AVIATION INDUSTRY ASSOCIATION CONFERENCE
ROTORUA 28 JULY 2006

THE AIR NEW ZEALAND – QANTAS CODE-SHARE

John Blair, General Counsel, Air New Zealand

I welcome the opportunity to address you today on what has been portrayed as one of the airline industry's great conspiracies – our application for approval of the proposed code share between Air New Zealand and Qantas has been made to the Minister of Transport.

No previous application has received the intense public scrutiny that is being brought to bear on the current one. The motives for much of that scrutiny are more of a mystery than our application.

Our opponents have suggested this is a legal loophole to "circumvent" the Commerce Commission. We have endured allegations of "secret" meetings – in a well known Wellington restaurant; questions in the House; claims that the process will be behind closed doors and suggestions that the process is inadequate. Nothing could be further from the truth.

Over the next 20 minutes, I would like to briefly remind you what the code share is about and consider the legislative background to our application to demonstrate that the process is based on a legislative regime designed for aviation. I can also assure you that the Ministry of Transport is being assidious in ensuring that the process will enable the Minister to make a decision on all the proper criteria.

The rationale behind the code share is simple. There is too much capacity in the Tasman market with 6,300 seats remaining empty every day. This is extremely expensive wastage and gets worse as fuel prices continue to escalate. By effectively combining the Tasman fleets of Air New Zealand and Qantas we can reduce the cost of the wasted capacity and at the same time each provide our customers with more flights to choose from.

The airlines benefit from reduced cost, not from pushing up fares. If we tried to do so, we know Emirates, Virgin Blue and others are there to step in – and that is fine – that's called competition. We also know that if regulators considering the application here and in Australia conclude that fares would rise significantly as a consequence of the code share, they will not approve it.

We have plenty to do to survive in this industry without wasting our time with an application we considered unlikely to succeed.

It has to be acknowledged that we didn't succeed last time at the Commerce Commission – but we did succeed at the Australian Competition Tribunal. Unfortunately we needed approval at both ends of our routes. The Commerce Commission was constrained by New Zealand case-law requiring a quantitative approach to benefits and detriments and the High Court was only able to consider limited updating evidence. In contrast the Australian Competition Tribunal approach – now upheld by objectors as the preferred regime of a specialist competition regulator – was able to consider the reality of the market at the time of the appeal with a clean sheet of paper. They agreed that the alliance would produce no net detriment to competition.

The proposed code share is very different from the previous alliance proposal we took to the Commerce Commission. It is strictly limited to the trans-Tasman market – but there are two very important differences for the purposes of today's discussion. The alliance proposal included the domestic New Zealand market and Air New Zealand shares being issued to Qantas. Both those matters brought the alliance proposal clearly within the jurisdiction of the Commerce Commission.

The code share involves only international routes and therefore the proper process in New Zealand is to apply to the Minister of Transport.

The Civil Aviation Act 1990 provides at s.88 that the Minister,
"may from time to time specifically authorise all or any provisions of a contract arrangement or understanding....in respect of international carriage by air and related to such carriage so far as the provisions relate, whether directly or indirectly, to the fixing of tariffs, the application of tariffs, or the fixing of capacity, or any combination thereof."

There are a number of prohibited provisions which I will return to, which address the competition effects of contracts, arrangements or understandings.

This part of the Civil Aviation Act originated nearly 20 years ago in 1987, but the legislative history is relevant to today's discussion.

At the time the Commerce Act was introduced in 1986, there were a significant number of exemptions and transitional provisions in respect of some pricing regimes and certain industries. One of the transitional provisions allowed time until March 1987 for consideration of international aviation.

The Ministry of Transport supported the creation of a separate competition regime governing international air carriage agreements. In supporting the Civil Aviation Amendment Act 1987 – which introduced the predecessor to today's section 88 – The Hon Jonathan Hunt, on behalf of the Minister of Civil Aviation stated:

"The advent of the Commerce Act 1986 rendered unlawful, conduct that was otherwise basic to the interlocking international aviation network."

The resulting s.29A of the Amendment Act has been the subject of two minor amendments since 1987 to add the phrases "directly or indirectly" and "any combination thereof" into today's section 88. The scope of the section has been progressively and deliberately extended.

Section 88 is not some "legal loophole". It was created by the Ministry of Transport to meet the specific needs of the international aviation industry – the needs of a global network industry. An exemption from the Commerce Act was made in respect of international carriage of goods by sea for similar reasons. (s.44 (2) Commerce Act). The section has been utilised as the proper authorisation process by successive governments, Ministers and numerous airlines. The process is of course available to any airline.

It has been the basis of approval for a number of code shares including the Air New Zealand – Singapore Airlines Alliance in 1998, the Air New Zealand – United Airlines Alliance in 2002 and the Qantas – British Airways Joint Service Agreement in 2003. All of those agreements included provision for agreeing prices and capacity and all were approved in the corresponding jurisdictions under their respective competition regimes.

Much of the criticism of our application to the Minister has sought to create the impression that there is no consideration of the effects on competition. Again, this is not correct.

Section 88 (4) describes provisions which the Minister cannot approve because they are contrary to basic principles of competition.

Contractual provisions which allow enforcement through "fines" or market pressure equate to abuse of market power and cannot be approved. Likewise discrimination between consumers through restricted access to competitive fares would lessen competition and cannot be authorised. Setting of fares which have the effect of excluding an airline from a market is tantamount to capacity dumping and cannot be approved. No provision can prevent a party from withdrawing from a contract, arrangement or understanding without penalty and on reasonable notice, ensuring that airlines are reasonably free to exit agreements and compete separately.

To again quote The Hon Jonathan Hunt,

"The circumstances in which fair trading practices are deemed not to be met are defined in the proposed new section. These include anti-competitive situations that discriminate against consumers or other suppliers of international carriage by air."

The Hon W P Jeffries made the same point in the third reading of the Bill when he observed,

"The tests promote competition and ensure that the authorisation procedure is not abused." He added, "The Bill is not a blank cheque for cartel arrangements on an uncritical basis."

These provisions are all subject to an over-riding discretion of the Minister to approve them if declining authorisation "would have an undesirable effect on international comity between New Zealand and any other State." I am not aware of this provision being invoked but my view is that it exists as a reflection that under the international bilateral air rights system political expediency is often high on the agenda. If for example a potentially lucrative trading partner state was to want a protected air service to further that trade, then the Minister would be able to authorise that protected service.

The approval regime we have in New Zealand is unusual – but that should not be viewed negatively. As a nation we generally pride ourselves on creativity. The legislation provides a structure in which the officials who are the experts in international aviation agreements can make decisions in the interests of New Zealand. These are the same people who negotiate our access rights with other states and fully understand the importance of those rights in a wide economic sense. They can assess the value of international air rights being utilised in the country's interests. These are the people who make the recommendation to the Minister.

Why would the Government not provide for airlines to go to such experts for assessment of international agreements? Why would Air New Zealand and Qantas not apply through this specialist regime for authorisationof the proposed code share? Those in the Ministry know the industry and understand the issues. That is not to say they will necessarily agree with us – but we can move quickly to fully informed discussion.

That does not detract from the abilities of specific competition authorities. In many of the larger jurisdictions they also have the luxury of specialist aviation experience as a result of the many airline matters they are called on to determine. By design though, their assessment is one dimensional – namely the effect on competition. The Minister has a wider perspective under the Civil Aviation Act. For example, development of inbound tourism markets may not demonstrate significant short term quantifiable gains, but can be of great value in the longer term or as an introduction to a trading partner for New Zealand.

Against this background, we are bemused by the paranoia being exhibited by Wellington Airport in its opposition to the code share. The rantings of a natural monopoly about the need to preserve competition are ironic to say the least. It is rather like being lectured on law and order by Dick Turpin! We think that competition is not something New Zealand airports know much about. The altruistic concerns for the economic well being of the Wellington region and its people ring hollow from the airport that is the most expensive in the country per passenger.

When we as an airline look at the financial rates of return achieved by New Zealand airports – which rank among the highest in the world – we ask ourselves about the legislative framework which requires a natural monopoly to "set such charges as it from time to time thinks fit".

Wellington Airport may have concerns about forecast passenger numbers which are forecast by the airlines to reduce by about 0.8%. That translates to about $50,000 of international departure fees – far less I'm sure than is being spent on the Wellington Airport campaign. All this is from a plot of land which has just revalued itself by a further $131million ahead of "consultation" with its customers about the tolls it will charge for the next five years.

Air New Zealand customers travelling to and from Wellington will have the benefit of more flights to choose from. Flights from Wellington to Brisbane will increase from 6 to 8 per week, to Melbourne from 7 to 13 and from Wellington to Sydney there will be an increase from 13 to 23 flights each week.

Air New Zealand has made it clear that we cannot sustain the millions of dollars of losses in operating the current level of services to Wellington. When opposing the code share as self appointed guardians of the citizens of Wellington, the owners of Wellington Airport should be careful what they wish for. They run a substantial risk of causing much more harm to the Wellington region than good.

The code share enables the airlines to offer better services to customers while reducing costs to keep fares as low as possible. Cynics imply that the savings won't translate to sustainably lower fares. This was considered by the Australian Competition Tribunal which noted that,

"...we expect that the Alliance will be promptly and competitively constrained should it seek to raise fares." (ACT par 445)

There is nothing to prevent Wellington Airport taking more constructive action itself to stimulate travel to and from Wellington. Something more realistic should be considered than one B787 Dreamliner flying 180 passengers from Wellington to four different Asian hubs each day. Air New Zealand's hub is Auckland – nothing else makes sense and airlines around the world operate on a hub structure. Even if the market was of sufficient size, a Wellington "direct" service would simply take passengers to different hubs. There are solutions to be explored, but they are only viable in a co-operative relationship.

The airline industry is notoriously competitive and dynamic. At Air New Zealand we constantly try to create competitive advantage from our small size in the context of the world's airlines. Much of that can occur only by being nimble in response to changes in the market – or better still, in leading change.

The industry expertise within the Ministry of Transport and its authority to approve agreements such as the code share gives us an industry specific framework with an ability to respond quickly. Often we have to move at a pace dictated in other jurisdictions, but why would we not use such an appropriate process as we have in our home market?

In the global arena we are a tiny airline in a small country. Like any New Zealand business we have to seize opportunities quickly when they arise. We must – and we will – use any chance we have to react efficiently. The process available under the Civil Aviation Act is designed to allow just that.