OPAANZ-C

7 November 2006

Mr Phil Taylor
Bell Gully
P O Box 4199
Auckland

Mr Andrew Peterson
Russel McVeagh
P O Box 8
Auckland

COMMERCIAL IN CONFIDENCE

Dear Mr Taylor and Mr Peterson

1. The purpose of this letter is to set out some preliminary views we have reached regarding your clients' proposed Tasman Networks Agreement (TNA) and the Civil Aviation Act 1990 (the Act) and to give your clients an opportunity to comment.

2. In summary, we have reached the preliminary view that the Minister cannot authorise the TNA in its current form because it breaches s.88(4)(e) of the Act, one of the statutory prohibitions.

3. Further, we outline our preliminary view that the structure of the agreement causes concern due to its open ended nature, particularly in relation to tariffs.

4. We cover these points in more detail below.

Section 88(4)(e)

5. As you will be aware, s.88(4)(e) of the Act provides that "authorisation shall not be given…to any provision…that…has the purpose or effect of preventing any party from seeking approval, in terms of section 90 of this Act, for the purpose of selling international carriage by air at any other tariff so approved".

6. While the prohibition in s.88(4)(e) is couched in the context of the authorisation mechanism under s.90, reflecting the regulatory practice when all tariffs required approval as a matter of course, the overriding concern of s.88(4)(e) is to ensure that individual carriers can set their own tariffs irrespective of any agreements entered into with other carriers.

7. In providing that the parties "will cooperate on all aspects of pricing of passenger services" and requiring the working group to set tariffs for Tasman services, the TNA has the effect of preventing either party from seeking approval under s.90 for its own tariffs on Tasman services and therefore does not comply with s.88(4)(e). The provisions of the TNA would indicate that if one of the airlines were to set its own tariffs and apply for approval under s.90 it would be acting in breach of the TNA.

8. We have noted your answers to our information request number 14 where we asked you "to explain in practical terms how the TNA does not prevent any party from seeking approval for other tariffs".

9. You focussed on our current regulatory practice whereby airlines are normally required to file tariffs only pursuant to a licence condition or where they are seeking a specific exemption from the Commerce Act. You note that neither Air New Zealand nor Qantas is required to file trans-Tasman tariffs under their International Air Services Licences and that, if approval under s.88 for the Working Group process was given, there would be no need to seek approval under s.90 for the tariffs so agreed.

10. Although you are not required to seek approval under s.90 for individual tariffs, the effect of s.88(4)(e) is that you must be permitted to do so should you so wish.

11. The argument that you have put forward, that approval under s.88 would negate the need for s.90 approval of tariffs agreed by the Working Group, does not address the fact that s.88(4)(e) relates to the airlines retaining the ability to set tariffs outside of any arrangements approved, i.e. it relates to 'any *other* tariff'. Therefore your statement that approval under s.88 negates the need for approval under s.90 does not address this point.

12. Therefore our preliminary view is that the TNA cannot be approved in its current form.

13. We note that many of the other code-share arrangements which Air New Zealand has entered into included provisions along the lines of "the Parties agree that nothing in this Agreement shall be interpreted in any way as detracting from or limiting the continuing right of each Party to market its available capacity on the Code-shared Flights, including the fare levels for transportation in such capacity, to the travelling public independently of the other Party".

14. Moreover, agreements that have provided that the parties may agree tariffs have also included provisions such as "each Party retains the right to make independent operational and business decisions".

15. However, in the case of the TNA, we have also noted the applicants' submissions as to why tariff setting is integral to the operation of the TNA. In particular, we note the answer to our information request number 33 where you submitted that Air New Zealand and Qantas must in effect operate as a joint business and that:

> Tariff setting is critical to achieving the objectives of the TNA – without the ability to set tariffs the parties would not agree to set schedules, capacity and frequency in the manner set out in the agreement; and
>
> Absent the ability to set tariffs, the parties would have the incentive and ability to act to further their own interests, at the expense of the objectives of the TNA.

16. From this we conclude that the inclusion of a provision on tariffs, which brought the arrangements into compliance with s.88(4)(e), would fundamentally alter the nature of the TNA.

Other concerns

17. Aside from the specific issue regarding s.88(4)(e) set out above, the open ended nature of the TNA whereby tariffs and schedules are set by working group or committee, without any set parameters, causes additional difficulties.

18. We have to report to the Minister on compliance with other paragraphs of s.88(4) and s.90 and provide advice on any exercise of the Minister's general discretion.

19. In the absence of any indication within the agreement as to how the Working Group will calculate the tariffs, or what the quantum of the tariffs to be determined by the Working Group will be, the Minister is not in a position to determine whether:

    - The criteria in s.88(4)(c), (d) or (e) are met;
    - The criteria in s.90 (2)(a)-(c) are met; and/or
    - The residual national or public interest requirement is met.

20. For your information we also note that we are still working through some additional issues, including jurisdictional issues in terms of whether all the provisions of the TNA would fall within the scope of the type of provision that can be authorised pursuant to s.88 of the Act. We may be writing to you further in connection with these matters.

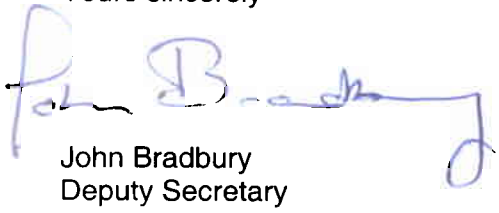
Opportunity to comment

21. In our letter of 16 June 2006 we undertook to give you the opportunity to comment on any issue that would be adverse to you before concluding a view on that issue.

22. Accordingly, should you have any comments on the matters set out in this letter, would you please send them to us by Tuesday 28 November.

23. Please note that, in the interests of a free and frank exchange and to preserve commercial confidentiality, we do not intend posting this letter on the Ministry of Transport web site at this stage.

Yours sincerely



John Bradbury
Deputy Secretary