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Hon Kiri Allan

Action required by:

Associate Minister of Transport

Friday, 10 March 2023

cc Hon Michael Wood

Minister of Transport

REAUTHORISATION OF THE QANTAS/EMIRATES ALLIANCE - INITIAL ADVICE

Purpose

Qantas and Emirates have applied for re-authorisation of their airline alliance. This briefing provides our initial advice on the proposal. We are seeking your views at this stage since we would need to give the airlines an opportunity to comment if, contrary to our advice, you were to decline authorisation.

Key points

- Qantas and Emirates' Restated Master Agreement is due for authorisation on 31 March 2023.
- Airline cooperation agreements are a common feature of international aviation. While alliances can result in benefits to consumers, they also risk resulting in a reduction in competition, which can lead to higher fares or reduced services.
- We believe there are public benefits in authorising the Restated Agreement, as it will provide improved connectivity and improved scheduling for passengers travelling to and from New Zealand. We consider the alliance will assist Emirates and Qantas as they continue to re-build their networks and schedules post Covid-19.
- We do have some concerns about the trans-Tasman market for air services, and the lack of competition on these routes. These concerns were echoed by stakeholders, and the Australian Competition and Consumer Commission (ACCC). However, we do not believe that declining authorisation will alleviate these concerns in any material way.
- Given the effective duopoly on the Christchurch-Sydney route, there is a perceived risk of price coordination and scheduling decisions across their respective networks, raising airfares above competition levels. However, this isn't apparent from our analysis.
- On balance we have determined that concerns regarding competition on the Tasman, particularly during pandemic recovery conditions, are unlikely to be resolved through declining authorisation.

- Under current legislation, we do not have the statutory ability to impose conditions. However, we anticipate the ACCC will propose to monitor the Sydney – Christchurch route and reserve the ability to impose conditions on the route if they see fit.
- In mid-March, we will provide you with a report containing our full analysis regarding the authorisation of the Restated Agreement. Our initial view is that the Restated Agreement be authorised for a period of five years. In the meantime, officials are available to discuss the authorisation, should you require.

Recommendations

We recommend you:

- 1 **note** that we anticipate finalising advice to you, recommending reauthorisation of the Qantas-Emirates alliance
- 2 **advise** whether you would like to discuss this with officials prior to submission of our final report Yes / No



Tom Forster
Manager Economic Regulation
 1 March 2023

Hon Kiri Allan
Associate Minister of Transport
 / /

- Minister’s office to complete:**
- Approved Declined
 Seen by Minister Not seen by Minister
 Overtaken by events

Comments

Contacts

Name	Telephone	First contact
Bronwyn Turley, Deputy Chief Executive, Strategy & Regulatory Design	s 9(2)(a)	✓
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REAUTHORISATION OF THE QANTAS/EMIRATES ALLIANCE - INITIAL ADVICE

Airline alliances are a common feature of international aviation but need authorisation to mitigate the risk of lessening competition

- 1 International aviation is governed by a network of thousands of bilateral air services agreements. These agreements often restrict the destinations airlines are able to serve and the capacity they are able to provide. Many of these agreements also require airlines to be majority owned by nationals of their home State. This makes it difficult for airlines to merge or establish joint ventures in the same way that other businesses can.
- 2 No airline in the world can operate every possible route combination that may be wanted by its passengers. Through alliance arrangements, airlines can expand their reach by, in effect, combining their separate route networks.
- 3 In order to overcome the restrictions imposed in bilateral air services agreements, and the inability to serve all routes with their own aircraft, airlines have developed means of working with one another to expand their global reach. Cooperation between airlines generally takes a number of forms.
 - “Interline” arrangement: in which one airline buys tickets for travel on another airline at a pre-determined price. This is the mechanism through which (for example) Qantas is able to sell its passengers a ticket from Melbourne to Invercargill, even though it does not operate a service to Invercargill.
 - Code-share arrangement: an agreement through which an airline is effectively given the ability to sell seats on flights operated by another airline as if it were operating that flight with its own aircraft. Code-share agreements are relatively common and rarely raise competition issues.
 - Revenue-sharing alliance: an extensive commercial agreement in which two or more airlines agree to co-operate on all aspects of pricing, scheduling and service delivery in a particular market. These arrangements are generally subject to a much higher level of regulatory scrutiny as they have the potential to reduce competition. The agreement which the Applicants are currently working under, and the Restated Agreement, closely resemble a revenue sharing alliance.
 - Global airline alliance: many airlines are members of one of three global alliance groups - Star, Oneworld and Skyteam. Members of global alliances work together to provide services to consumers, by co-operating in areas such as marketing, scheduling, ticketing, and frequent flier schemes. The level of cooperation differs between members, however it is common for members of the same groups to enter into interline and code-share agreements with one another. Qantas is a member of the Oneworld Alliance. Emirates is unusual in that it does not belong to a global alliance.
- 4 Alliances can result in benefits to consumers, for example, better access to connecting flights, more choices of routes, and the ability to earn and redeem frequent flyer points across the networks of both airlines. Alliances also have the potential to reduce costs for airlines, which in competitive markets results in reduced costs for consumers.

- 5 However, alliances can carry significant risk as they typically result in a reduction in competition, which can lead to higher fares or reduced services.

Qantas and Emirates are seeking reauthorisation of their Restated Agreement

- 6 Qantas and Emirates (the Applicants) are currently working together under a Master Coordination Agreement that was first authorised by the Minister of Transport in May 2013. The agreement was authorised for a period of five years and was reauthorised for a further five years in March 2018.

- 7 The current authorisation expires on 31 March 2023.

- 8 The Applicants seek authorisation for a period of at least 5 years through to at least 31 March 2028.

- 9 The Applicants intend to continue their alliance under the Restated Agreement. The Restated Agreement provides for continued cooperation and coordination across the Applicants' global networks, examples which include in relation to:

- planning, scheduling, operating and capacity;
- sales, marketing, advertising, promotion, distribution strategies, reservation priority and pricing (including fares, rebates, incentives and discounts) for passengers, freight customers and agents;
- connectivity and integration of certain routes;
- codeshare and interline arrangements;
- frequent flyer programs;
- all passenger-related aspects to provide a consistent level of service to customers including ground services and lounge access;
- harmonising service and product standards in order to provide a seamless product to passengers;

- 10 The Restated Agreement covers bodies corporate related to the Applicants, including Qantas subsidiaries Jetstar Airways and Jetstar Asia Airways.

Authorisation is under Section 88 of the Civil Aviation Act

- 11 The Applicants have requested authorisation of the Restated Agreement under section 88 of the Civil Aviation Act 1990. The effect of authorisation under this section is that the arrangements under the Restated Agreement are exempt from the provisions of the Commerce Act 1986 that prohibit arrangements substantially lessening competition.

- 12 Section 88 sets out several statutory pre-conditions that must be met before authorisation is granted. We have determined that the application for authorisation meets these conditions. A full analysis of how the provisions in the Restated Agreement relate to each of the section 88 pre-conditions will be provided in our final report.

13 s 9(2)(h)

[Redacted content]

Qantas and Emirates play an important role connecting New Zealand to the world

- 14 Qantas has a strong market presence in both Australia and New Zealand. Aside from its large domestic network in Australia, it offers trans-Tasman services to four destinations in New Zealand, and through its subsidiary Jetstar, offers domestic services from five New Zealand airports.
- 15 It is the second largest carrier on the trans-Tasman network. Since returning to New Zealand, the airline has rapidly committed to expanding service, with capacity now over 100,000 seats per month.
- 16 Qantas is the major carrier connecting Australia to the rest of the world and connects directly into the One World airline alliance. There are spill-over benefits to New Zealand through the onward travel of international visitors from Australia. Fifty percent of all passengers arriving on Qantas flights have originated at some point beyond Australia.
- 17 Emirates is a key airline that connects New Zealanders and travellers to and from long haul destinations. Emirates has significant presence in international markets, where it operates a large network via its hub in Dubai to destinations in Asia, UK/Europe, Middle East and North Africa.
- 18 During the pandemic Emirates demonstrated continued support to the New Zealand market and were the only feasible airline for repatriating New Zealanders from many places abroad.

Public benefits of the alliance

- 19 We consider the main public benefit of the alliance is improved connectivity and improved scheduling for passengers travelling to and from New Zealand. In the application for re-authorisation, the Applicants have pointed to the fact that the alliance has allowed passengers access to more than 2,000 origin/destination points over their combined networks.
- 20 The alliance has allowed the Applicants to play to their strengths. Passengers are able to benefit from Qantas' greater presence in the Australia and New Zealand markets, while also benefiting from Emirates' greater network reach in regions such as Europe and the Middle East.
- 21 Absent the alliance, the Applicants would have little ability or incentive to co-ordinate their schedules to allow customers more options in terms of routes and timings across their respective networks.

- 22 We agree that the Alliance is likely to support trade and tourism in New Zealand to help aid post-pandemic recovery.

Our main consumer concerns relate to trans-Tasman services

- 23 In order to determine the impact on consumers, we have analysed each of the individual routes which are relevant to the authorisation of the Restated Agreement. In general, alliances between airlines with complementary networks are more efficient and less restrictive of competition than those involving airlines with more overlapping networks. The networks of Qantas and Emirates are somewhat complementary, but they do involve some direct and indirect overlaps (routes which both Applicants operate over).
- 24 In most cases, we consider that there is sufficient market presence from competing airlines to ensure that there is no substantial lessening of competition on these routes. Our main concerns relate to the market for trans-Tasman services. Christchurch-Sydney is the only New Zealand route where there is an overlap between the scheduled services of the Applicants. These concerns, which were echoed by stakeholders, are detailed below.

Historically two alliances dominate in the trans-Tasman market

- 25 The trans-Tasman market was previously dominated by two alliances Emirates/Qantas/Jetstar and Air New Zealand/Virgin Australia. This created an effective duopoly across the trans-Tasman. However, since October 2018 there is no longer an alliance between Air New Zealand and Virgin Australia. Virgin Australia suspended its trans-Tasman services in 2020 in the face of COVID and being put into administration. It has only recently re-started limited services to Queenstown.
- 26 The remaining passenger market is made up of fifth freedom¹ carriers (which carry passengers as part of services connecting to the airline’s own country). These include China Airlines, AirAsia X, Lan Chile.



¹ The "Freedoms of the Air" are a set of aviation rights that govern the commercial operations of airlines between different countries.

Emirates is due to recommence some trans-Tasman services in March 2023

- 27 Emirates withdrew from the Christchurch-Sydney route during the pandemic. The service is scheduled to recommence later in March 2023. When it does, it will be the only overlapping alliance route to New Zealand.
- 28 In the meantime, Qantas has been restoring services across the Tasman following the easing of entry restrictions into New Zealand and is providing additional Sydney-Christchurch services until Emirates services resume.
- 29 The alliance has dominated the market and had a relatively steady market share for the route before the pandemic of around 70 percent.
- 30 The Ministry has concerns about the lack of competition on this route with the Alliance, pre pandemic, accounting for such a large market share. This could potentially lead to the Alliance having market power on the route in the future.
- 31 Although Air New Zealand is another strong competitor, pre pandemic, they had a significantly smaller market share of around 25-30 percent. Once Emirates re-enters the market, it is likely the Alliance will re-establish their dominant position on this route.

Concern about lack of competition required more reporting

- 32 In 2018, the ACCC did have concerns on the Christchurch-Sydney route but rather than imposing capacity constraints, they instead required the Applicants to report for each 6-month scheduling season on the number of seats flown, route specific costs, revenues and average fares on the Auckland-Australia and Sydney-Christchurch routes.
- 33 Although the Applicants believe reporting requirements are unnecessary, it is likely that the ACCC could impose these same reporting conditions if it re-authorises the Restated Agreement. We do not anticipate that the ACCC would go further than it previously did and introduce capacity constraints due to the nature of post-pandemic recovery.

Low barriers to entry mitigate competition concern

- 34 Although there are some competitive concerns on the Christchurch-Sydney route, there are few regulatory barriers to entry into the trans-Tasman market between Australia and New Zealand. This is because both New Zealand and Australia have 'Open Skies' agreements, under which there are unlimited capacity entitlements between Australia and New Zealand for airlines from many countries. Although independent players could enter the market, the airline business is very challenging and many companies have tried and failed, as it is a capital-intensive business.

Other Factors

- 35 The COVID-19 pandemic has had an unprecedented level of disruption to global aviation. Airlines are still operating in an environment where passenger volumes are not expected to fully recover to pre-pandemic levels until 2024 at the earliest.
- 36 For example, Virgin Australia suspended its trans-Tasman services in 2020 because of the pandemic and has only just returned to servicing Queenstown in November 2022.

Pre-pandemic, Air New Zealand and Virgin Australia were strong competitors in the trans-Tasman market.

- 37 The pandemic has made it difficult to assess the recent performance of the alliance or to assess the short to medium term impact of the alliance where there is constrained capacity within global aviation markets.
- 38 The Applicants argue that reauthorisation will support restoration of capacity on trans-Tasman services between New Zealand and Australia.
- 39 From Emirates' perspective, continuing of the Alliance will help accelerate its plans to ramp up back to pre-pandemic levels. Emirates views the Alliance as supporting its intended resumption of its daily Airbus A380 services between Christchurch and Sydney (which is an extension of Emirates daily Dubai-Sydney service) in March 2023.
- 40 Restoration of these Dubai-Australia services will provide additional options to New Zealand consumers connecting to these services from trans-Tasman services operated by Qantas, Jetstar Airways and Emirates (once it resumes its Christchurch-Sydney route in March 2023).²

Australian Competition and Consumer Commission is also considering reauthorisation

- 41 In Australia, collaborative arrangements in international air services are considered by the Australian Competition and Consumer Commission (the ACCC). Given the Restated Agreement covers a number of routes to, from and through Australia, decisions made by the ACCC can impact our assessment of the Application.
- 42 The ACCC is expected to issue a final determination and interim authorisation decision before the end of March. In line with our analysis, the ACCC, amongst other analysis, is also focused on competition on the overlapping Sydney – Christchurch route the Applicants will operate.
- 43 We anticipate that the ACCC may propose that the Applicants continue to be subject to a reporting condition like that in their 2018 determination. This information will be used to assess whether the Applicants are limiting capacity in order to raise fares on the Sydney – Christchurch route.

Length of authorisation

- 44 If you choose to authorise the agreement, we advise that this should be for a period of five years. This is consistent with past authorisations, will allow us to reassess the alliance at an appropriate time and is likely to be the period of any ACCC authorisation.

² In 2018, there were 6 times the number of passengers flying on Qantas than there was in 2021 on the Christchurch to Sydney route

Stakeholders recognise some benefits but ask for competition scrutiny

- 45 The Ministry asked for submissions from stakeholders on the proposed authorisation of the Restated Agreement. Submissions were received from Auckland International Airport Limited, the NZ Airports Association, and Tourism Industry Aotearoa (TIA).

NZ Airports Association

- 46 NZ Airports is of the view that reauthorising the agreement for five years would be of benefit to consumers, but that the Minister should, as always, carefully scrutinise the benefits to ensure they are in New Zealand's interests.
- 47 NZ Airports remains concerned the effect the alliance has on competition on the Tasman market. Air capacity and a competitive airline environment are the major enablers for maintaining and growing trans-Tasman tourism.
- 48 NZ Airports requests that consideration be given to implementing appropriate controls to ensure the claimed benefits are realised and for a fair and equitable market structure on the Tasman during the term of the new agreement.

Auckland International Airport Limited (AIAL)

- 49 Auckland Airport acknowledged there is currently no network overlap between the Applicants on their Auckland routes, meaning they do not compete on routes to Auckland. As a result, Auckland Airport has no current concerns that this agreement, if extended for a further five years, would risk either airline significantly reducing capacity on the routes they fly to Auckland.
- 50 AIAL shared NZ Airports comments regarding scrutiny of claimed benefits.

Tourism Industry Association (TIA)

- 51 While TIA did not provide a formal submission, they indicated they had no concerns as the reauthorisation sought is a continuation of previous authorisations in 2013 and 2018.