

SUBMISSION ON APPLICATION FOR AUTHORISATION OF THE PROPOSED MASTER COORDINATION AGREEMENT BETWEEN QANTAS AND EMIRATES

Introduction

- 1 Christchurch International Airport Limited (*CIAL*) welcomes the opportunity to submit to the Ministry of Transport (*MOT*) on the application by Qantas Airways Limited (*Qantas*) and Emirates (together, the *Airlines*) for authorisation under section 88 of the Civil Aviation Act 1990, of the proposed Master Coordination Agreement.
- 2 *CIAL*'s submission is based on our review of the Airlines' application and on correspondence *CIAL* has entered into with the Airlines. We have also been briefed by representatives of Qantas on the key elements of the proposed Master Coordination Agreement.
- 3 In addition to *CIAL*'s own recommendations, *CIAL* endorses the New Zealand Airports Association (*NZAA*) submission on the proposed Master Coordination Agreement.

Executive Summary

- 4 In assessing airline alliance applications under section 88 of the Civil Aviation Act, the *MOT* is responsible for protecting the public interest by maximising the opportunities for New Zealand producers and consumers to travel and trade, having regard to relevant counterfactuals.
- 5 From the South Island's perspective, the current trans-Tasman air services market does not provide effective connectivity and so does not maximise the opportunity for travel and trade. Given this low base, maintaining and increasing air services through Christchurch Airport (*CHC*), the principal gateway to the South Island (being the only 24 hour, long-haul capable airport in the region) is vital for the South Island's economy, and the national interest.
- 6 *CIAL* is actively engaged and highly motivated to deliver a wider range of travel options to the South Island. As New Zealand's second largest airport, *CIAL* places a priority on sustaining and growing New Zealand's connectivity to the world from *CHC*, so as to improve the returns from the visitor economy and for the betterment of trade.
- 7 *CIAL* would like to acknowledge that Emirates has consistently shown a steadfast commitment to the South Island and has proven to be an excellent partner for *CHC*, Canterbury and New Zealand. *CIAL* welcomes the on-going strength of commitment demonstrated by Emirates, and appreciates Emirates' most recent commitments regarding maintenance of existing Emirates services out of *CHC*.
- 8 However, in its current form, the proposed Master Coordination Agreement has the potential to be either helpful or harmful to South Island trans-Tasman connectivity.
- 9 The proposed Master Coordination Agreement could be harmful to the South Island because, under the Trans-Tasman Capacity Commitment, there is the potential for the Airlines to replace South Island trans-Tasman air services with predominantly North Island services. The Airlines' application mentions the possibility of a further expansion of Qantas services between Adelaide and Auckland, and the Airlines'

application to the Australian Competition and Consumer Commission (ACCC) suggests that Perth – Auckland services could be considered. Replacing South Island services in this way would further restrict the region's air services and would have significant competitive implications on the already highly concentrated South Island trans-Tasman air services market.

- 10 Given that the South Island is already underserved by international air services, when the MOT is considering alliance applications like the Master Coordination Agreement - with the potential to further restrict South Island air services and increase market concentration - the MOT must be confident there are robust safeguards to protect consumers and promote the national interest.
- 11 CIAL has corresponded with Qantas and Emirates seeking commitments regarding the Airlines' services to CHC, to ensure:
 - 11.1 the existing trans-Tasman services using the Airlines' own aircraft are maintained (including the Qantas red-tail service on the CHC-Sydney Airport (SYD) route); and
 - 11.2 the airlines apply an even spread of trans-Tasman services on the CHC-SYD route, scheduled throughout the day.
- 12 With these commitments, CIAL would support the MOT's approval of the Master Coordination Agreement. This is because CIAL would be assured that the resulting alliance would be beneficial to Canterbury, the South Island and the national interest.
- 13 Without these commitments, CIAL submits the MOT cannot be confident that it is in the national interest to approve the proposed Master Coordination Agreement, unless the MOT imposes the conditions on the Airlines as part of its authorisation. CIAL recommends conditions of authorisation below at [20].
- 14 Without these commitments, or MOT conditions of authorisation, there would be a risk of South Island connectivity being severely limited through the Airlines:
 - 14.1 replacing their South Island trans-Tasman air services with predominately North Island services;
 - 14.2 consolidating their current, closely aligned ('wingtip-to-wingtip') trans-Tasman services out of CHC into one or two flights, rather than maintaining the existing three services by Emirates, Jetstar and Qantas; and/or
 - 14.3 replacing existing Qantas red-tail services with Jetstar services that do not provide the same level of connecting itineraries, or quality of service, to passengers or freight customers.
- 15 The Airlines are capable of giving commitments to protect the South Island against market changes that would further restrict the region's already limited connectivity. Such commitments have been given to airports in the past – for example, Air New Zealand and Virgin made scheduling commitments to Wellington Airport and Auckland Airport as part of their alliance application in 2010. CIAL acknowledges

that commitments protecting against market changes would not be expected to endure force majeure events or 'Acts of God'.

- 16 Qantas has only given CIAL tentative assurances regarding the maintenance of its existing trans-Tasman services, and both Airlines have only given tentative assurances regarding their future scheduling of services into and out of CHC. CIAL also understands that the Airlines have made verbal commitments to New Zealand officials to the effect that they are committed to the South Island.
- 17 However, in considering authorisation of the proposed Master Coordination Agreement, the MOT must recognise that the Airlines are refusing to make formal commitments regarding their CHC services.
- 18 In addition to raising concerns unique to the South Island, the proposed Master Coordination Agreement is problematic more generally, for the following reasons:
 - 18.1 It will lead to a duopoly on the Tasman, whereby 96% of capacity is controlled by Air New Zealand/Virgin on the one hand, and Qantas/Emirates on the other.¹ As noted in the NZAA submission, this raises significant market concentration issues with the potential to harm consumers and the economy. CIAL also notes that the Airlines have overstated the potential for the alliance to prompt a competitive response from other airlines on the Tasman.
 - 18.2 The Trans-Tasman Capacity Commitment is heavily caveated and, in strictly legal terms, provides very limited protection against competitive harm to New Zealand exporters and travellers.
 - 18.3 Ten years is too long a period for authorisation, especially given the dynamic nature of the market. The MOT needs to be confident that consumers are protected and such confidence is not possible if the proposed Master Coordination Agreement is authorised for such a long period of time.
- 19 Before approving the proposed Master Coordination Agreement, the MOT needs to be confident that the resulting alliance would be a net positive for New Zealand, including the South Island. The MOT has a responsibility to all New Zealanders here.
- 20 In recognition of the potential harm that the proposed Master Coordination Agreement could cause to the public interest, CIAL **recommends** that the MOT impose the following conditions on its authorisation of the Master Coordination Agreement:
 - 20.1 the authorisation is for a period of 3 years, with the possibility of renewal if the Airlines can establish that the Master Coordination Agreement continues to be in the public interest;
 - 20.2 the Airlines must maintain their existing trans-Tasman services into and out of CHC (including the Qantas red-tail service on the CHC-SYD route, and the Qantas dedicated freighter service); and

¹ NZAA submission on Master Coordination Agreement.

20.3 the Airlines must implement an evenly-spread daily schedule of trans-Tasman services into and out of CHC, to achieve better connectivity with the newly proposed operating 'banks' (wave of arriving and departing flights at the Airlines' hubs) proposed in the Airlines' application.

South Island perspective on Trans-Tasman air services market

21 From the South Island's perspective, the current trans-Tasman air services market does not provide effective connectivity. This means that maintaining the current base level of trans-Tasman services through CHC, and increasing this base level where possible, is vital for the South Island economy and the national interest.

South Island tourism and production industries depend on CHC to connect internationally

22 CHC is the principal international gateway to the South Island, being the only airport in the region that is:

22.1 open 24 hours a day; and

22.2 capable of facilitating long-haul, wide-body aircraft.

23 Consequently, the South Island visitor economy and production industries depend on CHC to connect with international markets. And given the centrality of these regional tourism and production industries to the New Zealand economy, we should be doing all that we can to ensure this connectivity is optimised. The public interest depends on it.

Tourism

24 The South Island is home to New Zealand's most popular tourist attractions. This is reflected in Government statistics, which show that, over the five years prior to the February earthquakes, international visitors have consistently spent more time and money in the South Island than in the North Island:

24.1 the average stay in the South Island is 24 days, compared to an average stay of 21 days in the North Island; and

24.2 the average amount of money spent in the South Island is NZD \$3,444, compared to an average spend in the North Island of \$2,605.²

25 Statistics also show that tourists stay 60% longer in New Zealand with an entry into CHC, than is the case with any other entry point in the South Island.³

Production

26 South Island importers and exporters rely on bellyhold freight capacity in passenger air services to connect with international markets.

27 The South Island produces almost half of New Zealand's primary sector goods (seafood, vegetables, meat and fruit),⁴ resulting in a strong demand for time-

² Statistics New Zealand 2011.

³ Statistics New Zealand; CIAL data.

⁴ PWC "Opening up the South – A report to the Canterbury Development Corporation" (12 August 2011) at 1.

sensitive, export air freight services out of CHC. There is a particularly acute demand to get these exports across the Tasman. In total, Australia receives a 41% share of the South Island's export weights, representing 56% of the South Island's total export value.⁵

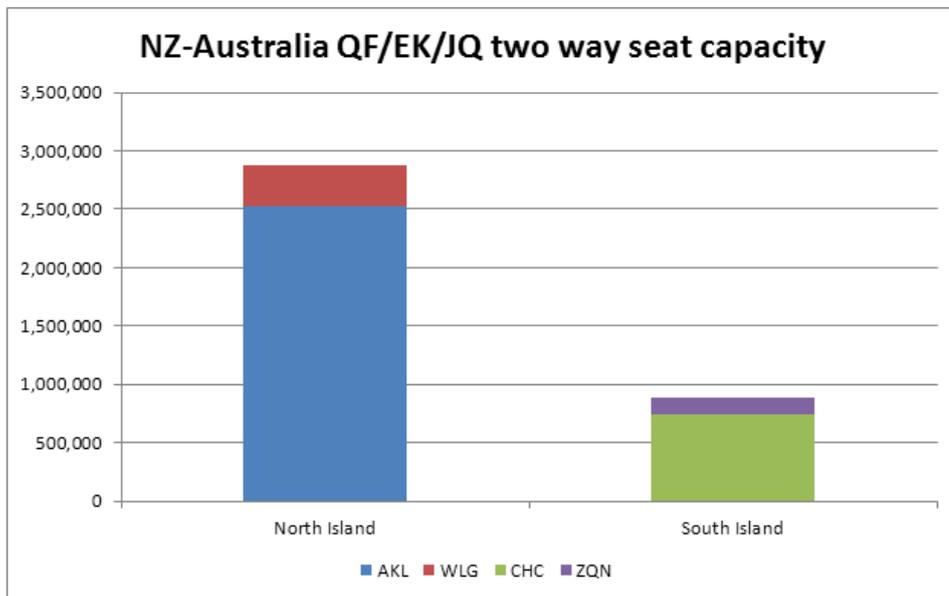
28 South Island importers also require air freight services into CHC, primarily for other time sensitive freight (excluding perishables), and high value manufactured goods.⁶ Although less pressing than the demand for export services to Australia, the South Island still relies on effective trans-Tasman connectivity for Australian imports. In total, Australia is responsible for 33% of the South Island's import weights, worth 17% of the South Island's total import value.⁷

Trans-Tasman services out of CHC are limited

29 Despite the pressing need for effective South Island trans-Tasman connectivity, South Island air service capacity to Australia is very limited - especially relative to the significant trans-Tasman capacity operating through North Island airports.

30 The five airlines operating trans-Tasman services out of CHC are Air New Zealand, Emirates, Jetstar, Qantas, and Virgin Australia.

31 With respect to Qantas, Emirates and Jetstar services, the following table illustrates the current, significant gap in trans-Tasman service capacity into and out of the South Island, compared to the North Island:



32 The proposed Master Coordination Agreement would lead to:

32.1 an effective duopoly on the trans-Tasman routes out of the South Island;

⁵ PWC analysis.

⁶ PWC "Opening up the South – A report to the Canterbury Development Corporation" (12 August 2011) at 21.

⁷ PWC analysis.

32.2 a very high degree of market concentration on the important CHC-SYD route. The proposed alliance would have a 72% market share.

33 In short, the MOT needs to be acutely conscious that this proposal impacts on important routes with connectivity to important international markets.

Proposed Master Coordination Agreement has the potential to be helpful or harmful to South Island trans-Tasman connectivity

Potential to further reduce capacity on city-pair routes

34 The proposed Master Coordination Agreement has the potential to be particularly harmful to South Island trans-Tasman connectivity, by further reducing overall capacity on city-pair routes between CHC and Australia.

Trans-Tasman Capacity Commitment

35 The potential for a reduction in capacity on city-pair routes exists because, under the proposed Trans-Tasman capacity commitment, the Airlines commit to making available “not less than 100% of the Trans-Tasman Base Year Seat Capacity”.

36 ‘Trans-Tasman Base Year Seat Capacity’ is defined as follows:

...the Applicants’ combined total seat capacity in the Base Year for the Trans-Tasman...and, for the avoidance of doubt, means the aggregated total number of seats for the Applicants across the Trans-Tasman, without any seat capacity being attributed to any specific carrier or Route.

37 Because the Airlines are making a commitment with respect to overall seat capacity, rather than particular routes, there is scope for South Island trans-Tasman services to be replaced with predominantly North Island services.

38 The potential for this to occur is indicated in the Airlines’ application – which mentions the possibility of a further expansion of Qantas services between Adelaide and Auckland, and the Airlines’ application to the ACCC suggests that Perth – Auckland services could be considered. Replacing South Island services in this way would further restrict the region’s air services and would have significant competitive implications on the already highly concentrated South Island trans-Tasman air services market.

39 Further, it is also important to note that the Trans-Tasman Capacity Commitment is heavily caveated and practically of limited comfort. This is discussed in more detail below.

40 Replacement of South Island services would be a particular risk, given the potential for Qantas, Emirates and Jetstar to consolidate their current wingtip-to-wingtip daily services out of CHC.

Effect of reducing capacity on South Island city-pair routes

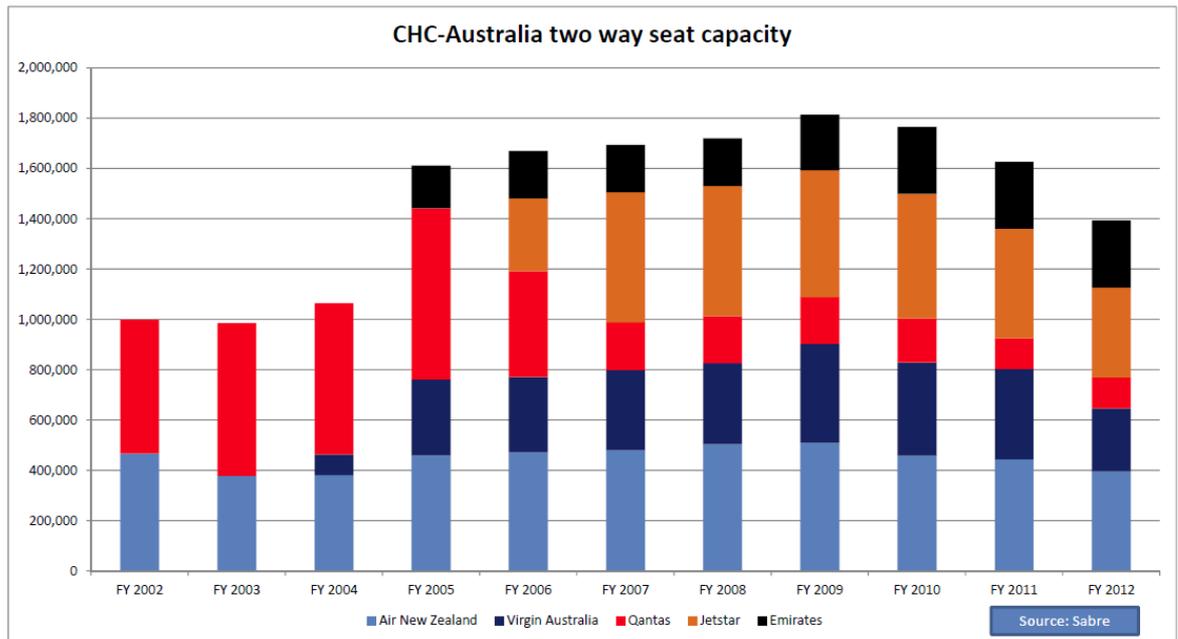
41 A reduction in capacity on South Island trans-Tasman city-pair routes would have the undesirable effect of:

41.1 further restricting South Island connectivity with Australia; and

41.2 further concentrating the already highly concentrated South Island trans-Tasman air services market, to the detriment of consumers and the economy. By way of illustration of current market concentration, Jetstar, Qantas and Emirates are responsible for 72.3% of the services on the CHC-SYD route.

The importance of Qantas services for connectivity

42 The following graph illustrates how, over the last 10 years, a considerable change in the CHC-Tasman market has taken place, which has seen Qantas' presence at CHC decline over time:



43 This has reduced the South Island's accessibility to other connecting markets on the Qantas long-haul network. CIAL is very concerned about the potential for further declines in connectivity, at the point in time when Qantas, under the proposed Master Coordination Agreement, alters its airline schedules and boosts connectivity to Asia by realigning its business to be more attractive to its premium customers.

MOT should consider effect of capacity reduction on city-pair routes

44 It is proper that, in considering authorisation of the proposed Master Coordination Agreement, the MOT ensures that the public interest is protected, having specific regard to the competitive effects that the agreement could have on trans-Tasman city-pair routes. Taking such a route-by-route approach to the assessment of market effects is warranted, given that substitutability between city-pair routes is not generally a feature of the air services market.

45 Given that the South Island is already underserved by international air services, alliance applications like the Master Coordination Agreement - with the potential to further restrict South Island air services - should be viewed by the MOT with caution.

Potential to be helpful through maintenance of existing services and improved scheduling

- 46 To ensure the proposed Master Coordination Agreement is beneficial to the South Island and the overall public interest, CIAL has corresponded with Qantas and Emirates seeking commitments regarding the Airlines' services to CHC, to ensure:
- 46.1 the existing trans-Tasman services using the Airlines' own aircraft are maintained (including the Qantas red-tail service on the CHC-SYD route); and
 - 46.2 an even spread of trans-Tasman services will be scheduled throughout the day on the CHC-SYD route.

Maintenance of current trans-Tasman services using the Airlines' own aircraft

- 47 Maintaining existing trans-Tasman services out of CHC using the Airlines' own aircraft is very important to South Island connectivity.

- 48 In particular, CIAL needs comfort that the following Qantas services will be maintained:

- 48.1 the daily CHC-SYD red tail service; and
- 48.2 the dedicated freighter service.

- 49 The Airlines suggest in their submission that "The Proposed Conduct may also include interlining and, at a later stage, codesharing on Jetstar-branded services where appropriate."⁸

- 50 It would be harmful to South Island connectivity if the daily Qantas CHC-SYD was replaced with a Jetstar service. This is because the Qantas business model has a greater focus on:

- 50.1 premium passenger services from a networked hub providing interconnecting itineraries; and
- 50.2 quality of service.

- 51 Qantas:

- 51.1 is a full service carrier whose core business focus is "high yielding corporate, government and premium leisure traffic";⁹
- 51.2 offers codeshare and interline services with a vast number of Frequent Flyer international partners, oneworld alliance airlines and other Qantas International partners - as illustrated in the Qantas in-flight magazine and noted in the Airlines' application for authorisation; and
- 51.3 works with a number of interline partners, including Emirates.

⁸ Airlines' application for authorisation at 18.

⁹ Airlines' application for authorisation at 15.

- 52 In contrast, Jetstar:
- 52.1 is a low cost, value based airline, whose core business focus is the leisure point to point market;
 - 52.2 offers only limited connectivity to the Qantas International route network, due to the current mix of flight schedules from CHC; and
 - 52.3 provides very few interline or onward carriage options to other international destinations from its points of operation or with many other partners.
- 53 The Airlines' application refers to consumer benefits of the proposed Master Coordination Agreement, including through the Airlines' respective frequent flyer programmes. It is accepted in the industry however, that Jetstar does not provide the same service standards or benefits that the Qantas brand offers, reducing consumer appeal for some market segments.
- 54 Furthermore, Qantas offers a codeshare service on a Jetstar flight from CHC for its customers to connect with international onward destinations. However, there are two problems with this:
- 54.1 the Jetstar service is of lower quality, turning off a section of the market; and
 - 54.2 Jetstar only offers the service to Qantas or American Airlines codeshare customers, missing out the range of customers at the disposal of Qantas International.
- Even daily scheduling of services on CHC-SYD route*
- 55 The Airlines should apply an even spread of trans-Tasman services between CHC-SYD, scheduled throughout the day.
- 56 Qantas International operates a bank of flights to international destinations from SYD at peak times, and is proposing to re-time a number of services to key international destinations from the airline's hubs, such as SYD. Currently, Jetstar provides some connectivity from CHC to these Qantas International operations from SYD. However, the current schedule misses a number of connecting markets with the range of partners Qantas International coordinates with.
- 57 Furthermore, Jetstar operates services from SYD to CHC 3 days a week, within a time band that results in all three partners to this alliance arriving into CHC within one hour and 50 minutes of one another (Qantas arriving at 13.30; Jetstar at 14.55 and Emirates at 15.20) - according to the proposed Northern Hemisphere Winter Seasons 2012/2013 schedule.
- 58 With respect to improved scheduling, CIAL proposes:
- 58.1 The existing Emirates services, with wide-body capability for carrying freight, remain unchanged from a scheduling point of view. The Emirates service would continue to provide premium service to passengers from SYD and CHC.
 - 58.2 Jetstar services are re-timed earlier from SYD, to arrive into CHC closer to the middle of the day, serving a leisure market in both cities.

- 58.3 The Qantas International service is retimed to exit SYD in the late afternoon/early evening, to arrive back in Christchurch in the late evening (the aircraft would then stay overnight in CHC).
- 58.4 The Qantas International aircraft would depart first thing from Christchurch the following morning, achieving an effective end of day rotation, but also maximising the aircraft operational times.
- 59 This proposed schedule would spread the alliance partners operations out across the day, rather than the current bunching of services at least 3 times a week, on other days remove the existing Qantas International and Emirates service that operate every day, within less than 2 hours of one another.
- 60 The spreading of the services would enable the partners to offer the maximum range of connecting flights possible, to the widest number of markets (premium and leisure) if the proposed alliance is aimed at achieving better connectivity from the Sydney hub as well as others in long-haul markets.
- 61 The combined alliance partnership allows all three brands, Emirates, Jetstar and Qantas, to serve all very distinct market segments. CIAL is supportive of the alliance should a spreading of the existing partners schedules into and out of CHC on the CHC-SYD sector be implemented. This would ensure an optimal schedule is achieved and all market segments are served.

Proposed Master Coordination Agreement has the potential to be harmful to public interest generally

Creation of a duopoly on the Tasman

- 62 If authorised, the Master Coordination Agreement will lead to a duopoly on the Tasman, whereby 96% of capacity is effectively controlled by 2 groups: Air New Zealand/Virgin on one hand and Qantas/Emirates on the other.¹⁰
- 63 This is a very significant challenge to competition in New Zealand's most important aviation market. There can be no doubt that competitors coming together to co-ordinate their activities in a way that creates a duopoly – which will be the net result of moves by Air New Zealand, Virgin, Qantas, JetStar and Emirates – harms New Zealanders and makes the country worse off.
- 64 The competition concerns raised by this high market concentration, with respect to monopoly pricing and the resulting decline in passenger movements, is well illustrated in the NZAA submission.
- 65 Further, CIAL is of the view that the Airlines have overstated the potential for the alliance to prompt a competitive response from other airlines on the Tasman. Contrary to the Airlines' assertions, it is unrealistic to expect either Etihad or Qatar to re-enter the trans-Tasman market. Both of these airlines already have local partners operating the Tasman and both airlines operate long-haul aircraft that are less suited to short-haul flying.

¹⁰ NZAA submission on the Airline's application.

66 The MOT bears a heavy responsibility here to make sure that it does not approve an agreement between competitors that results in significant, long lasting, damage to the trans-Tasman aviation market.

Tentative nature of Trans-Tasman Capacity Commitment

67 The market participants proposing the Master Coordination Agreement have anticipated these concerns, and proposed a Trans-Tasman Capacity Commitment. The Capacity Commitment is made in clause 2 of Annexure J of the Airlines' application. However it must be read together with clause 3 of Annexure J (Exemption from the Conditions) and clause 1 of Annexure J (Exceptional Circumstances).

68 CIAL submits that the MOT should take note of the following features of the Capacity Commitment:

68.1 it is only a commitment at the trans-Tasman level. As discussed above, it gives no assurance at all that current levels of service will be maintained on important routes, such as the CHC-SYD route.

68.2 the Capacity Commitment is heavily caveated. The parties can unilaterally depart from the Capacity Commitment where:

(a) a force majeure event occurs (which CIAL agrees is reasonable); or

(b) where there is a change in demand or operating costs that is less than a force majeure event but the parties decide is material.

69 This last carve out, in particular, robs the Capacity Commitment of much of its utility. The parties can at any time declare that they will reduce capacity to reflect material changes in demand or cost, and there is no ability to challenge that assessment.

70 If the reduction in capacity is for more than 30 days then an application for variation is deemed to have occurred, but by that time as a practical matter the MOT will be on the back foot. The reduction will have occurred, the alliance will still be operating, and the MOT will face an onus of demonstrating why the agreement should be changed back. This is not a place the MOT will want to go.

71 In short, the current version of the Capacity Commitment is not sufficiently robust to provide sufficient comfort at the national level, and it provides no comfort at all at the South Island / city-pair level.

10 years is too long

72 A further feature of this move to duopoly is the proposal that the MOT approve the duopoly for 10 years.

73 CIAL submits that ten years is too long a period for authorisation of any alliance, especially given the dynamic nature of the market. But this is especially so for an alliance that proposes such a dramatic change in the competitive landscape on the Tasman.

- 74 To approve an application by competitors to stop competing and start working together to promote their collective interests, the MOT needs to be confident that consumers are protected and that the national interest is also advanced.
- 75 It is simply not possible to be confident that an agreement between Qantas, Jetstar and Emirates to stop competing and start co-ordinating on the Tasman will be in the national interest, and stay in the national interest, for the next 10 years. The air services market is dynamic and the NZAA submission provides a good illustration of how significantly the market has changed in 10 years. The MOT cannot, and should not be asked to, confidently predict how the air services market will change over the next 10 years and make a judgment that the proposed Master Coordination Agreement will be in the national interest the whole time.

MOT should impose conditions on the proposed Master Coordination Agreement

- 76 In considering authorisation of the proposed Master Coordination Agreement, the MOT must recognise that the Airlines are refusing to make formal commitments regarding their CHC services.
- 77 Consequently, and in light of the potential harms to the public interest discussed, CIAL **recommends** that the MOT impose the following conditions on the authorisation of the proposed Master Coordination Agreement:
- 77.1 the authorisation is for a period of 3 years, with the possibility of renewal if the Airlines can establish that the Master Coordination Agreement continues to be in the public interest;
 - 77.2 the Airlines must maintain their existing trans-Tasman services into and out of CHC (including the Qantas red- tail services on the CHC-SYD route, and the Qantas dedicated freighter service); and
 - 77.3 the Airlines must implement an evenly-spread daily schedule of trans-Tasman services into and out of CHC on the SYD-CHC route, so as to achieve better connectivity with the newly proposed operating 'banks' (wave of arriving and departing flights at the Airlines' hubs), proposed in the Airlines' application.