

Air New Zealand/Qantas – Response to Ministry of Transport Questions

1. **Please provide data (in an Excel spreadsheet) for each of the 12 month periods ending 31 March 2003-06 for transit passengers, who do not pass through immigration at the Australasian port of disembarkation, carried by the applicants on each of their trans-Tasman city-pair routes in a form that allows reconciliation between total trans-Tasman carriage and New Zealand and Australian entry/departure data.**

See response provided on 28 August 2006

2. **Please provide data (in an Excel spreadsheet) for the period 1 April 2002 to 31 March 2006 for each applicant's seat capacity, revenue passengers and load factors on a month-by-month basis on each route of their trans-Tasman services.**

See response provided on 28 August 2006

3. **Please provide information on annual average load factors comparing Tasman routes with other international routes operated by the applicants.**

See response provided on 28 August 2006

4. **Please provide further information on recent trends in trans-Tasman cargo capacity and carriage.**

4.1 Background

Tasman cargo capacity has increased by 35% since the Northern Winter 2002 Scheduling Season, from 4167 tonnes per week, to 5610 tonnes per week in Northern Summer 2006. On the key Auckland – Sydney route, cargo capacity has increased by 86% over the same period. As a result of this increase and for the reasons explained more fully in response to Question 31, the Applicants consider that the TNA would not have any material adverse impact in the Tasman cargo market.

4.2 Air NZ

[CONFIDENTIAL]

4.3 Qantas

[CONFIDENTIAL]

Financial Data

5. **Please provide further information (in an Excel spreadsheet) on a route-by-route basis for all routes that would be covered by the TNA using industry-standard measures for costs, revenue (yield) and profitability over each of the 12 month periods ending 31 March 2003-06, explaining briefly the basis of the management accounting used to derive the results.**

See response provided on 28 August 2006

6. **Please provide cost data using industry-standard measures (e.g., cents per ASK) for each of the aircraft types that the applicants could use on Tasman operations.**

See response provided on 28 August 2006

7. **For Air New Zealand only, please provide data on the impact of the proposed schedule on aircraft utilisation rates.**

See response provided on 28 August 2006

8. **For Air New Zealand only, for the same time periods as requested in 5 above please provide information on route profitability by geographical area that would allow a comparison to be made between Tasman operations and other areas of the company's operations.**

Air NZ's profitability on the Tasman relative to other routes was discussed during the confidential briefing session on 28 August 2006.

9. **For Air New Zealand only, please provide more comprehensive financial estimates of the overall impact of an approval on the company's financial position compared with the status-quo and counterfactual.**

See response provided on 28 August 2006

10. **Please expand on what the applicants consider an "appropriate return on capital" would be given airline industry norms and to what extent approval of the application is likely to assist in meeting this objective.**

See response provided on 28 August 2006

Consumer Market Research

11. **Please provide information on any relevant consumer market research as to the relative value different groups of consumers (business, leisure, shippers etc) place on scheduling, low-fare/rate levels, tariff-condition flexibility and frequent flyer programmes in making their travel/shipping decisions.**

Note that we are particularly interested in indications of consumer demand for the kind of schedule changes proposed (i.e., less "wing tip" flying).

11.1 **Air NZ**

[CONFIDENTIAL]

11.2 Qantas

[CONFIDENTIAL]

12. **With respect to the applicants' frequent flyer programmes, please provide any information on what proportion of trans-Tasman passengers are members of a) the Air New Zealand scheme b) the Qantas scheme and c) both.**

See response provided on 28 August 2006

S.88(4) Criteria

13. **In the absence of any indication in the application as to the level of proposed tariffs for trans-Tasman carriage, please expand on your statement with respect to s.88(4)(c).**

See response provided on 28 August 2006

14. **Given the wording of the TNA, please explain in practical terms how it does not prevent any party from seeking approval for other tariffs.**

No provision of the TNA has the purpose or effect of preventing any airline from seeking approval, in terms of section 90 of the Civil Aviation Act, for the purpose of selling international carriage by air at any other tariff approved under that section.

As set out in the Ministry of Transport's (the **Ministry**) previous authorisation recommendation in respect of the alliance between Air NZ and United Airlines, there are two situations where approval of tariffs may be considered under section 90.¹

- (a) (**Pursuant to a licence condition**) An airline may have a licence condition which requires it to file full fares with the Ministry, which are filed for authorisation under section 90. However, as noted in the Ministry's authorisation recommendation concerning the Joint Services Agreement between Qantas and British Airways, there is no requirement or need for section 90 tariff filings under the New Zealand – Australia Air Services Agreement. For that reason, neither of the Applicants would have a practical reason or requirement to file fares for Tasman routes.²
- (b) (**A specific exemption**) Carriers may wish to offer joint tariffs in respect of certain routes and can seek specific approval for those tariffs from the Ministry under section 90 as a means of gaining exemption from the Commerce Act. The Ministry has, however, indicated informally that airlines are generally discouraged from filing tariffs under section 90, in favour of a section 88 authorisation.

It follows from the foregoing that the TNA does not, in any way, impact the ability for third party airlines to file tariffs under section 90 in respect of the Tasman or any other international route. Further, for the reasons described above in paragraph (a), neither of the Applicants would have any reason or need to file a tariff in respect of the Tasman and the TNA does not relate to or impact any other international route.

¹ Ministry of Transport Authorisation recommendation, 28 February 2002, p. 4.

² Ministry of Transport Authorisation recommendation, 15 December 2003, para 27.

As set out in the opinions of Mr Alan Galbraith QC and Mr David Goddard QC (provided to the Ministry on 14 August 2006), an authorisation under section 88 of the tariff setting machinery of the TNA is sufficient to authorise the joint tariffs which result from the operation of that machinery.³ Therefore, while the TNA does not prevent an application for authorisation of any such tariffs under section 90 an authorisation of the TNA under section 88 merely makes it unnecessary.

15. Please clarify the meaning you attribute to the expression “international comity” and what your legal basis for that meaning is.

“International comity” is functionally equivalent to “comity of nations.” Both expressions refer to the courtesy and mutual consideration that states accord to each other. The implications of the principle are context-specific (including, for example, the presumption against extra-territorial interpretation of statutory enactments and the public policy doctrine preventing the enforcement of contracts that involve illegal activities in foreign states).

In the context of section 88(5), “international comity” refers to the implications of refusing to authorise an international air carriage arrangement for New Zealand’s relationships with other countries. As the Treasury advised the Minister of Transport in 2002 in respect of the application of section 88(5), the Minister *“is also required to have regard to international comity and thus take into account the impact on New Zealand’s...wider international relationships”*.⁴ Accordingly, if a refusal to authorise a price or capacity-fixing arrangement would have an undesirable effect on the relationship between New Zealand and another state, the Minister may authorise the arrangement notwithstanding the provisions of section 88(4).

15.1 Legal dictionaries on the meaning of international comity

This view accords with the definitions in leading law dictionaries:

- (a) The *Oxford English Dictionary* defines “comity of nations” to mean “the courteous and friendly understanding, by which each nation respects the laws and usages of every other, so as may be without prejudice to its own rights and interests”;
- (b) The *Encyclopaedic Dictionary of International Law* defines “comity” to mean “the rules of politeness, convenience, and goodwill observed by states in their mutual intercourse without being legally bound by them”; and
- (c) The *Dictionary of International and Comparative Law* defines “comity of nations” to mean “acts or practices of nations based on good will and mutuality, rather than strict application and enforcement of rules of law”.

15.2 Case law on the meaning of international comity

In *Hilton v Guyot* 159 US 113 (1895), the United States Supreme Court observed at 163-164:

³ Opinion of Alan Galbraith QC, 3 August 2006, p 3; Opinion of David Goddard QC, 10 August 2006, paras 2.4, 17.

⁴ Treasury Report to the Minister of Transport, AANZ-SH, 8 October 2002.

‘Comity,’ in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard to both international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws.

Counterfactual

16. **For Air New Zealand and Qantas separately, please provide more information about what you consider the implications (capacity, tariffs, network, financial, aeropolitical and wider economic) for each of you of the application not being approved would be.**

16.1 **Air NZ**

[CONFIDENTIAL]

16.2 **Qantas**

[CONFIDENTIAL]

In respect of tariffs, whether or not the TNA is authorised, the Tasman will remain a dynamic market in which Virgin Blue and Emirates operate as vigorous and effective competitors. This will have a strong constraining influence on prices on all Tasman routes.

Qantas considers the key economic implications of the Minister declining authorisation for the TNA will be the inability of Air NZ and Qantas to take advantage of a unique opportunity to reduce both airlines’ costs through the removal of some surplus Tasman capacity without adversely affecting the frequency of flights, the network offering and the city presence of each airline.

In particular, the Applicants’ will not be able to obtain the cost savings implicit in the TNA. This will impact their profitability and ability to compete, including passing-on cost savings to consumers.

From a broader perspective, if the Minister declined to authorise the TNA the New Zealand economy will be denied access to the entire range of public benefits described in the original submission of Air NZ and Qantas.

Contestability of the trans-Tasman Air Transport Market

17. **Please provide more information on any likely slot, runway length or terminal space constraints on entry or increased services by third-party airlines.**

Airport facilities do not pose a significant constraint on entry or expansion in the Tasman market. This was accepted by the Australian Competition Tribunal which concluded that “the availability of terminal facilities and slots is not a barrier to entry or expansion in the foreseeable future”,⁵ and confirmed by Dr Tretheway in his report where he concluded:

⁵ Qantas/Air NZ decision at 72.

“airport access is generally no longer a barrier to entry in either Australia or New Zealand”.⁶

As set out in further detail at 19.1 below it is in the financial interests of airports to accommodate new carriers or the expansion of services by existing carriers. For example, Virgin Blue has been able to get access to airport facilities and services at every airport to which it operates.

It remains the case that there are no barriers to access at any of the Australian airport facilities that service Tasman routes, including at Sydney Airport. There are some morning peak apron constraints at Sydney Airport, however, as Dr Tretheway notes⁷ Virgin Blue already has a large number of slots allotted to it between 7am and 10am at Sydney Airport. As such, it could expand its Tasman services by reallocating a domestic slot or operating flights immediately prior to or after the peak period. This is not a barrier to expansion for Virgin Blue.

17.1 Auckland International

There are no runway constraints in terms of hourly aircraft movements in Auckland.

In terms of inbound passenger processing, outside of certain peak periods there would be little difficulty in obtaining an arrival slot within 15 minutes of desired timing. There are inbound passenger processing peaks between 0500-0700, 1030-1500, and 1700-1830. However, there is normally the ability to find, within those peaks, an arrival slot for a narrow-body aircraft. Further, a new entrant carrier or a carrier with less than four existing aircraft movements at Auckland on a particular day receives priority over an incumbent carrier in the event that both requested the same new arrival time.

In terms of outbound passenger processing, there is little difficulty obtaining slots at any time of the day.

Contact gates can be more challenging to obtain at various times across the week, but there are sufficient remote stands available to cater for additional arrivals. Normally a contact gate can be found for a departure, but some bussing could occur.

17.2 Christchurch International

There are no runway constraints in terms of hourly aircraft movements in Christchurch.

In terms of inbound passenger processing, outside of certain peak periods there would be little difficulty in obtaining an arrival slot within 15 minutes of desired timing. There are inbound passenger processing peaks between 1330-1530 on all days and 2300-2359 most days. However, on some days there would be an ability to find an arrival slot for an additional narrow-body aircraft within these peak times. As in Auckland, a new entrant carrier or a carrier with less than four existing aircraft movements at Christchurch on a particular day receives priority over an incumbent carrier in the event that both requested the same new arrival time.

⁶ Tretheway Report at 9.4.5.

⁷ See Tretheway Report at 9.4.5-6.

In terms of outbound passenger processing, the only constraint would be between 1500-1600 daily when counter congestion would probably preclude a carrier from establishing a new departure within that one hour time period.

There are no gate constraints, though availability is tight on most days between 1300-1600. There are currently no remote gates, although these could be added.

17.3 Wellington International

While there are curfews for international arrivals (0100-0559) and international departures (2359 to 0559), these are highly unlikely to amount to a constraint on a new service. Wellington's runway length precludes services operated with aircraft larger than 777-300 series and there are some minor pay-load constraints ex-Wellington on 737-800, 737-700 and 737-400 aircraft (Virgin Blue operates 737-700 and 737-800 aircraft), although the Applicants do not consider these to be material constraints given Virgin Blue provides or has provided services to Sydney and Brisbane.

In terms of inbound and outbound passenger processing, an additional arrival or departure would be able to be accommodated within 30 minutes of desired timing. It is also relevant that Wellington International Airport has announced plans to expand its terminal facilities.

Gate availability does not impose a constraint, although gate availability is tight at peak times (0600-0645, 1400-1600 and 2300-2359 daily). Overnight parking, if needed, could be tight for additional layover aircraft.

18. **For Qantas only, please provide a list of the countries that have exchanged trans-Tasman fifth freedom rights with Australia, together with any related capacity or route limitations) and a list of those countries with airlines that serve Australia that do not have access to trans-Tasman fifth freedom rights.**

See response provided on 28 August 2006

19. **Please supply supporting international comparative evidence for the statement that "The Tasman is one of the most competitive aviation operating environments."**

There are two key factors underpinning the competitiveness of the Tasman:

- the absence of barriers to entry and expansion; and
- the different airline models operating in the market.

19.1 Absence of barriers to entry and expansion

In a number of overseas aviation markets barriers to entry exist, meaning carriers cannot deploy additional services. However, there are no material barriers to entry or expansion on the Tasman. Dr Tretheway independently reached this view in his report.⁸ For example:

⁸ Tretheway Report at 2.4.1.

- In relation to access to airport facilities, it is in the financial interests of airports to accommodate new carriers or the expansion of services by existing carriers. For example, Virgin Blue has been able to get access to airport facilities and services at every airport to which it operates.
- Both Emirates and Virgin Blue also have access to aircraft capacity:
 - Emirates has an aircraft flying services from Dubai to Melbourne that could immediately be deployed across the Tasman on a marginal cost basis to increase its share;
 - any deployment of the A380 on the Tasman would further increase Emirates' ability to carry an expanded number of passengers on the Tasman; and
 - Virgin Blue has aircraft deployed elsewhere that could be quickly redeployed to the Tasman if it was profitable to do so.
- There are no significant regulatory barriers. A carrier based in Australia or New Zealand may be licensed to serve the trans-Tasman market either via the Single Aviation Market agreement, or via traditional international air service licenses. There are no limits on the number of carriers that may be authorised to operate trans-Tasman services.

This is consistent with the Australian Competition Tribunal's conclusion on barriers to expansion in the *Qantas/Air NZ* decision that:

"If the Alliance were to go ahead, there would not be any barriers to significant entry nor would there be any barriers to effective expansion by either or both of Virgin Blue or Emirates."⁹

The entry and growth of airlines such as Emirates and Virgin Blue and the expansion of total capacity on the Tasman indicates the continued absence of any such barriers to entry or expansion.

19.2 Number of different models

Competition is greater in aviation markets where there is more than one type of business model being employed. The significant changes adopted by both Air NZ and Qantas in response to the rise of the low cost carrier or LCC model and growth of Emirates, illustrate this point.

On the Tasman, there are:

- traditional network airlines, in the form of Air NZ and Qantas;
- LCCs, in the form of Virgin Blue, Jetstar and Freedom Air; and
- a number of fifth freedom airlines operate on the Tasman on a marginal-costed basis, in particular Emirates, who is treating the Tasman as a key market in its own right.

⁹ ACT Decision para. 419

(a) ***The Virgin Blue model***

Virgin Blue's current structure continues to incorporate all of the features of an LCC, including:

- the operation of a single type of aircraft (a fleet of Boeing 737 planes);
- significant emphasis on point-to-point routes that offer Virgin Blue the opportunity to both win market share from incumbent operators and grow demand through lower fares;
- maintaining a low cost base that can drive affordable airfares (for example, Virgin Blue's "controllable" costs (i.e., excluding fuel) have continued to decline on a c/ASK basis, falling from 6.09c/ASK to 5.93c/ASK in the six months to 31 March 2006 relative to the same period the year before (falling 2.6%));¹⁰ and
- a continued emphasis on price structure to ensure the ability to offer everyday low airfares to consumers and grow the markets in which it operates.

However, Virgin Blue has continued to make innovations which serve to increase the breadth of its appeal to passengers across its network, particularly corporate or business travellers, without a significant impact on costs. This includes the development of new products on a pay-per-use basis and additional services which have traditionally afforded legacy carriers healthy yields. Virgin Blue has defined this approach as part of the process of developing a "new world carrier" model and predicts that this model will expand the scope of competition with traditional full service network carriers.¹¹

(b) ***Emirates***

It is economically viable for Emirates to operate on the Tasman on a marginally costed basis. By flying a Tasman route when its aircraft would otherwise be sitting idle in Australia, Emirates is able to improve aircraft utilisation as well as providing additional "through traffic" for its Australia – Dubai – Europe services.

Emirates is therefore able to provide a quality full service offering on the Tasman at highly competitive prices. The airline is an attractive alternative for Tasman business travellers that do not have a high frequency imperative.

19.3 Number of carriers operating

There are a number of other carriers competing on the Tasman all of which operate using either the low cost or the marginal cost models. In addition to Air NZ and Qantas, Emirates, Virgin Blue, Aerolineas Argentinas, Garuda Indonesia, Lan Chile and Royal Brunei all operate Tasman services using the low-cost or marginal-costing models.

¹⁰ Virgin Blue "Half Year Results for the six months ended 31 March 2006" Presentation – Virgin Blue's costs (inclusive of fuel) rose from 7.72c/ASK to 7.96c/ASK over the same period.

¹¹ "Virgin Blue announces birth of 'New World Carrier'", Media Release, 30 November 2005.

20. **Please expand on your comments concerning the competitive strength of Pacific Blue in light of its substantial reduction in Wellington services.**

The Applicants do not accept the characterisation of Virgin Blue “substantially reducing Wellington services”. While Virgin Blue has withdrawn its Wellington-Sydney service (which was 7 x per week), it has replaced that service with a Wellington-Brisbane service. Although that service operates 3 times per week Virgin Blue is a significant competitor on the route, with a capacity share of over 30%.

Virgin Blue imposes a significant constraint on the Tasman. The Applicants refer to their ACCC Further Response to Third Party Submissions (21 August 2006), and to the report of Dr Michael W. Tretheway prepared for Air NZ, both of which have been provided to the Ministry. In particular, the Applicants refer to Dr Tretheway’s conclusions that based on his analysis of Tasman average fares:

“The evidence indicates that even with modest capacity shares, carriers such as Pacific Blue and/or Emirates will effectively constrain the ability of the Applicants to achieve a significant and sustained price increase”.

Dr Tretheway also concluded that: “the impact of Virgin Blue and Emirates is felt in a sizeable way even on routes they do not serve”.

A key reason for this constraining influence is the ability of Virgin Blue and Emirates to quickly expand onto a new route should existing competitors attempt to increase prices in the short to medium term. As discussed at paragraph 19.1 above, there are no barriers to entry or expansion on Tasman routes and both Virgin Blue and Emirates have the resources to enter and expand quickly. It is the ability and capacity of Virgin Blue and Emirates to respond to the Applicants which creates a competitive constraint.

21. **Please provide any relevant market research concerning the impact of pricing on the substitutability of trans-Tasman destinations for leisure travellers.**

Neither Qantas nor Air NZ has any specific information on the substitutability of trans-Tasman destinations for leisure travellers. Both Air NZ and Qantas price different trans-Tasman routes at a common rate due to the commercial reality that leisure passengers consider a range of destinations to be substitutable when making a purchase decision. As a consequence, there is no pricing impact by which to measure the extent of this substitutability.

Substitution between destinations for leisure passengers has been previously accepted by Australian Federal Court (on appeal) in *Taprobane*¹² where the Federal Court noted that a market definition of the supply of wholesale packages from Australia to the Maldives was too narrow because consumers would substitute to alternative destinations:

“In the end the relevant substitutions are not between airlines, but between destinations. The evidence supports the conclusion that there are island holiday packages available at the retail and wholesale levels which are substitutable for Maldivian holiday services. The range of possible alternatives is wide as Professor McKern pointed out in his evidence and would include such destinations as Bali, Fiji, Tahiti, New Caledonia, Hawaii, Penang, the Philippines, the Solomon Islands, the Barrier Reef Islands, Guam and Mauritius. It is not at all clear that the

¹² *Re: Singapore Airlines Limited v Tarobane Tours W.A. PTY LTD* No. WA G101 of 1990 FED No. 808 Trade Practices (1992) 14 ATPR 41-159 at paragraph 57, per French J.

product market would not extend to the provision of holiday package tours to the Mediterranean and Caribbean Islands.”

Substitutability of other destinations was also one of the elements taken into account by the Ministry of Transport when it authorised the Tri-Partite Alliance between Air New Zealand, Singapore Airlines and Ansett.¹³

A practical example of destination substitution (albeit between Pacific Island destinations) is by data comparing revenue of Air NZ routes through Nadi with Air NZ routes through other Pacific Islands during and immediately after the coup in Fiji in 2000. While revenue in July 2000 on routes through Nadi decreased by \$[CONFIDENTIAL], revenue on routes through other Pacific Islands increased by \$[CONFIDENTIAL] for the same period. Similar results were also recorded in August 2000.

22. Please comment on the current pricing behaviour of Emirates now that it has achieved higher load factors and enhanced brand awareness.

Since 2003, Emirates has made a significant investment in developing brand awareness on both sides of the Tasman through sponsorship of key events and organisations, including the Emirates Team New Zealand yachting syndicate. Nonetheless, the fundamental underpinnings supporting Emirates’ highly competitive Tasman prices remain securely in place.

It remains economically viable for Emirates to provide a quality full service offering on the Tasman at highly competitive prices because Emirates flies the Tasman in order to improve aircraft utilisation when its aircraft would otherwise be sitting idle in Australia (as well as to obtain additional “through traffic” for its services from Dubai) and can, therefore, price on a marginally costed basis. This allows Emirates to offer leisure passengers, who generally have more flexible scheduling requirements, and those business travellers who do not have a high frequency imperative, an attractive alternative to the Applicants, ensuring an ongoing competitive constraint.¹⁴

This business model has not altered since Emirates commenced its Tasman services and provides the foundation for the airline’s competitive advantage. Emirates continues to take advantage of this model by offering highly competitive prices.

Emirates continued material level of pricing constraint in the Tasman market is evidenced by Dr Tretheway’s Report. [CONFIDENTIAL]

23. Please provide information on the interline (IATA or other) fares/prorate arrangements that would be available to passengers and third-party airlines for trans-Tasman carriage on the services of the applicants.

See response provided on 28 August 2006

¹³ Report from the Ministry of Transport to the Minister of Transport *Air New Zealand: Application for Authorisation of Alliance between Air New Zealand, Ansett Australia Limited, Ansett International Limited and Singapore Airlines Limited* 4 December 1997.

¹⁴ It is also worth noting that the availability of one-way fares means that passengers who might demand higher frequencies can still utilise the services of Emirates in one direction, whilst flying with another carrier on the return leg.

24. **Please provide a comparison between the interline fare levels and the other fare levels (tariffs) available on the applicants' trans-Tasman services.**

See response provided on 28 August 2006

25. **Please provide an outline of all prorated agreements that allow for carriage on third-party airlines to be combined with trans-Tasman carriage by the applicants.**

See response provided on 28 August 2006

26. **[CONFIDENTIAL]**

Public Interest Considerations

27. **Please provide a detailed route-by-route comparison of the net capacity (seat and frequency) impacts comparing the indicative schedule with the last comparable season of trans-Tasman operations by the applicants.**

See response provided on 28 August 2006

28. **Please elaborate on the likelihood of any new trans-Tasman routes (including to additional New Zealand airports) being offered were the application to be approved.**

See response provided on 28 August 2006

29. **Please provide an analysis of the impact of the indicative schedules on individual New Zealand airport revenues (notably on landing charges and passenger throughput).**

This response has been compiled by Bell Gully using information provided separately by Air NZ and Qantas, and is provided in the attached spreadsheet. All data is commercially sensitive and hence confidential to each airline and as between the airlines.

30. **Please provide any observations you wish to make on whether by spreading scheduled flight times there would be a reduction of the need for capital expenditure to cater for schedule peaks at any particular New Zealand airports.**

The following "observations" are provided by Air NZ. They are very much estimates, but Air NZ is happy to discuss these further with the Ministry if that would assist.

All other things being equal, there are CAPEX reductions possible at Auckland, Wellington, and Christchurch with a better spread of schedule times.

- 30.1 **Auckland**

[CONFIDENTIAL]

- 30.2 **Wellington**

[CONFIDENTIAL]

30.3 Christchurch

[CONFIDENTIAL]

31. Please provide additional commentary on your assessment of the likely implications of an approval for your other New Zealand suppliers (including travel agents), shippers of air cargo and the New Zealand tourism industry.

Neither of Air NZ's or Qantas' New Zealand suppliers or travel agents nor any related participants in the tourism industry will suffer detriment under the TNA and, in fact, the Applicants consider that these parties stand to benefit if the TNA is introduced.

31.1 Travel Agents

Air NZ considers that travel agents will benefit from the TNA because they will be able to offer stronger product propositions to their customers. This is because:

- There will be 63% more Air NZ coded Tasman flights;
- Air NZ and Qantas will be able to offer customers a better schedule of flights with less wing-tip flying; and
- Passengers will be able to earn and redeem Airpoints dollars on all Air NZ coded flights irrespective of which carrier operates the flight. The same will apply to Qantas Frequent Flyer Points on Qantas coded flights.

The Applicants have sought a one off alignment in the basis on which incentives are paid to travel agents (refer to response to Question 33 below). This will ensure that travel agents are paid for all bookings made rather than being paid nothing on some bookings and twice on others.

The Applicants will continue to negotiate and maintain their relationships with the travel trade independently of each other. The Applicants have taken deliberate measures to ensure that they will not share the incentive rates they offer to agents with each other. As such, the Applicants do not consider that the TNA will have any adverse effect on travel agents' remuneration.

31.2 Cargo/shippers of air cargo

While the TNA provides the Applicants with the option of working together in relation to their cargo business on the Tasman, no decision to do so has been made at this time and there is no immediate intention to do so. In the absence of any such agreement, each party will independently maintain its own relationships with its cargo customers and any cargo will be carried within the belly space of the flights that carrier operates.

The TNA will not result in any decrease in competition in the market for air freight for the following reasons:

- (a) There are minimal barriers to entry or expansion in the Tasman freight market, as the ACT acknowledged in the Qantas/Air NZ Decision (see paragraph 526).
- (b) As noted in response to Question 4, competition for cargo business has materially increased since Emirates entered the Tasman market. The entry of Emirates demonstrates the minimal barriers to entry and expansion in this market.

- (c) The fifth freedom carriers operating on the Tasman, most notably Emirates, use only wide-bodied aircraft, which are best suited for the carriage of freight. The pricing offered by fifth freedom operators on the Tasman significantly impacts the price the Applicants are able to charge for air freight services and acts as a direct constraint on their conduct.
- (d) In addition to the passenger aircraft carrying cargo on Tasman routes, there are a number of dedicated freighter services all operating on the Tasman in competition with the Applicants, including Singapore Cargo, CV Cargolux and HJ Asian Express DHL.

31.3 New Zealand's tourism industry

The Applicants support the comments of the Tourism Industry Association that a strong national carrier is critical to continuing to promote New Zealand as a tourist destination, which in turn will benefit the wider New Zealand economy.

Tourism is critical to the New Zealand economy, accounting for 18.3% of export earnings, 9.4% of GDP and 9.9% of employment. For the year ended June 2006 arrival numbers to New Zealand were 2.4m, of whom 37% were from Australia. 40% of Australians travelling to New Zealand do so for a holiday and Australian tourists spent \$1.494b while on holiday in New Zealand in the year ended June 2006.

However, passengers travelling from Australia for a holiday are not "locked in" to coming to New Zealand, but are free to choose where to take their breaks. Destinal competition is significant in this regard.

This means that for New Zealand to remain an attractive holiday destination, the price of travel on the Tasman must be at levels which are internationally competitive, together with a service offering which ensures that schedules maximise the convenience of travel to New Zealand (see response to Q11 on the value placed on price and schedule by Tasman passengers). The TNA supports both these goals:

- (a) The extraction of significant cost from the removal of the some surplus capacity will support sustainable low airfares and, further, will provide Air NZ with increased resources to develop and promote New Zealand as a destination, particularly in Australia, which will directly benefit the wider tourism industry.
- (b) The TNA schedule reduces wingtip flying and creates a greater schedule spread/range of flight times.

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The TNA will also provide tourists who are either from or passing through Australia and who are considering travel in New Zealand with a range of benefits which will make a journey to New Zealand considerably more "hassle-free":

- *Better schedule spread:* The TNA will result in the reduction of wingtip flights at times when tourists are less likely to want to travel (such as very early in the morning on a weekday). This will allow the Applicants to provide a greater spread of flights at other times and will give travellers a greater choice of flight times when planning their itinerary.
- *Better connectivity:* A better schedule spread under the TNA will increase connectivity with the regional networks established by Qantas in Australia and Air

NZ in New Zealand. In particular, because all Qantas Tasman services will also carry the NZ code, travellers will have a greater number of Tasman connections to choose between and waiting times for the Tasman leg of a journey will be reduced. Tourists travelling to New Zealand from Australia will enjoy a much more seamless travel experience and will be able to access a large number of smaller destinations in New Zealand more easily.

- *Greater flexibility:* A traveller who has booked on a flexible Qantas fare will be able to change their ticket to an Air NZ or Qantas flight across the full schedule of flights operated by both airlines. This will allow travellers to have greater flexibility when planning a holiday in New Zealand.

These aspects of the TNA will make travelling to New Zealand easier and more attractive, both for international travellers as part of a longer travel itinerary and for people living in Australia who are considering a short holiday. In turn, this is likely to lead to positive flow on effects for those involved in the New Zealand tourism industry, particularly in smaller regional centres.

32. Please provide further explanation as to why Jetstar and Freedom would be included in the revenue-sharing arrangements from the outset but not the code sharing.

Freedom and Jetstar are included in the revenue-allocation arrangements under the TNA from the outset for the reasons articulated in response to Question 33. That is, all aspects of the Air NZ Group and Qantas Group businesses need to be included in the tariff setting and revenue-allocation arrangements because without these joint arrangements the parties:

- would not agree to set schedules, capacity and frequency in the manner set out in the TNA; and
- would have the incentive and ability to act to further their own interests, at the expense of the TNA's objectives.

As regards Freedom and Jetstar specifically, they form part of the combined network and decisions about their deployment must be made bearing in mind the same considerations as for Air NZ and Qantas services.

There are no similar imperatives upon the parties to ensure that Freedom (and Jetstar) participate in the code-sharing arrangements between Air NZ and Qantas. As the Ministry is aware, in broad terms code-sharing involves an arrangement where one carrier markets/sells a service and places its code on another carrier's flights.

Given the different business models adopted by Air NZ relative to Freedom Air (and Qantas relative to Jetstar), code-sharing may not be an appropriate strategy in many circumstances on the Tasman. For example, under the TNA code-share the operating carrier is called upon to meet the "Minimum Inflight Service Offering" for all passengers – this offering is defined to include a meal, a beverage service and a movie at no additional charge, baggage transfer and other requirements.

Schedule 9 of the TNA provides a framework within which the Applicants can introduce code-share arrangements as between respective carriers (including Jetstar and Freedom) if and when the appropriate opportunities present themselves. For example:

[CONFIDENTIAL]

In the event a new proposal is made to include Freedom and/or Jetstar in code-sharing arrangements of the type outlined in Schedule 9, clause 7.1(c)(i) of the TNA states that this decision is "... subject to the Committee first agreeing the terms on which such codeshare flights will be operated".

Currently the Applicants have no plans to include Freedom and/or Jetstar in the TNA code-sharing arrangements.

33. **Please provide a fuller explanation as to why joint tariff setting and revenue sharing need to be part of the TNA, as opposed to arrangements that only cover code-sharing ?**

See response provided on 28 August 2006

Commission Regime

34. **Please explain what you envisage would be the relationship of the Commission regime that you seek to the current Commission regimes dated 8 September 1983.**

*Note our preliminary interpretation of the current Commission regime is that it already provides for the payment of commission on the Qantas basis. To quote 4(1) of the passenger regime, "... travel on the **services** of a principal ..." We interpret this as including code-share services.*

The Applicants have taken deliberate measures to ensure that they will not share the commission, rebate and incentive rates they offer to travel agents with each other under the TNA. The TNA discussions have been expressly limited to implementing a one-off structural change to the method of calculating revenue, in order to avoid an unintended result.

The Applicants agree that the current Commission regime includes codesharing services and allows for the payment of commission on the Qantas basis. However, a new commission regime is required because, whereas the current regime specifies that commission is to be paid at a set percentage of each fare (section 4(1)), under the TNA each of the Applicants will set the rate at which commission is paid unilaterally, which arguably takes the arrangement outside the existing Commission regime.

35. **The new Commission regime would operate concurrently with the existing regime but would be applicable solely to Commissions, incentives and rebates payable by Qantas and Air NZ (and their subsidiaries) during the term of the TNA. Please advise details of any discussions that you have held with TAANZ about the proposed new Commission regime.**

35.1 **Air NZ**

[CONFIDENTIAL]

35.2 **Qantas**

Qantas has not had any discussion to date with TAANZ about the proposed new commission regime. This is because Qantas is of the view that the new commission regime does not represent a significant change to current arrangements.

[CONFIDENTIAL]

As part of the TNA, the Applicants have agreed to implement a one-off structural change to the method by which revenue is calculated for the purpose of incentive commissions paid in respect of Tasman sectors. The agreed method is “marketed” revenue.

[CONFIDENTIAL]

36. **If you still maintain that a new Commission regime is required, please advise in further detail what you consider would be its content.**

As discussed in the response to Question 34, the new Commission regime would retain the provisions of the current Commission regime, but would also to allow the Applicants to set the rate at which commission is paid by the Applicants (and their subsidiaries) under the TNA unilaterally rather than at a fixed percentage of the fare. This would require only a small number of amendments to the current regime, as follows:

- (a) The following operative clause be added to section 4:

Subject to the provisions of this notice, if, and only if, any approved agent arranges at an approved location any travel on the services of a TNA Carrier as principal which are operated pursuant to the Tasman Networks Agreement, either of the TNA Carriers may pay to that agent a commission at a rate to be determined solely by the TNA Carrier who shall be responsible for paying the commission under the terms of the Tasman Networks Agreement.

- (b) The following defined terms be added to section 2:

“Tasman Networks Agreement” means the agreement entered into between the TNA Carriers dated 12 April 2006 and authorised under section 88(2) of the Civil Aviation Act 1990 on [];

“TNA Carriers” means Qantas Airways Limited and Air New Zealand Limited.