24 August 2004

Mr Tony Hinton
Commissioner
Australian Government Productivity Commission
PO Box 80
Bleconnen
ACT 2616
AUSTRALIA

Dear Tony

At our meeting on 3 August I agreed to write to you confirming the position in relation to the issues paper ("Trans-Tasman harmonisation"), which I provided to you at the meeting. I am pleased to confirm that our Chairman has authorised its provision to the Commission on the record as a document which may be referred to and as appropriate, copied.

I also agreed to confirm in writing the financial consequences of Air New Zealand having had to make application in Australia and New Zealand for regulatory approval of the proposed Alliance with Qantas. This process which has involved applications to the Australian Competition and Consumer Commission and to the New Zealand Commerce Commission began in late 2002 and still awaits determination in both jurisdictions. In Australia the matter has been appealed to the Australian Competition Tribunal and in New Zealand to the High Court. Decisions in respect of both those appeals are pending.

During the nearly two years of the process, the costs to Air New Zealand have totalled approximately NZ$23 million, this information will be publicly available in Air New Zealand's Annual Report, to be released on Wednesday 25 August. From that Report, it will also be evident that this expenditure has been approximately equally incurred during our two financial years ended 30 June 2003 and 2004. It should be noted that this is external expenditure only in relation to legal, economic and other professional advice. It takes no account of the literally thousands of hours of management time dedicated to the regulatory approval processes and appeals. My understanding (but with no specific knowledge) is that the expenditure incurred by Qantas in relation to these applications has been at a similar level. Certainly, many of the external costs were by prior agreement, shared on a 50:50 basis.

We welcome this initiative by the Productivity Commission and I look forward to receipt of a copy of the first draft report for comment and further discussion. In the meantime, please feel free to contact me should there be any issues you wish to discuss further at this stage.

Yours sincerely

John Blair
General Counsel & Company Secretary

COMPETITION LAW

TRANS-TASMAN HARMONISATION

Introduction

The legislation on competition law and the underlying policy issues are already closely aligned between Australia and New Zealand. The divergence is around the regulatory approaches and processes.

It is unlikely either country will be prepared to make radical change to their regulatory structure or process. In the light of that, harmonisation needs to concentrate on an "Australasian" approach as suggested below.

Legislation

Following recent changes in New Zealand, our legislation now aligns closely with Australia on almost all issues and this has been an intentional direction. The only material difference is that Australia takes a more "black letter law" approach to some deemed ("per se") offences, but this is of limited significance.

It should also be noted that Australia and New Zealand competition law closely follows the principles of Europe and USA.

Regulatory Approach

The difference in approach between ACCC and NZCC is best summed up by the ACCC taking a qualitative approach and the NZCC (following a Court of Appeal decision) taking a quantitative approach. That said, the recent trend of the NZ High Court is to suggest that the pure quantitative approach needs to take into account the inherent inaccuracy of economic modelling of future outcomes and consider whether they properly reflect the true or likely effect on competition.

These differences of approach make it very difficult and expensive to secure regulatory approval in both jurisdictions – two quite different applications are required to be developed from the same underlying facts and evidence.

Regulatory Process

At the "clearance" level (ie. confirmation that "no substantial lessening of competition" arises) the ACCC has an informal process which competitors can subsequently challenge whereas the NZCC has a formal investigation and decision making process. The former is less burdensome but gives less certainty of outcome, the latter has the regulatory cost but greater certainty (not complete certainty as a clearance decision could be appealed by a competitor or a material change in circumstances could arise).

For an "authorisation" the ACCC and NZCC processes are very similar, involving formal application, consultation, public conference and draft and final decisions.

The appeals processes are very different, although the structure and nature of the forums are similar. The New Zealand appeal lies to the High Court and requires a review of the NZCC

decision based on the updated, formal record of that decision. The Australian Competition Tribunal, which includes a senior judge, rehears the case afresh and reaches its own decision.

It should be assumed that neither country will change their regulatory structure and at least in the short term that is probably undesirable. There will be some efficiencies from familiarity with process in each jurisdiction

Trans Tasman Issues

In the context of CER, a very strong case must exist in respect of two key issues:-

- a requirement to consider competition implications in an Australasian market (rather than, as at present, a New Zealand or an Australian market in isolation)
- jurisdiction of either NZCC or ACCC to make decisions with binding effect in an Australasian market.

Market Scope
A major criticism of the legislation in both countries is the required restricted view of the effects of competition on domestic markets only (except where predatory conduct is at issue). This is evident in respect of any application involving international trade and has long since been outdated as business has become increasingly "global". It is nowhere more evident than in networks businesses.

Considering international business transactions in the limited scope of domestic markets denies companies the ability to grow internationally and potentially return significant benefits far greater than the generally short term benefits "provable" to the regulators.

When a business in New Zealand may point only to public benefits to New Zealand, it will be unduly constrained in pursuing its growth as an international business. In the CER context there should at the very least be equal "credit" for benefits to Australia (and vice versa) to facilitate Australasian growth. This principle of recognising the value across a larger market is central to the European model of centralised competition authorisations by the EU.

Australasia also needs to avoid falling too far behind – and becoming isolated from – trends in major overseas markets. This could be addressed in part by allowing regulators to consider, as a separate and specific issue, trends in overseas markets. At present consideration of this issue is limited to evaluating the strength of evidence about the expected local trends – which may be quite different from international trends, particularly in the longer term. For example the recent approval of Air France / KLM merger shows a recognition of the current state of the international aviation market. While the European and Australasian markets will have local differences, they are both part of the international industry and the competitive environment in which it exists.

Jurisdiction
CER still lacks the maturity to even contemplate a "one stop shop" for Australasia – and even if it could, it would inevitably be the Australian model which may not necessarily be the best in all cases.

Given that position a viable solution exists in giving both regulators (including the respective appellate bodies) not only a mandate to consider Australasian markets but a jurisdiction spanning both countries.

To avoid simple “forum shopping” (which would probably gravitate applications to lower cost New Zealand or whichever regulator was perceived as more liberal) – a simple financial or percentage of sales threshold could be imposed on applicants to ensure a relevance to the jurisdiction in which the application is made. This is also consistent with the successful EU model.

Efficiency and Competitiveness

For competition approval applications involving New Zealand and Australian markets, the current requirements for parallel and significantly different applications is enormously inefficient and imposes substantial regulatory compliance cost. Businesses are also materially constrained in trying to build international competitiveness, by the narrow view of markets in which benefits must be demonstrated.

John Blair
General Counsel
Air New Zealand

18 March 2004