M42266 r/a

29 May 2006

Charles Finny
Chief Executive Officer
Wellington Regional Chamber of Commerce
P O Box 1590
WELLINGTON

Dear Charles Finny

On behalf of Hon Annette King, Minister of Transport, I acknowledge your letter of 18 May 2006 concerning the Air New Zealand/Qantas Code-share proposal.

You may expect a personal reply from the Minister in due course.

Yours sincerely

Anya Zohrab
Private Secretary

MQ2266 r/a

WELLINGTON REGIONAL

Business Vitality

18 May 2006

Hon Annette King
Minister of Transport
Parliament Buildings
WELLINGTON

Dear Minister

AIR NEW ZEALAND/QANTAS CODE SHARE PROPOSAL

1. I write on behalf of the members of the Wellington Regional Chamber of Commerce.

2. First, congratulations again on obtaining the Transport portfolio. Although with the number of important current issues under the portfolio, it will no doubt keep you very busy.

3. We want to raise with you the application by Air New Zealand and Qantas (**"the application"**), under Part 9 of the Civil Aviation Act 1990 (**"CAA"**), for authorisation of their Tasman Networks Agreement (**"the agreement"**).

4. We understand that you have not yet considered the application in detail, but you will be aware that the agreement incorporates a code share supported by revenue/pricing arrangements for the various Tasman markets.

5. We wrote to the acting Minister of Transport, Hon Pete Hodgson, on 13 April 2006 stating in brief our concern that Air New Zealand and Qantas had applied for authorisation under the CAA.

6. We understand that you intend to use a fair and transparent process in your consideration of the application. We of course welcome that, and thought it would be helpful to write setting out what we think a full and transparent process includes. We also take the opportunity to alert you to some of our substantive concerns, on which we would like to make fuller submissions as part of that process. We would value a meeting with you in the near future.

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AIR NEW ZEALAND

Summary

7. We have been advised that some parts of the agreement are clearly outside your powers under section 88 of the CAA, and would therefore need to be considered by the Commerce Commission. Your consideration of the application under section 88 of the CAA therefore carries a risk that there will be dual consideration of the agreement by you and the Commerce Commission, which may result in inconsistent outcomes. Given the significance of the proposed code share to the national and regional economies, it might be helpful to you if the Commerce Commission reviewed those provisions of the agreement outside your powers before you consider the matters within your powers of authorisation. Indeed, it may also be that the airlines would seek to make substantial amendments to their proposed agreement after having the benefit of the Commerce Commission's views on the agreement, insofar as they must be considered by the Commission.

8. We are advised also that, in this case, it is necessary for you to take competition issues into account in your decision-making, so you will need expert advice on competition law and economic impacts.

9. Given the significant number of interests that could be directly, significantly or adversely affected by the code share arrangement, we agree that a fair, open and inclusive process would allow all affected parties to make a submission, in accordance with the principles of natural justice. This would include issuing a draft authorisation so that affected parties may make further submissions, before issuing any final authorisation under the CAA.

Parallel Regimes

10. We have been advised that the application is likely to result in parallel authorisation regimes for the agreement. Thus, if the parties intended the application under section 88 of the CAA to avoid having to seek any further authorisation from the Commerce Commission, they are unlikely to succeed.

11. That is because your power under section 88 of the CAA is limited to authorising provisions to the extent that they relate to the fixing or application of tariffs, or the fixing of capacity, or a combination thereof. Revenue sharing, which is a key part of the agreement, clearly falls outside that power, and will be of interest to the Commerce Commission. Other parts of the agreement such as scheduling and planning of flights, agreeing minimum service standards, pricing of airfares made available for holiday packages and aligning travel agency commission payment regimes are also outside the scope of section 88, and should be of interest to the Commerce Commission also. Thus, section 88 allows you to authorise part of the agreement only.

12. The application therefore raises some difficult legal issues around the relationship between the CAA and Commerce Act 1986 ("**Commerce Act**") authorisation regimes.

13. Any provisions of the agreement that are authorised under section 88 of the CAA will be excluded from the application of sections 27 to 29 of the Commerce Act (under section 91 of the CAA). However, they will not be excluded from the application of other provisions in the Commerce Act such as taking advantage of market power (sections 36 to 36B of the Commerce Act). These provisions are not referred to under section 91 of the CAA.

14. Further, provisions in the agreement that are not or cannot be authorised by you under the CAA will be fully exposed to the Commerce Act.

15. This creates a risk that your decision under the CAA may be inconsistent with any determination on the agreement by the Commerce Commission under the Commerce Act. You may decide to authorise parts of the agreement under the CAA, and the Commerce Commission may refuse authorisation of other parts of the agreement under relevant provisions of the Commerce Act.

Competition Issues

16. The risk is real given that the application raises complex questions as to how the code share might detrimentally affect distinct competitive markets. For example, Wellington is a distinct market for trans-Tasman services, with significantly less competition than say, Auckland or Christchurch. It is very unlikely that any other airline will enter the Wellington trans-Tasman market. Accordingly, there is a strong argument that competition will be significantly reduced on those routes.

17. Treasury recognised this in a report to the Minister of Finance on 8 March 2006, which suggests that "there may be significant risk of public interest in the outcome of this issue owing to a possible perception that code sharing will reduce competition".

18. We are advised that you will need to take into account competition considerations as part of your decision-making under section 88 of the CAA. You may therefore need to seek independent expert advice on such issues and/or wait to see if the Commerce Commission intends to inquire into the agreement, since their findings may be relevant to your own decision-making. Any delay would need to be reasonable and consistent with your public law obligations.

Australia

19. The same quirk of law giving rise to dual authorisation regimes does not exist in Australia, where Air New Zealand and Qantas have been required to apply directly to the Australian Competition and Consumer Commission (**"ACCC"**) (the equivalent of the Commerce Commission) for the necessary authorisations.

20. The ACCC will assess the public benefits and detriments of the authorisation application. To grant authorisation the ACCC must be generally satisfied that the public benefit arising from the conduct in issue outweighs any detriment, particularly anti-competitive detriment, arising from the conduct. Of course, the ACCC's mandate is to consider the welfare of consumers in Australia, not New Zealand.

21. The ACCC has sought submissions from interested parties, and will then issue a draft decision for comment. In its notice seeking submissions, the ACCC expressly listed a number of complex competition issues that it was particularly interested in hearing views on.

22. We welcomed the opportunity to make a submission to the ACCC, and look forward to making a submission to you also.

No Prescribed Process

23. The CAA does not prescribe a process to decide an application for authorisation under section 88. The process used to determine those previous applications has not been publicly documented. Indeed, we note that a Treasury report to the Hon Phil Goff, Associate Minister of Finance, outlining a process for authorisation under the CAA (and providing preliminary advice on the public policy issues that arise) has been withheld in full under the Official Information Act. We understand that that report has been forwarded to you.

24. Section 88 has been used previously by Air New Zealand to seek authorisation of strategic alliances (i.e. the Tripartite Alliance between Air New Zealand, Ansett and Singapore Airlines, and the Alliance Expansion Agreement with United Airlines).

25. In our view, the agreement is unique compared to other proposals that have previously been considered under section 88 of the CAA in that it will form a strategic alliance between two airlines operating on the same (trans-Tasman) routes. In the past, applications have been made under section 88 for strategic alliances between airlines covering different routes (i.e. so that the strategic alliance obtains greater total coverage). We think the agreement raises competition issues to a greater extent than previous proposals considered under section 88 of the CAA.

Natural Justice and Consultation

26. The lack of a statutorily prescribed process or publicly available precedent, combined with the significant public interest in the application, means that the common law principles of natural justice as affirmed by section 27(1) of the New Zealand Bill of Rights Act 1990 are particularly important in this case.

27. You will be familiar with those principles so we do not go into any detail here, especially given our understanding that you already intend to follow a fair and transparent process.

28. We therefore understand that parties that will be affected by any authorisation will be given an opportunity to state their case to you, the decision-maker, and that you will reach your decision following a process that is fair to all parties affected by the decision. This would include giving affected parties an opportunity to comment on a draft before making any final authorisation.

Further Reasons Why Public Consultation Appropriate

29. Section 88 of the CAA does not prescribe any mandatory requirements to be met for authorisation to be granted.

30. That means you have a broad discretion to consider any factors that you consider relevant to your decision in the national interest, so long as you do not consider clearly irrelevant factors (which may also show that your power was exercised for an improper purpose). In those circumstances, it is appropriate for you to consult widely on the application to properly take account of the national interest considerations.

31. We note that Treasury advised the Minister of Finance on 31 March 2006 that the provisions of section 88 of the CAA "suggest that any decision is heavily dependent on an assessment of public costs and detriments".

32. Earlier Treasury advice on 8 March 2006 to the Minister of Finance states:

> We will be reporting to the Associate Minister of Finance (Mr Goff) to whom you have delegated your regulatory responsibilities for Air NZ advising that he seeks information from the Minister of Transport about the nature of the process he intends to conduct in order to inform his decision, stipulating the need for the Ministry of Transport to consult with the Treasury in the preparation of advice for the Minister and details of any proposed communications process.

33. Treasury has therefore recognised that there is significant public interest at stake. This underscores the importance of giving those parties directly, significantly or adversely affected by the application an opportunity to make a submission on the application.

34. We also note that section 88(4) of the CAA states that "authorisation **shall not be given** under this section" if any of the prescribed requirements are met. This is an objective standard, and is mandatory. Accordingly, you may find it helpful to receive submissions from affected parties and experts so that evidence can be provided to allow you to fully consider whether any of the requirements listed under section 88(4) are met.

35. In this case, we anticipate that sections 88(4)(c) and (d) will be particularly relevant for the Wellington-Australia market. Those sections 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". Our submission would address these issues in detail.

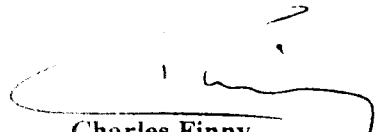
Conclusion

36. We trust that you find the above comments helpful, and that they give you comfort that inviting submissions as part of a public process is appropriate.

7. Given the significance of the public issues raised by the agreement, we thought we should also write to some of your senior Cabinet colleagues with portfolio interests in this matter to alert them to the issues, including Rt. Hon Helen Clark, Hon Phil Goff, Hon Trevor Mallard, Hon Lianne Dalziel and Hon Jim Anderton. We anticipate that you will be consulting with your Cabinet colleagues before making any final decision, so it should be helpful if we write to them also.

8. We would welcome an opportunity to meet with you to discuss our views further. We look forward to hearing from you.

Yours sincerely



Charles Finny
Chief Executive Officer
Wellington Regional Chamber of Commerce