SUBMISSION on the application by Qantas and Emirates for authorisation of the airlines' re-stated Master Coordination Agreement

1. EXECUTIVE SUMMARY

1.1 The New Zealand Airports Association (**NZ Airports**) welcomes the opportunity to comment on the application by Qantas and Emirates (**the applicants**) for authorisation of their restated master coordination agreement (**the agreement**).

1.2 The trans-Tasman market is vital for New Zealand tourism and commerce. An ongoing competitive aviation environment is important to ensure that passengers have access to frequent, high-quality and competitively-priced services to cross the Tasman. Air capacity and a competitive airline environment are major enablers for maintaining and growing trans-Tasman tourism. If capacity is restricted and fares rise, Australian visitors will go elsewhere.

1.3 NZ Airports acknowledges that both Qantas and Emirates have contributed significant economic benefit to New Zealand, and their ongoing operational health and viability remain important to national tourism and trade interests. However, we consider the application presents some risks for the growth of trans-Tasman traffic, and we encourage the Minister to take a robust approach to assessing the risks and benefits for New Zealand consumers.

1.4 When considering the application, the Minister should therefore be satisfied that: (a) clear benefits will be delivered for New Zealand consumers; and (b) clear mechanisms are in place to ensure those benefits eventuate. In particular, given the structural features of the trans-Tasman market, and the importance of that market for New Zealand, the Minister must be satisfied that appropriate conditions are in place to ensure a robust supply of capacity, choice and competitive airfares for the benefit of the travelling public and New Zealand's tourism sector.

2. THE NEW ZEALAND AIRPORTS ASSOCIATION (NZ AIRPORTS)

2.1 NZ Airports is the industry association for New Zealand's airports and related businesses. Its members[1] operate 36 airports across the country including the international gateways to New Zealand. This infrastructure network is essential to a well-functioning economy, and enables critical transport and freight links between each region of New Zealand and between New Zealand and the world.

2.2 This submission should be read in conjunction with any submission provided by our individual member airports.

---

[1] Our member airports are Ardmore Airport, Auckland Airport, Chatham Islands Airport, Christchurch Airport, Dunedin Airport, Gisborne Airport, Hamilton Airport, Hawke's Bay Airport, Hokitika Airport, Invercargill Airport, Kapiti Coast Airport, Kaikohe Airport, Katikati Airport, Kerikeri Airport, Marlborough Airport, Masterton Airport, Matamata Airport, Motueka Airport, Nelson Airport, New Plymouth Airport, Palmerston North Airport, Queenstown Airport, Rangiora Airport, Timaru Airport, Rotorua Airport, Takaka Airport, Taupo Airport, Tauranga Airport, Wairoa Airport, Wanaka Airport, Whanganui Airport, Wellington Airport, Westport Airport, Whakatane Airport, and Whangarei Airport.

3. CONTACT

Kevin Ward
Chief Executive
New Zealand Airports Association

Address for Service:

New Zealand Airports Association Inc.
P O Box 11 369
Manners Street
WELLINGTON 6142

Telephone: (04) 384 3217
Email: kevin.ward@nzairports.co.nz

4. THE IMPORTANCE OF TOURISM TO THE NZ ECONOMY

4.1 In recent years it has become commonplace to note that tourism is a major pillar of the New Zealand economy. For the 12 months ended March 2016 international tourism accounted for $14.5 billion or 20.7% of New Zealand's export earnings. Tourism directly contributes 5.6% of New Zealand's total GDP and a further 4.3% is indirectly contributed[2].

4.2 However, the current success and recognition of tourism is relatively recent and has been hard won. Since the industry strategy *Tourism 2025* was launched in March 2014, tourism growth has exceeded all forecasts, but this has been a turn-around requiring a number of players to come together, including airlines, airports, the Ministry of Transport, Tourism New Zealand and others.

4.3 It is useful to reflect on the fragility of the building blocks underlying the current position of tourism. Ongoing attention is important to ensure that recent gains are protected and built upon.

5. PROTECTING RECENT GAINS IN AIR CONNECTIVITY

5.1 New Zealand is an island nation dependent on air connectivity. *Tourism 2025* noted that connectivity with markets is crucial to any country's tourism strategy. 99% of visitors to New Zealand arrive by air so the aviation sector is a fundamental driver of tourism. However, in the years to 2014 a focus on aviation had been lacking. No robust public reporting of air capacity existed and airlines had come and gone, with capacity growing at 1.6% over the 5 years to December 2013 – below the global average.

5.2 New Zealand's isolation, coupled with a large number of uncontrollable factors influencing the operating environment, had resulted in New Zealand routes achieving comparatively lower yield returns than other international routes to competing tourism destinations. So, in general, airlines were not highly motivated to grow capacity into New Zealand and the tourism industry struggled to gain momentum.

5.3 Internationally, New Zealand was considered vulnerable to reductions in air capacity due to the small volume of airlines based in New Zealand and New Zealand's low population limiting the growth in outbound traffic. In 2014 the Ministry of Transport listed 18 passenger airlines as operating to/from New Zealand. Growth in New Zealand's airline connectivity to some of the world's key developing markets had been in decline. Long run growth was impacted by carrier exits, natural disasters and fragile economies. Tourism 2025 concluded that New Zealand must work hard to increase demand and drive market

[2] Key Tourism Statistics, Ministry of Business, Innovation & Employment, 26 October 2017.

share improvements that will lead to sustainable growth in air capacity. *Tourism 2025* also identified that to become an attractive destination for airlines to deploy their highly mobile capital, we need to:

- grow demand among higher value visitors, and
- increase volumes of visitors.

5.4 Capacity, competition and choice are important elements of the mix that has allowed New Zealand to move forward from the poor position just a few years ago, and must be carefully protected.

6. THE IMPORTANCE AND FRAGILITY OF TRANS-TASMAN TOURISM

6.1 Trans-Tasman tourism is a critical element of New Zealand's visitor economy. In the year ended September 2017 Australian visitors comprised 40% of international arrivals (1,467,000 visits) – much more than China (11%), USA (9%), UK (7%), Germany and Japan together[3]. Australian visits grew by 6% compared to the previous 12 months.

6.2 Australia is also the biggest market in expenditure terms, at $2.488 billion, and forecast growth is significant. In the period to 2023 visits by Australians are forecast to grow to 1,759,000 and spend is expected to grow to $3.073 billion[4].

6.3 Unlocking further Australian demand and ensuring appropriate capacity is therefore highly desirable. Auckland Airport estimates that Australian demand is currently under served by approximately 25%[5].

6.4 Air capacity and a competitive airline environment are major enablers for maintaining and growing trans-Tasman tourism. If capacity is restricted and fares rise, Australian visitors will go elsewhere.

6.1 New Zealand as an outbound destination for Australians, while still the largest at 1,151, 560 in 2016[6], does not dominate the data in the same way that Australian arrivals do here. Numbers of Australians visiting Indonesia and USA are not far behind, and New Zealand must compete strongly to maintain its position.

6.2 New Zealand's competitiveness as a destination for Australian travellers is facing ever increasing pressure from low cost air capacity on routes into Asia. Many of these destinations provide an excellent visitor product at a lower cost compared to New Zealand and for this reason they are growing in popularity with Australian travellers.

6.3 To illustrate, a search on *Skyscanner.com* for travel from Sydney to "Anywhere" in February 2018 provides fare options to Singapore from $156 one way, Indonesia $219, New Zealand $222, Fiji $223, Vietnam $230, Thailand $234, Philippines $256, Malaysia $257, Hong Kong $267, India $304, China $320, and Cambodia $321. There are 10 countries in Asia which can be reached at fares within $100 of New Zealand fares, most of which are operated on sectors which are over twice as long.

6.4 It is also important to note that the Tasman is not the "blood bath" it was once described as by airlines seeking authorisation to work together in the interests of their very survival. The fares above demonstrate that, in some instances, the short Tasman sectors can be relatively expensive compared to other available options. It is likely that this is due at least

[3] Key Tourism Statistics, Ministry of Business, Innovation and Employment, October 2017.
[4] Ibid.
[5] Auckland Airport Craigs Investor Day presentation, March 2017, https://corporate.aucklandairport.co.nz/investors/investor-presentations
[6] Statista, 2017 https://www.statista.com/statistics/619864/australia-outbound-tourists-by-destination/

in part to the duopoly effect of the high level of coordination that presently exists in the market.

6.5 The trans-Taman aviation market is the lifeblood of New Zealand's tourism industry. The agreement was previously authorised as it promoted additional Tasman capacity and connectivity. With Emirates' recent strategic move to serve Dubai non-stop, the case for the Minister to Authorise this arrangement from a New Zealand perspective is less clear, but the potential for a less competitive Tasman market to damage New Zealand's growth prospects remains very clear.

7. GLOBAL AVIATION TRENDS RELEVANT TO THIS APPLICATION

7.1 We agree with the analysis of the applicants that a structural shift in international routes is under way. In particular, the growth of Asia-Pacific markets combined with the capabilities of new aircraft are making it possible for airlines to serve more distant markets direct from their hubs. Emirates' direct service to Dubai from Auckland, and consequent withdrawal from some Tasman routes, is an example. Direct services are generally favoured by passengers, when available.

7.2 In this context, fifth freedom carriers can increasingly be expected to fly direct and the option of one-stop routes across the Tasman will be less relevant.

7.3 Notwithstanding this trend, one-stop services remain an important stepping stone to build passenger volumes and markets. This is recognised in the *Tourism 2025* air connectivity strategy.

7.4 Our conclusion, contrary to the assurances of the applicants, is that the trend towards fewer one-stop international routes will have the effect of increasing the market dominance of the Australian and New Zealand national carriers on Tasman routes. This will need to be actively counter-balanced by the Minister.

8. ISSUES FOR THE MINISTER OF TRANSPORT TO CONSIDER

8.1 Qantas and Emirates have set out a number of potential benefits for consumers in the application for reauthorisation. Although NZ Airports would welcome these potential benefits, it is important to remember that there is no guarantee that the claimed benefits will materialise, and limited information about the extent to which they will benefit New Zealand consumers in particular.

8.2 The application constitutes, in essence, a re-authorisation of the original 2013 Master Coordination Agreement for a further term of 5 years. If authorised, this would bring the total term of the alliance to ten years, albeit the applicants now seek to remove any capacity commitments.

8.3 At the time of the earlier application a term of ten years was sought, however after considering submissions and other advice the Minister elected to grant a shorter term of 5 years. The shorter term provided an opportunity for the Minister to receive and assess evidence that public benefits have been derived from the alliance such that any potential detriments had been outweighed in the initial term. Such evidence is a very relevant consideration for the further term for which authorisation is now sought.

8.4 Benefits to New Zealand anticipated by the application, which are far less evident than when the application was last considered, must be clearly articulated and committed to for the duration of any authorisation. This is the only way to ensure any benefits are indeed realised but, most importantly, that the substantial potential detriment is avoided. As it currently stands, any competition detriments from the application (e.g. the potential for reduced capacity and higher prices on trans-Tasman routes) are likely to materially outweigh the claimed benefits (such as greater international connections, access to loyalty programmes, cost efficiencies etc). This reinforces the need to carefully examine the lack of a capacity condition in the application.

8.5 If, after due consideration, the Minister is minded to grant the application, NZ Airports encourages the Minister to consider implementing appropriate controls as part of the authorisation to ensure the claimed benefits are realised and that a fair and equitable market structure will operate on the Tasman during the term of any new agreement.

8.6 Competitive impacts. The applicants assert that the agreement will have no adverse impact on consumers – on the contrary, they consider it will have pro-competitive effects and be beneficial for consumers, particularly because Qantas will substantially backfill the capacity Emirates will no longer operate to Auckland.

8.7 In our view this assertion needs to be thoroughly tested. Is the current up-gauging by QF genuine and sustained? Or is there a real risk that, absent capacity requirements, current trends will see capacity reductions, removal of competitive tensions, and loss of consumer benefits?

8.8 According to the airlines' application, in May 2017 the Qantas Group (including Qantas and Jetstar) had a share of 31.6 per cent and Emirates had a share of 13.2 per cent of all passenger services between New Zealand and Australia, giving a combined total of 44.8 per cent. Air New Zealand had a share of 33.0 per cent and Virgin Australia had a share of 14.5 per cent, giving a combined total of 47.55 per cent. Therefore, between the two groups they held a dominant market share of 92.35 per cent.

8.9 The significant market concentration raises issues, in the absence of safeguards such as capacity commitments, of the potential to harm consumers and the economy, with respect to monopoly pricing and the resulting decline in passenger movements. This was acknowledged by the Ministry in 2013 when it stated:

"*There will be a change of competitive dynamic on the four trans-Tasman routes on which both Qantas and Emirates currently operate, with a reduction in independent decision making about scheduling and pricing*"

8.10 At the time the Ministry felt this detrimental effect could be managed by a five-year duration for the coordination agreement to allow an assessment of the impact of the alliance, and to incentivise the applicants to ensure that benefits are delivered and the capacity conditions imposed met. This logic remains intact, and is persuasive.

8.11 In the face of a structural shift towards a stronger duopoly (discussed above), we encourage the Minister to carefully consider whether it would be in New Zealand's best interest for capacity requirements to be removed, as requested by the applicants.

8.12 Competitive responses from other carriers. We note the applicants' argument[7] that, in addition to competitive pressures from Air New Zealand/Virgin on the Tasman, reductions in capacity and/or increases in fares could draw new entrants or expansion onto the Tasman market. NZ Airports considers this statement should be rigorously tested.

8.13 In our view the applicants have overstated the potential for the alliance to prompt a competitive response from other airlines on the Tasman, as the decisions of other carriers are more likely to be driven by factors affecting their global operations and core markets. The frequency and schedule-sensitive Tasman market is not likely to be highly attractive to other major players, and the applicants' argument that air service policy settings in New

[7] See section 4.6 of the public version of the Application

Zealand and Australia encourage new entrants does not necessarily flow through to such operations actually materialising.

8.14 Consideration should also be given to the current circumstances facing any new entrant who must compete against the 'home' advantages of strong national carriers at each end of each Tasman route, both backed by strong global network carriers. This is in addition to the challenges New Zealand poses with small market sizes, isolation and relatively high operating costs. In this environment, dominated by two airline groups, we think the possibility of new entrants is considerably dampened.

8.15 In the counter-factual world (in the absence of the prevailing alliances) Qantas/Jetstar would be competing with Emirates, both would be competing with Air New Zealand, who would also be in competition with Virgin/Tiger. The dynamism of such a market may also make it easier for airlines such as Scoot and Air Asia X to grow Tasman services.

8.16 We also encourage the Minister to rigorously test the applicants' assertion that Emirates would have withdrawn their trans-Tasman flights without the alliance and/or would not re-introduce the routes.

8.17 The competition environment is important because, as discussed elsewhere, competition ensures consumers have access to choice, competitive prices, and a high-quality product offering (including in-flight service, aircraft type, seating density, and frequent flyer benefits). There is a risk that, with a reduced threat of a competitive response due to alliances, some of these customer benefits may diminish over time.

8.18 Capacity requirements. In their 2012 application for authorisation, the applicants proposed a formal commitment not to reduce their combined trans-Tasman capacity for a period of ten years. This capacity commitment was welcomed by NZ Airports, and we also supported an appropriate measure of market growth being included to ensure that organic growth did not provide an opportunity for the exercise of market power through capacity constraint.

8.19 The applicants say that, given the continuing excess capacity and material changes to market conditions on the Tasman following the introduction of new direct services to New Zealand, they do not consider it necessary or appropriate for the Australian Competition and Consumer Commission (ACCC) to impose a mandatory level of capacity as it did in 2013. They consider there have been material changes in market conditions on the Tasman, with new entrants adding direct services to New Zealand that bypass Australia, and reduced demand for point to point services between New Zealand and Australia.

8.20 Since 2013, capacity conditions imposed by the ACCC (and taken into account by the NZ Minister of Transport in his 2013 decision) have meant that the applicants cannot reduce capacity below 2012 levels (subject to review by the ACCC). This helped to provide a safeguard for consumers by limiting the applicants' ability to increase prices through reductions in capacity.

8.21 NZ Airports considers that capacity conditions should remain a feature of any approval. We recommend these should be set at the time of any authorisation so the status quo of the market is protected and the benefits of the existing authorisation (should the Ministry determine there are net national benefits) are captured and not eroded. In any event, such new trans-Tasman capacity commitments should be not less than the commitment required under the previous authorisation.

8.22 NZ capacity conditions. We recognise that the applicants require authorisation from both Australian and New Zealand authorities and, in the event approvals are granted, complications could arise if different capacity requirements are applied by both the Minister and Australia's ACCC. However, we also consider that the ACCC in setting and (if necessary) enforcing or reviewing capacity conditions, will necessarily be focussed on

Australia's national interest. This is unlikely to equate to New Zealand's national interest, except at the most general level of principle. There are likely to be material differences in the context and the factual situations between New Zealand and Australia in any assessment of future capacity changes.

8.23 We recommend that the Minister consider adopting capacity conditions within his own authorisation and legislative ambit, even if the conditions effectively mirror any ACCC conditions, to ensure that any response to a change in capacity during the term of any approval can properly include consideration of New Zealand's interests.

9. IMPLICATIONS FOR THE RENEWAL OF THE AIR NEW ZEALAND – VIRGIN ALLIANCE

9.1 The applicants have proposed that capacity conditions no longer be applied to the agreement. If capacity requirements were to be removed from the Qantas-Emirates agreement, Air New Zealand and Virgin will no doubt ask for the same at the time their current agreement expires.

9.2 The Air New Zealand–Virgin alliance was re-authorised in 2013 for a period of five years (until 31 October 2018). Under the terms of reauthorisation in New Zealand, the airlines are not required to meet any minimum capacity requirements. However, they are required to meet minimum capacity requirements which have been imposed in Australia by the ACCC. NZ Airports considers that capacity requirements would remain necessary in any re-authorisation of the Air New Zealand-Virgin alliance to ensure they do not have the ability to reduce capacity and increase prices.

9.3 In the absence on both sides of capacity requirements, a dominant two airline group duopoly scenario is further enabled, and the likelihood would increase that consumers will lose choice and frequency, and pay more. In addition, if a capacity condition is not included in the Emirates-Qantas alliance but maintained for Air New Zealand-Virgin, this would create an uneven playing field and distort the trans-Tasman market. In our assessment, maintaining ongoing competitive tension and a balanced market structure requires capacity to be set for both groups.

10. RECOMMENDATIONS

10.1 In recognition of both the potential benefits and the potential harm to the public interest that the proposed Master Coordination Agreement could create, NZ Airports makes the following recommendations:

(a) That the application be subject to a rigorous analysis of whether authorisation is in the wider New Zealand public interest, having regard to demonstrable evidence that the public benefits claimed by the applicants have been delivered during the last five years; that national benefits are likely to be delivered in the term of any new authorisation; and that those benefits outweigh the public detriment of the alliance.

(b) That any authorisation should be for the shortest period possible to deliver the claimed benefits and not longer than a period of 5 years, with the possibility of renewal if the applicants can clearly demonstrate that the coordination agreement continues to be in the public interest.

(c) That minimum capacity conditions should be retained in any authorisation to ensure that the effective duopoly of airlines groups on the Tasman retains an incentive to grow capacity over time to keep pace with market growth. We note that Qantas has effectively recognised the importance of capacity in its proposal to increase trans-Tasman capacity to ‘backfill’ Emirates capacity.

(d) Consider whether capacity requirements, which may be aligned with any ACCC conditions, should also be incorporated into any New Zealand approval of the proposed coordination agreement, with the objective of ensuring that New Zealand’s national interests can be properly considered in the event of a change of capacity.

NZ Airports
18 November 2017