ALAN GALBRAITH QC
L.L.B. (Hons), B.C.L. (Oxon)

SHORTLAND CHAMBERS
70 Shortland St, Auckland
PO Box 4338, DX: CX 10258
Telephone: (09) 309-1769
Facsimile: (09) 309-1119
Email: argalbraith@xtra.co.nz

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Bell Gully
Fax: 916 8801

Attention: Phil Taylor

Russell McVeagh
Fax: 367 8163

Attention: Andrew Peterson

AIR NEW ZEALAND/QANTAS

I have been asked to advise on three issues arising out of the application for authorisation of the proposed Tasman Networks Agreement. These issues are:

(a) Whether authorisation under section 88(2) only extends to the process by which matters of tariff and capacity setting are determined and does not authorise the outcomes of the exercise of that process, i.e. the actual tariffs and capacity set by the parties; and

(b) Whether the prohibition against authorisation arising from section 88(4)(c) only arises if the contract, arrangement or understanding contains a provision that unjustifiably discriminates between consumers of international air services in the access they have to competitive fares or whether the Minister is prohibited from authorising an arrangement if he considers the implementation of the arrangement might in the future offend the prohibition;

(c) Whether the revenue sharing provisions of the TNA are capable of approval by the Minister under section 88.

I have also been asked to have regard to Professor Taggart's opinion which has been provided to the Ministry by Infratil.

Process/Outcomes

What can be authorised under section 88 and therefore excepted from the application of the Commerce Act is limited to "provisions of a contract, arrangement, or understanding ... 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."

To that extent Professor Taggart is correct when he says, somewhat colourfully, that authorisation is not a magic wand that can give immunity to aspects of the agreement that do not fall within the terms of section 88. Obviously, therefore, the core question is what can

be authorised under section 88. That question will be determined by the text of the section interpreted in the light of its purpose.

It is immediately apparent from the text that in adopting the terms "relate, whether directly or indirectly" the legislature has cast a very wide net. The reasons are evident both from the legislative history and from considerations of practicality necessary to permit the authorisation regime to work efficiently.

It is apparent from the legislative history that the inappropriateness of the Commerce Act regime applying to international air carriage arrangements was early recognised. For that reason the 1986 Ministry Report to the Cabinet Development and Marketing Committee concluded that a separate authorisation regime would "more readily fit within accepted aviation regulatory systems". The Hansard references at the time of the introduction of the Civil Aviation Amendment Act 1987, which included the authorisation provisions in similar form to those at present applying, clearly indicate that the scheme of authorisation was to be separate from the Commerce Act regime and that the then equivalent of section 88(4) was intended to define the relevant parameters of unfair competition in respect of air services which would prevent authorisation being given.

For example, on the third reading, the Hon. W P Jeffries said:

> "Even though an arrangement might be an objectionable one under the Commerce Act, the proposed new section 29A(4) sets out the tests, and if the arrangement passes those tests it can be authorised. The tests promote competition and ensure that the authorisation procedure is not abused .... The Bill is not a blank cheque for cartel arrangements on an uncritical basis. Arrangements and combinations still have to meet the criteria set out in such detail in the Bill." – 478 NZPD 7393 (26 February 1987)

Or a little more colloquially the Hon. Geoff Baybrooke is recorded as saying:

> "The Bill is needed so that Air New Zealand will not be caught up in the claws of the Commerce Act." – 478 NZPD 7209 (19 February 1987)

Equally significantly, at the Select Committee stage, the qualifying words in the authorisation section were changed from "so far as the provisions provide for the fixing of tariffs or capacity or both" to the words now contained in the section. It is evident that the change was made to broaden the scope of the authorisation power.

When the Civil Aviation Act 1964 was replaced by the 1990 Act the authorisation provisions were substantially replicated in Part 9. Authorisation under Part 9 is deemed to have the effect of a specific authorisation under section 43 of the Commerce Act with the result that Part 2 of the Commerce Act that relates to restrictive trade practices will not apply. As well the 1990 Act abandoned the previous scheme of controls on airline tariffs.

Although the early Hansard references would provide some basis for an argument that section 88 is a code with the Minister only able to refuse authorisation on the grounds set out in section 88(4), subject to the override of section 88(5), I doubt that such interpretation would now be accepted. In my view the more likely interpretation is that the text of section

88(2), which provides that the Minister "may" authorise, would be taken to confer a discretion with section 88(4) read as a list of matters in respect to which the Minister has no discretion except to refuse authorisation. That interpretation would sensibly reflect the fact that there would be a great number of potential considerations that could exist, both potentially positive and potentially negative, in respect to a proposed arrangement that might directly or indirectly relate to tariffs or capacity but which are not considerations that are specifically referred to in section 88(4). Obviously the discretion which the Minister has under section 88(2) can only be exercised within the parameters of and for the purpose of the statute.

If the Minister does have a discretion, which is the interpretation I prefer, the next question is whether the initial authorisation of a provision is limited to the process by which the matters of tariff and capacity are set but does not authorise the outcomes of the exercise of that process, i.e. the actual tariffs and capacity. In my opinion an interpretation which separates process from outcome is inconsistent with the legislative history and the evident intent to establish an authorisation regime appropriate for international air carriage separate from the Commerce Act regime and, implicitly, a regime that could be practically applied.

It is obvious that authorisation permits what is explicit, i.e. price fixing. The question is whether authorisation extends to the logical outcomes of the authorised provisions, i.e. the tariffs or capacity agreements which result. In my view it does. The interpretation that it does not seems to me to be unlikely. It is inconsistent with the expressions of purpose at the time that the authorisation regime was first legislated. But even setting that legislative history to one side, such an interpretation would impose a two step process, requiring a second authorisation under section 88 (or section 90 for tariffs) or else a bifurcated process where authorisation was required both under the Civil Aviation regime and under the Commerce Act. Neither finds any support in any express indication in the Act and either interpretation would impose serious practical inhibitions on the effectiveness of any tariff or capacity setting arrangement.

It is worth noting that Professor Taggart does not suggest any such distinction in his advice – see his discussion at paras 17-21.

It is my understanding that to be effective and responsive to changing market conditions tariff and capacity decisions have to be capable of being made and implemented quickly. The proposition that each decision made pursuant to an authorised provision itself requires a further authorisation either under section 88 (or section 90) or by Commerce Act procedure is, in my opinion, clearly impractical and therefore unlikely to have been contemplated by the legislature.

The fact that section 90 does provide a mechanism for the Minister to authorise tariffs does not affect my view. That is a stand alone provision which I understand is generally used for the purpose of approving IATA tariff schedules. However, while there is nothing to stop approval being sought under section 90 for a tariff that is the result of a provision authorised under section 88 there is nothing in section 88 to suggest any linkage. As well there is no provision equivalent to section 90 providing for authorisation of capacity agreements other than section 88. The absence of any specific provision in relation to capacity obviously weakens any argument that the existence of section 90 supports a two step interpretation.

In my opinion the only argument that could be made in support of an interpretation that there is a two stage process would be founded on the potential for the process to produce an unintended consequence, e.g. a tariff or capacity agreement that was discriminatory. It seems to me that the answers to that argument are:

(1) While the authorisation of a provision may explicitly permit price fixing, because that is the inevitable consequence of the provision, it will not authorise the subsequent use of the provision for a purpose in breach of, say, section 36.

(2) The future potential of the provision to produce an unintended consequence would be a consideration to be taken into account under section 88(2) in deciding whether or not to authorise.

In my opinion therefore the unintended consequence argument is not a sufficient justification for imposing the process/outcome dichotomy.

In summary my view is that the better interpretation of the statute is that the Minister may take into account both process and potential outcomes at the time of determining authorisation rather than an interpretation which imposes on the section 88 regime a two step or two jurisdiction constraint which will render it ineffective.

Section 88(4)(c)

In my opinion the wording of the subclause does require the discrimination to be inherent in the provision before authorisation is required to be declined under section 88(4). However, that does not mean that the Minister cannot take account of the possibility of unjustifiable discrimination occurring under the provision in the future. Consideration of that possibility would be a factor that, if a proper basis has been laid, could be taken account of by the Minister in the exercise of the discretion which section 88(2) gives to him.

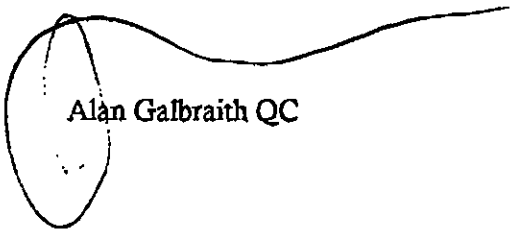
Revenue Sharing

The third question raises the issue whether the revenue sharing provisions of the TNA relate directly or indirectly to the fixing of tariffs and/or capacity in terms of section 88. In my view this is more a question of fact than law. Use of the terms "relate" and "directly or indirectly" in the legislation which, as I have noted above, were specifically adopted in preference to the former narrower term "provide for" makes it clear that the application of the section is intended to be wide and will encompass considerations which bear upon or are connected to tariff or capacity issues but which are not themselves directly the fixing of tariffs or capacity.

My understanding is that in seeking to manage capacity it is important that the incentive for either airline to game the situation is removed. The most practical way of doing this is to have a revenue sharing arrangement such as is contained in the TNA because that removes the incentive for either airline to game the tariff revenue advantages of having greater capacity at times of highest demand. Unless incentives are aligned the primary objective of the TNA of reducing excess Trans-Tasman capacity will not be achieved. If I have correctly understood the factual position then, in my view, the revenue sharing provisions can be said to indirectly relate to both capacity and tariff. I suspect that Professor Taggart's contrary

view follows from a lack of information about the operational background and the necessity to align incentives.

Yours faithfully



Alan Galbraith QC