

31 July 2006

John Macilree
Principal Advisor
Ministry of Transport
PO Box 3175
Wellington

Dear Mr Macilree

Please find attached a copy of the Chamber's submission on Air New Zealand's and Qantas Airways' "Codeshare" proposal.

Yours sincerely

Jeremy Harding
Policy Manger

Wellington Regional Chamber of Commerce

Submission to the Ministry of Transport

On the Application from Air New Zealand and Qantas Airways on the “Codeshare” Proposal

Introduction

The Wellington Regional Chamber of Commerce has membership of 1,200 businesses in Wellington city and represents a regional hub of Chambers of Commerce with a further 4,500 businesses as members. The Chamber promotes policies that reflect the interests of the region’s business community and the development of the Wellington economy.

This submission relates to Air New Zealand’s and Qantas Airways’ **(the Parties)** application to the Minister of Transport for authorisation of the Tasman Networks Agreement **(TNA)** pursuant to Part 9 of the Civil Aviation Act 1990 **(CAA)**.

The Tasman Networks Agreement

According to the airlines, the TNA (known as the codeshare) is designed to facilitate cooperation between Air New Zealand and Qantas on the Tasman allowing the airlines to reduce surplus capacity. The airlines say that it will have the benefits of enhancing the airlines’ long term economic sustainability and will offer co-ordinated scheduling which may be preferable to two different airlines departing at the same time (wing-tip to wing-tip flying). They also argue that fewer flights will also have positive impact on the environment in terms of lower fuel consumption and reduced carbon emissions.

Notwithstanding these stated benefits we are concerned that reduced competition could result in reduced services and increased prices for freight and passengers. As well as an increase in standard fares, fewer “special airfares” and more non-flexible fares may be offered. This in turn will threaten to reduce the number of passengers carried. Furthermore, we do not accept the airlines’ argument that customers will get more choice under the TNA. This overlooks customers’ existing ability to switch between airlines when choosing flights.

A recent survey of Wellington businesses conducted by the Chamber showed 95% of respondents support careful scrutiny of the proposed TNA.

The TNA could have negative implications for the delivery of the goals of the Wellington Regional Strategy. Specifically this strategy makes it clear that the future of the region is dependent on expanded international air links, greater tourism, more students studying in Wellington and expanded trade in services and goods.

For these reasons, the Chamber is submitting that the proposed TNA be given careful scrutiny by a body with the necessary expertise to assess competition impacts. In New Zealand this would appear to be the Commerce Commission. If current legislation does not allow the proposal to be examined by the Commerce Commission, then it should either be declined by the Minister or deferred until this is

possible. Because of a particular lack of competition into and out of Wellington, we submit that the Wellington routes should be excluded from the proposed TNA. If the TNA is authorised, rigorous conditions would need to be set to ensure that the negative implications of the TNA are ameliorated particularly the Wellington routes.

The proposed TNA should be referred to the Commerce Commission.

The Parties' application has been made pursuant to Part 9 of the CAA 1990. Because of the significance the TNA has to the national and regional economies we are submitting that it also needs to be considered by the Commerce Commission.

Qantas and Air New Zealand are the dominant airlines on the trans-Tasman routes and currently the competition between the two is very strong. Consequently the market environment would change significantly if the TNA is approved and that competitive element is eliminated. The Commerce Commission is therefore the appropriate body with the relevant expertise to consider this proposal.

Furthermore, we note that section 88 of the CAA is limited to authorising agreements to the extent that they relate to the fixing or application of tariffs, or the fixing of capacity, or a combination thereof.

The TNA incorporates a number of things that are outside the scope of section 88. These include revenue sharing, scheduling and planning of flights, agreeing minimum service standards, pricing of airfares made available for holiday packages and aligning travel agency commission payment regimes. All of these factors would be of interest to the Commerce Commission. We are also advised that competition issues need to be taken into account as part of the decision making under section 88 of the CAA.

The Commerce Commission would need to investigate whether there would be any barriers to entry and expansion under the TNA. It would also need to test whether any public benefit would outweigh any detriment particularly anti-competitive detriment.

The fact that Air New Zealand is 82% owned by New Zealand taxpayers (some of which are Wellington businesses) is not pertinent to this issue. It is New Zealanders' interests as consumers not New Zealanders' interests as shareholders that are relevant here. Given its ownership stake in the airline, the Government should be cautious in its deliberations so as not to be seen to be overriding the interests of consumers.

Wellington should be excluded from the TNA

The Chamber strongly submits that the Tasman should not be regarded as a single market. There are twenty five trans-Tasman routes between Australian and New Zealand cities all with varying degrees of competition. While there are eight independent airlines operating the Tasman, 22 of the trans-Tasman routes have three or less airlines operating.

Wellington is a distinct market for Trans-Tasman services. There are three significant Wellington routes – to and from Sydney, Brisbane and Melbourne - plus two flights a week to the Gold Coast.

The Wellington region relies on direct services to Australia. Flying from Wellington to Australia via either Auckland or Christchurch is not the preferred route for customers

and is usually only undertaken should people be wanting to fly to destinations not serviced from Wellington – eg Adelaide, Perth, Cairns, or where there are no seats offered directly from Wellington on the preferred day at the required price.

There is currently significantly less competition on the routes between Wellington and Australian cities than there is on the Christchurch and Auckland trans-Tasman routes.

While there are a number of operators servicing some Auckland – Australia and Christchurch – Australia air routes, there is no effective competition on the Wellington – Australia air routes except for that between Qantas and Air New Zealand.

Of the 55 weekly flights between Wellington and Australian cities, only 3 (5%) are offered by airlines other than Air New Zealand or Qantas. We estimate that the equivalent figures for Auckland and Christchurch are 41 and 24 respectively (22 and 28 percent respectively). Even in those markets, Air New Zealand and Qantas appear to dominate market share.

Weekly Flights from Wellington to Australia			
	Pacific Blue	Air New Zealand	Qantas
Sydney	0	13	14
Brisbane	3	6	3
Melbourne	0	7	7
Gold Coast	0	2	0

Source: Wellington International Airport Ltd

The three non Air New Zealand/Qantas flights are three flights a week by Pacific Blue between Brisbane and Wellington. These represent 25% of the flights on this predominately leisure route. The airlines do not have any third party competition between Wellington - Sydney and Wellington - Melbourne. These routes are more business oriented suggesting the burden of the TNA may fall disproportionately on businesses travelling to Sydney Melbourne vis a vis leisure travellers to Brisbane.

Under the TNA, the number of weekly flights to Wellington would reduce by 10% from 50 to 44 (figures from the TNA) with nine of these flown by Air New Zealand (all to Sydney) and the rest by Qantas. We estimate the number of seats available weekly would decrease by about 11% under the TNA¹

The TNA has the potential to jeopardise Wellington's external links by making it more expensive to travel and reducing the opportunities to fly into and out of the city. It has the potential to reduce the numbers of visitors to Wellington with the consequential impacts on Wellington businesses – not least the tourism industry.

Higher fares and fewer flights would also inhibit Wellington businesses and other travellers from crossing the Tasman cost effectively. Suppliers of services to the airlines would suffer if there were reduced flights to and from Wellington. Cross border business, trade and investment could also suffer. All of this would feed through negatively to New Zealand's economic growth.

¹ Air New Zealand figures show there will be 335,000 seats under the code share compared with current demand of around 249,000. Based on a 66% load factor, the current capacity must be 377,000 which suggests an 11% drop in capacity under the code share.

Diverting trans-Tasman travellers to fly via Auckland or Christchurch in response to reduced frequency of Wellington flights would be an inconvenient option for many travellers due to the much greater travel time. The overall impact would remain reduced travel both ways.

Flying to Australia via Auckland or Christchurch on an airline other than Air New Zealand and Qantas is also often more costly when the domestic leg is with either of these two airlines (ie travel on two separate airlines.)

The TNA aims to reduce surplus capacity without impacting on passenger numbers. However, there is some evidence to show that demand follows supply and that a drop in the number of available seats would generate a corresponding reduction in the number of passengers. In other words there is a risk that the TNA will fail to reduce surplus capacity as well as result in fewer passengers flying into and out of Wellington.

In 2003 an alliance between Qantas and Air New Zealand in relation to trans-Tasman flights was declined by the New Zealand and Australian competition authorities. In 2004 the New Zealand High Court upheld the decision of the New Zealand Commerce Commission. The airlines note that in that same year the Australian Competition Tribunal overturned the Australian Competition and Consumer Commission's (ACCC) rejection of the proposed alliance on the grounds of limited barriers to entry and expansion on the Tasman.

We consider it to be less likely that other airlines will enter or expand the Wellington to Australia market should this new proposal be authorised without rigorous conditions on price predation. Emirates is not able to fly to Wellington because of its aircraft type being unable to use the Wellington runway with full payloads. Likewise Pacific Blue has not grown its fleet, and has remained but a niche player on Tasman routes.

We understand that cargo will not initially be part of the arrangement although we note the TNA does allow the airlines to coordinate cargo services and agree cargo rates. Authorisation of the TNA, could potentially lower airfreight capacity and result in an increase in freight prices.

Much of the Wellington region's fresh produce is exported by air on flights to Australian cities, which is either the final destination, or a transfer point for flights to Asia. 20% of New Zealand's lucrative export trade in live lobsters comes through Wellington airport, for example.

In addition to the cargo carried on passenger services, dedicated freighter services operate on the Tasman by Air New Zealand and Qantas competitors. However this additional competition seems to be out of Auckland only. Exporters from the Wellington region could be disadvantaged relative to other regions should the TNA be authorised.

Because of the lack of competition into and out of Wellington, if the TNA is authorised, Wellington should be excluded from it. If the competition authorities were to find some reasons to permit a form of arrangement, rigorous conditions should be set to ensure that the negative implications of the TNA are ameliorated. These could include enforceable price undertakings to maintain equivalence with current and recent fare levels, as well as full scrutiny of the availability of seats at each fare level on each route.

Comparisons with Auckland and Christchurch would be insufficient because it is far from proven that, even though they have more competition than Wellington, they have sufficient competition to prevent significant fare increases. This would require an extensive and independent monitoring regime and public reporting of findings. It may be that the cost of operating such mitigations is more than airlines simply finding an alternative approach to the Tasman. We note that in a speech to the Chamber on 4 May 2006, the CEO of Air New Zealand commented that they have four options, only one of which is the TNA.

Finally, we note that sections 88(4)(c) and (d) of the CAA do not allow authorisation to be given if the agreement “unjustifiably discriminates between consumers of international air services in the access they have to competitive tariffs” or “so far as it relates to tariffs, has the effect of excluding any supplier of international carriage by air from participating in the market to which it relates”. This is relevant for the Wellington-Australia market if the lack of third party competition under authorisation disadvantages Wellington consumers more relative to Auckland and Christchurch and it reinforces the case for price or capacity undertaking.

Recommendation

The proposed TNA be referred to the Commerce Commission for scrutiny.

Should the Commerce Commission agree that our concerns are valid we would expect that either:

- authorisation for the applications be declined, or
- Wellington-Sydney, Wellington-Melbourne and Wellington-Brisbane be excluded from the code share arrangement (TNA), or
- rigorous conditions be set to ensure that the negative implications of the TNA are ameliorated.

Rigorous conditions could include:

- active and independent price monitoring,
- enforceable price undertakings (eg maintain equivalence with recent fares and the status quo.),
- enforceable capacity undertakings
- regulation to ensure that there is no price predation should a competitor spring up after a code share commences.

If the legislation does not allow the Commerce Commission to fully investigate the proposal, the application should be deferred until that is possible. If it is not possible to defer the application and have the Commerce Commission consider it, then the Minister should decline the application or deferred until this is possible.

We would expect a chance to respond to decision arising from this process before it is finalised.