, the proposed amendments are not particularly extensive. The most noteworthy proposal is for removal of the requirement that a shipper demonstrate that it would suffer “substantial commercial harm” in order to be eligible to obtain a regulatory remedy against a carrier with respect to a rate or service (such as competitive line rates or level of service). The

“substantial commercial harm” requirement would be repealed on the ground that it focuses on the shipper rather than the behaviour of the carrier.

In the area of passenger rail services, the proposed amendments would allow public passenger rail service providers to seek Agency adjudication of the terms and conditions for use of a railway company’s rail, land, equipment, facilities or services, including the amount to be paid for their use. The public passenger service provider may apply to the Agency to decide the matter only after reasonable efforts to negotiate commercial terms of access have been unsuccessful.

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